Risk & Return on Common Stock of Listed Non-Life Insurance Companies in Nepal

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Abstract—*The main objective of the study is to analyze risk and return of the common stocks of non-life insurance companies in the Nepalese market, the study is focused on the common stock and dividends of insurance companies. The data used in this study are mainly quantitative. The study reveals that there is altogether 18 non-life insurance and out of them 5 companies have been selected for the sample. From the five insurance companies, the average MPS and average dividend of EIC is maximum whereas the average MPS and average dividend of NICL is minimum. Similarly, the average rate of return of PIC is maximum and of EIC is minimum. The coefficient of variance of NICL is maximum and of EIC is minimum. The Pearson's r for the correlation between the MPS and return variables of NICL is maximum and of HGIC is minimum. The Sig.(2-tailed) value of HGIC is maximum and of NICL is minimum. The study focuses in making suggestion to investors to create optimal portfolio of stocks of non-life insurance companies and to minimize risk in nonlife insurance business.*

Keywords: *Risk, Return, Stock, Correlation*

1. BACKGROUND

Institutional investors such as insurance companies are inventory in securities and spreading the risk. There are various institutions in Nepal, which help to collect the unused fund from the general public and mobilize it in productive sector. Insurance companies also fall under such category. Insurance means a contract where one party in consideration of money payment called premium undertakes to protect other party against any loss or pay to that party the agreed sum of money on the happening in certain event. In business as well as private life there is danger of every kind. The aim of the insurance companies is to make provision against such danger. Insurance companies are there to compensate for the possible loss. An insurance company does not prevent risk of loss but it compensates the loss by spreading out the risk on shoulders of the community. In reality insurance is a social security. It helps to protect certain level of income of people. In today's uncertain environment it has gained immense popularity.

In Nepal insurance companies were properly developed after 1968 AD. Insurance companies are registered under insurance company Act 1968 AD. Since then number of insurance companies providing services to general public is increasing rapidly and this reveals that the insurance companies are important and useful in the everyday life of the people we can see that this fact has been stated to be acknowledged by the general public. They have started taking it very seriously. Long-term investment is available in life insurance whereas non-life is usually of 1 year and below. The focus of this study will be those insurance companies that are listed in NEPSE. But we have not included all the insurance companies listed in NEPSE due to certain constraints like time and availability of adequate data, we hope the selected insurance companies of this study will represents all other insurance companies listed in NEPSE.

2. REVIEW OF LITERATURE

Since the study is about the risk and return of insurance companies, light must be thrown on into make it clearer. Whenever a company needs capital for expansion, for creation of new job, for product development etc, it sells of share of its stock to public. Common stock may be defined, as shares in the ownership of the firm Common stockholder are real owner of business firm. Common stocks are more risky than both bonds and preferred stocks but it has also benefit like voting right in participation in profit. And also common stock may be purchase and sold immediately.

"EPS, BV and PE have the positive significant impact on equity share prices while size has negative association with market value of equity stocks. DPS and DP are found to be insignificant determinants."(Almumani:2014)

"Financial performance, policy and information dissemination are the factors that are mostly used by small and infrequent investors followed by governance and ethical practice of the company."(Motwani:2013)

"Earnings per share and return on capital employed is the significant determinants of equity share prices in India."(Dabade:2012)

"Mostly respondents consider both fundamental and technical analysis while taking investment decisions in securities but use of analysis changes according to the conditions of market. In bearish market, investors mostly rely on fundamental

analysis; on the other hand if there is bullish market, technical analysis is used by the investors."

(Venkatesh and Tyag:2011)

Financial risk refers to risks involved with capital and financial market risk (Ai & Brockett, 2008). The market risk is associated with fluctuations in value of traded assets (McNeil, Frey & Embrechts, 2005) and consists of interest rate, commodity risk, foreign exchange risk. The credit risk is —the risk of not receiving the promised repayments on outstanding investments, because of default of the borrowerǁ (McNeil et al., 2005), or in short default risk (Ai & Brockett, 2008).

There are multiple types of non-financial risks: Hazard risk, operational risk and strategic risk (Ai & Brockett, 2008). Hazard risk refers to physical risks like theft, fire, liability claims, business interruptions, etc. Operational risk is a broad concept and is defined by the Basel Committee on Banking Supervision (2004) as —the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.ǁ This can include internal and external fraud, products and business practices, damage to physical assets, business disruption and system failures, and execution, delivery and process management. Strategic risk is closely related to the firm's overall strategies. Reputation risk, competition risk and regulatory risk are included in the strategic risk. To prevent losses to occur from these risks, multiple forms of risk management can be implemented.

Risk is the uncertainty associated with the end of period value of an investment. Risk and return are the determinants for the valuation of the securities. However, risk means that we do not know what is going to happen even though we occasionally have a good idea of the range of possibilities. Risk is a hazard, a peril and exposure to loss or injury. Thus most risk refers to the chance that some unfavorable event may occur, while other view it as a chance of loss but in reality particular activity or event. Risk is the product of all potential outcomes expressed with probability associated with each other and it distribution of such outcomes.

Insurance companies face two types of risk: financial risk and non-financial risk (Ai & Brockett, 2008). Over the past years the financial risks have become more important. New types of risks are created due to the changing business environment (Casualty Actuarial Society [CAS], 2003). The foreign exchange risk for instance companies occurred due to growing globalisation.

"Risk exists because of the inability of the decision maker to make perfect forecasts. Forecasts can be made with perfection or certainty since the future events on which they depend are uncertain. An investment is not risky, if we can specify a unique sequence of cash flow for it. But risk arises in investment because we cannot anticipate the occurrence of the possible future events with certainty. Risk associated with an investment may be defined as the variability that is likely to occur in the future returns from the investment. If the investor

invests in share of company than it is not possible to estimate future returns accurately. The return could be negative, zero or some extremely large table". (Pandey, 1999:574-575)

"Common stock is a type of security which represents a commitment on the part of a corporation to pay periodically whatever its board of directors deems appropriate as a cash dividend. A firm may promise a right to share in its profit in return for an investor's fund. Nothing pledged, and no irrevocable promises, are made. The firm pays simply whatever its directors deem reasonable form time to time. However, to protect against serious malfeasance, the investor is given the right to participate in the board of directors. The investor's property right is represented by a share of common stock, which could be sold someone else, who win then be able to exercise right the holder of common stock is said to be an owner of the corporation and can, in theory, exercise control over its operationǁ through the board of directors." (Sharpe, 1995:3-7)

So common stocks are more risky than both bond and preferred stock from the point of investment. Equity stock gives several rights to the stockholders. He/she has the right to vote, the right of dividend, right of being offered right shares, the right to bonus issue and certain tax benefit. Investment in common stock is highly liquid because common stock may be purchased and sold immediately. While the stockholders have the right of being the owner of the firm his liability is limited only to the extent of his investment. Due to high and more advantages common stock is most popular and attractive investment among investors.

Return is reward received from investment for sacrifice of present certain amount of asset. It is commonly defined as reward for bearing risk. Return is the major factor behind any investment. It is the most important outcome of any investment. It measures the investor's rate of wealth accumulation i.e. increase or decrease in the wealth of the investor. Return is the total gain or loss expire need in an investment over a given period of time. It can also be defined as the after tax increase in the value of the investment.

"Return is desired as the dividends yields plus the capital gain or loss. The relationship between different levels of return on their relative frequencies is called a probability distribution for the relative frequency of a firm's annual return by analyzing its historical returns over the previous year. But we know that history never repeats itself exactly. Hence after analyzing relative frequencies of historical return for the individual company. We can form a probability distribution based on a historical data plus the analysis for the outlook for the economy, for the industry and outlook for the firm in its industry and other factor" (Weston & Brigham 1990: 94)

The Oxford dictionary gives multiple definitions of the term _risk': —The possibility that something unpleasant or unwelcome will happenǁ and also —The possibility of financial loss. Horcher (2005) states that risk and exposure are

closely linked. Risk is defined as the probability of loss, while exposure is defined as the possibility of loss. Risk arises as a result of exposure. Financial market exposure can lead to losses but also to opportunities for gain or profit. Risk is the likelihood of losses occurring from the exposure to the market and changes within the market. Since every organisation exists to provide value for its stakeholders, every organization needs to have a level of exposure to create opportunities for gain and profit.

3. RESEARCH METHODOLOGY

Research methodology is the systematic way of solving research problem. It refers to the overall research process, which a researcher conducts during his/her study. In this chapter research design, population and sample, sources of data, data collection technique, data analysis tools are include. A research can be conducted on the basis of primary and secondary data. In this study all the data are from secondary sources and the observed data is analyzed with using appropriate financial and statistical tools.

Research Design

Research design is necessary to fulfill the objectives of well-set research. It is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. A research can design in many different ways. It serves as a framework for the study, guiding the collection and analysis of data. Researcher design is the plan and structure and strategy of the investigation.

This study based on data extracted from annual reports of sample insurance companies for 5 consecutive years starting from 2013 to 2017. This study is quantitative and also analytical and descriptive research design has been used. It covers quantitative method in a greater extent and analyzes risk and return of five insurance companies in Nepal. This study also tries to analyze portfolio construction separate systematic and unsystematic risk, to find out proportion of diversified and undiversified risk.

Population and Sample

This study is based on the insurance companies listed in the NEPSE index. Currently there are 210 companies listed in the NEPSE. Among them 27 are insurance companies and among them 18 are non-life insurance companies. For this study, 5 sample non-life insurance companies are selected randomly from those which are in operation from 2003 AD. The sample covers about 28% percent of population.

The name list of the sample selected for the research is as follows:

Category	Population Size	Sample Size	Name of the Sample Companies
Insurance Companies	18	5	Premier Insurance Company (PIC). Everest Insurance Company (EIC). Himalayan General Insurance Company (HGIC). National Insurance Company (NICL) United Insurance Company (UIC)

Sources of Data: www.nepalstock.com.np

This study is mainly based on secondary data provided by Nepal Stock Exchange, Financial Statistics, Annual Report, and Trading Report. Other datas are provided by Security Board of Nepal and related company' datas are taken from the companies as well as their web sites, other related books and booklets.

4. DATA ANALYSIS

Five insurance companies are taken as sample due to various constraints. All together 18 non-life insurance companies are listed in NEPSE but in my study, I have included only five of them as sample. Risk and return analysis of these companies individually presented and analyzed below.

This study has presented and analyzed of these company's MPS, Dividend, expected return, standard deviation and correlation.

Premier Insurance Company (PIC)

Premier Insurance Company was established under the company act in 1992 A.D. (2048 B.S.) and was listed with NEPSE in 1995 A.D. (2052/05/01). The office is located at Narayanchaur, Naxal, Kathmandu. The authorized capital of this company is Rs. 75, 00, 00,000, issued capital is Rs. 50, 00, 00,000 and paid up capital is Rs. 509142000. The par value of share is Rs. 100.

Report			
	Return	MPS	Dividend
Mean	1.0490	834.0000	5.0000
N	6	6	6
Std. Deviation	1.70063	807.86435	5.51362
Correlations			
		MPS	Return
MPS	Pearson Correlation	1	.444
	Sig. (2-tailed)		.378
	N	6	6

Return	Pearson Correlation	.444	1
	Sig. (2-tailed)	.378	
	N	6	6

The average MPS of PIC is 834 and the average dividend distributed by PIC is 5 from 2012 to 2017. The expected rate of return of PIC is 1.0490(104.90%) from 2012 to 2017. The standard deviation of rate of return is 1.70063. The coefficient of variation will be 1.6212 which measures the risk per unit of return.

The Pearson's r for the correlation between the MPS and return variables is 0.444 which denotes an average relationship between MPS and returns of PIC. The positive correlation shows as the MPS is increasing, the return on stock is also increasing.

The Sig.(2-tailed) value is 0.378 which greater than 0.05. So, there is no statistically significant correlation between these two variables.

Everest Insurance Company (EIC)

Everest Insurance Company is an insurance company, which established in the year 1992 (2048 B.S.). The office listed in NEPSE on 12/20/51 B.S. (1995A.D.). The major objective of the company is the carry out life and non-life insurance business in the country. The authorized capital of this company is Rs. 100,000,000, issued capital of Rs. 30,000,000 and paid up capital of Rs. 147015000. The paid up value per share of EIC is Rs. 100.

Report			
	Return	**MPS**	**Dividend**
Mean	.5667	1069.5000	6.6667
N	6	6	6
Std. Deviation	.76607	1016.27255	8.16497

Correlations			
		MPS	**Return**
MPS	Pearson Correlation	1	.502
	Sig. (2-tailed)		.310
	N	6	6
Return	Pearson Correlation	.502	1
	Sig. (2-tailed)	.310	
	N	6	6

The average MPS of EIC is 1069.5 and the average dividend distributed by EIC is 6.667 from 2012 to 2017. The expected rate of return of EIC is 0.5667(56.67%) from 2012 to 2017. The standard deviation of rate of return is 0.76607. The coefficient of variation will be 1.3518 which measures the risk per unit of return.

The Pearson's r for the correlation between the MPS and return variables is 0.502 which denotes an average relationship between MPS and returns of EIC. The positive correlation shows as the MPS is increasing, the return on stock is also increasing.

The Sig.(2-tailed) value is 0.310 which greater than 0.05. So, there is no statistically significant correlation between these two variables.

Himalayan General Insurance Company (HGIC)

HGIC was established under the company act in 1988A.D. (2044 B.S.) and was listed in NEPSE on 10/13/50 (1994A.D.). The objective of the company is undertaking non-life and re-insurance business from insurance board under insurance act 1992 and started its business from November 1993 A.D.

The authorized capital of this company is Rs. 500,000,000, issued capital is Rs. 250,000,000 and paid up capital Rs. 10,272,000. The paid up value of per share is Rs. 100 and par value is also Rs. 100.

Report			
	Return	**MPS**	**Dividend**
Mean	.8183	735.8333	5.5000
N	6	6	6
Std. Deviation	1.24825	689.42191	6.12372

Correlations			
		MPS	**Return**
MPS	Pearson Correlation	1	.437
	Sig. (2-tailed)		.386
	N	6	6
Return	Pearson Correlation	.437	1
	Sig. (2-tailed)	.386	
	N	6	6

The average MPS of HGIC is 735.8333 and the average dividend distributed by HGIC is 5.5 from 2012 to 2017. The expected rate of return of HGIC is 0.8183(81.83%) from 2012 to 2017. The standard deviation of rate of return is 1.24825. The coefficient of variation will be 1.5254 which measures the risk per unit of return.

The Pearson's r for the correlation between the MPS and return variables is 0.437 which denotes an average relationship between MPS and returns of HGIC. The positive correlation shows as the MPS is increasing, the return on stock is also increasing.

The Sig.(2-tailed) value is 0.386 which greater than 0.05. So, there is no statistically significant correlation between these two variables.

United Insurance Company (UIC)

United Insurance is an insurance company, which established in 1992A.D. (2049 B.S.) with an objective of providing non-life insurance in the field of fire, machine, vehicle and miscellaneous insurance. The company was listed on NEPSE in the year 1994 A.D. i.e. (51/01/17B.S.). The authorized capital of this company is Rs.50, 0,000,000, issued capital is Rs. 252,000,000 and paid up capital is Rs. 302,400,000. The par value of share is Rs. 100.

Report			
	Return	**MPS**	**Dividend**
Mean	1.0233	776.1667	4.0000
N	6	6	6
Std. Deviation	1.78963	640.27101	4.56070

Correlations			
		MPS	**Return**
MPS	Pearson Correlation	1	.476
	Sig. (2-tailed)		.340
	N	6	6
Return	Pearson Correlation	.476	1
	Sig. (2-tailed)	.340	
	N	6	6

The average MPS of UIC is 776.1667 and the average dividend distributed by UIC is 4 from 2012 to 2017. The expected rate of return of UIC is 1.0233(102.33%) from 2012 to 2017. The standard deviation of rate of return is 1.78963. The coefficient of variation will be 1.7489 which measures the risk per unit of return.

The Pearson's r for the correlation between the MPS and return variables is 0.476 which denotes an average relationship between MPS and returns of UIC. The positive correlation shows as the MPS is increasing, the return on stock is also increasing.

The Sig.(2-tailed) value is 0.340 which greater than 0.05. So, there is no statistically significant correlation between these two variables.

Nepal Insurance Company (NICL)

National life and general insurance company limited was established in 1985A.D. under the company act 1964. The main objective of the company is to provide insurance services in the field of life and non-life sector. The authorized capital of the company is Rs.50,00,00,000, issued capital is Rs. 29,70,00,000 and paid up capital is Rs. 629,345,100. The par value of share is Rs. 100.

Report			
	Return	**MPS**	**Dividend**
Mean	.6983	689.5000	3.0000
N	6	6	6
Std. Deviation	1.28447	547.57785	4.69042

Correlations			
		MPS	**Return**
MPS	Pearson Correlation	1	.541
	Sig. (2-tailed)		.267
	N	6	6
Return	Pearson Correlation	.541	1
	Sig. (2-tailed)	.267	
	N	6	6

The average MPS of NICL is 689.50 and the average dividend distributed by NICL is 3 from 2012 to 2017. The expected rate of return of NICL is 0.6983(69.83%) from 2012 to 2017. The

standard deviation of rate of return is 1.28447. The coefficient of variation will be 1.8394 which measures the risk per unit of return.

The Pearson's r for the correlation between the MPS and return variables is 0.541 which denotes an average relationship between MPS and returns of PIC. The positive correlation shows as the MPS is increasing, the return on stock is also increasing.

The Sig.(2-tailed) value is 0.267 which greater than 0.05. So, there is no statistically significant correlation between these two variables.

5. CONCLUSION

This study focuses on the common stock investment among other securities. Investors of common stock are ultimate owner of the company, who are ultimately associated with risk and return. So to maximize the share price, the finance manager must learn these two key determines: risk and return. It becomes easier when there is existence of developed and healthy stock market in the country. Risk and return is getting considerable attention in financial management.

People's participation in the security investment and its dynamic trading plays a very important role in the overall economic development of a nation. The investment environment detects the availability of investment opportunities. The central focus of this study is the risk and return trade off and the relationship between risk and return is described by investor participation about risk and their demand for compensation. No investor will like to invest in risky assets unless he/she is assured of adequate compensation for the acceptance of risk. Hence risk plays a vital role in the analysis of investment. Investor often ask about the total risk they will be assuming in an investment and like to know the risk premium provided is enough. Higher risk will command higher premium and the trade – off between the two assumes a linear relationship between risk and risk premium.

The investor in general, expects two kinds of return on stock investment i.e. dividends and capital gain. Rational investors consciously examine the behavior of stock return sand ultimate risk associated with it and then invest their fund in efficient portfolio from which they can realize higher return with lower risk. But in Nepal, it is found that most of the investors invest their funds in single securities rather they can be benefited by investing in portfolio through diversification risk.

The study mainly focused at evaluating the risk and return associated with common stock investment of insurance companies in Nepal. The main objectives of the study are to analyze risk and return of the common stocks in the Nepalese market, the study is focused on the common stock of insurance companies. Five listed companies are taken into the consideration to analyze the risk and return. While analyzing the risk and return brief review of related studies has been

performed. Research methodology has been used to analyze data and tables, graphs and diagram are used to make the findings sample and to present data in easily form. It is based on only secondary data. The secondary data are collected from Nepal Stock Exchange, NRB, SEBON and financial records of studied companies.

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