THE IMPACT OF INDIVIDUAL BEHAVIOUR OF INVESTOR ON STOCK MARKET OF NEPAL

A thesis proposal

By

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1. Background of the Study

Investment refers to the commitment of funds at present in anticipation of some positive rate of return in future. An investor is a person who allocates capital with the expectation of a financial return. There are three type of investors namely conservative investors, moderate and aggressive investors. The stock market involves by definition, one buyer and one seller. The stock market includes a very large number of investors, each having their own motives for becoming buyers and sellers. According to the traditional market theories (Al- Tamimi, 2006). It is not only the markets that do not behave in accordance with tenets of expected utility theory. The investors consider their investment needs, goals, objectives and constraints in making investment decisions. But it is not possible to make a successful investment decision at all times. Their attitude is influenced by various factors such as dividend, get reach quickly strategy, stories of successful investors, online trading, investor awareness program, experience of other successful investors etc. A better understanding a behavioral processes and outcomes is important for financial planners because an understanding of how investors generally respond to market movements should help investment advisors in devising appropriate assets allocation strategies for clients (Al-Tamimi and Hussein, 2006).

Stock market is a place where buying and selling of securities takes place in an organized way. The parties involved in stock market are investors. Intermediaries and specialists. Investors who are willing to buy or sell stock quickly may be searching good offers or accepting poor offers with higher risk and of higher return. The position of liquidity and profitability and the degree of risk comprise on it are indicators taken into consideration while selecting the best options for investment. There are also different avenues available to invest for investor's namely corporate securities, equity shares, preference share, debentures, bonds etc. investors invest in both primary and secondary market for their investment. Since those in the secondary investors, speculators are also investors. The investors or the specular should have better knowledge and update market news, market indicators and technical system so that he could invest them in best avenues and get back the investment safely and get regular income out of it. Individual investors are those who commit money to investment products with the expectation of financial return. Generally, the primary concern of an investor is to minimize risk while maximizing returns as opposed to a speculator, who is willing to accept a higher level of risk in the hope of collecting higher- than average profits. Investors participate in the capital market by purchasing and selling different stocks and it is quite important to identify various economic and behavioral motivations that affect their purchasing decision (Gurung, 2004).

The capital market is used as the main vehicle to mobilize funds for the economic growth of the country. It performs crucial functions like the conversion of savings of the households and institutions into investment, creation of financial assets and development of assets-related products. A well-functioning securities market is conducive to the sustained growth of any country in the world, Levine and Ross (2008). Nepalese capital market is one of the slightly growing markets at the current moment. It has grown impressively during the recent years in tune with the global financial market. The Nepalese capital market comprises of two segments, namely the primary market and the secondary market. The fresh issues of securities take place in primary and trading among investors take place in secondary market. The primary market is a major channel through which the saving of the households are mobilized by the companies directly for investment purposes. It is the centre stage of the capital market that really boosts industrial and financial activities by providing long term funds to the corporate and the government. It infuse new securities, adding volume and wider base of securities in the secondary market. The secondary market afford liquidity to the investment in securities and reflects the general health of the economy.

Paudel (2005) states that stock markets, due to their liquidity, enable firms to acquire much needed capital quickly, hence facilitating capital allocation, investment and growth.

Devkota, Upadhyaya and Joshi (2007) insist that Nepalese stock market is still in infancy and could not play a significance role in terms of putting impact on the economic activities in the country. Similarly, K.C (2010) indicates that financial development does matter and stocks do spur economic growth of Nepal. However, the small market size of Nepal, illiquidity, dominance of few large companies and inability of market to handle risk relative to the volume of trading make it vulnerable to manipulation and ragging.

Investment behaviors of investor are defined as how the investors judge, predict, analyze and review the procedure for decision making, which include investment psychology, information gathering, defining and understanding, research and analysis (slovic, 1972; Alfredo and Vicente, 2010).

Investors do not act rationally in taking decisions relating to investment. They have certain weaknesses like cognitive and emotional which take a predominating role in taking investment decision of individuals. They have behavioral biases in the event of taking investment decision. The most crucial challenge faced by the investors in perhaps in the area of taking investment decisions. Every investor differs from the others in all aspects due to various factors like demographic factors, socio-economic background and marital status, educational attainment level, age , gender, information (Kabra, Mishra, and Dash, 2010).

Information has been one of the most important components in determining behavior of individuals. In case of their behavior in stock market, it becomes even more critical to access and incorporate into their decision making updated information included in financial reports. Periodical press releases, and media coverage and so on. There is strong demand for information about the product safety and quality, and about the company's environmental activities Epstein (1994).

From different study it is found that the behavior of investors in the stock market is influenced by certain factors such as demographic factors, awareness and risk attitude factors. Investors do not act rationally they have certain weakness like cognitive and emotional which take predominating role in taking investment decision. All the investor differs from the others in all aspect due to various factors.

The field that has been recently getting lots of attention from finance academics and the behavior of investor will be dealt and will focus on exploring why Nepalese investors invest in share market and whether their decisions to invest in share market are in a way influenced by behavioral factors.

2. Statement of the Problem

A research in to individual investor and their behavior has received a lot of consideration during the past and is increasingly in the focus of interest of many scientists, being not confused only to economists. The globalization of financial markets has been increasing the number of small investors over the past two decades by providing a wide variety of market and investment options. However, it make the investment decisions process much more complex. The small investors generally consider their investment needs, goals, objectives and constraints while making investment decisions. But it is not possible for them to make a successful investment decision at all.

According to Lovric, Kaymak and Spronk (2008) large body of empirical research indicates that real individual investors behave differently from investor in these models. Most individual investors hold under diversified portfolios. Many apparently uninformed investors trade actively, speculatively, and to their detriment. And, as a group, individual investors make systematic, not random buying and selling decision.
Financial economists and investors have been spending considerable time searching for investment strategies that yield abnormal returns. But the reliable one is yet to be found several studies have confirmed that the firm level fundamental variables are useful in explaining the stock returns patterns and the future price movements. For instance, earning yield effect of (Basu, 1977), size effect of (Banz, 1981), leverage effect of (Bhandari, 1988), book-to-market effect of (Stattman, 1980), joint effect of beta , size, leverage, book-to-market equity and earning yield of (Chan, et al, 1991) ,annual reports and interviews with company official (Gentry and Fernandez, 2008) are some of the major studies. These evidences shows that firm level past accounting variables have the explanatory power to predict the future returns. The return comprises the dividends plus the capital gains. The future prospects and the market opportunities determine the degree of stock returns and level of investments. Similar to stock returns, investment decision is an important phenomenon in the area of finance. Among the others, the size and book-to-market equity have more significantly explained the variation in stock returns. These variables are taken as explanatory variable for the study that help to conform the existence of similar results in Nepalese context.

The overreaction hypothesis and Lakonishok, et al.(1994) argued that the reversal and book-to-market effect are the result of investor’s overreaction to the past firm performance. In contrast, Fama and French (1995, 1996) argued that since past performance is likely to be negatively associated with changes in systematic risk, high book- to-market firms are likely to be riskier and hence require higher expected returns. Some evidences explained investors overreact to the past accounting growth rates. On the contrary, some other studies documented that the increased risk and return of high book-to-market firm is the result of distress brought by the poor past performance. The controversy in whether investor overconfidence or the risk and return trade-off is the causes of book-to-market effect or return reversal is the motivation of the study.

The prominent issues in the stock market might be the fluctuating stock market indices, the capital centric trading system, limited numbers of dominant investors, and their influences in stock market. Kafle (2007) stated that the stock market is bullish and getting to new peaks, there are numbers of contributing factors out of them investors awareness on the risk return and investment profile is the one. The major task of the securities regulating authorities is to protect investor's right and to provide the congenial trading environment with confidence and commitment. The development and expansion of the current infrastructure and the facilities is the another aspect. There is no the practice that regulators provides the specific investment advice, regulators should not recommend the purchase or sale of particular stocks. Similarly, they should not provide particular strategies to guide investor's investment decisions. But, the authority can do well and compel to do awareness level of the investment communities.

The above reviewed literature shows that there is no uniformity in the findings. Some of the major studies indicates the positive relation between stock return and size whereas inverse relation between returns and market-to-book value. The positive relation between stock returns with earning yield and size whereas negative relation with book-to-market ratio and cash flow yield and book-to-market value is found to be more informative, book-to-market equity is the most significant determinant of stock returns and in other study the evidence shows that Nepalese stock market is inefficient. These studies provided the evidences that book-to-market equity and size are the major determinant of stock return even if the capital market is inefficient in Nepal. Thus, the existing literature provides sufficient evidences of the controversy and lack of consensus. The existing gap justifies the need of further evidences on factors interacting stock returns.

To sum up, this study tries to address the following research question

i. What is the position of investor's behavior in stock market of Nepal?
ii. Do Nepalese investors take rational decision for investment in stock market

3. Purpose of the Study

The aim of the study is analysis of individual behavior of investor on stock market. To reach the aim we have three specified objective. These are.

i. To assess the position of investor's behavior in stock market of Nepal.

ii. To determine the way of investment decision of Nepalese investors in stock market.

4. Significance of the Study

The study on factors influencing retail investors' attitude towards investing in equity stocks in Tamil Nadu concluded that the factors that had very high influence over the retail investor's attitude towards investing in equity stocks are investors' tolerance for risk, strength of the Indian economy, media focus on the stock market, political stability and finally government policy towards business (Bennet, et. al. 2011). The main objective of the study was to identify the various factors that influence the retail investors' attitude towards investing in equity stock markets. The study was heavily depend upon primary data and was descriptive in nature. The required data were collected from the retail investors living in Tamil Nadu conducted during the period between July and October 2010 through a structured questionnaire. The sample size covered 200 retail investors who were spread through ten different places in Tamil Nadu. However, on a detailed scrutiny of the filled in questionnaires, it was found that 12 of them had given incomplete information and the study was based on 188 selected respondents from the retail investors. Participants were asked to evaluate the importance of 26 variables, identified from the literature and personal interviews as potentially influencing the value of equity shares, by making seven choices for every one of the 26 variables: "strongly agree" for the variables which had a strong influence on the factors considered to be influencing equity shares and "strongly disagree" for the variables that does not have much influence on the factors considered to be influencing equity shares. Descriptive statistics and factor analysis were used for analysis of the data. The study also revealed that four factors were given lowest priority or which had low influence on the attitude of the retail investors investing in equity stocks are Stories of Successful investors, get rich quick philosophy, information available on internet and cost cutting by companies.

Sindhu, Kalidas and Anil Chandran (2014) try to analyze the various factors influencing investor sentiments in the Indian stock market. They conclude that there exists significant relationship between gender of the investors and the factors like herd behavior, risk factors, and confidence and performance factors.

The study on an empirical analysis of factors influencing Indian individual equity investors' decision making and behavior concluded that most of the equity investors do not have the sufficient knowledge of basic economic concepts required to make investment decisions (Sultana and Pardhasaradhi, 2012). The objective of the study was to analyze and identify the factors influencing the Indian individual equity investors while choosing a stock for investment.

The study of Schmidt and Spreng (1996) specially focused that better-educated investors have a more extensive knowledge structure and are more capable of identifying, locating, and assimilating relevant information. Therefore, investors with a higher education level would be able to search using sources that require more knowledge, such as books, newspapers, or the internet. Moreover, investor with higher educational levels may be more realistic about their own ability to invest and more open-minded toward professional service provider.

Based on the review of some of the major earlier studies, it is realized that there is a specific research gap in the area of individual behavior of investors in Nepalese context. Previous studies focused only on certain factors like risk attitudes, market information. Thus, this study tries to blend both scopes in an effort.

In order to fulfill the above gap, all the factors affecting the investor's behavior can be categorized into demographic factors, awareness and risk attitudes factors. It focused on analysis of major factors determining investor's behavior while trading stock market in Nepal and also consider about the way of Nepalese investor's investment decision in stock market. This study help to overcome the limitations of the previous studies and also to make a valid conclusion.

5. Limitation of the study

Every study is conducted under any constraints and limitations. Likewise, this study is also limited by some constraints. The some limitations of the study are as follows:

i. Three behavioral dimensions of individual investors is considered so may not give clear guideline for policy making.
ii. Two types of investor invest on stock market, they are individual investor and institutional investor. So the findings can only be generalized in individual investors.
iii. Most of the primary data are based on research questionnaire. Therefore, the reliability and validity of the data depends upon their source.

6. Literature Review

Namazi and Saleh (2010) has analyzed the sentiment of investors positively influence the probability of occurrence of stock market crises with in a one year horizon and the impact of investors sentiment on stock markets in stronger for countries that culturally more prone to herd like behavior and overreaction and countries with low efficient regularity institutions.

Bennet, Amoako, Charles. Edward, & Darkwah (2012) analyzed the factors that had very high influence over the retail investor’s attitude towards investing in equity stocks are investors’ tolerance for risk strength of the Indian economy, media focus on the stock market, political stability and finally government policy towards business.

The study on determinants of individual investor behavior concluded that the five underlying psychological axes that appear driving the Indian individual investor behaviour are prudence and precautious attitude, conservatism, under confidence, informational asymmetry, and financial addiction (Chandra and Kumar, 2011). The objectives of the study are identification and verification of the psychological biases considered to drive a momentum effect by influencing investor behaviour in stock market.

Nayak (2010) examined the nature of investor’s grievances and also to evaluate the role of grievance redressal agencies. Using convenient random sampling technique he collects primary data on the investor’s demographic profile, knowledge about various grievances redressal agencies, loading of complain and their satisfaction level in Valsad district of Gujrat state. By using chi squre analysis he shows that there is significant differences between the various demographic variables and investor's knowledge of grievances, awareness of functions of redressal agencies, loading of complain and their satisfaction level.

Chaudhary (2013) examined the meaning and importance of behavioral finance and its application in investment decision. He has also discussed some trading approaches for investors in stock and bonds to assist them in manifesting and controlling their psychological roasblocks.

Ngoc (2014) investigate behavioral factors influencing the decision of individual investors at the securities companies in Ho Chi Minh city, Vietnam.There are five behavioral factors of individual investors at the Ho Chi Minh stock exchange: herding market, prospect, overconfidence, gamble's fallacy, and Anchoring ability bias. The herding factors includes behavioral dimensions: following the decision of other investors (buying and selling, choice of trading stock, volume of trading stocks). The market factors consist of dimension: prices changes, market informations. The prospect factor consist of dimensions: loss aversion, regret aversion, and mental accounting. The heuristic dimensions are grouped in to two factors: overconfidence-gamble's fallacy and anchoring-ability bias. He recommends that investors should consider carefully before investment, but should not care too much about the prior loss for later investment. Besides, the investor should not reduce their regret in investment by avoiding selling decreasing stock and selling increasing ones.

Gavriilidis, Kallinterakis, and Micciullo, (2007) further explain in the case of intentional herding, conformity, namely the condition under which people feel more convenient when doing what others do, seems to be playing a major role. If investors have conformity needs, investors might not make their investment decisions in isolation Hirschleifer and Teon (2003) agree on existence of conformity bias and point out that all of us are influence by others in almost every activity and this includes investment and financial transactions.

Kadariya (2012) analyzed the market reactions to tangible information and intangible information in Nepalese stock market to examine the investors opinion in Nepalese stock market issues. After analysis of 185 stock investors he find that the capital structure and average pricing method is one factor that influence the investment decision, the next is political and media coverage , the third factor is belief on luck and the financial education, and intangible information are essential to succeed in Nepalese capital market.

Varadharajan and Vikkraman (2011) focused on identifying the investor's perceptions towards investment decision in equity market. They study their attitude towards selection of stock, company, risk, equity, portfolio, financial affairs and their expected return. They find that there exists independency between the demographic, majority of the factors and the returns obtained.

Barber (2011) study motivates on studying the behavior of individual investors mostly stressing that the bulk of research in modern economics has been built on the notion that human beings are rational agents who attempt to maximize wealth while minimizing risk. He cited Grossman and Stiglitz's (1980) study that shows rational expectations model, some investors choose to acquire costly information and other choose to invest passively. Informed, active, investors earn higher pre-cost returns, but in equilibrium, all investors have the same expected utility.

Subedi (2017) explained that the secondary market is under pressure due to the increasing lending rates and deposit crunch in banks and financial institutions. He also explained that if the interest rates do not drop soon, the secondary market may fall further. "Investors were expecting the market to grow after the elections. However, though the political environment was favorable, the problem of credit crunch hit the banks and this has put pressure on investors."

Namazi & Salehi (2010) study on affect of stock market crises on investor sentiment concluded that the sentiment of investors positively influence the probability of occurrence of stock market crises within a one-year horizon. Moreover, the impact of investor sentiment on stock markets is stronger for countries that culturally more prone to herd-like behavior and overreaction and countries with low efficient regularity institutions. The main objective of the study was to analyze the ability of sentiment indicators to predict international stock market crisis.

The study on determinants of Tunisian individual investors' behaviors concluded that the Tunisian investors' behaviors are subject to five behavioral biases: representativeness, herding attitude, loss aversion, mental accounting, and anchoring (Rekik and Boujelbene, 2013).The study reveals the absence of overconfidence bias in the Tunisian Stock Market. Tunisian investors seem to be under-confident, hesitant and very sensitive to others' reactions and opinions. There was also an interaction between demographic variables and financial behavioral factors. The result also found that gender, age and experience have an interaction with behavioral financial factors in investment decisions.

The study on small investor's behavior on stock selection decision of Guwahati stock exchange concluded that majority of the sample small investors in Assam took into consideration all the 38 factors before selecting the stocks to invest (Das, 2011). The main objective of the study was to identify the factors which influencing the stock selection decision and examine the role of various socio-economic, demographic and attitudinal factors affecting the investment decision of investors in the market. The study used a qualitative methodology to investigate small investor's behavior in choosing stocks in Guwahati stock market.

The study on study on investment preferences among urban investors in Orissa concluded that the study reveals that investors invest in different investment avenues for fulfilling financial, social and psychological need (Mohanta and Debasish, 2011)). The main objective of the study was to the factors that influence investment behavior of Urban Investors.

Maditinos, Sevic, and Theriou (2007) Analyzed most of people rely more on newspapers/media and noise in the market when making their investment decisions. While professional investors rely more on fundamental and technical analysis and less on portfolio analysis.

Sawalqa (2012) has analyzed Jordanian individual investors place more emphasis on the usage of written information rather than verbal information for the purpose of the investment decision making.

The study on an empirical evidence of factors in equity selection process in Malaysia concluded that neutral information appeared to be the most important factor for Malaysian investors, followed by accounting information, social relevance and advocates' recommendations in equity selection process (Chong and Lai, 2011) The objective of the study was to examine the factors influencing equity selection process and its association with expected and actual return. The result reveal that neutral information was significant positively correlated while accounting information was negatively correlated with expected return.

Kadariya, Subedi, Joshi, & Nyaupane (2012) Analyzed the equity investors are aware and their level of awareness is high compare to needed level, aware and their equity investors have more chances of holding high volume of equity investment and there is problem on access to information for equity investors in secondary market.

There are various masters' thesis prepared by various researchers in the past year. Among them, some of these are reviewed here for analysis of literatures.

Prasad Dangol (2004) examine the impact on stock market as per the change in investors' perception and to examine whether investors perception leads to growth of the stock market.

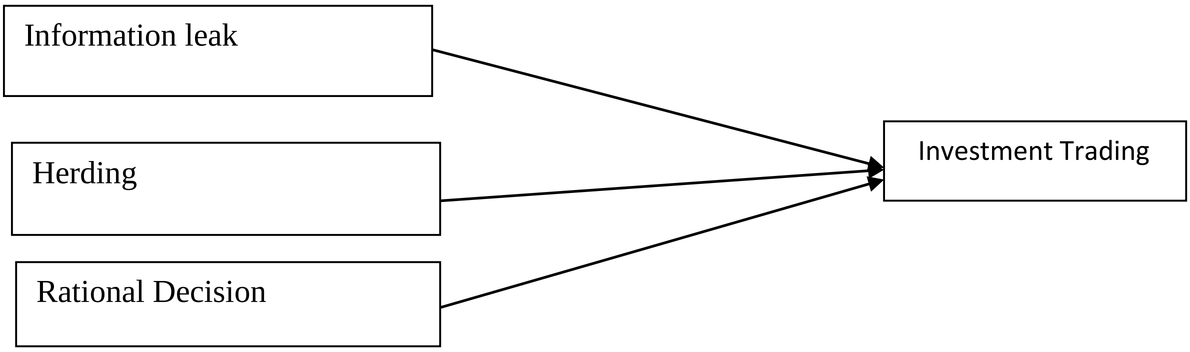
His study contributes to the importance of the investor's perception and shows the change of investors' perception impacts on the stock market and how the perception on investors leads to growth of the stock market. It shows that there is a negative impact on the Nepalese stock market as per the changes of investors' perception because there has been a negative effect on the perception on investors.

Jeevan, Puspa and Arjun (2000) concluded that individual Nepalese savers have extremely limited opportunities for investing their long- term savings. To secure maximum returns, these investors should have opportunity to invest into long-term corporate equities rather than state of the stock market. Both individual and institution are putting for more of their savings into bank deposits and fixed interest, government securities than they would if the market were working properly. Thus, long-term saving that should be invested in the stock market is going into short term investment.

7. Conceptual Framework

Below are indicated independent and dependent variables included in the research topic individual behavior of investors on stock market of Nepal. The study categorized these factors in to 3 groups: information leak, herding and rational decision.

Independent variable **Dependent variable**



8. Methodology

This chapter puts lights on the research process and methods design to meet the stated objectives of the study. The research methodology explores the research process regarding the impact of individual behavior of investors on share market of Nepal. The broad process of research methodology has been further categorized for simplicity into various subtopics which consists of research design, population and sample, sources of data, data collection and processing procedure and data analysis tools.

8.1 Research Design

This study used correlational research design and made attempted to collect data from randomly selected individual investors of stock market. The study used variable like information leak, herding and rational for primary data analysis. A five point likert scale anging from (1.Strongly agree, 2.agree, 3.neutral, 4.disagree and 5.strongly disagree) has been used to collect opinion data. The target population of this study is all individual investors of stock market. To determine the sample size of population, rule of thumb proposed by Roscoe (1975) is used. Following this rule, 120 investors are taken as a sample. This study includes descriptive statistical tools like standard deviation, mean and percentage is used to described result obtained and regression model used to show the relationship between variable.

8.2 Population and Sample

The target population of this study is all individual investors of stock market. To determine the sample size of population, rule of thumb proposed by Roscoe (1975) is used. Following this rule, 120 investors are taken as a sample.

8.3 Sources of Data

This study is mainly based on primary data. Primary data are collected by means of structured questionnaire administering on individual investors of stock market. For the purpose of questionnaire the investors are walk-in basis.

8.4 Data Collection and Processing Procedure

The data is collected from individual investors of stock market through a structured questionnaire using five point likert scale ranging from (1.strongly agree, 2.agree, 3.neutral, 4.disagree, 5.strongly disagree). Hence, choices of 1 and 2 indicated agreement with statements and choices of 4 and 5 indicated disagreement with statements.

8.5 Data Analysis Tools

This study uses the descriptive statistics associated with the primary data analysis which is carried out on the basis of responses derived from questionnaire survey. The responses were coded in Microsoft excel and then analyzed by using SPSS software. This study used correlation analysis, regression model and descriptive statistics like mean, standard deviation and percentage. The demographic variables was explained through descriptive statistics. Frequency, percentage and mean were computed to describe the variable. Correlation analysis is used to identify the relationship between dependent and independent variables and Regression analysis is used to analyze the impact of independent variables with the dependent variable by considering the possible influence of demographic variables as well.

8.6 Validity and Reliability

The reliability analysis was conducted using the Cronbach'a analysis. This approach was used to test the the internal consistency and reliability of measurements. Nunnally (1978) suggested 0.7 to be an acceptable reliability coefficient but lower thresholds are sometimes used in the literature. Hence, this study considered the acceptable Cornbach's alpha to be 0.7 or more and the Cornbach's alpha test was done by SPSS software.

9. Chapter Plan

This study has been organized into a total of five chapters. Chapter one consists of general background of the study including statement of the problem, purpose of the study, significance of the study and organization of the study.
The chapter two provides the clear insights of literature reviews. It includes the reviews of literature from global context and review of some Nepalese context. In addition, theoretical framework has been developed.

Likewise, chapter three covers research methodology process such as research design, nature and sources of data, population, sample size, data analysis procedure and model used for data analysis.

The chapter fourth deals with analysis and interpretation of data using statistical tools such as descriptive statistics, co-relation matrix, regression analysis. Major findings of the study have been presented at the end of this chapter.

The chapter five is last chapter of the study that provides the summary, conclusion, recommendations and scope for future research.

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