

**A COMPARATIVE STUDY OF STOCK PRICE BEHAVIOUR  
OF FOREIGN JOINT VENTURE COMMERCIAL BANKS: *With  
Reference to Nabil Bank Ltd and Everest Bank Ltd***

**A Thesis Proposal**

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## **1.1 Background of the Study**

The history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the company Act in 1964, the first issuance of Government Bond in 1964 and the establishment of Securities Exchange Centre Ltd. In 1976 were other significant development relating to capital markets. When security exchange centre converted into Nepal Stock Exchange (NEPSE) in 1993, the objectives of this institution become; to import free marketability and liquidity to the government and corporate securities by facilitating transactions in its only trading floor through market intermediaries' i.e. brokers as well as market makers. Nepal Stock Exchange, in short NEPSE, is a non-profit organization, operating under securities Exchange Act, 1983. NEPSE opened its trading floor on 13<sup>th</sup> January 1994. Member of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities.

At present Nepal have so many banks, insurance companies, micro finance companies performing different tasks. It shows there is perfect competition between these institutions. Commercial banks are working more effectively. It is because the banks have highly skilled personnel, modern banking services, and international network and country suited services. Besides all these, banks are performing various functions such as money creation and generation, deposit collection, credit extension, credit card issue and cheque transaction, import letter of credit, traveler cheque, export bill, issue of draft, telex transfer, RTGS etc. In the developed capital market, corporations are allowed to buy shares back for better utilization of their unused cash. However, Nepalese company acts 1997, section 47 has prohibited company from purchasing its own shares and supply loans against the security of its own shares.

Commercial banks plays a vital role in the economic resource allocation of country. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. The primary objective of commercial banks is always to earn profit by investing or generating loan and advances to people associated with trade, business, industry and so on. Good

financial performance rewards the shareholders for their investment and encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth.

In a country where the financial sector is dominated by commercial banks, any failure in the sector has an immense on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank runs, crisis and economic troubles. Thus, in order to take precautionary and mitigating measures, there is need to understand the fundamentals of banks and its determinants. Performance evaluation is an important approach for enterprises to give incentive and restraint to their operators and it is an important channel for enterprise stakeholders to get the performance information.

People invest their money for satisfactory and expected return. To these objectives, firms distribute the earnings to their shareholders. Earning is that amount which remains after deducting all operational and non operational expenses. Shareholders expectations may vary with their investment priorities, some invest for capital appreciation of stock and some for earning as dividend. In the capital market, all firms operate in order to generate earnings. Shareholders make investment in equity capital with the expectation of making earnings either directly in the forms of dividend or indirectly in the forms of capital gains in future.

Nepalese capital market has not efficient communication network even today. It has made capital market less efficient and efficiency in results the risk. Even though, it is hoped that Nepalese capital market will be moving towards efficiency in the days to come. In capital market all firms operate in order to generate earning, shareholders make investment in equity capital with the expectation of making earning either directly in the form of dividend or indirectly in the form of capital gains in future. The sole objective of each and every business is maximizing the shareholders wealth. Financial management is the heart of management and the numbers of decisions are made by the financial decision in order to run the company smoothly.

Capital market is the place where long term securities are traded having maturity period more than one year. The capital market mobilizes savings of individuals as investment in different securities, which are ultimately utilized for productive purposes in various sectors of the economy. Capital market can be divided into primary market and secondary market. Primary market is the market place where first issuance of securities takes place and secondary market is the place where trading of existing issued securities takes place.

The development of the capital market in Nepal started in 1976 after the establishment of Security Exchange Center with the objective of facilitating and promoting the capital market in Nepal. Security Exchange Center was converted into Stock Exchange Limited in 1993 and with this broker system for secondary market came in existence in Nepal. Its basic objective is to impart free marketability and liquidity to the government bonds and corporate securities by facilitating transactions in the trading floor through market intermediaries such as brokers, market makers and others.

A fundamental analysis is all about getting an understanding of a company, the health of its business and its future prospects. It includes reading and analyzing annual reports and financial statements to get an understanding of the company's comparative advantages, competitors and its market environment. Fundamental analysis is the examination of the underlying forces that affect the well-being of the economy, industry groups and companies. As with most analysis, the goal is to derive a forecast and profit from future price movements. At the company level, fundamental analysis may involve examination of financial data, management, business concept and competition. At the industry level, there might be an examination of supply and demand forces for the products offered.

Fundamental analysis is built on the idea that the stock market may price a company wrong from time to time. Profits can be made by finding under priced stocks and waiting for the market to adjust the valuation of the company. By analyzing the financial reports from companies you will get an understanding of the value of different companies and understand the pricing in the stock market. After analyzing these factors one can have a better understanding of whether the price of the stock is undervalued or overvalued at the current market price. Fundamental analysis can also be performed on a sectors basis and in the economy as a whole.

For a fundamental analyst, the market price of a stock tends to move towards its 'intrinsic value', which is the 'true value' of a company as calculated by its fundamentals. If the market value does not match the true value of the company, there is an investment opportunity. Example of this is that if the current market price of a stock is lower than the intrinsic price, the investor should purchase the stock because he expects the stock price to rise and move towards its true value. Alternatively, if the current market price is above the intrinsic price, the stock is considered overbought and the investor sells the stock because he knows that the stock price will fall and move closer to its intrinsic value. To determine the true price of the company's stock, there are some factors need to be considered.

## **1.2 Statement of the Study**

Nepalese securities' market being inefficient, most of the investors invests without having proper information and knowledge about the market. Investors are highly influenced by the friend circles and rumors in the market. Actual position of an organization is reflected in its financial statements, but very few investors have knowledge and insight of the actual performance of companies while investing. Fundamental analysis of companies are very important so as to have the glance of true picture of the company and invest wisely but Nepalese market is highly directed by market whim and instincts of investors.

This study is directed towards analyzing chosen commercial banks to know it's fair price at present and to find whether its right time to buy or sell the security. A fundamental analysis is all about getting an understanding of a company, the health of its business and its future prospects. More specifically the study has sought answers to the following questions:

- Are the chosen commercial banks performing fundamentally well?
- Are the stocks of chosen commercial banks priced fairly in stock market?

### **1.3 Objectives of the Study**

The major objective of the study is to analyze the stock price behavior of the chosen commercial banks of Nepal as against the financial valuation tools. However, the specific objectives of the study are as follows:

- To analyze the stock price movement of stock of chosen commercial banks in relation to the financial valuation tools and
- To compare the stock price behaviors of sample commercial banks in relation to the financial valuation tools.

### **1.4 Significance of the Study**

Banks are the most important financial intermediaries in the most economics that provide a bundle of different services. Banks are the financial intermediaries that pool scattered money through its various deposit schemes and invest it in various sectors of the economy. As financial intermediaries, banks play a crucial role in the operation of most economies. Commercial banks are key providers of funds and their stability is of paramount importance to the financial system.

As we know that investors in Nepal are investing in companies without proper study and knowledge of the stock market and company itself, this research will help investors to know about the chosen commercial banks regarding their profitability and riskiness. It will also be helpful to institutions like merchant bankers, investment bankers, portfolio managers etc. Similarly, it will also be helpful to the organization themselves as the study will provide glimpse of past financial performances and its position in stock market for better knowledge on the future prediction for investment.

This study has identified the following research questions regarding fundamentals of commercial banks with special reference to Everest Bank Limited and Nabil Bank limited.

- What is the status of present stock price of Commercial Banks?
- Are the Commercial Banks fairly priced in stock market or not?

## **1.5 Literature Review**

Literature review is one of the essential parts of the research which demonstrate the past researches related to the subject matter. It discovers what has been done in the past and what are left in the past researches. Knowledge of past study provides foundation to the present study.

Studying various books, journals, newspaper, magazine, old thesis and very useful suggestion of the investigators and experts of the related field have been systematically and effectively presented in this part.

### **1.5.1 Financial Market**

Financial Markets provide a forum in which suppliers of loans and investments can transact business directly. The loans and investments of institutions are made without the direct knowledge of the suppliers of funds (savers), suppliers in the financial markets know where their funds are being lent or invested. The two keys of financial markets are the money and the capital market. Transactions in short term debt instruments, or marketable securities, take place in the money market. Long term securities (bonds and stocks) are traded in the capital market.

#### **1.5.1.1 Money Market**

Money market is the market for the short term securities like Treasury-Bills, Government bonds, certificates of deposits, banker acceptances and commercial paper or promissory notes. It includes both primary and secondary market activities. The money market exists because certain individuals, businesses, governments and financial institutions have temporarily idle funds that they wish to place in some kind of liquid assets or short term interest earning instrument. Like this other individuals, businesses, governments and financial institutions are in need of seasonal or temporary financing. Thus the money market provides the platform for the supplier (who have idle funds for some period) and demand makers of short-term liquid funds.

#### **1.5.1.2 Capital Market**

Capital market is the market for the long term funds. Capital market can play vital role to mobilize the market follows capital to invest on the corporate sectors by the means of

securities. The capital market is a financial relationship created by a number of institutions and arrangements that allows the supplier and demanders of long term funds (funds with maturities of more than one year) to make transactions. Included among long term funds are securities issue of business and government. The backbone of the capital market is formed by the various securities exchanges that provide a forum of debt and equity transactions. The smooth functioning of the capital market, which is enhanced through the activities of investment bankers, is important to the long-run growth of business (Gitman, 1992). The capital market is the trading center for the financial instrument. In capital market different types of financial securities such as ordinary share, preference share, treasury bills, and debenture are traded. This market can be further divided into two parts:

i) Non-securities market

ii) Securities market

### **Non-securities market**

Non-securities market is a market where financial needs of the borrower (demanders) are fulfilled for a longer period of time without issuance of any securities like shares, bonds and debentures. Financial transactions between the lending institutions such as banks, business houses, saving institutions or individuals come under this non-securities market.

### **Securities Market**

The securities market is known as the market where all types of securities are traded. Security market is a broad term embracing a number of markets in which securities are bought and sold. Security market sets a price for the securities it trades and makes it easy for people to trade them. Security market facilitates the sale and resale of transferable securities. The security market can be defined as the mechanism for bringing together buyer and seller of financial assets to facilitate trading. Security market is classified into two, the market in new securities are sold is called primary market and the market in which existing securities are resold is called the secondary market. Secondary markets are created by brokers, dealers and market makers. Brokers bring buyer and seller



together with themselves actually buying and selling; dealers set price at which they themselves are ready to buy and sell (bid and ask price respectively).

All securities, whether in the money or capital market are initially issued in the primary market. This is the only market in which the company or government is directly involved in the transaction and receives direct benefit from the resale of securities. Once the securities began to trade among individuals, business, government, or financial institutions, savers and investors, they become part of the secondary market. The primary market is where "new securities are sold" and the secondary market can be viewed as a "used" or "pre owned" securities market.

The securities market may also be divided into two parts:

- Primary market
- Secondary market

#### **1.5.1.2.1 Primary Market**

When firms need capital, they may choose to sell new securities. They sell securities in the primary market. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of a new stock, the sale is an initial public offering (IPO), though it can be found in the prospectus. Investment bankers which is called the primary market typically market these new issues of stocks, bonds or other securities. The issue of the securities in the primary market leads to direct transfer of money from the savers to the issuer of the securities. Thus, the primary market transfers the funds from savers to investors to make the capital available for new investments in building, equipment, stock of necessary goods. The growth of capital market open a venue for trading in the secondary market followed by primary market and it is drawing dimension of investment banking services undertaken by NIDC capital market, Citizen Investment Trust, Nepal Share Market, etc. The linkage between companies and investors has created inveigling conditions in the flow of funds both in primary and secondary market.

Characteristics of Primary market are:

- Market for new long term capital.
- The securities are sold for the first time.
- The securities are issued by the company directly to investors.
- Used by the companies for the purpose of setting up new business or for expanding or modernizing the existing business.

#### **1.5.1.2.2 Secondary Market**

Secondary market is the market where secondhand securities are traded. It means securities once purchased through primary market are traded in secondary market. Both the primary and secondary markets are complementary to each other. In the absence of one market another market cannot flourish. Secondary market comprises stock exchange and Over-The-Counter market, popularly known as OTC market. Unlisted securities are not traded in stock exchange. Exchanges generally do have their own listing rules. So unlisted securities are traded in OTC market. Nepal does not have OTC market. NEPSE is only the secondary market in the country.

Secondary market is also known as economy barometer of country. This is because it reflects the economic policy of the country. All other things remain the same, the rising price of stock exchange shows the policy is favorable and the declining price indicates the opposite.

#### **1.6 Organization of the Study**

The study has been organized into five chapters in total. The study starts with the first chapter (introduction) that includes general background followed by the statement of the problem, purpose of the study, significant of the study, and operational definitions. The second chapter (literature review and theoretical framework) provides the clear insights of the literature review. It includes the review of major studies, review of recent studies and review of Nepalese studies. In addition, conceptual framework - on how study has been carried out - is illustrated under this chapter. This chapter ends with the concluding remarks. Chapter three (research methodology) cover the research design, nature and sources of data, data analysis process, models used for the data analysis and limitations of

the study. Fourth chapter (presentation and analysis of data) focuses on the systematic presentation and analysis of data. It consists of structure and pattern analysis, descriptive analysis.. Finally, chapter five (summary and conclusion) includes summary, conclusion, recommendation and future scope based on major findings of the study.

### **1.7 Research Plan and Design**

The study is based on descriptive and causal-comparative research designs. The descriptive research design has been adopted for fact-finding and searching for adequate information about the fundamental of Nepalese commercial banks. It describes the real and actual condition, situation and facts. Hence, the research design adopted in this study is of descriptive type. The study also establishes the cause and effect relationship between selected variables and fundament of commercial banks in Nepalese context. More specifically, the study analyzes the present condition and future prediction of the Nepalese commercial banks during the time period of 20011/12 to 2015/16.

Appropriate research design will be carried to achieve the objective of the research. It is one of the very important and crucial parts in the research work. Research design is a plan structure and strategy of investigation conceived so as to obtain answer to research question and to control variances.

This study aims to analyze the fundamentals of commercial banks through assessment of their financial statements and forecasting their financial statements to find the intrinsic value to find whether they are overpriced or underpriced in the stock market. The research design followed for this study is descriptive and analytical research design.

### **1.8 Nature and Source of Data**

This section elaborates on how data will be collected to carry out the study. The entire study will be done on the basis of secondary data available from various sources. In the study financial statements of commercial banks will be the key source for analysis. Balance sheets, income statements and principal indicators of commercial banks will be taken from annual report of commercial banks. The necessary secondary data and information will be collected from the Annual Reports of selected commercial banks, Banking and Financial Statistics and Bank Supervision Report published by Nepal Rastra

Bank (NRB). Likewise some data and information will also be collected from economic journals, periodicals, bulletins, magazines and other published and unpublished reports and documents from various sources. Other required data will also be acquired from NEPSE, SEBON, NRB, MOF and company itself.

### **1.9 Tools used**

In particulars, financial valuation tools namely, PEG from EPS growth and PEG from earning growth will be used to establish the valuation of the individual banks against the stock market price at the end of the fiscal year. Financial and statistical tools will be the main tools to be used in the analysis of the data. The collected data from different sources will be presented systematically in table, bar diagrams and figures.

### **1.10 Population and Sample**

This study intends to analyze the fundamentals of commercial banks and to know whether they are fairly priced or not in the stock market according to its fundamentals. So, the population of the study is all the listed commercial banks in NEPSE.

Out of that population, following two commercial banks are selected as samples for this study by using random sampling method.

- Everest Bank Limited
- Nabil Bank Limited

Above banks are taken sample on the following bases (criteria) :

- Both banks are foreign joint venture banks.
- Both banks were established before 1995.
- The size of earning per share of both banks for last five years is much similar as this study has used EPS as one of the tool for stock price behaviour.

### **1.11 Limitations of the Study**

Every research study has some limitations. This study is only a partial fulfillment of MBS program. So, limitation of this study will be as follows:

- i. Out of 28 commercial banks of Nepal only some few commercial banks are considered for the purpose of study. Some banks got merged during the study period and some banks data were not available hence, such banks are excluded from the purpose of study.
- ii. This study will take secondary data, so the accuracy of study depends upon the availability and reliability of the data.
- iii. Forecasting of only five years will be done. Only the data from fiscal year 2011/12 to 2015/16 will be used for performance analysis.
- iv. This study is particularly done for partial fulfillment for the degree of Master of Business Studies only, so it is not a comprehensive study.
- v. The findings of this study could not be generalized to manufacturing and trading enterprises because the study is only based on the banking sector.