

# INVESTOR'S RATIONALITY ON SECURITIES MARKET IN NEPAL

## CHAPTER I: INTRODUCTION

### 1.1 Background of the Study

Nepal, a landlocked country, which is rich in natural beauty, inherits cultural diversity, and natural resources. Nepal is situated amongst the two giants, India and China. When looking at these two countries, we can experience that they have made significant growth in few decades whereas when comparing to Nepal, it can be said, a very nominal growth has been made. Being a neighbor of these two giants, one can expect growth to the periphery but the situation is not convincing. Although, Nepal inherits huge natural resources, but is disposed by lack of resources. Long time back, agriculture used to be the backbone of our economy but now, it also has marginalized to somewhere around 40% of the GDP. Another hindrance to Nepalese economy can be said is due to the lack of its own port and dependence on the Indian peninsula.

The industrial development of the country began during 1940s after the successful establishment of manufacturing industries like textiles, cement factory, jute mills, and sugar factories. Consecutively, the need for financial institutions was felt during the time and this led to establishment of commercial banks and capital market institutions in support of the country's pace towards industrialization.

Since Nepal is listed as one of the least developed countries in South Asia, it is compelled to strive its available resources for possible outcomes. Towards this effort, capital plays a vital role in utilizing the financial resources efficiently for the elaboration of economic environment. On the contrary, the earning of people in the preceding years was based on agriculture but due to persistent deterioration in generating revenue, slow diversification took place from agro-based economy slowly and steadily towards the industry-based economy. Efforts for minimizing the economic gap between rich and poor were initiated by both from the government and non-government sectors. A sense of mobilizing available resources from unproductive or less productive sectors to a productive sector is considered necessary for the economic developed. To recapitulate, the effective mobilization of capital resources in productive sector has now become base for

development. So one can easily understand the fact that financial market has become an important sector for carrying out productive activities in economy.

The financial market encompasses of money market and capital market. Capital market deals with an important function of transfer of savings, especially of the household sector to the companies, government and public sectors. On the other hand, capital market works as a bridge between lenders and borrowers of funds, arranging of funds transfer process to seek others benefits (Philips, 1979:3-5).

Similarly, capital markets also deals with securities such as bonds and stocks, which is associated with mobilization of financial resources on a long term basis. In the present context, transaction of securities has become a major component of the capital market system. The motive of securities market exists in order to bring buyers and sellers of securities together, meaning their mechanisms are created to facilitate the exchange of financial assets. In the securities market, various security instruments such as, common stock, preferred stock, debenture, bonds etc., are trade (Sharpe and Bailey, 2003:12-13). It can be further classified as primary market and secondary market.

In the ancient period, purchasing of fixed assets such as land, building as well as speculative assets like gold, silver, etc., were considered as investment. During those periods, barter system for transaction was famous amongst people as the circulation of monetary instruments were very scarce or limited, or in other words, money circulation was very infamous in the society as compared to that of barter system. It may sound awkward but still in remote areas of our country, barter system is in practice. In contrast, the term investment is regarded differently in today's world and is interpreted in a broad and very practical sense.

Regarding choices amongst investment opportunities, we can now find couple of alternatives for investment. There are two very famous terms which points toward investment alternatives available for an investor. An investor either can invest in real assets or in financial assets. In the meanwhile, the investment patterns, risk taking behavior, investment strategies, and objective for investment varies from one investor to another. But regarding the prime focus on investment of financial securities or financial instruments, it implies bearing of risk and positive return in the future.

Since we are concerned with Nepalese context, Financial Market generally is understood as Capital Markets and Money Markets. Capital market is the market for securities, where companies and governments can raise long-term funds. The capital market includes the stock market and the bond market. In capital markets, financial resources are mobilized on a long-term basis. So it is obvious that transaction of securities is one of the major components of capital market system. A market place for merchandising securities is created to ease the exchange of financial assets. Common stock, preferred stock, bonds, debentures, etc. are generally traded in securities market. Financial regulators like SEBO/N (Securities Board, Nepal) oversee the capital markets to ensure that investors are protected against fraud.

The capital market consists of the primary market and the secondary market. The primary market is where new stock and bonds issues are sold (underwritten) to investors. On the contrary, it also can be said that markets in which corporations raise new capital are known as primary markets. Thus, primary markets are basically concerned with the accumulation of fund. The secondary markets are where existing or already-issued securities are traded. Nepal Stock Exchange (NEPSE) is an example of secondary market. Securities are sold and bought from one investor or speculator to another, usually on an exchange.

A security is a fungible, 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. The company or other entity issuing the security is called the issuer. What specifically qualifies as a security is dependent on the regulatory structure in a country. In Nepal, private investment pools may have some features of securities, but they may not be registered or regulated as such if they meet various restrictions.

Securities may also be represented by a certificate or, more typically, by an electronic book entry issued in accordance with the prevailing laws. Certificates may be *bearer*, meaning they entitle the holder to rights under the security merely by holding the security, or *registered*, meaning they entitle the holder to rights only if he or she appears on a security register maintained by the issuer or an intermediary. They include shares of corporate stock or mutual funds, bonds issued by corporations or governmental agencies,

stock options or other options, limited partnership units, and various other formal investment instruments that are negotiable and fungible.

The market whereas the corporation acquires the long term capital fund by issuing the security to the general public through Initial Public Offering (IPO) and right issue is known as primary market. The secondary market is that market where the once-issued stocks of the corporation are traded. The advantage of secondary market is to provide liquidity and investment opportunities to investor and to make certain assets more attractive to buyers and sellers.

## **1.2 Brief History of Securities Market in Nepal**

In economics, typically, the term *market* means the aggregate of possible buyers and sellers of a thing and the transactions between them.

Also, the term "**market**" is sometimes used for what are more strictly *exchanges*, organizations that facilitate the trade in financial securities, e.g., a stock exchange. This may be a physical location (like the NEPSE). Much trading of stocks takes place on an exchange, while any two companies or people, for whatever reason, may agree to sell or buy stocks from the one to the other without using an exchange.

Regarding the evolutionary phases of Nepal Stock Exchange (NEPSE), the history extends, back to 1976 when the government established securities market centre in 1976. It was later converted into Securities Exchange Centre (SEC).

In earlier years of its establishment, the centre confined its activities in trading government securities. It started listing and trading corporate securities in November 1984. The centre was converted into Nepal Stock Exchange (NEPSE) in 1984 and operate under Securities Exchange Act, 1983. The objective of NEPSE is to enhance marketability and liquidity of corporate securities by providing trading floor and facilitating and regulating trading activities. Nepal Stock Exchange Ltd. is the only stock exchange in the country. HMG/N, NIDC and its member and their ownership; in the exchange are 52.5%, 39.72%, 7.04% and 0.69% respectively.

Security Exchange Act, security regulation, and NEPSE's own memorandum and articles of association have empowered NEPSE to promulgate various bylaws, 1996 and membership; of stock exchange and transaction and their clearing and settlement

activities are more clearly and fair. (Annual Report, SEBON 2003/04) Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 23 member brokers and 2 market makers, who operate on the trading floor as per the Securities Exchange Act, 1983, rules and bylaws.

Besides this, NEPSE has also granted membership to issue and sales manager securities trader (dealer). Issue and sales manager works as manager to the issue and underwriter for public issue of securities whereas securities trader (dealer) works as an individual portfolio manger. At present, there are 11 sales and issue manager and 2 dealers (secondary market). The tenure of the membership is one year. The license should be renewed within 3 months after the closure of the fiscal year. If not, it can be done within another three months by paying 25% penalty.

Trading on the floor of the NEPSE, is restricted to listed corporate securities and government bonds. At present, 186 companies have listed their securities (150 equities, 1 Mutual Fund, 1 preference share) to make them eligible for trading at the end of the fiscal year 2064/65. Besides this, NCM mutual fund enlisted its units to make them eligible to trade in the floor. The listing fee and the annual fee to be paid by the listed company are based on the capital of the company. (Latest data from [www.nepalstock.com](http://www.nepalstock.com))

NEPSE has gone through a huge transformation, from “Open Out-Cry” system to the modern Computer Assisted Trading system (CATS). It means transactions of securities are conducted directly from the computer based system. Security trading is based on auction principle on the trading floor. The buying broker with the highest bid will post the price and his code number on the system, while the selling broker with the lowest offer will post the price and code number on the selling zone in the system. The market maker quotes their bid and offer price in their own board before the floor starts. Once the bid and offer price match, contracts between the buying and selling brokers or between the brokers and market makers are concluded on the floor.

**FINANCIAL MARKET:**

It is the place where the financial instruments are traded. Financial instruments include share, bond, debenture etc. It is a mean to transfer funds from savers to those in need of funds. Financial experts have mentioned it as a brain of the entire economic system. The failure of the financial market obstructs the progress of the whole economy. Financial markets can be defined as the centres or arrangements, which provide facilities for buying and selling of financial claims and services.

Specifically, financial market chiefly refers to money market and capital market. It facilitates the transfer of funds from the savers to those who wish to invest in capital goods.

**MONEY MARKET:**

It can be defined as short-term financial market, which facilitates liquidity and marketability of securities. It is the market for short-term marketable instruments having less than one-year maturity period.”

Money markets are sometimes defined as organized and unorganised money markets. The organized or formal money markets provide an institutional mechanism for the transactions of short-term securities and commercial banks, finance companies and other saving/credit unions are the players in the money market. Local merchants, indigenous bankers and relatives come under the informal or the unorganised sector.

The development of efficient market requires the development of institutions, instruments and operating procedure that aids widening and deepening of the market and allocation of short-term resources with minimum transactions costs and delays.

**CAPITAL MARKET:**

Capital Markets plays vital role in the national economy. Capital market facilitates the allocation of funds between the savers and borrowers. This allocation will be optimum if the capital market has efficient pricing mechanism. If the capital market is efficient, the current share prices of the company fully reflect the available information and there will be no question of the share price being over or under priced. Capital market is concerned with the long-term finance. The funds collected in the market are raised and traded by long-term financial instruments such as equities and bonds.

Nowadays in Nepal too, securities are considered as the prime investment alternatives but mostly in urban and educated societies only. Today, there is an organized exchange market – Nepal Stock Exchange (abbreviated as NEPSE) for trading of securities from various corporate as well as government bodies.

### **“STOCK EXCHANGE”**

It is a market for long-term capital where both new capitals can be raised by companies and where existing shares can also be bought and sold. By providing a second hand market for investors to sell their shares, it facilitates the raising of new capital on the new issues market. The stock exchange also provides a market for government loans and securities, and increasingly involved in the buying and selling of securities in the overseas companies. On the market, the main operators are the market makers who trade in a group of share, and the stock brokers who act as agents for their clients, who are the investors who are actually buying and selling shares.”

New York Stock Exchange (NYSE), London Stock Exchange, Tokyo Stock Exchange, Paris Stock Exchange, Frankfurt Exchange, Toronto Stock Exchange are the biggest stock Exchanges of the world. Mumbai Stock Exchange is the largest stock Exchange of India and Nepal Stock exchange (NEPSE) is the only organized stock exchange of Nepal.

### **Constituents of Capital Market in Nepal Security Board, Nepal (SEBO/N):**

Security Board, Nepal was established on May 26, 1993, under the provision of the Security Exchange Act, 1983. It was established with the objectives of the promoting and protecting the interests of investors by regulating the securities market. It also assumes the responsibility of development of securities market in the country, besides the regulatory role. Security Board has identified the policy development, legal and regulatory reform, stand arising disclosers, bringing enforcement to insure compliance and promoting broad based market as priority area to reform. The private sector has also been participating equally in establishing a sound system of security exchange. In private sector – investors, listed companies, financial and market intermediaries and in government sector – Ministry of Finance, Registrar of Companies (Ministry of Industry, Commerce and Supply), Nepal Rastra Bank, Nepal Stock Exchange, Federation of Nepalese Chamber of Commerce and Industries (FNCCI), Institute of Chartered

Accountants of Nepal (ICAN) and Associations of Chartered Accountants have been playing vital role in promoting the capital market of the country.

The objectives of the Board are to promote and protect the interest of the investors by regulating the issuance, sale and distribution of securities and purchase, sale or exchange of securities, to supervise, look after and monitor the activities of the stock exchange and other related firms on securities business, and to render contribution to the development of the capital market by making securities transactions fair, healthy, efficient and responsible.

**Nepal Stock Exchange (NEPSE):**

Along with the formation of Security Exchange Board, His Majesty's Government converted the Securities Exchange Centre Ltd. into Nepal Stock Exchange Ltd. (NEPSE) in 1993 with a view to reform the Capital Market. It is a non-profit making organization operating under Securities Exchange Act 1983. Brokers and market makers operate on the trading floor as per the Securities Exchange Act rules and by laws of NEPSE. Nepal Stock Exchange started its trading operation on 13 January 1994 through its licensed members. The Securities Board was constituted in 1993 under Sec. 1 of the Securities Exchange Act 1983.

Its main objective is to provide essential policy direction for the systematic and regular exchange of securities and develop competitive stock exchange market by protecting and promoting the interest of the investors. Nepal Stock Exchange is a trading (operational) institution, whereas Securities Board is the regulatory body. Before the Board came into existence, the Securities Exchange Centre carried on both the functions. Though any corporate body desirous to carry out the transaction of securities can submit application to the Board for obtaining the license, till now Nepal Stock Exchange Ltd. alone is representing the securities market in the country.

At present, there are 23 valid member brokers and 2 market makers who operate on the trading floor as per the Security Exchange Act, 1983, rules and bylaws. At present, there are 11 sales and issue managers and 2 dealers (Secondary Market). At present, 186 companies have listed their securities to make them eligible for trading. Besides this, NCM Mutual Fund enlisted its units to make them eligible to trade in the floor. NEPSE has transformed its “Open Out-Cry” system to Computer Assisted Trading system



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

<b>TYPES OF TRADING</b>	<b>DAYS</b>	<b>TRADING TIME</b>
<b>Government Bond Trading</b>	Sunday to Friday	10:30 A.M. to 11:30 A.M.
<b>Regular Trading</b>	Sunday to Thursday	12:00 NOON TO 2.00 P.M.
<b>Odd Lot Trading</b>	Monday & Friday	2-3 Monday, 11 -12 Friday

NEPSE has fixed the board lot of 10 shares if the face value is Rs.100 or 100 shares if the face value is Rs.10. The transactions on regular trading should be done on at least one board lot. The transactions of less than 10 shares are permitted only on odd lot trading hours. NEPSE has adopted a T+3 system, which means that settlement of transactions should be done within 5 working days following the transactions day. Settlement will be carried out on the basis of paper verses payment.

The rate of brokerage on equity transactions ranges from 1 percent to 1.5 percent depending on the traded amount.

### **SECURITIES MARKET:**

In simple sense, securities market is the place where people buy and sell financial instruments. These financial instruments may be in the form of government bonds, corporate bonds or debentures, ordinary share, preference share etc. So far security market is concerned; it is an important constituent of capital market. It has a wide term embracing the buyers and sellers and all the agencies and institutions that assist the sell and resell of corporate securities. Although security market is concerned in few locations, they refer more to mechanism rather than to place designed to facilitate the exchange of securities. Security market can be defined as a mechanism for bringing together buyers and sellers of financial assets in order to facilitate trading. In order to allocate capital efficiently to maintain higher degree of liquidity in securities, the securities market should be efficient enough in pricing the shares solely by economic considerations based on publicly available information.

An efficient market is one where current price of the shares gives the best estimate of its true worth. Thus, the securities market is a place where shares of listed companies are

traded or transferred from one to another on a fair price through the organized brokerage system. The major function of securities market is a competitive price thereby, importing future market ability and liquidity. It is a medium through which scattered savings and scarce resources are transferred to productive areas that ultimately help in the economic development and industrialization of the nation. Biratnagar Jute Mills Ltd. initiated the first public floatation of shares in the securities market in 1937. There were very few companies in Nepal issuing shares to the general public until another company Act came into operation in 1951. In the absence of developed security market in Nepal, the government was the sole issuing authority of Development Bonds and National Saving Certificates. Therefore, the securities generally in the market were mainly the government securities. Government securities are fully traded under the management and supervision of Nepal Rastra Bank (NRB). Institutional development of securities market in Nepal started from the year 1976 when Securities Exchange Centre (SEC) was established under the Companies Act with the joint Capital contribution of Nepal Rastra Bank and Nepal Industrial Development Corporation. The Industrial Policy of the Government also encouraged the promotion of securities exchange activities in Nepal. The main objective of the establishment of the Centre was to mobilize public savings and encourage the people to participate in the ownership of industries and business enterprises. As a securities market intermediary, its role was to organize and provide marketing facilities of channelling securities exchange business through the centre. Its activities included the purchase, underwrite and sale, directly or through the licensed brokers or sub-brokers of the Centre, the shares, stocks and debentures of public limited companies and also Development bond as well as Treasury bills issued by the Government.

Securities market can be further categorized into two groups as Primary Market and Secondary Market. Primary Market denotes the market mechanisms for the original sale of securities time of their initial issuance. In other words, a market for newly issued securities is called primary market. Corporate bodies issue new securities in the primary market. Securities available for the first time are offered through the primary security market. The issuer may be a brand new company or one that has been in business for years. The securities offered might be a new type for the issuer or additional amount of security – used frequently in the past. The key is that these securities absorb new funds for the offers of the issuer.

All the securities whether in the money market or capital market, are initially issued in the primary market. This is the only market in which the corporate or government issuer is directly involved in the transaction and receives direct benefit from the issue, that is, the company actually receives the proceeds from the sale of securities.

Secondary Market is the market in which securities are traded that has been issued at some previous point of time. In other words, where outstanding securities are traded is referred to as the secondary market or more popularly known as the stock market. Share or stock is the major component of the securities market. Stock market is the medium through which corporate sector mobilizes funds to finance productive projects by issuing shares in the market. The efficient collection of small amounts of savings and transferring funds into the complete and efficient uses requires a well functioning capital market to facilitate the process.<sup>8</sup> Thus, Secondary market deals with previously issued shares mainly traded through stock exchange, over the counter market or direct selling.

Secondary market in simple sense, are markets in which existing, already outstanding securities are traded between investors. It is the market that creates the price and allow for liquidity. If the secondary markets do not exist, the investors would have no place to sell the assets. Without liquidity many people would not invest at all. The function of the security market is to provide liquidity for the securities purchased in the primary market.

### **1.3 Investment and Investor's Perception:**

There are different parties involved in transaction of securities in the securities market. Investors are one of the main parties among them from whom the Corporation acquires fund. Investment process is concerned with how an investor should proceed in, making decision about what marketable securities to invest in, how extensive these instrument should be made (Winfield & Curry, 1985:1). Investors are those people who invest their savings in the securities to take the risk and return. On the investment in other properties, investor can not get dual benefit as from investment in stock. The investors are benefited from both capital appreciation as well as dividend appreciation from investing in the stocks.

Simply, investment is regarded as financial sacrifice at present in hopes of additional benefits in the future. In other words, investment is a process of exchanging income during one period of time for an asset that is expected to produce additional earnings in

future. An investor always has autonomy in making investment decision to channel the savings into a venture with the expectation of some extra return in the future.

The increased amount that one gets from the investment, as its return, is termed as profit. It has been a common proverb that “profit is always followed by risk”, so the profit is always characterized by uncertainty and this uncertainty is what termed as risk. The general concept regarding risk found to be only at return, but risk also prevails invested sum or the principal amount. Therefore, risk and return are the two most important aspects for conducting rational investment decision. Every rational investor attempts to minimize risk and maximize return. To do so, the investor must understand the concepts and measures of risk and return. Investors in Nepal are gradually getting conscious towards risk and return analysis. Investors may choose any securities either the long-term or the short-term, and may have different attitudes on the securities. Similarly, the return or reward may take several forms such as cash dividends or stock dividends (bonus shares) in case of stocks and regular cash inflows (interest receipts) in case of bonds and debentures. However, in case of short-term securities such as treasury bills, commercial papers, etc, the return is the difference between par value and the purchase price. Capital works as oxygen, as it works for human, for the business organizations. Every business enterprise requires short term, intermediate, and long-term capital for smooth operation and expansion of organizational activities. Among these types of fund, the long-term funds plays highly significant role for future growth and prosperity of the organizations. Most business organizations gather long-term funds from financial market.

Similarly, short-term investment proclaims investment of high quality and low risk. The goal of this type of fund is to protect capital with low-risk investments while achieving a higher return. These types of funds are usually used by investors who are temporarily parking funds before moving them to another investment that will provide higher returns.

Investors always have autonomy over investment choices. They can select any of the alternatives, prevailing in the investment environment, on their own cognition. Investors' decision is always guided by their own preferences over the investment but the rational investor always makes preferences after analyzing various aspects of the investment instrument. Therefore investment rationality in securities market is crucial to the investor and it requires a specific investment decision process, analysis of securities, making appropriate investment strategies as well as construction of efficient portfolio etc.

(Pandit, 2004:3). Rational investment should always ensure two aspects; first, the money should be available back when it is needed; second, the invested money should grow because a rupee's in hand today is greater than a rupee's value tomorrow in a world of inflation. Investment Rationality is concerned with the increment of the investor's wealth (Cheney and Moses, 1999:13-14).

There are many factors that should be considered while taking investment decision in the securities market. Some of these are the book value of the stock, risk-return trade off, companies' future prospects, government rules and regulation, the prevailing tax system on transaction of securities and its earnings, the direction of Nepal Rastra Bank and SEBO/N. But because of the poor governance and lack of timely information, the investors depend upon some available experts for the analysis of stock price. Besides individual investors dominate the market whose speculative behavior make the price fluctuate. This makes the potential investors depend on whim and rumour in stock trading. So this research study will try to evaluate the investor's rationality and the ways to be more effectively aware regarding the Nepalese Securities Market.

#### **1.4 Statement of Problem**

For any reliable transaction, the price and the value of commodity should be matched to reflect the rationality of the investors. The reliable price is possible to calculate only when the investors are provided with sufficient, authentic information necessary to calculate the real value of securities and the future prospects of its growth. But using limited flow of information, insufficient knowledge and poor education; the investors could not identify the good and bad stocks among many.

Furthermore, there is required the adequate number of organized investors to analyze the information regarding the performance of the companies in the stock market in Nepal. According to Lord, Ross and Lepper, securities marketing analysts and investors generate information for trading through means such as, interviewing management, verifying rumours and analyzing financial statements that can be executed with varying degree of skills. If an investor overestimates his ability to generate information or to identify the significance of existing data that others neglect, he will underestimate his forecast error. Traders could instead be over confident about the way they interpret information rather than about the information in self. They overweight information that is consistent with

their existing beliefs, are prone to gather information that support these beliefs and readily dismiss information that does not.

The investor is also tended to rely on the explanatory information and do not show interest on the statistical data and technical analysis. Since the sufficient information of financial performance of the listed companies has not been disseminated to the general public, the health and dynamism of the stock market suffers due to the lack of transparency. Brokers' role is one of the main sources for making aware to the shareholders in securities trading. In NEPSE, the brokers are not able to provide various services related to the trading of the stocks as compared to brokers of the stock market in other countries. The role of broker companies only act like a mediator and only focus on doing as much as transaction possible and gather commission. On the contrary, the trend only seems favourable to their peers rather than a common stockholder or possible investor.

Investors need to make the technical and fundamental analysis while making investment in stock. The technical analysis theory of share price behavior is based on past market information. On the assumption that history tends to repeat itself, it is believed that knowledge of past patterns of share prices will help to predict future prices under similar circumstances. It involves the study of past market behavior with reference to various financial and economic variables to forecast the future. The individual investor's investment policy is found to be buy-and-hold and pray strategy.

Investors are not context to follow the crowd, although investors do not mind the crowd and momentum investors buying shares that investors already own. Investors believe it is difficult to make money chasing the hottest trend, and investors often do the opposite of the fashionable trade. The current problems of securities market are stated as follows:

- ❖ Are investors aware enough regarding securities market or not? Do they possess adequate knowledge about investment procedure and analyze the factors affecting investment decisions?
- ❖ What is the psychology of an investor while making investment?
- ❖ Does there exist proper information disseminating system on securities behavior for potential investors?
- ❖ If provided relevant information, are the investors analyzing these while making investment?

- ❖ The investors should have the analysis technique to make the rational decision. Are the Nepalese investors making the investment by analyzing the different analysis techniques?
- ❖ Are the investors making rational decisions regarding their investment in securities market?
- ❖ What are the factors that influence investor's cognition while making investment?
- ❖ How the investors make their investment, do they make their decision on the basis of whim, rumour, and/or intuition, or do they consider other factors?
- ❖ How does the international economic scenario influence the security market of our country and how it affects the investor?
- ❖ How does the tax system affect investment decision?
- ❖ What are the major influences of investment for investors, are investors only inclined to transact stocks of financial and banking sectors or is it necessary to invest on the manufacturing sectors?

### **1.5 Objectives of the study**

The main motivation factor for initiating this study is that, much of the Nepalese investors' are still now are of what really investment principle works, what other factors should be considered before making an investment, what instruments are available to forecast future benefits, and what provisions are available making different investment options on the stock market. This study tries to evaluate the investors' rationality in the securities market in Nepal.

After stating the various problems, following are the specific objectives of the study as follows:-

- ❖ To analyze the cognition of investors' regarding securities trading and securities market.
- ❖ To analyze how investment decision takes place and what are its motivating factors.
- ❖ To analyze the investment trend in the security market of Nepal.
- ❖ To analyze if investors are aware of government provisions and tax system on stock transaction.
- ❖ To provide recommendation based on findings.

## **1.6 Significance of the Study**

This research is very useful to all the parties who are involved in the securities market. Even a common public might have enormous knowledge on stock market and rationality to be made during making investment decisions. Similarly, it is also very helpful to the university graduates and undergraduates who are curious to have knowledge about the investors' rationality in the securities market in Nepal.

Security market plays vital role in the economic development of the countries. Investment in securities affects the whole economic environment of the nation. The investors are very significant assets of the security market. Thus this study is important because it is conducted to provide some information about the present level of investors' rationality in the security market in Nepal.

Investment in stock markets is proved to be significant role model in economy. The economic environment of nation is influenced by the trend of stock market. Securities market being one of the prominent sources for the economic development, ultimately potential investors are considered to be the biggest assets. Hence this study targets to explore 'the investors rationality in securities market in Nepal'. As it is known that investors in Nepal are affluences to invest by imaginary unreal risk. This study is conducted to provide some information about the present level of Investors rationality in Nepalese securities market.

The prime motive of securities market is to uplift the economy from stagnation to develop the financial and industrial sectors through the effective mobilization of the funds. The acquisition of the funds by different companies of different sector depends on the investment decision and flow of investors in particular sector. It is seen that the majority of the Nepalese stock investors are trended towards the shares of financial and banking sector except some manufacturing and others. When any new company (especially of banking and financial sectors) issues share through primary market, large no of applicant apply for owner's certificate.

Since investor have autonomy in making investment decisions, it is the duty of corporate official and stock market intermediaries to accelerate favourably to accumulate the needed fund by eliminating the bad signs and signals of the weaker sector of the economy. So this study tries to find out the different influential factors of investors



decision and to recommend the necessary activities to be carried out to enhance the rationality of the investors by creating the awareness among them for the fair transaction of the securities and to highlight the growing importance of this particular topic for the acquisition of the required fund for different corporate sectors. This study also focuses on the impact of present existing situation faced by the general investors while making investment decision.

### **1.7 Limitation of the Study**

This research is not that easy to evaluate generally, there are some limitations in every study so the limitations of the study are as follows:

- ❖ This study area is limited. It is oriented to only the Kathmandu valley.
- ❖ This research study is limited only on common stock trading on the primary market and secondary market.
- ❖ This study is based on the last 5 years data beginning from 2002/2003 to 2007/2008.
- ❖ This study is based on the secondary sources of data as well as primary data. Primary data are acquired mostly by using the questionnaire, personal interviews from three sources via investors, brokers, staff of NEPSE and SEBON.
- ❖ The secondary data is taken with limited periods for the study.
- ❖ The research is based upon the data provided by the office of SEBON and those data are not verified by the expert.
- ❖ Time and financial constraints are also tile major limitations of the study.
- ❖ Stock trend is only seen with the help of NEPSE index.
- ❖ Though there is illustration of latest data to analyze the research but this research is only confined to the data up to the fiscal year 2064/65 (i.e. till July16, 2008).

The trends of NEPSE (Stock Market) are more fluctuated than any other transaction in financial market. That is why; the research could not fully support the actual trends happening in current period rather it supports to forecast the ‘will be’ scenario of the financial market.

## **1.8 Organization of the Study**

The main objective of the study is to find out Investors' awareness in the Securities Market in Nepal within the listed companies. This study has been divided into five chapters and they are as follows:

Chapter I: Introduction.

Chapter II: Review of literature.

Chapter III: Research Methodology.

Chapter IV: Data presentation and analysis.

Chapter V: Summary, Conclusion and Recommendation.

The first chapter is "Introduction" where the general introduction, statement of the problem, significance of the study, objectives of the study, and limitation of the study and organization of the study is included.

The second chapter is "Review of Literature". Here, the previous study done by different persons both individually and institutionally are reviewed is reviewed. Similarly different articles, journals, books and periodical are also to be reviewed.

The third chapter deals with the "Research Methodology". In this chapter, different statistical and financial tools, which are used to tabulate and analysis the data available from the primary and secondary sources are discussed.

The fourth chapter is the main body of research. It deals with presentation and analysis of data.

Finally the fifth chapter provides summary, conclusion and recommendation of the study. This chapter presents the major finding and recommends suggestions to impact the level of the general public as discovered from the research study. The appendices and bibliography will also be incorporated at the last.

## **CHAPTER - II**

### **REVIEW OF LITERATURE**

#### **2. INTRODUCTION**

In this chapter, review of basic literatures along with different theories, articles, as well as previous researches are reviewed generalizing the topic. In other words, this chapter encompasses review of theories related to the topic in a more descriptive and concrete manner. Books of different writers, articles, previous researches, as well as definitions in different websites are explored. On the other hand, consultations with teacher are also presented.

The first section of this chapter contains brief description regarding theories of investment, and its risk and return aspects. It also includes information about technical analysis, fundamental analysis, and efficient market theories. Similarly, the second section provides reviews on pragmatic experience of previous studies.

#### **2.1 Conceptual Framework**

Nepal entered into the adopted liberalization approach in planning since the late 1980s. One of the aims of this approach is to reduce public expenditure and encourage the private sector for direct participation and investment. So far, this 21<sup>st</sup> century is the period of globalization. In such, globalization is considered to be the most influential factor in economy. Globalization can be interpreted as a consecutive progress rather than simply a change. Through globalization, the world indeed has turned into a very narrow space, but in broader sense, it has created enormous opportunities for potential investors. Happenings in one part of the world impacts the other. Investors always are curious for opportunities that are supposed to bring good financial fortunes in the future and maximize their wealth. Investors always have liberty in making investment choices and balancing their expectations. On the course, financial market with variety of investment options provides investor handful of choices that are supposed to give more secure perspective as well as build strong financial base. Concerning about the investment patterns, general public information regarding the company has been observed to be the major stimulating factor for an investor in making an investment. Making investment is a cognitive and planned process (although it encompasses certain risk) rather than just making a bet.

The most important means for ensuring investors' rationality is to make rational investment decision where it is important to have adequate knowledge on what really investment is, the whole investment environment, and the mechanisms.

### **2.1.1 Investment**

The word investment originated from the Latin "vestis", which refers to the act of putting things (money or other claims to resources) into others' pockets. The basic meaning of the term being an asset held to have some recurring or capital gains. It is an asset that is expected to give returns without any work on the asset per se. Investment in its simplest form means employing money to generate more in future. Return is the primary motive of investments, but it always entails some degree of risk.

Investment in its broadest sense, means the sacrifice of current rupees for future rupees. Two different attributes are generally involved: "time" and "risk". The sacrifice takes place in the present and is certain whereas the reward comes later, if at all, and the magnitude is generally uncertain. Investing is the active redirecting resources from being consumed today so that they may create benefits in the future; the use of assets to earn income or profit. Similarly, it is also said that an investment is the choice by an individual to risk his savings with the hope of gain. In some cases, the element of time predominates (eg. government bonds). In other cases, the risk is dominant attribute (eg. call options and common stocks). In yet others, both time and risk are important (eg. shares of common stock).

A distinction is often made between investment and savings. Savings is defined as foregone consumption; investment is restricted to "real" investment for the sort that increases national output in the future. Although this distinction may prove useful in other contexts, it is not especially helpful here. However, it is useful to make a distinction between real investment and financial investment.

A company's future profitable expansion and plans require bulk finances and it is financed by the sale of new common stock in the primary market (the market in which securities are sold at the time of their initial issuance). Similarly, these invested common stocks itself represents a financial instrument to the purchasers who may subsequently trade these shares in the secondary market (in which previously issued securities are traded).

Generally, investment is distinguished from speculation based on time-horizon and risk and return characteristics of investment. The true investor's is interested usually in long term investment with a good rate of return, earned on a consistent basis. Such investors are normally not willing to take high risk and expect moderate rate of return. In practice, most investors have irrational behavior due to lack of intelligent speculation in the sense information from market to investigation and decision of investment is important. This is what that regulating authority is drawing the attention of investors to have investigation before investing.

### **2.1.2 Investment Environment**

- ) Securities (Treasury bills, long-term bonds, common stocks)
- ) Risk, Return, and Diversification
- ) Security Markets {on the basis of issue includes primary markets and secondary markets; and on the basis of life span includes money markets and capital markets}
- ) Financial Intermediaries

### **2.1.3 Investment Policy**

Whether an investor is an individual or represents an institution, a clear sense of why investments are being made and how long-run goals are to be achieved, he or she is likely to pursue inefficient approaches that lead to missatisfactory results. An investor needs a plan that directs his or her efforts. That plan is called an investment policy.

Investment policy is a combination of philosophy and planning. On the one hand, it expresses the investor's attitudes towards important investment management issue such as, "Why am I investing in the first place?" or "To what extent am I willing to accept the possibility of large losses?". The answers to those questions will vary among investors in accordance with their circumstances and temperaments.

It is also a form of long-range of strategic planning. It demarcates the investor's specific goals and how the investor expects those goals to be realized. In this sense, investment policy comprises the set of guidelines and procedures that direct the long-term management of the investor's assets.

Essentially, any relatively permanent set of procedures that guide the management of a plans assets fall under the rubric of investment policy. Nevertheless, a comprehensive investment policy should address a group of issues that includes (but it is not restricted to).

) **Mission Statement**: A description of long-run financial goals. For example, an individual might be focusing on savings for a child's college education. A pension fund might be intended to accumulate sufficient assets to fund promised benefits.

) **Risk Tolerance**: The amount of risk that an investor is willing to bear in pursuit of the designated investment missions. An elderly retiree may have a relatively low risk tolerance. Conversely, a well-funded pension fund with a young workforce may have a relatively high risk tolerance.

) **Investment Objectives**: The specific investment results that will indicate when the investment program has been successful. For example, an investor's common stock might be expected to perform at least as well as a broad stock market index over a multiyear period.

) **Policy Asset Mix**: The investor's long-run allocation to broad asset classes, such as stocks and bonds. This choice is by far the most important decision that the investor makes and should be consistent with the investor's mission, risk tolerance, and investment objectives.

) **Active Management**: The extent to which the investor attempts to "beat" the market by luring investment management firms that analyze and select individual securities or groups of securities expected to exceed the performance of specific benchmarks.

A critical part of any investment policy involves the preparation of a written Investment Policy Statement (IPS). An IPS summarizes the investor's key investment policy decisions and explains the rationality for each decision. The level of IPS detail will vary among investors. Institutional investors who typically have complex investment programs, should generally prepare more-detailed statements than indirect investors. Nevertheless, an IPS serves the same role for all investors: It enforces logical, disciplined investment decision making, and it limits the temptation to make counterproductive changes to an investment program during periods of market stress.

#### **2.1.4 Investment Process**

Investment process describes how an investor should go 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.

1. Set Investment Policy
2. Perform Security Analysis
3. Construct a Portfolio
4. Revise the Portfolio
5. Evaluate the Performance of the Portfolio

##### **Setting Investment Policy**

The initial step in setting an investment policy involves determining the investment objectives and the amount of one's investable wealth. Investment is always related with risks and returns. Making money alone cannot be an appropriate objective. It is appropriate to state that the objective is to make a lot of money by recognizing the possible losses. It also involves the identification of the potential categories of financial assets for consideration in the ultimate portfolio. The identification of assets depends upon many things, such as investment objectives, investable wealth, tax considerations etc.

##### **Performing Security Analysis**

It is the second stage of an investment process which involves the analysis of securities, which are identified in the previous stage of the process. The main purpose of analyzing securities is to find out the miss-priced securities. There are many approaches can be used to analysis the securities. Technical analysis and Fundamental analysis are most used approaches. Technical analysis involves the study of market price in an attempt to predict the future price movement. By examining the past prices, the pattern of price movements is studied and thus expected future price is forecasted. Sometimes, Technical analysis is called chartists.

Fundamentals analysis, the second approach to security analysis, tries to identify the real and true value of financial assets. The fundamental analyst attempts to forecast the timing

and size of these cash flows, and then converts them into their equivalent present value by using an appropriate discount rate.

### **Portfolio Construction**

It is the third step of our investment process. At this stage, we identify assets in which to invest, as well as determining the proportion of the investor's wealth to put in each one. While constructing a portfolio, the selectivity, timing and diversification need to be addressed by the investor.

### **Portfolio Revision**

Portfolio Revision means representing previous three steps of the process. That is, over the period of time, the objectives of the investor may change and the current portfolio may no longer be optimal.

- ) The investor can sell some unattractive securities and introduce attractive ones to form a new optimal portfolio.
- ) Some securities that are initially unattractive may turn out to be attractive later and vice versa.

### **Portfolio Performance Evaluation**

The last step of investment process is portfolio performance evaluation. Investor should evaluate the portfolio performance periodically. The performance should be evaluated not only in terms of the returns but also the risk experienced. To evaluate the performance, appropriate measures and standards are needed. "A portfolio is a combination of investment assets" (Thapa, 2002:24).

Regarding investment process, intuition is undoubtedly a crucial part of it. It is not surprising as an investor that they focus so much energy and efforts on investment philosophies and strategies, and so little on the investment process. Though it does not get sufficient attention, understanding the investment process is critical for every investor for several reasons:

1. The investment process outlines the steps in creating a portfolio, and emphasizes the sequence of actions involved from understanding the investor's risk preferences to asset allocation and selection to performance evaluation. By emphasizing the sequence, it provides for an orderly way in



which an investor can create his or her own portfolio or a portfolio for someone else.

2. The investment process provides a structure that allows investors to see the source of different investment strategies and philosophies. By so doing, it allows investors to take the hundreds of strategies that they see described in the common press and in investment newsletters and to trace them to their common roots.
3. The investment process emphasizes the different components that are needed for an investment strategy to be successful, and by so doing explain why so many strategies that look good on paper never work for those who use them.

The process always starts with the investor and understanding his or her needs and preferences. For a portfolio manager, the investor is a client, and the first and often most significant part of the investment process is understanding the client's needs, the client's tax status and most importantly, his or her risk preferences. For an individual investor constructing his or her own portfolio, this may seem simpler, but understanding one's own needs and preferences is just as important a first step as it is for the portfolio manager.

The next part of the process is the actual construction of the portfolio, which we divide into three sub-parts. The first of these is the decision on how to allocate the portfolio across different asset classes defined broadly as equities, fixed income securities, and real assets (such as real estate, commodities, and other assets). This asset allocation decision can also be framed in terms of investments in domestic assets versus foreign assets, and the factors driving this decision.

The second component is the asset selection decision, where individual assets are picked within each asset class to make up the portfolio. In practical terms, this is the step where the stocks that make up the equity component, the bonds that make up the fixed income component and the real assets that make up the real asset component are picked.

The final component is execution, where the portfolio is actually put together, where investors have to trade off transactions cost against transactions speed. While the importance of execution will vary across investment strategies, there are many investors who have failed at this stage in the process.

The final part of the process, and often the most painful one for professional money managers, is the performance evaluation. Investing is after all focused on one objective and one objective alone, which is to make the most money you can, given the risk constraints you operate under. Investors are not forgiving of failure and unwilling to accept even the best of excuses, and loyalty to money managers is not a commonly found trait. By the same token, performance evaluation is just as important to the individual investor who constructs his or her own portfolio, since the feedback from it should largely determine how that investor approaches investing in the future.

### **2.1.5 Investment Decisions**

Gross investment is determined by two main factors: The real interest rate and expected profit rate. The higher the expected profits rate on capital, the greater is the amount of investment, other things remaining the same. To decide whether to undertake an investment, a firm compares the expected profit rate with the opportunity costs of funds. This opportunity cost is the real interest rate. The lower the real interest rate, the greater is the amount of investment undertaken, other things remaining the same (Parking, 1996:202).

To make investment decision, it needs lots of information related to financial assets. Situation of market, risk and return factors involved to the stocks other opportunities available in the market, interest rate of bank, government current policies, tax laws regulations as well as attitudes of investors are the determinant of whether the investment be made.

In other term, investment decisions are made by investors and investment managers.

Investors commonly perform investment analysis by making use of fundamental analysis, technical analysis and gut feel.

Investment decisions are often supported by decision tools. The portfolio theory is often applied to help the investor achieve a satisfactory return compared to the risk taken.

**Investment Decision Biases:** The promise of abnormally high rate of return the lead to cognitive dissonance. Bad decisions are often followed by a feeling of investor's remorse.

### **2.1.6 Investment Alternatives**

Investors nowadays get hold of making investment in numbers of investment alternatives in market. Broadly, alternatives to invest may be classified as financial and real assets alternatives. Common stock, preferred stock, and bond as financial assets. But with the increase in financial market, concept and principals, a lot of other financial alternatives have mushroomed. Gather financial assets that serve as investment alternatives are convertibles, warrants, rights, commodity futures, financial futures, options etc. Real estate, precious metals, collectibles (diamond, stamp etc) are the some of the examples of real assets alternatives.

The only impedance for investors here in our country is because we have small capital market to provide various investment alternatives. Common stocks and government securities are popular alternatives but bond and preferred stocks can rarely be found. Other investment alternatives like options, rights, futures, convertibles, warrants are not in practice yet. There are some investment alternatives available in the business world such as listed below.

There are some investment alternatives available in the business world such as listed below:

#### **Direct Investment Alternatives:**

1. Fixed Principal Alternatives:
  - ) Cash
  - ) Saving A/C
  - ) Saving Certificates
  - ) Government Bonds
  - ) Corporate and debentures
2. Variable Principal Securities:
  - ) Preference Share
  - ) Equity Share
  - ) Convertible Debenture or Preference Securities
3. Non-Security Investment
  - ) Real Estate
  - ) Mortgages

- ) Commodities
- ) Business Ventures
- ) Art, Antiques, and other Valuables

**Indirect Investment Alternatives**

- ) Pension Fund
- ) Provident Fund
- ) Insurance
- ) Investment Companies
- ) Unit Trust and other trust funds

Direct investments are those where the individual makes his own choice and investment decision. Indirect investments are those in which the individual has no direct hold on the amount he invests. He contributes his savings to certain organizations like life insurance or unit trust and depends upon them to make investments on other people's behalf. So, there is no direct responsibility.

**International Investment Alternatives:** International investment is the investments by individual in debt or equity securities issued by organizations outside the country of residence of the investor. International investors are traded in organized exchanges and OTC (over-the-counter) market. Some examples of such international investment alternatives could be,

- ) Multinational Corporations' Stock and Bond
- ) Foreign Stocks Traded on a Local Exchange
- ) American Depository Receipts

**2.1.7 Investment Risk and Return**

It is a common proverb to say that risk and return are an integral part of investment which keeps on following it. The degree of risk and return depends upon the kind of the securities. Corporate securities are risky securities where as Government securities are risk less securities. The securities having the high risk yield high return. The trade off between risk and return is directly proportional as higher the risk, higher will be return and vice-versa.

### 2.1.7.1 Investment Risk

The unfavourable part in investment is what is considered as risk. In other word, risk is defined as the probability of suffering form of loss or damage. It is the chances of unfavourable even. An event is one more of the possible outcomes of doing something. The term applies to outcomes that cannot exactly predict. A risk seeker is one who prefers risk. The risk averter would select the less risky investment. The person who is indifferent to risk would not care which investment he or she received numerous factors usually mentioned are business risk, financial risk, liquidity risk, default risk, interest risk, management risk and liquidity risk.

On ground of assurance of the return, there are two kinds of investment- **Riskless** and **Risky**. Riskless investments are guaranteed, but since the value of a guarantee is only as good as the guarantor, those backed by the full faith and confidence of a large stable government are the only ones considered "riskless." Even in that case, the risk of devaluation of the currency (inflation) is a form of risk appropriately called "inflation risk." Therefore no venture can be said to be by definition "risk free" - merely very close to it where the guarantor is a stable government.

#### **Types of risk:**

Depending on the nature of the investment, the type of **investment risk** will vary.

A common concern with any investment is that you may lose the money you invest - your capital. This risk is therefore often referred to as "capital risk."

If the assets you invest in are held in another currency there is a risk that currency movements alone may affect the value. This is referred to as "**currency risk**."

Many forms of investment may not be readily saleable on the open market (e.g. commercial property) or the market has a small capacity and may therefore take time to sell. Assets that are easily sold are termed liquid; therefore this type of risk is termed "**liquidity risk**."

The risk that there may be a disruption in the internal financial affairs of the investment, thereby causing a loss of value, is called "**financial risk**."

Perhaps the most familiar but often least understood form of investment risk is "**market risk**." In a highly liquid market like the collective stock exchanges in the United States and across the developed world, the price of securities is set by the forces of supply and demand. If there is a high demand for a given issue of stock, or a given bond, the price will rise as each purchaser is willing to pay more for the security than the last one. The reverse of that occurs when the sellers want to rid themselves of an issue more than the buyers want to buy it. Each seller is willing to receive less than the last one and the market price, or valuation, declines.

The same form of risk applies to a house, an issue of stock, a mutual fund, or a bond. Some forms of investment risk can be insured against. For example, the risk that an investment rental property might burn down, or the custodian of your stock and bond investments might go out of business. Most of the forms of risk that we concern ourselves with, financial risk, market risk, and even inflation risk, can at least partially be moderated by forms of diversification.

#### **2.1.7.2 Investment Return**

**Rate of Return:** As early stated, return always follows investment, just the matter of fact is that either it meets the expectation of the investor or not. Simply, return is the income from an investment. It is the primary motivation for making investment. The return is the total income or loss on an investment over a giving period of time. The single period rate of return is one of the most important concepts in measuring return. It relates the total rupee return during a period to the original investment. Every investor is return conscious and average investor must know how to calculate return on investment and to interpret data as an input to his\her investment decision.

In finance, rate of return (ROR), also known as return on investment (ROI), rate of profit or sometimes just return, is the ratio of money gained or lost (realized or unrealized) on an investment relative to the amount of money invested. The amount of money gained or lost may be referred to as interest, profit/loss, gain/loss, or net income/loss. The money invested may be referred to as the asset, capital, principal, or the cost basis of the investment. ROI is usually expressed as a percentage rather than a fraction.

ROI does not indicate how long an investment is held. However, ROI is most often stated as an annual or annualized rate of return, and it is most often stated for a calendar or fiscal year. Here, ROI indicates an annual or annualized rate of return, unless otherwise noted.

ROI can be used to compare returns on investments where the moneys gained or lost are not easily compared using monetary values.

The rate of return can take on any value greater than or equal to 100%, a positive value corresponds to capital growth, a negative value corresponds to capital decay, and a value of 0% corresponds to no change.

### **2.1.8 Factors to be Considered when Choosing Investment Alternatives**

Investors do not invest in all investment alternatives available in the market. They choose a few among them. While choosing, they consider the following factors.

#### **Investment Objectives:-**

All investors have some purpose of investing. Some invest to children's education some for ensure regular income for retirement age, some for emerging fund. In the context of Nepal, investors do not seem to have clear-cut investment objective. At present, however, slowly some investors are found objective focus in investment alternative choice.

#### **Investment horizon:-**

It means the length of time for which the investment is mad. It is closely related to the investor's objective of investment. The investment horizon depends on the nature and type of investment alternative. In the context of Nepal, investors have not yet considered the investment horizon.

#### **Taxes:-**

Government taxes income received from most investment alternatives. Further, taxes to be paid also depend on the tax status of the investor. In Nepal, tax implication of investment income should be simple harass the investors without creating investment environment although in public speech the speck the investors to protect.

**Rate of Return:-**

An investor begins his selection process by looking at the past rate of return of the alternatives. Therefore, investors should estimate the expected rate of return of the alternatives under consideration.

**Risk Analysis:-**

Risk is understood as the possibility of suffering some form of loss or damage. It is the chances of unfavourable events. In the context of Nepal, investment is the chances of incurring losses. Strictly speaking, the risk is the chances of incurring losses, but we define it as the variability of returns, because the analysis of risk in terms of variable return produces same result, as the analysis of chances of incurring losses.

**Investment Strategies:-**

Investment strategies are a combination of select timing and diversification. It plays a vital role take an investment decision.

**Investment Selection:-**

Investors have various alternatives investment. Due to imperfect market, investors are not found selective in their investment decision.

**Timing:-**

It is also an important factor the influences investment decision. Appropriate time is required to invest the amount of money.

**Diversification:-**

Diversification is a process of reducing of reducing risk. An individual investor should make a diversified portfolio. There are various alternatives of portfolio. So the investors should identify possible alternatives and select the best one. Hence, diversification also affects the investment decision.

**2.1.9 Sources of Investment Risk**

Every investment that we have made certain as they are made under uncertainty even fixed income securities. There are certain risks that are associated with the time value of money. The sources of uncertainty that contribute to investment risk are as follows.

**Interest Rate Risk:-**



The interest rate risk is defined as variability return caused by changes in the market interest rate. If the market interest rate rises, the value of assets (bond) will decrease and vice versa.

**Purchasing Price Risk:-**

Purchasing price risk is the variability of return investor suffers because of inflation. Inflation erodes the purchasing power of the rupees and increase investment risk. The rate of inflation is measured by percentage change in the consumer price Index (CPI) the period.

**Bull-Bear Market Risk:-**

The various market forces make securities price upward and downward. The upward trend of market price (Bull market) and downward trend of market price (Bear market) create a long lasting source of investment risk.

**Management Risk:-**

All these decisions made by the management materially affect the risk faced by investors. Sometimes, the management may make a decision, which turns out to be wrong later on. For e.g. the poor management of Nepal Bank Limited arouses the investment risk to the shareholders. The share price continuously fell and had de-listed from the Nepal Stock Exchange. This has been creating risk to the investors.

**Default Risk:-**

The risk is that risk which is closely related to the financial condition of the company issuing the security and the security is rank in claims on assets in the event of a default or bankruptcy.

**Liquidity Risk:-**

Liquidity risk is associated with uncertainty created by the inability to sell the investment quickly for cash. The return variability will increase if price discounts and sales commission are to be given in order to liquidate assets in time. If the liquidity is less then the risk will be high.

**Political Risk:-**

Political risk is the assets total variability of return caused by changes in the political environment. The current Nepalese political environment has made a significant impact on the investment to increase losses.

**Industry Risk:-**

The industry is a group of business that operates in same environment, which are affected by some factor. For e.g. The Nepalese textile industry is facing the same industry risk in the near future because the quota provided by the US is going to expire.

**2.1.10 Financial Markets**

For any sort of transaction, there have to be an existence of a mechanism to proper the dealings. Therefore, financial market provides the required mechanism for financial assets trading. Financial markets provide a forum in which suppliers of loans and investments can transact business directly. The loans and investments of institutions are made without the direct knowledge of the suppliers of funds or savers. "Suppliers in the financial markets do not know where their funds are being lent or invested. The two financial markets are the money market and the capital market. Transactions in short term debt instruments or marketable (bonds or stocks) are traded in capital market.". The financial market can be categorized into two types according to their nature in time duration of contract.

**2.1.10.1 Money Market**

A gyration of financial relationship between the suppliers and demand makers of short term funds, which have maturities of one year or less than that, creates the money market. As far as money is concerned, banking institutions are at the helm of monetary activities for this reason; it is also called the short term financial market. It is the act of supplying short term debt or working capital needed for industries, business or incorporated body etc. In generally money market refers in debentures, commercial papers, government short –term debentures, business bill etc.

**2.1.10.2 Capital Market**

Similarly, the capital market is created by a financial relationship between a number of institution and arrangements that allows the supplier and demand makers of long term funds, which have maturities of more then one year to make transactions. In capital markets financial transactions are made for mostly longer period. In capital market different types of financial securities such as ordinary share, preference share, treasury bills and debenture are traded. The capital market can be divided in to two parts:

1. Securities market
2. Non securities market

#### **2.1.10.2.1 Non Securities Market**

Non–Securities Market is also that type of market where financial transactions are carried out between the lender and borrower for a longer period without issuing any securities in the form of share, bonds and debenture. Financial transactions between the term lending institutions such as development banks and the business houses and individuals between the contractual savings institutions and individuals or business houses etc. come under non securities market. The contract between parties of capital exchange has less liquidity due to restriction of liquidation of these loans in secondary security market.

#### **2.1.10.2.2 Securities Market**

Securities market interchangeably known as the integral part of capital market is in fact basis of the economy. The most effective use of idle and surplus resources can be bought into practice only by means of market mechanism. This indicates the structural network of the savers and users groups of fund presumably garnered for long term financing. But the formation of network originates via conversion process of saving in to investment outlet. Thus the security market upholds the attempts particularly concerned with the collection and mobilization of savings. Saving meticulously diverted towards the regenerating activities, in essence financialisation and industrialization activities will result in the repercussion favourable to the economy as a whole (Khatiwoda, 2055:16).

There are two important functions of securities market, namely the raising of funds in the form of shares and debentures and trading in the securities already issued by the companies. While the first aspect is obviously much more important from the point of view of economic growth, the second aspect is also considerably, important. In fact, if facilities for transfer of existing securities are abundant, the raising of new capital is considered assistant for the buyer of a new issue of securities are abundant, the raising of new capital is considered assistant for the buyer of a new issue of security is confident that whenever he wants to get cash he can find a buyer without much difficulty.

Security market sets a price for the securities it trades and makes it easy for a people to trade them. Securities market facilitates that sale and resale of transferable securities. The security market can be defined as a mechanism for bringing together buyer and seller of financial assets to facilitate trading. In other words, the securities market is known as the market where all types of securities are traded. Security market is a broad term embracing a number of markets in which securities are bought and sold. Securities market includes how an individual investor goes about the business of placing any order to buy or sell, how the order is executed, the process of setting the payment and transfer costs, and one hopes the payment of federal personal income taxes on the profits from the transaction.

Security market is the place or market where the long-term exchange of capital takes place. The user issues security for the capital it raises through the suppliers. The issuer issue different type of security instrument like common stocks, preference share, debentures, bond etc to raise fund from the market. The server provides supplies of capital by buying this instrument as their financial instruments. The securities market can be further divided into two parts:

- A. Primary Market
- B. Secondary Market

#### **2.1.10.2.2.1 Primary Market**

The primary market is that part of the capital markets that deals with the issuance of new securities or it also can be said that the securities are issue for the first time in public. This market allows pathway for real existence of stock as well as transaction in the real world of stock market for transaction. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The company i.e. raising funds or capital for its operations issues certain type of securities through an agent called its authorized selling agent called underwriter and the process of selling new issues to investors is called underwriting. The primary markets provide an important allocation function by channeling the funds to those who can make the best use of them- presumably, the most productive. The primary market is the place where the security is distributed among the interested investors. In the case of a new stock issue, this sale is an

initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.

Features of primary markets are:

- ) This is the market for new long term capital. The primary market is the market where the securities are sold for the first time. Therefore it is also called the new issue market (NIM).
- ) In a primary issue, the securities are issued by the company directly to investors.
- ) The company receives the money and issues new security certificates to the investors.
- ) Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.
- ) The primary market performs the crucial function of facilitating capital formation in the economy.
- ) The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as "going public."
- ) The financial assets sold can only be redeemed by the original holder.

The primary market further deals with two types of issue and they are:

**Unseasoned issue:** This type of issue, which is initially issued by the newly operating corporate bodies. This is also called initial public offering or IPOs. The distribution in primary market can be done by private placement, which is done by most private limited companies and public placement which is done by advertising its issues openly to general public.

**Seasoned issue:** This type of issue is made by already existing corporate securities to raise additional capital for its operation. Eg. Right issue.

#### **2.1.10.2.2 Secondary Market**

The secondary market, also known as the aftermarket, is the financial market where previously issued securities and financial instruments such as stock, bonds, and options are bought and sold. With primary issuances of securities or financial instruments, or the

primary market, investors purchase these securities directly from issuers such as corporations issuing shares in an IPO or private placement, or directly from the federal government in the case of treasuries. After the initial issuance, investors can purchase from other investors in the secondary market.

The security exchange provides a floor for the buy and sell of primary issue securities through a prescribed procedure. The investors who are interested to invest in existing securities can buy desired securities through the secondary market. The secondary market liquidates the shares and provides the opportunity between the investor and seller of the securities. The company must list the securities in the security market for the transaction process. The secondary market provides enter and exit channel for the investor. The investors can enter the investment and when they feel the investment profitable and can exit as they feel it worthless. However the transactions in the secondary market do not give any cash flow to the issuing company, but it is important as the exchangeability provides liquidity to the instrument and it makes the security investment attractive to investors.

#### **2.1.11 Growth and Performance of Securities Market in Nepal**

Securities Board, Nepal, an apex regulator and facilitator of capital market, and Nepal Stock Exchange Ltd., only a single stock market, are the main constituents of securities market in Nepal. A new thought is being generated to create another stock exchange these days, but it ain't that simple task. This paper attempts to study the growth trend and analyze the performance of Nepalese securities market; likewise, the variables such as number of listed and traded companies and their securities, number of transactions, trading turnovers, paid up value, market capitalization and NEPSE index are analyzed for the secondary market.

SECURITIES MARKET AS A MECHANISM, created to facilitate the exchange of financial securities or assets by bringing together buyers and sellers of securities (Sharpe 1998). Securities markets provide an effective way of procuring long-term funds by issuing shares and debentures or bonds for corporate enterprises and government and at the same time provide an investment opportunity for individuals and institutions. Thus, the market place for these financial securities is called securities market which is further subdivided into the primary and secondary market. The former market denotes the market

for newly issued securities to the public whereas the latter market refers to the market for secondhand securities, traded previously in the primary market (Francis, 1991).

The securities market plays an important role in mobilizing savings, and channeling them into productive investment for the development of commerce and industry of the country. It basically assists the capital formation and economic growth of the country. In many developing countries like Nepal, the undeveloped capital market is still prevailing in the economy. The Nepalese securities market still could not take its height. The further improvement of this market is very crucial. It helps in accumulating even small savings for development activities of the economy otherwise, which would have spent in unproductive areas. But it is true that there is no presence even of organized money market in rural areas, which covers almost 90 percent of the total area of the country. Thus, the securities market is only confined to the very limited urban areas of Nepal. Despite these truths, an attempt has been made to analyze the growth trends and performance of Nepalese securities market.

### **Historical Perspective of Nepalese Securities Market**

The history of capital market in Nepal dates back to 1936 in which year the shares of Biratnagar Jute Mills Ltd. were floated. In 1937, Tejarath was set up to facilitate loans to the government employees and was converted into Nepal Bank Ltd. HMG Nepal introduced the Company Act in 1964 and the first issue of government bonds made in the same year through Nepal Rastra Bank to collect the developmental expenditures. It carried 6 percent rate of interest and had the maturity period of five years (Shrestha 2038). HMG Nepal announced the Industrial Policy in 1974 and under this policy an institution named Securities Marketing Center (SMC) was established to deal in government securities-development bonds and national savings bonds, and corporate securities of few.

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The government has the virtual monopoly over the security market. Then, Securities Exchange Center (SEC) was established in 1976 with an objective of facilitating and promoting the growth of capital market. It was the only capital market institution in Nepal. Securities Exchange Act came into force in 1984. Since then, SEC started to operate under this act. The purpose of this act was to provide systematic and favorable

market environment for securities ensuring and protecting the interest of individuals and institutional investors as well as to increase the public participation in various firms and companies.

SEC had provided facilities to trade the government securities and few of corporate securities like shares and debentures. Only the shares of 10 companies were listed in SECONDARY and there was involvement of no broker and dealer in the securities market. So, SEC itself was undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services (NEPSE 1998). Apart from this, there was the absence of effective secondary market to ensure liquidity to the securities.

The interim government (1990/91) initiated financial reform program and two indirect investment vehicles-Citizen's Investment Fund and NIDC Capital Markets Ltd.-were established with the collective investment schemes in the corporate sector. Then, due to the world whim of privatization and economic liberalization, the operation of SEC was felt to change to make it compatible with the changing economic system. As a result, HMG Nepal brought about change in the structure of SEC by dividing it into two distinct entities-Securities Board, Nepal (SEBO/N) and Nepal Stock Exchange Ltd. (NEPSE) at the policy level in 1993. Since then they are operating as the main constituents of securities market in Nepal. SEBO/N was established on June 7, 1993 with its mission to facilitate the orderly development of a dynamic and competitive capital market and maintain its credibility, fairness, efficiency, transparency and responsiveness under the Securities Exchange Act 1983 (SEBO, 2001). It is an apex regulator of the securities market in Nepal until this period. It registers the securities and approves the public issues. Moreover, SEBO frames the policies and programs required to monitor the securities market, provides license to operate stock exchange business and stock brokers and supervises and monitors the stock exchange operations and securities businesspersons. NEPSE Ltd. is a non-profit organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as brokers and market makers, etc. NEPSE opened its trading floor on January 13, 1994 through its newly appointed licensed members and has adopted an "Open Out-Cry" system for the transaction of securities. The trading floor is



restricted to listed corporate securities and government bonds with the market intermediaries in buying and selling of such securities.

### **Public Issue Approval**

Public issue of securities is made in the primary market. Funds mobilized through the primary market constitute investment. Issue of securities may be made especially through prospectus and/or offer for sale and private placement. As per the securities legislation, it is mandatory for corporate bodies to get their securities registered with the SEBO/N. The SEBO/N reviews the application and documents and gives issue approval of different class of securities such as equity shares, rights share, debentures, preference.

### **Growth and Performance of Securities Market**

Stock market indices are used to study the trend of growth pattern in the economy, to analyze as well as to forecast business cycles and to correlate it with economic activities (Bhalla 1997). The higher the index implies the increase in market price of securities and the better performance of companies and vice versa. NEPSE follows the Standard and Poor's Index method for its calculation by taking the market capitalization of all listed securities based on February 12, 1994 prices as 100 (SEBO 1998). NEPSE index at the end of 1993/94 was 226.03 then it started to move down and reached a level of 163.35 in 1997/98. Then, in the two subsequent FYs it was increased and reached to a peak level of 360.70 points in the FY 1999/00. From FY 2000/01 onwards there has been downward trend in NEPSE index. These facts prove that the NEPSE index has highly fluctuated during the observed period. On the whole, the market was bullish in 1997/98 to 1999/00 and then it took its bearish trend till the last FY. The overall growth in NEPSE index during the study period is 3.55%. Till the very end of the FY 2008, the market again hit the bullish and reached it apex. The only thing to occur this event is due to the issuance of shares of the Nepal Telecom, followed by rumors and expectances, but the market became bearish at the end of the year and remained this. On the other hand, the tax rise in price appraisal also hindered the charm in investors and finally, amalgamating all these, the market fell to an unbelievable trough. The very low and highly fluctuating NEPSE index growth rate indicates poor performance of public limited companies listed in stock exchange. This further implies unsatisfactory performance and deteriorating economy of the country.

### **2.1.12 Characteristics of Different Secondary Markets**

A secondary market is a place where outstanding securities are traded but the differences in the secondary markets exist around the world on the basis of their operation system and regulations. The following are the characteristics of different secondary markets:-

**a) Intertemporal Consolidation of Trades:-** Under this characteristic, the secondary market can be divided into two types: Call market and Continuous market. In call market, trading is allowed only at certain specified times. This market accumulates clients trading orders, which arrived over a period of time, into batches that are executed simultaneously. In continuous markets, on the other hand, trades may occur at any time during the trading day.

**b) Spatial Consolidation of Trades:-** Some secondary markets like NYSE collect orders from around the world and execute them on the floor. Such a market is called geographically consolidation market where as some markets operate within a limited area and trade limited financial assets. Such a market is called a geographically fragmented market.

**c) Maximum Daily Price Change Limitation:-** Some of stock exchanges around the world allow the prices of securities to fluctuate freely. But some stock exchanges limit it in some range. If the price of any stock changes more than that exchange's maximum daily limit, trading is stopped – usually for the rest of that day.

**d) Margin Requirements:-** The initial margin requirement in different countries ranges from a very tiny down payment to 100%. There is no similarity in the margin requirement in the secondary market around the world and there is difference even in the same secondary market on the basis of type of securities.

### **2.1.13 Inter Relationship between Primary Market and Secondary Market**

The primary market and secondary market have a symbiotic relationship. While the primary market creates long- term securities, the secondary market gives liquidity to the security. The new issues are influenced by existing securities of same kind in secondary market. The high price appreciation possibility and prosperity of security in secondary market motivates investment among the institutional and individual investors to subscribe new issues. It is because of presence of secondary market investors are not afraid to put

their money in to market. As because whenever they feller like to make them cash they can do it easily in secondary market. In other word it will be suitable to be described as a seasoning provided to securities to make them more attractive. Again when an existing security performs well in secondary market it will help to build goodwill and hence helps to make the seasoned or additional issues of securities popular and demanding among public. Secondary market provides an exist channel to the investors in security market.

Also, it helps to make a back flow of fund from capital market in the economy. The high investment in capital market will result in low supply of money in the market resulting less money to be spent in other expenses.

#### **2.1.14 Types of Investors:-**

Investors are anyone who makes the investment in the securities though there is not much attraction of investor's towards the world of financial instruments. 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. Institution investors:-**

Institution investors are those investors, which is an institution or organization. Their base is very small to mobilize saving in a cost effective manner for individual savers who otherwise might not participate in the stock market. The growth institutional investor portfolios had a bearing on many of the financial instruments and investment management techniques. The security market have been dominated by the institutional investors as they have large capital available to invest. The institutional investors take an advantage from the various profits available from the security market. The security market have been a good place to invest for institutional investors as it gives an opportunity to institutes to make their capital works or decrease non performing assets.

“To ensure sustained price and market the policy level author should encourage institutional buyer said stock broker and general secretary stock broker association of Nepal (SBAN) Parmeshowor Malla”. Analytical bulk buying is rendered possible through such institutional buyer which in turn help make the market less volatile than at present, Malla observed. There are dozen-plus commercial banks and about 45 finance companies that are potential institutional buyer. “Investors awareness is a healthy stock

market overall, there is a big lack of relevant and updated information about companies in the market” said Prof Dr. Manohar Krishna Shrestha. The institutional investors seek to derive the necessary information are stock recommendations, earning forecasts, written reports and overall performance sources before taking investment decisions.

#### **b. Individual investors:-**

Individual owns a portfolio of securities and becomes investor. But individual investors are part timer, they are businessman government worker, doctors, lawyers and even housewives students and unemployed adults. When an individual buys a security holds them and gets dividend or profit through price appreciation the cash flow becomes income to the people.

Although we see very few well known successful investors in Nepal we can get very good examples of successful investors in our neighboring country an well known international icons like warren Buffet, John Templeton, Peter lynch, George soros, David Dreman etc. The well-known Indian Investment Gurus Chandra Kant Sampat, Nemish Shah are people who took investment as their carrier. The average investor in securities is a part- timer, with neither the ability nor the time to evaluate a large (and often complex) flow of information. Most individual investors have a job apart from investing.

Individuals have opportunity cost obtaining investment information, such as reading publication, tracking stock price, and building files on securities. This opportunities cost is the time and resources for gone that could have been used in other endeavors (Jones, 1988: 36).

#### **2.1.15 Factors to be considered before Investing in Securities**

Stock investors who want to invest in the stock market. Stock investors do not invest directly in corporation. At first, they come in stock exchange market they investment on the information base of prospectus of company and other public notice and details, which are published by the company. While investment policies needed to be formed, the investor needs to consider many factors. Usually these are the factors to be considered in the investment planning decision (Shim and Siegel, 1989:256). Investment is all about making multiplying and making money to earn money by investing in available alternatives rationally. If anybody just invest in market without a proper knowledge it

will be as foolish as going to unknown places. “Investors without first learning all you can about an opportunity is like running through an unfamiliar room with you’re closed” Says Diana Ahman, Wyoming's secretary of states, you are going to hurt yourself people do not have to see the securities as only an alternative ways to invest their money in. “More than anything else, no one has anything to hand (g) their hats on”. What reason do they have to buy stocks?”

As investment in securities done with longer planned procedure and with short planned or with the situational attitudes the actions of the investor can be divided in to two types.

- (i) Investors
- (ii) Speculator

**Investors:-**

Investor is one which has written long term planning for investment. His/her period of investment or holding security will be minimum of one year. This type of player generally uses his/her own funds.

**Speculator:**

While speculator does not have plans and investment in short period. He/she just take an advantage of the move of stock market. This type of players usually uses borrowed funds of capital market which can be very substantial to his/her personal resource.

**Investment Consideration to Potential Investors in the Primary Security Market**

Investors should be able to manage their investment from beginning of planning for investment till the security is liquidated. While buying in initial market or primary market the investor should be aware of different aspect of the securities issued. Rules and Regulation alone would not be able to protect the interest of investment. Investors should be able to analyze and evaluate the different aspects of the company before taking their investment decisions. Investors should select those company’s shares, which are regarded as well operating and good future prospect, protective provision of in debenture, reliable management, beneficial sector or high growth before they finally invest.

The investors who invest in stock, they must compare price and the value of share in the market and should select shares which have lower market price in comparison to its

intrinsic value. The investors who invest in bond and debenture should find out the provision of repayment of principle in case of default.

The investors are to be informed about the following before making investment in the Initial Public Offerings (IPO) (SEBO\N, 2058:11).

a) The investors should take necessary information about companies such as, promoters, size of company, growth of company, company's environment, Board of Directors (BOD), and the past and forecasted statement (Performa Balance Sheet) etc from the prospects, Articles, memorandum of the concerned company, and company's promoters.

b) The investors should make a Public Announcement made by the company in national daily newspaper before 7 to 15 days the opening of the issue of shares.

### **Investment Consideration to the Potential Investors in the Secondary Market**

a) Investor should keep the information of the companies return to the shareholders in the form of cash dividend, stock dividend, Bonus share etc. They should keep timely information about companies Earning per share (EPS), Book price of share (BPS), Price earning ratio (P\E ratio), future plan and growth expectancy of the company, Quarterly and half yearly performance report, Profit and Loss account, Balance sheet and annual reports etc.

b) Investors should follow and read the act and regulation concerning to the shareholders right.

c) Investors should learn at analyze information (price sensitive and other information) notified to the investors in the notice board of SEBO\N and NEPSE about the listed companies.

d) To study the articles related to the trading to the trading of shares and economics matters published in the different newspaper and magazines and the annual reports and other information published by SEBO\N.

e) To study the trading statements and financial analysis of the listed companies published by NEPSE.

f) The investors should update. Knowledge of different sources, which provides information about stock and securities market, likes websites of SEBO\N (sebonp.com) and NEPSE (nepalstock.com). The investor's first step in establishing a satisfactory relationship with the broker is to choose a firm that is suitable for his needs and to select representative of firm with whom he can work. In practice it is hard it separate the two choices, for if one has chosen a satisfactory firm but is unhappy with the representative, it is embracing to shift one's account to another representative with in the some firm. The brokerage firm should be a well- known and long established institution. In selecting a firm an investor can ask for recommendations from his bank or form friends whose opinions he trusts. The representative should be able to furnish the investor at all times, on reasonable notice, information on any specific company's securities (Fisher and Jordon, 1992:17).

The reprehensive should not be the type who is always trying to sell the investor something, on the other hand, he should be aware of the securities held by the investor and should inform him of any news that is relevant to these holding. Basically, the function of the representative is to given service and information to the investor so that the latter can make investment decisions and for a mutually satisfactory business relationship between his own investing philosophies and goals quite clear so that he representative will be able to offer the type of service desired. Most investors have access to investment information in the form of oral and written form their brokers. Brokers are most active trading agents of capital market. Stockbrokers are backbone of stock market growth and its smooth function.

The intrinsic value so arrived at is then compared with the security's current market price. If every investor must be able to calculate the intrinsic value of security and if market price available below the intrinsic value, the purchase should be made. Conversely, a sell is recommended in opposite situation.

### **2.1.16 Need of Securities Market to the Less Developed Countries**

In the view of many economist, capital is regarded not only central position to the process of economic development but also as strategic. According to Dr. R. S. Mahat "Capital which is itself the product of the human labor with the collaboration of the nature in the past is one of the ingredients in the process of production. It is required to start and run

any productive operations. It is more so industry where the capital intensity is normally higher than in agriculture.” We know that the capital information is playing a key role for economic development. But capital information capacities of Nepalese are very poor. On the other hand, they expenses collected savings on the unproductive channels such as real estate, precious metals, inventories, foreign exchange etc. in place of financial assets. The individuals who hold such assets are not necessarily those who are willing or capable to hold productive assets because ownership of productive fixes assets entail entrepreneurial and managerial function as well. Therefore, they will not use it for productive purposes. In this case, the security market helps to the unproductive issues to the productive one.

Economic development demands transformation of savings or invertible resources into actual investment. People who initiate actual investment are not necessarily those who have funds for the purpose. The process of industrial development starts in modern lines self- financing becomes insufficient to support it. Private means of finance becomes not only limited but also even uneconomic therefore, it becomes necessary funds. There are other people generally households who have surplus funds but do not have the desire and or capability to utilize them for investment activity. The market, which performs this function, is the capital market Lavington an authority of British Capital Market opines that its function to enable control over resources to pass into the hands of those who can employ them most effectively there by increasing productive capacity. In underdeveloped countries generally comes across a situation where entrepreneurs do not find resources or productive investment while savers invest their money in real assets or relatively low social productivity. The financial institutions remedy such a situation by soliciting the resources from savers by offering them a variety of financial securities differentiated in maturity yield provide them to the most efficient users. Thus a more efficient allocation of invertible funds results. In this way to the conclusion we say that the need of securities market is still greater in an underdeveloped country like Nepal where a host of traditional social and psychological between surplus units and deficit units.

#### **2.1.17 Benefits of the securities Market**

The benefits of the securities markets are as follows:-

1) **Promote efficient financial system:-** Securities markets break the oligopoly that would be enjoyed by the banks in the absence of securities markets. The governments do



not automatically have privileged and subsidized access to funds and must compete on equal terms. Securities markets provide impetus for the establishment of financial prices based on scarcity values rather than on administrative fiat. Such market determined financial prices and investment options, in circle of innovation and mobilization that contributes to the overall efficiency of the financial system.

2) **Allow deconcentration of ownership:-** Equity sales provide for a wider participation in enterprise management and for a wider distribution of corporate profits these factors would help allay the fear that a few individuals or groups linked to the ruling party would dominate the private sectors. Wider distribution of corporate profits develops a general sense of ownership and an assumption of responsibility on the part of the citizen. People will now be united by their common defense of their business interests and ethnic and religious differences would gradually dissipate.

3) **Helps privatizations efforts:-** Public investments vastly exceed private investment in transitional economies. Economists widely believe that privatization of state enterprises will reduce losses and create efficiency. However, transitional economies generally lack the financial infrastructure and the legal framework to engender privatization efforts. One of the most notable problems associated with privatization of state enterprises is the lack of well developed domestic equity markets. An inadequate supply of capital due to low savings, low gross national product and limited access to international capital markets has been an impediment. One of the main challenges for transitional economies is, therefore, to improve the quality of financial intermediaries and resources allocation to contribute to a more rapid rate of economic growth that would lead to higher levels of savings and investments.

4) **Help term transformation and improve capital structure:-** Healthy debt\equity ratios are important for a robust economic system. Corporations in many developing countries are undercapitalized. In the absence of equity markets, debt\equity ratios inevitably rise. First in growing companies, retained earnings and fresh cash injections from the controlling shareholders usually can not keep pace with the needs for more capital, thus slowing growth. Second, outside investors require liquidity and some sense of security that can be provided only by an organized market place. When active secondary markets for securities exist, savers can be induced to provide the long term

funding that corporations seek because savers and assures that the markets can provide them with liquidity.

**5) Improving accounting and auditing standards:-** Securities purchases rely in part on corporate information provided in financial reports to take their investment decision. The development of securities markets is usually accompanied by increased reporting standards and requirements, which contribute to the efficiency of the markets and their mobilizing and allocating functions. A regular disclosure of adequate, reliable and timely information makes it possible to compare performance of various companies. The development of widely accepted accounting procedures, checked by independent external auditors is also an important benefit derived from the development of securities markets. Availability of good information helps corporations make better decision and provides better statistics for economic policy makers. Good information may even help tax authorities collect taxes in a more efficient and equitable fashion. The need for disclosure of financial information is strong incentive for the improvement of accounting and auditing standards.

### **2.1.18 Regulation of Securities Market**

Securities market in Nepal, till the recent past, has all the characteristics of an underdeveloped economy. It was characterized by the absence of professional promoters, underwriting agencies, market intermediaries, organized market, regulatory bodies, and rules and regulation. However, after the restoration of democracy in 1990, a trend towards an organized stock market can be marked with numerous developments in the Nepalese securities market, removing its earlier deficiencies. A details legislative code has been adopted by the government to protect the investors' interests. The Securities Exchange Regulation, 1993, provides for those reforms in stock exchange trading methods and practices. The regulation has added further functions, powers and duties of the securities Board, Nepal (SEBO). The regulation has authorized the SEBO for internal housekeeping mater, made provision regarding licensing Stock Exchange and their subsequent operation, specified requirements for the registration and listing of securities along with authority for the registration of the market intermediaries such as brokers, market makers, dealers and issue manager. The regulation, different provision regarding

allowances and benefits as well as duties, powers and functions of chairman of SEBO funding, accounting and auditing are also specified by the regulation.

The company Act, 1997, marks an important stage in the development of corporate enterprises in Nepal. The provisions made under this act especially relevant to the securities market are provisions regarding the issuance and publication of the prospectus, which is necessary for public issue of securities. As per this provision, the details of the content of prospectus are prescribed and the prospectus is to be approved by the Companies Registrar's Office (CRO). Under this act, different provisions have been made for the establishment of a company (either public or private) and its liquidation, conduction of Annual General Meeting (AGM), incorporation of Memorandum and Articles of Association, issue of shares and debentures, preparation of annual accounts and their audit and the annual report. Securities Exchange Act, 1983 (Second Amended) provides reforms in securities market regulating practices. It can be taken as the very important legislation of the securities market. The act has been formulated to systematize and regularize the stock exchange in order to maintain the economic interest of the people. It also contributes to the development of the country, to protect the interest of the investors and to increase the participation in the industrial sector. For this purpose, this act provides legal framework for the securities regulatory system by establishing SEBO as an apex regulatory body. As per this act, SEBO provides license for the operation of stock Exchange, registers securities and grants approval, supervises and monitors stock Exchange and market intermediaries. This act also enables SEBO to issue directives and make by – law and guidelines and also allow the Stock exchange to frame by – laws. Similarly, some provisions have been made regarding inside information and order forbidden activities, however they are not covered broadly.

In order to manage sales and promotion of Securities and make the sales and issue manager accountable for their services, SEBO has issued the Securities Management Guidelines, 1998. This guideline has been made as per the provision of section 35 of the Securities Exchange Act, 1998 (Second Amendment). The guideline further specified various provisions regarding disclosure, application for registration of Securities, agreement between issue manager and issuing companies, execution procedures of the sales management and code of conduct to be specified etc. Similarly, share Allotment Guidelines, 1994, issued by SEBO make the share allotment procedures fair the

transparent. The directives were intended to create broader ownership according to the mass participation policy. Thus, from the foregoing brief discussion, it is clear the securities Exchange Act, 1983 (Second Amendment) and securities Exchange Regulation, 1993 set up a general framework for regulating securities market, which has facilitated and encouraged the development of securities market in Nepal.

### **2.1.19 Costs and Environmental Requirements of the Securities Market Development**

The costs and environmental requirements of the securities market development are as follows:-

1) **Interest rate fluctuations:-** The fluctuations in interest rates, which occur in a financially competitive environment, make planning more difficult for both borrowers and savers. The additional efforts required for information gathering and decision making in such environments, together with the need for borrowers and savers to adjust their positions more frequently overtime, constitute costs brought about by a liberalized financial system.

2) **Market cycles:-** During the early stages of securities markets developed the supply of stocks and bonds is limited, manipulated is relatively easy, investors are unsophisticated is underwriters and brokers are in experiences and securities legislation often has loopholes. As a result, economic cycles are most difficult to predict. Thus, the job of a financial analyst would be very difficult during the early years of development.

3) **Income inequalities:-** While securities markets provide wider investment choices for savers and also serve to spread ownership in companies, it is likely that in the initial stages of securities market development, the benefits of securities ownership will accrue to a limited group of investors. According to Wai and Patrick (1973), until a wide range of firms (in terms of size) and savings units (in terms of distribution of income and wealth) participate in the securities markets directly or indirectly (through mutual funds, pension funds, insurance companies, etc.) the development of the capital market particularly the market for equities, is likely to increase the inequality of income and wealth distribution. A vigorous program of wealth distribution through higher progressive income taxation is one counter – measure, although it is fraught with its own problems.

4) **Intermediation and Regulation**:- The institutions and individuals that constitute the securities markets fall into the following categories.

- ) Participants who are the savers and users of capital (individuals, corporations and governments).
- ) The financial institutions and intermediaries that channel capital from savers to users.
- ) Supporting and supervisory entities which are typically government bodies that facilitate and regulate the activities of the participants. The markets itself has two levels:
- ) The primary market where newly issued securities of newly created or existing enterprises trade.

The secondary market where trading in outstanding shares are done. The specialized services of financial intermediaries in securities markets are costly, yet indispensable. The strategic position that financial intermediaries hold in the market system in terms of access to information and control over transactions can lead to profiteering behavior that decreases the benefits accruing from the mobilizing and allocating functions of the securities markets system as a whole. The reporting requirements also represent costs to participants firms. In addition, firms have incentives to falsify such reports, which results in distorted investment decisions on the part of securities purchasers that may lead to the organization and function of regulatory agencies as securities commissions, stock exchanges and administrative organs represent monitoring costs associated with the control of securities abuses.

#### **2.1.20 Role and Significance of Securities Markets in the Economy**

Securities Market is recognized as an effective way of raising capital for raising capital for commercial enterprises and at the same time providing an investment opportunity for individuals and institutions. The activities of buying and selling securities in the securities market are extremely important for the efficient allocation of capital within economies. The securities markets are requisite for the sound development of an economy because it not only provides stable long-term capital for companies and an effective savings vehicle for the public. A developed securities market is the medium through which only productive firms that have better performance can easily raise capital.

In other words, well-developed capital markets enable high quality firms to increasing finance themselves from securities (bond and equity) rather than from bank loans. Securities markets play a crucial role in the economy by channelling investment where it is needed and by putting it to best use (Lieberman and Fergusson, 1998). The securities markets help to channel public savings to industrial and business enterprises. Securities Markets agents manage liquidity and productivity risk by eliminating premature capital liquidation, which increases corporate sector productivity. Securities Markets also accelerate growth indirectly by reducing liquidity risk which encourages firm investment. More liquid markets reduce the disincentives to investing in long duration projects because investors can easily sell their stake in the project if they need their savings before the project matures. Enhanced higher return projects that boost productivity growth. Securities Markets help investors it copes with liquidity stock to sell their stake to other investors. The result is that capital is not prematurely removed from firms to satisfy short term liquidity needs. More, securities markets play a key role effect on the economy in aggregate. The development of the securities market is a necessary factor for modern day economy. There should be no doubt regarding the significance of securities market as it is clear that countries having developed securities market mechanism are developed and countries with poor securities mechanism are undeveloped (Dhungel, 2001, April\May).

Securities markets must function well for the sustainable economic development. If the investment is required for new technology for the projects with long – gestation period, premature liquidation of the capital is always inevitable without the existence of liquid and well functioning securities markets. Securities market forms dynamic functioning of the economy and in promoting industrial and economic development of a country. Securities market plays a crucial role in mobilizing a constant flow of saving and channelling these financial resources for expanding productive capacity in the countries. Thus, securities markets assume a greater role and significance in the present day economies.

#### **2.1.21 Government Securities**

Government issues securities to finance their activities. Revenues collects by the government seldom cover expenses and the differences have been financed primarily by issuing debt instruments. New instruments are issued to repay the old debt. Various types of securities are issued to raise necessary fund, some securities have short term, where as

other are long term. Treasury bills, development bond, saving bonds etc. are some examples of government debt instruments. Various types of government securities are:-

### **A. Treasury Bill**

Treasury bills, often referred to as T- bills, are securities with a maturity of one year or less, issued by national governments. T-bills are issued on a discount basis and government pays the face value at maturity. T-bills are issued in discount; however, the difference is treated as interest income for tax purpose. All bills are sold by auction and bids may enter on either a competitive or non competitive basis. The total fund to be raised may be spitted into two parts: competitive and non competitive. Under competitive bid investors must bid the price they are willing to pay by undoing the bank discount computation and under non competitive bids, the average price in the accepted competitive bids will be charged. Similarly, Treasury notes, treasury bonds, saving bonds, zero coupon bond etc. also government securities. Treasury notes are issued with maturities from one to ten years in US and generally make coupon payments semi-annually. Treasury bonds have maturities greater then ten years at the time of issuance savings bonds are non marketable and offered only to individual and selected organization.

### **B. Development Bond**

It is a long term government bond. It has normally five years maturity period. Individual and institutions can purchase it. It can be used as collateral when taking loans. The holder normally begins 90% amount of total value if he keeps them on collateral. It has also fixed minimum interest percentage. The interest amount will be paid in semi-annual basis. The income from these bonds is taxable. The developments bonds are also major sources of government funds. Nepal Rastra Bank, the central bank of Nepal has been issued these bonds in the market on behalf of the government.

### **C. National saving bonds**

It is a long term government bond normally matures in five years period. It has fixed interest rate and can be transferred from one person to another. It has also semi-annual interest payment. It can be purchased as promissory note. The bond holder gets the

principal after a certain maturity period. These bonds are normally tax-free bonds and have higher interest rate. The national savings bonds have large trading in the market.

#### **D. Citizen Saving Certificate**

Citizen Saving Certificate is also long term government security. It has normally five years maturity period. It is issued for only generally public in open market. The citizen saving certificate has fixed interest rate. The interest amount is paid on semi annual basis. Individual and institutional buyers can purchase it. It is also taxable government bond. Development bond and National Savings can be used as collateral if holder needs funds immediately but citizen saving certificate can not be used as collateral.

#### **E. Special Bond**

Special bond is a security issued by the government in order to acquire fund necessary for financing special project carried on by the government in special condition. Such types of bond are not issued for general public so, it is not required to provide information regarding the issue of special bond.

## **2.2 REVIEWS OF ARTICLES**

### **2.2.1 Reviews of Articles in International Perspective**

An article by Kent Daniel, David Hirshlaifer and Avanidhar Surahamanyam (1991), "Investor psychology and market under and overreactions" concluded that securities market and overreactions based on two well-known psychological biases, investor over confidence about the precision on private information and biased self attribution, which causes asymmetric shifts in investor's confidence as a function of their investment outcomes. According to them overconfidence implies negative long- term auto-correlation, excess volatility and when managerial actions are correlated with stock mispricing, public event based return predictability. Biased self attribution add positive short lag auto-correlation "momentum", short run earning "drift" but negative correlation between future returns and long term past stock market and accounting performance.

The article written by Brad Barber, Reuven lehavy, Maoreen McNichols, and Brett and Trueman (2001), "Can Investors Profit the Prophets?" assess that examines whether



investors can profits from the publicity available recommendations of security analysis. Academic theory and Wall Street practice are clearly at odds regarding this issue. On the other hand, the semi – strong form of market efficiency posits that investors should not be able to trade profitable on the basis of publicity available information such as analyst recommendation. On the other hand, research departments of brokerage houses spend large sums of money on security analysis, presumably because these firms and their clients believe its use can generate superior returns. The article written by Phelim Boyle and Tan Wang (2001), "Pricing of New Securities in an incomplete Market" assess that there are two distinctly different approaches to the valuation of a new security in an incomplete market. The first approaches taken the prices of the existing securities as fixes and uses no-arbitrage arguments to derive the set of equivalent martingale measures that are consistent with the initial prices of the traded securities. The price of new security is then obtained by appealing to certain criteria or on the basis of some preference assumption. The second method prices the new security within a general equilibrium framework. It clarifies the distinction between the two approaches and provides a simple proof that the introduction of the existing securities. They are left with the paradox that a genuinely new derivative security is not redundant but the dominant pricing paradigm derivative security pricing is the no-arbitrage approach, which requires the redundancy of the security.

The article written by Asrat Tessema (2003), "Prospects and Challenges for Developing Securities Markets in Ethiopia" assess that an analytical review of the prospects and challenges of developing countries markets in Ethiopia. With the full of communism and emergence of capitalism, many countries around the world are moving toward market – oriented economies and securities markets are spring up on all continents around the globe securities markets have come to symbolize to many the essence of capitalistic economic relations. When studying the economies of developing countries, the first thing that becomes apparent in the existence of immense and, to a considerable extent, unemployment human resources as well as an acute development. Recognizing the role that securities markets play in mobilizing capital more than a dozen African countries have established stock markets. Ethiopia is not one of them. There is little current research which focuses on Africa's securities markets. This study helps to contribute to that effort by focusing on Ethiopia the second largest country in sub – Saharan Africa plagued with major economic problems. It concludes by recommending the establishment

of a stock market and providing suggestions on how to do it. The article written by Peter Montagnon (2004), "The Governance Challenge for Investors" assess that it examines how and why corporate governance has come to be of particular interest to investors, locating, the discussion in an international context, yet focusing also on the issues raised for the UK, particularly in the light of the Higgs report. It argues that observation and monitoring of corporate governance, with a concern to see well – governed companies, could proud a wise strategy for investors. The article written by Megumi Suto and Masashi Toshino (2005), "Behavioral Biases of Japanese Institutional Investors" assess that it examines the behavior biases of Japanese institutional investors and discusses implication for their role in corporate governance, based on the findings of a questionnaire survey of a fund managers carried out in 2003. Statistical analysis of the survey result reveals a short term bias in fund manager's investment time horizons, herding and self- marketing to improve the appearance of portfolio performance under the procedure either of customers or of institutional restraints. The writer concludes that institutional investors' behavior contradicts their role as shareholders.

The article written by MU Haw, Kyung Joo Park, Daging Qi, woody Wu (2006), "Securities Regulation, the Timing of Annual Report Release, and the markets Implications" assess that using a sample of earnings announcements of Chinese firms in the fiscal years 1994-1999, covering the periods before and after the annual reports, they reassess the relation between earnings news and the timing of earnings announcements. They find that even though the reporting lag and the timing of have significantly shortened as a result of the regulation, the pattern whereby good news is announcements earlier than bad news persists. Then they examine the behavior of stock prices before earnings announcements and find some indication of information leakage. These findings suggest that the regulation has the expected effect of reducing reporting delay and earnings release clustering. Yet, it did not appear to reduce the extent of the preannouncement leakage of information.

### **2.2.2 Reviews of Articles in Nepalese Perspective**

Lack of adequate and effective trading mechanism with Nepal Stock Exchange, the only secondary market in the country for securities transaction, is virtually, blocking an early issuance of newer financial instruments into the capital market. Even official at the securities board, the regulatory authority governing the stock market operations in the

country conceded that lack of proper set up has prevented new entrants into the financial markets and marked the development of capital markets (The Kathmandu Post, May13, 2003).

An article by Rabindra Bhattra (2003)," Debenture are welcome" discusses the future prosperity of debentures. Bhattra recognized that debentures have good future market potentiality, though its market size is small in the present context. Followings are the significant results of his article.

- ) The bond market in Nepal is very lean. Very few companies have issued bond in the market.
- ) Bottler's Nepal limited made the first issuance of corporate bond issue. When it issued 18% rate coupon rate of corporate bonds is as five as five years.
- ) Though the government bonds are not available in the stock exchange floor, corporate bonds are being made available. The issuance of the 8.5% Himilayan Bank Limited 2009 bond and it's listing in the secondary market with separate trading system became a milestone in his regard.
- ) Corporate bond issued by the bank is highly over subscribed where as bond issued by the manufacturing is heavily under-subscribed. Overall debentures have good future prospects. The article written by Nabaraj Adhikari (2004),"Securities Market in Nepal" assess that there is no clear provisions regarding the entry and process of securities business persons in the Securities Markets. As mentioned by him, the Membership of Stock Exchange and Transaction by laws, 1998 states that companies interested to operate as securities business persons can apply for membership only when NEPSE publishes a notice for the same. Whereas, the Securities Exchange Act, 1983 states the Stock Exchange can only grant membership to those companies registered as securities business persons in SEBO. He further addressed that full fledged brokerage firm are yet to be developed in the markets. In concluding remarks Mr. Adhikari said that there are some of major issues of Nepalese securities markets that need to be addressed to make it an important alternative for capital mobilization. The article written by Nabaraj Adhikari (2005)," Securities Market Development in Nepal" assesses that the Nepalese securities market is in an underdeveloped stage. Weak regulation, insufficient market infrastructures, poor corporate governance, inefficient trading

system, low instrument diversification, low involvement of institutional investors are the major issues of Nepalese Securities Markets. These issues should duly be addressed to develop the markets as an important venue for funds mobilization in Nepal. The article written by Rabindra Bhattarai (2006), "Shining Days Ahead" assesses that stock market showed a good shine with the change in political scenario in the country. A bearish market since the early march turned bullish increasing the NEPSE index by 6.66 points in April 25, the days after the King's announcement of reinstating the House of Representatives. Now this political change is likely to bring a boom in the stock market similar to that seen during early February 2005. The market increase by so much on a single day despite the 19 days political tension in the investor about the country's economy with the development of sound political environment. However this is not only a case of the changing confidence of the investor with the change in the political environment. The current increase in the market is influenced by other fundamental factors as well. The third quarter financial reports of the bank and finance companies to be published in the near are expected to show better performance of banks, the major companies in the stock exchange. The banks had reported improved performance also in the previous quarter.

### **2.2.3 Review of Previous Thesis**

There are many dissertations written by various researchers in past years. Among them some dissertations are reviewed here for analysis of literature.

**Aryal (1999)**, had studied entitled "The General Behavior of Stock Market." The objectives of the study are:

- ) To develop the empirical probability distribution of successive price changes of an individual common stock market as a whole.
- ) To discuss theoretically the movements of the stock market price changes of an individual common stock market as a whole.
- ) To examine whether the successive price change of stock market are independent to each other or not. The main findings of the study were: The general behavior of 21 security price of Nepal Stock Exchange is remarkably far from that, mainly the assumption of independence as predicated by random walk mode of security price behavior. Thus, the model of such kind has been refuted at least for Nepal loan

context as a first approximation even on a rough way for early days to stock market operation .Here this rejection of hypotheses make clear that this knowledge of past now becomes useful in predicting the future movements of stock market prices, than investors , on the floor of exchange for securities can make higher expected profits in the future based solely on those historical prices series under certain systematic trading scheme of general market for securities. If broadly speaking the implications with respect to conclusions derived by the study are of two natures: statistical and economic. Statistically, the characteristic feature of stock market movement with respect to distribution of price change implies that the general shape is platykurtic character has been demonstrated previously, due to higher values of standard deviation for individual price changes. Higher standard deviations are result of frequent large price fluctuation. The economic reason for higher values of standard deviation implies that the inherent instability of market, change in economic environment. Government actions, company's developments that causer abrupt price changes, ultimately the value of standard deviations for individual price changes has been higher consequently platykurtic character of distribution observed i.e. too few relative frequencies are contained near to mean of the price changes in the central bell and all the relative frequencies are concentrated within higher limits of standard deviations from the mean of the price changes. Finally, with respect to distribution of price changes, from the investor point of view, the sole interest is in the shape of distribution that is the only information needs to make meaningful investment decisions.

**Shrestha (2000)**, has concluded in her study that the NEPSE is efficient in its weak form hypothesis. But her study report itself is contradictory. At the same time she has also stated" It is possible to beat the market by using technical analysis in NEPSE". Since the weak form efficient market is defined in terms of usefulness of technical tools to beat the market. If it is possible to beat the market by using technical tools of analysis, the market never could be ascertained as efficient even in weak form.

**Pokharel (2001)**, had studied entitled "Legal Provisions to the Protection of Investors Under the Nepalese Law and Analytical and Critical Study". The objectives of his study are identify the investor and focus on the find out title legal lacunas and weakness of

execution bodies in regards to investor's protection. In his study, Investment and investing process both are separate but interrelated due to the present modern era of investing patterns. Investor's protection belongs to the various rights of invests as like to make an action against the insider trader proud defaulter and malpractice over the investors. Nepalese investors are not governed under the corporate norms and values due to lack of proper knowledge of their rights. They can be victimized but they do not complain at concerned authority. Rules and regulations alone would not be able to protect the interest of investors. In this study, it can be found that Nepal legal provisions are not sufficient to protect the interest of investors and other hand; there is existing the genuine legal lacunas and loopholes. Besides these, existing legal provisions are not properly exercised due to weak implementing mechanism; contradiction on Jurisdiction and lack of awakes of investors about their rights and obligations themselves. So the legal provision for protection of the investors and its practical impact is in weak condition in Nepal.

**Joshi (2002)**, has studied on topic of the Investors' problems in choice of optimum, portfolio of in Nepal Stock Exchange. His objectives were analyzing the trend of NEPSE, analyzing the problems and finding out some resolution for the problems, sub-testing the measures for the improvement of the stock market as well as for better meet of investors and trying to find out the best portfolio of NEPSE to invest. The conclusion of his study is that the investor does not know in which stock to invest not to portfolio constructed. He also stated that "even many stocks –holder does not give the information to the investors. Investors are purchasing and selling their stocks mostly on the pressure of broker. Due to lack of sufficient information the decision or purchase and sell of stock are difficult. It needs special knowledge as well adequate skills small change in proportion of investment may change the risk and return in very large scale. So it is difficult tasks".

**Shrestha (2002)**, has conducted the thesis "A Study of Securities Market in Nepal". The main purpose of this study is to examine and analysis the trend as well as the risk and return of different sectors listed in securities market. Study pointed about the risk and returns trend of the different sectors i.e. Banking, Finance, Insurance and Manufacturing and service organizations. According to her "Among all sectors listed in the securities market, banking sectors has the highest expected return (50-33%) followed by the finance sector with (47-36%). The sectors having lowest expected return are the one categorized

as others with just 10.3% and the trading sector with 10.65%. Pokhrel has used the different tools and techniques to analyze and interpret the data to meet the concrete report about securities market but she has not centralized her study on specific subjects matter.

**Joshi (2003)**, has studied entitled 'Role of NEPSE' in the securities market. The objectives of the study are as follows:-

- ) Introduction of security market, composition of primary and secondary market and its performance behavior.
- ) To prescribe ways and means by which secondary market would be more effective and meaningful.
- ) To forecast the future trends of business and economic activity in the NEPSE in terms of quality, value and volume.
- ) To assess the past and present behavior of business operations in NEPSE market.
- ) Study on legal provisions relating to protection of investor interest.

The major findings are:-

- ) Public response is high due to lack of investing opportunity in other field.
- ) The dynamism of the stock market has been greatly reduced by the domination of the long term shareholder's.
- ) The secondary market, which presented as institutional mechanism that was inadequate, non transparent, hardly regulated and rarely geared to investors protection, has also witnessed no table development.
- ) The performance of banking group is highly attractive and liquid.
- ) The stock price should indicate the direction in which community's saving should be invested. Price system established on share exchange provides guidance to investors and helps them in directly the flow of fund in to firms having prosperous and bright future.

**Upadhaya (2004)**, "Investor's Preferences and Financial Instruments in Nepal" was mainly centered with the investors' preferences and the financial instruments in Nepal. The objectives of his study are as follows:-

- ) To study the preferences of the investors in the financial instruments.

- ) To assess investors' awareness regarding the investment decision in selecting securities.
- ) To analysis the investment trend in the security market of Nepal.

The study was mainly based on the primary analysis. The research was conducted by pooling the views of the different groups by applying survey method. His majors finding in the study are:-

- ) The majority of the Nepalese investors preferred the equity share for investment. They preferred government securities after common stocks. The debenture and preferred stocks are least preferred.
- ) Among the various sectors, investors preferred the banking sector for investment.
- ) The trend of investment is highly in the common stock. The equity share including rights shares covers about 90% of issued approval made.
- ) Majority of investors is unaware regarding their investment alternatives.

**Bajracharya (2004)**, had studied entitled "Individual Investor's Preference and Financial Instruments in Nepal". B.R. Bajracharya sets the objectives are as follows: to understand investment procedure and behavior of individual investors for their investments, to justify how individual investors select specific type of instruments to invest their savings, to identify the element of investment that is considered important by individual investors in a preferential scale; to identify whether personal factors like age, sex, education and occupation of investors play significant role in their investment behavior.

Bajracharya has concluded that majority of people takes preference share as the median alternatives for their investment preference. They give moderate preference to preference share. The individual investors gives high preference to investments like real estate, common stocks, fixed deposit, bank and debenture while they gives less preferences to personal money lending, mutual funds, precious metals and collectibles.

## **2.4 Research Gap**

There have been several researches done before in the topic of Nepalese Stock Market and Investors rationality. All of these researches have many useful findings and have their own limitations. Study on the rationality of stock market was only started from Mr. Pradhan in 1993. But at that time, the capital market in Nepal was very small. After that



time, many researchers have performed many researches in similar topics. These researches are helpful in different areas. The findings of previous researches are equally important. The main focus of the research will analyze the performance, investors' views, growth, and downfalls of the stock market. This will help to analyze whether the investors rationality regarding stock or stock market is in uphill trend or in decreasing trend. It is also believed that this will help understand the investment pattern of individual investors and post investment behaviors as well as their efficiency in analyzing the market trend. By analyzing these aspects, focuses can be set on the weak points so that such weaknesses can be put into consideration and suggestive recommendations could be made which will further robust the efficiency in investors as well as the stock market.

A thesis entitled "A study on investors' awareness in security market in Nepal" prepared by me in 2008. The main objective of this research is to explore the stock transaction system and to examine whether the investors are fully aware or not in the share trading system in Nepalese stock market at present. There are many thesis performed by many students in the similar related topics. But the thesis performed by me is different from them in the manner of objectives and research design.

To meet the objectives of the research, I have given more priority to primary research. It is very difficult to collect data from primary sources. Most of the respondents neither give time nor provide actual data. It also takes more time and it is expensive. I have collected the views of many respondents, such as investors, management students, brokerage agents, officers of NEPSE and SEBON by providing them structured questionnaire. The outcomes of respondents are analyzed by using most acceptable tools and techniques and presented in quantitative manner.

At last, I conclude that the rationality in most of the investors is not satisfactory. Out of 100%, around 30% of total stockholders are enjoying the privilege of making huge profits by their forecasting as well as other techniques. On the other hand, whims and rumors are playing a huge role in the security market in Nepal which itself is a great misfortune to Nepalese investors. Investors do not have theoretical and technical knowledge to evaluate common stock behavior and price trend of related companies. It means that the level of investors' rationality is quite low.

## **CHAPTER – III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter deals with the research methodology, which are used in the period of research. Research means to re-search the problems again and again to find out something more about the problems. Similarly, methodology refers the various steps that are generally adopted by a researcher in studying his research problems along with the logic behind it. Thus, research methodology is a way to systematically understand and solve the research problem. In this regard, this chapter explains not only research methods but also considers the logics behind this method which we use in our study. This chapter deals to the research methodology adopted and implied for the resources used in achieving the predetermined objectives as stated in the earlier chapter. Thus this chapter contains research design, nature and sources of data, data collection techniques, and finally statistical tools used.

#### **3.2 Research Design**

Research design is the conceptual structure within which research is conducted. It includes an outline of what the researcher wants to extract the meaning from by writing the objectives to its operational implication along with the analysis of data. It facilitates smooth sailing of the various research operations, thereby making research as efficient as possible.

#### **3.3 Sources and Analysis of Data**

To accomplish the above-mentioned objectives, this research is based upon the primary and secondary sources of data. The primary data have been collected by letting individual investors attain questionnaires on the spot via lap-top computably in order to economize the procedure. Many concerned personalities (investors) were interviewed in the course of collecting relevant information. The queries related to the availability of information, price analysis, risk-return analysis, etc. has been asked. As stated previously, methods of analysis are applied as simple as possible. Similarly, the secondary data have been collected from SEBO/N, NEPSE, and other concerned organizations, bulletins, publications, researches, journals, library visits, unpublished

thesis reports, newspapers, and internet. The logical impression is included in the resulted conclusion as well as data presentation. For easy understanding, results are presented in a tabular form and clear interpretations on it are given simultaneously and detailed calculations are presented at the end of this study.

The facilities available at Shanker Dev Campus Library, Central Library and concerned agencies researches are used which have a wide range of related books, journals, and other publication.

### **3.4 Data Collection Techniques**

Regarding the fulfillment of objective of the study, I have gone through the primary as well as secondary data. Considering primary data, views of the individual investors were gathered with the help of well-structured questionnaire and outcomes were presented in quantitative manner.

Similarly, in order to gather secondary data, the researcher visited different libraries, NEPSE, SEBO/N and other useful bookstores; and collected related publications and periodicals. Official websites were searched in order to collect required information. Furthermore, secondary data related to common stocks of concerned companies and its transaction overview have been downloaded from the official website of NEPSE.

Lastly, the collected data is presented numerically applying percentage method. In some extent, to clarify the all, I have presented different figures, charts, and tables.

### **3.5 Population and Sample**

NEPSE has categorized the total listed companies in 14 different headings. All of these companies make total portfolio in the market. This concludes that the population size in securities market is numerous and reaching to each and every one of them is impossible. Hence, attempt is made to marginalize the whole research process by taking a sample size of 75 individuals including the potential investors, real investors, as well as some members of the brokerage house, especially Brokerage House (Siprabi Securities Pvt. Limited), Code #22, of Kupondol, Lalitpur to derive intended goal that is essential for the research.

## **JUDGMENTAL SAMPLING**

<b>TOTAL SAMPLE SIZE :</b>		<b>75 INDIVIDUALS</b>	
<b>CATEGORY</b>	Potential Investors	Real Investors	Brokering Agents (Brokerage House #22))
<b>Respondents (75):</b>	<b>36</b>	<b>36</b>	<b>3</b>

### **3.6 Tools for the Analysis**

On the basis of secondary and primary data collected from the published books, journal, formal/informal discussion, and questionnaire with different financial and non-financial experts, individual investors, brokers, mid-staff as well as officers of NEPSE and SEBO/N were done so that the effective analysis of the data could be made.

## **CHAPTER - IV**

### **PRESENTATION AND ANALYSIS OF DATA**

#### **4.1 Introduction**

In this chapter, considerable data has been organized in a tabulated form and analyzed them in a manner so that they answer the research questions.

In this chapter, with the help of various questionnaires and interviews, relevant data has been tried to extract for analysis and interpretation. The analysis of investor's rationality has been done by acquiring relevant information and data from securities investors. Appropriate statistical tools have been used to perform the analysis as described in the previous chapter, Research Methodology.

The information of the questionnaire distribution data is presented consecutively in the subsequent paragraphs with adequate chart demonstration. This information is further analyzed by using statistical tools to reflect better conclusive picture. The analyses of the result obtained from the questionnaire were presented subsequently and the calculations made from the responses were presented consecutively in a harmonious fashion.

#### **4.2 Analysis of Primary Data**

##### **4.2.1 Common Responses:**

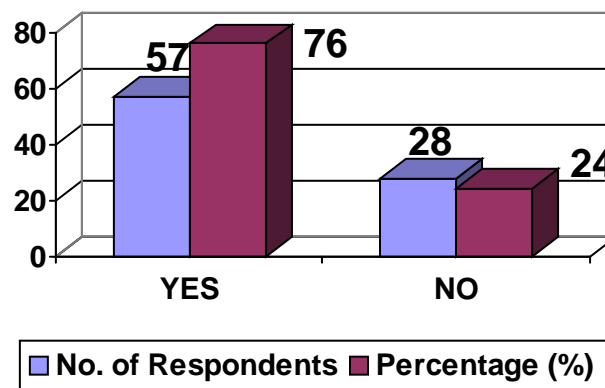
##### **1. Investment Pattern in Shares of Listed Companies?**

In the communal section, the first question was asked regarding the investment pattern of shares of listed companies. Answers were divided into two groups, the first one as YES and the other as NO. Most of the investors' attitude is found to be inclined towards common stock/share rather than other investment options like bond, debenture, etc. Out of 75 respondents, 57 ticked YES meaning they invested in the shares making 76% of total whereas 24% remaining stated that they are interested in other kinds of investment like government bonds because of its risk-free nature.

Table 4.2.1  
Investment Pattern in Shares

Response	No. of Investors	Percentage (%)
Yes	57	76
No	28	24
<b>Total</b>	<b>75</b>	<b>100</b>

*Investment Pattern in Shares*



## 2. Investors' Interest in Sector-Wise Investment

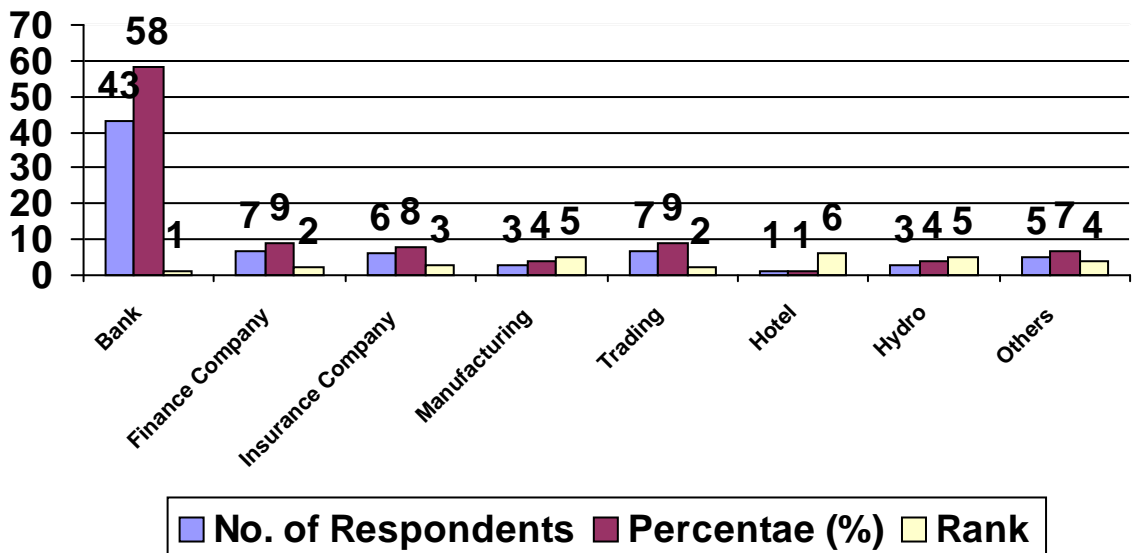
Similarly, researcher's second question was about the investors' concern on different sector-wise investment. This question has been prepared to visualize the scenario of investors' preference on investment in different sectors of investment. Out of the numbers of sector, 43 of 75 which makes 58% of respondents said better opportunity in banking sector and least one which is 1% of the respondents said least opportunity in the hotel sector at the present time due to the deteriorating economic and political situation and unsatisfactory performance of tourism sector. Therefore, the respondents have given minimum weight for the manufacturing and hotel sector. Similarly, the mushrooming as well as good performance of private banking sectors have attracted huge number of investors and the opportunity of capital gain relies high in this sector, which is the sole reason for the respondents to choose it. The summarized results can be presented in following table.

Table 4.2.2

Investors' Interest in Different Sectors

Sectors	No. of Respondents	Percentage (%)	Rank
Bank	43	58	1
Finance Company	7	9	2
Insurance Company	6	8	3
Manufacturing	3	4	5
Trading	7	9	2
Hotel	1	1	6
Hydro	3	4	5
Others	5	7	4
Total	75	100	

Investors' Interest in Different Sector



### 3. Reasons for Selling Shares

Again the investors were asked for the reasons for selling shares they owned and the option for their response were,

- ) For personal need
- ) To buy other more profitable stock
- ) Expectation of price fall
- ) No payment of dividend by the company
- ) Current price appreciation

Of the total 46 investors who sold their shares in secondary market, 14 which are 30% have sold their shares to fulfill their emergency personal needs. Similarly, 6 which is 13% each of investors sold their shares in secondary market in order to buy more profitable-considered share and due to expectation of future price fall. It was found that the cause to sell the securities to buy other securities and expectation of future price fall is equal. In the same ground, 4 which is 9% sold their securities due to no payment of dividend by the company in time. Majority of the respondents sold their shares because of current price appreciation. The number of respondents for selling shares due to price appreciation were 16 i.e. compounding total of 35%.

#### 4. Causes for Investing in Secondary Market

Similarly, the respondents were asked for the reasons to purchase shares from secondary market and their available options as answers were,

- ) High rate of dividend
- ) Expected price appreciation
- ) To invest excess money
- ) Speculative purpose

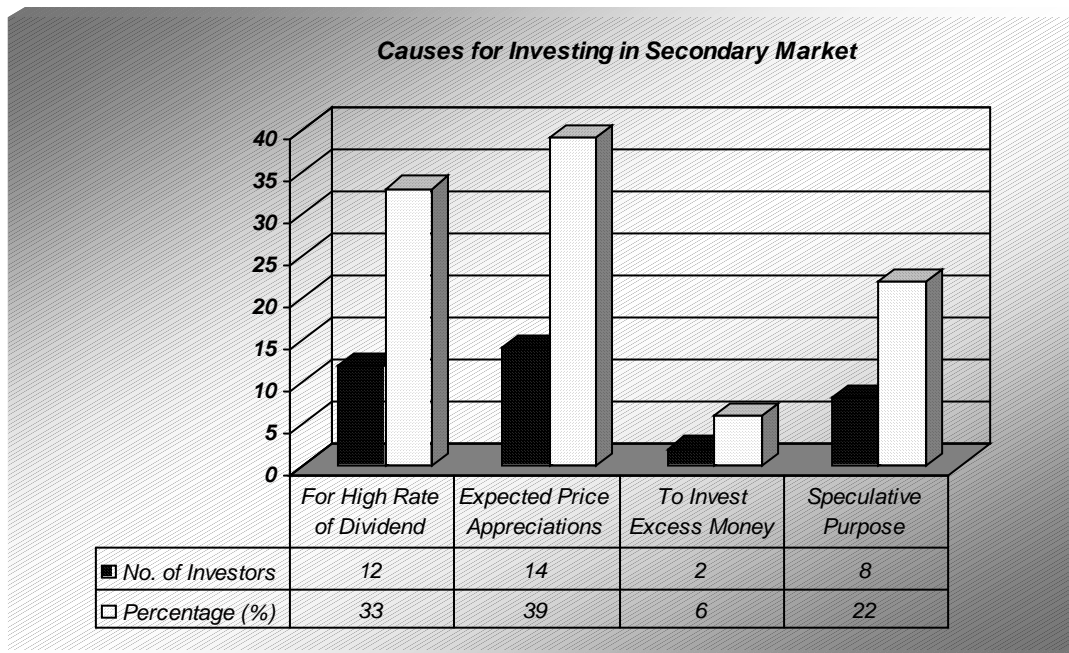
Of the 36 investors who have purchased shares from secondary market. 12 that is 33% purchased the shares to get the higher rate of dividend declared by the company. Similarly 14 which is 39% of them invested their money in shares through secondary market because of the future expected price gain. Only 2 which is 6% of the respondents answered that he/she purchased the shares from secondary market to utilize excess money he/she holding. 8 of which is 22% of the investors who purchased shares from secondary market for speculative purpose.

Table 4.2.4

#### Causes for Investing in Secondary Market

SN	Research variables	No of investors	Percentage (%)
1	For High Rate of Dividend	12	33
2	Expected Price Appreciations	14	39
3	To Invest Excess Money	2	6
4	Speculative Purpose	8	22
	Total	36	100





### 5. Investors Interest on Price Movement of the Shares

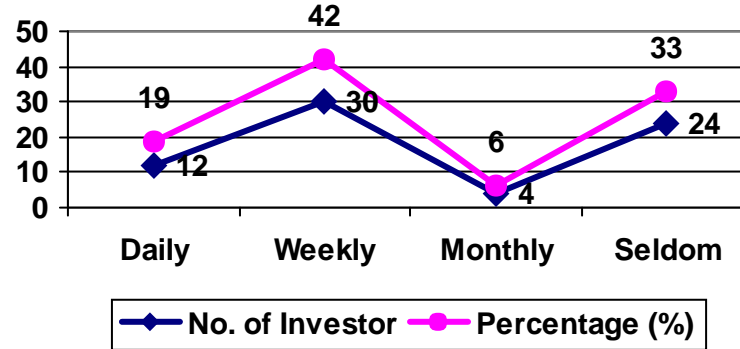
To acknowledge the interest of investors towards their shares price, 72 investors were asked how often do they seek the prices or they watch the trend of price movement of securities they have purchased. Of the total 72 respondents, 12 investors making up 19%, expressed that they explore the price of their securities daily. Similarly, 30 which is 42%, 4 i.e. 6%, 24 i.e. 33% and 2 i.e. 3% of the investors seek the price of their shares weekly, monthly, seldom and never respectively. The result of this question is presented in the following table.

Table 4.2.5

**Investors Interest on Price Movement of the Shares**

SN	Research variables	No of investors	Percentage (%)
1	Daily	12	19
2	Weekly	30	42
3	Monthly	4	6
4	Seldom	24	33
	Never	2	3
<b>Total</b>		<b>72</b>	<b>100</b>

**Investors Interest on Price Movement of the Shares**



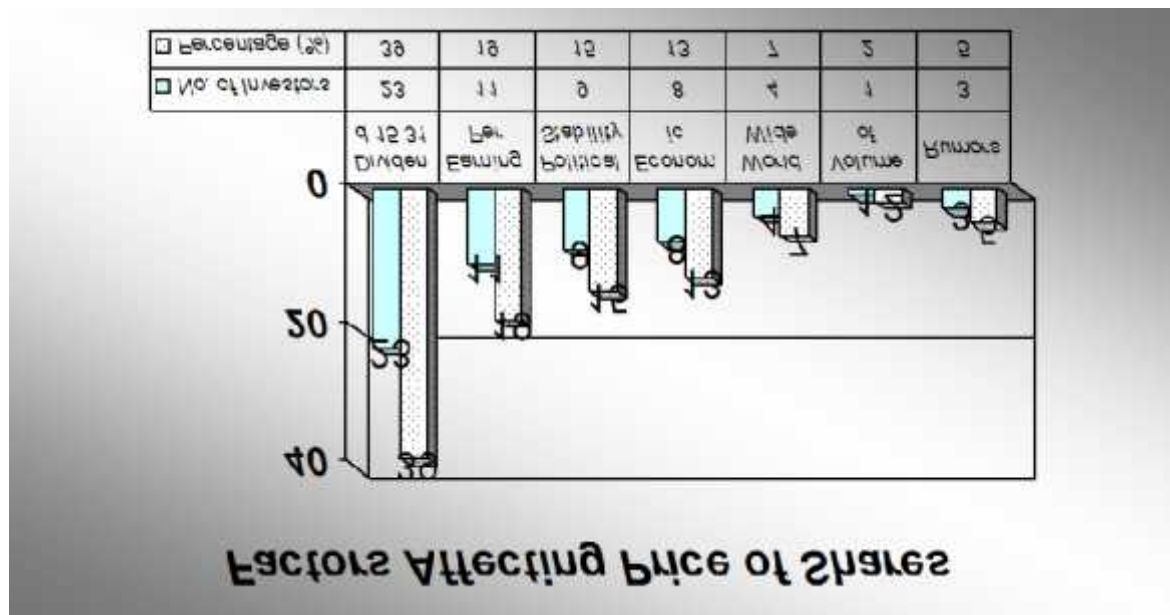
**6. Factors Affecting Price of Shares**

Regarding the influencing factors for price fluctuation of share in capital market, different investors gave different views and their own ideas. 23 of the total 59 respondents i.e. 39% gave their views as dividend as the influencing factors, 11 i.e. 19% said earning per share (EPS), 9 i.e. 15% said political stability of the country, 8 which is 13% said economical fluctuation of the country, 4 i.e. is 7% said world wide economic trend, 1 which is 1.6% of the respondents said volume of transactions, and 3 which is 5% said rumors. Theoretically, DPS and EPS are the major factors to influence the share price of a company which is also reflected in the respondents view.

Table 4.2.6

**Factors Affecting Price of Shares**

S.No.	Research Variables	No. of Investors	Percentage (%)
1	Dividend	23	39
2	Earning Per Shares	11	19
3	Political Stability	9	15
4	Economic Growth	8	13
5	World Wide Trend	4	7
6	Volume of Transactions	1	2
7	Rumors	3	5
	<b>Total</b>	<b>59</b>	<b>100</b>



### 7. Investors Views Regarding the Returns from their Investment

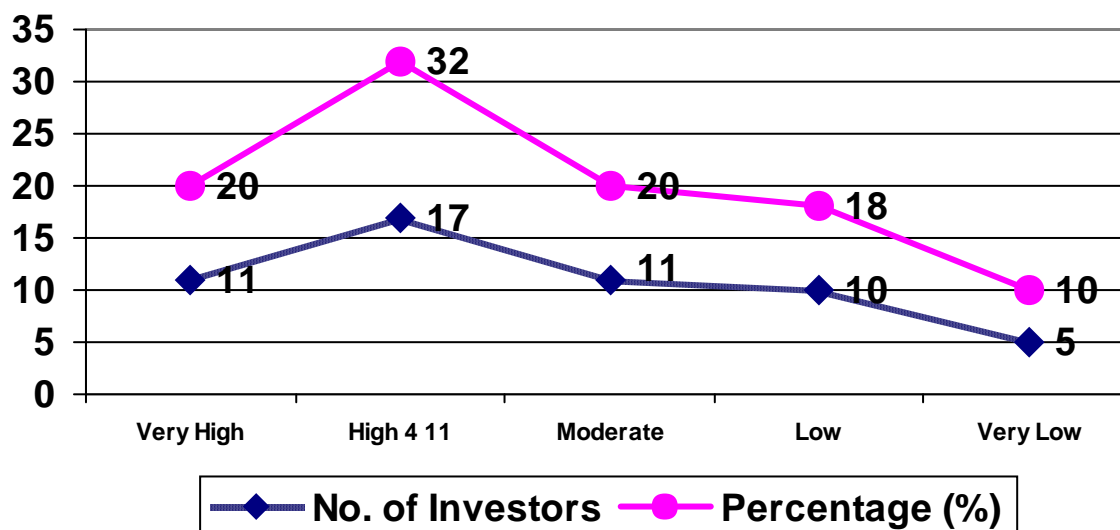
To find out how much the investors are satisfied from the returns from their investments question was presented to the respondents as the level of return from the investment presently getting in comparison their expectation. Out of 54, only 11 of the respondents replied that they are getting satisfactory (very high) return making up 13%; however 17 out of 54 which is 7% replied that they getting high level of return, similarly 11 i.e. 33% said moderate, 10 i.e. 36% low and 5 i.e. 20% very low. The result is presented in the following.

Table 4.2.7

#### Investors views regarding the returns

Sn	Research variables	No of investors	Percentage (%)
1	Very High	11	20
2	High 4 11	17	32
3	Moderate	11	20
4	Low	10	18
5	Very Low	5	10
	<b>Total</b>	<b>54</b>	<b>100</b>

## Satisfaction from the Return of Shares



### 8. Investors and Brokerage House

Question was asked specially on the relation between investors and brokerage house. The conclusive answer drawn relies on constituent relationship between the two. Investors viewed Brokerage house as a pathfinder to safe pass their hard-earned investment to a most profitable return. Investors also viewed those agencies as an information disseminating component in the securities market and legitimizing their process of investment. So, with these statements, it can be viewed that there has been relevancy of relationship between these two factors of securities market.

### 9. Types of Services Presently Getting from Brokers

The eleventh question was asked particularly to investors to know what types of services they were presently getting from the brokers. 45 investors respondent this question, among them 29 (64.44%) respondents that they were getting only trading services from brokers while 16 (33.56%) respondents that they were getting both trading and information services.

### 10. Flowing of Information from Listed Companies to the Investors

The next question was asked to know if the listed companies were providing the information related to their performance and future planning. Forty-seven investors and

thirteen brokers responded to this question. Among the investors, 14 (i.e. 29.78 percent) responded positively while 33 (i.e. 70.22 %) responded “NO”. Among the brokers, 4 (i.e. 30.78 %) responded “YES”, while 9 (i.e. 69.22 %) responded “NO”.

### **11. Adequacy and Reliability of Information Provided by Brokerage House to the Investors:**

Regarding the issue of adequacy and reliability of information provided by Brokerage house to investors, many of the investors were in the state of ambiguity whether one can have complete information or rely on the information provided by agency houses. Some stated that the flow of information is only reliable to the ones close to them but not to every ordinary investor. Some said, the Brokerage House is always in a state of profit so their reliability can be questioned. In contrast, some reflected their views as brokerage house as only the supporting factor besides investors own cognition on stock market. So the view can be regarded as 50/50 situation where both trust and equivocality persist.

#### **4.1.3 Individual Response**

##### **1. Do you have any idea about share market?**

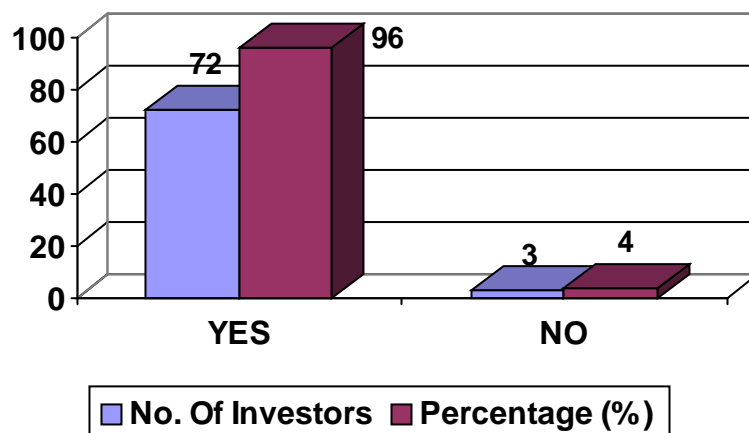
The first question was asked to obtain the information about the awareness of the share market. According to collected responses out of 75 respondents, 72 of them responded they have awareness toward the share market and the remaining 3 responded they are not fully aware about the stock market. From the response, it can be said that the level of awareness about stock and securities market have risen when compared to the previous thesis.

Table 4.1.3.1

Awareness on Stock Market

<b>Response</b>	<b>No. of Investors</b>	<b>Percentage (%)</b>
YES	72	96
NO	3	4
<b>Total</b>	<b>75</b>	<b>100</b>

### Awareness on Stock Market



### 2. Are you conscious about the trading procedure of securities?

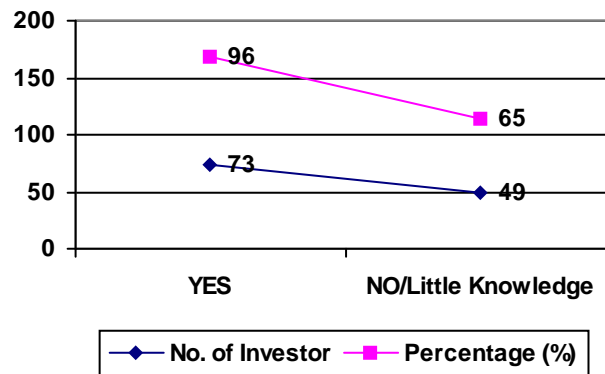
Similarly, another question was asked to investors for obtaining information regarding investors' wakefulness about the trading process of securities in NEPSE. Through this questionnaire, it was found that out of 75 respondents, 58 turned to acknowledge about the trading process whereas remaining 17 responded having no knowledge about trading procedure. On the other hand, most of them numbering in total of 73 having knowledge about primary market whereas out of 75, 49 responded of having little knowledge about secondary market.

Table 4.1.3.2

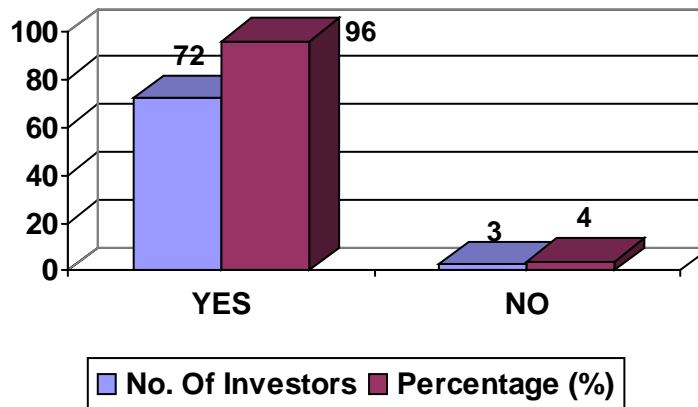
Consciousness about Trading Procedure in NEPSE

Response	Response on Trading Procedure		Response on knowledge on primary and secondary market	
	No. of Investors	Percentage (%)	No. of Investors	Percentage (%)
YES	58	77%	73 (Primary)	96%
NO/Little Knowledge	17	23%	49 (Secondary)	65%
<b>Total</b>	75	100%		

**Response on knowledge on primary and secondary market**



**Awareness on Stock Market**



**3. What does NEPSE stands for, any idea? (Please tick)**

NEPSE stands for	NEPSE stands for
Nepal Security Exchange	Nepal Stock Exchange
( )	( )

To test whether investors are faking out or if they really know what NEPSE stands for, the result was astonishing where around 73 ticked the right answer and remaining 3 stated bit confusion. From the obtained data, it is clear that most of the investors' have full knowledge why is NEPSE for but those who stands in the row of bit confusion do also have knowledge about NEPSE.

**4. How often do you watch the security price via any means, either NEPSE website or in different forms of daily newspaper?**

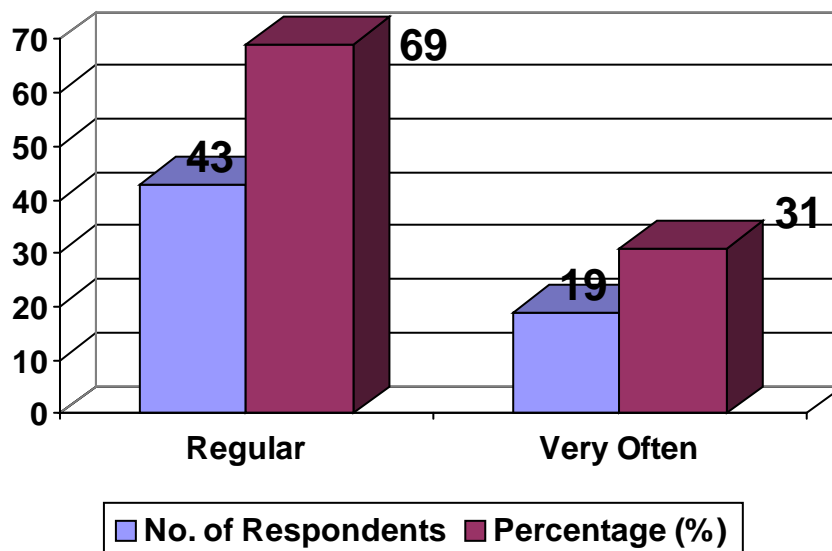
Another mean of obtaining information on investors' rationality, it seemed to me crucial to know whether investors watch the share price regularly or not. Out of 75, only 62 investors responded the question. From the obtained data, (out of total 62 making it 100%) it is found that 43 (69%) investors keep updated with the share price regularly mostly via daily newspaper and few through website, 19 (31%) have an eye on the share price regularly but on an occasional basis.

Table 4.1.3.3

**Factors Affecting Price of Shares**

Response	No. of Respondents	Percentage
Regular	43	69%
Very Often	19	31%
<b>Total</b>	<b>62</b>	<b>100%</b>

*Factors Affecting Price of Shares*



**5. Do you keep up with information regarding Securities Market?**

To further test the rationality, it was felt necessary to learn whether investors go through different publications, artifacts, or articles regarding Nepalese Securities Market for updated information. Surprisingly, very few of the investors totaling to only 33 out of 75

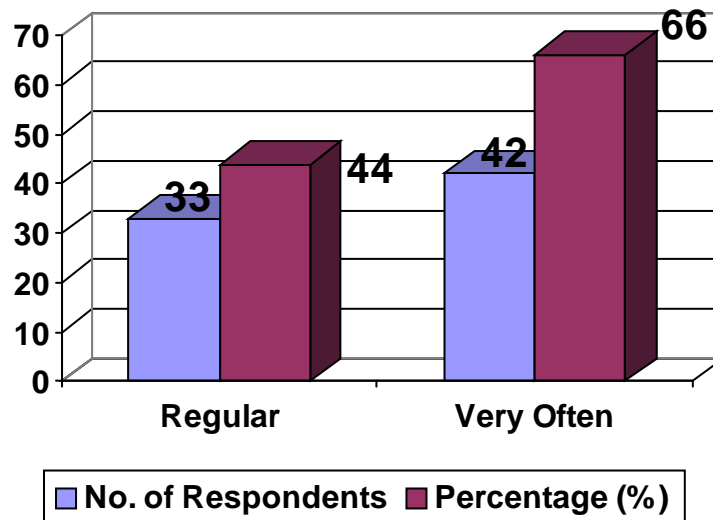


responded they do keep up with information regarding securities market whereas some of the remaining responded that inadequate sort of information or say that the information is not adequate enough to deliver/satisfy the quench/emotion of investors with clear understanding.

Table 4.1.3.4

**Factors Affecting Price of Shares**

<b>Response</b>	<b>No. of Respondents</b>	<b>Percentage</b>
Adequate	33	44%
Inadequate	42	66%
<b>Total</b>	<b>75</b>	<b>100%</b>



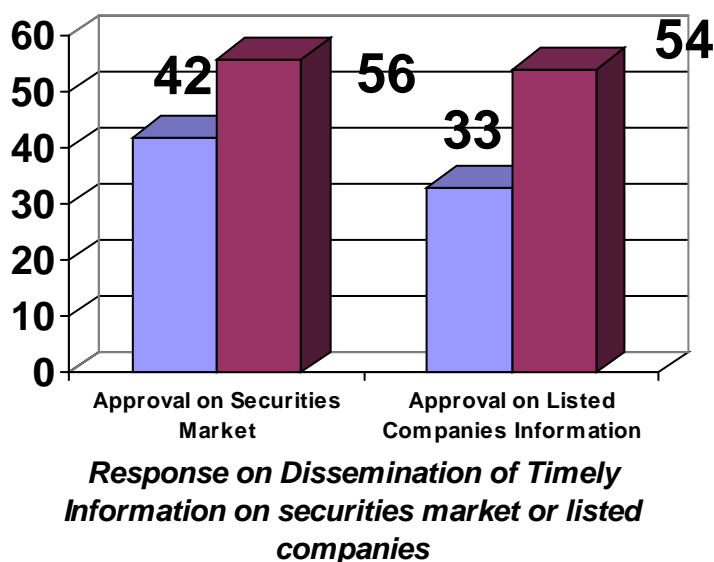
**6. Do you think it is necessary to get the timely information about Securities Market or listed companies?**

This question was prepared to acknowledge the curiosity and willingness of investors' if they motivate for timely information regarding securities market, if provided. It was astonishing that all out of 75 investors' expressed their acceptance. This reflects that investors would welcome the opportunity if provided to obtain timely and relevant information so that to understand their own investment situation. In contrast, 42 investors expressed their acceptance to timely information on securities market whereas remaining 33 showed their interest on timely information of listed companies.

Table 4.1.3.5

**Dissemination of Timely Information on securities market or listed companies**

<b>Response on Dissemination of Timely Information on securities market or listed companies</b>	<b>No. of Respondents</b>	<b>Percentage</b>
Response on Securities Market	42	56%
Response on Listed Companies Information	33	54%
<b>Total</b>	<b>75</b>	<b>100%</b>



**7. While investing, do you try to obtain any information beforehand?**

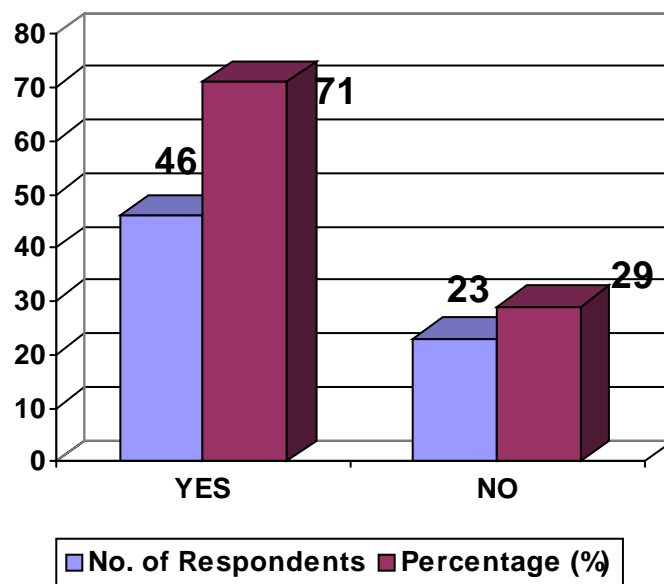
Investors should make the analysis of different information related with the securities before investing in shares of listed companies. So for this purpose, responses were collected from the investors about the analysis of information. Out of 75, 69 investors responded the question. Among them, 46 of the respondent gave positive answer meaning they will oversee the financial performance of the company and consult with specialists beforehand an investment whereas remaining 23 gave negative answer that means they do not consider the information of the listed company while making

investment in shares because they have no idea how to analyze the company via different tools and get winded with the rumors, but utmost from their trusted ones.

Table 4.1.3.6

Obtaining information beforehand while investing

Response	No. of Respondents	Percentage
YES	46	71%
NO	23	29%
<b>Total</b>	<b>69</b>	<b>100%</b>



**8. Whim and rumor have now become one of the integral part of securities market, do you follow the same attitude while making an investment?**

Persuasion of whim and rumor has nowadays become a fundamental part of securities market, which sometimes can bring fortune to investors whereas sometimes provides devastating experience to the investor. It's all nothing more than a risky part existed in securities market which some follows and some does not. Turning anyone's hard-labored saving into investment is not an easy task. With this though in mind, we asked investors if they were cautious about the whims and rumors existed in the securities market and among 75, 55 numbers of investors answered they don't have the guts to take the risk market on the basis of just rumors whereas some of the remaining said that they have no other choice than to follow the rumors, and some ultimate remaining expressed that those rumors sounded effectual than the overwhelming information provided by the companies.

This led to us that overall, the promulgated pattern of information is not easy achievable to all and not easy understanding to some.

**9. Do you inherit any knowledge about analysis technique before investing?**

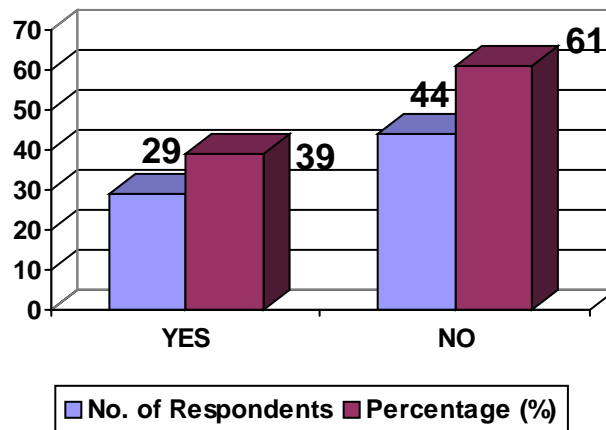
Rational/perfect investors always possess specific analysis technique for profitable transaction. With this statement in mind, we asked investors about possessing analysis technique and implementing it during the process of investment, only 29 investors out of 73 responded that they do have some knowledge about analysis technique and they do try to use them while making investment but the remaining 44 investors expressed not possessing any of the analysis technique rather than the only option of consulting with specialists or agencies to find out the real status of their investment.

This puts me in woe to learn that most of the investors are not self-sufficient to analyze their investment status, even some of the educated ones.

Table 4.1.3.7

**Inheritance of Analysis Technique**

<b>Response</b>	<b>No. of Respondents</b>	<b>Percentage</b>
YES	29	39%
NO	44	61%
<b>Total</b>	<b>73</b>	<b>100%</b>

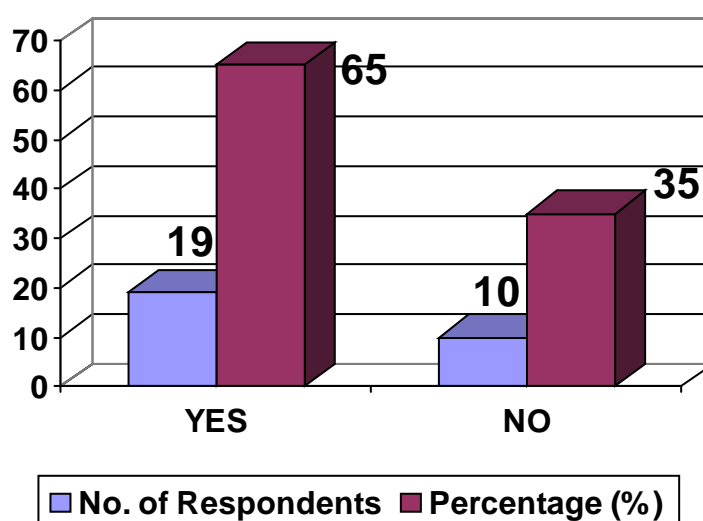


**8. (Only if “YES” to question #7) So, do you follow the principles of such analysis techniques or not?**

Out of the 29 investors who stated their possession of analytical techniques that could benefit their investment, 19 of them stated for their understanding of technical analysis by analyzing the supply and demand of stock movement whereas 10 of them stated of possessing both technical as well as fundamental analysis technique and few of them stated that these techniques have really helped predict their investment options.

Table 4.1.3.8  
Application of Analysis Techniques

Response	No. of Respondents	Percentage
YES	19	65%
NO	10	35%
<b>Total</b>	<b>29</b>	<b>100%</b>



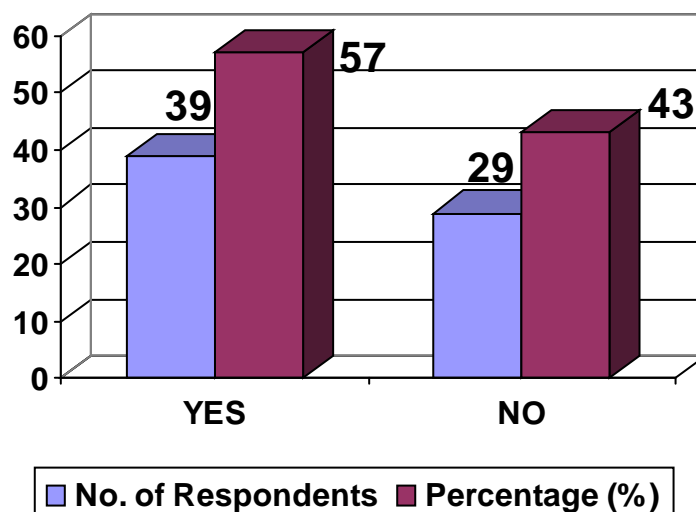
**9. There are lots of consulting agencies nowadays, do you consult with any professionals before making any investment in shares?**

Brokerage house acts as a consulting agent for potential investors and the growth in number has really enhanced the approach of investors towards proper factual information and such consulting activities are done by professional, so one could always look at the bright side if they make their investment via such assistance but the fact is that most of them hesitate to pass through this process again due to rumors of being misguided or delayed process. This thing struck my mind and a questionnaire is presented to total 68

investors out of which 39 responded that they have positive perspective towards brokerage house and they do pass through their advices but, some of the remaining experienced players in the share market expressed their proficiency in making decisions on their own. The least percentage of investors stated that they knew of such assistance/guidance but they are reluctant to get some.

Table 4.1.3.9  
Consulting with Professionals/Agencies

Response	No. of Respondents	Percentage
YES	39	57%
NO	29	43%
<b>Total</b>	<b>68</b>	<b>100%</b>



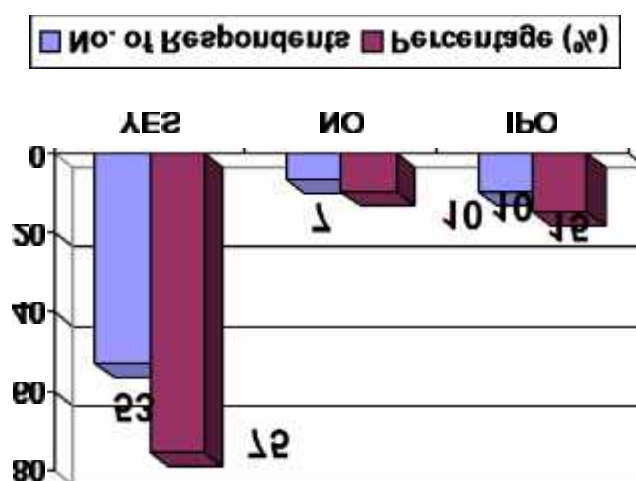
**10. As there is no doubt that there always exists factors like risk and return while making an investment, do you look after these parts while making investment or you make a blindfold investment?**

Though risk and return stands as two sides of a coin while making an investment, investors always seek for making maximum return with their investment, but as the proverb says **Everyday is not Sunday**, investors do not make profit on every investment they do not make good consideration on risk and return factor. To analyze this curiosity if investors put their effort on finding risk and return factors, the above question was asked to 70 investors where 53 investors stated that they take care of their investment lay good return and consider on these factors where as 7 of the remaining expressed that they had a

perception that investing in share always brings good return. The ultimate remaining 10 investors stated that if its an IPO, then its sort of risk-free investment so that they do not care about these things as they think its always beneficial to hop in and regarding investing in secondary market, they do care about the risky side of investment.

Table 4.1.3.10  
Analyzing risk-return factors

Response	No. of Respondents	Percentage
YES	53	75%
NO	7	10%
IPO	10	15%
<b>Total</b>	<b>70</b>	<b>100%</b>



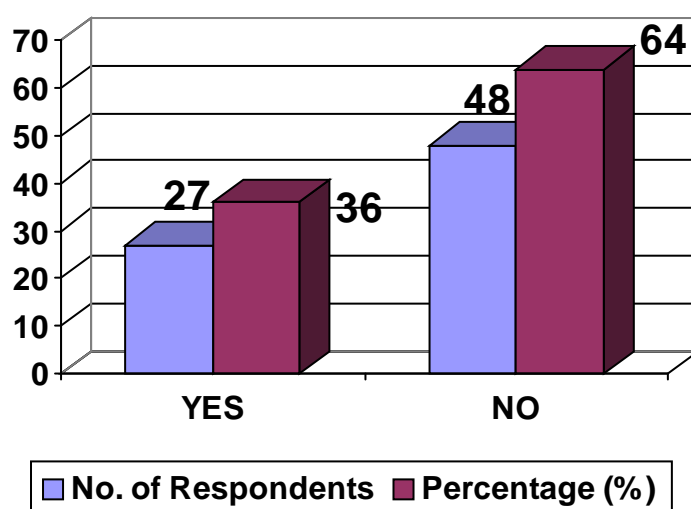
**11. Do you consider different factors involved in securities periphery (which might influence the company/investment in the future) before investing in shares?**

Different factors should be considered before making an investment like financial health of the company, future prospectus, management, size and growth, competition, etc. Should be given much priority while making investment if it's IPO and in case of secondary market, net worth, EPS, and DPS should be considered in order to analyze the company's status. It is found that most of the investors just hop in without making any investigation on such factors mainly on the basis of rumor. So, questions were asked with investors regarding their securitization/consideration on any factor of a company while they make investment. Among 75 respondents, 27 investors responded positive whilst

remaining responded they don't but they investigate in their own way predicting maximum return on the foundation of peers and acquaintances.

Table 4.1.3.11  
Factors Affecting Price of Shares

Response	No. of Respondents	Percentage
YES	27	36%
NO	48	64%
<b>Total</b>	<b>75</b>	<b>100%</b>



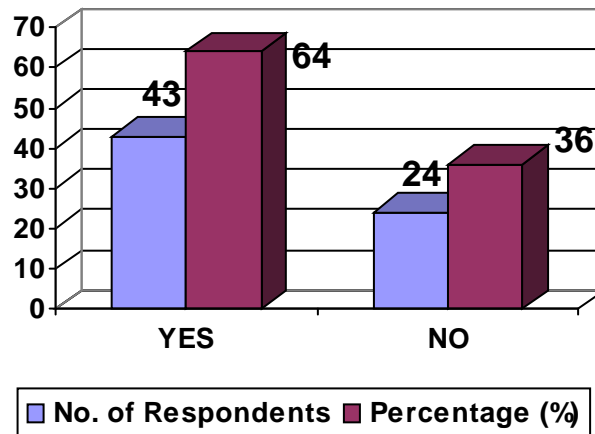
**12. Financial health of the company is one of the major aspects before making an investment, do you desire to/look after those aspects for securing your savings?**

Besides everything stated in the above question, investors were particularly asked if they seek out information regarding financial health of the company of which they are interested to invest in, and out of the total respondent totaling 67, 43 responded that they clearly study or consult with experts regarding the financial health of the company whereas the remaining 24 opposed the response.

Table 4.1.3.12  
Analyzing Financial Health of the Company

Response	No. of Respondents	Percentage
YES	43	64%
NO	24	36%
<b>Total</b>	<b>67</b>	<b>100%</b>





**13. Portfolio is selection of investment alternatives extending your finance to not only one kind of security but in multiple kinds of shares. Do you consider these aspects while making an investment?**

Portfolio has always been a tricky game to investors. It enables an investor to make investment in not only one but in various companies' shares with an objective to benefit an investor with higher return from either or both of their investment choices. With this question, we talked with 74 investors. The result rendered me speechless while learning that most of the investors do practice portfolio investment in an unknowingly fashion. They expressed they have no idea about what portfolio stands for but they do make investment in a diversified manner to minimize the risk of price depreciation and huge loss. Some even said that they seek out an opportunity to invest in government debentures and bonds as well as in listed companies to make a better portfolio for the same objective, minimize the risk. Hence, a rising trend is seen in investors that they are willing to invest in listed **Banking** as well as **Hydro Power** sectors in order to make a complete portfolio.

**14. Do you seek suggestions from the brokers while making investment?**

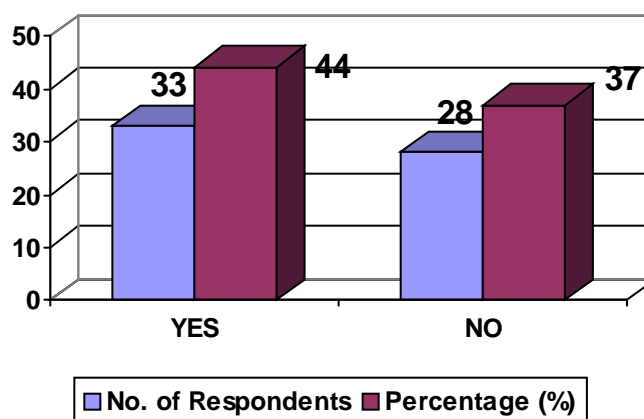
These days, share-trading activities completely relies on brokerage house or stock brokers. It is deemed reasonable to make investment seeing adequate suggestion and guidance from the assisting agents (brokers). On the course, we asked 74 investors regarding their quest for seeking suggestions through brokers during investment, of which only 33 responded positive meaning they seek help from brokers on choosing

fruitful stocks whereas 28 of the remaining stated they don't and others remaining 13 stated that most of the brokerage house is only limited in the major cities, so they do not have access outside the valley and that is the reason they do not seek help from brokers.

Table 4.1.3.13

Seeking Suggestion from Brokers

Response	No. of Respondents	Percentage
YES	33	44%
NO	28	37%
Remaining	13	19%
<b>Total</b>	<b>74</b>	<b>100%</b>



**15. Are you aware about the Capital Gain Tax system?**

In Aarthik Bidhayak Act 2066, as per the section 52 of the Act specifies that the capital gain tax on listed securities are as follows:-

Capital gain tax for individuals: 10% of the Gain

Other than individuals: 15% of the Gain

Similarly, in case fo non-listed securities

Capital gain tax for individuals: 10% of the Gain

Other than individuals: 15% of the Gain

We asked 74 investors on what they think about the new capital gain tax. We gave investors three options to express their interest which is presented below:

What is your response on Capital Gain Tax acted from 2006?

I think it is acceptable.

I think it is unscientific.

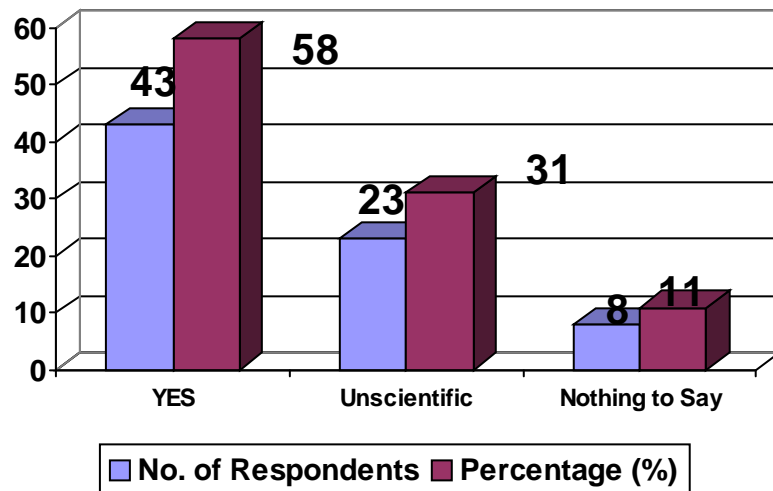
No comments.

Out of 74 investors, 43 accepted the Capital Gain Tax. They expressed if there is profit, then there is nothing to worry about the 10-15% of tax for all categories. Similarly, 23 expressed that the decision of government is unscientific and its misuse of authority towards investors and suggested that the capital gain of anywhere between 5-10% may satisfy thatm. The remaining of 8 investors responded they have nothing to say about this.

Table 4.1.3.14

**Awareness on Capital Gain Tax System**

<b>Response</b>	<b>No. of Respondents</b>	<b>Percentage</b>
Appreciate	43	58%
Unscientific	23	31%
Nothing to say	8	11%
<b>Total</b>	<b>74</b>	<b>100%</b>



**16. Do you think the Aarthik Bidhayak Act 2066 is beneficial to the investors in any way?**

Most of the investors deemed that it's always good to share easy return from shares to the government in the form of tax when it is most profitable. They also stated that the recent updated organization of NEPSE is due to the open-wide vision of government towards securities market and mutual cooperation between NEPSE and government. Investors adore this and wish for further growth in securities market but they think that too much tax in investors can dissatisfy investors and might disinterest their behavior. So what they wished was the situation should be balanced in a “give and take” manner. They expressed their concern that the recent **Aarthik Bidhayak Act 2066** is okay in every form except the recent capital gain tax which range from 10-15% and investors wished if it was anywhere between 5-10% for all sort of listed/or nonlisted companies. They also stated the previous tax system really affected investors transaction pattern.

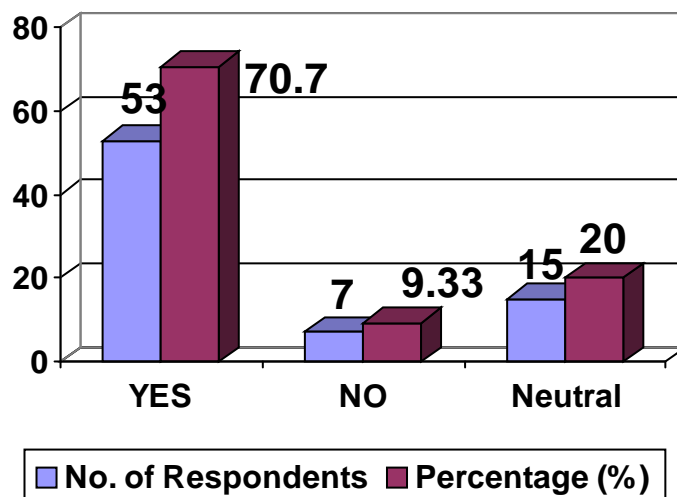
**17. Do you consider that the tax system on stock transaction affects investment behavior?**

Out of 75 investors, 53 directly responded positive meaning “**YES, tax system affects investment behavior**” because higher the tax percentage leads to lower the profit margin, so they stated this directly hinders investment behavior of an investor. A total of 7 investors of the remaining, stated that they are new players in the stock market and what they have done is just invested in some company's' shares but has not made any transaction so they do not have any idea regarding how things work via tax cut system. Ultimately, remaining 15 stated that they have no problem with the lingering/persisting capital gain tax percentage.

Table 4.1.3.15

Tax System Affecting Investment Behavior

<b>Response</b>	<b>No. of Respondents</b>	<b>Percentage</b>
YES	53	70.7%
NO	7	9.33%
Neutral	15	20%
<b>Total</b>	<b>75</b>	<b>100%</b>

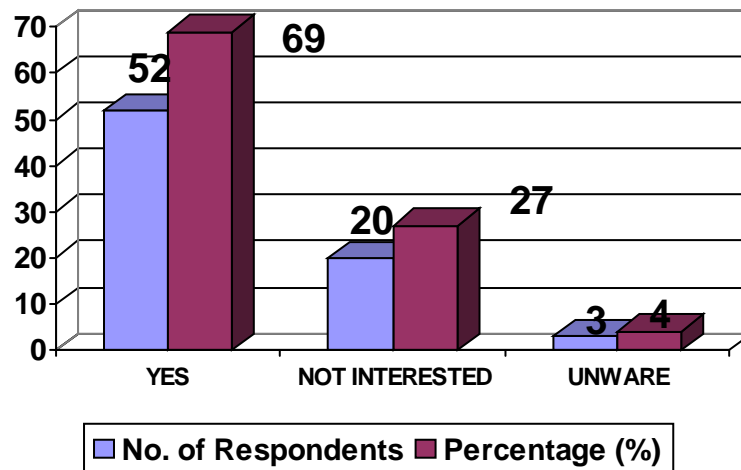


**18. Do you participation in the AGM of the company to know about your investment status?**

AGM (Annual General Meeting) is the occasion which tries to clarify each and every query of investors as well as creates a bond between investors and the company for better understanding. With this quest in mind, we asked investors if they attend AGM of their invested companies; and the response was pleasing than that of the preceding years' researches. Out of 75, 52 answered positive. Most of them stated that rather than stalking on the stock price or watch stock index fluctuate up and down, its good to be there and pleasure the eye and ear learning that the company men are making progress and are determined to bring positive surprises to the investors/shareholders. Out of remaining, 20 investors stated that they are not interested in attending AGM. Ultimate remaining 3 individuals responded that often, they are aware of when and where is the AGM going to held, either they miss the information or they are ignored.

Table 4.1.3.16  
Participation in AGM

Response	No. of Respondents	Percentage
Yes	52	69%
Not Interested	20	27%
Unaware	3	4%
<b>Total</b>	<b>75</b>	<b>100%</b>



**19. While making investment in security, which factor do you think should be given priority on a hierarchy basis. Please rank them from 1-10 on the basis of priority (1 being the topmost priority and 10 being the least)?**

- |  |  |
|--|--|
| <input type="checkbox"/> Earning per share (EPS) | <input type="checkbox"/> Management/Performance                                      |
| <input type="checkbox"/> Competition             | <input type="checkbox"/> Market Interest Rate  |
| <input type="checkbox"/> Market Risk             | <input type="checkbox"/> Size and Growth of Company                                  |
| <input type="checkbox"/> Net Worth               | <input type="checkbox"/> Dividend Per Share (DPS)<br>and Dividend Payout Ratio (DPR) |
| <input type="checkbox"/> Liquidity Position      | <input type="checkbox"/> Leverage or Debt Ratio                                      |

A total of 75 investors were asked to rate the different factors to be considered from 1 to 10 according to their priority for investment, in which 38 investors responded EPS, 26 DPS, and 11 responded Management/Performance. This suggests that EPS, DPS, and Management/Performance are the major considerations of investors while making investment. Different investors ranked differently ranking from 1-10 as listed below:

Table 4.1.3.17

## Factors Affecting Price of Shares

Factors affecting price of Shares	No. of respondents	Ranking
Earning Per Share (EPS)	28	1
Competition	10	3
Market Risk	2	7
Liquidity Position	2	7
Net Worth	3	6
Management	7	4
Market Interest Rate	3	6
Size and Growth of Company	5	5
Dividend per share and DRP	12	2
Debt Ratio	3	6
Total Responses	75	

(Rank 1 being the topmost priority and 10 being the least consecutively)

**20. Which source do you think is more reliable and more informative while obtaining information before/after an investment?**

Annual Report

SEBO/N

NEPSE

Local Government

Economic Review

Journals or Others (if any) . . . . .

It is for sure that the same information cannot be obtained from all the sources. So the response is collected from the investors about the sources they follow for acquiring the information. From the collected responses, it is found that most of the investors follow the single source for getting information. Few investors are found very sensitive towards the information that uses every type of sources for acquiring information. Most of the investors follow annual report of the listed company for getting information.

Table 4.1.3.18

## Reliable Source for Obtaining Timely Information

<b>RESPONSE</b>	<b>NO. OF RESPONSE</b>
Annual Report	43
NEPSE website	33
Economic Review	7
SEBO/N	3
Local Government	2
Others (if any, please specify)	0

**21. During the preceding one-year period, the NEPSE index has fallen unexpectedly, what factor do you think might have caused the fall?**

- Irrationality of investors
- Political Instability
- Lack of foresightedness of Government
- Due to the “stock politics” implemented by major players of stock market
- It might be the effect of International Recession
- Tax system in security transaction

The preceding year, NEPSE index rocketed to the highest of between 1200-1300 and amazingly it plunged to the lowest the same year. It was the most concerning part for many of the investors. During that one year period, many have benefited unexpectedly whereas many have experienced hard heartache. Many predict this downfall due to both investors irrationality and lack of foresightedness of government. Some even predict this situation occurred due to the politics of certain major players of stock market and brokers. Some even indicated that this situation took place due to instability of political situation in the country. Whatever the cause might be, the tremendous downtrend of NEPSE index has really affected the stock market. With recent stabilized-seemed political situation and open policy of government, the NEPSE index is rocketing up but in a tortoise speed pace. But, optimistic investors are also hopeful that their investment will bring good fortunes one is able to stabilize his patience and enthusiasm.



### 4.3 Hearsay Information by Investors

Investors strongly believe that the real as well as timely information should be provided to the investors to maintain efficient price formation in the market. They said that the flow of financial information from the trading, manufacturing, and service companies are at a very poor level. This was why mainly the lack of information was hampering the efficiency in the stock market. Because of the lack of educational and technical qualifications, most investors acted as amateurs. No one used to analyze before they invest in shares. The vast majority of investment is made upon the basis of rumors that is spread in the market and investors only run after the market price but never analyze the market supply and demand factor.

The external factor situated in economy also affects any sort of market including the stock market too. In bygone days, our economic development as well as stock exchange growth is limited by the political situation. Therefore, it is for sure that stock market is affected by externalities like,

- ) Political instability
- ) Economic Recession (National and/or International)
- ) Low per capita income
- ) Inadequate supply of information on movement in stock market and security market
- ) No adequate attractive incentives towards the security market activities
- ) Lacking government efforts on actualizing/monitoring organizations'/companies' performance and revealing factual findings to the customers
- ) Monopoly of brokerage houses/investors lacking trust in brokerage houses
- ) Merely demand and supply affecting price of the stock

Every transaction takes times as it requires some ritual/process/formalities. Similarly, the time span for making a share trading also has certain criteria and thus, it takes time and requires certain process to undergo. But, the process of transfer of shares takes much time which is believed to be the lingering behavior of brokerage house and concerned parties, and moreover is the ignorance of investors on share trading process.

On the other hand, dissemination of adequate information on stock market and other contributing factors, was suggested by staffs of NEPSE and SEBO/N on different sources either about the economic situation of a nation and company, or its affecting factors and different reasonable aspects to make aware investors in order to enable invest rationally.

The price formation of securities depends upon the demand and supply of shares, but merely this happens in the Nepalese Stock Market. The main reason for happening so is because most of the investors rely on whims and rumors. So, it is deemed necessary to train and educate investors to bring effectiveness to enhance the analyzing power of the investors while investing in the shares but our misfortune is that such training organizations are running through private sector and government sectors are incompetently gazing the situation.

On the other ground, it is clear that investors would not entangle themselves in order to analyzing other factors while investing their saving into the securities. They wanted to buy the share of the company whose demand is very high in the market so that they could make speculative profit by buying the share of that particular company at a lower rate and selling them at higher price. So, this trend gives ground to efflorescence whims and rumors and tempt the investors to invest in but absence of analyzing skills can turn their prospective-thought investment into poor one. So it can be seen that most of the investors who have invested in the Hotel industries when it was in charm now, the share price has gone below its par value. So investors do not seem so rational to invest their savings in Nepalese Stock Market.

#### **4.4 Major Findings of the Study**

Studying the investors' rationality in Nepalese Stock Market, it is found that the concept of understanding and evaluating investors' awareness in stock market is new and is in a growing state. The fact is that investing in stock has been only accessible and interesting to very few and turned profitable to some long time back due to complete blankness/insentience about stock market in ordinary civilians. Since the continuous awareness on stock market and realization of securities market as a sound investment sector as well as the most profitable one too, nowadays lots of individuals having more, little, or no knowledge on stock market are inclined to invest in stock market. But still after all these, irrationality is persistent in investors as to the fact that they are only

inclined in banking sector as their perception toward commercial banks is such that this sector is most profitable and as a fact, other sectors like Finance, Manufacturing, Trading, Hydro, Hotels and Others are in shadow and is experiencing unpleasant circumstances in a sense of negligence in delivery/possession of adequate information. This clearly reflects that the Nepalese investors are not completely rational enough while making investment.

### **Major Findings obtained from the Primary Data**

- ) Most of the investors were found to be aware about the securities market i.e. they have the knowledge of the securities market. But it was also found that though most of the investor's responded positively toward the awareness about the securities market, they seem to be unaware of the trading procedure in NEPSE. The fact in this part contains is that only few in the so called "Rational Investors" are actually aware of what stock market is and the mechanisms of it whereas many of the investors still observes their investment skill as perfect but to no avail, what they call rationality is nothing more than the periphery in Stock Market.
- ) Share price is also one of the reliable factors for testing the rationality. Most of the investors were found to explore the share price daily rather than the weekly, monthly, occasionally, and even twice a month. This clearly states that most of the investors in primary market have "Buy and Hold" strategy. In view of IPO investment, investors are just fine enough to consider it as a risk-free investment so the trend on seeking out wavering in stock price is very low.
- ) Regarding timely and relevant information of the listed company on its performance and its financial health is deemed important by many of the investors whereas many of the remaining expressed their incoherence on such subjects so what they seek out is overall trend of stock market and indices.
- ) A huge trend of not participating in the Annual General Meeting of the invested company is seen among investors. Many regarded attending such meeting is nothing more than just attaining the dids and dones of the management group throughout the year and nothing more. In other hand, many deemed attending AGM of the company is beneficial to investor which enables them to clear out the status of the company in comparison to their competitors and also help acquaint

their curiosity on future progress and prosperity of the company. Many of the investors also responded which is humorous in itself that they acknowledge about the AGM after two to three months of accomplishment. This part of finding also clearly points out the part of irrationality in investors.

- ) According to the vast proportion of the respondents, it is also found that government rules and regulation are not sufficient enough to protect/secure the investment in the securities market.
- ) It may sound awkward but learning that one of the very strong component in Nepalese Stock Market regulation is the comporment/presence of whim and rumor in share investment. For those with clever brain, seek out information from brokerage house and keep the pace up with information disseminated in different forms whereas with individuals having very little or no knowledge on stock market, make their investment on the basis of whim and rumor and/or seek information from their peers. This sort of investment has proven to be nothing more than gambling their investment which could bring both fortune as well as misfortune. Such tendency in huge number of investors points out towards prevalence of irrationality in investors.
- ) For obtaining profit, most of the investors follow the information of the annual report rather than NEPSE, SEBO/N, Economic Review, and Others while investing in the Securities. Investors' analyses different information before investing in stock but most of them use the trading trend of past and present (technical analysis) rather than potential factors affecting both past and present.
- ) Its very crucial to know that investors are only concerned in investing single-headed direction. Very few investors make their investment in a diversified manner making a good portfolio and hedging in order to minimize risk, but a large number of investors are only focused about investing and only investing rather than investing in diversified securities in secondary market in order to minimize the risk of huge loss.
- ) Most of the investors study the financial health of the company before investing their savings in the shares of the company. This gives clear vision on, whether the investment will be beneficial or not, before making investment in shares but most of the investors analyze the trend of return and price stability which is also good factor to note in but not adequate enough to surpass complete security of

investment rather than being aware of financial health and its future prospect, handling, and strategies.

- ) Majority of respondent agree to analyze different techniques while investing in stock. Among the different technique, technical analysis is popular in Nepal.
- ) An evident find out from the study is that Nepalese stock market has the shortage of professional investors. It seems that investors buy the stock only for dividend and they are not interested on speculative motive. Some investors are interested on the pricing behavior but they are not interested on trading of the shares in secondary markets. Similarly, people are only investing in shares with the excess money they have over their expenditure. So, Nepalese security market has the shortage of professional investors.
- ) Major of the investors are not trading in secondary market and those who trade in secondary market, sold their shares due to the expected price appreciation and few of the investors sell their shares due to the non declaration of the dividend by the company.
- ) Investors were mostly found to prefer ownership transfer and blank transfer were very few of total investors. So, it showed that investors were mostly of speculative nature and they get involved in trading of shares for capital appreciation rather than dividend appreciation in Nepalese Securities Market. But the trading of shares in NEPSE was very less and is of only 5 to 17 listed companies' shares were traded in the NEPSE during the observation period. It can be said that investors are investing in the shares as long-term investment rather than for short period.
- ) It was found from the data collected from the questionnaire, that the median value of investors is very low. Investors themselves said that they are getting very low level of reliable and adequate information from brokers regarding the transaction of shares in the securities market. So, brokers should think at this point to serve their clients by providing a wide array of services related to the share trading activities. There was no any significant difference between the views of two sectors in regards to the level of responsibility of reliable and adequate information are getting/providing from brokers regarding the transaction of shares in NEPSE.

) The mutual trading was found to be high and low. This is responsible for stock market disorders. So, it should be restricted to create highly competitive environment in the stock market. So, consideration should be given to prevent such market disorders.

## **CHAPTER - V**

### **SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS**

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

#### **5.1 Summary**

Security Market in Nepal is in the early stage of development. There is no long history of development of securities market in Nepal. Capital markets, which deal with securities such as stocks, bonds etc are associated with financial resource mobilization on a long term basis. Securities transaction is a major component of the capital market system. Securities market exists in order to bring together buyers and sellers of securities. In the security market, various security instruments such as, common stock, debenture, bonds etc. are traded.

Investors' rationality in securities market is crucial to the investor and it requires a specific investment decision process, analysis of securities, making appropriate investment strategies as well as construction of efficient portfolio etc. The investment rationality includes the kinds of marketable securities that exist and where and how an investor should make decisions about what marketable securities to invest in, how extensive the investments should be, when the investments should be made. The factors affecting investment decisions must be viewed in the light of the investor's requirements and circumstances. Investors need to analyze basic information about the returns from and risk of investing in common stocks. Nepalese financial market consists of various types of investors from very small to large ones. Still such investors are found who are completely unaware of market mechanism. Similarly, there are professional players who are enjoying maximum benefit from the security market. In such scenario, this study is conducted to analyze the investors' awareness in the securities market in Nepal.

Nepalese financial market consist varied types of investors from very small to large investors. There are those investors who are completely unaware of market mechanism on the other hands there are professional players of security market also. In such

scenario, this study is conducted to find out whether the investors are behaving rationally in the Nepalese Stock Market or not. It is conducted to test the rationality of the Nepalese investors. The study is conducted on the basis of primary data. The percentage analysis technique is used to test the status of the rationality of the investors.

This study is mainly related to identify the Nepalese rationality in securities market toward different kinds of financial securities such as common stock, bond, government securities and preferred stock etc. This study is mainly exploratory for it attempts to explore the status of investors' attitude/behavior/awareness toward securities and movement of security market. The important inferences have been drawn on the basis of sample size of 75 respondents applying different tools and techniques for analyzing and presenting the data. Every constituents of the capital market may take advantage of this study for restructuring the operational and policies issues in respect to the capital market. Main findings of the study can be summarized in the manner below:

Study of investors' rationality toward particular securities reveals that common stock is the kind of security that is most preferred by the investors, followed by government bonds, preferred stock and debentures respectively. The main reason to prefer common stock by investors is that it entitles holders the rights to participate in earnings. Among the various features of common stock, the most preferred feature is that it entails the right to participate in earnings. Next to this, marketability is the second feature of common stock in terms of the perceived importance of Nepalese investors. In this way Bulk transaction, Power to exercise rights and participation in management are in third, fourth and fifth priority in the Nepalese investor's perception. Sense of ownership is in last to attract the motive of investor to purchase common stock. Analysis of attractiveness of industry sector shows that for Nepalese investors most attractive sector is banking sector, as the median value for this sector is highest of all. Finance sector is the next most attractive sector to banking sector for Nepalese investors. This finding supports the growing tendency of investment in this sector. Analysis to identify the objective of holding particular security shows that out of the given kind of objectives 'sufficient return' is the kind of objective for which institutional investors attach most in comparison with others. The second most important objective for them is less risk, as the median value of this option is least of all the option except that of the first option. So less risk is another important aspect next to sufficient return for Nepalese investors. After the



sufficient return and less risk institutional investors want security having features of good marketability and thereafter they seek security that enhances social status. In contrast, individual investors seems more attracted towards less risk as the finding of this analysis shows first rank which is computed on the basis of median value. The second most important objective for the individual investor is sufficient return, as the median value of this option is least of all the option except that of the first. So, sufficient return is another important aspect next to less risk for individual investors. After the less risk and sufficient return, individual investors want security having features of good marketability and thereafter they seek security that enhances social status. The analysis that has performed to find out reason for less or no use of debt or preferred stock shows that the reason to less or no use of debt can be attributed to the cause that debt or preferred stock does not provide wide variety in their kinds so investors are less interested towards these forms of securities. In this way, the second thing investors' agree upon is that these securities provide less return than it actually required for compensating the risk inherent in these security. The reason that these securities are illiquid and less marketable, investors tends to have negative attitude towards these securities (i.e. Debentures and preferred stocks). Of course there are no provisions for investors who do require adjustable return as per the market scenario. As a result they also agree that the securities in question provides stable return and this sometime seems unreliable as the market may create good opportunity to earn extra return if the same investment is made in other area. Due to this very feature of these securities, Nepalese investors do not want to invest in. It is perhaps due to them being high risk and return investors. Among the various disadvantages investors are less vexed at the overburden of legal formalities, lack of professional practices, and legal insecurity etc.

Analysis of the factor determining investor's choice of security reveals that 'company's overall performance receives first rankings as such this factor can be regarded as the most important factor determining their choice of security. Out of the given factors 'return pattern' is in the second position to determine the investor's choice of security. There are few respondents rating availability of security is the important factors determining the choice of security.

On the other hand, existence of investment in government securities is also in a row. The most important feature of government securities to propel investors to purchase these is

for it being advantageous to construct portfolio as it can be used to uplift the opportunity set thereby provides more wide risk return space. Likewise, as per the overall ranking, stable return is in the third ranking.

Out of the total respondents, majority of investors were found to possess no knowledge on setting investment policy. It is also found that most of the investors do not analyze security before making investment decision. On the run, it is found interesting that most of the investors do not construct portfolio deliberately, either they do not know about it or they simply do not know how to construct portfolio. Whoever were found to construct portfolio, it is rare event that they revise their portfolio alternatives. The last step in investment process is portfolio performance evaluation. For this step too, Nepalese investors seem alienated, as there is only very mild majority of investors who evaluate performance of portfolio and most of the remaining investors do not evaluate the performance of portfolio. Analysis of general awareness of investor's towards security market and its functioning shows that investors are less aware towards the general functioning of security market in the country. This result is so dismal as few respondents are concerned over the general information as to the security market and it's functioning. Most of the respondents who purchase security in secondary market have the complain that there are no timely delivery to dividends, bonus share, and right share. Likewise, there is also significant number of respondents those complain no timely delivery of information as to the price, financial statements, and other vital information. Out of the total respondents, very few reacted about untimely arrangement of AGM. The grievances of the investors who purchase share from primary market against Issuer Company also seems to be significant as there is large number of investors complaining against Issuer Company in one or other area of functioning. Most of the respondents complain as to the company's tendency to influence unduly to the investors through different type of source of information having their reach and some of the respondents. Also, most of the respondents (67 out of 75) poured their dissatisfaction with the process of allocating shares to the investors. There are also elite group who have grievance against Broker Company. These respondents felt that the Broker Company does not provide necessary information as to the market scenario and obstructs investor's from being informed with the same and moves accordingly on a profit motive. In their views, this is the most offensive act to not provide vital information as and when investors feel necessity of such information. Some complained that the order is not executed in a timely manner which

creates further difficulties to search for alternative investment opportunities. It may sound awkward but some of the investors did poured their alteration against exchange center. The complaint is that the center stock exchange does not inform to market as to the price sensitive information and financial statements. The respondents further complain that the company used to provide information and financial statement in previous year in a web site [www.nepalstock.com](http://www.nepalstock.com) and presently one cannot find the financial statements of listed company in the web site which has revealed their irresponsibility towards investors as per the investors' views. Furthermore, another few respondents complained that the company cannot make up-to-date information changes as to membership, listing of securities and transactions etc. The first thing that must be done to accelerate the present state of the Nepalese security market is to make conducive environment for the access of the securities services, professionalism of the stock market and traders, institutional capacity and services not only in the capital city are the must. Current condition of stock trader and market seems lacking professionalism hence it needs to be professional in trading stock in the market, like wise security services are bounded in the capital city only and this needs to be corrected by expanding the services in outskirts too that propels all the people in the country to participate in the investment activities that may result into the more developed of security market. Next thing investors actively concerned over are amendment and strict implementation of current rules and regulations in order to accelerate the current status of Nepalese security market.

The questionnaires were distributed to acquire the information relevant to the study problem. The questionnaires which could define the behavior of investors and can test the rationality of the investors were distributed to the investors. 95 questionnaires were distributed and among them, only 75 questionnaires were collected. The information was then analyzed by using statistical tools as described in the Research Methodology. Major findings constitute the core of any research. The major findings of the present study are briefly summarized as follows:

Most of the investors (96%) were found to possess noesis (knowledge) regarding the securities market but many of them responded negatively while questioning about the idea of trading procedure in NEPSE. 23% investors responded that they do not know about the trading procedure of stock in NEPSE.

Most of the respondents seemed to watch the share price regularly whereas 31% of investors look after the share price very often. A bulk of investors responded thinks that it is important to get the timely information of the listed company. Among those investors who think it is necessary to get the timely information, were found to not making further research and analyzing the status of their stock company in which they are making/or having their investment.

A total of 55 investors responded that they do not rely on whim and rumors while making their investment as there is prevalence of high rate of risk than that of return proportion. As well, very few investors (31%) were found who are aware of the analysis technique and among them also only few investors make their investing utilizing those analysis technique. Regarding assisting agencies, 57% of investors responded that they do seek help from such agencies while making investment but a very large number of investors making it close to 50% responded that they do not seek help from such agencies while or after making investment.

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making it close to 50% responded that they do not seek help from such agencies while or after making investment.

Those investors who do not possess cognition on analysis techniques, were also not found to seek help from investment assisting agencies or seek counseling from the professionals.

Most of the investors were found analyzing the risk and return factor before making investment. 75% investors responded positively that means they analyze the risk and return factor while making investment decision. Investors responded that they do not make analysis of different risk-return factors while making the investment in the share of a particular company. Among 70 respondents, only 53 investors were found who make the analysis of different factors before investing in shares of the particular company. Whereas 10 respondents making 15% of total, responded that they consider IPO as a risk-free investment option to hop in.

About 64% investors were found to review financial health of the company that means they go through all the financial statements of the company before making their investments. Only few investors were found to diversify their savings into the stock. Most of the investors have invested their investment into the single stock and they have not diversified their investment in different combination of securities or different price of securities of different sectors.

About 58% of investors responded that they welcome the recent tax system on capital gain whereas 41% of responded poured their view as the recent tax system on capital gain is unscientific and is not motivating to the investors. The remaining 11% stated their neutral view on tax system.

Similarly, around 70% individuals responded that tax system really affects investors' perception on investment decision whereas about 10% responded it affects in no aspect to the investment decision and remaining 20% stayed neutral.

About 75 respondents, 52 respondents (62%) participate in the AGM of the company. Some respondents (27%) replied that they have very low interest in attending AGM of the company. On the other hand, 4% of respondents replied that they just misses the information on AGM disseminated by the company and stays unaware.

Most of the investors were found considering the single factor which influences the investment decision and uses a single source of information of the listed companies. Most of the investors consider only the earning price per share rather than the management, growth of the company and other essential factors to be considered while making the investment in the securities.

Investors were tended to invest into the shares of the companies whose shares have easy availability for selling rather than analyzing the different factors related to the share and the concerned company. This fact was informed by different investors while talking informally with them during the observation period at NEPSE floor for the research study.

## **5.2 Conclusions**

Although history of security began from 1936 with the issue of Jute Mill, the scenario of Nepalese financial system has not developed significantly. It took very long to give financial market a well structured organized shape. History shows that in Nepal only, four types of (common stock, preference shares, debentures, and mutual funds) of securities issued at varying time. Nepalese security market is completely dominated by the equity shares. There are very less number of professional investors, which is countable in fingers. However, there are large numbers of tiny individual investors, who just hold 10 to 50 shares of two to three banking companies. A dualism can be found if the scenario of investors is seen, there is very large number of individual investors who have little or no knowledge about the market mechanism. Similarly, there is another group of professional and institutional investors who has high level of awareness level about securities market. Large number of the investors who have invested on the basis of market whim and rumor even do not know the procedure of share trading in the factor influencing the share investment. The rationality of the investors in Nepalese investors is seen to be at lowest level. They have very little knowledge of the trading procedures and price formation mechanism in NEPSE. At present, there is a general low level of investors' rationality about the listed companies, the operation and potential role of securities market, techniques of financial analysis, and risks and rewards of holding securities.

Fair and timely information disclosure is essential ingredients to function the securities market efficiently. Information deficiency in the capital market may be one of the reasons for the investors' awareness and rationality. Norm's regulatory submission and disclosure of information by the listed companies are meant for ensuring good corporate governance, transparency, and investor protection. They information which is available are also not considered and analyzed by the investors before making their investment. For those investors having little knowledge, broker's role becomes one of the main sources of information for their investment. There is lack of professional investors in Nepalese Stock Market. The market is almost totally captured by individual investors who buy very little number of shares and therefore they do not bother analyzing the data and information before buying and selling the stock. They do not prefer to watch the share price regularly and are not aware of the analysis technique. Those who are aware of the analysis technique also do not make any type of analysis before making their investment. Investors who have no idea about the factors affecting the securities investment, risk return, and price factor also do not consult any professional. They do not think it is important to take suggestion from the brokers. People, in Nepal simply invest in shares mainly on the basis of whim and in a single sector rather than diversified sector. They are not well aware of the fact that investing in shares involves risk. So, the concerned bodies should feel responsible to provide sufficient and reliable information about investment in shares so that rationality could be upgraded.

### **5.3 Recommendations**

The transparency and openness of transactions, quality of professional service, and improved legal and regulatory and supervisory frameworks are the urgent needs to buildup the confidence of the potential investors of Nepalese stock market. This requires an integral plan of action, not piecemeal effort. There must be sufficient updated and relevant information flow from the listed companies to the investors at the joint initiative of the NEPSE and SEBO/N. Inactive securities should be de-listed. Similarly companies not meeting disclosure requirement or not-holding Annual General Meeting (AGM) timely be de-listed. The NEPSE should be exposed to the lasted concepts and techniques that are employed within the region. Tax system should be simplified and rationalized to encourage the private sector capital and there should be no or very minimal capital gain tax on securities on transactions to encourage long-term investment through the stock

market. Stock market investment is a risky venture. To win in the strengths, weakness, needs, desires, risk taking capabilities, and how to react on different and ever changing market conditions. This is one game where self-knowledge, superior forecasting ability, sound understanding on the information of stock market can give a winning edge to the investors.

The corporate body should give attention towards the fresh reliable information and the present economic position of the company. Otherwise it would not be fruitful for the company in general and for the shareholders. The following recommendations are made to the different sectors trading to share trading and regulation on the basis of the findings and the conclusions.

### **Recommendation to the Investors**

- ) Stock market investment is a risky venture. To win in the stock market, investors should always be clear to his strengths, weakness, needs, desires, risk taking capabilities and how to react on different and ever changing market conditions. This is one game where self-knowledge, superior forecasting ability, sound understanding on the information of stock market can give a winning edge to the investors.
- ) Rational investors tend to be contrarians. Investors are not content to follow the crowd, although investors do not mind the crowd and momentum investors buying shares that investors already own. Investors believe that it is difficult to make money chasing the hottest trend, and investors often do the opposite of the fashionable trade. Ultimately, investors' goal is to generate positive returns regardless of the prevailing direction in the market and to do so rationally.
- ) Individual investors' participation in the securities should be encouraged. Investors need to be given necessary education, trainings and provided different skills on securities investment. They should be made aware of the investment opportunities; benefits attached with the securities and rational investment processes.
- ) Investors should not act on instinctive motive/impulse or in emotion. They should not buy the shares of a company until they have details about it and have full understanding of the outcome of their investment.



- ) The first thing investor should define is his/her priorities. It should be cleared out for what purpose he wants to make an investment, is it capital/price appreciation, safety, or income. Firstly being clear on these issues clears his determination on his/her choice of shares' which to buy and which not to. It is extremely important that s\he define these priorities because the entire strategy to win has to be based on these.
- ) Every investor should follow different sources which could provide information. Only one source either NEPSE or SEBO|N is not sufficient for the investors. Others sources of information like Economic review, annual report of listed companies. Journals, research extracts, etc. should be referred frequently. It provides extensive statistical data, financial news, and even a bit of humor.
- ) Investors should always be aware of the daily stock price and volume figures of stock price record, published by NEPSE.
- ) Investors should seek assistance in order to foster their understanding on investment or on securities market and to assure the condition of their investment.

### **Recommendations to the concern Authorities**

- ) The stakeholders should understand their respective roles and play their roles with sincerity to ascertain better return to the scattered and different economic-level investors.
- ) The stock Exchange should have speed settlement and clearance system, investors'-friendly environment, well equipped office, and well trained brilliant and hard working staff in order to accelerate the daily transaction in a smooth and effortless way.
- ) The government, concerned bodies and individuals have to work hard to make the investment in securities preferable to investors by implementing the rules, regulations, policies and activities more strictly. The regulatory of the stock market should try to rise the trading of shares by regulating the activities and performance concerned bodies such as brokers and the listed companies frequently to create the efficient pricing of shares.
- ) Effective monitoring and controlling should be ensured in regards to securities issuance, listings and performance rating. SEBO's activities need to be active in regards to the proper implementation of the rules and regulations.

- ) Various researches, findings and studies on individual investors need to be conducted both by the companies and concerned bodies to identify the expectations, preferences and problems of the investors in securities investment.
- ) The listed companies should fulfill their liabilities by providing the financial status of the companies timely and comprehensively in a transparent way, and they should hold the AGM regularly.
- ) Although SEBO/N has been trying to enhance the understanding of the existing stock investors and the potential investors as well by disseminating the information related to the share market and trading activities by using various Medias and its own publications, it could not be regarded as satisfactory. Most of the investors out of the Kathmandu valley are facing various difficulties in taking information regarding to securities market as in most cases, majority of people are computer illiterate and similarly the reach of computer or internet is not accessible to everywhere. So, this is one of the hindering drawback for an investors' rationality. So, maneuvers should be made for the necessary arrangement to increase the participation of the investors who live out of the valley.
- ) The development of stock market is also depending on political stability of the nation. So political parties and government should try to maintain the political stability to develop the securities market and ultimately the whole economy of nation.
- ) The government should promulgate suitable policies to foster the development of corporate sectors in the economy.
- ) Brokers should help regulatory bodies to perform their activities by providing the financial statements and other required information in time and regularly. They should strictly obey the ruled and regulations made for them help the regulatory bodies in creating the effective price information on security market. Brokers should open their offices in the place easily accessible to the present and potentials investors as it was seen during the observation period that almost all of the brokerage offices are not opened in easily seen place.
- ) Investors' prefer to invest in those securities whose overall company performance is outstanding. This suggests that development of security market is not only the matter of investor's rationality but also a thing of company's performances. This

calls for the new initiatives from the part of Nepalese companies to enhance their deteriorating performance.

- ) Most of the investors in Nepal have one or other type of complaints against various types of institutions. These all the grievances should be handled promptly and reasonably otherwise the transparency, accountability and credibility of securities market will come to a difficult verge and the expense of which will be irrecoverable.
- ) Current condition of stock trader and market seems lacking professionalism hence it needs to be professional in trading stock in the market, like wise security services are bounded in the capital city only and this needs to be corrected by expanding the services in outskirts to that propels all the people in the country to participate in the investment activities that may result into the more developed security market.
- ) Consulting firms and financial consultants should be opened for guiding the potential as well as existing investors. Stockbrokers need to play more active role in regards to these matters.

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Dear Sir/Madam:

I humbly request you to fill up the questionnaire prepared with an objective for collecting the precious data, which will be used for facilitating the research conducted for the partial fulfillment of the requirement of the Master Degree in Business Studies (MBS) on the topic of “**Investors’ Rationility on Securities Market, in Nepal.**” Your valued responses are crucial for completing the research study.

I would like to thank you for sparing your valuable time and kind cooperation. You are requested to put the tick marks ( ) on the answer you feel suitable.

Sachin Nepali  
(Researcher)  
Master Degree in Business Studies  
Shanker Dev Campus, T.U.

About the respondent:

Name: .....

Address: .....

Signature: .....

Date: .....

All the information given will be kept confidential



**COMMON QUESTIONS:**

**2. What sort of investment pattern do you prefer while investing in shares of listed companies? [Please tick any ( )]**

- 1. Common stock ( )
- 2. Preferred stock ( )
- 3. Debentures/Bonds ( )
- 4. Government Bonds ( )

**2. Following are the eight industrial sectors. In your opinion, which of the sectors is attractive so far as the matter of investing in securities is concerned? Please rank in order of their attractiveness as per the given scheme.**

More attractive Least attractive

---

1                      2                      3                      4                      5

- 1. Bank ( )
- 2. Finance ( )
- 3. Insurance ( )
- 4. Manufacturing and Processing Company ( )
- 5. Trading ( )
- 6. Hotel ( )
- 7. Hydro ( )
- 8. Others ( )

**3. Why do you think that investors sell their shares? The available options are presented below.**

- For personal need ( )
- To buy other more profitable stock ( )
- Expectation of price fall ( )
- No payment of dividend by the company ( )
- Current price appreciation ( )

**4. Why do you think that huge investment is made in the secondary market? The available options are presented below.**

- High rate of dividend ( )
- Expected price appreciation ( )
- To invest excess money ( )
- Speculative purpose ( )

**5. How often do you acquire information on share price movement?**

- Daily ( )

- Weekly ( )
- Monthly ( )
- Seldom ( )
- Never ( )

**6. Which of the followings best matches with presumption on factors affecting share prices? Please tick any.**

- Dividend ( )
- Earning Per Shares ( )
- Political Stability ( )
- Economic Growth ( )
- World Wide Trend ( )
- Volume of Transactions ( )
- Rumors ( )

**7. Which of the followings best matches with your expected return with the actual return?**

- Very High ( )
- High ( )
- Moderate ( )
- Low ( )
- Very Low ( )

**8. How do you draw relationship between Brokerage House and potential investors?**

**9. Do you have any idea what sort of services does Brokerage House provide?**

**10. Do you think the listed companies are disseminating adequate information to their shareholders on a timely manner?**

**11. Is the information provided by Brokerage House is adequate enough to rely upon? What do you think.**

**INDIVIDUAL QUESTIONS:**

**1. Do you have any idea about share market?**

- |     |     |
|-----|-----|
| Yes | No  |
| ( ) | ( ) |



**8. Whim and rumor have now become one of the integral part of securities market, do you follow the same attitude while making an investment?**

Yes                      No  
( )                      ( )

**9. Do you inherit any knowledge about analysis technique before investing?**

Yes                      No  
( )                      ( )

10. (Only if “YES” to question #9) So, do you follow the principles of such analysis techniques or not?

Yes                      No  
( )                      ( )

**11. There are lots of consulting agencies nowadays, did you consult with any professionals before making any investment in shares?**

Yes                      No  
( )                      ( )

**12. As there is no doubt that there always exists factors like risk and return while making an investment, do you look after these parts while making investment or you make a blindfold investment?**

Yes                      No                      IPO  
( )                      ( )                      ( )

**13. Do you consider different factors involved in securities periphery (which might influence the company/investment in the future) before investing in shares?**

Yes                      No  
( )                      ( )

**14. Financial health of the company is one of the major aspects before making an investment, do you desire to/look after those aspects for securing your savings?**

Yes                      No  
( )                      ( )

**15. Portfolio is selection of investment alternatives extending your finance to not only one kind of security but in multiple kinds of shares. Do you consider these aspects while making an investment?**

Yes                      No  
( )                      ( )

**16. Do you seek suggestions from the brokers while making investment?**

Yes                      No  
( )                      ( )

**17. Are you aware about the Capital Gain Tax system? Recent tax rate on capital gain is presented below. What will be your notion on this,**

In Aarthik Bidhayak Act 2066, as per the section 52 of the Act specifies that the capital gain tax on listed securities are as follows:-

Capital gain tax for individuals:                      10% of the Gain  
Other than individuals:                                      15% of the Gain

Similarly, in case fo non-listed securities

Capital gain tax for individuals:                      10% of the Gain  
Other than individuals:                                      15% of the Gain

**Your view:**

I think it is acceptable.

I think it is unscientific.

No comments.

**18. Do you think the Aarthik Bidhayak Act 2066 is beneficial to the investors in any way?**

Yes                      No  
( )                      ( )

**19. Do you participate in the AGM of the company you have invested to know about your investment status?**

Yes                      Not Interested                      Unaware  
( )                      ( )                      ( )

**20. While making investment in security, which factor do you think should be given priority on a hierarchy basis. Please rank them from 1-10 on the basis of priority (1 being the topmost priority and 10 being the least)?**

( ) Earning per share (EPS)                      ( ) Management/Performance

- |   |  |
|---|--|
| <input type="checkbox"/> Competition        | <input type="checkbox"/> Market Interest Rate  |
| <input type="checkbox"/> Market Risk        | <input type="checkbox"/> Size and Growth of Company                                  |
| <input type="checkbox"/> Net Worth          | <input type="checkbox"/> Dividend Per Share (DPS)<br>and Dividend Payout Ratio (DPR) |
| <input type="checkbox"/> Liquidity Position | <input type="checkbox"/> Leverage or Debt Ratio                                      |

**21. Which source do you think is more reliable and more informative while obtaining information before/after an investment?**

- |                 |                          |                             |                          |
|-----------------|--------------------------|-----------------------------|--------------------------|
| Annual Report   | <input type="checkbox"/> | SEBO/N                      | <input type="checkbox"/> |
| NEPSE           | <input type="checkbox"/> | Local Government            | <input type="checkbox"/> |
| Economic Review | <input type="checkbox"/> | Journals or Others (if any) | <input type="checkbox"/> |

**22. During the preceding one-year period, the NEPSE index has fallen unexpectedly, what factor do you think might have caused the fall?**

- Irrationality of investors
- Political Instability
- Lack of foresightedness of Government
- Due to the “stock politics” implemented by major players of stock market
- It might be the effect of International Recession
- Tax system in security transaction

I thank you very much for your worthwhile time and partake. The information provided will be kept confidential.

Sachin Nepali  
 Resarcher, MBS (Finance Group)  
 Shanker Dev Campus