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Factors Affecting Investment Decisions in Nepali Stock Market: A Systematic Review

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Abstract

The study examines factors influencing investment decisions in the Nepali stock market. It employs a thorough review methodology, drawing on past research across various stock market conditions. By analyzing relevant concepts, findings, and conclusions from these studies, it provides insights specific to the Nepali context. Key factors identified include market environment, investment motives, information availability, third-party opinions, the company's reputation, and herding behavior. The study highlights the importance of aligning investment strategies to achieve both long-term gains and short-term profits. Additionally, it emphasizes the need for diversification by building an investment portfolio to mitigate risks and enhance returns in the Nepali stock market.

Keywords: *Capital market, herding behavior, investment decision, portfolio, stock market*

Background

A capital market is defined as a market where medium to long-term finance can be raised (Akingbohungbe, 1996). Similarly, the capital market helps the flow of non-productive small savings spread among the people to the productive sector through fund mobilization. The capital market launches working relations between the people involved in mobilization, saving, and investing capital. A capital market plays an important role in the economy as it assembles idle financial resources in fruitful divisions of the economy (Nepal Rastra Bank, 2012). The funds collecting institutions such as investment trusts or companies, banks, specialized financial corporations, and stock exchanges are some of the significant parts of the capital market. It can be categorized as a primary capital market and a secondary capital market. A primary market is a marketplace in which new offerings of security, such as a stock and bond are sold to primary buyers by concern or government agency. On the other hand, the secondary market involves exchanges and over-the-counter marketplaces where securities are subscribed and traded after their issuance in the primary market. It delivers liquidity to these devices, through the exchange and clearance of the stock (Mishkin & Eakins, 2012).

Investors in the stock market consider their investment needs, goals, objectives, and constraints in making investment decisions. However, it is not probable to create effective investment decisions at all times. Conventional finance models have two fundamental conventions about investors' decisions with esteem to stock market investment: first, investors make sensible decisions based on their investment policies and risk-return concerns; second, they have impartial estimates about future stock yields. An argument against the traditions of traditional finance theories promotes that investors do not have similar natures of deals at all times, and hence their decisions also be determined by their awareness of several factors that change the investment decisions (Baghdadabad et al., 2011).

A stockholder can obtain returns from stocks when prices of stocks increase over time or when dividends are distributed (Mishkin & Eakin, 2012). Therefore, investors reflect on different factors such as Firms' image, accounting information, unbiased information and so many factors before making investment decisions. There is no hesitation that investors are accountable for not taking self-judgment, and self-control in the selection of securities for money investment. Thus, having an absence of adequate information about the securities of assured companies, investors are randomly financing in shares (Joshi, 2010). The Nepali stock market is highly irrational, and fundamentals and analysis are of minimal help. The size of the secondary market was very small back wherein a handful of investors could easily manipulate the market, which had an average daily turnover of only 20-30 million. While physical permit management was a protracted and dull portion of portfolio management facilities in the past, the current restructuring and digitization of share market procedures into full-fledge dematerialized trading brings with it efficiency that provides a key advantage for Portfolio Management Services. However, the Nepalese stock market has evolved over the years with the opening of more stock brokerage offices, entry of mutual funds and credit rating agencies, increase in the number of merchant bankers entry of hydropower companies, and an overwhelming participation of investors in the primary market. The increasing volume has made the market more efficient and liquid, decreasing the chances of share price manipulation, while the capital market today offers a great opportunity for investors to diversify their investment requirements.

Adhikari (2010) detected that Nepali stockholders financed in shares for both financial causes. Likewise, Kadariya (2012) investigated the market responses to real facts and elusive evidence in the Nepali stock market. The findings exposed that earnings, dividends, book-to-market ratio, number of equities, and political partyheaded government are the top five most vital aspects for investment decisions. Similarly, Joshi (2010) suggested that the most influencing factor in investment decision-making is the status of the firm. The stockholders are presumed to concentrate on receiving rich quick ideas but the data exposed that they are least affected by it. It indicates that investors are not conscious about the projected gain they can produce by taking the chance. The result shows that the belief of stockholders in broker reference is very inadequate. It involves that stockholders are well attentive that stock dealers can certainly influence them if they carelessly depend on their approvals while constructing investment decisions.

With the Stock market reaching new heights every day, investment in the security market has just enlarged its reputation in emerging countries like Nepal due to its important advance. The prospective investors need to open a transaction account at a stock broker's office to participate in the secondary market. There are currently 50 stock brokers licensed by NEPSE while there are a few stock broker offices outside Kathmandu. From different studies, it is originated that the conduct of investors in the stock market is affected by definite factors such as awareness, demographic factors, and risk assertiveness factors. Every stockholder has his individual investment risk tolerance level, objectives, inflows and outflows of money, and other restraints. Therefore, the study aims to analyze the elements affecting individual investors to finance in the capital market.

Literature Review

The stock market is recognized as the secondary market on the other side of the market sector under the capital market. It comprises all exchangeable securities allotted in the past by corporate bodies; such securities are also transacted in the stock exchange. The stock market does not contain securities of private existence as they are not accomplished of being apportioned in on the stock exchange and are not traded securities due to the constraints on transferability. To yield the benefit from the stock market the corporate houses should have registered the security in the stock exchange.

The stock market includes activities relating to the distributing of securities, whether good or bad, for the liquidness and trading purposes. Only the securities of prevailing companies are marketable on the stock exchange regardless of issuers, corporate institutions, or government (Vaidya, 2000). In the Nepali context, the government introduced liberal economic policies then the mid-1980s. The Nepalese economic system has experienced rapid mechanical changes in the last two and half decades. It has been exposed that the Nepali financial system is mainly bank-dominated. Capital markets and stock markets have not been advanced in full-scale processes and the banking institutions, mainly the commercial banks, seem to be the major financial mediators in adequate financing requirements of industrious units of the economy (Upadhyaya, 2019).

The stock market is one of the most important sources for companies to raise money. This allows the business to be publicly traded, or raise additional capital for expansion by selling shares of ownership of the company in a public market.

Liquidity provides enough money to investors to sell securities in a short period of intervals. It plays a vital role in the financial system. It is measured as one of the best ways to increase funds. But before we make any investment into the stock market, we should know how to get started. It may turn out to be a profitable affair as long as we know the tricks of the trade (Upadhyaya, 2019). A stock market is a marketplace for the exchange of publicly alleged company stock and linked financial tools. Initially, stock markets were "open outcry", where transactions took place at the bottom of a stock exchange. Most contemporary stock swapping is done in electric exchanges where buying and selling happens from online corresponding of order-sited buyers and sellers.

Stock Market

Primary Market

Securities accessible for the first time are untaken over the primary market. The issuer may be a new company or one that has been in trade for many years. The securities existing might be a new type for the issuer or additional volumes of security used regularly in the previous time. The significance is that these securities engage new funds for the deals of the issuer (Fischer & Jordan, 1979). The primary markets are broadcasting through which new financial assets are dispensed or made. They are the media through the subscribers and traders of today's funds, the makers and acceptors of financial privileges meet. In these primary markets, financial properties are generated and exchanged, sustaining in part the financial requirements of demanders and traders of today's funds. In the contemporary context, it is the market for straight issuances of government securities. The primary market of the nation is led by the government securities due to the presence of immaterial new issues market for trade securities. An original public offering, or IPO, is an instance of a primary market. These transactions provide a chance for investors to acquire securities from the bank that did the primary endorsing for a particular stock. An IPO takes place when a private company trades stock to the public for the first time.

Secondary Market

The secondary financial market is that market wherever many owing assets are transacted from old to new holders. The secondary market offers liquidity for financial assets creating them more demanded. So, the secondary market is a place where the securities once traded are acquired and repurchased to deliver liquidity to the government securities. In Nepal, the secondary market is very thin because of limited suppliers of the securities. NEPSE is regulated to endorse the market used to upkeep the market even concerning itself buying and selling events if required. The secondary market permits unresolved securities to be transacted from old to new holders. The benefit of the secondary market is to be responsible for cash and investment chances to investors and to create certain assets more liked by buyers and sellers. (Weston & Brigham, 1987).

According to Pandey (2006), it is a kind of market where prevailing securities of a market are transacted on daily and nonstop conditions. It is a market for current securities. This involves contacts and over-the-counter markets where securities are subscribed and traded after their issuance in the primary market. It has slightly to do with persuading the mode an economy assigns its capital resources or how to transfer surplus and savings deficit unit transactions. The secondary market is where stockholders buy and sell securities they previously owned. It is what most people usually think of as the "stock market," though stocks are also traded on the primary market when they are first allotted. The nationwide exchanges, such as the New York Stock Exchange (NYSE) and the NASDAQ, are secondary markets. The number of secondary markets that occur is always growing as new financial securities become accessible. In the case of assets such as loans, several secondary markets may occur. Bundles of advances/debts are often provided into securities such as GNMA pools and retraded to investors.

Participants in the Stock Market

Broker

A stock agent is a member of stock exchanges and a substitute broker is any person who performs on behalf of a stock dealer as an agent or otherwise for supporting the investors in buying, selling, or allocating securities through such agent. Condition for yielding of permits to stock broker, the rules specify the recording is required for performing as broker or sub-broker. The situations for the contribution of a license or registration to performance as a stock-broker are;

- Holds the membership of a stock exchange act.
- Brokers shall tolerate the rules, guidelines, and bylaws of the stock exchange of which he/she is a member.
- Brokers shall pay the amount of fee for registration.

The ground brokers are formally devoted to other members. Floor brokers are also members of the stock interchange and they support commission brokers when there are too many guidelines ensuing into the market for the commission brokers to switch alone. For their support, they obtain part of the commission born by the customers. Floor brokers are occasionally termed two-dollar brokers because of a commission. They are generally free-lance members of the market (Francis, 1992).

Floor Traders

These members trade merely for themselves and are forbidden by exchange rules from behavior public orders. They are confident to make money by absorbing the advantage of believable trading disparities that result in provisional miss-pricings, thus permitting them to “buy low and sell high. These members are also recognized as listed competitive markets-makers, competitive brokers, or listed traders.

A floor trader is an exchange member who performs transactions from the floor of the exchange, completely for their account. Floor merchants used to practice the open outcry technique at the bottom of a service or stock exchange, but now most of them practice electronic exchange systems and do not seem in the bottom. Floor traders achieve an important role in commodity and stock markets provided that liquidity and tapering bid-ask ranges. Floor traders may also be mentioned as separate liquidity suppliers or registered competitive agents (Harris, 1997).

Dealers

A dealer purchases securities at a price and agrees to take and sell them at an upper price. Dealers trade merely for themselves and are forbidden from conducting public orders. Since dealers have contact with the floor and can personal securities in their possess name, they assistance from buying at low and trading at high prices. The profit of the dealers to the market is that their buy-and-sell activities enhance the liquidity of the securities (Bhalla, 1983).

Dealers are people or firms who buy and sell securities for their account, whether through a broker or otherwise. A dealer acts as a principal in the transaction for its account, as different from a broker who acts as an agent who performs orders on behalf of its customers. Dealers are vital existence in the market. They create markets in securities, endorse securities, and deliver investment facilities to investors. That means dealers are the market creators who offer the bid and request quotes that see when look up the price of a security in the over-the-counter market. They also aid generate liquidity in the markets and enhance long-term progress.

The security dealers concentrate on buying and selling securities, i.e. securities offered by government and public orders. They perform as a jobber and are organized to yield risks intrinsic in the complete purchase and sale of securities to happen current necessity. The market is an OTC market and each purchase and sale has to be distinctly exchanged. The market, therefore, has a tendency to be constrained (Bhalla, 1983). Dealers have an entrance on the floor and can personal securities in their name. They benefit from buying at low and selling at high prices. The margin of dealers to the market is that their buy and sell act further up the liquidity of the securities.

Market Makers

Market makers, also recognized as experts, enable the transaction of securities by sustaining inventory in specific securities. They are parallel to dealers in many techniques except that they always stance prepared to buy and sell securities at their bid and requested price for which they are market creators.

Securities exchange is measured as a quote-driven market where prices are fixed from quotations prepared by market experts. Securities exchange is measured as an order-driven market or auction market where prices are fixed by exploration of orders to buy or sell shares via public investors without market creators as middlemen (Madhavan, 2000).

Issue Manager

The issue manager transmits out the purposes connected to the public issuance of securities on behalf of the delivering company. Issue executives are compulsory to set up their annual reports with balance sheets, profit and loss accounts, cash flow statements, and securities tradeoff reports to SEBON within four months of the finishing of the fiscal year.

Any financial institution/intermediary that can carry out the activities connected with issue management is registered with SEBI follows its regulations and guidelines is capable of venturing into issue management. Issue management is an important activity for merchant bankers.

Concept of Investors

An investor is an individual or entity (such as a company or mutual fund) that allocates capital with the expectation of financial returns. Investors use a variety of financial tools to achieve their goals, such as saving for education, retirement, or accumulating wealth over time. Investment securities include stocks, bonds, mutual funds, derivatives, commodities, and real estate. Investors vary widely in terms of risk tolerance, capital, investment styles, preferences, and time horizons. Some prefer low-risk investments with steady returns, such as certificates of deposit and secure bonds, while others are willing to take on higher risk for the potential of greater returns, investing in currencies, emerging markets, or stocks with frequent trading.

From the perspective of a capital-exporting country, understanding the types of investors and their characteristics helps shape investment policies and identify who will benefit from investment agreements. Conversely, for capital-importing countries, knowing the target investors helps in attracting foreign investments. For investors, understanding how investment assets are structured helps protect their investments under contractual agreements. Organized investors, such as financial institutions or mutual funds, pool capital from many smaller investors to make larger investments, often exerting more influence over markets compared to individual investors.

Investment Decision and Affecting Factors

Various studies have explored factors influencing stock market investment decisions. Al-Tammi (2006) identified key factors for UAE investors, including predictable company earnings, potential for quick wealth, stock trading, previous stock performance, government ownership, and well-organized financial markets. Dimitrios (2007) found that individual investors rely heavily on media and news, while expert investors focus more on fundamental and technical analysis. Li et al. (2009) discovered that institutional investors, being better informed, exhibit stronger herding behavior than individual investors who rely on public information.

Namazi and Saleh (2010) examined how investor sentiment affects stock market crises, highlighting that sentiment indicators can predict crises, especially in countries prone to herd behavior and with less efficient regulatory institutions. Varadharajan and Vikkraman (2011) investigated perceptions towards investment decisions, finding an independence between demographic factors and returns. Chaudhary (2013) discussed behavioral finance's impact on investment decisions and the role of psychological barriers. Rani (2014) categorized factors affecting investor behavior into demographic, economic, social, and psychological aspects, with significant influences including over-reaction, herding, cognitive biases, and past firm performance.

Singh and Yadav (2015) highlighted the importance of financial and procedural analyses before investing, finding that male investors place more emphasis on financial ratios and company performance compared to female investors. Gill et al. (2018) explored the role of economic expectations and information search in investment decisions, suggesting that while economic expectations impact decisions, information search may not always have a significant effect.

Rana (2019) identified key factors affecting investment decisions in Nepal, including corporate governance, earnings, reputation, and market fundamentals. Pokharel (2020) found that market factors significantly influence investment decisions, while heuristics, herding behavior, and possibilities had no significant connection to performance. Silwal and Bajracharya (2021) confirmed that behavioral factors such as overconfidence and herding have a positive connection to investment decisions, though some biases have a negative impact.

Artikis and Kampouris (2022) demonstrated that stocks with higher intrinsic value tend to earn higher returns, reinforcing the importance of intrinsic value in investment decisions. Paneru (2023) noted that in the Nepali stock market, intrinsic value and earnings announcements are significant factors, though the market is still developing and may not be fully efficient.

Results and Discussion

The study on investment decisions in the Nepali stock market reveals that factors such as firm image, herding behavior, capitalization factors, brokerage roles, investor motives, information, and third-party opinions are significant. Silwal and Bajracharya (2021) found that herding, market factors, and heuristics positively affect investment decisions, while Rana (2019) identified corporate governance, earnings, and fundamental market factors as crucial. However, not all factors have been comprehensively studied, and there is room for further research.

Conclusion and Implications

The study concludes that third-party opinions, including family, friends, and market experts, play a critical role in investment decisions. Despite the influence of these opinions, many investors lack clear motives and factors such as industrial performance and dividend per share do not significantly impact investment choices.

Investors may be misusing information or not considering it important, highlighting the need for better analysis of return on investment, company performance, and economic conditions.

The findings suggest that investors should avoid relying on rumors and conduct thorough research before investing. Both fundamental and technical analyses are essential for making informed decisions, and diversifying investments can help reduce risks and maximize returns. Further research is needed to explore additional variables affecting investment decisions in developing markets like Nepal.

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