

ANALYSIS OF RISK AND RETURN RELATIONSHIP

A CASE ON LISTED MANUFACTURING COMPANIES IN SRI LANKA

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Faculty of Management

Uva Wellassa University

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ABSTRACT

The relationship between risk and return is an essential aspect in all human decision making. The aim of investors is getting investment opportunities with minimum risk and maximum returns. Risk and returns are important variables that investors are looking for, at the time of investment decision making (Hasanali S.at.al, 2010). Hence, the research investigates as main objective, to find out relationship between systematic risk and expected return. With that purpose, CAPM is applied to find risk and return relationship.

Listed manufacturing companies are selected as research population. There are 37 listed manufacturing companies in Sri Lanka. The final sample consists with 27 manufacturing companies and other 10 companies are eliminated since, lack of data in sample period of 2001 to 2011. Other than identification of risk and return relationship, there are two secondary objectives; to identify the relationship between systematic risk and market performance of listed manufacturing companies in Sri Lanka and to identify the degree of risk and proposed investors for listed manufacturing companies in Sri Lanka. Sharpe ratio, Jensen's alpha and Treynor ratio is used for measure company performances. Through secondary data research was conducted and to achieve primary objective of risk and return relationship and correlation analysis is used. Moreover, to analyze systematic risk and market performance, same method was applied (correlation analysis). According to systematic risk value, the degree of risk and proposed investors are determined. Regressing All Share Price return and company return the systematic risk was calculated.

At last the results conclude there is a strong positive correlation (0.723) between risk and return and it is significant under P value of 0.05. That is prove risk is one of the main determinant of return. Market performances are determined by Jensen's Alpha, Sharpe and Treynor ratio. Jensen's Alpha values of market performance and systematic risk has positive correlation and it is significant under p value of 0.05. As well Sharpe values of market performance and systematic risk has positive correlation and it is significant under p value of 0.1. Treynor values of market performance and systematic risk has weak positive correlation and it is significant under p value of 0.1. The degrees of risk of manufacturing companies are moderate since most of the companies are having low risk than market risk. Therefore it is better to introduce moderate risk seekers.

***Key words:* CAPM, Expected return, Risk, systematic risk, Market performance**