

CHAPTER 1: INTRODUCTION

1.1 Background

1.1.1 Financial market

Financial markets are a catalyst in the development of the country's economy. As such, developed economies have highly sophisticated financial institutions. Over the past decade or two, many developing economies have established capital markets as they moved towards more liberal economic policies. These emerging markets have shown extraordinary growth with very high volatility, which have attracted many investors into these markets. In 1994, the Government of Nepal established a stock market with the technical assistance of the Integrated Risk Information System (IRIS) Center at the University of Maryland under the United States Agency for International Development (USAID) sponsored Economic Liberalization Project. This paper looks at the institutional changes and the consequent market behavior that took place in this process and summarizes the lessons learned and needed policy responses drawn from the post 1992 Nepal experience of capital market development.

Financial markets play a fundamental role in the economic development of a country. They are the intermediary link in facilitating the flow of funds from savers to investors. By providing an institutional mechanism for mobilizing domestic savings and efficiently channeling them into productive investments, they lower the cost of capital to investors and accelerate economic growth of the country. Financial intermediation between borrowers and savers is done by commercial banks. This credit market enables debt financing for investments. An alternative method of intermediation is through equity financing. This is only possible through the development of capital markets. Capital markets, which deal with securities such as stocks and bonds, are associated with financial resource mobilization on a long term basis. By raising capital directly from the public, they lower the cost of capital. Capital markets also allow for wider ownership among the public, thereby distributing risks and wealth amongst smaller investors. For investors, they provide an effective vehicle for making investment choices which suit their own preferences of risk and returns based on available information. As such, capital

markets help the economy to generate more savings and productive investments. A basic feature of an efficient capital market is constant liquidity, i.e., an easy mechanism for entry and exit by investors. This requires sufficient volume and size of transactions in the market. Typically in developing countries, for various economic and policy reasons, financial markets are underdeveloped. In those countries where a capital market does exist, it is in a very rudimentary state. Private wealth and investments are concentrated among several large companies and individuals. The choice of market instruments is also very limited. As a result, these capital markets are very narrow based. They are constrained by limited investment opportunities and low income and savings rates. In many cases, the economy has high inflation, leading to a savings disincentive and capital flight. Financial sector development is a lengthy, evolutionary process. It is an indicator of the state of economic development of the country, since an efficient well-developed financial market is only possible when there is substantial income generation and investment opportunities.

1.1.2 Securities markets

Securities enable to raise funds to meet the financial requirements of a company. Most of the companies require huge amount of money to meet their financial requirements. Therefore, securities like equity shares, preference shares, and debentures are crucial for meeting the company's monetary requirements. A sound and well developed security market can easily help meet their financial requirements. A security market consists of activities in organizing, distributing and trading in securities. A security market includes stock exchange as well. A stock exchange is the organized market for buying and selling of the financial instruments, such as stocks, options, and futures. Stock exchanges serve important roles in national economies. They encourage investment by providing places for buyers and sellers to trade securities, stocks, bonds, and other financial instruments. Companies issue stocks and bonds to obtain capital to expand their businesses. Most stock exchanges have specific locations where intermediaries called brokers conduct buying and selling of shares and debentures.

Stocks are shares of ownership in a company. People who buy a company's stock are entitled to dividends, or shares of any profit. A company can list its stock on only one

major stock exchange, though options on its stock may be traded on another. Each exchange establishes requirements that a company must meet to have its stock listed. The different exchanges tend to attract different kinds of companies. Smaller exchanges typically trade the stock of small emerging businesses, such as high-tech companies. Corporations issue new securities in the primary market (as opposed to the secondary market, where securities are bought and sold), usually with the help of investment bankers. In the primary market, corporations receive the proceeds of stock sales. Thereafter, they are not involved in the trading of stocks. Owners of stocks trade them on a stock exchange in the secondary market. In the secondary market, investors, not companies, earn the profits or bear the losses resulting from their trades. Stock exchanges encourage investment by providing this secondary market. By allowing investors to sell securities, exchanges increase the safety of investing. Stock exchanges also encourage investment in other ways. They protect investors by upholding rules and regulations that ensure buyers will be treated fairly and receive exactly what they pay for. Exchanges also support the state-of-the-art technology and the business of brokering, both which help traders to buy and sell securities quickly and efficiently. Stock brokers must be registered with the exchange in which they trade. Most brokers belong to brokerage firms. Brokerage firms maintain staffs of many brokers, each of whom have experience in the trading of securities of certain companies or those of particular economic sectors, high tech, utilities, or transportation businesses, for instance. Brokerage firms also tend to trade in the stocks of specific companies, and, therefore, keep inventories of the stocks of those companies. To become a member of an exchange, a firm must register its brokers by buying seats for them.

A seat is simply a right to trade on an exchange. Member firms have the right to vote on exchange policy and must also arbitrate in disputes among customers. In larger exchanges, seats could sell for several hundreds of thousands of rupees. Exchanges attract larger or smaller brokerage firms depending on how high or low their fees are. Brokerage firms that pay high membership fees to exchanges like the New York Stock Exchange (NYSE) have the opportunity to make large profits trading in the stock of very successful businesses. They also risk losing large amounts, and, therefore, charge their clients higher prices than do smaller firms. To some extent large companies use large brokerage firms

and list on large exchanges because of the potential losses possible to those trading on securities.

1.1.3 Development of security market in Nepal

Nepal is a landlocked, mountainous country situated between India and China. It is a small, mostly agrarian based economy, sharing an open border with North India. Industrial development began in Nepal only in the mid-sixties, when the Government began establishing manufacturing industries such as the jute industry, cement factories, and sugar factories. In order to support this industrialization process, government actively promoted financial institutions, such as commercial banks and capital market institutions.

The real boost into the capital market in the form of a private sector led growth began with the financial sector liberalization. In the mid-eighties, Nepal opened its doors to foreign investors as joint venture partners in the banking sector, which revolutionized commercial banking services in Nepal. Since then, a variety of private sector based financial institutions have evolved. In 1992, the Finance Companies Act was amended. These enabled finance companies to be established to function in various areas such as leasing, housing finance, and hire-purchase. These institutions were also allowed to perform capital market functions such as share issue, portfolio management, market making and custodial services.

In Nepal the history of security market did start by issuing the shares to the public in the year 1937. Two companies, namely the **Biratnagar Jute Mills** and the **Nepal Bank Limited**, issued their shares to the public. These two companies were considered as the pioneer of issuing the security to the general public. Since then for almost four decades, there were no formal institutions that came into existence to look after the security issues in the country. In the year 1976 the Security Marketing Centre (SMC) was established with a view to develop security market in Nepal. In the initial period the SMC started trading of securities. The SMC changed its name into the Security Exchange Centre in 1984 that was the only institution responsible for managing and operating primary and secondary markets. It acted as a sole agent of operating primary and secondary markets for long-term government and corporate securities. Later individuals began to think of having a separate body for regulating security markets in Nepal. The first amendment of

the Security Exchange Act 1993 in the year 1993 lay concrete on restructuring the security markets in Nepal. Consequently, the Security Board of Nepal (SEBON) was established on 7th of June 1993 as an apex institution of regulating securities market in the country. The main mandated objectives of the Board was to regulate issue and trading of securities and market intermediaries, promote the market and protect investor's rights. The former Securities Exchange Centre (SEC) was converted into the Nepal Stock Exchange Ltd. (NEPSE) with the objective of operating and managing secondary transactions of securities. Following this conversion, the open outcry system of securities trading among the stock brokers commenced. Since then all the intended investors can deal in security only through licensed brokers. The second amendment of the Security Exchange Act of 1993 in 1997 made several provisions that were: to register all the securities business persons in SEBON, to issue licenses to the stockbroker, securities dealer, market-maker and issue manager, and also submit their semi-annual as well as annual reports.

1.1.4 Financial information

Financial statements are easy enough to understand – if we know what to look for. There is compulsion for the public companies to disclose their financial statement at every certain period of time. Financial statements summarize an organization's financial position- at a given movement in time as well as over longer periods (monthly, year-to-date, quarterly, annually). Public companies should publish their financial statement at a general understanding form on the national newspaper and the company's publications. This provision facilitates the general investors to understand the clear picture of company's financial position. In another words investors can be able to collect the relevant financial information.

There are two major financial statements: the statement of financial position (or balance sheet) and the statement of activities (also known as the income statement). The balance sheet presents the organization's assets, liabilities, and net worth (net assets) at a particular period in time (the reporting date). The income statement presents the financial operating results, income, and expenses over a given period of time.

The essential characteristics of accounting are: the identification, measurement, and communication of financial information about economic entities to interested parties. Financial statements are the principal means through which a company communicates its financial information to those outside it. Financial statements are of no importance within themselves; the importance of financial statements lies in information they provide to statement users. Users of those financial reports include investors, creditors, managers, unions, and government agencies. By using different analytical tools, financial statement can be analyzed. These tools may be ratio analysis, trend analysis, relation analysis etc. one of the most popular analytical tool is ratio analysis. Some of the more information containing and important ratios are capital fund to RWA ratio, non performing loan (NPL) to total assets ratio, total loan loss provision to total NPL ratio, price earnings ratio, cash reserve ratio (CRR), return on total assets ratio etc. Other most valuable financial indicators are earning per share, dividend per share, and net worth per share and total assets per share.

Investors are the primary party interested in financial accounting information. It is assumed that financial statements enable investors in determining firm value. The research investigates the relation describing firm value in terms of accounting numbers. It focuses on finding accounting numbers that associate with market measures of value, for example with stock prices.

The purpose of financial information is to provide decision makers like investors, creditors and managers with information to support their decisions. The concept of value relevance of financial information's originates from the work of Ball and Brown (1968) and Beaver (1968), investigating whether investor's availability on accounting information is useful information when taking investment decisions. The main objective of value relevance research is to examine whether there is a statistical relationship between financial statement variables and market variables. If investors use conventional accounting data then they must find accounting information useful. Accounting information plays a major role in purchases, sales and other financial processes of the business. The concept of value relevance of financial information originates from the idea whether investors availability on accounting information is useful information when taking investment decisions. Observations the last two decades indicate an increase of

interest in connecting accounting numbers to market value. The main emphasis is to empirically examine if financial statement variables can explain the variability in capital market variables. If there exists a relationship, measures are made to interpret how much of the variation in the dependent stock market variable are explained by the independent accounting variables. Several researchers describe accounting information as value relevant if it significantly relates to equity market value. If there is no association between accounting numbers and company value, accounting information cannot be termed value relevant. This implies that value relevance research measures the usefulness of accounting information from the perspective of equity investors.

1.2 Focus of the study

The focus of the study attempts to find out the relationship between the financial information and the movement of market price of shares. The study also finds out the level of investors awareness to the financial information of organizations, whose shares are trading in the secondary market. Nepali security market is struggling in the infant phase so it is operating in the imperfect condition. Due to the lack of professional skill of investors as well as brokers, the price fluctuation of shares is abnormal at various times. Many times there existed ample variations between the expert's forecast and the actual market price of share. That is the result of investor's action taken for trading stocks depending upon rumors (not on analyzed factual data). This study will find out the investors current investment dependency on financial disclosure. This study is based on the relationship between earning per share and the market price of share at that time. The earnings per share represent the financial information. Listed companies are kept under different categories i.e. Commercial bank, development bank, finance company, insurance company, hotel, manufacturing company and other company in Nepal Stock Exchange (NEPSE). Among them commercial banking sector is a major player of NEPSE index. So this study is focused on the commercial banking area.

1.3 Statement of the problem

The present Nepalese stock market is embryonic in nature and has various imperfections. The information dissemination is very poor in the market and most of the investors are not properly analyzing the fundamentals like company performance and profitability, past and current growth rate, future risk and return of securities. The weak monitoring and regulation system, no transparency on trading system, unstable political environment, no well-trained manpower and management are responsible for market imperfection. The lack of technical knowledge, majority of investors is unable to analysis the available information.

Unreliable and irregular disclosure of market information, lack of technical knowledge and awareness among the majority of investors to read and analyze the financial information, the market has become non-competitive and inefficient. Along with these, lack of strong professional analyst, independent buyer and seller, well trained manpower and management, delay in transfer of share, rational investor exist in Nepalese Stock Market. Most of investors are not very responsive to many financial and economic changes. Some of the monetary and fiscal announcement would immediately attract the attention of investors and do have immediate effect on the stock price.

Nepalese stock market is not efficient enough to evaluate the prices of stock. Most of the investors are not very responsive to many financial and economic changes. But it has been felt that they invariably respond to the dividend incomes, earning per shares, capitalization of profit to issue bonus shares and issue of right shares. The leakage of secret information in the share market from inside the company called insider trading also sometimes raises share price upward. But this is the temporary phenomenon; when the company discloses the information, the price is automatically corrected in the market. There is no doubt that their demand and supply affects the price of shares in the stock market. When there is a tendency of rising prices in the market, the supply of shares will be increased; and in contrast, when the price are falling, investor would demand more of the shares to buy, other things remaining the same. But because of the lack of reliable and regular disclosure of market information and lack of awareness and technical knowledge amongst the vast majority of investors to read and analyze the financial information, the market is non-competitive and inefficient.

- The Nepalese Stock Market is weak because the investors don't analyze the financial indicators of the public limited companies listed with NEPSE.
- There is lack of awareness among investors of the financial indicators in which they are investing their funds.
- Investors prefer real assets as land, building, etc rather than financial assets as stocks, bonds, etc, so there is low capital formation and slow growth of capital market.
- The market rumors have significant impact on share price.
- Lack of knowledge about the factors that determine the movement of stock prices, the relationship between the key factors and prevailing market price.
- Investors lack knowledge to differentiate the good and bad stock.

1.4 Theoretical framework

The primary and independent variable that has been considered in this study is financial information (i.e. earnings per share.) of selected commercial banks. The variable which is supposed to be independent is market price of share of selected banks. While going through the literature review, it is found that financial information and price of share are related. The significance of the relationship will be tested in the analytical chapter i.e. chapter 3. The positive correlations are expected in their relations. The better the financial performance, higher will be the price of share.

1.5 Hypothesis

From the theoretical framework discussed earlier, the following hypothesis have been developed which have been thoroughly tested in the chapter-3.

- The earnings per share (EPS) and market price of stock (MPS) are correlated.

1.6 Objective of the study

The main objective of this study is to examine, whether the investors aware about quarterly financial disclosure of public companies, they are investing on their shares.

The study is undertaken with the objective of discussing, examining and evaluating the financial operation and position of commercial banks. In this context, the main objectives of the study are as follows:

- To conduct the empirical analysis of price movement by investigating the market position of each sample bank and compare them in terms of earning per share, return on equity, return on total assets etc.
- To analyze the sensitivity of securities and compare them.
- To understand how the price behaves in stock market and how an investor can safeguard his/her investment on stock market.
- To study the present status of stock market.

1.7 Research methodology

Research Methodology can be understood as a science of studying how research has been done. This chapter looks into the research design, nature and sources of data, data collection procedure and tools & technique of analysis. For the purpose of achieving the objectives of the study, the applied methodologies are used. The research methodology used in the present study is briefly mentioned below.

1.7.1 Research design

This research design attempts to analyze the relationship between financial information and stock price behavior of commercial banks. This research is based on historical data analysis. For the analysis of market price movement of commercial banks correlation research design under comparative research design will be used. For the analysis purpose, the study covers the time period of five years. The research design will include specification of the method of the proposed study and detailed plan for carrying out the study with various empirical data for the analysis of the problem.

1.7.2 Population and sample

Nepal Stock Exchange (NEPSE) is only one secondary stock market in our country. Where primarily issued stocks are traded. Listed companies are put on their respective segments as per their nature of operation. There are various segments, they are; commercial banking, development bank, finance company, insurance company, hotel, manufacturing company, other companies etc. This study includes only the commercial bank listed in NEPSE because of huge influence of these stocks in the stock market (NEPSE). Similarly, the banking sector is an emerging sector. The availability of the relevant data is more prospective than other sectors. The result will be more reliable because commercial banks keep their financial and accounting data more systematically. This sector covers more than half of the total market capitalization i.e. 54.74%. So the result will represent as the result of all stocks of NEPSE. As per the annual report of Security Board Nepal 2011/12, there are 32 commercial banks listed on NEPSE. That is 17.30% of total number of listed companies. There are 185 companies listed in NEPSE. Among these 32 listed commercial banks, 10 banks are taken as sample to represent the performance, trend and behavior of capital market on the basis of their financial information. Random sampling method is used to select the sample banks.

Selected sample banks with their general introduction are as follows:

1. Bank of Kathmandu (BOK):

BOK started its operation in March 1995 with the objective to stimulate the Nepalese economy and take it to newer heights. BOK also aims to facilitate the nation's economy and to become more competitive globally. Bank of Kathmandu Limited has become a prominent name in the Nepalese banking sector. Bank of Kathmandu Limited (BOK) has today become a landmark in the Nepalese banking sector by being among the few commercial banks which is entirely managed by Nepalese professionals and owned by the general public.

2. Everest Bank Limited (EBL)

Everest Bank Limited (EBL) started its operations in 1994 with a view and objective of extending professionalized and efficient banking services to various segments of the society. The bank is providing customer- friendly services through its Branch Network. All the branches of the bank are connected through Anywhere Branch Banking System (ABBS), which enables customers for operational transactions from any branches.

With an aim to help Nepalese citizens working abroad, the bank has entered into arrangements with banks and finance companies in different countries, which enable quick remittance of funds by the Nepalese citizens in countries like UAE, Kuwait, Bahrain, Qatar, Saudi Arabia, Malaysia, Singapore and UK. Bank has set up its representative office s at New Delhi (India) to support Nepalese citizen remitting money and advising banking related services.

3. Himalayan Bank Limited (HBL)

Himalayan Bank Limited (HBL) is one of the largest and reputed private sector banks of Nepal. The bank was incorporated in 1992 by a few eminent individuals of Nepal in partnership with the Employees Provident Fund and Habib Bank Limited, Pakistan. The bank commenced its operations in January 1993. Himalayan Bank is also the commercial bank of Nepal with most of shares held by private sector of Nepal. Besides commercial banking services, the bank also offers industrial and merchant banking service. With its corporate and head office at Thamel, Kathmandu, the bank has 33 branches. Thirteen of its branches are located inside the Kathmandu Valley while the rest are spread across the nation.

4. Nepal SBI Bank Limited (NSBL)

Nepal SBI Bank Ltd. (NSBL) is the first Indo-Nepal joint venture in the financial sector sponsored by three institutional promoters, namely State Bank of India (SBI), Employee Provident Fund (EPF) and Agricultural Development Bank Ltd. (ADBL) through a Memorandum of Understanding signed on 17th July 1992. NSBL was incorporated as a public limited company at the office of the Company Register on April

28, 1993 under Regn. No. 17-049/50 with an authorized capital of Rs. 12 cores and was licensed by Nepal Rastra Bank on July 6, 1993 under license No. NRB/I.pa./7/2049/50. NSBL commenced operation with effect from July 7, 1993 with one full-fledged office at Durbar Marg, Kathmandu with 18 staff members. The staff strength has since increased to 511. Under the banks & financial institutions Act, 2063, Nepal Rastra Bank granted fresh license to NSBL classifying it as an “A” class licensed institution on April 26, 2006. The authorized, issued and paid-up capitals have been increased to Rs.200 cores, Rs.186.93crores and Rs.186.93crores respectively. Consequently, the bank’s corporate status has undergone change from its previous status as a joint-venture Bank to a Foreign Subsidiary Bank of SBI. Presently 55% of the total share capital of the Bank is held by the SBI, 15% is held by the EPF and 30% is held by the general public.

5. Nepal Investment Bank Ltd. (NIBL)

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, had acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank’s Annual General Meeting, Nepal Rastra Bank and Company Registrar’s office with the following shareholding structure:

A group of companies holding 50% of the capital

Rastriya Banijya Bank holding 15% of the capital

Rastriya Beema Sansthan holding 15% of the capital

The remaining 20% being held by the general public

6. NABIL Bank Limited

Nabil Bank Limited, the first foreign joint venture bank of Nepal, started operations in July 1984. Nabil was incorporated with the objective of extending

international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 47 points of representation across the kingdom and over 170 reputed correspondent banks across the globe. Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business. Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world-renowned software from Infosys Technologies System, Bangalore, India, Internet banking system and Telebanking system.

7. Laxmi Bank Limited (LBL)

Laxmi Bank was incorporated in April 2002 as the 16th commercial bank in Nepal. In 2004 Laxmi Bank merged with HISEF Finance Limited, a first generation financial company which was the first and ever merger in the Nepali corporate history. Laxmi Bank is a Category 'A' Financial Institution and re-registered in 2006 under the "Banks and Financial Institutions Act" of Nepal. The Bank's shares are listed and actively traded in the Nepal Stock Exchange (NEPSE). We are a technologically driven progressive Bank with strong risk and corporate governance foundations. We are known for our innovation and claim to many "firsts" in the Nepalese financial market. We have the best asset quality among all financial institutions in the country and our technology has been rated "Highly Secure" by an independent internationally accredited information system auditors. The capital structure is as follows:

Promoter group representing the country's leading business group 55.42%

Citizen investment trust, a government of Nepal undertaking 9.02%

General public comprising of more than 10,000 shareholders 35.56%

8. Standard Chartered Bank Limited (SCBNL)

Standard Chartered Bank Nepal Limited has been in operation in Nepal since 1987 when it was initially registered as a joint venture operation. Today banking is integral part of standard chartered group having ownership of 75% in the company with 25% shares owned by the Nepalese public. The bank enjoys the status of the largest international bank currently operating in Nepal.

Standard Chartered has a history of over 150 years in banking and operates in many of the world's fastest- growing markets with an extensive global network of over 1750 branches (including subsidiaries, associates and joint ventures) in over 70 countries in the Asia Pacific Region, South Asia, the Middle East, Africa, the United Kingdom and the Americas. As one of the world's most international banks, Standard Chartered employs almost 75,000 people, representing over 115 nationalities, worldwide. This diversity lies at the heart of the Bank's values and supports the Bank's growth as the world increasingly becomes one market. With 19 points of representation, 23 ATMs across the country and with more than 425 local staff, Standard Chartered Bank Nepal Ltd. is in a position to serve its customers through an extensive domestic network. In addition, the global network of Standard Chartered Group gives the Bank a unique opportunity to provide truly international banking services in Nepal.

9. Kumari Bank Limited (KBL):

Kumari Bank Limited, came into existence as the fifteenth commercial bank of Nepal by starting its banking operations from Chaitra 21, 2057 B.S (April 03, 2001) with an objective of providing competitive and modern banking services in the Nepalese financial market. The bank has paid up capital of Rs. 1,485,000,000 of which 70% is contributed from promoters and remaining from public.

It has been providing wide - range of modern banking services through 28 points of representations located in various urban and semi urban part of the country, 19 outside and 9 inside the valley. The bank is pioneer in providing some of the latest / lucrative banking services like E-Banking and SMS Banking services in Nepal. The bank always focus on building sound technology driven internal system to cater the changing needs of the customers that enhance high comfort and value. The adoption of modern Globus

Software, developed by Temenos NV, Switzerland and arrangement of centralized data base system enables customer to make highly secured transactions in any branch regardless of having account with particular branch. Similarly the bank has been providing 365 days banking facilities, extended banking hours till 7 PM in the evening, Utility Bill Payment Services, Inward and Outward Remittance services, Online remit Services and various other banking services.

Visa Electron Debit Card, which is accessible in entire VISA linked ATMs (including 30 own ATMs) and POS (Point of Sale) terminals both in Nepal and India, has also added convenience to the customers. The bank has been able to get recognition as an innovative and fast growing institution striving to enhance customer value and satisfaction by backing transparent business practice, professional management, corporate governance and total quality management as the organizational mission.

The key focus of the bank is always center on serving unfulfilled needs of all classes of customers located in various parts of the country by offering modern and competitive banking products and services in their door step. The bank always prioritizes the priorities of the valued customers.

10. Nepal Credit and Commerce Bank Limited (NCC):

Nepal Credit & Commerce Bank Ltd. (NCC Bank) formally registered as Nepal - Bank of Ceylon Ltd. (NBOC), commenced its operation on 14th October, 1996 as a Joint Venture with Bank of Ceylon, Sri Lanka. It was the first private sector Bank with the largest authorized capital of NRS. 1,000million. The Head Office of the Bank is located at Siddhartha Nagar, Rupandehi, the birthplace of **LORD BUDDHA**, while its Corporate Office is placed at Bagbazar, Kathmandu. The name of the Bank was changed to Nepal Credit & Commerce Bank Ltd., (NCC Bank) on 10th September, 2002, due to transfer of shares and management of the Bank from Bank of Ceylon, an undertaking of Government of Sri Lanka to Nepalese Promoters.

At present, NCC Bank provides banking facilities and services to rural and urban areas of the country through its 18 branches. The Bank has developed corresponding agency relationship with more than 150 International Banks having worldwide network.

1.7.3 Data collection methods

The necessary information and data are collected from different sources. The study is primarily based on the secondary data. Most of the data are collected from quarterly report and official report of concerned organization. Some data and information are collected directly visiting their office and some are collected through their official website. Similarly other supplementary information are collected from the ministry of finance, depart of industry, commerce and supplies, economic survey published by Nepal government, quarterly economic bulletin published by Nepal Rastra Bank (NRB), national planning commission, and Security Board Nepal (SEBON) with the help of their official internet web site. Also, for other related information, various books and periodicals have been referred from library and some that the researcher self has. The nature of this analysis is secondary data based. Financial information collection of all companies through primary method is almost impossible. Because a researcher may not have sufficient knowledge to prepare and analyses all financial statement, similarly it is a project work prepared for academic purpose so I have time limitation also.

1.7.4 Data analysis tools

Before analyzing the data, the data and information have been presented systematically in the formats of Tables, Graphs and Charts which will explain a lot about the data and information collected. Analysis is the systematic and careful examination of available fact so that certain conclusions can be drawn from it. The major part of the study is based on to analyze stock price behavior. Mere presentation of data is not enough to analyze stock price behavior unless it is further proceed. Many mathematical and statistical tools have been developed to process relevant data to reach a conclusion. In this study both statistical and financial tools have been used to analyze and interpret the relevant data so that meaningful conclusions can be drawn.

1.7.4.1 Financial tools

Ratio analysis is the best tool for financial analysis. Ratios can be taken as expression of relationships between two items or group of items and therefore may be calculated in any number and ways so far meaningful co-relationship is obtainable.

Pandey (1995) emphasizes that a ratio is used as a benchmark for evaluating the financial position and performance of a firm.

The following ratios related to the banks are used to analyze the data:

i. Earnings per share (EPS)

EPS is the portion of a company's profit allocated to each outstanding share of common stock. It serves as an indicator of a company's profitability. Earnings per share are generally considered to be the single most important variable in determining a share's price. The profitability of a firm from the point of view of the ordinary shareholders is the EPS. It measures the profit available to the equity holders on a per share basis, i.e. the amount that they can get on every share held. It is calculated by dividing the profit available to the shareholders by the number of outstanding shares. The profits available to the ordinary shareholders are represented by net profits after taxes and preference dividends. EPS is closely watched by the investing public and is considered an important indicator of corporate success.

The EPS is calculated as,

$$\text{EPS} = \frac{\text{Net income- Dividends on preferred stocks}}{\text{Average No. of shares outstanding}}$$

An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment) – that company would be more efficient at using capital to generate income and all other things being equal would be a “better” company. Investors also need to be aware of earnings manipulation that will affect the quality of the earnings numbers. It is important not to rely on any one financial measure, but to use it in conjunction with statement analysis and other measure.

ii. Return on total assets (ROA)

An indicator of how profitable a company is relative to its total assets. At this movement this profitability ratio is measured in terms of the relationship between the net profits and assets. Calculated by dividing a company's annual earning by its total assets, ROA is displayed as a percentage. The ROA may also be called profit to assets ratio. It measures the overall effectiveness of management in generating profits with its available assets. The higher the firms return on total assets, the better. The return on total assets is calculated as follows:

$$\text{Return on Total Assets} = \frac{\text{Net profit after tax}}{\text{Total Assets}}$$

ROA gives an idea as to how efficient management is at using its assets to generate earnings. Sometimes this is referred to as "return on investment".

iii. Capital Adequacy Ratio (CAR)

Capital adequacy ratio is the foremost tool to analyze the capital fund of a bank. Actually, the fundamental objective of this research study is to examine capital adequacy of sampled banks.

The capital adequacy ratio is based on total risk-weighted assets (TRWA) of the bank. Capital adequacy ratios are a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. This ratio is used to examine adequacy of total capital fund and core capital, which is yielded by the following formulas:

To measure the adequacy of total capital fund:

$$\frac{\text{Total Capital Fund}}{\text{TRWA}} \times 100\%$$

To measure the adequacy of core capital:

$$\frac{\text{Core Capital}}{\text{TRWA}} \times 100\%$$

iv. Price earnings ratio (P/E ratio)

Price earnings ratio is the relationship between earning per share and market price of the stock. A valuation ratio of a company's current share price compared to its per share earnings. The P/E ratio reflects the price currently being paid by the market for each rupee of currently reported EPS. P/E ratio can be calculated as follows:

$$\text{P/E ratio} = \frac{\text{Market price of a share}}{\text{Earnings per share}}$$

In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E.

Liquidity ratio (CRR)

Liquidity is the management of liquid assets and liquid liabilities in such a way that can easily meet all legitimate demands for funds without interruption for minimizing costs. So that the organization can easily grab the opportunity and can face with threats. Managing liquidity is absolutely essential to the survival of an organization.

This research is concerned with analyzing the financial statement of commercial banks (financial institutions). So liquidity represents the cash with bank (vault cash) and cash at central bank (cash reserve ratio (CRR)). In this context, the research is focused on to analyze the CRR. As per the NRB directives 5.5% CRR is necessary for eligibility. The following formula is used to calculate the CRR:

$$\text{Cash Reserve Ratio (CRR)} = \frac{\text{Cash deposit in central bank}}{\text{Total deposit collection}}$$

v. Dividend in Share Capital Ratio

Dividends are a form of profit distribution to the shareholder. Having a growing dividend per share can be a sign that the company's management believes that the growth can be sustained.

Dividends in the portion of profit that is ready to be available for shareholders. A part of the net profit belonging to equity shareholders is retained in the business and the balance is paid them as dividends. The dividend paid to the shareholders on a per share basis is the DPS. In other words, DPS is the net distributed profit belonging to the shareholders divided by the number of ordinary shares outstanding. The dividend in share capital ratio is calculated as two fold i.e. total dividend with bonus to share capital and cash dividend to share capital. We use the first one i.e. dividend with bonus to total equity share capital. It is also calculated on per share basis. That is:

$$\text{Dividend in share capital} = \frac{\text{Dividend per share}}{\text{Book value per share}}$$

Dividends are a form of profit distribution to the shareholder. Having a growing dividend in share capital ratio can be a sign that the company's management believes that the growth can be sustained.

1.7.4.2 Statistical Tools

The following statistical tools are used to analyze the data:

a) Arithmetic mean

The arithmetic mean is the sum of the observations divided by the number of observations. It is average of a series obtained by dividing the total values of the various items by their number. The mean of a set of numbers, $X_1, X_2, X_3, \dots, X_n$ is typically denoted by "x bar" (\bar{X}) is given by:

$$\bar{X} = \frac{\sum X}{N}$$

Where,

$\sum X$ = sum of observations

N = number of observations

a) Standard deviation:

The standard deviation is the positive square root of the mean of the square of the deviations about the mean. Standard deviation is the best measure of dispersion because

- It is based all observations.
- Deviations are taken from mean.
- Algebraic sign of each deviation is considered.

The standard deviation of the set of observations is calculated by the following formula:

$$\text{Standard deviation ()} = \sqrt{\frac{(\bar{X}-X)^2}{n}}$$

b) Karl Pearson Correlation analysis:

It is statistical relationship between two or more random variables or observed data values. Correlation analysis is necessary in order to find out whether the selected variables in time series have any relation or not. Correlation analysis establishes the closeness of relationship between or mere variables. It measures the degree of relationship or association between variables. Karl Pearson's Coefficient of correlation is used to measure the degree of association among the variables. The formula used to calculate the coefficient of correlation is as:

$$r = \frac{N \sum XY - (\sum X)(\sum Y)}{[\sum X^2 - (\sum X)^2] [\sum Y^2 - (\sum Y)^2]}$$

Where,

N = Numbers of pairs in observation

X = Product of the first variable

Y = Product of the second variable

To ease the calculation, a shortcut formula has been proposed which has been used in to calculate correlation coefficients in this thesis report. The shortcut formula is as follows:

$$r(X,Y) = \frac{\sum xy}{\sqrt{\sum x^2} \cdot \sqrt{\sum y^2}}$$

Where,

$$x = (X - \bar{X})$$

$$y = (Y - \bar{Y})$$

The value of correlation coefficient ranges between -1 and +1. Following rules are available in interpreting the value of correlation coefficient:

- When $r = 0$, the variables are uncorrelated.
- When r falls between 0 to +1, two variables are increasing or decreasing to the same direction.
- When r ranges between 0 to -1, two variables are increasing or decreasing to the opposite direction.
- When $r = +1$, it indicates there is perfect positive relationship between the variables.
- When $r = -1$, it means there is perfect negative correlation between the two variables.

d) Test of Hypothesis

The calculated correlation coefficients have been used to test the hypothesis as proposed in Chapter 1 by using the following t-test formula:

$$t = \frac{r \sqrt{n-2}}{\sqrt{1-r^2}}$$

Where,

r = calculated correlation coefficient

n = number of observations

The hypotheses have been tested with at a 95% level of confidence.

1.8 Limitations of the study

Nepal as being a least developed country, the stock market is in developing phase. It is not perfect as like as in the developed countries. Due to the lack of adequate infrastructure, limited activities of stock exchange limited, the trend of insufficient & late information dissemination, lack of technical expertise in investor as well as in broker the development of secondary market has remained in floor.

Regarding various problems, the study is mainly concerned with the relationship between financial information (earning per share) and market price per share. The main limitations are as follows: Time constraint is the main limitation of this study. This thesis must be submitted within the prescribed time frame by the course of study of Master of Business Studies (MBS) under the Tribhuvan University.

- This study is mainly based on few sample banks listed in the NEPSE. So it might not represent the overall study of capital marker and can't be generalized.
- This study is done for eight quarter of two fiscal year's transaction (2009/10 – 2010/11), it may not reflect the true picture.
- Balance sheets, profit & loss accounts and other financial statements are considered as basic source of data. Thus, the study is mainly based on the secondary data collected from various sources.
- It is also limited to analyze these problems that directly affect a stock price and also stock market.
- For the literature review various newspapers, journals, unpublished thesis works and nevertheless the internet have been referred. However, the literature review has been limited to very few articles and research works due to unavailability of sufficient such matters even after very hard quest.
- Earnings per Share are used as the representative of whole financial information. Lack of sophisticated technology limit the area of study and many financial tools can't be applied.

1.9 Organization of the report

The organization of the thesis report comprises a total of four chapters which have been briefly described as follows:

Chapter 1: Introduction

To start the this report, this chapter includes the background of the study, meaning (capital market & financial information), development of security market, focus of the study, statement of the problem, theoretical framework, problem hypothesis, objective of the study, research methodology, limitation of the study, organization of the study. This chapter has been targeted to help the reader to understand get the rhythm of the subject matter of the thesis report.

Chapter 2: Literature Review

This chapter includes the conceptual review, review of financial market, NEPSE, financial information and its impact on share price movement. This chapter reviews the existing literature. For this purpose, various books, journals and periodicals as well as internet have been utilized.

Chapter 3: Data Analysis and Presentation

This chapter illustrates the collected data into a systematic format. The analysis of these data using various financial and statistical tools is also included in this chapter. As well as, interpretation of analysis has also been done in this chapter.

Chapter 4: summary, conclusion, and recommendations

In this chapter, the summary of the entire thesis has been comprised. This chapter further describes the major findings of the thesis. Conclusions of the study have also been included in this chapter. As well as, possible and viable recommendations has also been presented in this chapter.

**CHAPTER 2:
REVIEW OF LITERATURE**

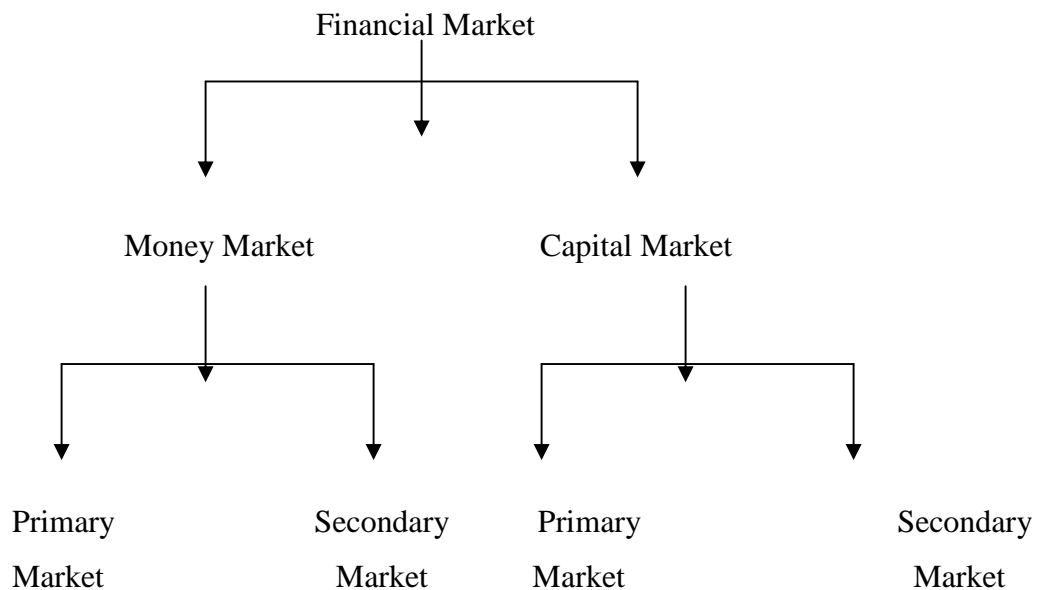
2.1 Conceptual Review

2.1.1 Overview of Financial institutions:

Financial institutions are those institutions that perform the essential function of channeling funds from those with surplus funds (supplier of funds) to those with shortage of funds (users of funds). Some of the examples of FIs are commercial banks, saving banks, thrifts, insurance companies, securities firms and investment banks, finance companies, mutual funds, pension funds etc.

2.1.2 Financial Market

Financial markets play a fundamental role in the economic development of a country. They are the intermediary link in facilitating the flow of funds from savers to investors. By providing an institutional mechanism for mobilizing domestic savings and efficiently channeling them into productive investments, they lower the cost of capital to investors and accelerate economic growth of the country. Components of financial market are shown with the help of following figure:



2.1.3 Money Market:

Money markets exist to transfer funds from individuals, corporations and government units with short term excess funds (suppliers of funds) to economic agents who have short-term needs for funds (users of funds). Specially, in money markets, short term debt instruments (those with an original maturity of one year or less) are issued by economic units that require short term funds are purchased by economic units that have excess short term funds. Once issued, money market instruments trade in active secondary markets. Market participants who concentrate their investments in capital market instruments also tend to invest in some money market securities so as to meet their short term liquidity needs. The secondary markets for money market instruments are extremely important, as they serve to reallocate the (relativity) fixed amounts of liquid funds available in the market at any particular time.

The need for money markets arises because the immediate cash needs of individuals, corporations, and governments do not necessarily coincide with their receipts of cash. For example, the Nepal government collects taxes quarterly: however, its operating and other expenses occur daily. Similarly corporation's daily patterns of receipts from sales do not necessarily occur with the same pattern as their daily expenses (e.g. wages and other disbursements). Because excessive holdings of cash balances involve a cost in the form of foregone interest, called opportunity cost, those economic units with excess cash usually keep such balances to the minimum needed to meet their day-to-day transaction requirements. Consequently, holders of cash invest "excess" cash funds in financial securities that can be quickly and relatively in low cost which can easily converted back to cash when needed with little risk of loss of value over the short investment horizon. Money markets are efficient in performing this service in that they enable large amounts of money to be transferred from suppliers of funds to users of funds for short periods of time both quickly and at low cost to the transacting parties. In general, a money market instrument provides an investment opportunity that generates a higher rate of interest (return) than holding cash, but it is also very liquid and (because of its short maturity) has relatively low default risk.

Notice, from the description above, the money markets and money market securities or instruments have three basic characteristics.

First, money market instruments are generally sold in large denominations (often in units of \$1million to \$10millions). Most money market participants want or need to borrow large amount of cash. So that transactions cost are low relative to the interest paid. The size of the initial transactions prohibits most individual investors from investing directly in money market securities. Rather, individuals generally invest in money market securities indirectly, with the help of financial institutions such as money market mutual funds or short-term funds.

Second, money market instruments have low default risk; the risk of late or non-payment of principal and /or interest is generally small. Since cash lent in money markets must be available for a quick return to the lender, money market instruments can generally be issued only by high-quality borrowers with little risk of default.

Finally, money market securities must have an original maturity of one year or less. The longer the maturity of a debt security, the greater is its interest rate risk and the higher is its required rate of return. Given that adverse price movement resulting from interest rate changes are smaller for the short term securities, the short term maturity of money market instruments helps lower the risk that interest rate changes will significantly affect the security's market value and price.

Money Market Instruments or Securities

1.Treasury Bills:

Treasury Bills (T-Bills) are short term obligations or the government issued to cover current government budget shortfalls (deficits) and to re-finance maturing government debt. It is also known as a tool of central bank in conducting monetary policy through open market operations.

2.Federal Funds:

Federal funds (fed funds) are short-term fund transferred between financial institutions, usually for a period of one day. For example, commercial banks trade fed funds in the form of excess reserves held at their local central bank. That is one

commercial bank may short of reserves, requiring it to borrowed excess reserves from another bank that has a surplus. The institution that borrows fed funds incurs a liability on its balance sheet “federal funds purchased”, while the institutions that lends the fed funds records an asset, “federal funds sold”. The overnight (or any day) interest rate for borrowing fed funds is the federal fund rate. The fed funds are a function of the supply and demand for federal funds among financial institutions.

3.Repurchase Agreement:

A repurchase agreement (repo or Rp) is an agreement involving, the sale of securities by one party to another with a promise to repurchase the securities at a specified price and on a specified date in the future. Thus, a repurchase agreement is essentially a collateralized fed funds loan, with the collateral backing taking the form of securities. The securities used most often in repos are U.S Treasury Securities (e.g., T-bills) and government agency securities (e.g. Fannie Mae). A reverse repurchase agreement (reverse repo) is an agreement involving the purchase (buying) of securities by one party from another with the promise to sell them back at a given date in the future. Because the parties in every repurchase agreement transaction have opposite perspectives, the terms repo and reverse repo can be applied to the same transaction. That is, a given transaction is a repo from the point of view of the securities seller and a reverse repo from the point of view of the securities buyer. Whether a transaction is termed a repo or a reverse repo generally depends on which party initiated the transaction. Most repos have very short-term maturity (generally from 1 to 14 days), but there is a growing market for longer term 1-to 3 months repos.

Many commercial firms, while idle funds in their deposit accounts at banks, use repos as a way to earn a small return until these funds are needed. In this case the firm uses its idle funds to buy T-bills from its bank. The bank then agrees to repurchase the T-bill in the future at a higher price. However most repos are collateralized fed funds transactions entered into by banks. As discussed above, in a fed funds transaction, the bank with excess reserve sells fed funds for one day to the purchasing bank. The next day, the purchasing bank returns the fed funds plus the one day’s interest reflecting the fed funds rate. Since there is a credit risk exposure to the selling bank in that the

purchasing bank may be unable to repay the fed funds the next day, the selling bank may seek collateral backing for the one-day loan of fed funds. In a repos transaction, the funds selling bank receives government securities as collateral from the funds purchasing bank. That is, the funds purchasing bank temporarily exchanges securities for cash. The next day, this transaction is reversed, with the funds borrowed plus interest (the repo rate); it receives in return, or purchases, its securities uses as collateral in the transaction.

4.Negotiable Certificates of Deposits:

Negotiable Certificates of Deposit (CD) is a bank issued time deposit that specifies an interest rate and maturity date and is negotiable (i.e. salable) in the secondary market. A negotiable CD is a bearer instrument - whoever holds the CD when it matures receives the principal and interest. A negotiable CD can be traded any number of times in secondary markets; therefore, the original buyer is necessarily the owner at maturity. The large denominations make negotiable CDs too large for most individuals to buy. However, negotiable CDs are often purchased by money market mutual funds, which pool funds of individual investors and allow this group to indirectly purchase negotiable CDs. Negotiable CD maturities range from two weeks to one year, which must having a maturity of one to four months.

5.Bankers' acceptances:

A banker's acceptance is a time draft payable to a seller of goods, with payment guaranteed by a bank. Time drafts issued by a bank are orders for the bank to pay a specified amount of money to the bearer of the time draft on a given date.

Many bankers' acceptances arise from international trade transactions and the underlying letters of credit (or time drafts) that are used to finance trade in goods that have yet to be shipped from a foreign exporter (seller) to a domestic importer (buyer). Foreign exporters often prefer that banks act as guarantors for payment before sending goods to domestic importers, particularly when the foreign supplier has not previously done business with the domestic importer on a regular basis. Bank insures the international transaction by stamping "accepted" on a time draft written against the letter of credit between the exporter and importer, signifying its obligation to pay the foreign

exporter (or its bank) on a specified date should the importer fail to pay for the goods. Foreign exporters can then hold the banker's acceptance (the accepted time draft written against the letter of credit) until the date specified on the letter of credit. If they have an immediate need for cash, they can sell the acceptance before that date at a discount from the face value to a buyer in the money market (e.g., a bank). In this case, the ultimate bearer will receive the face value of the banker's acceptance on maturity.

Having reviewed the different money market securities has a number of characteristics in common: large denominations, low default risk, and short maturities. It should also be noted that these securities are quite different in terms of their liquidity. For example, Treasury Bills have an extensive secondary Market. Thus, these money market securities can be converted into cash quickly and with little loss in value. Commercial paper, on the other hand, has no organized secondary market. These can't be converted cash quickly unless resold to the original dealer/underwriter, and conversion may involve a relatively higher cost. Federal funds also have no secondary market trading, since they are typically overnight loan transactions and are not intended as investments to be held beyond very short horizons (thus, the lack of a secondary market is inconsequential). Indeed, longer-horizon holders simply roll over their holdings or, in the case of those in need of liquidity, simply do not renew their fed funds loans. Bank negotiable CDs can also be traded on secondary markets, but in recent years trading has been relatively inactive; as most negotiable CDs are being bought by "buy and hold" oriented money market mutual funds, as are bankers' acceptances.

6. Commercial Paper:

Commercial paper is an unsecured short-term promissory note issued by a corporation to raise short-term cash, often to finance working capital requirements. Commercial paper is the largest of the money market instruments. One reason for such large amounts of commercial paper outstanding is that companies with strong credit ratings can generally borrow money at a lower interest rate by issuing commercial paper than by directly borrowing (via loans) from banks. Commercial paper's maturities generally range from 1 to 270 days- the most common maturities are between 20 and 45 days. This 270 days maximum is due to a securities and exchange commission (SEC) rule

that securities with a maturity more than 270 days must go through the time-consuming and costly registration process to become a public debt offering (i.e., a corporate bond). Commercial paper can be sold directly by the issuer to a buyer such as a mutual fund (a direct placement) or can be sold indirectly by dealers in the commercial paper market.

2.1.4 Capital Market:

Capital markets are markets that trade equity (stock) and debt (bonds) instruments with maturities of more than one year. The major suppliers of capital market securities (or users of funds) are corporations and governments. Households are the major supplier of funds for these securities. Given their longer maturity, these instruments experience wider price fluctuation in the secondary markets in which they trade than do money market instruments. For example, all else constant, long-term maturity debt instruments experience wider price fluctuations for a given change in interest rates than short-term maturity debt instruments.

Capital market is further classified into Bond Markets, Mortgage Markets, Foreign Exchange Markets, Stock Markets and derivatives Securities Markets. Each of the categorized capital market is described in detail as follow:

1. Bond Markets:

Bonds are long-term debt obligations issued by corporations and government units. Proceeds from a bond issue are used to raise funds to support long-term operations of issuer (e.g., for capital expenditure projects)/ in return for the investor's funds, bond issuers promise to pay a specified amount in the future on the maturity of the bond (the face value) plus coupon interest on the borrowed funds (the coupon rate times the face value of the bond). If the terms of the payment are not met by the bond issuer, the bond holder (investor) has a claim on the assets of the bond issuer.

Bond markets are markets in which bonds are issued and traded. They are used to assist in the transfer of funds from individuals, corporations, and government units with excess funds to corporations and government units in need of long-term debt funding. Bond markets are traditionally classified into three types:

- Treasury notes and bonds
- Municipal bonds
- Corporate bonds

2.Mortgage Market:

Mortgages are loans to individuals or business to purchase a home, land or other real property. Many mortgages, particularly residential mortgages, are subsequently securitized by the mortgage holder-they are packaged and sold as assets backing a publicly traded or privately held debt instrument. Securitization allows financial instruments asset portfolios to become more liquid, reduces interest rate risk and credit risk, provides FI's with a source of fee income, and helps reduce the effects of regulatory constraints such as capital requirements, reserve requirements, and deposit insurance premiums on FI profits.

The mortgage market is examined separately from bond and stock markets for several reasons. First, mortgages are backed by a specific piece of real property. If the borrower defaults on a mortgage, the financial institution can take ownership of the property. Only mortgage bonds are backed by a specific piece of property that allows the lender to take ownership in the event of a default. All other corporate bonds and stocks give the holder a general claim to a borrower's assets. Second, there is no set size or denomination for primary mortgages. Rather, the size of each mortgage depends on the borrower's need and ability to repay. Third, primary, mortgage generally involve a single investor (e.g., a bank or mortgage company). Bond and stock issues, on the other hand, are generally held by many (sometimes thousands of) investor. Finally, because primary mortgage borrowers are often individuals, information on those borrowers is less extensive and unaudited. Bonds and stocks are issued by publicly traded corporations that are subject to extensive rules and regulations regarding information availability and reliability.

3.Foreign Exchange Market:

In addition to understanding the operations of domestic financial markets, a financial manager must also understand the operations of foreign exchange markets and

foreign capital markets. Today's leading companies are operating globally. It is therefore essential that financial managers understand how events and movements in financial markets in other countries affect the profitability and performance of their own companies. Foreign trade would not be possible without a market where investors can easily buy and sell foreign currencies. Additionally, as firms and investors increase the volume of transactions in foreign currencies, hedging foreign exchange risk has become a more important activity. Financial managers, therefore, must understand how events in other countries in which they operate affect cash flows received from or paid to other countries and thus their company's or FI's profitability. Foreign exchange markets are the markets in which traders of foreign currencies transact most efficiently and at the lowest cost. As a result, foreign exchange markets facilitate foreign trade, facilitate raising capital in foreign markets, facilitate the transferring of risk between participants, and facilitate speculation on currency value.

Cash flow from sale of products, securities, or assets denominated in a foreign currency are transacted in foreign exchange (FX) markets. A foreign exchange rate is the price at which one currency (e.g., U.S. dollar) can be exchanged for another currency (e.g., NRs) in the foreign exchange markets. The actual amount of U.S. dollars received on a foreign transaction depends on the (foreign) exchange rate between the U.S. dollar and the foreign currency when the non-dollar cash flow is received (and exchanged for U.S. dollars) at some future date. If the foreign currency declines or (depreciates) in value relative to the U.S. dollar over the period between the time foreign investment is made and the time it is liquidated, the dollar value of the cash flows received will fall. If the foreign currency rises (or appreciates) in value relative to the U.S. dollar, the dollar value of the cash flows received on the foreign investment increases.

4. Stock Market:

Stock markets allow suppliers of funds to efficiently and cheaply get equity funds to public corporations (users of funds). In exchange, the fund users (firms) give the fund suppliers ownership rights in the firm as well as cash flows in the form of dividends. Thus, corporate stock or equity serves as a source of financing for firms, in addition to debt financing or retained earnings financing. Legally, holders of a corporation's

common stock or equity have an ownership stake in the issuing firm that reflects the percentage of the corporation's stock they hold, specially, corporate stockholders have the right to a share in the issuing firm's profits, as in dividend payments, after the payment of interest to bond holders and taxes. They also have a residual claim on the firm's assets if the company fails or is dissolved after all debt and tax liabilities are paid. Bond holders, on the other hand, are creditors of the issuing firm. They have no direct ownership interest in the firm, but they have a superior claim to the firm's earning and assets relative to that of stockholders.

Further, common stockholders have voting privileges on major issues in the firm such as the election of the board of directors. It is the board of directors that oversees the day-to-day operations of the firm. The board is charged with ensuring that the firm is being run so as to maximize the value of the firm (i.e., the value of its equity and debt claims). Thus while stockholders have no direct control over a firm's day-to-day operations, they do decide on who will oversee these operations and they can replace the board when they feel the firm is not being run efficiently from a value-maximizing perspective.

The secondary market for corporate stock is the most closely watched and reported of all financial security markets. Daily television and news paper reports include recaps of the movements in stock markets (both in the developed and developing world). This is because stock market movements are sometimes seen as predictors of economic activity and performance. This is also because corporate stocks may be the most widely held of all financial securities. Most individuals own stock either directly or indirectly through pension fund and mutual fund investments, and thus their economic wealth fluctuates closely with that of the stock market.

Stock Market Securities or Instruments:

Two types of corporate stock exist: common stock and preferred stock. While all corporations issue common stock, many do not offer preferred stock. Both types of stock offer investor a two- part rate of return. The first part is capital gains if the stock appreciates in price over time. The second part is periodic (generally quarterly) dividend payments to the stock holder. Preferred stock dividends are generally present at a fixed

rate, while common stock dividends vary over time and are thus more uncertain. Return to stockholder over a period is calculated as follow:

$$\frac{P1-P0}{P0} + \frac{D1}{P0} \quad \text{Or} \quad \frac{Pt-Pt-1}{Pt-1} + \frac{Dt}{Dt-1}$$

i. Common Stock:

Common stock is the fundamental ownership claim in a public corporation. Many characteristics of common stock differentiate it from other types of financial securities (e.g., bonds, mortgages, preferred stock). This includes- 1) discretionary dividend payments, 2) residual claim status, 3) limited liability, and 4) voting rights. These characteristics are described next.

Dividends:

While common stockholders can potentially receive limited dividend payments if the firm is highly profitable, they have no special or guaranteed dividend rights. Rather, the payment and size of dividends are determined by the board of directors of the issuing firm (who are elected by the common stockholders). Further, unlike interest payments on debt, corporation doesn't default if it misses a dividend payment to common stockholders. Thus common stockholders have no legal recourse if dividends are not received, even if a company is highly profitable and choose to use these profits to reinvest in new projects and firm growth. Another drawback with common stock dividends, from investors' points of view, is that they are taxed twice-once at the firm level (at the corporate tax rate, by virtue of the fact that dividend payments are tax deductible from the firm's profit or net earnings) and once at the personal level (at the personal income tax rate). Investors can particularly avoids this double taxation effect by holding stocks in growth firms that reinvest most of their earnings to finance growth rather than paying larger dividends. Generally, earnings growth leads to stock price increases. Thus, stockholders can sell their stock for profit and pay capital gains tax rather than ordinary income in the form of dividends.

Residual Claim:

Common stockholders have the lowest priority claim on a corporation's asset in the event of bankruptcy—they have residual claim. Only after all senior claims are paid (i.e., payments owed to creditors such as the firm's employees, bondholders, the government (taxes), and preferred stockholders) are common stockholders entitled to what assets of the firm are left. The residual claim feature associated with common stock makes it riskier than bonds as an investable asset.

Limited Liability:

One of the most important characteristics of common stock is its limited liability feature. Legally, limited liability implies that common stockholder losses are limited to the amount of their original investment in the firm, if the company's asset value falls to less than the value of the debt it owes. That is, the common stockholder's personal wealth held outside their ownership claims in the firm are unaffected by bankruptcy of the corporation—even if the losses of the firm exceed its total common stock ownership claims. In contrast, sole proprietorship or partnership stock interests mean the stockholders may be liable for the firm's debts out of their total private wealth holdings if the company gets into financial difficulties and its losses exceed the stockholders ownership claims in the firm. This is the case of “unlimited” liability.

Voting Rights:

A fundamental privilege assigned to common stock is voting rights. While common stockholders do not exercise control over the firm's daily activities, they do exercise control over the firm's activities indirectly through the election of the board of directors.

ii. Preferred Stock:

Preferred stock is a hybrid security that has characteristics of both a bond and common stock. Preferred stock is similar to common stock in that it represents an ownership interest in the issuing firm, but like a bond it pays a fixed periodic (dividend) payment. Preferred stock is senior to common stock but junior to bonds. Therefore,

preferred stockholders are paid only when profits have been generated and all debt holders are paid). Like common stock, if the issuing firm does not have sufficient profits to pay the preferred stock dividends, preferred stockholders cannot force the firm into bankruptcy. Further, if the issuing firm goes bankrupt, preferred stockholders are paid their claim only after all creditors have been paid, but before common stockholders are paid.

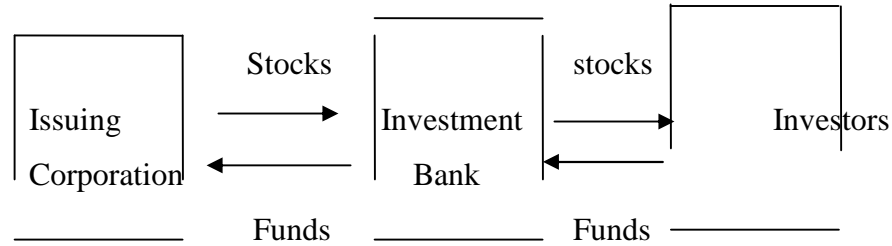
Dividends on preferred stock are generally fixed (paid quarterly) and are expressed either as a Rs. amount or a percentage of the face or par value of the preferred stock. Preferred stockholders generally do not have voting right in the firm. An exception on this rule may exist if the issuing firm has missed a promised dividend payment. Typically, preferred stock is non-participating and cumulative. Non-participating preferred stock means that the preferred stock dividend is fixed regardless of any increase or decrease in the issuing firm's profits. Cumulative preferred stock means that any missed dividend payments go into arrears and must be made up before any common stock dividends can be paid.

Primary and secondary stock market:

Before common stock can be issued by a corporation, shares must be authorized by a majority vote of both the board of directors and the firm's existing common stockholders. Once authorized, new shares of stock are distributed to existing and new investors through a primary market sale with the help of investment banks. Once issued, the stocks are traded in secondary stock markets (such as the NYSE, NASDAQ, and NEPSE etc.).

Primary market:

Primary markets are markets in which corporations raise funds through new issues of stocks. The new stock securities are sold to initial investors (suppliers of funds) in exchange for funds (money) that the issuer (user of funds) needs. As illustrated in the following figure:



Most primary market transactions go through investment banks, which serve as the intermediary between the issuing corporations (fund users) and ultimate investors (funds suppliers) in securities.

Like the primary sale of bonds, the investment bank can conduct a primary market sale of stock using a firm commitment underwriting (where investment bank guarantees the corporation a price for newly issued securities by buying the whole issue at a fixed price from corporate issuer) or a best efforts underwriting basis (where the underwriter does not guarantee a price to the issuer and acts more as a placing or distribution agent for a fee). In a firm commitment underwriting, the investment bank purchases the stock from the issuer for a guaranteed price (called the net proceeds) and resells them to investors at a higher price (called the gross proceeds). The difference between the gross-proceeds and the net proceeds (called the underwriter's spread) is compensation for the expenses and risks incurred by the investment bank with the issue.

In Nepal, to issue the securities in primary market, firm should follow company act. The act has briefly specified the process of issuing prospectus. Prospectus is useful for investor to collect the information regarding investing companies.

During stock market boom in our country, many public limited companies such as Jyoti Spinning Mill, Butwal Dhago, Unilever Nepal, Agro Nepal, Himgiri Textile, Gorakhkali Rubber etc. have issue shares to finance their project and become successful to record over subscription. Even though these companies are being successful in tapping funds from primary market but they are unable to satisfy their investors, except, Nepal Lever (Unilever Limited) market price of stock is not satisfactory. However, at present, there is gaining of public confidence due to overwhelming demand for primary issues of Sanima Development Bank, Global Bank, Sunrise Bank and so on.

Most primary market transactions are arranged through financial institutions called investment banker. For example, NIDC capital market, Nepal. Merchant Banking and Finance Ltd. plays the role of investment bankers in our country.

Role and Function of Investment Bankers:

The investment bankers differ from traditional commercial bankers whose main functions includes accepting deposits from the public and invest those deposits to the public. The main function of investment banker is to create market for new issuer. Investment bank is an important financial institution that assists in the initial sale of securities in the primary market. It does this by underwriting securities and also created underwriters. It guarantees a price for a corporation's securities and then sale them to the public. Investment bankers offer three basic services:

i. Advice and counsel:

The investment bank provides the security issuer (the user of funds) with advice on securities issue such as the offer price and number of securities to issue and attract the initial purchaser. By issuing primary market securities with the help of an investment bank, the fund user saves the risk and cost of creating a market for its securities on its own.

ii. Underwriting:

Once the investment bank has determined the type of security, price, issue date, and any special features, the issue is ready to market to the public. If he investment banking firm underwrites the securities, it agrees to purchase the securities in the hope of re-selling them at a higher price to the public. The difference between purchase price and selling price is known as spread. Size of spread varies with the type of issue (e.g., bonds have a smaller spread than common stocks).

If investment banking firm acts only as an agent, it assumes no obligation to purchase any of the securities. This is known as best-efforts-offering. Under this, the investment banker does not underwrite the issue but they try more to sell the issue to the public. All unsold securities are returned to the issuer. Best-efforts-offerings are usually

followed by small firms, where risk of underwriting is too great, or for well-known firms that are confident the public will purchase their securities.

iii. Distribution:

Investment bankers can distribute securities to investor in different ways. The investment banker may purchase the issue and then sell the securities (an underwriting) or, the investment banker may simply act as an intermediary in bringing together issuer and investors in a private placement.

Methods of issuance of security in primary market:

In primary market securities are sold in the following way:

i. Initial Public Offering (IPO):

Initial Public Offering is the first public issue of financial instruments by a firm. In other term it is a first time sale of common stock by an issuer to the public. In IPO any individual or corporation can allow to purchase the securities. In this provision issuer most follow the legal formalities and they should publish the objectives, plan, policy, strategy, strength, weakness, and opportunities of the firm (fund user). Public offering shares are listed on the exchange market.

ii. Private placement:

Rather than public offering, a primary market sale can take the form of private placement. With a private placement, the securities issuer (funds user) sold the securities to the particular investor such as institutions (pension fund) or individual. Privately placed securities have traditionally been among the most illiquid securities, with only the very largest financial institutions or institutional investors being able to or willing to buy and hold them. Privately sold securities are not listed and traded on stock exchanges and there is risk of liquidity and lack of confidence.

iii. Right offering:

Right offering is mechanism of selling securities (common stock) only to the existing shareholders. In other terms in right offering existing shareholders are allowed to purchase new issue according to proportionate of already purchased stock.

Secondary Market:

Secondary stock markets are the markets in which stocks, once issued, are traded- that is, bought and sold by investors. The New York Stock Exchange (NYSE), National Association of Securities Dealers Automated Quotation (NASDAQ), Nepal Stock Exchange (NEPSE), Hong Kong Stock Exchange, Tokyo Stock Exchange, Bombay Stock Exchange etc. are well-known example of secondary markets in stocks. When a transaction occurs in a secondary stock market, funds are exchanged, usually with the help of a securities broker or firm acting as an intermediary between buyer and the seller of the stock. The original issuer of the stock is not involved in this transfer of stocks or the funds.

The function of secondary markets is to provide liquidity for securities purchased in the primary markets. Once investors have purchased securities in the primary market they need a place to sell those securities. Without the secondary market, firm would have difficulty raising funds for productive purposes in the primary markets. The main purpose of secondary market is to make the financial instruments more liquid while securities are purchase and sell in the secondary market the issuer does not receive the funds. In other term in secondary market funds are transfer between buyer (investors) and seller only primary market flow the funds to the issuer or corporation. The advantage of secondary market is that the firm can sell new securities at high price. In other words, the higher the security's price in the secondary market, the higher will be the price that the issuing firm will receive for a new security in the primary market and thus the greater the amount of capital it can raise.

Secondary markets can be classified in to organized market (stock exchange market) and unorganized market (over the counter market).

a) Organized Market (Stock Exchange Market):

Organized stock exchange market is the secondary market in which buyers and sellers of securities (or their agents or brokers) meet in once central location to conduct trades.

An organized security exchange provides a fixed place at which trade in securities is made possible. The organized securities exchange is voluntary association that tries to maintain smooth operation of market. In other words organized exchanges are the central physical location where trading of the securities are done under a set of rules and regulations. Example of such exchanges are New York Stock Exchange (NYSE), and American Stock Exchange (AMEX) in united state, London Stock exchange (Britain), Tokyo Stock Exchange (Japan)' Bombay Stock Exchange (India) and Nepal Stock Exchange (NEPSE).

Features of organized stock exchange market

i. Autonomous corporation:

Organized stock exchange market is autonomous and an organized association. As it exists as an autonomous body, it does not need to be dependent on any external body. It has a legal status. It is thus also said that a company is an artificial person created by law. Though, company is not a natural person, it can yet function like a person. Law considers the company as a person. It derives all its authority from law. It is like a person, capable of holding property, incurring debts, and suing and be sued in its name.

ii. Voluntary association:

Organized stock exchange market is an absolutely voluntary organization. Any person can become a member of such organization and may also quit according to his desire.

iii. Physical location or trading floor:

The distinct feature of organized stock market is that it has certain location or trading floor for purchase and sale of securities. All transaction occurring on the exchanges occur at a specific place on the floor of the stock exchange called trading post.

iv. *Membership or seat:*

In an organized market securities are purchase and sale through its member. In order to be a member, one has to own seat by way of membership. The board is empowered to accept or reject the membership and only the person of sound financial position and higher public relationship are allowed to be members of exchange. The members are usually broker. For example, there are 1,444 members who own a seat most of the seat are owned by brokerage firms.

v. *Restriction on time:*

In an organized stock exchange market trading is occurred on particular place (trading floor) and time. Trading time for NEPSE is as follows:

Types of Trading	Days	Trading Time
) Regular trading	Sunday Thursday	11am to 3pm
) Odd lot trading	Monday Friday	2pm to 3pm

vi. *Involvement of specialist:*

Stock exchange market appoints at least one specialist. Specialist is one of the important member of the exchange specialists are responsible for maintaining a “fair and orderly market”.

vii. *Auction market:*

Stock exchange market is also known as Auction Market because their securities are purchase and sale through open out-cry system.

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

Markets that do not operate in a specific fixed location, rather transactions occur through telephone, wire transfer and computer network is called over-the-counter (OTC) market. OTC market is referred to unorganized market in the sense of having no physical place (building) or trading floor. Instead trading occurs over sophisticated telecommunications networks. Such network is called the National Association of Securities Dealers Automated Quotation system (NASDAQ).

In the OTC market generally securities of small business groups, banks, financial companies, and mutual funds. In addition most corporate municipal and government bonds are traded on OTC.

Features of OTC market:

i. *Negotiated or unorganized market:*

Over the counter market refers to all security transactions not taking place on the organized exchange. The OTC has no central location as the major and regional exchange do; instead, it is a network of broker dealers who deal (negotiate) for their own transaction with the help of telephone, computer, network, internet, wire transfer etc. for this reason; it is called negotiated or unorganized market.

ii. *Automated and self regulated market:*

In OTC market securities are purchased and sold on the basis of mutual understanding between buyers and sellers by the help of computer network. The members of OTC can make rules, regulations and code of conduct.

iii. *NASD (National Association of Security Dealers):*

OTC market is run by the group of bankers and dealers are called National Association of Security Dealers.

iv. *NASDAQ (National Association of Security Dealers Automated Quotation):*

It is a computerized network that links dealers around the country together and provides price quotations (purchase and selling price) on OTC securities.

v. *Trading of non-listed securities:*

Securities that are not trade on organized stock exchange market traded on OTC market. In OTC market there is no time bound for security trading or there is no particular business hour.

vi. *Negotiable commission and transactions on cost:*

In organized market commission and transaction costs are fixed but in the OTC market commission and transaction costs are based on negotiation.

Members of organized stock exchange:

i. *Brokers:*

Brokers are the agents of investors who match buyers with sellers of securities. When individuals want to transact on the stock exchange, they contact their broker. The broker then sends the order to its representatives at exchange or to a floor broker.

ii. *Commission broker:*

Employees of brokerage firm that is a member of the stock exchange who execute buy and sell order. They are agents on the exchange floor who buy and sell securities for clients of brokerage houses. Commission brokers communicate through telephone with brokerages, they receive transactions from the brokerage that employ their services, and they send back confirmation messages.

iii. *Floor brokers:*

Floor brokers are independent owners of a seat on the stock exchange. They are also known as “broker’s brokers”, they accept and reject for the commission brokers when trading activities is high, floor brokers are sometimes called two-dollar brokers, because for a commission (which once was \$2 per order) they execute orders for commission brokers who have more orders than they can handle.

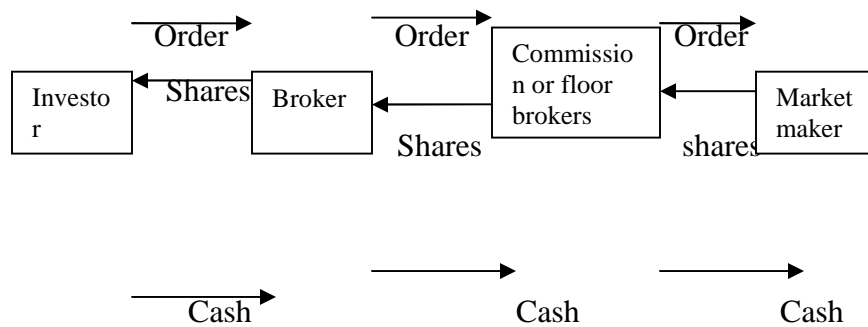
iv. *Floor traders:*

Floor traders are members of the organized stock exchange. Who buy and sell solely for their own account. They are also called registered traders, differ from floor brokers because they trade primary for their own account. Floor traders are speculators who search exchange floor for profitable buying and selling opportunities. They are trade free of commission, since they own their own seats and deal for their own account. As a

result floor traders sometimes buy and sell the same stock on the same day, an activity that is called day trade in order to profit from small price moves.

v. *Specialists:*

Specialists are exchange member who have an obligation to keep the market going, maintaining liquidity in their assigned stock at all times, in other term specialist is a stock exchange member responsible for maintaining a “fair and orderly market” in the securities to which he or she is assigned.



5. Derivatives Securities Markets:

A derivative security is a financial security whose payoff is linked to another, previously issued security. Derivative securities generally involve an agreement between two parties to exchange a standard quality of an asset or cash flow at a predetermined price and at a specified date in future. As the value of the underlying security have to be exchanged changes, the value of the derivative security changes. A securitized asset such as a mortgage- backed security is a derivative security in that its value is bases on the value of an underlying security (e.g. a mortgage). Option contracts are also derivatives since their value depends on the price of some underlying security (e.g. a stock) relative to a reference (or strike) price.

Derivative securities markets are the markets in which derivative securities trade. While derivative securities have been in existence for centuries, the growth on derivative securities markets occurred mainly in the 1980s, and 1990s. As major market, therefore, the derivative securities markets are the newest of the financial security markets. Derivative securities are developed to manage the financial risk (i.e., interest rate risk,

exchange rate risk, & uncertainty about stocks price change). The term derivative indicates that it has no independent value, i.e. its value is derived from the value of underlying assets. The underlying assets can be securities, commodities, currency, live stock or anything else. In other words derivative means option, forward, future or any other hybrid contract of predetermined fixed time period.

“A security i.e.; neither debt nor equity but that derives its value from an underlying asset that is often another security, called derivatives”. – L.G. Gitman.

“Derivative is an instrument whose price depends on or is derived from the price of another asset” - S.L. Gupta.

Derivative can be based on real assets and financial asset. Derivatives based on real assets are physical assets it includes agriculture commodities, metals and sources of energy. On the other hand derivatives based on financial assets include stocks, bonds and currencies. Presently, there are varieties of derivatives instruments are available in the market, along them the basic financial derivatives which are popular in the market have been described in brief:

1. Options:

Option is a contract or agreement between two parties (investors) that gives the holder the right (but not obligation) to buy or sell specified securities at a given price (exercise price or strike price) during a specified period of time. In other words, option is a financial instrument that grants the holder the right to buy (call) or sell (put) other financial instruments at a stated price (exercise price or strike price) and time. There are two basic types of option. A call option gives the buyer or holder the right to buy underlying assets (stock) at a specific price and time. In the other hand, a put is an option contract giving the buyer the right to sell underlying asset (stock) at predetermined price and time.

2. Forward Contract:

Generally forward contract refers to the contract that is to be held in the future date. Forward contract is an agreement between two parties (between two financial investors or financial institutions) about buy or sell an asset at a certain future time for a certain price. One of the parties to a forward contract assumes a long position and another party assumes a short position. Party who follows the long position; they agree to purchase the underlying asset on a certain specified future date and price. In the other hand, the party, who follows the short position, they agree to sell the asset on the same date (specified date) for the same price (specified price). The specified price is called the delivery price.

3. Future contracts:

Future contracts simply called futures are similar to the forward contracts. They are standardized contracts, traded on a future exchange to buy or sell a certain underlying instrument at a certain date in future, at predetermined price. The future date is called the delivery date or final settlement date. The pre-determined price is called future's price. Future contract is standardized contract, that is as the two parties to the contract do not necessarily know each other, the exchange also provide a mechanism which gives the two parties a guarantee that the contract will be honored.

“Future is a contract that obligates the holder to buy or sell on asset at a predetermined delivery price during a specified future time period. The contract is marked market daily”. – John C. Hull.

4. Swaps:

In general swap is the agreement between counter parties to exchange one type of commodity with other type. But in finance literature, swap refers to the agreement between the counter parties to exchange the securities. The underlying securities may be foreign currencies, bonds or equities. Under swap agreement, terms such as the date when the cash flows are to be paid, the currency in which to be paid and the mode payments are determined and finalized by the parties.

“A swap is a transaction on which two parties agree to pay each other series of cash flows over a specified period of time”. – Don, M. Chance.

“A swap is an agreement between two companies to exchange cash flows in the future. The agreement defines the dates when the cash flows are to be paid and the way in which they are to be calculated.” –John C. Hull.

There are four types of swap agreement-interest rate swap, currency swap, equity swap and commodity swap. Derivatives market is successful market because they have many different types of **traders**. We found three categories of traders in the markets.

1. Hedgers:

Hedging is a type of transaction designed to reduce or, in some cases eliminate risk. Person (or trader) who engages in this work is known as hedger. In other words, hedger is an investor in future contract (derivatives) whose primary objective is to offset an otherwise risky position. Hedgers use futures, forwards and options to reduce the risk that they face from potential future movements in a market variable.

2. Speculators:

The objective of speculation is to take profit at very short holding period. Speculator is an investor in future contracts whose primary objective is to take a profit from buying and selling those contracts. In other terms, speculator is an individual who is taking a position in the market. Usually the individual is betting that the price of all assets will go up or that the price of all assets will go down. Speculator can use futures and options market to take advantage from changes in price, where as hedgers wants to avoid an exposure to adverse movement in the price of an asset.

3. Arbitrageur:

Arbitrage is simultaneous buy and sell of the same or essentially similar assets in two different markets for advantageously different price. This strategy is designed to profit from imperfection in market. If markets are inefficient, then same security may sell simultaneously at different price in different market. Arbitrageurs are third important

trader of futures, forward and option market. Arbitrage involves locking in a risk less profit by simultaneously entering into transactions in two or more markets.

2.1.5 Security Market in Nepal

Security market 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 (Adhikari 2004). 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.

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 companies. 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 (Gurung 1999).

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 SEC 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 (Gurung 1999). 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. 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.

2.1.6 Current status of Nepalese security market

-) The year on year (y-o-y) NEPSE index declined by 20.6 percent to 321.18 points in mid-September 2011. This index had stood at 404.43 in the corresponding period of the previous year. The decline in share prices was on account of the significant increase in the supply of securities.
-) The y-o-y stock market capitalization decreased by 13.4 percent to Rs. 286 billion in mid-September 2011. The ratio of market capitalization to GDP stood at 21.3 percent in mid-September 2011. This ratio was 28.2 percent a year ago. Of the total market capitalization, the share of bank and financial institutions stood at 68.3 percent followed by manufacturing and processing companies (3.8 percent), hotels (1.8 percent), business entities (0.5 percent), hydropower (4.4 percent) and other sectors (21.2 percent).
-) Total paid-up capital of the listed companies stood at Rs. 100.48 billion in mid-September 2011, registering an increase of 16.4 percent over the period of one

year. This increase was largely due to the additional listing of securities at the NEPSE. As at mid- September 2011, total securities worth Rs. 6.68 billion (bonus shares of Rs. 0.04 billion, right share of Rs. 1.6 billion, convertible preference share of Rs. 0.04 billion and government securities of Rs. 5 billion) were listed at the NEPSE.

- J) Total number of companies listed at the NEPSE increased from 180 in mid-September 2010 to 209 in mid-September 2011. Among them, 177 were banks and financial institutions (including insurance companies), followed by production and processing industries (18), hotels (4), business entities (4), hydropower (4) and companies in other groups (2).

Source: Nepal Rastra Bank,

Recent Macroeconomic Situation, (Based on First Six months data of 2068-69)-New

2.1.7 An overview of Sector Wise Listed Companies

In the fiscal year 2010/11, with the listing of 33 new companies, merged between Himchuli Bikas Bank Ltd. and Birgunj finance Company and delisted of Nepal Development Bank Ltd. the total number of listed companies reached to be 207 while it was 176 in the fiscal year 2009/10. The detail of listed companies in the fiscal year 2010/11 is presented in the following table:

Sector Wise Listed Companies

S.N.	Sector	Number of Listed Companies	Percent
1	Commercial Banks	23	11.00
2	Development Banks	61	29.67
3	Finance Companies	70	33.97
4	Insurance Companies	21	10.05
5	Hotels	4	1.91
6	Manufacturing & Processing Companies	18	8.61
7	Trading Companies	4	1.91
8	Other Companies	6	2.87
	Total	207	100.0

Source: SEBON annual report 2010/11

2.1.8 Financial Statement:

A financial statement (or financial report) is a formal record of the financial activities of a business, person, or other entity. In British English—including United Kingdom company law—a financial statement is often referred to as account, although the term financial statement is also used, particularly by accountants.

For a business enterprise, all the relevant financial information, presented in a structured manner and in a form easy to understand, are called the financial statements. They typically include four basic financial statements, accompanied by a management discussion and analysis:

1. **Statement of Financial Position:** also referred to as a balance sheet, reports on a company's assets, liabilities, and ownership equity at a given point in time.
2. **Statement of Comprehensive Income:** also referred to as Profit and Loss statement (or a "P&L"), reports on a company's income, expenses, and profits over a period of time. A Profit & Loss statement provides information on the operation of the enterprise. These include sale and the various expenses incurred during the processing state.
3. **Statement of Changes in Equity:** explains the changes of the company's equity throughout the reporting period
4. **Statement of cash flows:** reports on a company's cash flow activities, particularly its operating, investing and financing activities.

For large corporations, these statements are often complex and may include an extensive set of notes to the financial statements and explanation of financial policies and management discussion and analysis. The notes typically describe each item on the balance sheet, income statement and cash flow statement in further detail. Notes to financial statements are considered an integral part of the financial statements.

Purpose of financial statements by business entities

"The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a

wide range of users in making economic decisions." Financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities, equity, income and expenses are directly related to an organization's financial position. Financial statements are intended to be understandable by readers who have "a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently." Financial statements may be used by users for different purposes:

) Owners and managers require financial statements to make important business decisions that affect its continued operations. Financial analysis is then performed on these statements to provide management with a more detailed understanding of the figures. These statements are also used as part of management's annual report to the stockholders.

) Employees also need these reports in making collective bargaining agreements (CBA) with the management, in the case of labor unions or for individuals in discussing their compensation, promotion and rankings.

) Prospective investors make use of financial statements to assess the viability of investing in a business. Financial analyses are often used by investors and are prepared by professionals (financial analysts), thus providing them with the basis for making investment decisions.

) Financial institutions (banks and other lending companies) use them to decide whether to grant a company with fresh working capital or extend debt securities (such as a long-term bank loan or debentures) to finance expansion and other significant expenditures.

) Government entities (tax authorities) need financial statements to ascertain the propriety and accuracy of taxes and other duties declared and paid by a company.

) Vendors who extend credit to a business require financial statements to assess the creditworthiness of the business.

) Media and the general public are also interested in financial statements for a variety of reasons.

Government financial statements

The rules for the recording, measurement and presentation of government financial statements may be different from those required for business and even for non-profit organizations. They may use either of two accounting methods: accrual accounting, or cash accounting, or a combination of the two (OCBOA). A complete set of chart of accounts is also used that is substantially different from the chart of a profit-oriented business.

Financial statements of non-profit organizations

The financial statements that non-profit organizations such as charitable organizations and large voluntary associations publish tend to be simpler than those of for-profit corporations. Often they consist of just a balance sheet and a "statement of activities" (listing income and expenses) similar to the "Profit and Loss statement" of a for-profit. Charitable organizations in the United States are required to show their income and net assets (equity) in three categories: Unrestricted (available for general use), temporarily Restricted (to be released after the donor's time or purpose restrictions have been met), and Permanently Restricted (to be held perpetually, e.g., in an Endowment).

Personal financial statements

Personal financial statements may be required from persons applying for a personal loan or financial aid. Typically, a personal financial statement consists of a single form for reporting personally held assets and liabilities (debts), or personal sources of income and expenses, or both. The form to be filled out is determined by the organization supplying the loan or aid.

Audit and legal implications

Although laws differ from country to country, an audit of the financial statements of a public company is usually required for investment, financing, and tax purposes.

These are usually performed by independent accountants or auditing firms. Results of the audit are summarized in an audit report that either provides an unqualified opinion on the financial statements or qualifications as to its fairness and accuracy. The audit opinion on the financial statements is usually included in the annual report.

There has been much legal debate over who an auditor is liable to. Since audit reports tend to be addressed to the current shareholders, it is commonly thought that they owe a legal duty of care to them. But this may not be the case as determined by common law precedent. In Canada, auditors are liable only to investors using a prospectus to buy shares in the primary market. In the United Kingdom, they have been held liable to potential investors when the auditor was aware of the potential investor and how they would use the information in the financial statements.

Nowadays auditors tend to include in their report liability restricting language, discouraging anyone other than the addressees of their report from relying on it. Liability is an important issue: in the UK, for example, auditors have unlimited liability.

In the United States, especially in the post-Enron era there has been substantial concern about the accuracy of financial statements. Corporate officers (the chief executive officer (CEO) and chief financial officer (CFO)) are personally liable for attesting that financial statements "do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report." Making or certifying misleading financial statements exposes the people involved to substantial civil and criminal liability. For example Bernie Ebbers (former CEO of WorldCom) was sentenced to 25 years in federal prison for allowing WorldCom's revenues to be overstated by billion over five years.

Standards and regulations

Different countries have developed their own accounting principles over time, making international comparisons of companies difficult. To ensure uniformity and comparability between financial statements prepared by different companies, a set of

guidelines and rules are used. Commonly referred to as Generally Accepted Accounting Principles (GAAP), these set of guidelines provide the basis in the preparation of financial statements.

Recently there has been a push towards standardizing accounting rules made by the International Accounting Standards Board ("IASB"). IASB develops International Financial Reporting Standards that have been adopted by Australia, Canada and the European Union (for publicly quoted companies only), are under consideration in South Africa and other countries. The United States Financial Accounting Standards Board has made a commitment to converge the U.S. GAAP and IFRS over time.

Inclusion in annual reports

To entice new investors, most public companies assemble their financial statements on fine paper with pleasing graphics and photos in an annual report to shareholders, attempting to capture the excitement and culture of the organization in a "marketing brochure" of sorts. Usually the company's chief executive will write a letter to shareholders, describing management's performance and the company's financial highlights.

In the United States, prior to the advent of the internet, the annual report was considered the most effective way for corporations to communicate with individual shareholders. Blue chip companies went to great expense to produce and mail out attractive annual reports to every shareholder. The annual report was often prepared in the style of a coffee table book

Moving to electronic financial statements

Financial statements have been created on paper for hundreds of years. The growth of the Web has seen more and more financial statements created in an electronic form which is exchangeable over the Web. Common forms of electronic financial statements are PDF and HTML. These types of electronic financial statements have their drawbacks in that it still takes a human to read the information in order to reuse the information contained in a financial statement.

More recently, a market driven global standard, XBRL (Extensible Business Reporting Language), which can be used for creating financial statements in a structured and computer readable format, has become more popular as a format for creating financial statements. Many regulators around the world such as the U.S. Securities and Exchange Commission have mandated XBRL for the submission of financial information.

The UN/CEFACT created, with respect to Generally Accepted Accounting Principles, (GAAP), internal or external financial reporting XML messages to be used between enterprises and their partners, such as private interested parties (e.g. bank) and public collecting bodies (e.g. taxation authorities). Many regulators use such messages to collect financial and economic information.

Financial statement analysis

Financial statement analysis (or financial analysis) is the process of understanding the risk and profitability of a firm (business, sub-business or project) through analysis of reported financial information, particularly annual and quarterly reports.

Financial statement analysis consists of reformulating reported financial statements, analysis and adjustments of measurement errors, and financial ratio analysis on the basis of reformulated and adjusted financial statements. The two first steps are often dropped in practice, meaning that financial ratios are just calculated on the basis of the reported numbers, perhaps with some adjustments. Financial statement analysis is the foundation for evaluating and pricing credit risk and for doing fundamental company valuation.

1. Financial statement analysis typically starts with reformulating the reported financial information. In relation to the income statement, one common reformulation is to divide reported items into recurring or normal items and non-recurring or special items. In this way, earnings could be separated in to normal or core earnings and transitory earnings. The idea is that normal earnings are more permanent and hence more relevant for prediction and valuation. Normal earnings are also separated into net operational profit

after taxes (NOPAT) and net financial costs. The balance sheet is grouped, for example, in net operating assets (NOA), net financial debt and equity.

2. Analysis and adjustment of measurement errors question the quality of the reported accounting numbers. The reported numbers can for example be a bad or noisy representation of invested capital, for example in terms of NOA, which means that the return on net operating assets (RNOA) will be a noisy measure of the underlying profitability (the internal rate of return, IRR). Expensing of R&D is an example when such investment expenditures are expected to yield future economic benefits, suggesting that R&D creates assets which should have been capitalized in the balance sheet. An example of an adjustment for measurement errors is when the analyst removes the R&D expenses from the income statement and put them in the balance sheet. The R&D expenditures are then replaced by amortization of the R&D capital in the balance sheet. Another example is to adjust the reported numbers when the analyst suspects earnings management.

3. Financial ratio analysis should be based on regrouped and adjusted financial statements. Two types of ratio analyses are performed: 3.1) Analysis of risk and 3.2) analysis of profitability:

3.1 Analysis of risk typically aims at detecting the underlying credit risk of the firm. Risk analysis consists of liquidity and solvency analysis. Liquidity analysis aims at analyzing whether the firm has enough liquidity to meet its obligations when they should be paid. A usual technique to analyze illiquidity risk is to focus on ratios such as the current ratio and interest coverage. Cash flow analysis is also useful. Solvency analysis aims at analyzing whether the firm is financed so that it is able to recover from a losses or a period of losses. A usual technique to analyze insolvency risk is to focus on ratios such as the equity in percentage of total capital and other ratios of capital structure. Based on the risk analysis the analyzed firm could be rated, i.e. given a grade on the riskiness, a process called synthetic rating.

Ratios of risk such as the current ratio, the interest coverage and the equity percentage have no theoretical benchmarks. It is therefore common to compare them with the industry average over time. If a firm has a higher equity ratio than the industry, this is considered less risky than if it is above the average. Similarly, if the equity ratio increases over time, it is a good sign in relation to insolvency risk.

3.2 Analysis of profitability refers to the analysis of return on capital, for example return on equity, ROE, defined as earnings divided by average equity. Return on equity, ROE, could be decomposed: $ROE = RNOA + (RNOA - NFIR) * NFD/E$, where RNOA is return on net operating assets, NFIR is the net financial interest rate, NFD is net financial debt and E is equity. In this way, the sources of ROE could be clarified.

Unlike other ratios, return on capital has a theoretical benchmark, the cost of capital - also called the required return on capital. For example, the return on equity (ROE) could be compared with the required return on equity, K_e , as estimated, for example, by the capital asset pricing model (CAPM). If $ROE > K_e$ (or $RNOA > WACC$, where WACC is the weighted average cost of capital), then the firm is economically profitable at any given time over the period of ratio analysis. The firm creates values for its owners.

Insights from financial statement analysis could be used to make forecasts and to evaluate credit risk and value the firm's equity. For example, if financial statement analysis detects increasing superior performance $ROE - K_e > 0$ over the period of financial statement analysis, then this trend could be extrapolated into the future. But as economic theory suggests, sooner or later the competitive forces will work - and ROE will be driven toward K_e . Only if the firm has a sustainable competitive advantage, $ROE - K_e > 0$ in "steady state".

Financial analysis is the selection, evaluation, and interpretation of financial data, along with other pertinent information, to assist in investment and financial decision-making. Financial analysis may be used internally to evaluate issues such as employee performance, the efficiency of operations, and credit policies, and externally to evaluate

potential investments and the credit-worthiness of borrowers, among other things. The analyst draws the financial data needed in financial analysis from many sources. The primary source is the data provided by the company itself in its annual report and required disclosures. The annual report comprises the income statement, the balance sheet, and the statement of cash flows, as well as footnotes to these statements. Certain businesses are required by securities laws to disclose additional information. Besides information that companies are required to disclose through financial statements, other information is readily available for financial analysis. For example, information such as the market prices of securities of publicly-traded corporations can be found in the financial press and the electronic media daily.

Similarly, information on stock price indices for industries and for the market as a whole is available in the financial press. Another source of information is economic data, such as the Gross Domestic Product and Consumer Price Index, which may be useful in assessing the recent performance or future prospects of a company or industry. Suppose you are evaluating a company that owns a chain of retail outlets. What information do you need to judge the company's performance and financial condition? You need financial data, but it doesn't tell the whole story. You also need information on consumer financial ratios spending, producer prices, consumer prices, and the competition. This is economic data that is readily available from government and private sources.

Besides financial statement data, market data, and economic data, in financial analysis you also need to examine events that may help explain the company's present condition and may have a bearing on its future prospects. For example, did the company recently incur some extraordinary losses? Is the company developing a new product? Or acquiring another company? Is the company regulated? Current events can provide information that may be incorporated in financial analysis. The financial analyst must select the pertinent information, analyze it, and interpret the analysis, enabling judgments on the current and future financial condition and operating performance of the company.

2.1.9 Demand and Supply of Financial Information

What is observed in financial statements is the product of a diverse set of demand and supply forces. How the demand and supply affect the content of financial statements or the timing of their release.

Parties demanding financial statement information include shareholders, investors, security analysts, managers, employees, lenders and suppliers, customers and government regulatory agencies. These parties will demand financial statement information to facilitate decision making, to facilitate the monitoring of management, or to interpret contracts or agreements that include provisions based on such information.

Parties Demanding Financial Information:

A. Shareholders, investors and security Analysts:

Shareholders and other investors are major recipients of the financial statements of corporations. These parties range from individuals with relatively limited resources to large, well endowed, institutions such as insurance companies and mutual funds. The decisions made by these parties include not only which share to buy, retain or sell, but also the timing of the purchase or sales of these shares.

The analysis undertaken for decisions by shareholders and investors can be done by these parties themselves or by intermediaries such as, security analysts and investment advisors. These intermediaries can also act as a pressure group on management and other bodies (e.g., regulatory agencies) that influence the timing or content of information provided to external parties. Note, however, that these intermediaries can have different rankings for financial statement variables than the investors for whom the information analysis is conducted. For example, investors may support the mandatory disclosure of management earnings forecasts; whereas securities analysts may oppose this disclosure because it competes with their own activities and reduces the areas where the items included in analyst reports is the direct result of their own information analysis.

B. Managers:

One sources of demand for financial statement information by managers arises from contracts that include provision based on financial statement variables. One

example is management incentive contracts. In other cases, there may be implicit (but still very strong) linkages between compensation and financial statement variables such as earnings, earnings per shares, or the earnings to shareholders' equity ratio.

Managers also utilize financial statement information in many of their financing, investment, or operation decisions. A financial statement based variable, such as the current debt-to-equity ratio or interest coverage ratio, is frequently important in deciding how much long-term debt to rise. The financial statement of other firms can also be used in management decisions. For instance, when deciding where to redirect the resources of a firm, the financial statements of other firms can show areas where high profit margins are currently being earned.

C. Employees:

The demand for financial statement information by employees can arise from several motivations. Employees have a vested interest in the continued and profitable operations of their firm. Financial statements are an important source of information about current and potential future profitability and solvency. Employees can also demand financial statements to monitor the viability of their pension plans.

D. Lenders and other suppliers:

In the ongoing relationship that exists between suppliers and a firm, financial statements can play several roles; consider the relationship between a firm and the suppliers of its loan capital, for example, a bank. In the initial loan-granting stage of the relationship, financial statements typically are important items.

E. Customers:

The relationship between a firm and its customers can extend over many years. In some cases, these relationships take the form of legal obligations associated with guarantees, warranties, or deferred benefits. In other cases the long-term association is based on continued attention to customer service. Customers have a vested interest in monitoring the financial viability of firms with which they have long-term relationships. This interest is likely to increase when concerns develop about possible bankruptcy.

F. Government/regulatory Agencies:

Demands for financial statement information by government regulatory agencies can arise in an adverse set of areas such as tax collection, government controlling, rate determination, and regulatory intervention. Financial information is but one input into such decisions. Political factors also may be equally if not more important in some cases; for example, in determining whether to approve a government-backed loan guarantee, the policy platform of the party in power and the electoral areas suffering unemployment if the distressed firm becomes bankrupt may be critical factors.

G. Other parties:

The set of parties that make demands on corporations is open-ended. Diverse parties such as academics, environmental protection organizations, and other special interest lobbying groups approach corporations for details relating to their financial and other affairs. Many corporations do make concerted efforts to respond to some of the requests that come from these parties.

Now the focus of the study is on factors that affect the supply of financial statement information provided to external parties. Emphasis is placed on regulatory and market forces that affect the content of financial reports or the timing with which these reports are released. Financial reports are part of a broader set of firm disclosures that range from verbal qualitative responses to shareholder questions at annual meetings to written quantitative communications, such as physical production reports, and mineral exploration reports, as well as financial reports. Management has considerable discretion over the content and timing of the many diverse public disclosures it makes. These disclosures can be partial substitutes for each other with the result that expansion (or contraction) in one form of disclosure can affect the supply of information provided in other forms.

Factors affecting information set available to external parties are –decisions by firm, information set available to external parties, market forces, regulatory forces, decisions by non-firm information sources, for example, brokerage houses and industry trade associations.

A common feature of the financial reporting environment in many countries is the existence of public sector-based regulatory forces that affect the disclosure decisions of firms and other entities. In some cases, specific legislation governing the content of financial reports exists, such as the Company Act in many British Commonwealth countries. In other cases, legislation associated with corporate taxation is an important determinant of the content of financial statement, as in Germany, Japan, and Sweden. In yet other cases, decisions by government regulatory bodies exert an important influence, as with the Securities and Exchange Commission (SEC) in United States.

There are many pieces of evidences to suggest that factors other than regulatory mandates influence the supply of financial statements. Consider the following.

- Financial statements were publicly related by firms well before the formation of the major regulatory forces currently influencing financial reporting.
- Financial statements are voluntary issued by entities not under the jurisdiction of the SEC. many municipalities in the United States also issued financial statements despite there being no mandate by a regulatory body to release this information.
- Some firms issue financial statements at more frequent time intervals than in mandated by regulatory bodies. For example, both SEC and NYSE mandate U.S. companies file quarterly reports, some companies, however, voluntary release monthly interim reports.
- Some firm release considerably more information in their financial statements than is mandated by regulatory bodies. For instance, companies' instances, companies in Australia and United Kingdom are not required to disclose the market values of their properties; however, a considerable number of companies report such information in their annual reports.

There are three major market forces that affect the content or timing of financial statement information disclosure:

(A) Capital market forces:

Firms compete with each other in the capital market on many dimensions. These dimensions include.

- The instrument offered- equity securities, preferred securities, bank loans, and so on.
- The terms of the instrument offered- the taxation status of dividend payments, convertibility features of debt, the interest rate on loans, the security offered to lenders, and so on.
- The distribution of expected returns from each instrument.

Market forces will exert pressure on firms and other capital raisers to provide financial information that relates to the foregoing factors.

(B) Labor market forces:

If left unrestricted, management could make decisions that significantly reduce the value of the equity or debt components of the firm. Consider the following instances:

- Management sells all the assets of the firm, distributing the cash proceeds as dividends to equity holders and leaving debt holders with a “corporate shell”.
- Management re-invests all the assets of the firm in high- variance projects that redistribute wealth from debt holders to stock holders (due to debt holders sharing in large losses but not in large gains).
- Managers pay themselves salaries many times what their counterparts in other firms are earning for comparable jobs, thus reducing the value of both the equity and debt components. We have already noted that the equity and debt holders have a vested interest in reducing the propensity of management to take such actions.

(C) Corporate control:

Managers appear to value very high their ability to control the financing, investment, and operating decisions of firms. Attempts by external parties to take this control from existing management often encounter stiff opposition. The financial press contains many examples of (1) takeover battles between existing management and an unfriendly suitor or (2) proxy fights between a coalition of the existing management and a subset of shareholders vis-a-vis another subset of shareholders. One tactic that managements can use in such battles (or in an attempt to preempt such battles) is to

release financial information that they perceive will increase the likelihood of their retaining control.

Cost Associated With Disclosure

One factor that management consistently cites as important in disclosure decisions is the costs associated with those disclosures. These costs include:

(A) Collection and Processing costs:

Collection and processing costs include the costs borne by both the preparers and the users of financial data. Little systematic evidence exists as to the magnitude of these costs. The limited numerical information that is available mostly relates to the estimated costs of complying with regulatory mandates and should be viewed as “approximate at best”. Even less information is available about the processing costs borne by users of financial statement information. For newly disclosed items that are reasonably complex, these costs may well be quite considerable.

(B) Litigation costs:

Legal suits against the firm or its managers are an ever-present threat in today’s litigious society. In some cases, this threat can operate to reduce disclosure. For instance, one argument against voluntary disclosure of earning forecasts is that ex post they may turn out to be overly optimistic; investors then may use the incorrect forecast as one basis to sue management to obtain reimbursement for a drop in the price of their equity investment. In other cases, the threat of litigation can promote disclosure.

(C) Political costs:

Governments have the power to expropriate wealth from corporations and redistribute it to other parties in society. Governments have the power to expropriate wealth from corporations and redistribute it to other parties in society. Financial reports represent one source of information that governments can use to choose firms or industries that will be singled out.

Political cost considerations can also influence the disclosure decisions of firms. Firms may disclose certain information items if they provide evidence that the arguments used by those wishing to appropriate wealth from them are invalid. Firm also can choose to aggregate items in such a way that their political cost exposure is reduced.

(D) Competitive disadvantage costs:

A common argument presented against disclosure is the cost incurred when competitors use the disclosures to their own advantage. One sensitive area in this connection is information about research and development and new products. Firms that perceive that they have an advantage over competitors in these areas face difficult decisions when raising new capital. Unless they provide some information pertaining to the R & D or new products, the capital market is less likely to support a new share offering. Yet if they provide detailed information, they may reduce the lead time with which competitors learn about developments within the company. A second sensitive area is with disclosure of advertising budgets.

(E) Constraints on managerial behavior:

One set of disclosure costs reported to be important by some managers is the constraints that arise (or are perceived to arise) when specific disclosures are made. For example, when an earnings-per-share forecast is publicly released at the start of a fiscal year, there is pressure for managers to take actions during the year that result in the actual earnings-per-share being close rather than farther away from the forecast. Managements may reject opportunities that maximize firm value but that would result in the actual earnings-per-share diverging considerably from the publicly released earnings-per-share forecast.

2.2 Review of Related Studies:

2.2.1 International Review

Rolf W. BANZ, *Northwestern University, Evanston, IL 60201, USA* (1980), in his study on THE RELATIONSHIP BETWEEN RETURN AND MARKET VALUE OF COMMON STOCKS has concluded that if insufficient information is available about a subset of securities, investors will not hold these securities because of estimation risk, i.e., uncertainty about the true parameters of the return distribution. If investors differ in the amount of information available, they will limit their diversification to different subsets of all securities in the market. It is likely that the amount of information generated is related to the size of the firm. Therefore, many investors would not desire to hold the common stock of very small firms. He has shown elsewhere that securities sought by only a subset of the investors have higher risk-adjusted returns than those considered by all investors. Thus, lack of information about small firms leads to limited diversification and therefore to higher returns for the ‘undesirable’ stocks of small firms. While this informal model is consistent with the empirical results, it is, nevertheless, just conjecture.

To summarize, the size effect exists but it is not at all clear why it exists. Until we find an answer, it should be interpreted with caution. It might be tempting to use the size effect, e.g., as the basis for a theory of mergers - large firms are able to pay a premium for the stock of small firms since they will be able to discount the same cash flows at a smaller discount rate. Naturally, this might turn out to be complete nonsense if size were to be shown to be just a proxy.

Randi Navdal (2008), in his study on “Value Relevance of Accounting Information: Emphasis on the Financial Crisis in 2008”, found that an empirical examination of whether investors in the Norwegian stock market perceive accounting information, denoted in earnings and book value, to be value relevant. Using samples of available observations listed on the Oslo Stock Exchange Benchmark Index (OSEBX) from 2005 to 2008, empirical results support a large number of prior studies suggesting that accounting information is value relevant. My findings further suggest that book value of equity has a stronger ability to explain the variation in stock prices relative to earnings, regardless of which model specification applied. In addition, an inversely movement is observed in the explanatory power of between earnings and book value, implying that

when value relevance of earnings decreases, the value relevance of equity book value increases. This relationship is consistent across studies. There is a lack of studies investigating the value relevance of accounting information in the Norwegian stock market, especially during financial distress periods. Hence the main emphasis in this study is to examine the value relevance of accounting information during the financial crisis in 2008.

Past research has suggested that there is a better association between accounting information and stock prices when the economy slows down (e.g., Beisland & Hamberg, 2008; Davis-Friday & Gordon, 2005; Ibrahim et al., 2009). His empirical results show that the total value relevance of accounting earnings and book values has increased significantly during the financial crisis, attributable to an increase in the value relevance of book values. As predicted, he find a significantly increase in the explanatory power of book value and a decrease in the explanatory power of earnings during the crisis period. The change in value relevance may be directly attributable to the dominance of a liquidation effect. This effect suggests that as financial health decreases, equity book value's incremental explanatory power increases while incremental explanatory power for earnings decreases (Barth, Beaver, & Landsman, 1998). As a value, relevance of earnings decline, shareholders become more likely to value a firm based on liquidation value rather than earnings potential. If the liquidation effect contributed to disruption in the value relevance of accounting information during the crisis, the disruption is likely to be temporary. My findings indicate that investors value balance sheet information considerable higher relative to income statements during the financial crisis in 2008. Based on these results, he believe that the changes in value relevance during the economy collapse are likely to be attributable to changes in stock price information rather than the accounting systems poorly measuring the financial conditions.

“The investment decision in the stock market, coteries Paribas is a function of the prevailing market price and return to capital. By return to capital is meant the algebraic sum of increment in the value of yield.” (Doodha, K.S.; 1962; 125)

Levine and Zervos (1998) analyzed by using stock market liquidity (turnover of shares and value), size (market capitalization), volatility (twelve month rolling standard deviation), integration with world markets (CAPM and APT intercept terms), and bank

credit for the private (bank credit to the private sector to GDP as predictors of economic growth, capital accumulation, improvement in productivity, and savings growth rate for forty-seven countries from 1976-93. The study reveals a positive relationship between stock market and bank development and economic growth, capital accumulation, and productivity growth. The authors conclude that stock markets provide an easy means to trade the ownership of productive assets, which facilitates resource allocation, which, in turn, facilitates capital formation, which leads to faster economic growth.

“There are two important aspect of capital market, 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 most important from the point of view of economic growth, the second aspect is also of considerable importance. In fact if facilities for transfer of existing securities are abundant, the raising of new capital is considered assisted for the buyer of new issue of security is confident that whenever he wants to get cash he can find buyer without much difficulty. Thus, the liquidity of the stock market affects the raising of new capital from the market.” (Kunt A. And Levin, 1996:224)

2.2.2 National Review

The Nepalese stock market is in developing phase. So it is not as efficient market. There is little study available on the relationship between financial information and market price of share. Moreover, the stock market of Nepal has been less subjected to investment research than their counterparts elsewhere. So I have reviewed some available unpublished thesis, these are somehow related to this study.

One of the studies conducted by Mohan Khatiwada about “securities investment in Nepal” in 1995 is related with stock market performance. He tried to present new issues market and stock market performance in theoretical base such as legal aspects of secondary market, primary market and also money market. He tries to show a real picture how the security market has been functioning by analyzing the same stock market indicators. He concluded his study with the following findings:

- Nepalese stock market has no liquid and small size of market than other countries.
- Institutional base, dominating role of money market and rigid rules and regulations are main problems seen in stock market.

- Securities return is less than market return.
- Dominant roles of banking and financial institution in stock market and also management groups and majority shareholders groups in company.

Similarly, another study by Bharat Prasad Bhatta concluded the descriptive and analytical study about stock market “Dynamics of Stock Market”. The main purpose of this study is to analyze performance and trends of stock market. It also helps to analyze market price of share, impact of secondary market on primary market and financial data of sectors such as banking, financing and insurance, manufacturing, trading and hotel sector to find out the basic objective of this study. It is based on parametric test and data based on 1985/86 to 1995/96 but sector analysis was based on 1988/89 to 1994/95. Some financial and statistical tools such as simple average, standard deviation, and some ratios are used in his study.

“The study focuses on the corporate time series analysis of financial parameters of various industries, belonging to the stock markets and their stock markets and their effects on the stock price and ultimately the impact on the economy”. (Bhatta, 1998:20) only concerning with descriptive approach, the study doesn’t give appropriate vision of the stock market performance and trends. This study only analyzes some financial parameters such as EPS, DPS, NPS, SPS, MPS and same price and profitability ratio. As rational investor, one should mostly concern with risk and return concept have a significant implication on investment decision, but this study could not mention about it. The major findings of this study are given below:

- Due to the lack of proper implication of government rules, policy and program, people are not conscious well and aware about the stock market.
- Stock market development indicators and economic indicators have a close relationship, the growth rate of equity; market capitalization and turnover are higher than GDP.
- Due to under developed stock market, there exists few number of stock listed in stock market, size of stock market is very low (-1), low liquidity and low development indicators are found in stock market.

Radhe Shyam Pradhan, 1993, in his study on “stock market behavior in a small capital market” concluded that this study helps to provide at least some insight into stock market behavior in Nepalese context by concerning listed and traded shares in secondary market. The purpose of this study is to address the stock market equity, market value to book value, price earnings and dividends with liquidity, leverage profitability assets turnover and interest coverage. His findings of stock market are summarized below:

- Data could not be obtained in contracting the individual enterprise as they traded them confidently.
- The result indicate that larger stock have longer price earnings ratio of market value to book value equity, lower liquidity, lower profitability and smaller dividends.
- Price earnings ratio and dividend are more variable for smaller stocks: where as market value to book value of equity is more variable for larger stock. Larger stock also has higher leverage, lower turnover and lower interest coverage but there are more variables for smaller stocks than for larger stocks.
- Stock with larger market value to book value of equity has larger price earnings ratio and lower dividends. These stocks also have lower liquidity, higher leverage, lower profitability, lower turnover and lower interest coverage.
- Stock paying higher dividends has higher liquidity, low leverage, high earnings, high turnover and high interest coverage, liquidity and leverage ratio are more variable for the stock paying lower dividends while earning assets turnover and interest coverage more variable for the stock paying higher dividends.

Sudha Kumari Ssethia, 2011, conducted a study on “Stock Price Behavior in Commercial Banks” concluded that security market is one of the components of capital market. It affects the economy through creation of liquidity, marketability, etc. due to the liquidity it is easier to investors for short term investment and it makes the equity trading less expensive. Like liquidity, market efficiency is another most profound idea to affect the investment decision process in security market. This means that efficiently proved

markets in which this price of security does not depart for any length of time for justified economic values. The security values are also determined by investor's expectations about earning risk and so on. In efficient market values is going to be changed by reacting with new information. Thus, securities are efficiently priced on a continuous basis. But the stock market of Nepal is still in preliminary stage and it is developing in slow pace. Similarly it is an inefficient stock market.

Using different financial tools, the company's performance has been analyzed to relate their market price with EPS, DPS, Book Value, and Liquidity, Return on Assets and Return on Equity. This analysis shows a mixed behavior in these relationships. Some companies having low EPS have high price and companies having high EPS have low price. The same fluctuating trend follows in the case of DPS also.

Chapter 3:

Data Analysis and Presentation

This chapter deals with the presentation, analysis and interpretation of relevant data and information of sampled commercial banks. This is the heart of the study. This chapter will be of great for this study as all the finds conclusions and recommendations are going to be delivered from the calculation done in this chapter. To obtain best result, the data and information have been analyzed according to the research methodology as mentioned in the chapter-1. The main purpose of analyzing of the data is to change it from an unprocessed form to an understandable presentation. The analysis of data consists of organizing, tabulating, diagramming and performing statistical analysis (wolf & pant 1999).

This chapter is partitioned into the sections of: 1) presentation of data along with Coefficient of Variation (C.V) analysis, 2) correlation analysis between EPS and MPS and 3) testing of hypothesis.

3.1 Presentations of Data along with C.V. Analysis:

This sub-topic deals with the financial performance analysis of the sampled banks. Some of major financial indicators are taken for this analysis. These indicators are earning per Share, Dividend per Share, Return on Total Assets, Returns on Equity, Price Earnings Ratio and Liquidity Ratio. The performances of individual companies that are listed in the stock exchange have direct impact on capital market. A company having a good performance has highest market price, high volume of transaction, higher demand of stocks, lower risk and low cost of capital.

3.1.1 Earnings per share (EPS):

The profitability of a firm from the point of view of the ordinary shareholders is the EPS. It measures the profit available to the equity holders on a per share basis, i.e. amount that they can get on every share held. It is calculated by dividing the profit available to shareholders by the number of outstanding shares. The profits available to the ordinary shareholders are represented by net profits after taxes and preference dividends.

EPS is closely watched by the investing public and is generally considered to be the single most important variable in determining a share's price.

Thus,

$$\text{EPS} = \frac{\text{Net profit available to equity holders}}{\text{No. of common stock outstanding}}$$

Table 3.1.1: EPS of the sample banks

S.N	Banks/Years	2006/07	2007/08	2008/09	2009/10	2010/11	Average (\bar{x})	Standard deviation ()	Coefficient of variation (C.V)%
1.	BOK	43.50	59.94	54.68	43.08	44.51	49.14	6.89	14.02
2.	EBL	78.42	91.82	99.99	100.16	83.18	90.71	8.77	9.67
3.	HBL	60.66	62.74	61.90	31.80	44.66	52.35	12.24	23.38
4.	NSBI	39.35	28.33	36.18	23.69	24.85	30.48	6.22	20.41
5.	NIBL	62.57	57.87	37.42	52.55	48.84	51.85	8.59	16.57
6.	NABIL	137.08	115.86	113.44	83.81	70.67	104.17	23.84	22.89
7.	LBL	10.75	16.45	20.70	24.12	23.25	19.05	4.93	25.87
8.	SCBNL	167.37	131.92	109.99	77.65	69.51	111.29	35.91	32.27
9.	KBL	22.70	16.35	22.04	24.24	15.67	20.20	3.50	17.32
10.	NCC	(16.56)	35.63	29.35	30.28	15.78	18.90	18.90	100

The above tabulated results of sampled banks clearly specify that the Standard Chartered Bank has the highest average EPS and the Nepal Credit and Commerce bank has the lowest. So SCBNL is most attractive and NCC bank is least attractive for investment to the potential investor. Similarly, other banks are also on the rank of their attractiveness as per their average EPS.

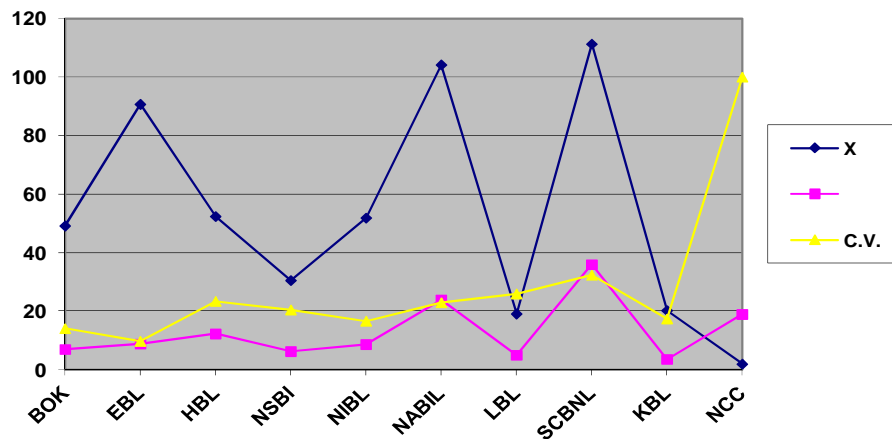
But, if investors widen their study in financial result i.e. without being limited in earning, they analyze the risk portion also, the result may vary. Highest earning is less important in the place of their steady. So lower the variability, lower the investment risk, which creates the higher attractiveness of the firm and vice-versa. From the above results, we come to know that Kumari Bank has the least Standard deviation i.e.3.50, it is more

attractive bank and Standard Chartered Bank has the highest Standard deviation i.e.35.91, it is least attractive bank among sampled banks to the investors.

If investor took investment decision based just only one side i.e. either return or risk, he may face more financial problems. So a rational investor always sees both return and risk of potential investing firm simultaneously. In statistics, a tool, Coefficient of variation (CV) is used for this purpose. In the above table Everest Bank Limited has less CV i.e.9.67, which is the most attractive and NCC Bank has more CV i.e.100, which is least attractive bank for the investors.

The following figure gives the clear picture of EPS analysis:

Figure 3.1 EPS of the sample banks



3.1.2 Return on Assets (ROA):

Here, the profitability ratio is measured in terms of the relationship between the net profits and assets. The ROA may also be called profit-to-assets ratio. It measures the overall effectiveness of management in generating profits with its available assets. It shows the company's capacity for utilizing its available assets or the degree of utilization of assets. The higher the firms return on total assets, the better. The return on total assets is calculated as follows:

$$\text{Return on Total Assets} = \frac{\text{Net Profit after tax}}{\text{Total Assets}}$$

Table 3.1.2 ROA of sample banks

S.N	Banks/Year s	2006/07	2007/08	2008/09	2009/10	2010/11	Average (\bar{x})	Standard deviation (σ)	Coefficient of variation (C.V)%
1.	BOK	1.80	2.04	2.25	2.18	2.44	2.14	0.22	10.10
2.	EBL	1.38	1.65	1.73	2.09	2.10	1.79	0.28	15.64
3.	HBL	1.47	1.76	1.91	1.19	1.91	1.65	0.28	16.97
4.	NSBI	1.83	1.44	1.05	1.03	1.01	1.27	0.32	25.20
5.	NIBL	1.79	1.77	1.68	2.20	2.02	1.89	0.19	10.05
6.	NABIL	2.72	2.32	2.55	2.38	2.43	2.48	0.14	5.70
7.	LBL	0.95	1.13	1.22	1.66	1.76	1.34	0.32	23.88
8.	SCBNL	2.42	2.46	2.56	2.70	2.56	2.54	0.10	3.83
9.	KBL	1.48	1.16	1.41	1.59	1.23	1.37	0.16	11.67
10.	NCC	(1.56)	5.48	3.76	3.21	1.61	2.5	2.38	95.2

The above table depicts the result of average, Standard deviation and the coefficient of variation (CV) of ROA of sampled banks. The average shows the return, the standard deviation shows the risk and the CV shows the risk on per unit return.

NABIL bank and Standard Chartered bank have utilized their assets most efficiently than other sampled banks. It means small investment can generate more return in these banks. So naturally investors are more eager to invest such banks. So that the market price of share of such banks must be higher than others due to high demand of share in the stock market. Inversely NSBI Bank (1.24) and Laxmi Bank (1.34) utilized their assets less efficiently. It indicates that large investment also generates small return in such banks. So investors are less willing to invest in the share of such banks. Thus the market price of share of these banks is normally lower than others.

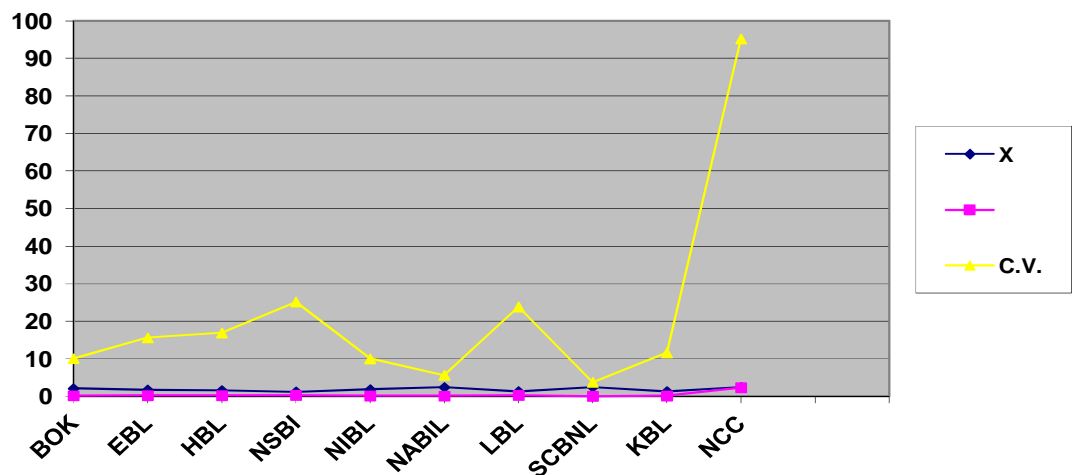
Another side of analysis is risk, is represented by standard deviation. As per the above table, Nepal SBI Bank and Laxmi Bank have more risk on ROA. It shows that there is high volume of volatility in ROA. Normally rational investors do not willing to

take mere risk. So they do not pay more interest in investing on share of these banks. Similarly Standard Chartered Bank i.e.0.10 and NABIL Bank i.e.0.14 have minimum risk (standard deviation) on ROA. There is low degree of volatility in ROA. So it builds up the investor's confidence, results the higher market price of share of such banks.

If the investor consider the both aspects (risk and return), he may certainly takes his decision on the basis of the results showed by the coefficient of variation (CV). In this analysis Standard Chartered bank has minimum CV i.e. 3.83. So it is the most attractive banks for investment and its market price per share would be high. But NCC bank has so high CV i.e. 95.20. Thus it is the least attractive bank and its market price per share would be low.

The following figure gives the clear picture of ROA analysis:

Figure 3.2 ROA of the sample banks



3.1.3 Price Earnings Ratio (P/E ratio):

Price earning multiple is the relationship between earning per share and market price of stock. Earnings per share show the company's performance in the sense that how well the company has managed its material as well as human resources to satisfy the

interest of stockholders. The P/E ratio is sometimes referred to as the “multiple”, because it shows how much investors are willing to pay per dollar of earnings. In other words, the P/E ratio measures investors’ expectations and the market appraisal of the performance of the firm. As a general rule, the higher the P/E ratio, the better it is for the owners. Security analyst to assess a firm’s performance as expected by the investor’s popularity uses this ratio. It is the most important and useful tool to compare one company to other company in some industry.

$$\text{P/E ratio} = \frac{\text{Market Price per Share}}{\text{Earnings per Share}}$$

Table 3.1.3 Price Earnings Ratio of sample banks:

S.N	Banks/Years	2006/07	2007/08	2008/09	2009/10	2010/11	Average (\bar{x})	Standard deviation ()	Coefficient of variation (C.V)%
1.	BOK	31.61	39.21	33.30	19.50	12.81	27.29	9.67	35.42
2.	EBL	30.99	34.11	24.55	16.27	13.15	23.81	8.11	34.06
3.	HBL	28.69	31.56	28.43	25.66	12.88	25.44	6.55	25.76
4.	NSBI	29.89	53.34	55.52	31.28	22.74	38.55	13.30	34.50
5.	NIBL	27.63	42.33	37.10	13.42	10.54	26.20	12.57	47.98
6.	NABIL	36.84	45.53	43.19	28.45	17.72	34.35	10.20	29.69
7.	LBL	64.18	67.66	51.31	23.63	14.62	44.20	21.44	48.51
8.	SCBNL	35.25	51.77	54.64	42.23	25.90	41.96	10.58	25.21
9.	KBL	36.56	61.47	31.76	19.31	16.98	33.22	15.73	47.35
10.	NCC	(19.08)	12.83	11.41	9.08	10.58	4.96	12.08	243.55

Above table shows that the Laxmi Bank has highest average P/E ratio i.e. 44.20, it means investors perception and expectation towards this bank is positive. They believe that the bank is doing its management very nicely and will continue it in future. So investors invest more in such banks share. Thus the price of share of such banks is also high. Just opposite NCC Bank has the lowest average P/E ratio i.e. 4.96, it indicates that

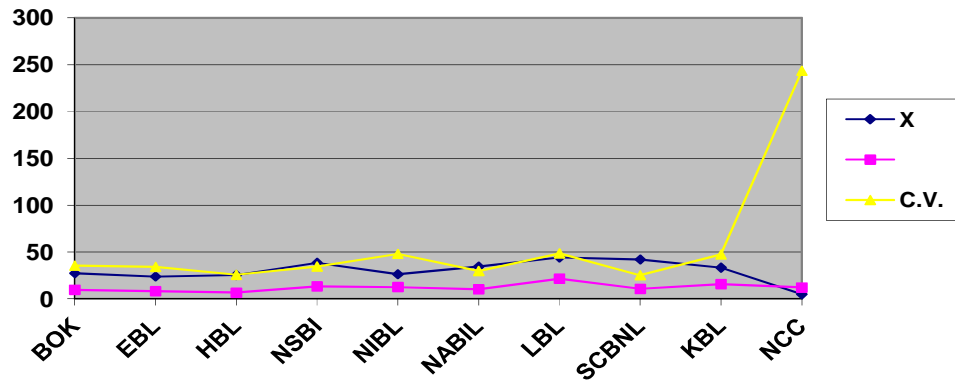
the investors expectation towards the management of material and human resources is negative. So the market price per share is low.

The standard deviation (risk) of Himalayan Bank is lowest i.e.6.55 among the sampled banks. It means there is least volatility in P/E ratio of HBL Bank which is a major attractiveness of the bank to the investors. Similarly the standard deviation of Laxmi Bank is highest i.e.21.44. So there is high volatility in P/E ratio of LBL. Thus the investors fear for investment. Due to this reason the market price of share of such banks may be low.

Similarly, coefficient of variation (CV) analysis shows that the CV of Standard Chartered Bank i.e. 25.21 is least than the other sampled banks so it best option for investment. But the CV of NCC bank i.e. 243.55 is largest than other, so investors are less interested to invest in such banks. So the market price of share of such banks is comparatively lower.

The following figure gives the clear picture of P/E ratio analysis:

Figure 3.3 P/E ratios of the sample banks



3.1.4 Liquidity Ratio (CRR):

Liquidity is the management of liquid assets and liquid liabilities in such a way that can easily meet all legitimate demands for funds without interruption for minimizing costs. So that the organization can easily grab the opportunity and can face with threats. Managing liquidity is absolutely essential to the survival of an organization.

This research is concerned with analyzing the financial statement of commercial banks (financial institutions). So liquidity represents the cash with bank (vault cash) and cash at central bank (cash reserve ratio (CRR)). In this context, the research is focused on to analyze the CRR. As per the NRB directives 5.5% CRR is necessary for eligibility. The following formula is used to calculate the CRR:

$$\text{Cash Reserve Ratio (CRR)} = \frac{\text{Cash deposit in central bank}}{\text{Total deposit collection}}$$

Table 3.1.4 Liquidity Ratio of sample banks:

S.N	Banks/Years	2006/07	2007/08	2008/09	2009/10	2010/11	Average (\bar{x})	Standard deviation ()	Coefficient of variation (C.V)%
1.	BOK	8.02	7.57	7.58	8.32	8.10	7.92	.30	3.79
2.	EBL	2.94	4.56	14.26	15.53	9.55	9.37	5.03	53.68
3.	HBL	5.92	5.13	6.76	6.76	5.75	6.06	0.63	10.4
4.	NSBI	5.60	5.72	6.67	9.03	7.00	6.8	1.24	18.24
5.	NIBL	10.47	10.91	10.32	7.77	7.67	9.43	1.41	14.95
6.	NABIL	6.00	8.37	9.03	3.02	4.90	6.26	2.22	36.10
7.	LBL	5.65	5.65	8.61	7.24	9.22	7.27	1.47	20.22
8.	SCBNL	5.46	5.84	8.18	6.74	6.10	6.46	.95	14.71
9.	KBL	3.65	1.91	7.13	8.02	5.74	5.29	2.24	42.40
10.	NCC	11.66	20.19	12.99	20.29	15.85	16.20	3.57	22.04

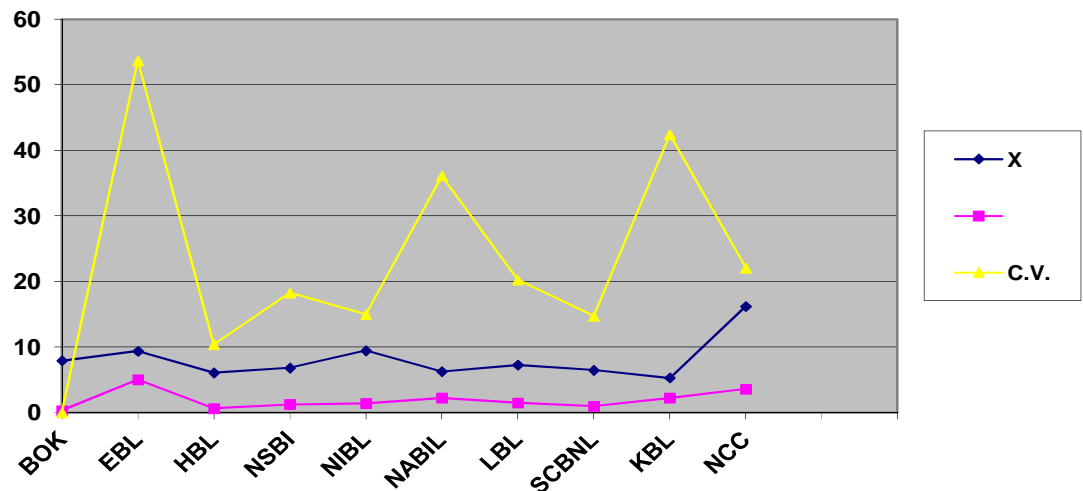
This table clearly specifies that the NCC Bank (16.20) and Nepal Investment Bank (9.43) have higher average liquidity ratio than other sampled banks. This reflects the strength of bank to grave any unseen opportunity and to defend the unexpected future threats. So such optimum liquidity helps to extend the value of firm. So the potential investors like to invest in such banks. In other hand Kumari Bank (5.29) and Himalayan Bank (6.06) have lower average liquidity. This shows the vulnerable condition of bank. Due to low liquidity, banks may unable to grave opportunity and they may be weak to fight against different challenge. So investors fear to invest in such banks.

The volatility of Everest Bank (5.03) and NCC Bank (3.57) are larger than others. So such banks are not an attractive investment destination. Similarly, the Bank of Kathmandu (0.30) and Himalayan Bank (0.63) have lower fluctuation on their liquidity ratio. This is a good signal for investor.

CV is a most reliable source of information for investment decision to the rational investor. The CV of Bank of Kathmandu is lowest among the sampled banks. Similarly, the Everest Bank and Kumari Bank have higher CV than others. So BOK is a target point for investor. Thus, its market price of share must be higher than other sampled bank.

The following figure gives the clear picture of Liquidity analysis:

Figure 3.4 Liquidity ratios of the sample banks



3.1.5 Dividend in share capital (including bonus):

Dividend is a portion of total profit earned to the share holders. Dividend distribution (either higher or lower) or not, is depends on a company's willingness. Dividend is a main source of earning to the shareholders. In other term, it is a direct source of return from investment. So it values more to the investors. Higher the ratio of

dividend to the capital higher will be the investor's interest for investment and vice-versa.

Dividend on share capital ratio is calculated by using the following formula:

$$\text{Dividend on share capital ratio} = \frac{\text{Dividend per share}}{\text{Book value per share}}$$

Table 3.1.5 Dividend in Share capital of sample banks:

S.N	Banks/Years	2006/07	2007/08	2008/09	2009/10	2010/11	Average (\bar{x})	Standard deviation ()	Coefficient of variation (C.V)%
1.	BOK	20	42.11	47.37	30	34.75	34.85	9.52	27.32
2.	EBL	30	30	30	30	10	26	8	30.77
3.	HBL	40	45	43.56	36.84	36.84	40.45	3.37	8.33
4.	NSBI	47.59	-	42.11	17.50	17.58	24.96	17.55	70.31
5.	NIBL	30	40.83	20	25	50	33.17	10.88	32.80
6.	NABIL	140	100	85	70	30	85	35.50	41.76
7.	LBL	-	21.05	5.26	13	15.79	11.02	7.71	69.96
8.	SCBNL	130	130	100	70	50	96	26.09	27.18
9.	KBL	21.05	10.53	10.58	12	8.44	12.52	4.41	35.22
10.	NCC	-	-	-	-	-	-	-	-

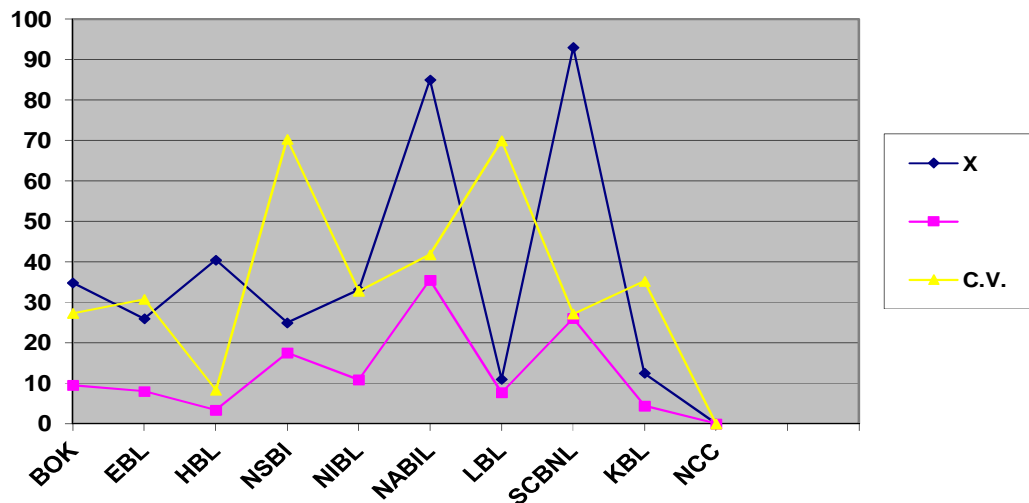
The above presentation clearly specifies that the average dividend on share capital ratio of NABIL Bank (85) and Standard Chartered Bank (96) have highest all over the sampled banks. It means investors of these banks are getting more return on their investment. So the market price of such banks will increase sharply in near future. Similarly NCC Bank (-) and Laxmi Bank (11.02) have smaller ratio. So their share price may lower than other sampled banks.

Volatility on dividend distribution in NABIL Bank (35.50) and Standard Chartered Bank (26.09) are large so there is more risk on price fluctuation of share price. But the Himalayan Bank (3.37) and Kumari Bank (4.41) have lower risk on investment. So such banks are the first priority for the investment to the investors.

But the decision taken as above may differ to the decision taken on the basis of CV analysis. The CV of Himalayan bank is lowest so it is more attractive bank. Similarly, the CV of Nepal SBI bank is highest so this bank is not attractive for investment for potential investors.

The following figure gives the clear picture of dividend analysis:

Figure 3.5 Dividend on share capital of the sample banks



3.1.6 Capital Adequacy Ratio:

It is the ratio between capital of a company and its risk weighted assets. The capital is also categorized in to two parts i.e. core capital and supplementary capital. So the capital adequacy ratio is calculated on the basis of core capital and total capital to risk weighted assets. We take only total capital to analyze the capital adequacy of sampled banks for easy purpose.

Capital adequacy refers to the sufficient capital to the company that sustains unexpected risk on its assets. . If any unexpected events happened, the adequate capital provides security to the depositor’s wealth or the funds. So depositors refer the bank with

high capital adequacy for the deposit of their surplus money. The same condition applies to the investors also. The following formula is used to calculate capital adequacy ratio:

$$\text{Capital adequacy ratio} = \frac{\text{Total capital (core capital + supplementary capital)}}{\text{Total risk weighted assets}}$$

Table 3.1.6 Capital Adequacy Ratio of sample banks:

S.N	Banks/Years	2006/07	2007/08	2008/09	2009/10	2010/11	Average (x̄)	Standard deviation ()	Coefficient of variation (C.V)%
1.	BOK	12.62	11.93	11.68	10.85	11.62	11.74	0.57	4.86
2.	EBL	11.20	11.44	11.34	10.77	10.43	11.04	0.38	3.44
3.	HBL	11.13	12.42	11.02	10.72	10.68	11.19	0.64	5.72
4.	NSBI	13.29	12.32	11.92	12.25	11.52	12.26	0.59	4.81
5.	NIBL	12.17	11.28	11.24	10.55	10.91	11.23	0.54	4.80
6.	NABIL	12.04	11.10	10.70	10.50	10.58	10.98	0.57	5.19
7.	LBL	12.43	11.17	11.48	13.71	11.63	12.08	0.91	7.53
8.	SCBNL	15.71	13.15	14.70	14.60	14.22	14.48	0.83	5.73
9.	KBL	11.22	14.41	11.56	12.34	13.76	12.66	1.23	9.72
10.	NCC	(9.14)	11.09	11.07	13.94	13.78	7.98	8.70	109.02

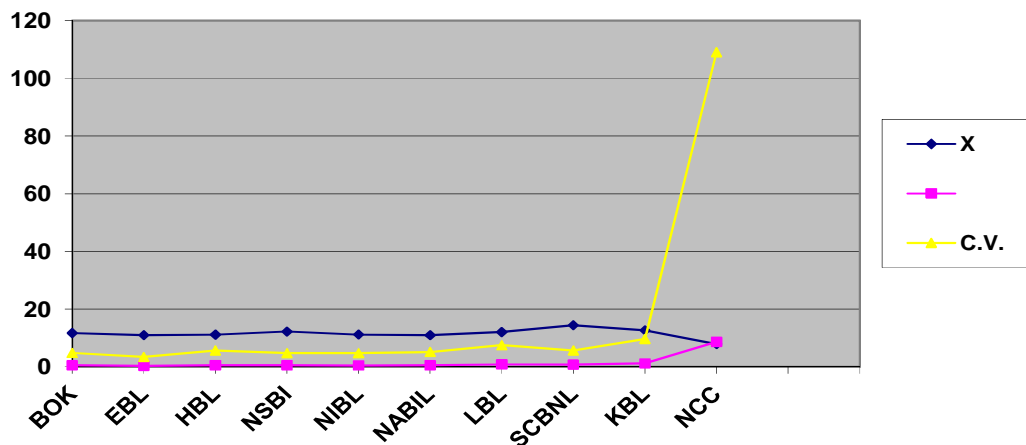
As results tabulated above, all sampled banks except NCC bank have sufficient average capital adequacy ratio. The necessary capital adequacy ratio (total capital to total risk adjusted assets) is 11% as per Nepal Rastra Bank Directives. There is highest capital adequacy ratio (14.48) of Standard Chartered Bank. It is good signal for investor. Thus normally market price of share may increase. But the NCC Bank has lowest average capital adequacy ratio i.e. 7.98. It is insufficient, because it is below than the NRB standard i.e. 11%.

The standard deviation of NCC Bank is largest i.e. 8.70 of sampled banks. So there is high risk. Similarly, Everest Bank has lowest i.e. 0.38, so there is high potentiality of increase in market price of share, that pull the investors to invest in such bank's share.

While the combine analysis of risk and return i.e. CV analysis, we get a result that is, the CV of NCC Bank (109.02) and Kumari Bank (9.72) are high. So, comparatively, they are not preferable for investment. But the Everest Bank (3.44) and Nepal Investment Bank (4.80) have low CV; they are attractive bank for investment. So the demand of such banks share in the share market may be high. Due to this reason, the price of such banks needs to be high.

The following figure gives the clear picture of capital adequacy analysis:

Figure 3.6 capital adequacy ratios of the sample banks



3.2 Correlation Coefficient Analysis between EPS and MPS:

Correlation analysis establishes the closeness of relationship between two and more variables. It measures the degree of relationship or association between variables. Karl Pearson's coefficient of correlation is used to measure the degree of association among the variables EPS and MPS. Correlations are useful because they can indicate a predictive relationship that can be exploited in practice. Correlations can also suggest possible causal or mechanistic relationships. The formula used to calculate the coefficient of correlation is as:

$$r = \frac{N \sum XY - (\sum X)(\sum Y)}{[\sum X^2 - (\sum X)^2 / N][\sum Y^2 - (\sum Y)^2 / N]}$$

Where,

N = Numbers of pairs in observation

X = Product of the first variable

Y = Product of the second variable

Table 3.2.1 Correlation between EPS and MPS of sample banks:

Name of banks	Average EPS (\bar{X})	Average MPS (\bar{Y})	Correlation coefficient (r_{xy})
1. Bank of Kathmandu	49.14	1392	0.90
2. Everest bank Ltd	90.71	2148.2	0.11
3. Himalayan bank Ltd.	52.35	1374.2	0.88
4. Nepal SBI bank Ltd	30.48	1178.6	0.64
5. Nepal Investment bank Ltd	51.85	1357.4	0.40
6. NABIL bank Ltd.	104.17	3771.4	0.94
7. Laxmi bank Ltd	19.05	755	(0.35)
8. Standard Chartered bank Ltd	111.29	4763.8	0.82
9. Kumari bank Ltd	20.20	653.8	0.04
10. Nepal Credit & Commerce bank Ltd.	18.90	310	0.29

Calculations are shown in Appendix.

The above summary table shows the result of correlation coefficient between EPS and MPS of sampled banks. A detail calculation has been illustrated in Appendix.

- The first result shows that the correlation coefficient between EPS and MPS of Bank of Kathmandu i.e. 0.90. This is a high degree of positive correlation. It means if, the EPS increase, the MPS also increase at the nearly same speed and vice versa.

- The second result shows the correlation coefficient between EPS and MPS of Everest Bank i.e. 0.11. There is a low degree of positive correlation. If EPS increases/decreases MPS also increases/decreases, but at low pace.
- The third result of correlation coefficient is of Himalayan Bank i.e.0.88. It shows that there is a high degree of positive correlation between EPS and MPS. Both of them flow to the same direction at nearly same speed.
- Similarly, the fourth result is of Nepal SBI Bank i.e. 0.64. It is also a high degree of positive correlation between EPS and MPS.
- The next results is the correlation coefficient of EPS and MPS of Nepal Investment Bank i.e. 0.40. This is a low degree of positive correlation. So if EPS goes up then MPS will also goes up but a low pace.
- The sixth result shows that the EPS and MPS of NABIL Bank are 0.94, which is a high degree of positive correlation. It means if, the EPS increase, the MPS also increase at the nearly same speed and vice versa.
- The seventh result is of Laxmi Bank. The correlation coefficient between EPS and MPS is -0.35. This is a low degree of negative correlation. It shows that if the EPS increases at a certain proportion then the MPS decreases at a proportion less than that of increase in EPS and vice versa.
- Another results is correlation coefficient between EPS and MPS of Standard Chartered Bank Nepal i.e. 0.82. That is a high degree of positive correlation.
- The second last result is of Kumari Bank. The correlation coefficient between EPS and MPS is 0.04. This is a low degree of positive correlation.
- The last but not the least is Nepal Credit and Commerce Bank. The correlation between EPS and MPS is 0.29. This shows that there is low degree of positive correlation.

The above result shows that, generally, there is positive correlation between EPS and MPS. Investors are conscious on the financial performance of firms. So higher the EPS the investors demand more the share of respective company, thus higher will be the market price of share of such company.

The following figures give the clear picture of relation:

Figure 3.7 Correlation Coefficient of the sample banks

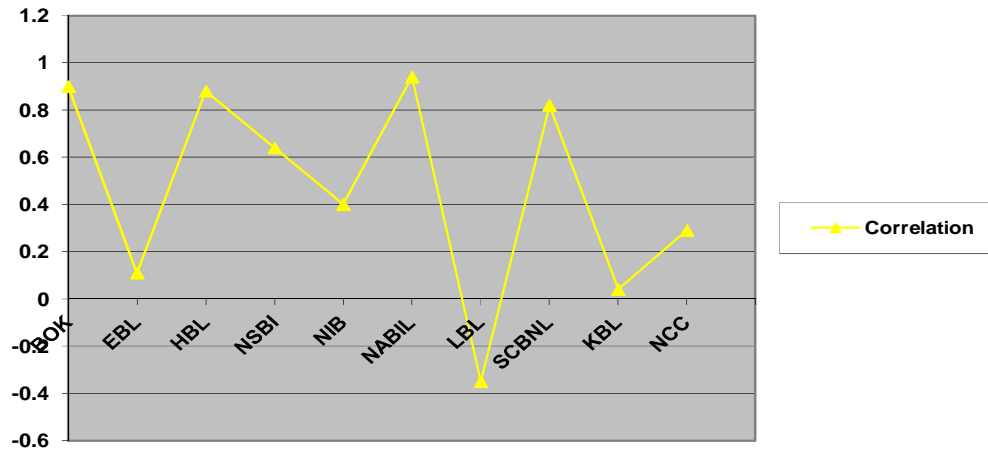


Figure 3.8 EPS of sample banks

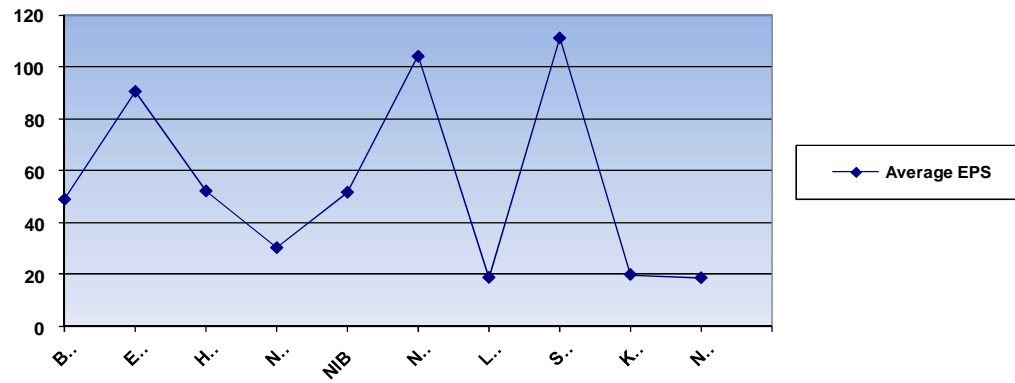
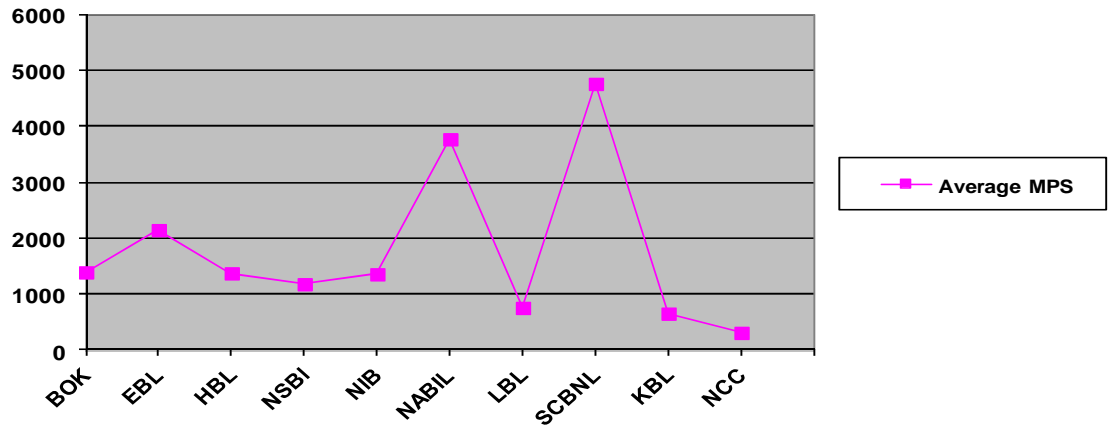


Figure 3.9 MPS of sample banks



3.3 Testing of Hypothesis:

As proposed in the first chapter, the calculated values of correlation coefficients presented in Table 3.2.1 are tested by using t-test. The tests are shown in the Appendix. The results of the tests are presented in the following table:

Table 3.3.1 Hypothesis 1

For the EPS & MPS of **Bank of Kathmandu (BOK)**

Null hypothesis: (H_0)	EPS & MPS of BOK are not correlated.
Alternative hypothesis: (H_1)	EPS & MPS of Bok are correlated.
Correlation coefficient (r)	0.90
Calculated value (t_{cal})	3.5763
Tabulated value (t_{tab})	3.182
Degree of freedom ($d.f.$)	3
Level of significance ()	5%
Decision	H_0 rejected i.e. EPS & MPS of BoK are correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed the existence of relationship between EPS and MPS of Bank of Kathmandu. Therefore, it has been concluded that EPS and MPS of this bank are correlated which indicates that increase/decrease in EPS has positive effect in MPS. It means investors should consider the financial information as an important base for investment decision. In other words Nepalese investors should be rational. Their investment decision should not be depends on the market rumors. Thus we can conclude that Nepalese stock market is going to be perfect.

Table 3.3.2 Hypothesis 2

For the EPS & MPS of **Everest Bank Limited (EBL)**

Null hypothesis: (H_0)	EPS & MPS of EBL are not correlated.
Alternative hypothesis: (H_1)	EPS & MPS of EBL are correlated.
Correlation coefficient (r)	0.11
Calculated value (t_{cal})	0.1917
Tabulated value (t_{tab})	3.182
Degree of freedom ($d.f.$)	3
Level of significance ()	5%
Decision	H_0 accepted i.e. EPS & MPS of EBL are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Everest Bank Limited. Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words Nepalese investors are not rational. Their investment decision mostly depends on the market rumors. Thus we can conclude that Nepalese stock market is still imperfect.

Table 3.3.3 Hypothesis 3

For the EPS & MPS of **Himalayan Bank Limited (HBL)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of HBL are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of HBL are correlated.
Correlation coefficient (<i>r</i>)	0.88
Calculated value (<i>t_{cal}</i>)	3.2089
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> rejected i.e. EPS & MPS of HBL are correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is an existence of relationship between EPS and MPS of Himalayan Bank Limited. Therefore, it has been concluded that EPS and MPS of this bank are correlated which indicates that increase/decrease in EPS has positive effect in MPS. It means investors should consider the financial information as an important base for investment decision. In other words Nepalese investors should be rational. Their investment decision should not be depends on the market rumors. Thus we can conclude that Nepalese stock market is going to be perfect.

Table 3.3.4 Hypothesis 4

For the EPS & MPS of **Nepal SBI Bank Limited (NSBI)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of NSBI are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of NSBI are correlated.
Correlation coefficient (<i>r</i>)	0.64
Calculated value (<i>t_{cal}</i>)	1.4427
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of NSBI are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Nepal SBI Bank Limited (NSBI). Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS.

Table 3.3.5 Hypothesis 5

For the EPS & MPS of **Nepal Investment Bank Limited (NIBL)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of NIBL are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of NIBL are correlated.
Correlation coefficient (<i>r</i>)	0.40
Calculated value (<i>t_{cal}</i>)	0.7560
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of NIBL are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Nepal Investment Bank Limited (NIBL). Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words Nepalese investors are not rational. Their investment decision mostly depends on the market rumors. Thus we can conclude that Nepalese stock market is still imperfect.

Table 3.3.6 Hypothesis 6

For the EPS & MPS of **NABIL Bank Limited**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of NABIL bank are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of NABIL bank are correlated.
Correlation coefficient (<i>r</i>)	0.94
Calculated value (<i>t_{cal}</i>)	4.772
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> rejected i.e. EPS & MPS of NABIL are correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is an existence of relationship between EPS and MPS of Himalayan Bank Limited. Therefore, it has been concluded that EPS and MPS of this bank are correlated which indicates that increase/decrease in EPS has positive effect in MPS. It means investors should consider the financial information as an important base for investment decision. In other words Nepalese investors should be rational. Their investment decision should not be depends on the market rumors. Thus we can conclude that Nepalese stock market is going to be perfect.

Table 3.3.7 Hypothesis 7

For the EPS & MPS of **Laxmi Bank Limited (LBL)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of LBL are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of LBL are correlated.
Correlation coefficient (<i>r</i>)	-0.35
Calculated value (<i>t_{cal}</i>)	0.6472
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of LBL are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Laxmi Bank Limited (LBL). Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words Nepalese investors are not rational.

Table 3.3.8 Hypothesis 8

For the EPS & MPS of **Standard Chartered Bank Nepal Limited (SCBNL)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of SCBNL are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of SCBNL are correlated.
Correlation coefficient (<i>r</i>)	0.82
Calculated value (<i>t_{cal}</i>)	2.4813
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of SCBNL are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Standard Chartered Bank Nepal Limited (SCBNL). So, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words, Nepalese investors are not rational. Their investment decision mostly depends on the market rumor, that's why Nepalese stock market is still imperfect.

Table 3.3.9 Hypothesis 9

For the EPS & MPS of **Kumari Bank Limited (KBL)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of KBL are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of KBL are correlated.
Correlation coefficient (<i>r</i>)	0.04
Calculated value (<i>t_{cal}</i>)	0.0693
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of KBL are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Kumari Bank Limited (KBL). Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause decrease/increase in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words Nepalese investors are not rational. Their investment decision mostly depends on the market rumors. Thus we can conclude that Nepalese stock market is still imperfect.

Table 3.3.10 Hypothesis 10

For the EPS & MPS of **Nepal Credit & Commerce Bank Limited (NCC)**

Null hypothesis: (<i>H₀</i>)	EPS & MPS of NCC bank are not correlated.
Alternative hypothesis: (<i>H₁</i>)	EPS & MPS of NCC bank are correlated.
Correlation coefficient (<i>r</i>)	0.29
Calculated value (<i>t_{cal}</i>)	0.5249
Tabulated value (<i>t_{tab}</i>)	3.182
Degree of freedom (<i>d.f.</i>)	3
Level of significance ()	5%
Decision	<i>H₀</i> accepted i.e. EPS & MPS of NCC bank are not correlated.

Calculations are shown in Appendix

The testing of hypothesis as above showed that there is no existence of relationship between EPS and MPS of Nepal Credit & Commerce Bank Limited (NCC). Therefore, it has been concluded that EPS and MPS of this bank are not correlated which indicates that increase/decrease in EPS doesn't cause increase/decrease in MPS. It means investors do not consider the financial information as an important base for investment decision. In other words Nepalese investors are not rational. Their investment decision mostly depends on the market rumors. Thus we can conclude that Nepalese stock market is still imperfect.

Chapter 4:

Summary, Conclusion and Recommendations

4.1 Summary

Securities are the powerful components of raising funds to meet the financial requirement of the company. Most of the companies need huge amount of money to meet their financial requirement. Therefore, securities like equity shares, preference shares, and debentures are crucial for meeting the company's monetary requirements. In Nepal the history of security markets started by issuing the shares to the public in the year 1937 by two companies Biratnagar Jute Mills and Nepal Bank Limited. These two companies were considered as the pioneer of issuing the security to the public. Since then almost for four decades, there were no formal institutions that came into existence to look after the security issues. Later in the year 1993 Security Board of Nepal (SEBON) was established as an apex institution of regulating securities and to promote the market and protect the rights of the investors. One of the important security market indicators of measuring the performance is market capitalization. However, market capitalization ratio for Nepal is very low as compared with other countries. Looking at the performance of stock market, Nepalese stock Market is still in infancy and could not play a significant role in terms of putting impact on the economic activities in the country. In many developed countries most of the investors rely upon the collective investment schemes for investing their saving in secondary market. There are two mutual funds operating in Nepal. Both of them came with the objective of collecting the capital from the small and the medium savers.

The stock market of Nepal is still in preliminary stage and it is developing in slow rate. It needs help from all concerned bodies to function properly. The government should formulate effective rules and regulations and implement it properly to develop the stock market. The listed companies should always be ready to help the market by obeying the rules and regulations, timely disclosing and submitting annual financial statement, avoiding rumors and not manipulating the price of stock.

This thesis investigates the interests of investor in financial information. It concentrates on the research of value relevance of financial statements. Value relevance refers to the idea that financial statement information should correlate with stock prices to a high extent. Generally, the results show that an investigated item of financial statements

is (to some extent) value relevant because most financial statement items correlate to some extent with market values. Research investigating the value relevance of financial statements with the help of correlation analysis has found that there is value relevance of financial statement information to market price of share. But while testing its hypothesis, the results show that there no any value relevance of financial information to the market price of share except BOK, NABIL, and Himalayan Bank Limited.

Using different financial and statistical tools, the company's performance has been analyzed to relate their market price. The performance has been analyzed with the help of some major financial indicators i.e. EPS, ROA, P/E ratio, Liquidity ratio, Dividend on share capital, and Capital adequacy ratio. This research report shows the relationship between EPS and MPS of sampled banks, that represents the relationship between financial information and market price of share of Nepalese capital market. In other words it shows the degree of awareness of investors towards financial information or disclosure of financial statement of companies where they are going to invest. This analysis shows the mixed behavior in this relationship. The correlation analysis shows that there is relationship (either positive or negative) between financial information i.e. EPS and MPS. But the testing of hypothesis of correlation coefficient shows that there is no existence of relationship between EPS and MPS except three banks, they are Bank of Kathmandu, Himalayan Bank Limited and NABIL Bank Limited.

The summary table presented below gives the exact idea about the company's performance in major aspects.

Table 4.1 Summarized table of performance of sampled banks

Description	Statistical tools	BOK	EBL	HBL	NSBI	NIBL	NABIL	LBL	SCBNL	KBL	NCC
EPS	\bar{X}	49.14	90.71	52.35	30.48	51.85	104.17	19.05	111.29	20.20	18.9
		6.89	8.77	12.24	6.22	8.59	23.84	4.93	35.91	3.50	18.9
	C.V.	14.02	9.67	23.38	20.41	16.57	22.89	25.87	32.27	17.32	100
ROA	\bar{X}	2.14	1.79	1.65	1.27	1.89	2.48	1.34	2.54	1.37	2.5
		0.22	0.28	0.28	0.32	0.19	0.14	0.32	0.10	0.16	2.38
	C.V.	10.10	15.64	16.97	25.20	10.05	5.7	23.88	3.83	11.67	95.20 s
P/E ratio	\bar{X}	27.29	23.81	25.44	38.55	26.20	34.35	44.20	41.96	33.22	4.96
		9.67	8.11	6.55	13.30	12.57	10.20	21.44	10.58	15.73	12.08
	C.V.	35.42	34.06	25.76	34.50	47.98	29.69	48.51	25.21	47.35	243.5 5
Liquidity ratio	\bar{X}	7.92	9.37	6.06	6.80	9.43	6.26	7.27	6.46	5.29	16.20
		0.30	5.03	0.63	1.24	1.41	2.22	1.47	0.95	2.24	3.57
	C.V.	3.79	53.68	10.40	18.24	14.95	36.10	20.22	14.71	42.40	22.04
Dividend in share capital	\bar{X}	34.85	26	40.45	24.96	33.17	85	11.02	96	12.52	-
		9.52	8	3.37	17.55	10.88	35.50	7.71	26.09	4.41	-
	C.V.	27.32	30.77	8.33	70.31	32.80	41.76	69.96	27.18	35.22	-
Capital adequacy ratio	\bar{X}	11.74	11.04	11.19	12.26	11.23	10.98	12.08	14.48	12.66	7.98
		0.57	0.38	0.64	0.59	0.54	0.57	0.91	0.83	1.23	8.70
	C.V.	4.86	3.44	5.72	4.81	4.80	5.19	7.53	5.73	9.72	109.0 2
Average MPS		139 2	214 8.20	1374. 20	1178. 60	1357. 40	3771.4 0	755	4763.8 0	653. 80	310

Table 4.2 summarized table of correlation and test of hypothesis.

Name of banks	Average EPS (X)	Average MPS (Y)	Test of hypothesis	Correlation coefficient (r _{xy})
1. Bank of Kathmandu	49.14	1392	Ho: rejected	0.90
2. Everest Bank Ltd	90.71	2148.20	Ho: accepted	0.11
3. Himalayan Bank Ltd.	52.35	1374.20	Ho: rejected	0.88
4. Nepal SBI Bank Ltd	30.48	1178.60	Ho: accepted	0.64
5. Nepal Investment Bank Ltd	51.85	1357.40	Ho: accepted	0.40
6. NABIL Bank Ltd.	104.17	3771.40	Ho: rejected	0.94
7. Laxmi Bank Ltd	19.05	755	Ho: accepted	(0.35)
8. Standard Chartered Bank Ltd	111.29	4763.80	Ho: accepted	0.82
9. Kumari Bank Ltd	20.20	653.80	Ho: accepted	0.04
10. Nepal Credit & Commerce Bank Ltd.	18.90	310	Ho: accepted	0.29

4.2 Conclusions

The main objective of this study is to find the role of financial information or investor's consciousness in this information to the investment decision.

Regarding this topic, I take six major financial performance indicators i.e. EPS, ROA, P/E ratio, Liquidity ratio, Dividend in share capital ratio and Capital adequacy ratio to examine their relatedness to the market price movement.

As a result obtained from the analysis of data in **Chapter-3**, it can be concluded that market price of share is driven by the performance of these companies. Higher the performance (i.e. financial indicators) higher the market price of share and vice-versa, except some exceptions. The analysis shows that the investors are observing only the general overview of financial statement; they do not analyze it thoroughly. So investors see return part only for investment. They are not conscious towards the risk portion. Hence, such kind of behavior of Nepalese investors' results that they are risk averter investors or they are immature investors. Higher the return, higher the market price of share and vice-versa. But the risk () and C.V. seems as like as unrelated or do not affect to market price of share.

Similarly, relation analysis is another crucial element of this thesis report. The correlation coefficient analysis between financial information and market price per share is analyzed using EPS as one of important component of financial information. The correlation analysis between EPS and MPS shows the relation between them (either positive or negative). It shows the positive relation among all sampled banks except one bank. It means while EPS increases the MPS also grows up at a slightly low pace than EPS. It gives the positive message about capital market of Nepal.

But, testing hypothesis, an important tool for research analysis shows that there is no existence of relationship between financial information (i.e. EPS) and market price per share (MPS). It indicates that Nepalese investors do not use financial statement for investment decision. They do their investment decisions based on just only rumors. Investors do not use their knowledge, skill, idea and capacity while taking investment decisions.

Finally, it can conclude that Nepalese stock market is still in infant phase. It is developing as our country. Stock market is in imperfect position. Normally investors are

irrational. Stock market is very risky because the market movement is not based on real factors.

4.3 Recommendations

After the thorough study of the research with the help of various literatures, relevant data, financial and statistical tools & technique, the following recommendations have been proposed for consideration by the concerns:

- ✓ Study of the relation of MPS with EPS, ROA, P/E ratio, Liquidity ratio, dividend on share capital and capital adequacy ratio of sampled banks shows that there is positive relation among them except a bank. Similarly, correlation analysis between EPS and MPS also shows their relation. But testing of hypothesis of correlation depicts that there is no existence of relation between EPS and MPS. It indicates the imperfection of Nepalese capital market. Long historical reference of developed capital market justifies that there must be a relation between financial performance and movement of market price of share. In the context of Nepalese capital market, investors have only little knowledge about security market. Majority of Nepalese investors are not well educated, they have lack of technical and analytical skill. So Nepal government should take initiation to grant investor awareness program, necessary training program, and analytical skill development program. Limiting not only this, the government, doing cooperation with Security Board Nepal (SEBON), should publicized the importance and requirements of capital to the economic prosperity of a country through the help of different media i.e., radio, T.V., hoarding board, poster and pump let, newspaper and magazines etc. All security market members should give pressure to the government to keep subject about capital market on academic course of study.
- ✓ The government should regulate & establish standard tools and techniques and all the public companies follow the same, so that genuine & accurate evaluation can be made between companies.
- ✓ The government should not only make policies for capital market development but also implement these policies timely and appropriately.

- ✓ The investment decision of the individuals is based to a large extent on signals they get from capital market. The market mechanism should be able to provide reliable information timely and widely. The listed company's data, their commitment to NEPSE should be updated and analyzed time and again.
- ✓ Concrete steps should be undertaken to make all the public limited companies to disclose of factual information about themselves and their financial performance on stipulated time.
- ✓ There should be proper mechanism for evaluating & reviewing the company's data and if any company is found with misappropriation against any law, proper action should be taken.
- ✓ The stock exchange should be investors' focused and market oriented along with strong operation with effective management.
- ✓ There should be good coordination and cooperation between concerned regulatory bodies.
- ✓ Buying and selling procedure of shares should be systematic, fast and less time consuming.

BIBLIOGRAPHY

Books:

- Berk, J. & DeMarzo, P. 2007. Corporate Finance Boston: Pearson Education.
- Bhalla, V.K.1999. Investment Management: security analysis and portfolio management, 6th edition. New Delhi: Sultan and Chand Company Ltd.
- Bhattari, Rabindra. 2065. Share Market of Nepal, 5th edition, Kathmandu: Buddha Academic Publishers and Distributors Pvt. Ltd.
- Doodha, K.S. 1962. Stock Exchange in Developing Economy, University of Bombay: Bombay.
- Fisher, Donald E. and Ronald J. Jordan. 2000. Security Analysis and Portfolio Management, 12th Indian Reprint. New Delhi: Prentice Hall of India Pvt. Ltd.
- Foster, George.2002. Financial Statement Analysis, Pearson Education Asia, India.
- Gupta, O.P. 1989. Stock Market Efficiency and Price Behavior, the Indian Experience: Anmol Publication.
- Horngren, W.T., & Harrison, C.T. 2008. Financial accounting (7th edition): Upper Saddle.
- Kam, V., 1990. Accounting theory (second edition). New York: Wiley.
- Khotari, C.R.1995. Research Methodology, Methods and Techniques: New Delhi.
- Pant, P.R.2009. Social Science Research and Thesis Writing, 5th edition. Kathmandu: Buddha Academic Enterprises Pvt. Ltd.
- Patheja, A. 1994. Financial Management of Commercial Banks. Delhi: South Asia Publications.
- Penman, S. H. 2010. Financial Statement Analysis and Security Valuation. Boston, Mass: McGraw-Hill/Irwin.
- Pradhan, R.S.1993. Stock Market Behavior of Small Capital Market: In a case of Nepal, The Nepalese Management Review.vol IX: 216
- Saunders, Anthony and Millon, C. Marcia. 2010. Financial Markets and Institutions, The McGraw.Hill Companies.

- Sharpe, Alexander. 1998. Investments, New Delhi: Prentice Hall.
- Shrestha, Sunity. 1995. Portfolio Behavior of Commercial Bank in Nepal, Kathmandu: Mandela Books Links.
- Van Horne, James C. 1998. Financial Management and Policy New York: Prentice Hall of India Private Limited.
- Van Horne, James C. 2002, Financial Management and Policy, 12th edition: Prentice-Hall of India.
- Weston, J.F. and Brigham, E.F. 1982. Management Finance, London: Holt-Saunders International Edition.
- Weston, J.F. and Copland, T.E. 1995. Managerial Finance, London: Holt-Saunders International Edition.
- Wolff, H.K. & Pant, P.R. (Eds.) 1999. A handbook for social science research and thesis writing. Kathmandu: Buddha Academic Enterprises Pvt. Ltd.

Websites:

www.bok.com.np	-Bank of Kathmandu Ltd.
www.everestbankltd.com	-Everest Bank Ltd.
www.laxmibank.com	-Laxmi Bank Ltd.
www.himalayanbank.com	-Himalayan Bank Ltd.
www.kumaribank.com	-Kumari Bank Ltd.
www.nabilbank.com	-NABIL Bank Ltd.
www.nccbank.com.np	-Nepal Credit & Commerce Bank Ltd.
www.nepalsbi.com.np	-Nepal SBI Bank Ltd.
www.nepalstock.com	-Nepal Stock Exchange Ltd.
www.nibl.com.np	-Nepal Investment Bank Ltd.
www.sebon.gov.np	-Security Board Nepal
www.standardchartered.com/np	-Standard Chartered Bank Nepal Ltd.