

Analysis of Risk on Common Stock of Commercial Bank in Nepal

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Abstract

The study was conducted to analyze the risk on common stock of commercial bank in Nepal and to understand the risks and movements of the stock in relation to the market. The main objective of any investor in the market is to maximize the profit and reduce the risk. The paper helps the investor to know the snapshot of various statistical tools to be used to analysis the risk and return of the stocks. The study is based on conceptual research so the various research papers written from 2002 to 2021 have been reviewed. It is found that the various tools are used to measure the risk like standard deviation, beta, and coefficient of variation. The investor always needs to find a combination of higher return with low risk. The beta is useful to judge Systematic Risk. Thus, this study helps the investor to arrive at a conclusion and also to provide information about the performance of various banking securities in the market in terms of return and risk.

Keywords: Bank, common stock, financial system, investors, risk, securities market, systematic risk.

1. Introduction

Risk is the future uncertainty or deviation from expected earnings or expected outcome. Risk measures the level of uncertainty that investor is willing to accept in exchange for a potential return on their investment. Risk is the possibility that an outcome will not be as expected, specifically in reference to returns on investment in finance. The field of risk and return analysis has been greatly advanced by a number of researchers. This section discusses the main points of a few academic papers that have been published in this area. Joghee (2021) looked at the risk-return analyses of a few banking industry. For measuring risk and return, the mean, standard deviation, covariance, variance, correlation, and beta were determined.

The study by Moolbharathi and Sugandi (2021) concentrated on gathering daily data from the stock market, such as the closing price of stocks for the last five years, i.e., from year 2017 to year 2021. For the most part, three broad types of sectors, such as the Auto mobile, banking, and IT sectors, are used to compute the daily return of the stock and measure the standard deviation. These sectors serve as direct indicators of the nation's economic health. Zafar and Ahmed Siddiqui (2020) from Pakistan defined volatility as the amount of uncertainty or risk surrounding the degree of fluctuations in the value of a stock. A safety's value may be distributed over a greater range of values if the variation is considerable. As a result, the security price may see a significant short-term change in either direction. The stock market is volatile for a variety of reasons. Likewise, monetary policy, inflation, interest rate, corporate income, financial stability, dividend policies, bond prices, and many other macroeconomic, social, and political variables, According to Abhinandan and

Nayak (2020), risk is the possibility that an investment's actual return will differ from what is anticipated. This involves the potential loss of a portion or the entire initial investment. Investors typically anticipate high rates of return with low levels of risk. However, in real life, there is a trade-off between large potential profits and high degrees of uncertainty (high risk). The study conducted by Srinivasa Rao et al. used different statistical techniques like return, average return, standard deviation, variance and Beta. Coefficient of variation analysis is to examine the relationship between two periods risk and return of banking stocks (Rao, Venkateswararao.Podile, & Navvula, 2020).

In a similar vein, Kandel (2018) discovered that choosing an investment relied on two variables: risk and return. They resemble the two halves of a coin. Risk is the possibility that the actual return on an investment will be lower or higher than anticipated. Technically, the standard deviation in statistics is used to measure it. Risk is a byproduct of uncertainty, and the scale of that risk relies on how variable an uncertain cash flow is. Gautami (2018) researched the changes in share prices of a few Indian corporations. The goal of the current study is to look at the risk and return analysis of a few Indian stocks. Risk is the potential for changes in real return. Gain in investment value is referred to as return. An investor can assess the financial performance of an investment by looking at the return on their investment portfolio. According to a study by Ravi and Patil (2018), stock market investments involve future uncertainty, which is a risk that all investors must be willing to take in exchange for the anticipated profits. Investments in the stock market therefore involve risk as well as reward.

According to Yadav (2017), Risk and return are two key elements in equities investing. The risk is typically low if the return on investment is small. On the other hand, a bigger return is associated with more risk. The volatility of the market has an impact on stock market performance as well. In contrast to developed nations, the Indian market has progressed to become more informative and continues to offer better returns with less volatility over long periods of time. A study by Sinha (2013) explained that Risk is a concept that denotes a potential negative impact to an asset or some characteristic of value that may arise from some present process or future event. It has gained a great deal of recognition for its resilience, especially in the wake of the most recent global economic catastrophes, which pushed its international competitors to the brink of collapse. Another researcher Sharma and Boddla (2012) mentioned that there are many different sorts of hazards, but systematic and unsystematic risks are the two main ones that affect investments.

This research deals with the analysis of risk involve in stock price of commercial banks on the basis of financial statements and other economic situations in Nepalese context. Risk is concerned with the possibility that the actual return will differ from the anticipated return. Higher risk entails a wider gap between the realized and predicted returns. In this sense, it is interesting to note that risk works both as 'upside potential' and 'downside risk'. Taking more risks increases the chance of great losses and possibilities of big wins at the same time.

1.1 Research Objective

This study has undertaken to focus on risk analysis of financial securities like common stock of selected commercial banks of Nepal. The main objective of study is to analyze the risk on common stock of commercial banks in Nepal and to measure the level of risk and return involved in commercial banks.

2. Materials and Method Used

The study is based on the review of literature and the source of information is secondary data. Descriptive study has been used for both qualitative and quantitative data for collecting the information. This is a conceptual research therefore various related research articles have been reviewed to get the findings and conclusions. It has used reliable sources and data from scientific journals or research papers that are well reputed.

3. Result and Discussion

Moolbharathi and Sugandi (2021) found that the standard deviation measures the stock's volatility; a higher SD indicates a higher risk, so investors are encouraged to select stocks with a low standard deviation. The stock's volatility in relation to the market is shown by the Beta (β). The investor would have selected ($\beta = 1$), suggesting that the stock's price reflects market fluctuations. Investors should steer clear of stocks with high volatility because a higher number (>1) denotes a stock's increased market volatility. HDFC Bank has the most systematic risk during the research period of the 25 organizations that were chosen. As a result, it suggests that HDFC Bank offers more risk and returns than any other stock in the analysis.

The results of the risk and return analysis for 12 banks over a 10-year span between two periods revealed that IndusInd Bank had greater returns (50.6%) with higher risk (52.62%) during the UPA government's tenure (2010–2014), meaning the investors profited by taking on high risk. Union Bank's lower returns (17.2%) and higher risk (63.32) indicate that there was a greater risk involved for investors than there were rewards. The HDFC Bank experienced better returns (23.39 percent) with minimal risk (18.32 percent) from 2015 to 2019 under the NDA administration, which is the ideal circumstance for any investor to hold investments in this stock. Yes, the bank reported negative value returns (-4.41%) with higher risk (54.76%), but not everyone expects this. (Rao, Venkateswararao. Podile, & Navvula, 2020).

The study conducted by Kandel (2018) found that both selected banks have a high proportion of unsystematic risk i.e., NABIL (89.29%) and NIBL (93.18%) which can be minimized from internal management. Hence, it is better to have a low proportion of systematic risk and comparatively a high proportion of unsystematic risk because unsystematic risk can be reduced to zero but systematic risk cannot be even reduced as it is created from market.

Similar study conducted by Suresh and Sai prakash (2018) is based on the analysis of stocks listed on Bank Nifty. The investor can use this information to decide if he needs to buy stocks based on how the stock has performed over a specific time period. A stock with a higher beta value should be avoided when building a portfolio since it is more susceptible to market risk, which cannot be diversified like unsystematic risk.

Another researcher Dinakar & Prathibha (2016) found from their research that, Except for Yes Bank and Kotak Mahindra Bank, all the stocks saw negative returns throughout the study period. It was also discovered that Yes Bank provided the best return, while Punjab National Bank provided the lowest return. Likewise, systemic risk was discovered to be lowest for Yes Bank and highest for SBI. Due to their negative beta, the author came to the conclusion that Bank of India and Syndicate Bank were less vulnerable to market risk than Punjab National Bank and Bank of Baroda, which had the highest market risk. The betas of

Punjab National Bank and Bank of Baroda were likewise discovered to be larger than one, indicating that these companies were exposed to considerable market risk.

4. Conclusions and Recommendation

After the analysis of risk and return of sample bank and based on difference research papers it is concluded that all the commercial banks, which are under study, are very much risky with fluctuated rate of return. From the findings of beta coefficient of each sample bank, NABIL is seen very much volatile than NIBL stock. The study also shows that the selected commercial banks under study, the required rate of return of both commercial banks i.e. (NABIL & NIBL) is more than expected rate of return, so both stocks are overpriced. Therefore, it is more profitable to take decision of short selling by investors.

There are two types of risk normally in common stock of commercial bank i.e. systematic risk and unsystematic risk. Systematic risk is measured by beta β . The Beta (β) indicates the volatility of the stock in comparison to the market. The Investor would choose the ($\beta = 1$) indicating the fluctuation of market is reflected same on the stock. More the ($\beta > 1$) indicates the stock is more volatile in the market; hence the investor should be avoiding those stocks with high volatile. The standard deviation is also a risk measurement tool which measures the volatility of the stock, More the SD implies more the risk and investor is advised to choose the stock based on minimum standard deviation.

In this study, it is also concluded that some of the banks have higher returns and some banks have high risk. The investor always needs to find a combination of higher return with low risk. The Beta is useful to judge systematic risk. Thus, this study helps the investor to arrive at a conclusion and also provide information about the performance of various banking securities in the market in terms of return and risk. In stock market, there are numbers of investment approaches, among them banking is considered as one of the sensitive ways for investment. Volatility in prices leads to higher risk for the investors. The present study focused on the risk and return analysis of selected banks in Nepal and it is important for investors to analyze the risk associated with stocks.

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