

**POLICIES AND PRACTICES FOR  
INITIAL PUBLIC OFFERING  
IN NEPAL**

**BY**

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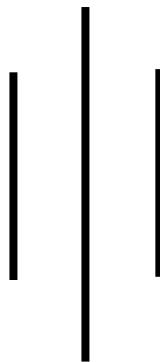
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**VIVA-VOCE SHEET**

We have conducted the viva-voce of the thesis presented

**By**  
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**Entitled:**  
**POLICIES AND PRACTICES FOR**  
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**IN NEPAL**

And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the Degree of **Master's of Business Studies (MBS)**

**Viva-Voce Committee**

Head, Research Department .....  
Member (Thesis Supervisor) .....  
Member (External Expert) .....

## **Declaration**

I hereby declare that the work reported in this thesis entitled "**Policies and Practices for Initial Public Offering in Nepal**" submitted to office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of **prof. Dr. Shilu Manandhar Bajracharya** of Sanker Dev Campus, T.U.

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**Til Bahadur Rayamajhi**

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## LIST OF ABBREVIATION

IPO	-	Initial Public Offering
NEPSE	-	Nepal Stock Exchange Ltd.
SEBON	-	Securities Board , Nepa
SEC	-	Stock Exchange Center
NRB	-	Nepal Rastra Bank
AGM	-	Annual General Meeting
BOD	-	Board of Directors
CRO	-	Company Registrar's Office
FY	-	Fiscal Year
MOF	-	Ministry of Finance
MOU	-	Memorandum of Understanding
RTS	-	Registrar to Share
KBL	-	Kumari Bank Limited
NMB	-	Nepal Merchant Banking and Finance Ltd
NUBL	-	Nirdhan Uthhab Bank Limited
NYSE	-	New York Stock Exchange
Rs.	-	Rupees (Nepalese currency unit)
NHL	-	National Hydropower Limited
OHL	-	Oriental Hotels Limited
SRCS	-	Securities Research Centre and Services
NATS	-	NEPSE Automated Trading System
CEDB	-	Clean Energy Development Bank
GBL	-	Global Bank Ltd.
KFL	-	Kaski Finance Ltd.
PIC	-	Prudential Insurance Co.
SFL	-	Shikhar Financel Ltd.
SICL	-	Siddhartha Insurance Co. Ltd.

# **CHAPTER-ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

Initial public offering (IPO) is a part of primary market mechanism. When an institution raises capital from public through issuance of its securities for the time, then its issues to the public are termed as initial public offering. The securities offered can be ordinary shares, debenture, preference share and mutual fund units, IPO is important and often the only major source of obtaining large sum of fixed rates long- term funds. IPO being an important component of capital market is bound to be influenced by the size and level of development of capital market. In this context, Nepal does not have long history of capital market development of a country, through its ability to mobilize resources from funds surplus group to fund deficit group does play an important role in economic development of a country. In this context, IPO an important capital market mechanism enables not only business entities but also government at occasions to raise long term fund at convenient terms.

Even though the flotation of ordinary shares of Biratnagar Jute Mill and Nepal Bank Ltd. In 1937 A.D., introduction of company Act in 1964 and the first issuance of Government bond in 1964 were some positive indication of capital market development in Nepal but the actual process started with the establishment of security exchange centre (SEC) in 1976 A.D. However, the process got actual impetus only when the government adopted the policy of economic liberalization and privatization during 1990's. During the same period SEC was divided into institutions namely Security Board of Nepal (SEBON) and Nepal Stock Exchange Ltd. (NEPSE). Security Board of Nepal (SEBON) was established by the Government of Nepal on June 7, 1993 and is now functioning as an apex regulator of security market in Nepal. As per Securities Ordinance, 2005. The major objectives of SEBON are to regulate issue, trading of securities and market intermediaries, promote market development and protect investors' right. Nepal stock exchange (NEPSE) is a non – profit sole Institution to facilitate secondary market transactions. It runs under securities exchange act 1983. It commenced its regular operations on Jan 13, 1994 and has adopted open-out-cry system but now it has been

operating in automated trading system (since, 7<sup>th</sup> of Bhadra, 2064). The basic objective of NEPSE is to impart free marketability and liquidity to the government corporate securities by facilitating transactions in its trading floor through market intermediaries, such as brokers and market makers. Government of Nepal, Nepal Rastra Bank, Nepal Industrial Development Corporation and its members are the shareholders of NEPSE. Member of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities.

## **1.2 Statement of the Problem**

Problems regarding initial public offering (IPO) of share are subject to the regulatory framework of the concerned governing bodies. However we can see growing concern of the general investors in the primary issue of share. At the same time the investment bankers play important role in the issue of new shares. There are also problems in this underwriting. The underwriters in consultation with the company decide on the basic terms and structure of the offering.

Still more than half of Nepalese citizens are under the line of literacy. And among the literate ones as well maximum do know nothing about the practice of stocks. They do not know what the securities mean at all. How can we expect them to invest in the securities? And even among the aware people there is still lack of confidence level. They do not want to take risk. In developing country like Nepal, primary issue of share is still new phenomenon.

The instable political situation of the country is also another problem for primary issue of share. Due to this people generally hesitate to invest in the stocks. Primary issue of share funding via financial institutional loans so not a healthy practice as it does not reveal the true picture of the company. Single investors apply hundreds of application showing dummy names. As a result they can capture large number of shares and can influence the company management and stock price too. In this way there are many problems regarding the communal response to the primary issue of share.

The study has focused on the following points:

- What is the role of investment bankers in primary issue of share?
- What are the problems and growth regarding primary share issue market in Nepal?

- What are the policies and practices for initial public offering in Nepal?
- How is initial public offering changing its pace?
- How do financial institutions loan affect the primary issue of share funding?
- How is the IPO practice in Nepal?
- How is subscription pattern of IPO analyzed in Nepal?
- What is the relationship between subscription pattern of IPO and capitalization?
- How can IPO be suggested and recommended on the basis of major findings?

### **1.3 Objectives of the Study**

Capital market of Nepal is still in its early days. Likewise its other mechanism, IPO and its practices are also very limited. In this regard the basic objective of the study is to analyze different aspects of IPO in Nepal. More specifically the study will carry following objectives:

- To examine and identify the initial public offering practices in Nepal.
- To analyze all the numbers of securities issued in Nepal since since 2000/01 to 2009/10 A.D.
- To study legal provision stated in Nepal that directly or indirectly affect IPO of share.
- To analyze the subscription pattern of Nepalese Initial Public Offerings.
- To study the relationship between subscription pattern of Initial public Offerings and capitalization.
- To analyze the pace of Initial Public Offerings.
- To analyze the problems and growth trend of Initial Public Offering in Nepal.
- To identify the roles of the investment bankers (issue manager) in the process of Initial Public Offering.
- To suggest and recommend on the basis of major findings

### **1.4 Significance of the Study**

This study is helpful to the prospective investors and the organization in the field of public offering as there is still lack of study regarding primary issue of share in Nepal. This study will assist in the formulation of policy and

will assist the policy makers to get the practical knowledge of existing rules and regulations.

From this study, investors will have more clear conception over their investment and they will be able to make a right choice. It will also help to find out the financial status of the company which wants to go public.

This study will be significant to analyze the legal provision, possibilities, problems and prospects of Initial Public Offering in Nepal. It will also be helpful to know the public respond to Initial Public Offering of share of different industries. The prospective offering company may also get significant knowledge from this study.

### **1.5 Limitation of the Study**

Every research has its own constraints and limitations. It is also not an exception. The research results and finding based on the secondary data, depends on the real information disclosed by the respective organization. The major limitations of the study are as follows:

- This study is based on the assumption that all data provided to the researcher are true and reliable.
- The study covered only nine years data.
- The interview while doing survey is assumed that they have no any biasness with the researcher.
- This study may not concentrate on each and every aspect of the securities will only consist IPO.
- This study is done from student's limited resources.

### **1.6 Organization of the Study**

The present study will be organized in the following steps:

#### **Chapter I: Introduction**

This is the first chapter and includes background of the study, statement of the problem, objectives of the study, significance of the study, limitation of the study, methodology of the study, organization of the study.

## **Chapter II: Review of Literature**

The second chapter will bridge the information chapter and actual research studies. It means reviewing research studies or other pertinent propositions in the related area of the study so that the past studies, their conclusions and deficiencies may be known and further research can be conducted. This chapter broadly consists of two segments theoretical/conceptual reviews are made for the conceptual clarity and to present the prevailing scenarios. Likewise, several other related studies are reviewed in separate segment; to show what types of studies were made in this field and what results were generated by prior researchers. Several related articles are also reviewed to present the glimpse of nature of primary market and securities underwritten in Nepal.

## **Chapter III: Research Methodology**

The third chapter deals with introduction of research design, nature and sources of data, population and samples, data gathering procedure, data analysis and analytical tools used.

## **Chapter IV: Presentation and Analysis of Data**

The fourth chapter deals with presentation of related data collection from different source and analysis of them, to reach closer to the actual result by using financial and statistical tools and techniques.

## **Chapter V: Summary, Conclusion and Recommendation**

The whole study is summarized and concluded in this final chapter. A list of findings from the analysis is also presented in this chapter. Finally, an extensive bibliography and appendixes are also included at the end of the study.

## **CHAPTER-TWO**

### **REVIEW OF LITERATURE**

#### **2.1 Review of Literature**

Literature review is an essential part of all studies. It is a way to discover what other researchers have covered and left in the area. A critical review of the literatures helps the researcher to develop through understanding and insight into previous research works that relates to the present studies. It is also a way to avoid investigations problems that have already been definitely answered. Thus a literature review is the process of locating, obtaining, reading and evaluating the research literature in the area of the student's interest,. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study and what remains to do. The primary purpose of literature review is to learn not to accumulate. It enables the researcher to know. (Wolff and Panta 2005, p: 40)

What research has been done in the study?

What others have been done in the study?

What others have been advanced?

The approach taken by the other researcher.

Area of agreement or disagreement.

Whether there are gaps that can fill through the purposed research.

This section of study reviews the related research works. It is divided into two sections: Conceptual review and review of related studies. Conceptual review identifies the components and ingredients that formed the foundation of the whereas review of related studies draws excerpts from the number of research works carried abroad and within the country, illustrating various facts of the subject matter.

#### **2.2 Conceptual Review**

It presents the core theoretical concept of IPO, IPO as capital market mechanism, IPO and its theoretical aspects, historical background of

capital market development in Nepal and procedural aspects of IPO practices in Nepal.

### **2.2.1 Introduction**

IPO is the first time issuance of securities to the public. It is the process through which fund seeker groups such as business entities obtain required fund for the willing fund surplus group such as investors. The securities offered in IPO may include bonds, debentures, preference shares, and common shares. However, in the case of this of this study, IPO is used in the sense of issuing common shares to the public for the first time. Thus, IPO can also be perceived as a medium through which privately held corporations are turned into public company. Public offering is a security offering where all investors have the opportunity to acquire a portion if the financial claims being sold (Keown and others, 204:471). Hence through IPO, public at large are able to buy the financial instruments that allow them to have some claim in the issuing company.

### **2.2.2 Reasons to go for IPO**

Of course obtaining required capital from public is the innermost reason to go for IPO but often it is not the only one. If the private firm is successful, usually the owners will want to take the company public with a sale if securities to outsider. Through IPO, the founder simply wants to establish a value and liquidity for the stock (Van Horne, 2002: 578). Thus, firms go for IPO not only to generate capital but also to establish value and develop liquid market for its stock. Similarly, the firm with major investment plans and high leverage gaining access to a non-bank source of finance is a benefit of going public. In this regard, Rajan (1992) asserted that, to reduce debt and increase investment with, lower cost firms are interested to go public. Hence, when interest rates are high, companies particularly those concerned by cost find it reasonable to go for IPO.

It addition, of diversification were important motive in the IPO decision, than riskier companies would be more likely to go public. Thus, IPO incidence may vary by industry. At the same time, firms recognizing that listed companies in their industry are overvalued have an incentive to go public (Ritter, 1984).Hence, sharing risk inherent in the business and cashing on overvalued issue could also be the reason to go for IPO.

Hence, it could be concluded that raising capital is not the only reason for firms to go for IPO. Whatever is the reason but it could be asserted the reason but it could be asserted the IPO's play an important in capital mobilization and renders positive influence on overall development of capital market.

### **2.2.3 Advantages of an IPO**

As discussed above, the primary reasons for conducting an IPO are to raise money and to create liquidity for investors. There are also important incidental benefits to going public. Objective benefits include (i) obtaining a readily ascertainable market value for the company's stock, (ii) the ability to make acquisitions through the payment of securities rather than cash, (iii) greater access to financing through commercial lending, (iv) greater access to the financial markets for follow-up offerings, and (v) heightened name recognition and prestige among customers and suppliers. Less objective benefits are the sense of success and accomplishment that accompanies a successful IPO and becoming a publicly traded company.

### **2.2.4 Disadvantages of an IPO**

The major disadvantage to becoming a publicly traded company may be compliance with the act reporting requirements. While registering under the act is quite simple, the periodic and event-based reporting obligations under the act require a significant amount of time and expense. In addition, the act obligations will compel disclosure of information that the issuer, its directors, management and controlling stockholders might otherwise want to keep to themselves. Financial and business information, executive compensation, transactions between the company and its directors, management and major stockholders, and certain employee benefits must all be disclosed in reports filed with the SEC, mailed to the stockholders, and made available to the public upon request. Directors and officers, as well as major stockholders, also must file reports with the SEC disclosing most transactions in the company's securities. Also, the failure to accurately make such reports may result in civil or criminal penalties. The direct financial costs, including legal, accounting and printing fees, of conducting an IPO and of being a publicly traded company are substantial, as are the indirect costs of the time required to be spent on these matters by management. Also, the management and governance of a publicly traded company is more difficult and less flexible. The solicitation of stockholder

votes on any matter is strictly regulated under the act, and rules of the exchange on which the securities are listed require certain matters to be approved by stockholder vote even if not otherwise required by state law. Additionally, because of pressure to raise the price of the company's stock, management may feel persuaded to adopt policies aimed at achieving short-term results rather than long-term goals.

### **2.2.5 Timing of an Initial Public Offering**

Obviously, not all companies that would like to go public are in a position to do so. Factors relevant to a company's ability to successfully close an IPO include (i) its past financial performance, its financial projections for the future, and its ability to generate consistent increases in revenues and earnings, all of which are crucial for a public company to survive in the market place, (ii) the experience and depth of the company's management team, (iii) a solid product position in the market with growth potential, (iv) a focused mission set forth in a well written business plan to present to prospective underwriters, and (v) attorneys, accountants and public relations firms experienced in working with the SEC. Especially in the case of technology-based companies, the determining factor in the success of an IPO may ultimately be the receptivity of the stock market to new issuances in a Company's particular industry at the time that the IPO is undertaken. The company will have to satisfy the underwriters that all of the above criteria are met, and even then the underwriter may insist on changes to the company's capital structure as a condition to its engagement. For example, the underwriters might require the company to affect a reverse stock split prior to the closing of the IPO in order to price the shares being offered in a typical IPO price range. If the underwriters do not feel that the company is offering a sufficient number of shares to ensure an acceptable "float" of publicly traded shares, they might require that certain stockholders participate in the offering by selling some of their own shares (a "secondary offering"). The underwriters might also insist on fundamental changes in the company's means of conducting its business as a condition to its engagement, such as the cessation of insider transactions and perceived conflicts of interest and the appointment of outside directors. Companies which are not willing to make such changes may not be able to attract an underwriter willing to manage the IPO. If the issuer belongs to a certain industry that is particularly attractive to investors at the time of the proposed IPO, it will have more leverage in choosing and negotiating with an underwriter. Conversely, if market conditions are unfavorable at the

time of the offering, the issuer will have less flexibility in how the deal is structured and may have to postpone the IPO altogether.

### **2.2.6 Initial Public Offerings Instruments**

Different types of securities offered in the primary market. They are:

#### **Common Equity/ Stock**

These are the offerings that entitle the holders or the buyers of the offerings the stake on the equity of the issuing company. In addition, they are entitled to:

- Voting right at the general meetings of the company and have the right to control the management of the company.
- Right to share the profits of the company in the form of distribution of dividend and bonus shares.
- In the event of the winding of the company, equity shares capitals are repayable only after repayment of the claims of all the creditors and preference shareholders.

#### **Preference Share/ Preferred Stock**

Preference shares capital mean, in the case of a company limited by shares, that part of the capital of the company which,

- Carries a preferential right to payment of dividend during the lifetime of the company;
- Carries, on a winding up, a preferential right to be repaid the amount of capital paid-up.

The different types of preference shares are:

- Cumulative Preferred stocks
- Non-cumulative Preferred stocks
- Redeemable Preferred stocks
- Non-redeemable Preferred stocks
- Convertible Preferred stocks

## **Bond/ Debenture**

Debenture includes debentures stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. Debenture is a document that either creates a debt or acknowledges it, and any document, which fulfills either of these conditions, is debenture. The characteristic features of a debenture are as follows,

- It is issued by the company and is in the form of a certificate of indebtedness.
- It usually specifies the date of redemption. It also provides for the repayment of principle and interest at specified date or dates.
- It generally creates a charge on the undertaking or undertakings of the company.

The different types of debentures are:

- Secured debentures
- Unsecured debentures
- Redeemable debentures
- Perpetual debentures
- Convertible debenture

## **Warrants**

The warrant gives a right to the holder to obtain equity shares specified in the warrant after the expiry of a certain period at a price not exceeding the cap price specified in the warrant. The warrant is a tradable and negotiable instrument and is also listed on the stock exchanges. It comes in different forms, mostly:

- Bonds with warrants
- Preferred stocks with warrants

Beside these instruments there is other instrumental mix available to the investment bankers to provide to the primary market investors. But, these are beyond the scope of this manual to describe.

### **2.2.7 Investment in Initial Public Offering securities**

Rules and regulations alone would not be able to protect the interest of investors. They should be able to analyze and evaluate following aspects of the company before taking their investment decision.

Investors should select those companies' securities which are regarded as well operating and good future prospects, reliable management, beneficial sectors or higher growth investing in the securities of these companies is less risky than others. The investors who invest in securities, they must compare the price and the value or the securities in the market and should select the securities which has lower market pace in comparison to its value.

The investors should take information regarding company's promoters, size, growth, environment, board of directors, past statements and as well as budgeted statements, which can be obtained from memorandum prospectus, articles of the concerned company.

### **2.2.8 Procedural Aspects of IPO's in Nepal: Legal Aspects and Process**

Any institution that goes for IPO needs to abide by various laws, acts and regulations. Generally Company Act, 2053 and Securities Exchange Act, 1983 used to guide IMP activities in the past, however these acts have been replaced by Company Act, 2063 and Security Act, 2063 respectively. As now onwards, companies need to abide by above mentioned acts and their provisions. However there also exist other legislations and guideline such as Security Registration and Approval Guidelines, 2000, Securities Allotment Guideline, 1994 Security Listing by Laws, 1996 to ensure that IPO process becomes transparent and disciplined.

The first and foremost step in the process of IPO is to get an authorized investment banker or issue manager (Authorized from NEPSE) to handle the whole process, as per provisions of Securities Registration and Issue Approval Guidelines, 2000. Often being appointed, the issue manager conducts due diligence investigation of the issuing company to analyze overall aspects of the issuing company that is mentioned in the proposal for the public issue like nature of business, its financial position, plans, management etc. Upon being satisfied, the issue manager prepares detail

document along with prospectus to be submitted into the company register's office (CRO)

CRO, upon receiving such prospectus, analyzes its various aspects in consultation with SEBON and only after being satisfied grants issue manager further need to register the prospectus along with other necessary documents in SEBON and obtain issue approval, as per provisions of Securities Act, 2063. The prospectus should contain detailed information regarding name of the corporation, its address, objective of its establishment, share capital value, potential risks involved and various other information, which will enable investors to make rational decision. In the case of financial institutions, they need to get issue approval from NRB as well.

Prior giving issue approval SEBON analyzes the validity of the information presented in the prospectus and the other documents. Due Diligence Report submitted by the issue manager often becomes basis for such analysis. After receiving issue approval from CRO and SEBON, the issue manager on behalf of issuing company is now legally authorized to make public issue. In fact, the issuing company should open its issue to public within two months from the date of approval by SEBON (Securities Registration and Issue Approval Guidelines, 2000)

## **2.2.9 Initial Public Offering (IPO) Manual**

Initial Public Offerings (IPO) manual is the detail procedure of handling Initial Public Offerings of the companies seeking “going public” for the first time. This manual outlines all the activities and steps that have to be observed by all issuing companies and issue managers in respect to Initial Public Offerings (IPO). This manual has been prepared with a view to present a detailed, descriptive and step-by-step action sequences in the Initial Public Offerings, relevant to all the companies offering shares to the general public. But, it is subject to periodic amendments and supplements. The Public Offering is not an easy task. There are many organizations involves during this periods. They are:

### **2.2.9.1 Issuing company**

Issuing company is the company raising funds from the general public through the process of public offering. The purpose of public offerings is for the collection of funds from general public, a fund sufficient group, by

the company as per its requirement of business expansion. The company seeking for public offerings could be a completely new company (initial public offerings), a new company set by the existing company (initial public offerings) or by existing listed company (successive public offerings).

As per the Company Act, only public companies are liable to go for public offerings. The Act specifically states that private companies are not allowed to sell their shares and debentures in the free market. For public company issuing debentures, the reasons for such issue, project to be financed and its estimated budget along with the information about secured or naked nature of the debenture, needs to be approved from the governing bodies.

NRB has made mandatory that financial institutions must go for common stock public offerings within specified time of operation commencement. NRB has also set forth different minimum percentage of equity holding to be offered to the public shareholders. For commercial banks, minimum shares to be held by public is 30%; for finance companies, it is 40%; for development bank it is minimum 30% and maximum of 50%. In the case of foreign participation, their equity holding would be arranged from the percentage allocated for the public. For finance companies, in the event of foreign participation, the minimum percentage to be allocated to the general public is 25% of paid-up capital. For other public companies such compliance to go into public offerings of equity holding are absent. For such companies, going into public signifies the need of funds for the company rather than the obligation. The Provisions and Conditions for Securities Registration and Issue, 2051 has set the guidelines that before going into public offerings, issuing company should take into consideration that.

**a. If the issuing company is industrial institutions**

- The institution has bought the land or made other provisions in which necessary infrastructure like factory; office buildings, go downs etc. are already build in or made necessary arrangements for it.
- Necessary technology has been selected for which spare parts of machineries needed have been bought. If not, LC has been opened to buy the necessary technologies.

- Estimated budget has been proposed for the project to be implemented and for which if loans are required, such agreements are already made.
- In the absence of long-term loan agreement, issue securities are underwritten.
- Necessary approvals according to the existing Acts have been taken.

**b. If the issuing company is financial institutions**

- According to the nature of the business, required infrastructures are installed.
- Approval has been taken under the Company Ordinance 2063.
- For commencing other activities, authority and approval from governing bodies based on existing Acts has been taken.

**2.2.9.2 Merchant Bankers**

Merchant bankers are intermediaries in which they work as mediators in the fund mobilization from the general public to the business groups. The funds are raised from the hypothetical market that comprises widely spread fund surplus groups, mainly the general public and the concentrated fund deficient groups, mainly the business groups. Funds are raised under different tool names that have long term and short-term maturing period. According to such maturity period of the tools traded, market is identified as capital market for long-term and money market for short-term tools to be traded. The role of merchant bankers in this market is to help create and expand securities underwriting, the secondary market for securities and money market. They also provide additional services in advising corporations and managing investment portfolio for the needing groups. The concept of merchant Banking differs from other commercial and development banks in respect that they do not require large funds to be invested as a principle. Their sources of income are basically the service charge they charge to their clients for playing intermediary role in the fund mobilization and their advisory role. Typically, the activities of domestically oriented investment banks can be grouped under,

- Securities underwriting
- The secondary market for securities
- The money market

- Corporate advisory services
- Investment portfolio management services, and also
- Venture capital
- Leasing/Hire purchase
- Other services (insurance, real estate etc.)
  
- The role of merchant Banking in managing the public offerings comes under the heading of securities underwriting. The working process of which would be described comprehensively later. For the working of merchant Banking function in Nepal, Nepal Rastra Bank (NRB) has set forth the working guidelines. Guidelines have identified working of merchant Banking into two sets of functions. The first set is the non fund based functions and the second set is fund-based functions. Fund-based activities identified for the merchant Banking are:
  - Bridging finance
  - Underwriting
  - Project Finance
  - Venture Capital
  - Acquisition & Merger

Non fund-based activities identified for the merchant Banking are:

- Share issue management
- Mutual Fund
- Portfolio Management
- Corporate Counseling
- Project Counseling
- Debenture Trusteeship
- Arranging International Finance
- Investment Advisor
- Advising Corporate Mergers

NRB has set the directives as for non fund-based activities of merchant Banking, for underwriting and for bridging finance it is not necessary to take separate approval from NRB. But, for other fund-based activities of merchant banking, it is necessary to take separate approval from NRB for different activities to be undertaken.

### **2.2.9.3 Securities Board**

Securities board has been formed under the Securities Exchange Act, 2040 Clause 3. This legislation has required for the creation of an independent statutory Board to be an apex authority for the securities market, thus resulting into the formation of Securities Board.

The need of legislative body is for maintaining healthy and orderly development of the securities markets and to ensure adequate investor protection. Establishment of SEB is necessary to promote markets that ensure:

- **Fairness:** The markets must promote integrity in dealings, high standards of conduct and good business practice.
- **Efficiency:** The markets should with professionals and be well informed, offering high standards of service at reasonable cost.
- **Confidence:** The market must inspire confidence in both investors and issuers to actively participate in and rely more on the securities markets.
- **Flexibility:** The markets should be resilient, innovative and be continuously responsive to the needs of all market participants. With the objective of providing this to the market, in accordance with the Act, the Security Exchange Bylaws 2054 has defined the work, responsibility and the authority of the Board as:
  - To work in safeguarding the interest of investors and help develop capital market.
  - To advise Nepal Government (NG) in formulating policies for the development of the capital market.
  - To implement the policies set forth by NG regarding securities exchange.
  - To supervise the work process management and working procedure of those involved in securities exchange to make issue management of securities regular and well managed
  - To approve registration of securities and issue of securities
  - To registers the name of securities issue dealers and give them approval letter.
  - To interrogate and supervise the workings of securities exchange dealers.
  - To formulate clauses to be followed by the securities exchange market and the dealers in security exchange market.

- To supervise, interrogate the working of securities market, securities dealers and the listed companies and when necessary make needed directions or undertake necessary actions.
- To develop and implement directives for proper management of securities market and for regular and well managed securities exchange.
- To approve Securities Market Sub-directives.
- To collect notices, data and prospectus from the listed companies and companies with securities registered; make above available information to the interested investors.
- To work for the healthy, competitive, regular and managed operation of the capital market with the objective of safeguarding the interest of the investors for continuous growth of the market.

### **Role of Securities Board in Issue of securities**

In its approach to manage public issues of securities, the Board will bear in mind

- a. Protection of rights and interests of the investor, especially,
  - The right to adequate, true and fair information
  - The need for liquidity
  - Prompt, fair and equitable allotment
  - Easy and efficient service in allotments and transfers
  
- b. The need to encourage corporate entities to tap the securities markets for their diverse resources needs. The Board would endeavor to evolve market and institutional structure, a set of instruments and methods of public offerings to cater the above objectives. The legislative provisions relating to public issues of securities may be classified under:
  
- c. Capital control, governing issue of securities and the terms of their issues;
  - To regulate terms of issues of securities from the viewpoint of investor protection, issuers needs and overall development of the securities market; and
  - To promote sound capital structure of companies.

- d. Prospectus provisions, governing the disclosure of information at the time of issue of any security;
- e. Obligations of regular disclosure of financial and other information on entities making public issues;
- f. Listing requirements governing traded securities;
- g. Provisions governing allotment and transfer of securities.
  - Ensuring fair and equitable allotment; and
  - Promoting speedier and more efficient service in matters of allotment and transfer.

#### **2.2.9.4 Offices of the Registrar of Companies (ROC)**

Registrar of Companies (ROC) is the governing body for any institution registered under Company Act. In its governing role, it observes and regulates any company going into public examining whether the process of “going public” is in accordance with the rules and regulation set forth by the existing Company Act or not. As per the Company Act 2063, public companies need to publish their prospectus before issuing securities to the public. Before publishing prospectus, one copy of the prospectus needs to be submitted to ROC. In this process, ROC approves the prospectus to be published. While approving the prospectus, ROC makes sure that important information is not missed out and unnecessary information is not mentioned. In the presence of such changes, ROC sends it back to the company for necessary changes. Upon satisfactory changes ROC grants approval to issuing company to issue the prospectus. Apart from approving the prospectus to be published by the issuing company before going into public, ROC does not play other major role.

#### **2.2.9.5 Nepal Stock Exchange**

Stock exchange has been defined as anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying and selling of or dealing in securities. The stock exchange therefore is the most important institution in the secondary market. In the primary market, it comes into play during primary share allotment, during issuing share in premium and when Securities Board asks Securities Exchange Market for its opinion. Securities

Exchange Act 2063 has stated that for the operation of the stock exchange market, approval needs to be taken from the Securities Exchange Board. Any registered institution except private companies willing to do or allow others to do security transaction should get approval for securities exchange market from the securities board. After the issue of securities to the public, the Act requires that companies be listed in the Security Exchange Market before the floated shares can be traded in the market. Nepal Stock Exchange Limited (NEPSE) is the only stock exchange market in the country.

#### **2.2.9.6 Financial Institutions**

They are financial intermediaries like commercial banks, finance companies (merchant bankers), and development banks and cooperatives institutions. These institutions are established under the Company Act and Nepal Rastra Bank Directives. These financial institutions perform the role of intermediaries in the securities issue as per the authority received from the Securities Exchange Board. Financial Institutions are involved in securities issue process as:

- Issue managers
- Underwriters
- Collection centers
- Bankers to the issue
- 

The role of financial institutions is to manage the issue process and be intermediaries in the process of transfer of funds from the investors to the issuing company. The financial institutions may also play a role of creditors to the issuing company by providing bridge finance.

#### **2.2.9.7 Nepal Rastra Bank (NRB)**

Nepal Rastra Bank is the central banking authority in Nepal. It is the governing authority in setting guidelines to all the financial institution regarding its area of operation. But, in the case of public offerings, its involvement is very minimal. Its role in the issue process is only to grant financial institutions approval to be involved with different role in the issue process. Also for different fund based activities of merchant banking, approval needs to be taken from Nepal Rastra Bank.

## **2.2.10 Parties and Terms Involved in the Process of Initial Public Offerings**

IPO being complex and time-consuming process often needs the participation of a number of entities. In this reference, generally those parties or institutions, which do play some role during the process of IPO's in Nepal, are discussed here under.

### **2.2.10.1 Issue Manager**

Issue manager is the institution solely holding the responsibility of managing the public offerings of any issuing company. Securities Exchange Act, 2040 clause 18, has defined issue managers as institutions holding license from the Security Board to manage public offering process. The format of application letter and required information to be provided while registering for issue manager are given in the appendix

### **2.2.10.2 Lead Manager**

In the event of more than one issue managers managing the issue of securities of any company, the term lead manager is used to identify the individual issue managers. The existing Act and the Directives have not clearly identified the maximum number of lead managers managing securities issue of any company at the same time.

### **2.2.10.3 Underwriting**

Underwriting is an agreement between the issuing company and a financial institution like bank, merchant banker, broker or other person, providing for their taking up the shares or debentures to the extent specified in the agreement between them, if it is not subscribed by the public. The underwriting agreements ensure that the public issued is fully subscribed. The commission paid to the underwriters as consideration for the underwriting arrangement is known as underwriting commission. The existing Company Ordinance does not require that the underwriting of all securities issued to be mandatory. Clause 26 of Company Act has specified that "in the event of issued securities subscribed less than the 50%, such securities should not be distributed to the general public". The Securities Exchange Directive 2055 has made mandatory for underwriting for those institution stated as "institution established as manufacturing industry and

has not appraised its venture project from the financial institution for the purpose of loan agreement, should underwrite its securities before being offered to the general public”.

But in the case of financial institutions, the governing body NRB requires that issue of securities by commercial banks and development banks are fully underwritten. But in the case of finance company the requirement has been relaxed. Similarly, Beema Sammity has made the public issue of securities of insurance companies to be fully underwritten. Under the underwriting provision, such information is to be mentioned in the prospectus. The reservation for preferential allotment for reserved categories should be excluded and underwriting is compulsory only to the extent of the offer to the public.

#### **2.2.10.4 Lead Underwriter**

Lead Underwriter is the one that arranges the whole underwriting process for the issuing company with the help of other sub-underwriters. The issuing companies and intermediaries should note that underwriting is a serious contractual arrangement having financial implications on the issuer and the underwriter. The business of underwriting, therefore, presupposes inherent financial strength on the part of the underwriters. In the process of identifying underwriters, therefore, issue manager must satisfy himself about the net worth of the underwriters and their outstanding commitments and disclose. In the event that the issued shares are not fully subscribed by general public, the distribution of unsold share to the underwriters would be held on the pro-rata basis based on the number of shares committed by them to underwrite.

#### **2.2.10.5 Underwriters or Sub-Underwriters**

They are the smaller institution agreeing to underwrite fewer number shares. Underwriters and sub-underwriters work under the management of the lead underwriter. Their financial responsibility remains within the total amount of shares agreed by them to undertake.

#### **2.2.10.6 Banker to the Issue**

Banker to the Issue(s) is (are) normally a commercial bank(s), which provide(s) the custodian service to the issuing company and keep the

subscription money. Bankers to the issue may or may not receive applications from the investors, issue acknowledgements for the same, and enter the application details in application schedules. It also involves in the process by realizing the proceeds of the cheques/draft and issue final certificates to the issue manager for the number of applications and amount collected. Issuing company in consultation with the issue managers makes the appointment of bankers to the issue. The bankers to the issue generally comprises the consortium of bankers providing working capital finance to the company, the banks providing underwriting assistance for the issue, the bank associated with the issue managers and other banks which are regularly and efficiently handling public issue work.

#### **2.2.10.7 Collection Centers**

Collection Centers are normally financial institutions such as banks, finance companies, brokerage houses etc. Collection centers receive applications from the investors, issue acknowledgements for the same, and enter the application details in application schedules. They also realize the proceeds of the cheques/draft and issue final certificates to the issue manager for the number of applications and amount collected. The appointment of collection centers is made in consultation with the issue managers.

#### **2.2.10.8 Prospectus**

The prospectus is defined as, “any document described or issued as a prospectus and includes any notice, circular advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of shares in, or debentures of, a body corporate”. The Company Act 2063 has made mandatory that any public institution going into public offerings must issue the prospectus before issuing the securities to the public. Act made provision before publishing for the public; the prospectus signed by the board of directors should be sent to get approval from the Office of Registrar of the Companies and Securities Board. The requirement is made to make sure that the information provided to the public is as per requirement and is not manipulated to mislead the public. The prospectus published for the public should state in the publication the approval from the Office of Registrar of the Companies. The Company Act 2063 has stated that matters referred in the prospectus are the liability and responsibility of company publishing it.

Board of Directors signing the documents is answerable to the matters stated in the prospectus. In the event that, company has knowingly published false statement in the prospectus and believing on which if securities has been purchased and loss incurred, such loss coverage would be the personal liability of the directors signing the prospectus. In short, prospectus is a legal document containing important features of Article of Association, Memorandum of Association, and important decision taken by the board of the company affecting the future of the company and important conditions to be obeyed by the general applicants. The main purpose of the publishing prospectus is to inform public about the company and the issue.

#### **2.2.10.9 Budget for the Issue**

Budget for the issue is a tentative figure of expenses that is estimated to incur in the process of public offerings. The budget is to be born fully by the issuing company, if not, according to the understanding reached between issuing company and the issue manager/s.

#### **2.2.11.1 Application form**

It is a form provided to general public to apply for the issued securities by a company. The application forms needs to be filled both in English and Nepali. It contains:

- Information about the company and issue
- Space for applicants to fill in his/her information

Application form is the legal document that the investor provides to the company stating the number of shares of a company he/she is willing to accept. The applicants submitting the application forms would imply that he/she has accepted the terms and conditions stated in the application form with the full knowledge about the matters referred in the prospectus. Attached with the application form a photocopy of citizenship is collected as a proof to applicants' acceptance to terms and condition and a remedy to possible discrepancies in identification. In case of minor applicants, citizen certificate of parents or guardian is to be attached.

### **2.2.11.2 Bridge Financing**

It is a short term lending provided to the issuing company till the date of share allotment, backed by the collection from public issue. The company is to make the payment after receiving allocated shares money from public offerings. Normally financial institutions provide bridge loans to companies against their underwriting commitments. The said loans are adjusted against allotment of shares/debentures. The bridge finance is issued when

- Companies require to meet their immediate requirement of funds
- If there is a substantial lead-time between making a public issue and commencement of commercial production
- If issues is to be deferred to the most opportune time.

### **2.2.11.3 Memorandum of Understanding**

In the process of issuing securities to the public, besides issuing company, different intermediaries are involved. Memorandum of Understanding is the legal agreement made between issuing company and different intermediaries. This agreement states the terms and condition in respect to the function and authority of the involved parties. Securities Issue and Issue Manager Directives, 2054 (7) has provided guidelines while going into agreements. Different MOU to be signed in the process of issue offerings are,

- MOU between issuing company and the issue manager/ lead managers: This is required as the Company Act requires securities issue process of any public company is to be done through the registered issue manager. This legal agreement between issuing company and issue manager specifies terms & condition, responsibilities and the authorities of involved party.
- MOU between issue managers and the underwriters: Except for the finance companies and manufacturing industries (except identified in Securities Exchange Directive 2055), all other public institutions, as per their respective directives, underwriting is mandatory.
- MOU between issue manager and the bankers to the issue.
- MOU between issue manager and the collection centers. Except for the MOU between issuing company and the issue manager, other

MOU is to be signed by issue manager on behalf of issuing company with the notification and the consent of the issuing company. In the case of MOU signed between issuing company and the issue manager, Company Act 2063 requires that copy of such agreements needs to be submitted to Office of Registrar of Companies within 7 days of such agreements made.

#### **2.2.11.4 Issue Commission**

It is the commission charged by the issue manager to the issuing company for the service it has provided. Issue commission is paid for issue management process. The responsibility of issue manager in the issue process and for which issue commission is to be charged is to be demarcated in the agreement itself. The commissions are normally set as per the negotiation.

#### **2.2.11.5 Underwriting Commission**

Underwriting commission is the amount charged by the underwriters for underwriting the securities issued. Securities Issue Bylaws (2nd amendment), 2054 has specified that underwriters may charge in maximum 3% of underwritten amount as the service charge to the issuing company. The commissions are normally determined as per the negotiation.

#### **2.2.11.6 Collection Charges**

Collection charges are the amount charged by the collection centers for collecting the application forms and other documentation process. The collection charges are also charged on percentage of the amount collected. The percentage charged also depends upon the negotiation between issue manager on behalf of issuing company and the collection centers.

#### **2.2.11.7 Refund Charges**

Refund charges are the amount charged by the collection centers for refunding the oversubscribed money to the general investors. The refund charges are charged on percentage of the total amount refunded. The percentage charged depends upon the negotiation between issue manager on behalf of issuing company and the collection centers.

### **2.2.11.8 Fix Charges to the Collection Centers – Finance Companies**

It is a fix charged given to the collection centers like finance companies for making required preparation for collecting application from the investors and conducting other required activities. The fix charge amount provided to the collection centers is also based on the negotiation.

### **2.2.11.9 Listing in the Nepal Stock Exchange Limited**

The Securities Registration and Issue Approval Provision and Directives 2051 has stated that securities issued publicly or procedurally should be listed in the registered securities exchange market or provision to be listed within 3 months of closure of the issue. For listing securities in the market, the issuing company should comply by the clauses as,

- Percentage of public issue stated by the securities exchange market
- Required number of public shareholders
- Easy transfer of ownership of issued securities
- Other stated directive for the listing of the securities in the market

Since, the securities listing is mandatory for the securities issued, SEBO/N requires that the issue process be approved from the securities exchange market before approving for the public offerings. Securities exchange market gives approval based on its criteria for approval.

### **2.2.11.10 Pre Issue & Post Issue**

Pre-issue in the issue process is defined from the point of approach by the issue manager to the prospective issuing company to the point of allotment of securities and refund of oversubscribed money to the investors. This segregation has been made on the basis of Company Act, as it requires that the process of securities issue, allotment of securities, collection of subscription needs to be done through institutions approved to carry out issue management.

### **2.2.12 Capital Market and IPO**

Capital market can be identified as the place where long term lending and borrowing takes place. It is the market where financial instruments having maturity period of more than one year are being traded. It mobilizes

savings of individuals through investment in various financial instruments like common shares, debentures, unit schemes from mutual funds etc, which are ultimately deployed for productive purposes in different sectors of the economy. It is the center of government, business firms and various other institutions to raise capital as per their need through the issue of intermediate and long term securities. The backbone of capital market is formed by various debts and equity transactions. In that sense, securities market can be considered extremely important constituent of capital market.

On behalf of securities transactions, capital market can be divided into two parts: primary market and secondary market. Primary market indicates that market where the securities issued for the first time are being traded whereas secondary market is the market where already issued securities are being traded. As per need of the study, only primary will be discussed.

### **2.13 IPO, a Subset of Primary Market**

Primary market is the place from which corporations get new capital. Depending upon whether the securities being offered is for the first time or in succession, the total offering in primary market can be divided as initial public offerings or the successive public offerings.

The volume of IPO's in the market especially that of common stock is directly related to the market condition. It means when the market is growing or showing bullish trend the number of companies issuing common stock through IPO increases but it decreases when the market is showing declining trend i.e. bearish trend. When the market is high or rising m, the number of new issues being offered to the public rises and when the market is low or falling, the number declines ( Cheney & Moses, 1992:64 ). Hence, the number of IPO's is offered in a year largely depends upon the state of market.

As far as issuing securities through IPO in primary market is concerned, the issuing company generally has two options. Either to sell directly through private placement or to sell through investment banker's public sale.

In the case of private placement, the entire issue is sold to one or few large institutional investors directly without the underwriting services of

investment bankers. It is also relatively cheaper method. As long as relatively few potential registrations, public notice and so on may be waived considerably reducing the cost of floating an issue (Gordan J. A. and Others, 2003:261)

In the case of public sales, issues are sold through investment bankers or often called Underwriters. Such investment bankers serve as intermediaries between issuing company and the investors. In general, there are group of underwriters who handle an IPO. Among such group of underwriters one act as a lead underwriter and rest as selling group. On being appointed by issuing companies, the underwriters provide an array of services to issuing company. At first it enables the issuing company to determine the range of price at which the securities are to be offered along with the numbers of shares to be sold. Furthermore, the reputation of underwriters comes in handy in convincing prospective investors that the shares worth the price at which they are being offered. Secondly, they actually do the selling job. Underwriters sell the issued shares to the retailer as well as institutional investors. Even, some underwriters maintain analyst to cover stock prices after they are issued just to ensure that investor's faith in the stock is maintained.

Generally, these underwrite either work in best effort basis or will underwrite the entire issue. In the best effort basis, the underwriter does not guarantee that the entire issue of the company will be sold but it will just put forth its best effort to sell the issue. However, on underwriting of entire issue agreement, the company does get the guarantee of entire issue from company and resell it to the public. In addition, most underwriting agreements have green shoe provision to deal with over allotment of issues to certain extent. The provision allows the underwriter to purchase additional shares up to 15% of the issue size at previously set price not at its existing market price.

In order to sell issues through IPO in primary market, a certain process has to be followed. The firm must first obtain the approval of its current shareholders before going to public (Gitman 2003: 370). Once the firm decides to go public, the first and foremost thing to do is to select underwriters. Underwriters are investment banking firms that act as financial midwives to a new issue (Brearley & Othes, 2004: 370). The investment banker is a financial intermediary that specializes in selling new security issues and advising firms with regard to major financial transaction

(Gitman,2003: 316) Merchant bankers are the underwriter of the securities who is responsible for promoting and facilitating the sale of the companies IPO's. Before any stock can be sold to public, the company must register the stock with the securities exchange commission (Van Horne, 2000: 492). The registration statement contains information about proposed financing and firm's history, existing business and plan for the future. The first part of the registration statement is distributed to the public in the form of preliminary prospectus (Brealey & Others, 2004:371). A prospectus describes the key aspects of the issue, the issuer and its management and financial position (Gitman, 2003: 316).

The SEC receives the registration statement and the prospectus to see that all required information presented and that it is not misleading (Van Horne, 2000: 493).It approves the registration and the company then is able to issue final prospectus and sell the securities.

## **2.14 The Process of Going Public**

Once a small business has decided to go public, the first step in the IPO process is to select an underwriter to act as an intermediary between the company and the capital markets. Joubert recommended that small business owners solicit proposals from a number of investment banks, and then evaluate the bidders on the basis of their reputation, experience with similar offerings, experience in the industry, distribution network, record of post-offering support, and type of underwriting arrangement. Other considerations include the bidders' valuation of the company and recommended share price.

There are three basic types of underwriting arrangements: best efforts, which means that the investment bank does not commit to buying any shares but agrees to put forth its best effort to sell as many as possible; all or none, which is similar to best efforts except that the offering is canceled if all the shares are not sold; and firm commitment, which means that the investment bank purchases all the shares itself. The firm commitment arrangement is probably best for the small business, since the underwriter holds the risk of not selling the shares. Once a lead underwriter has been selected, that firm will form a team of other underwriters and brokers to assist it in achieving a broad distribution of the stock.

The next step in the IPO process is to assemble an underwriting team consisting of attorneys, independent accountants, and a financial printer. The attorneys for the underwriter draft all the agreements, while the attorneys for the company advise management about meeting all SEC regulations. The accountants issue opinions about the company's financial statements in order to reassure potential investors. The financial printer handles preparation of the prospectus and other written tools involved in marketing the offering.

After putting together a team to handle the IPO, the small business must then prepare an initial registration statement according to SEC regulations. The main body of the registration statement is a prospectus containing detailed information about the company, including its financial statements and a management analysis. The management analysis is perhaps the most important and time-consuming part of the IPO process. In it, the small business owners must simultaneously disclose all of the potential risks faced by the business and convince investors that it is a good investment. This section is typically worded very carefully and reviewed by the company's attorneys to ensure compliance with SEC rules about truthful disclosure.

The SEC rules regarding public stock offerings are contained in two main acts: the Securities Act of 1933 and the Securities Act of 1934. The former concerns the registration of IPOs with the SEC in order to protect the public against fraud, while the latter regulates companies after they have gone public, outlines registration and reporting procedures, and sets forth insider trading laws. Upon completion of the initial registration statement, it is sent to the SEC for review. During the review process, which can take up to two months, the company's attorneys remain in contact with the SEC in order to learn of any necessary changes. Also during this time, the company's financial statements must be audited by independent accountants in accordance with SEC rules. This audit is more formal than

the usual accounting review and provides investors with a much higher degree of assurance about the company's financial position.

Throughout the SEC review period—which is sometimes called the "cooling off" or "quiet" period—the company also begins making controlled efforts to market the offering. The company distributes a preliminary prospectus to potential investors, and the small business owners and top managers travel around to make personal presentations of the material in what are known as "road shows." It is important to note, however, that management cannot disclose any further information beyond that contained in the prospectus during the SEC review period. Other activities taking place during this time include filing various forms with different states in which the stock will be sold (the differing state requirements are known as "blue sky laws") and holding a due diligence meeting to review financial statements one last time.

At the end of the cooling off period, the SEC provides comments on the initial registration statement. The company then must address the comments, agree to a final offering price for the shares, and file a final amendment to the registration statement. Technically, the actual sale of stock is supposed to become effective 20 days after the final amendment is filed, but the SEC usually grants companies acceleration so that it becomes effective immediately. This acceleration grows out of the SEC's recognition that the stock market can change dramatically over a 20-day period. The actual selling of shares then takes place, beginning on the official offering date and continuing for seven days. The lead investment banker supervises the public sale of the security. During the offering period, the investment bankers are permitted to "stabilize" the price of the security by purchasing shares in the secondary market. This process is called pegging, and it is permitted to continue for up to ten days after the official offering date. The investment bankers may also support the offering through overallotment, or selling up to 15 percent more stock when demand is high.

After a successful offering, the underwriter meets with all parties to distribute the funds and settle all expenses. At that time the transfer agent is given authorization to forward the securities to the new owners. An IPO closes with the transfer of the stock, but the terms of the offering are not yet completed. The SEC requires the filing of a number of reports pertaining to the appropriate use of the funds as described in the prospectus. If the offering is terminated for any reason, the underwriter returns the funds to the investors.

### **2.15 The Improving the Prospects for a Successful IPO**

For most small businesses, the decision to go public is made gradually over time as changes in the company's performance and capital needs make an IPO seem more desirable and necessary. But many companies still fail to bring their plans to sell stock to completion due to a lack of planning. In an article for *Entrepreneur*, David R. Evanson outlined a number of steps small business owners can take to improve the prospects of an IPO long before their company formally considers going public. One step involves assessing and taking action to improve the company's image, which will be scrutinized by investors when the time comes for an IPO. It is also necessary to reorganize as a corporation and begin keeping detailed financial records.

Another step small business owners can take in advance to prepare their companies to go public is to supplement management with experienced professionals. Investors like to see a management team that generates confidence and respect within the industry, and that can be a source of innovative ideas for future growth. Forming this sort of management team may require a small business owner to hire outside of his or her own local network of business associates. It may also involve setting up lucrative benefit plans to help attract and retain top talent. Similarly, the small business owner should set about building a solid board of directors that will be able to help the company maximize shareholder value once it has

become a public entity. It is also helpful for the small business owner to begin making contacts with investment banks, attorneys, and accountants in advance of planning an IPO. Evanson recommended using a Big Six accounting firm, since they have earned the trust of investors nationwide.

Finally, Evanson recommended that small businesses interested in eventually going public begin acting like a large corporation in their relationships with customers, suppliers, employees, and the government. Although many deals involving small businesses are sealed with an informal handshake, investors like to see formal, professional contracts with customers, suppliers, and independent contractors. They also favor formal human resource programs, including hiring procedures, performance reviews, and benefit plans. It is also important for small businesses to protect their unique products and ideas by applying for patents and trademarks as needed. All of these steps, when taken in advance, can help to smooth a small business's passage to becoming a public entity.

The pace of IPOs reached a new peak in 1999, when a record 509 companies went public, raising an unprecedented \$66 billion. IPO fever was fueled by "dotcoms," or new Internet-based companies, which accounted for 290 of the initial public stock offerings that year. These fledgling companies went public to take advantage of a unique climate in the stock market, as giddy investors trying to catch the next Internet fad did not demand much in terms of profitability. New Internet-based companies with limited track records were able to use the public markets as a form of venture capital. In fact, new issues of stock in dotcoms jumped an average of 70 percent on their first day of trading in 1999. By mid-2000, however, drops in the tech-heavy Nasdaq made investors more cautious and dramatically changed the situation for Internet IPOs. Studies showed that 40 percent of high-tech IPOs was trading below their original offering price by that time. As a result, 52 companies decided to cancel or postpone their IPOs in the first six months of 2000. The crash of Internet IPOs demonstrates the need for small business owners to keep a close eye on market conditions and make sure their companies are well positioned and show a strong chance of long-term viability before engaging in an IPO.

## 2.16 Review of Related Studies

Brau and Fawacetyl's, (2006) published an article, "Initial Public Offerings: An Analysis of Theory and Practice" where they had made great effort, theoretical and empirical, to understand managerial decision-making in the initial public offering (IPO) process. They explain further, most empirical IPO research relies on publicly available stock returns data or data contained in Securities and Exchange Commission (SEC) filings. Further in their article they explain that, historically, empiricists have had difficulty studying why firms go public due to data constraints. Their survey data allows us to overcome this constraint and directly ask CFOs why they conduct an IPO. It is found that CFOs identify the creation of public shares for acquisitions as the most important motivation for going public. Traditional textbook explanations such as lowering the cost of capital and the pecking order of financing are not among the most important reasons for conducting an IPO. Additionally, high-tech firms view an IPO more as a strategic reputation-enhancing move than as a financing decision. They explain, previous literature has documented IPO's tend to come in waves, characterized by periods of hot and cold markets, the timing of their issue. Venture capital (VC) backed firms and firms with small insider ownership decreases in the IPO tend to view market-timing issues as more important than their counterparts. Examining CFO sentiment toward underwriter selection criteria, they found that CFOs select underwriters based on overall reputation, quality of the research department, and industry expertise. They compared their results to Krigman, Shaw, and Womack (2001), they found that CFOs' criteria for choosing underwriters have remained stable in the pre and post-bubble period. Large-firm CFOs feel that IPO spinning (allocating shares to potential client-firm insiders) is more of a concern in underwriter selection than small-firm CFOs. CFOs in firms with high-prestige underwriters select underwriters based on reputation, quality, expertise, and institutional investor client base. By contrast, CFOs in firms that use low-prestige underwriters are more concerned with valuation promises, retail investor client base, and fee structures. These findings based on high and low underwriter prestige are not driven by a size effect. On average, IPOs are priced lower than their first-day market closing price.<sup>1</sup> known as under pricing; this topic is perhaps the most widely studied area in the IPO literature. CFOs are relatively well-informed regarding the expected level of under pricing. They feel that under pricing exists primarily to compensate investors for taking the risk of investing in the IPO. CFOs

indicate the second most important reason for under pricing is underwriters desire to obtain the favor of institutional investors. Further in this article, regarding signaling theory they explain, CFOs, especially of large firms, view strong historical earnings as the most positive signal in the IPO process. Using a top investment banker is the second strongest positive signal and committing to a long lockup is the third strongest positive signal. Selling a large portion of the firm, issuing units, and selling insider shares are all viewed as negative signals. The analysis of IPO process-design in the article (i.e., underwriting contract type, lockups, over allotment option, window-dressing, and unit offerings) reveals that CFOs view the use of a firm-commitment underwriting contract as the most important issue. Firm commitments are of particular importance to VC-backed firms and withdrawn firms. The lockup period is also important and serves primarily as a positive signal by insiders and secondarily as an alignment device. The overallotment option is viewed as only moderately important. Concerning window-dressing (accrual management in the IPO prospectus financial statements), CFOs recognize the importance of presenting strong earnings in the prospectus, but are not preoccupied with potential negative backlash from window-dressing. Relative to the other process issues, unit offerings (issues that include options with the stock offering) are not considered as important. The final issue examines in the article involves factors that influence the decision to withdraw or not conduct an IPO. They found that CFOs, particularly those in older firms, list maintaining decision-making control as the primary reason for remaining private. CFOs are also concerned about unfavorable market and industry conditions. CFOs that employ high prestige underwriters are more confident in the IPO process. High-tech firms are less concerned about control and dilution but are more concerned about bad market and pricing issues. In all of the preceding issues, they found that CFO sentiment is conditioned on the IPO status of the firm. For example, CFOs who attempted an IPO (either successfully or unsuccessfully) disagree with CFOs who have not tried an IPO (not-tried CFOs) pertaining to motivations for going public, underwriter selection criteria, reasons for under pricing, and negative IPO signals. Regarding the decision to stay private or the decision to withdraw, we find that CFOs of withdrawn IPOs hold different opinions from CFOs in the other two groups. Further, regarding IPO timing, successful CFOs feel industry conditions are less important relative to the other two groups.

Paudel (2006) who has done research on “Public Response to Initial Public Offering in Nepal”, with the objective of: to identify the dealing process of IPO, analyze the pace of IPO and analyze the public response to the IPO. He has concluded that general investors in Nepal do not have sufficient information regarding the primary market and in spite of this they are interested in investing money in the primary market. They are more interested in financial sector than non-financial sector. He has also summarized that pace of initial public offering in Nepal seems to be irregular. Even though the organization’s process of public offering is quite long, the service provided to the investors seems to be satisfactory. Public response in stock market is high due to lack of opportunities for investment in other sector. Despite this, public are attracted towards shares to increase their value of investment. Shrestha (2009) made a research on a topic of Initial public offering and Public Response in Nepal with an objective of finding out the situation of primary market and the public response. He concluded that the primary market is growing over the last decade mainly from the banking sectors and the public response in this sector is higher as compared to other sector. But in the later year the responses have been started decrease due to declining secondary market and over supply. He also found that investors are more interested to invest in financial sector than non-financial sector. He has also summarized that pace of initial public offering in Nepal seems to be irregular. He found that the increasing public response in the stock market is due to lack of investment opportunities for investment in other sector as well.

Panta, (2000) analyzed in her study, “Current Status of Share Market in Nepal”, that the trend of Nepalese stock market and present state of primary and secondary market was found satisfactory. Major objective of her study was, the development of stock market primarily depends on program and their implementation in Nepal, the overall market. Therefore she tried to find weather it is really difficult to develop more efficient secondary market, trading system for both equity and debt securities. Her research has analyzed the return from investment in stock which is not a short run phenomenon. She analyzed that, investors have to learn few things before they may investment on stock. First of all, they should know the financial health of the company. For example, if somebody wants to invest in Everest Bank's shares s/he must see its balance sheet or at least paid up capital, last year's net profit, currents year's anticipated profit and calculated earning per share and price earnings ratio etc. these two numbers would give a fair idea about company health and then market price would

judge through the discount factors based upon one of the sound company's data. Market price is equal to earning per share divided by discount factor. Her major research findings were, EPS can derive by dividing total net profit after tax by number of shares and price earnings ratio by dividing market price per share is EPS. Lower the price earnings ratio higher the chance of profit with capital gain and others. Capital Market is a crucial element in the national economy. Its role in reinvigorating and boosting the economic activity in the country is significant. The strategic plan released by securities board can, to a great extent. Energize the investors, dealers by increasing investor interest in it. Security market experiences both boom and bust soon after the beginning of securities trading through brokers member in the stock exchange floor. Through the market started to function quickly boosting the price of share to an unexpected level, it could not sustained.

Paudel (2002) Conducted research on the topic of "Investing in shares of Commercial Banks in Nepal: An assessment of Return and Risk Elements," Major finding of his studied were: The shares of commercial banks in Nepal are heavily traded in the stock market and, therefore, these shares play a key role in the determination stock exchange indicators. The average mean return on market portfolio, as measured by percent changes in the NEPSE index, was 5.51 percent over the sample period. All the shares produced higher rates of return than the return on market portfolio. However, the risk-return characteristics do not seem to be the same for all the shares reviewed. The shares with larger standard deviations seem to be able to produce higher rates of return. The portion of unsystematic risk is very high with the shares having negative beta coefficient. The risk per Units of return, as measured by the coefficient of variation, is less than that of the market as a whole for all the individual shares. Most of the shares fall under the category of defensive stocks, (having beta coefficients less than 1), except the shares of Bank of Kathmandu Limited. Return on the shares of Nepal Arab Bank Limited is negatively correlated with the return on market portfolio and, therefore, it has negative beta coefficient. From the analysis, it appears that none of the shares are correctly priced. Theoretically, the market price of an over-priced (under-priced) share will fall (rise) in order to increase the expected return such that the expected return equals the required return. Therefore, shares of Nepal Arab Bank Limited, Nepal Indosuez Bank Limited and Himalayan Bank limited which are overpriced relative to equilibrium thus market forces, will decline.

Bhattarai (2006) has performed a study on, "Public Response to Initial Public Offering in Nepal" with the basic objecting of assessing public response to the initial public offering. However, the study also focused on the dealing process and pace of the IPO. The study has used both primary and secondary data. Primary data were mainly collected through direct questionnaire provided to the general investors while secondary data were collected from various publications of SEBON, NEPSE and various other institutions.

The study concluded that most of the general investors in Nepal do not have significant information regarding the primary market but still they are very much interested to invest money in the primary market. It also found that almost each sector was getting good response from public. Specially, financial institutions and insurance companies were becoming more preferable for public than the other non-financial sectors.

Guni (2010) Conducted research on the topic of "Problems and Prospects of Primary Market in Nepal" with the objective of identify the problems of IPO, assess the growth of IPO, analyze the pattern of public response to securities and find the reasons of variation. He has summarized the finding as: public response in IPO is high due to lack of opportunities for investment in other fields. No proper investment analysis is been made. Despite this, public are attracted towards shares than other sectors, basically to increase their value of investment, be it dividend capital gain or bonus shares. It can be seen that public response to IPO on Banking and Financial sectors in normally higher than that of the manufacturing and services sector. Major causes for poor response in the period 2004 to 2008 were; interest rates were higher as compared to dividend yield, the public companies were not performing well and people did not know about the importance of investing securities. Now the response is highly positive because people are aware, money flow in the market is higher, people have seen that most companies are distributing dividends. Now that the average interest rates have gone down, more can be obtained from investment in securities.

## **2.17 Research Gap**

Initial Public Offering is not a new phenomenon in Nepal. About 150 companies have already gone to public and some companies are in line to go to the public. This is a good sign to development of the Nepalese capital

market. At present, there are lots of researches that have been done in the topic of capital market, stock trading mechanism, stock pricing behaviors etc. But there is still lack of research in the field of Initial Public Offering to the stock investment in Nepal. This study tries to understand the pace of initial public offering, general investor's response, legal provisions etc. This will be helpful to the issuing companies, issue managers, stock brokers, general investors and the new investors who wish to investment through Initial Public Offerings.

## **CHAPTER-THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Research methodology is concerned with various methods and techniques, which are used in the process of research studies. It includes wide range of methods including qualitative and quantitative technique for data analysis and presentation. Research methodology is simply the in-depth study or search of any particular topics, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. It is a careful search or inquiry in to any subject matter. Research methodology refers to the various segmental steps to be adopted by researcher in studying a problem with certain objectives in view (*Karlinger, 1994:230*). This process of investigation involves a series of well-thought-out activities of gathering, recording, analyzing and interpreting the data with the purpose of finding answers to the problem. Thus, the entire process by which we attempt to solve problems or search the answers to questions is called research (*Wolff and Pant, 2005:4*). It is significance to have appropriate choice of research methodology that helps to make this research study meaningful and more scientific. Therefore, appropriate methodology has been followed to meet the purpose objectives of the study. Thus, the overall approach to the research is presented in this chapter. This chapter contains the research design, population and sample size, sample selection procedure, data collection procedure, data processing, use of tools and techniques etc.

#### **3.2 Research Design**

The research design is the conceptual structure with in which research is conducted. It constitutes the blue print for the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. Research design is needed because it facilitates the smooth sailing of the various research operations, thereby making research as efficient as possible yielding maximal information with minimal expenditure of effort, time and money.

The analysis of this study is based on certain research design keeping the objectives of the study in mind. Various descriptive, analytical and exploratory research designs have been used to this research study. Descriptive and analytical research design along with graphical presentations is followed to present status of primary market of Nepal. Based on the exploratory research design, an attempt has been made to explore the problems responsible and possible prospects primary market and securities underwritten in Nepal.

### **3.3 Population and Sample**

Number of companies listed in Nepal Stock Exchange (NEPSE) by the end of FY 2009/10 has reached 311 and these companies are divided into eight sectors which include commercial banks, development banks, finance companies, insurance companies, manufacturing and processing companies trading houses, hotels and others. However, the study is focused on only those companies which have gone for IPO during the period of FY 2000/01 to FY 2009/10. Moreover, only those companies included in five sectors: commercial banks, development banks, finance companies, insurance companies and manufacturing and processing companies, have been selected and rest three sectors have been excluded as their numbers became small after considering above mentioned time frame of the study. Hence, the population of the study is 209 listed companies representing 5 different sectors

The study has focused of IPO of common shares only. Also, during analyzing the existing state of IPO's in Nepal, the offers (amount and number of issues) from collective schemes like mutual fund and Citizen Investment Trust have not been considered.

As far as sampling is concerned, stratified random sampling technique has been used to ensure that each and every company, representing different sectors had fair chance of being selected.

**Table3.1**  
**Population and Sample of the Study**

<b>Sector</b>	<b>Population of the study</b>	<b>Sample of the study</b>	<b>Percentage (%)</b>
<b>Financial Sector</b>			
Commercial Bank	24	4	16.67%
Development Bank	63	6	9.52%
Finance Companies	73	6	8.22%
Insurance Companies	21	4	19.05%
<b>Non-financial Sector</b>	28	4	14.29%
<b>Total:</b>	209	24	

Above table 3.1 Shows that from among the 24 Listed commercial bank, only 4 (i.e. 16.67%) are taken as sample. In the case of development bank and finance companies (i.e. 9.52%) and (i.e. 8.22%) samples are taken from population of 63 and 73 respectively. From 21 insurance companies 4 (i.e. 19.05 %) are taken as sample. From non-financial sector altogether 4 companies are taken as sample from 28 companies (i.e. 14.29%).

For the primary data collection 150 Respondents from bank, business, university, and brokerage firm have been taker as sample.

### **3.4 Sample Characteristics**

Among the 150 respondents for the primary data collection, 20% % (30) are students, 40% (60) are businessman, 16.67 % ( 25) are bankers, 3.33% (5) are brokers and rest 20% (30) are others.

### **3.5 Source and collection of data**

- Primary source of data
- Secondary source of data

Primary sources of data are mainly based on interview and queries and secondary data are mainly based on Booklets, trading Volume issued by Nepal Stock Exchange. Other primary data are collected from Nepal Security Exchange Board Nepal.

Primary and secondary source of data

- The major sources of secondary data are Nepal Stock Exchange (trading volume 2004/05), Rastra Bank, brokers and publication including daily papers. Secondary information was collected from these mentioned sources.
- Information has also been collected form Department of Industry, Banks, Financial institution and SEBO/N to assess the trend and the future potential.
- Interviews were conducted with the brokers and stock exchange market and securities Board and selected experts to determine the quality, value and volume of transactions, identify reason for fluctuation in price and volume of transactions and to assess the future trend.
- Interviews are making with a number of potential investors whose shares investment available in different companies to obtain their opinion and views regarding the present and future situation of of IPO market.
- Other related different statistical and financial tools are used. This study is based on primary source of data and less on secondary sources of data for showing problems and prospects of IPO market in Nepal. The primary sources of data used are interviews and questionnaire but the secondary sources of data used for analyzing are as follows:
  - Trading report published by stock exchange Nepal.
  - Financial statement and other transaction of listed companies listed by NEPSE
  - Outside published material directly related to problems and prospects IPO market.
  - Booklets published by other related agencies like SEBO, ministry of finance, and T.U. Library as the relevant materials.

### **3.6 Data Collection Techniques**

Annual reports covering different fiscal years of SEBON were collected from its head office at Thpathali. Similarly, trading reports of NEPSE were retrieved from its head office at Durber Marga. Daily newspapers like The Kathmandu Post and The Rising Nepal were accessed from Central Library of T.U. and weekly newspaper Arthik Abhiyan and Business plus were bought myself. Acts and regulatory information were obtained from law firms as well as official website of SEBON.

### **3.7 Data processing**

At first relevant data were extracted from above mentioned sources and recorded in the master sheet. The data were then entered into the spreadsheet to present them into appropriate tables and figures with the aid of computer programs like Microsoft Word. Finally, Microsoft Excel was run to analyze data revealing existing state of IPO's in Nepal and under pricing while sophisticated computer program like SPSS was run to obtain the growth rates of issued amount, average size of issue offered and amount of issues offered from financial and non-financial sector.

### **3.8 Analysis of data**

Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic (Cottle et al: 1988). This study is mostly based on the analysis of secondary data with the help of different statistical tools. The empirical results have been extracted in this study by using annual data of listed companies from 2000/01 to 2009/10.

### **3.9 Statistical tools**

Statistical tools are used to implicit the comparative results are as follows:

#### **3.9.1 Multiple Bar- diagrams and graphs**

Diagrams and graphs are visual aids which give a bird's eye view of a set of numerical data which show the information in a way that enables us to make comparison between two or more than two sets of data. Diagrams are in different types. Out of these various types of diagram one of the most

important form of diagrammatic presentation of data is multiple bar diagram which is used in cases where multiple characteristics of the same set of data have to be presented and compared.

### **3.9.2 Pie- diagram**

A pie- diagram is a widely used aid that is generally used for diagrammatic presentation of the values differing widely in magnitude. In this method all the given data are converted into 360 degree as the angel of a circle is 360 degree and all components of the data are presented in terms of angels that total 360 degree for one set of data.

### **3.9.3 Percentage**

Percentage is one of the most useful tools for the comparison of two quantities or variables. Simply, the word percentage means per hundred. In other words, the fraction with 100 as its denominator is known as a percentage and the numerator of this fraction is known as rate of percent.

## **CHAPTER-FOUR**

### **PRESENTATION AND ANALYSIS OF DATA**

#### **Introduction**

This chapter includes the presentation and analysis of data. Analysis is based on both primary and secondary data. Various types of data available in the market are used to analyze the primary market its problem and prospects in Nepalese capital market. The chapter basically focused upon the analysis of collected data from different secondary sources. In this chapter the relevant and the available data/information regarding the primary market have been presented and analyzed.

#### **4.1 Secondary Data Analysis**

##### **4.1.1 Number of Issue approved from SEBO**

As per the provision of the Securities Exchange Act, 1983 (now 2006) and regulation and guidelines made there under, the issuing company should register the securities in SEBO/N and get issue approval before going to public. For issue approval and registration, the company must submit required information within prescribed format otherwise SEBON may reject it. After registration and issue approval, the company must open issue within three month of issue approval. In case if the issue couldn't be made, then after another date should be fixed consulting with SEBON. The advertisement form application should be published in national daily news paper, the advertisement should consist all actual and real information. The advertisement should be able to identify application collection centre and its duration. Most of the Commercial bank and finance sector are issued different types of securities to the public. Other remaining sectors are issued securities to the public lowest percentage in comparison to the commercial bank and finance sector. Number of primary issue is increasing day by day. It seems that companies are interested to issue different types of securities for the public. The detail situation of number of issued in different year is presented in Table 4.1.

**Table 4.1**  
**Year wise issue approved from SEBON**

<b>Fiscal year</b>	<b>Number of Issue</b>	<b>% Number of Issue</b>
2000/01	9	2.79
2001/02	12	3.72
2002/03	18	5.57
2003/04	14	4.33
2004/05	14	4.33
2005/06	29	8.98
2006/07	34	10.53
2007/08	64	19.81
2008/09	64	19.81
2009/2010	65	20.12
<b>TOTAL:</b>	<b>323</b>	<b>100.00</b>

**Source: SEBON Annual Report**

**Figure 4.1**  
**Yearly no of Issue**

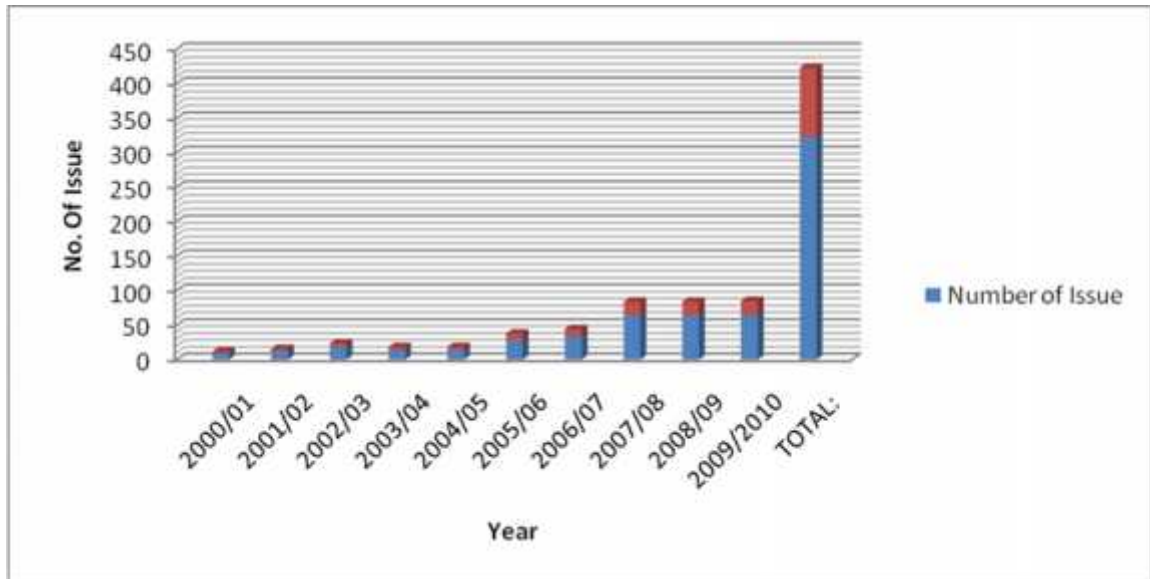


Table 4.1 and Figure 4.1 shows varied number of issue approved by SEBO during the period. Highest numbers of issues were approved in the fiscal year 2062/063, forwarded by fiscal year 2061/062 and 2050/051. Lowest issue approved percentage 3.09 percent and equal in the fiscal year 2053/054 and 2055/056. Over the 13 year of issue approval the number of issue is fluctuating every year. The total number of issue varies at various time periods. The number of issue was 16 in initial fiscal year 2050/051 but at the end of fiscal year 2064/065 the total number of issue approved was reached to the point of 260 issues. The highest number of issued was 64 (24.62%) in fiscal year 2064/065. The second highest issue was 34 issues (13.08%) in fiscal year 2063/064 number of issue were 29 (11.15%) and it was the third highest issue. In fiscal year 2061/062 and 2060/061 numbered of issue was 14 (5.38%) respectively. Similarly, the least three issued during the period were 5 issues (1.92%), in the fiscal year 2053/054 and 2055/056, 6 issues (2.31%) in the fiscal year 2056/057 and 9 issue (3.46%) in the fiscal year 2057/058 and 12 issues (4.62%) in fiscal year 2052/053 , 2054/055 and 2058/059 respectively.

#### 4.1.2 Amount of Issue Approved

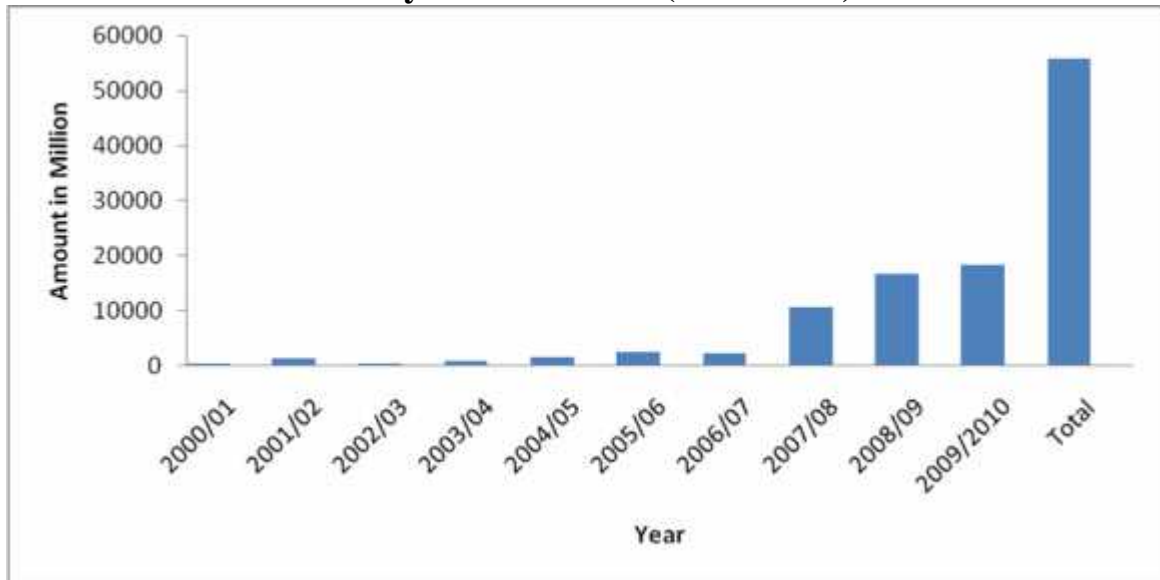
This Securities Exchange Act, 2063 has made mandatory that the issuing company should register the securities in Security Board of Nepal (SEBON) and get approval before going public. For registration the company must submit its memorandum and prospectus with other securities related documents within prescribed format. After registering the securities the company must inform about any allotment or sales within seven days of allotment or sale. If the company is going to sell securities to more than 50 persons at once, it must publish this information for public purpose. The provisions regarding application period price and allotment are as per specification made by SEBON. The issuing company must public its prospectus after approval of SEBON at any easily assessable media form public purpose. The prospectus should consist of general information of company, capital, its product and services, legal provisions, economic conditions of issuing authority, management, and information regarding its promoters. From the fiscal year 2000/2001 to 2009/2010 SEBON has approved in different year is presented in the table and figure.

**Table4.2**  
**Amount of issue approved ( in millions )**

FY	Total Amount	Annual Growth (%)
2000/01	410.5	0.74
2001/02	1441.4	2.58
2002/03	556.5	1
2003/04	1027.5	1.84
2004/05	1626.8	2.92
2005/06	2443.3	4.38
2006/07	2295.6	4.12
2007/08	10668.20	19.13
2008/09	16828.51	30.17
2009/2010	18479.13	33.13
Total	55777.44	100

**Source: SEBON Annual Report**

**Figure 4.2**  
**Security Issue Amount (in millions)**



The Table 4.2 and Figure 4.2 shows the securities issue amount approved by SEBON vary during the period. The highest amount of issue approved was Rs. 18479.13 million in the fiscal year 2009/2010, which is 33.13 Percentage of total issue till date. This is mainly because of IPOs and Right issues made by financial sector. They have been issuing shares to fulfill capital requirement obligations enforced by bank.

During last five years approved amount are in growing trend despite is fiscal year 2007/6, which indicates that companies are now interested in public offering of securities and right issues. Before the year 2001/02 issue amount is quite consistent and hovering around 150 million to 400 million. During this period Nepalese capital market was not so popular among investors. Only few investors of Kathmandu valley were trading. But, after 2002/3 more and more people entered in market. Specially, people who have been hard hit by maoist people's war found capital market as a good shelter for their money.

#### **4.1.3 Right offering since 2000/01 to 2009/10**

The number of right offering during the period of 2000/01 to 2009/10 varies differently which is presented in the table below.

**Table 4.3**  
**Right offering**

Year	Number of issue Approved	Issue Approved (Rs. in million)	%Total Approved
2000/01	2	131.79	0.4342
2001/02	5	621.87	2.049
2002/03	4	162.24	0.5345
2003/04	3	70	0.231
2004/05	6	949.34	3.13
2005/06	11	1013.45	3.339
2006/07	17	1265.30	4.169
2007/08	42	6793.40	22.3812
2008/09	49	9482.20	31.24
2009/10	53	9864.13	32.50
Total	192	30353.09	100

**Source: SEBON Annual Report**

**Figure 4.3**  
**Right Offering**

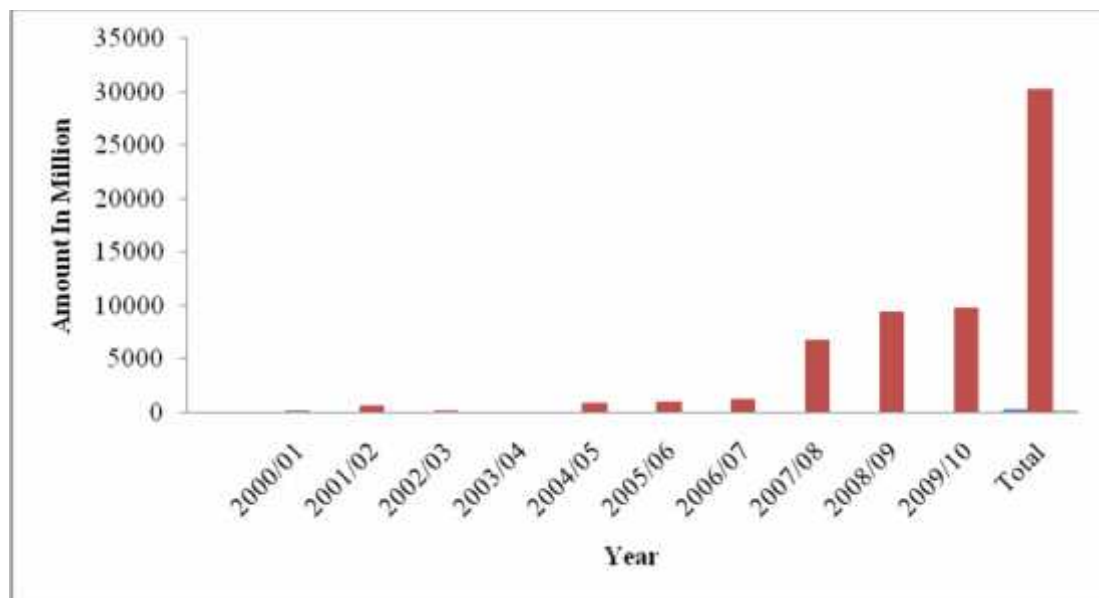


Table 4.3 and Figure 4.3 show the right offering of different companies during 2000/01 to 2009/2010. In the year 2009/10, 49 companies

comprising 9 commercial banks, 12 development banks, 23 finance companies, 4 insurance companies and 1 from other group listed their right share amounting to Rs. 9864.13 million in NEPSE. In the fiscal year 2003/04 the lowest right offering (i.e.70 million) was offered. In other periods the issued amount is moderate or fluctuating.

#### 4.1.4 Over and Under Subscription of Securities

The demand for securities may be greater or lesser than the issuing amount. When the demand is greater that is over subscription and when lesser that is under subscription.

**Table 4.4**  
**Over and Under Subscription of Securities**

Year	No. of Issue	Over Subscribed		Under Subscribed		Constant	
		No.	%	No.	%	No.	%
2000/01	7	7	100	0	0	0	0
2001/02	5	4	80	1	20	0	0
2002/03	14	14	100	0	0	0	0
2003/04	10	10	100	0	0	0	0
2004/05	7	6	85.71	1	14.29	0	0
2005/06	14	14	100	0	0	0	0
2006/07	15	15	100	0	0	0	0
2007/08	16	16	100	0	0	0	0
2008/09	12	12	100	0	0	0	0
2009/10	14	14	100	0	0	0	0
<b>Total</b>	<b>114</b>	<b>112</b>	<b>98.25</b>	<b>2</b>	<b>1.75</b>	<b>0</b>	<b>0</b>

**Source: SEBON Annual Report (2009/2010)**

Table 4.4 shows that during the period of fiscal year 2000/01 to 2009/10 out of the total listed companies only 112 companies issued their common stock for public and among them 112 companies (98.25%) have been oversubscribed and 2 companies (1.75%) have been undersubscribed. Furthermore, those companies who issued shares to public in fiscal year /2004/05 were under subscribed. In these year issues of both financial and non-financial sectors were undersubscribed due to different reasons i.e. lack of information, limited number of investors etc. Similarly, all those companies who issued their common stock in fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2005/06, 2006/07, 2007/08, 2008/09 and 2009/10 have been oversubscribed.

#### **4.1.5 Yearly Analysis of Securities**

The year wise analysis of different securities issued from the fiscal year 2000/01 to the fiscal year 2009/10 is shown in the following table.

**Table 4.5**  
**Yearly Analysis of securities**

Year	Ordinary Shares		Rights Shares		Preference Shares		Debentures	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
2000/01	7	278.7	2	131.79	-	-	-	-
2001/02	5	319.46	5	621.87	1	140	1	360
2002/03	14	394.3	4	162.24	-	-	-	-
2003/04	10	657.5	3	70	-	-	1	300
2004/05	7	377.48	6	949.34	-	-	1	300
2005/06	14	579.83	11	1013.45	-	-	4	850
2006/07	15	380.3	17	1265.30	1	400	1	250
2007/08	16	924.30	43	6793.4	-	-	5	2950
2008/09	12	1515.7	49	9482.2	-	-	2	750
2009/10	14	1724.2	60	9873.1	-	-	3	1750
Total	114	7151.77	200	30362.69	2	540	18	7510

**Source: SEBON Annual Report**

**Figure 4.5**  
**Yearly Analysis of Securities**

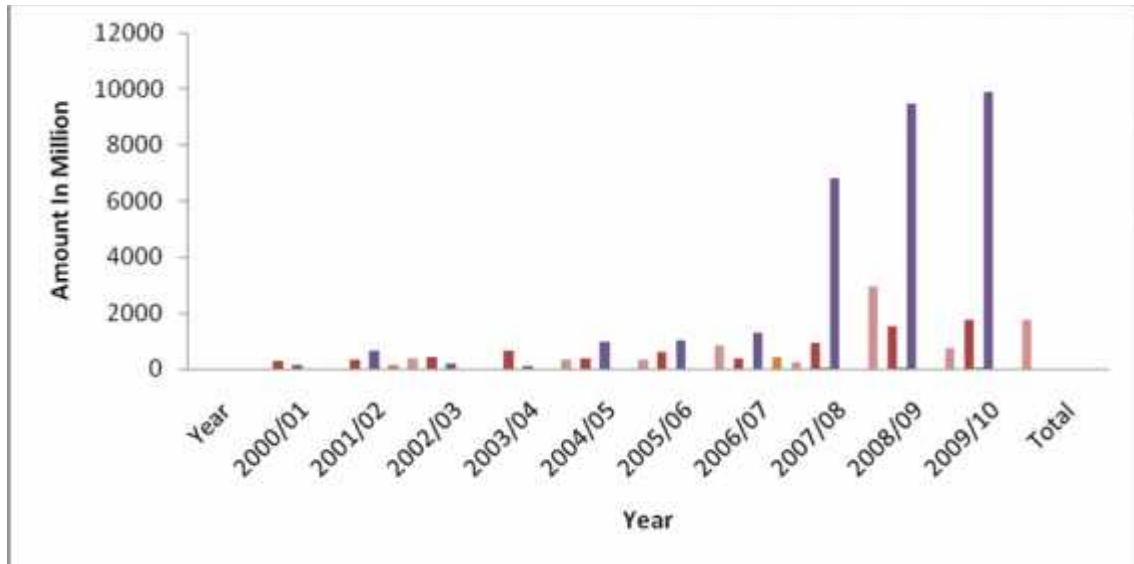


Table 4.5 and figure 4.5 show year wise analysis of different securities with their number and amount since 2000/01 to 2009/10. In fiscal year 2000/01 out of 9 different issues, 7 were ordinary shares of total amount of Rs. 278.70 and 2 issues were right shares of total amount of Rs. 131.79 million. In the fiscal year 2001/02 out of 12 different issues, 5 were issuing ordinary share amounting Rs. 319.46 , preference share were 1 amounting Rs.

## **4.2 IPO in practice**

Financial Sector includes commercial bank, development bank, finance companies and insurance companies.

### **4.2.1 Public Response to Commercial Banks**

There are 31 commercial banks among with only 24 are listed in the stock exchange. From the population of all total of 24 only 4 are taken as sample.

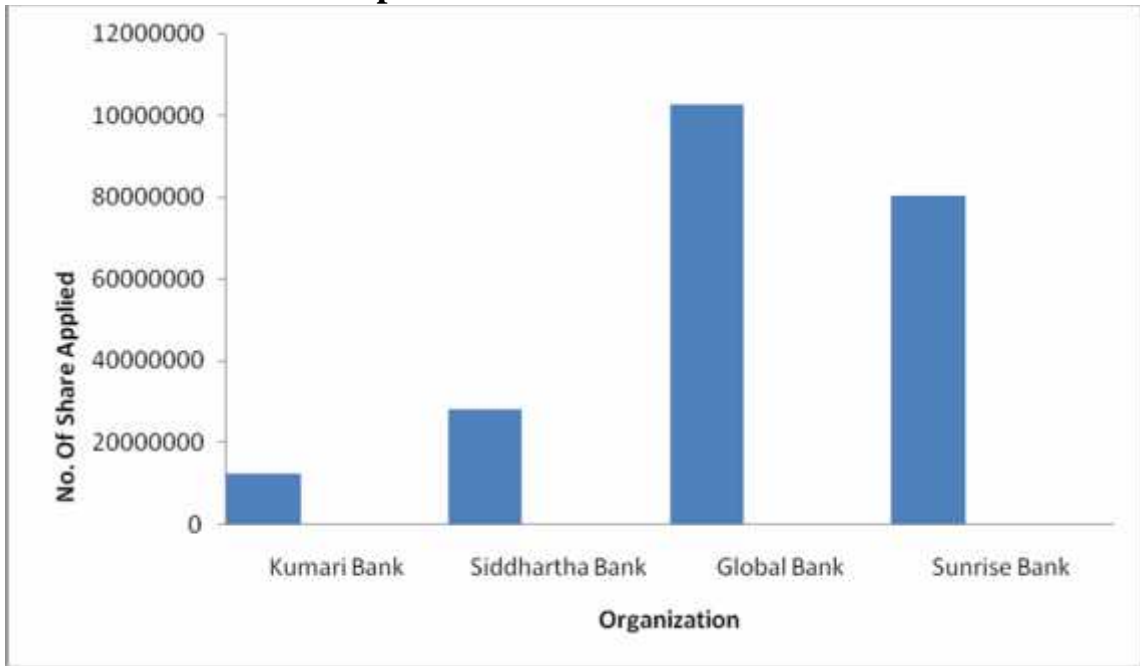
**Table 4.6**  
**Response to Commercial Banks**

<b>S. N.</b>	<b>Name of Company</b>	<b>Share Issued</b>	<b>Share Applied</b>	<b>Issued year</b>	<b>Sub. Times</b>	<b>Result</b>
1.	Kumari Bank	1500000	12170250	2003	8.11	Over subscribed
2.	Siddhartha Bank	1500000	27979950	2005	18.11	Over subscribed
3.	Global Bank	3000000	102750000	2008	34.25	Over subscribed
4.	Sunrise Bank	3000000	80250000	2009	26.75	Over subscribed

**Source: Annual Report of SEBO/N**

Above table 4.6 shows the issued shares of commercial bank along with applied shares. In all the six cases we have found applied number of share is higher than the issued one, i.e. all the issues are oversubscribed. Over subscription ranges between 5.14 to 34.25 times. For the 450000 shares issued by Bank of Kathmandu ltd 2413485 shares have been applied that means it was over subscribed 5.36 times. Similarly 5.14 times subscription in the case of Everest Bank ltd, 8.11 times in Kumari Bank ltd, 18.65 times in Siddhartha Bank ltd, 34.25 times in Global Bank Limited, 26.75 times in Sunrise Bank ltd.

**Figure 4.6**  
**Response to Commercial Banks**



In the above figure 4.6 it is clear that highest subscription was in the case of Sun Rise Bank with highest bar while the lowest bar shows that Kumari Bank was least subscribed.

#### 4.2.2 Public Response to Development Banks

To analyze the public response to development banks, 6 companies are chosen as sample, which are shown in the following table below.

**Table 4.7**  
**Respond to Development Banks**

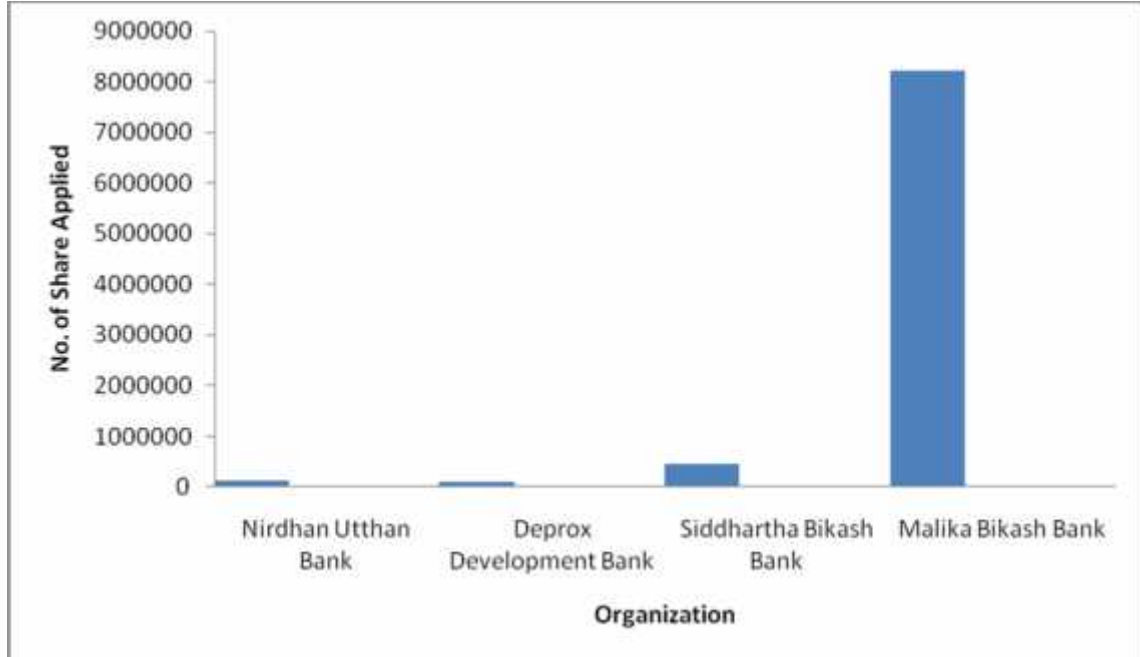
S. No.	Name of Bank	Shares Issued	Shares Applied	Issued Year	Sub. Times	Result
1.	Nirdhan Utthan Bank	33000	128080	2003	3.88	Over subscribed
2.	Deprox Development Bank	34800	90250	2005	2.59	Over subscribed
3.	Siddhartha Bikash Bank	200000	444860	2006	2.22	Over subscribed

4.	Malika Bikash Bank	150000	8226000	2007	54.84	Over subscribed
5.	Clean Energy Development Bank	960000	35001600	2008	36.46	Over subscribed
6.	Public Development Bank	600000	17028000	2009	28.38	Over subscribed

**Source: Annual Report of SEBO/N**

In all the investor issue of development bank, we found over subscription all the time. That means investor is also interested in development banks shares. Among them malika bikash bank bank ltd was highly subscribed, the subscription time was 54.84 times for the share issued 150000, there was application for 8226000 shares. The least subscribed is 2.22 times issued by Siddhartha bikash bank. The average subscription pattern is 21.40 times.

**Figure 4.7  
Response to Development Banks**



The above figure 4.7 shows that among development banks highest subscription was in the case of malika bikash bank with highest bar and lowest in the case of deprox development bank with lowest bar.

### 4.2.3 Public Response to Finance Companies

There are 73 finance companies which had issued share to the public and listed in the Nepal Stock Exchange Limited. Almost of these companies received good response from general public. Among 73 finance companies 6 are taken for public response.

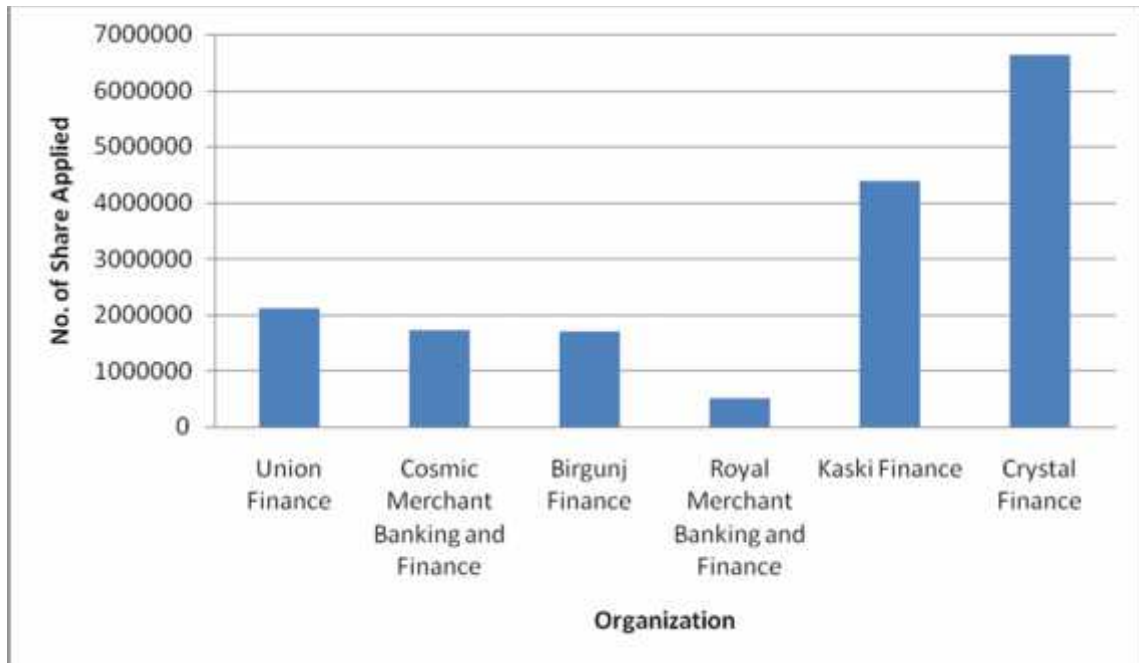
**Table 4.8**  
**Public Response to Finance Companies**

S. N.	Name of Companies	Share Issued	Share Applied	Issued Year	Sub. Times	Result
1.	Union Finance	240000	2108136	2002	8.7839	Over subscribed
2.	Cosmic Merchant Banking and Finance	240000	1722792	2003	7.1783	Over subscribed
3.	Birgunj Finance	240000	1690752	2004	7.0448	Over subscribed
4.	Royal Merchant Banking and Finance	175000	495775	2006	2.833	Over subscribed
5.	Kaski Finance	200000	4386000	2008	21.93	Over subscribed
6.	Crystal Finance	210000	6622600	2009	31.06	Over subscribed

**Source: Annual Report of SEBON**

**Figure 4.8**

**Public Response to Finance Companies**



The above Table 4.8 and Figure 4.8 show the status of IPO of deferent finance company over the same period. All the IPO's presented in the table are oversubscribed that shows the popularity of IPO made by finance companies. Among these companies three companies viz. Union Finance Company (UFC), Cosmic Merchant Banking and Finance (CMBF) and Birgunj Finance (BF)'s IPO are highest (240,000). These IPO's were highly oversubscribed by 8.78, 7.17 & 7.05 times respectively. According to the table Crystal Finance's IPO was highly oversubscribed (31 times). Out of the 6 IPO's Royal Merchant Banking and Finance Company's IPO received lowest attention from public, although it was oversubscribed by 2.83 times. Among these 6 finance company IPO, two IPOs were highly oversubscribed (21.93 & 31.06), whereas other four had medium public response. This shows that investors are more interested to purchase the

shares of finance companies. Finance companies are getting successful to attract investors.

#### **4.2.4 Public Response to Insurance Companies**

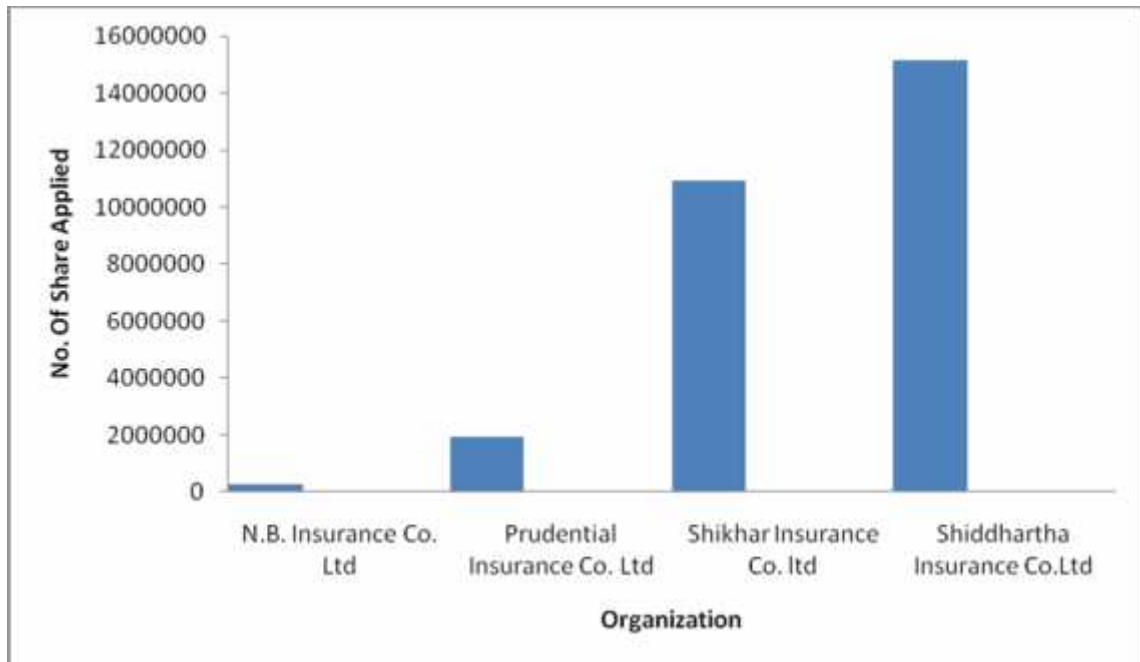
Out of 21 insurance companies, 4 were taken as sample, which are shown in the following table.

**Table 4.9**  
**Public Response to Insurance Companies**

<b>S. N.</b>	<b>Name of Companies</b>	<b>Share Issued</b>	<b>Share Applied</b>	<b>Issued Year</b>	<b>Sub. Times</b>	<b>Result</b>
1	N.B. Insurance Co. Ltd	200000	265380	2003	1.3269	Over subscribed
2	Prudential Insurance Co. Ltd	200000	1913620	2004	9.5681	Over subscribed
3	Shikhar Insurance Co. ltd	250000	10939650	2006	43.7586	Over subscribed
4	Shiddhartha Insurance Co.Ltd	250000	15157500	2007	60.63	Over subscribed

**Source: Annual Report of SEBON**

**Figure 4.9**  
**Public Response to Insurance Company**



The above Table 4.9 and Figure 4.9 show the public response to four different insurance companies with issued and applied number of shares. According to the table all four IPOs were oversubscribed. Table shows that among four insurance companies two had medium public response (1.3269 and 9.5681 times), and two have high oversubscription rate (43.7586 and 60.63 times). This shows that investors are more interested to purchase the shares of insurance companies. SHICL and SICL both received flood of application when they floated 250,000 shares in the year 2006 and 2007 respectively. SHICL received applications for 10939,650 shares which were 43.7586 times of its issues. Similarly, SICL received applications for 15157,500 shares in response of 250,000; 60.63 times more than that issued shares. The main factor behind this oversubscription was management and BOD of the companies and market sentiment. Well-known personalities of financial sector were involved in these companies and the stock market was in boom at that time.

#### 4.2.5 Public Response to Non-Financial Sector

In Nepalese context, non financial sector does not seem to be performing well in the market in comparison to financial sector. Many such companies are not able to make profit. Some companies, like Necon Air Limited, were already dissolved. Non-Financial Sector includes manufacturing and processing companies, trading companies, hotels and others (which also

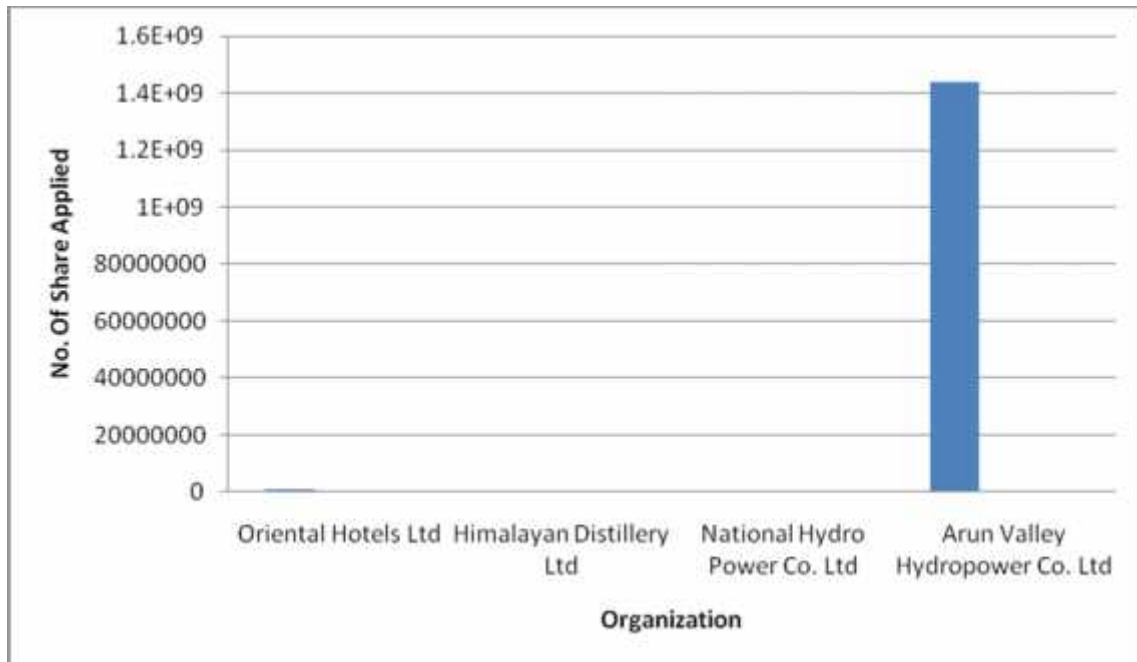
include hydropower sector). Among the listed companies 4 are taken as sample form research.

**Table 4.10**  
**Public Response to Non-Financial Sector**

<b>S. N.</b>	<b>Name of Companies</b>	<b>Share Issued</b>	<b>Share Applied</b>	<b>Issued Year</b>	<b>Sub. Times</b>	<b>Result</b>
1	Oriental Hotels Ltd.	1500000	9429000	2000	6.286	Over Subscription
2	Himalayan Distillery Ltd	1734500	183347	2001	0.1057	Under Subscription
3	National Hydro Power Co. Ltd	1400000	301700	2004	0.2155	Under Subscription
4	Arun Valley Hydropower Co. Ltd	51500000	1436335000	2009	27.89	Over Subscription

**Source: Annual Report of SEBON**

**Figure 4.10**  
**Public Response to Non-Financial Sector**



The above Table 4.10 and Figure 4.10 shows that the subscription of two companies are under- subscribed and rest two companies are over-subscribed. Oriental Hotels Ltd. had issued 1500000 unit shares and had received application for 9429000 unit shares. The public response to this company was medium with 6.286 times subscription. Himalayan Distillery Ltd. issued 1734500 units and had received application for 183347 unit shares. The response to this company was too low with 0.1057 times subscription. Similarly, National Hydro Power Company Ltd and Arun Valley Hydropower Company Ltd had issued 1400000 and 51500000 unit shares but received 301700 and 1436335000 with 0.2155 and 27.89 subscription times respectively. The public response to Arun Valley Hydropower Company Ltd was highest among the non-financial sector with 27.89 subscription times.

### 4.3 Major Findings on Secondary Data

The secondary data was taken to justify of the research on the topic. The major findings on secondary data are as follows.

- ) In the present circumstance, a single investor or a group of investor can adversely affect the market scenario. This is an underprivileged signal to the development of capital market.

- ) Public response to the financial institutions and insurance sectors is higher than non financial sectors.
- ) In the year 2000/01 it was poor response to IPO. Major cause's form poor response in that period was: interest rates were higher as compared to divined yield, also the public companies were not performing well, and people did not know about the importance of investing in securities.
- ) In financial intuitions and insurance sector, the subscription of commercial banks was 21.805 times in average, and of development banks was 21.40 times in average. This shows the public response to commercial banks were greater or more than development bank. Past data shows that the average subscription of finance companies was 13.14 times whole average subscription of insurance company was 28.82 times. Which shows the most responded sector was insurance sector.
- ) In the non-financial institutions the average subscription was 8.6243 times. It shows non-financial sector has got not such better response from the public. Last few years' experience shows that there are limited non-financial sectors available in the market.
- ) Now-a-days the public response is highly positive, because people are aware, money flow in the market is higher, people now realize the importance of share investment, people have seen that most companies are distributing dividends, and lack of better alternatives form investment.
- ) During the research period, Siddhartha Insurance Co. Ltd. and Malika Bikash Ltd. had issued their issued to the public and were significantly over subscribed by 60.63 times and 54.84 times respectively.

#### 4.4 Primary data analysis

Primary data are also taken to give more reliable outlook to the research. Questionnaire method is used to get the primary data, the result of which area as below. Only 150 respondents are taken from the data collection.

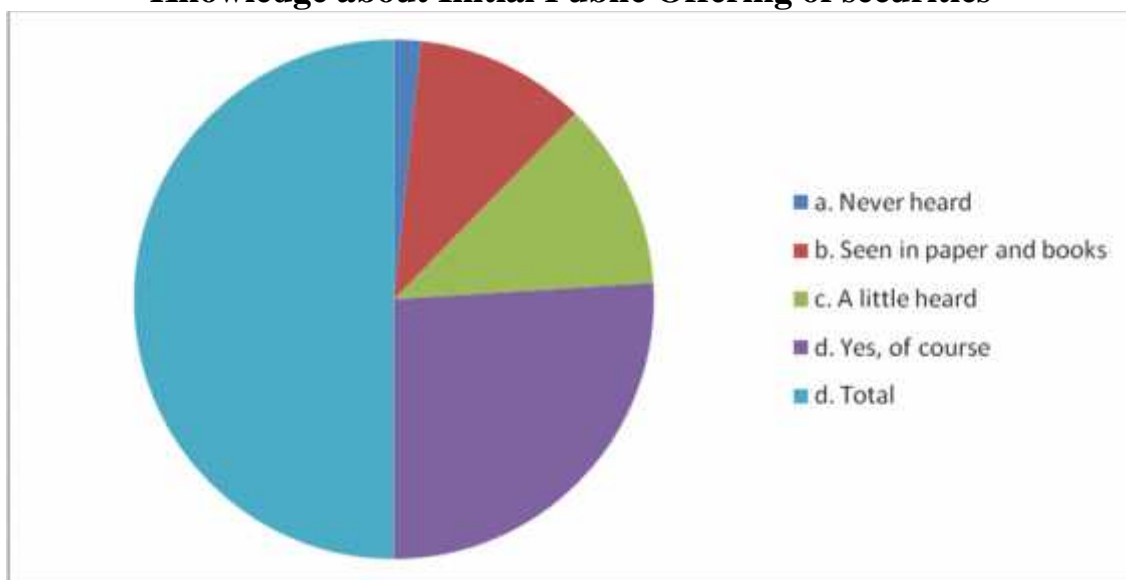
##### 4.4.1 Knowledge about IPO of securities

While getting information about people had heard about Initial Public Offering of securities from 150 respondents 3.33% said they have never heard about it, 21.33% said seen in papers and books, 23.33% said that they have heard a little about it and rest 52% said that they are well-known about Initial Public Offering of securities in Nepal.

**Table 4.11**  
**Knowledge about Initial Public Offering of securities**

a.	Never heard	5	3.33%
b.	Seen in paper and books	32	21.33%
c.	A little heard	35	23.33%
d.	Yes, of course	78	52%
	Total	150	100%

**Figure 4.11**  
**Knowledge about Initial Public Offering of securities**



Above Figure 4.11 shows that most of the people i.e. 52% are knowledgeable about Initial Public Offering of securities while least 3.33% are unknown about the IPO of securities that means they never had heard about this 21.33% have seen about in papers and books while 23.33% have heard very little about IPO of securities.

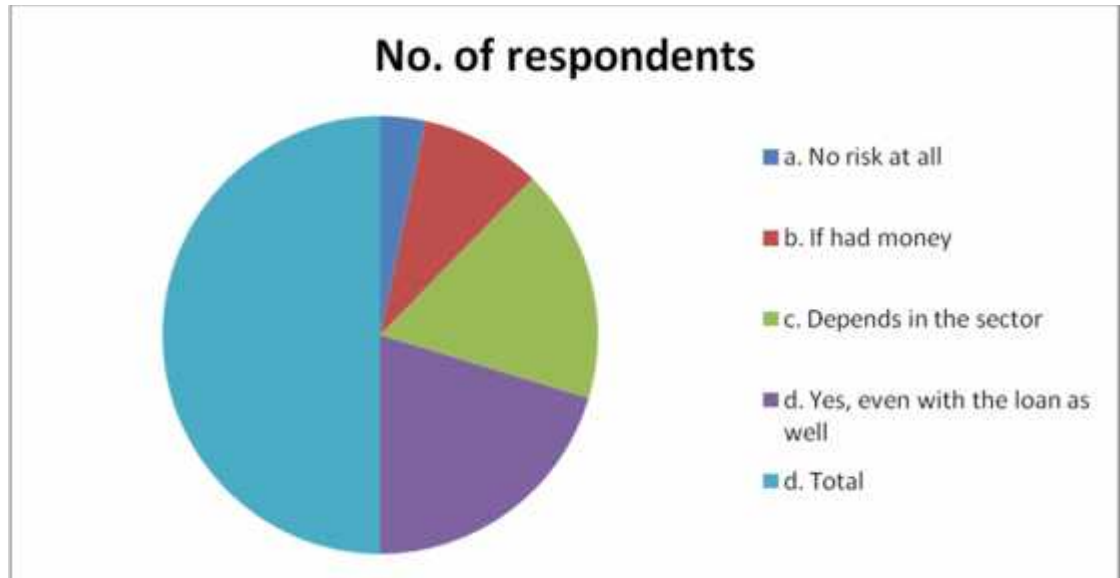
#### **4.4.2 Interest (willingness) to invest in IPO of securities**

Only 10 respondents (i.e. 6.67%) are found to be risk averter; they do not want to take risk at all from investing in IPO securities. 18% % stated they want to invest if had money (hard cash) 52 respondents (34.67%) stated that their interest to invest depends upon the sector. Rest 61(40.66%) stated that they are willing to invest in IPO over with the loan if not the hard cash.

**Table 4.12**  
**Interest (willingness) to invest in IPO of securities**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	No risk at all	10	6.67%
b.	If had money	27	18%
c.	Depends in the sector	52	34.67%
d.	Yes, even with the loan as well	61	40.66%
	Total	150	100%

**Figure 4.12**  
**Interest (willingness) to invest in IPO of securities**



From Figure 4.12 It is clear more than 40% people are interested to invest in IPO of securities ever with the loan and the least 6.6% does not want to take risk. Interest of 34.67% lies on the related sector of IPO. While 18 % wants to make only cash investment.

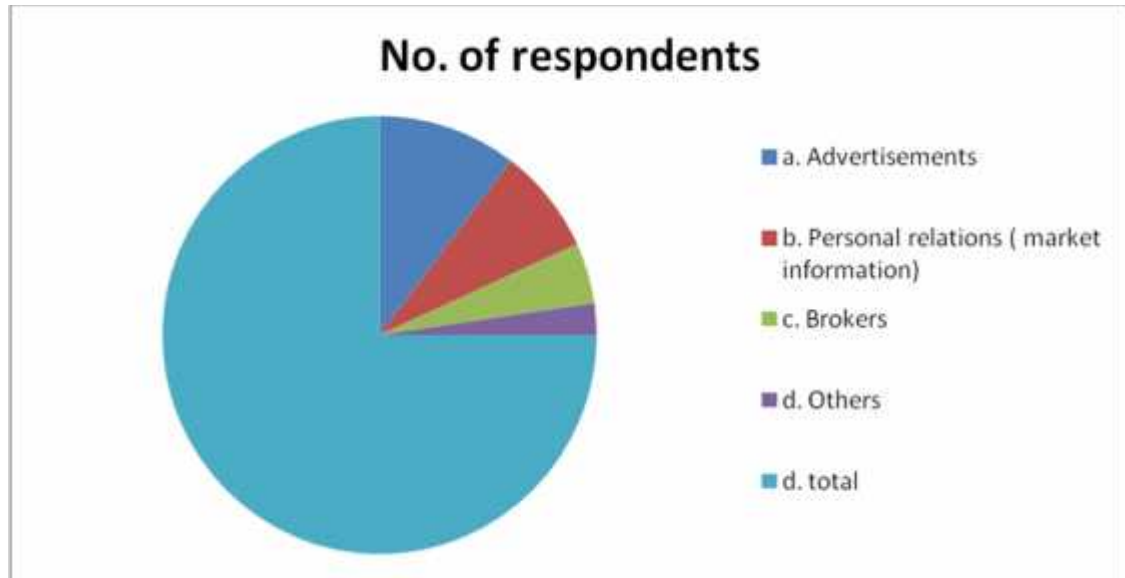
#### 4.4.3 Sources of information about IPO of securities

Out of 150 respondents, 41.33% said that they get information about IPO of securities from advertisements, 32.33 % people said from personal relations or from market. Similarly 18% respondents said that they get information from brokers. There are 9.33% people who find other way of getting information.

**Table 4.13**  
**Sources of information about IPO of securities**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Advertisements	62	41.33%
b.	Personal relations ( market information)	47	31.33%
c.	Brokers	27	18%
d.	Others	14	9.33%
	total	450	100

**Figure 4.13**  
**Sources of information about IPO of securities**



In the above Figure highest pie is covered by advertisement regarding the response on source of information i.e.41.33% and only 18% informed by the brokers and 31.33% get information from their relatives. Rest 9.33% take information from other sources.

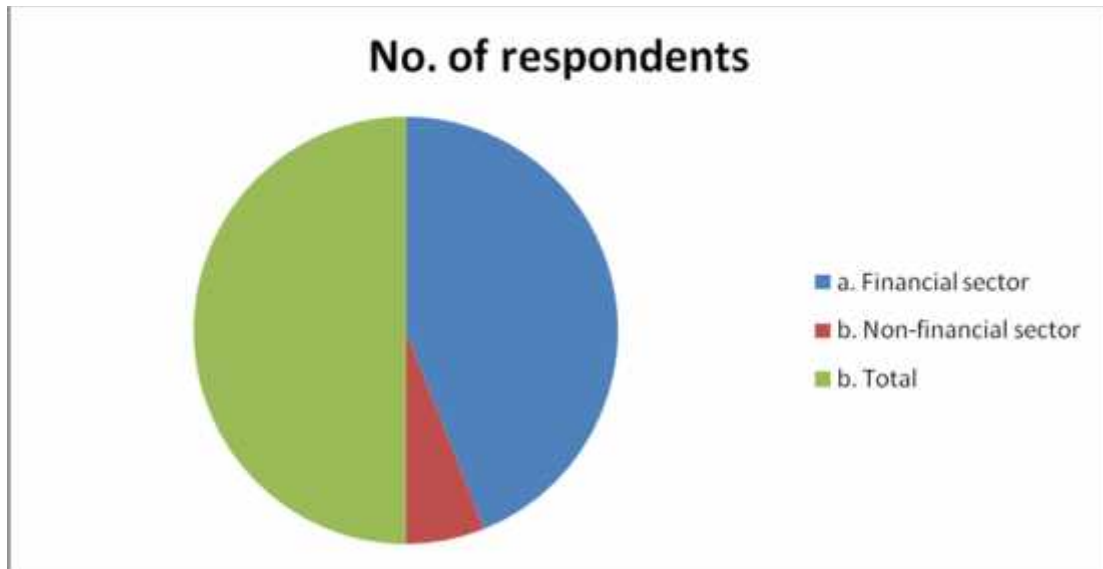
#### 4.4.4 Sector preference for investment

For the question whether to choose financial sector to invest or non-financial sector, 88% choose financial sector and rest 12% choose non-financial sector which have been clearly shown in the below chart.

**Table 4.14**  
**Sector preference for investment**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Financial sector	132	88%
b.	Non-financial sector	18	12%
	Total	150	100%

**Figure 4.14**  
**Sector preference for investment**



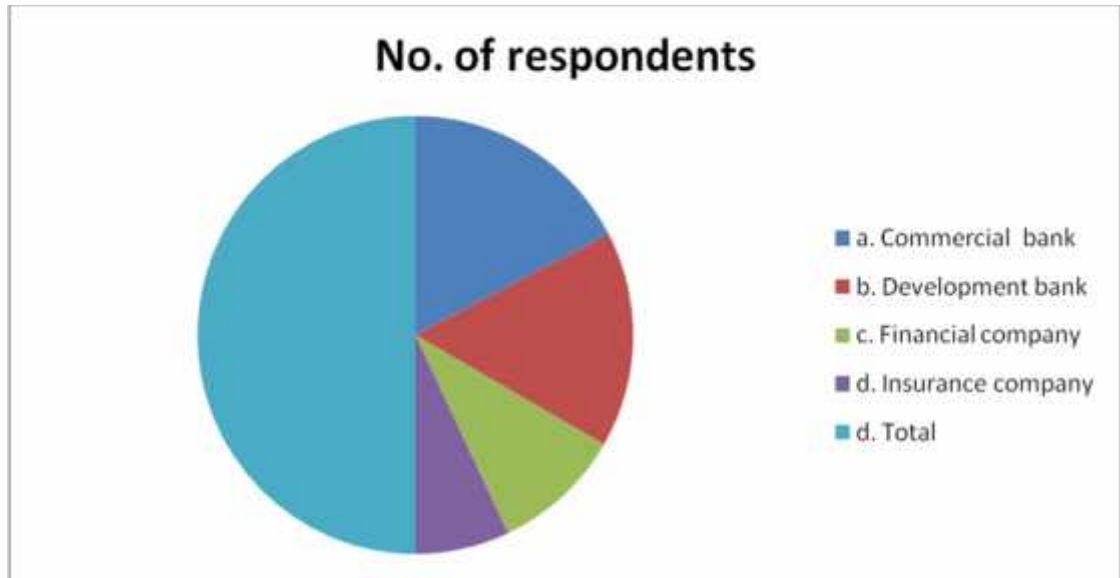
#### 4.5.5 Preferred financial sector

From among the 150 respondents 52 prefer commercial banks, 48 prefer development bank, 29 prefer finance company and only 21 prefer insurance company for investment in financial sector.

**Table 4.15**  
**Preferred financial sector**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Commercial bank	52	34.67%
b.	Development bank	48	32%
c.	Financial company	29	19.33%
d.	Insurance company	21	14%
	Total	150	100%

**Figure 4.15**  
**Preferred financial sector**



In the Figure 34.67% or most of the investors give preference to commercial bank for IPO of securities investment. 32% give to Development bank, 19.33% are found to be in favor of finance company and remaining 14% are in favor of insurance company. Among the investors least are in favor of insurance company.

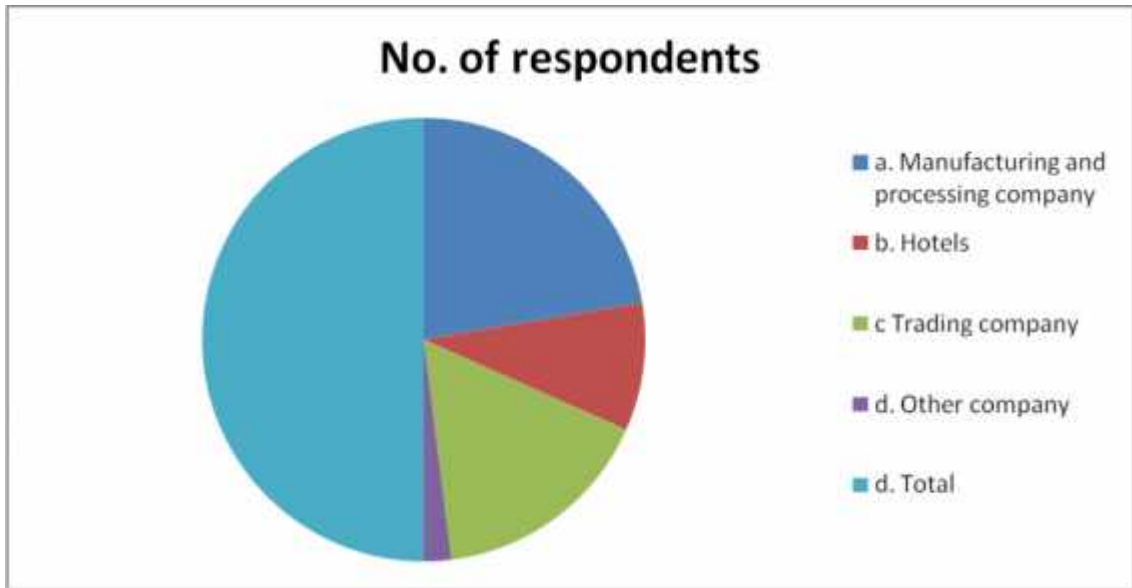
#### 4.4.6 Preferred non-financial sector

From among the 150 respondents for the question which non-financial would you prefer to invest the responses were as follows.

**Table 4.16**  
**Preferred non-financial sector**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Manufacturing and processing company	67	44.67%
b.	Hotels	28	18.67%
c.	Trading company	49	22.66%
d.	Other company	6	4%
	Total	150	100%

**Figure 4.16**  
**Preferred non-financial sector**



Above table and Figure show that for non-financial sector, 44.67% seems to be interested in manufacturing and processing company, 18.67% are interested in hotels while 22.66% interested in trading companies. And the least i.e. 4% are interested in other sector.

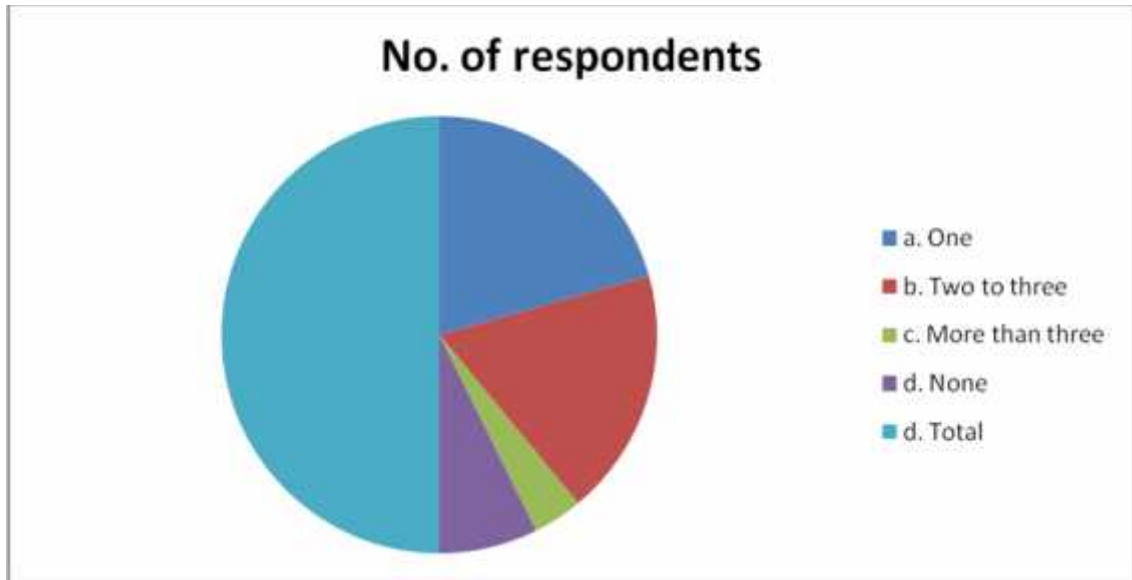
#### **4.4.7 Number of companies invested**

Out of 150 respondents 41.33% said that they have invested in only one company, 36.67% said two to three company, and 7.33% said that they have invested in more than three companies and 14.67% were found to invest in non of the organization.

**Table 4.17**  
**Number of companies invested**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	One	62	41.33%
b.	Two to three	55	36.67%
c.	More than three	11	7.335
d.	None	22	14.67%
	Total	150	100%

**Fig 4.17**  
**Number of companies invested**



Being back in share investment in Nepal 7.33% has been found to have invested in more than three companies. Most 41.33% have invested in only one company and 14.67% have invested in none.

#### 4.4.8 Fund used for the investment

In the question of fund used in IPO of securities, 92 respondents i.e. 61.33% answer personal fund while rest 38.67% answer loan/credit fund.

**Table 4.18**  
**Fund used for the investment**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Personal fund	92	61.33%
b.	Loan/credit	58	38.67%
	Total	150	100%

**Figure 4.18**  
**Fund used for the investment**

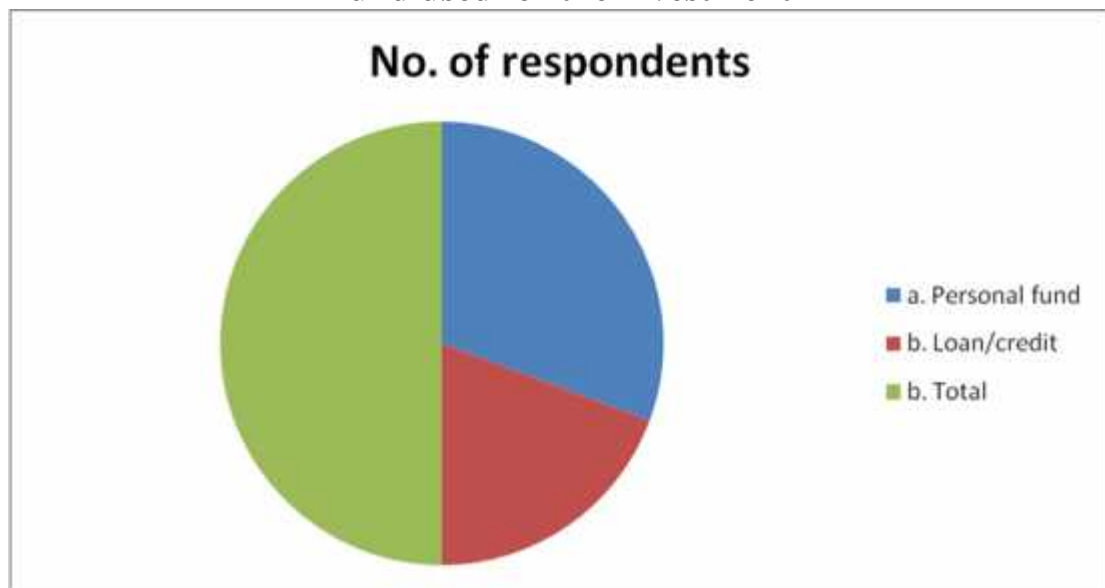


Fig 4.18 shows that more than half wants to use their own fund rather than credit.

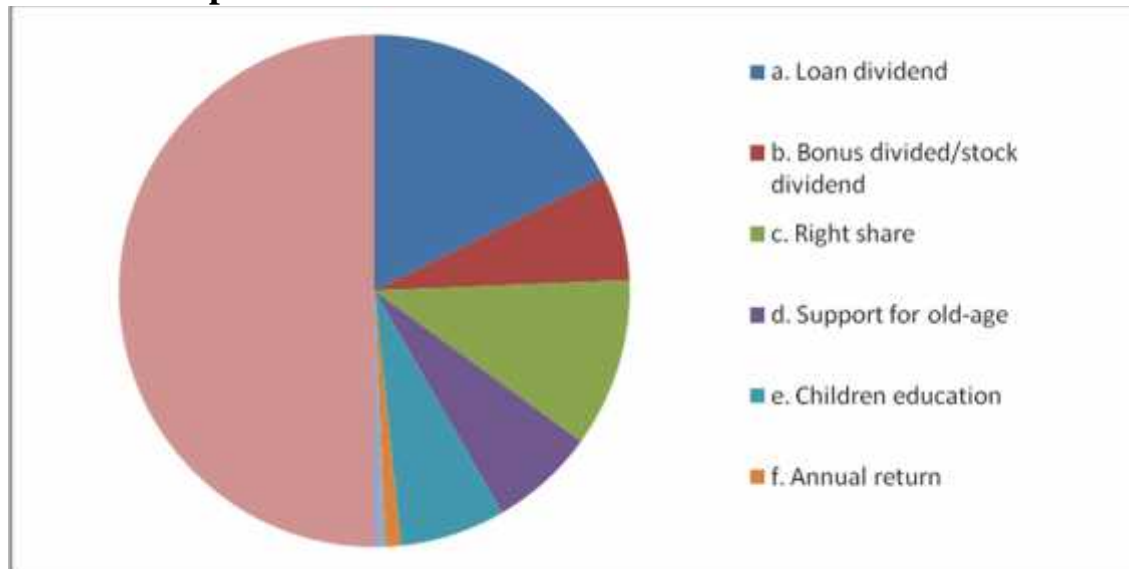
#### 4.4.9 Expectation behind investment in IPO of securities

Different people have different expectation behind investing in IPO of securities. For the question regarding these response where as follows.

**Table 4.19**  
**Expectation behind investment in IPO of securities**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Loan dividend	53	35.33%
b.	Bonus divided/stock dividend	20	13.33%
c.	Right share	32	21.33%
d.	Support for old-age	20	13.33%
e.	Children education	20	13.33%
f.	Annual return	3	2%
g.	Others ( please specify if any	2	1.33%
	Total	150	100%

**Figure 4.19**  
**Expectation behind investment in IPO of securities**



Here, higher expectation of investors seems cash dividend i.e. 35.33%. 21.33% are favor in right share. 13.33% states to be favor of bonus

dividend support for old age, children education. Rest 2% and 1.33% are in the favor of annual return and other benefit.

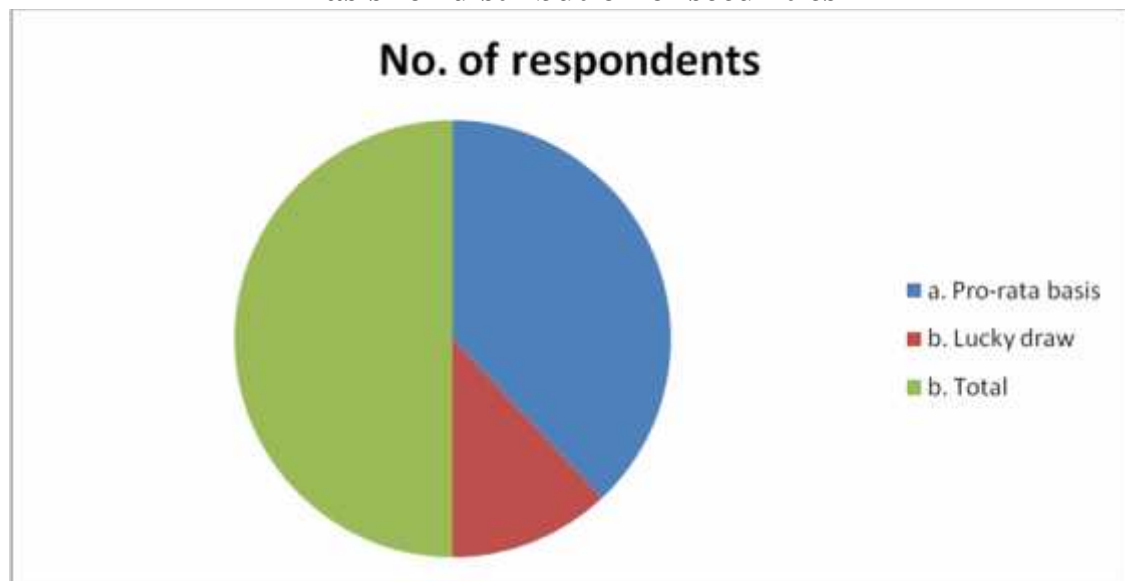
#### 4.4.10 Basis for distribution of securities

While questioning about the basis for distribution of securities to invest 76 % (114 respondents) were found to be in favor of pro-rata basis and the rest 24% (36 respondents) were in favor of lucky draw.

**Table 4.20**  
**Basis for distribution of securities**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	Pro-rata basis	114	76%
b.	Lucky draw	36	24%
	Total	150	100%

**Figure 4.20**  
**Basis for distribution of securities**



In the Figure 4.20 it is clear that 76% people prefer pro-rata basis while only 24% prefer lucky draw basis for share distribution.

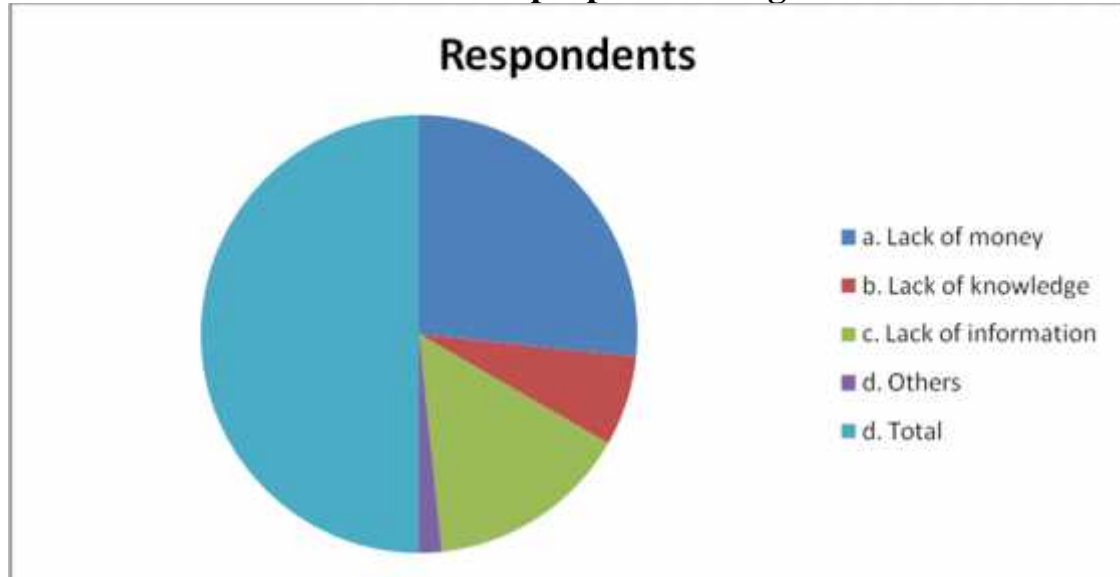
#### 4.4.11 Reason for limited people investing in IPO

Only limited people invest in the IPO of securities. For the reason asked 53.33% stated this is due to lack of money, 13.33% stated due to lack of knowledge, 30% said people lacks information and only 3.33% stated other reasons.

**Table 4.21**  
**Reason for limited people investing in IPO**

S.N	Alternatives	Respondents	Percentage (%)
a.	Lack of money	80	53.33%
b.	Lack of knowledge	20	13.33%
c.	Lack of information	45	30%
d.	Others	5	3.33%
	Total	150	100%

**Figure 4.21**  
**Reason for limited people investing in IPO**



In the above Figure 4.21 highest parts are covered by lack of money i.e. 53.33% which means most people do not invest in IPO due to lack of money. 13.33% shows the reason of lack of knowledge, 30% shows lack of information and least 3.33% do not invest due to other reason than these.

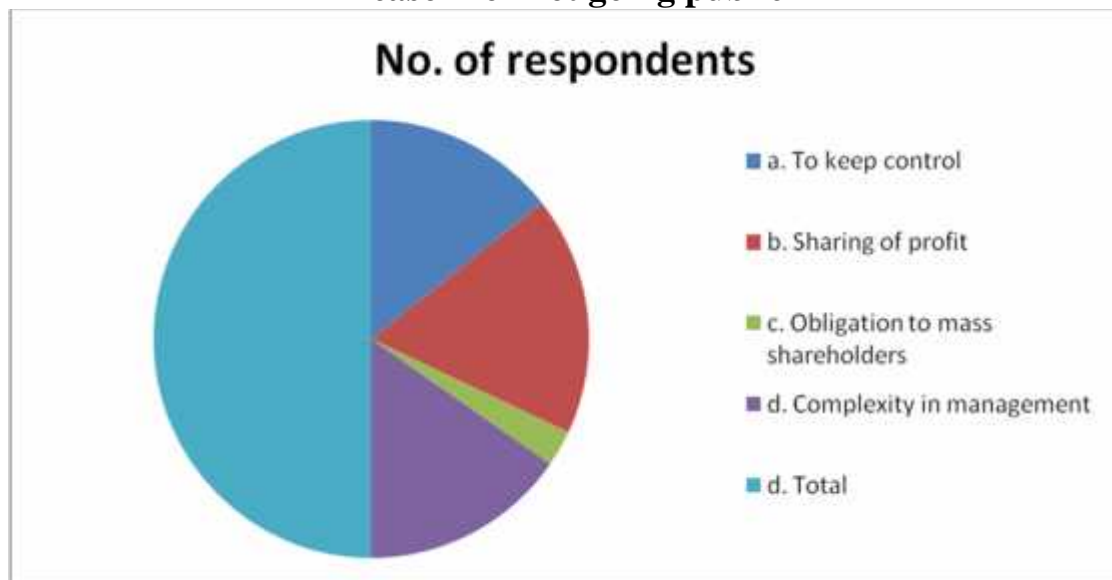
#### 4.4.12 Reason for not going public

All companies do not want to go public 28.67% think control is the only reason for it. Companies do not want to lose the control by going public 35.33% think they do not want to share profit 5.33% think they do not want to bear the obligation to mass shareholders and remaining 30.67% think they do not want to make the management complex by going public.

**Table 4.22**  
**Reason for not going public**

S.N.	Alternatives	No. of respondents	Percentage (%)
a.	To keep control	43	28.67%
b.	Sharing of profit	53	35.33%
c.	Obligation to mass shareholders	8	5.33%
d.	Complexity in management	46	30.67%
	Total	150	100%

**Figure 4.22**  
**Reason for not going public**



Above Table 4.22 and Figure 4.22 clearly show that the reason behind most of the companies not going public is they do not want to share profit

(35.33%),30.67% believe company fears complexity in management, 28.67% believes it simply because companies want to keep full control only, 5.33% believe that companies do not want to increase obligation mass shareholders

#### **4.5 Major findings on primary data**

Along with secondary data, primary data was taken to justify the study on the topic. Both interviews and questionnaires methods were implemented for this purpose. The major findings on primary data are as follows:

- ) Interviews are taken from the different personalities and Questionnaires are distributed to the respondents from different sectors to collect the primary data. Most of them expressed happiness over the growth of primary market but were not satisfied with the current situation of secondary market.
- ) Most of the people are investing in primary market form long term purpose that means they want to hold the shares. More than 56% people investing in primary market for such purpose. Rest of the people investing in primary market just to get the short term benefit.
- ) The primary source of data shows that the major source of information of public offering is media. Public getting information of IPO most from print media.
- ) People are getting aware to primary market to choose the right sector for investment. Investors are making portfolio of their investment.
- ) Most of the investor read prospects of the company before investing their money in securities.
- ) Profitability is the encouragement factor for investment. The investors think that those companies who are performing well in the market will do better in the future.

## **4.6 Growth of IPO Market**

During the study period numbers of primary issues are increasing in every Year. Primary market trend of the past 9 years shows the progress steady and public response is positive toward this sector. Growth of the primary market is directly related with the lack of opportunities for the investment in other sectors. The liquidity position of our country is also high which would have also led to high public response to the public issue of the different companies. Most of the companies attract the investor by issuing the different types of securities. Companies are also interested to go to the public. Investors are more attracted for the investment of the primary issue because of the higher return and low risk in comparison to the other investment. So, primary issues are increased in every year in all sectors. Growth of primary issue is almost positive in past history of Nepalese

## **4.7 Prospects of Nepalese IPO Market**

At present, individual Nepalese savers have extremely limited opportunities for investing their long-term savings. To secure maximum returns, these investors should have opportunities to invest into long-term corporate securities rather than depositing on the bank. However, because of the present state of the stock market, both individuals and institutions are putting far more of their saving into bank deposits and fixed interests government securities that they would if the market were working properly. Thus, long-term savings that should be invested in the stock market are going into short-term instruments. After the adoption of liberal economic policy by Nepal Government, a large number of companies established in the past 9 years. These companies cover a broad range of industries including airlines, hydropower, water supply, gas, pharmaceuticals, paper, food and beverages, cement, iron and steel, textiles, banking, insurance, finance services, hotels and resorts. Though, still there is enough liquidity in the market at present, investors are willing to invest in the common stocks of public companies but the corporate bodies are not coming ahead to collect fund from the primary market through public issues. They are obtains loan from banking and financial institutions for their long-term capital requirement. The retail investors are in search for long-term instrument with higher return for their savings. The number of insurance companies is growing and government is planning to establish a pension fund for its employees. Provident fund, pension fund as well as insurance

companies would prefer to invest in the equity of profitable companies through IPO rather than depositing on the bank. Entrepreneurs, who are establishing new business in response to liberalizations, will be constrained in realizing their capital gains if they cannot sell part of their original equity in successful company after some years of growth. Thus, there exists opportunities for the investors to invest in the stock of corporate bodies and the corporate bodies have the opportunities of collecting required capital through the issue of stock through primary market. However, there are a lot of things to be done to transform the present state of primary market in to a healthy and efficient one where corporate bodies can easily raise funds according to their requirements and investors can invest their savings into a long-term instrument with higher return.

#### **4.8 Impediment and Future Prospects**

The capital market needs laws that make the procedures for public issue Simple, transparent and unambiguous and defines clear roles and responsibilities of regulatory bodies. Lack of such laws is the main hindrance to the development of capital market. Lacks of investor education, lack of professionalism in the part of the companies involved in securities business and inadequate attention to enhance the institutional capabilities are some of the factors that are also contributing to the impediments to primary stock market development. Although there are many hurdles, the availability of enough liquidity in the market and the government's liberal economic policy, which is encouraging foreign as well as domestic investors to invest in various sectors such as hydropower, telecommunication, and infrastructure projects is certainly going to have high prospects for primary market in Nepal.

## **CHAPTER- FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

IPO behavior is one of the most important components of capital market. It facilitates the exchange of financial assets by bringing together buyers and sellers of securities. Capital markets provide an effective way of raising money for commercial enterprises and institutions. Thus, IPO has both theoretical and practical perspectives.

This study focuses on policies and practices on initial public offering of securities, problems and growth of IPO market in Nepal, role of investment bankers, the pace of IPO, impact of loans from financial institutions for IPO funding.

Even first public issue was in 1973 A.D, secondary market come into existence only in 1993, after the conversion of security exchange center in Nepal stock exchange ltd. with the emotment of securities ordinance 2005, all companies going public must be registered at the SEBO/N before issuance of securities and must publish prospectus after getting SEBO/Ns approval.

Most of the investors in Nepal lack of the knowledge about IPO and if even they know, they do not want to take risk at all. For this prevailing situation of the country can be another reason. This study covers almost all sectors companies i.e. commercial banks, development band, finance companies, insurance companies, manufacturing and processing companies whose issues were offered fro issue and are taken as a sample. For the purpose of this study, the necessary secondary data were collected from the period of 2000/01 to 2009/10 From the annual reports of SEBO/N, other bulletin of NEPSE and different websites. This study is based on the time series data analysis of the sample companies. The time series data are used to trace out the current situation of IPO behavior in Nepal. This study used a variety of statistical tools to accomplish its objectives. The statistical table, multiple bar diagram, pie chart were used to analyze the picture of IPO behavior.

## 5.2 Conclusion

Most of the general investors in Nepal do not have sufficient information regarding the IPO market but still they are interested to invest money in the IPO of securities. There is a good sign to the expansion of the IPO market. As per this study, almost every sector is getting good response from general public. Specifically financial institutions and insurance sector is more preferable for general public than non-financial sector. Pace of IPO in Nepal seems to be irregular. The number of companies approved for public offering by SEBON in a single year varies from 9 to 65. The highest amount of issue was Rs. 18479.13 million while the lowest amount of issue was Rs. 410.5 million. If we see on the basis of sector, SEBON had granted 91.67% approval for financial sector and 8.33% approval for non-financial sectors.

Even though the organization's process of public offering is quite long; the service provided to the investors to be satisfactory. If raising interest of the public in to IPO in one of the objectives, then the IPO market of Nepal is fulfilling this role gradually.

The structure of both segments of the market IPO and secondary/stock exchange has witnessed significant change. Some of the important development in the IPO which deserve specific mention are the establishment of merchant banks, provision of speedy up allotment/refund, proportionate allotment of shares, allotment of financial institution, increase in minimum application amount of investment in IPO issue such change have brought significant public response in new issue.

Most of the companies' issues received overwhelming demand from public which has led to oversubscription of their issues. Furthermore, issues from all the sampled companies belonging to commercial banks, development banks and insurance companies have been oversubscribed. Similarly, most of issues from finance companies have also been oversubscribed. Issues from only sampled non-financial sector, manufacturing and processing sector are mostly undersubscribed. This concludes that the general public has good faith on the IPO issues being offered by companies belonging to financial sector while issues from non-financial sector are not accepted with that great enthusiasm.

Nepalese share market is still in developing phase. Meanwhile Nepal Stock Exchange is preparing to launch the central depository system and then after launching the online transactions system which may easy to make transaction from abroad for foreigner as well as local investors. In online transaction, investors can make the buying and selling process using broker address sitting in house through internet.

Over subscription of shares in market can causes the liquidity crunches because most of the investors do not use the bank/credit loan for initial public offering, they use the personal fund withdrawing from the banks to use in IPO. So, it may bring the liquidity crunches in banking sector form short period.

Under subscription of share in market do not create such havoc as in over subscription but it shows the inactiveness of investors towards the company. It may be the cause of environmental factor, companies' performance, profitability factor and popularity of the company. This shows that under subscription may reflect the poor credibility of the issuer.

In spite of the long period of securities prevailing in the Nepalese market, most of the public do not know about primary issue of share. Even in the knowledge one most are interested in financial sector than non-financial sector. Even among the financial sector most are interested in commercial bank.

### **5.3 Recommendation**

After the research following recommendations are made for better IPO of securities

- ❖ Nepalese capital market is largely dependent on financial sector, which is not good sign for overall development of IPO market and capital market as a whole. In this regard the regulatory body and the government should take a step forward and encourage public issues from other sectors like manufacturing and processing by providing additional facilities such as tax-concessions.
- ❖ Ordinary share is found to be the most used financial instrument while other financial instruments like preference shares and debentures are rarely issued. The fact that such ordinary shares carry

maximum risk to investors on one hand and also cause dilution of ownership to issuing company, seemed to be forgotten. In this regard, it is recommended that root cause beneath should be traced and tackled for good.

- ❖ Public have shown faith on IPOs from financial sector while they do not have shown faith on IPOs from non-financial sector. This must have been due to the fact that non-financial companies have been performing poorly since last decade or so while financial sector has been doing well. In this perspective, companies from non-financial sector are recommended that before going for IPOs, they should inform public about their worthiness and regulatory body along with government are recommended to come up with schemes which will attract good companies belonging to non-financial sector to go for IPO.
- ❖ Even though most of the IPO issues were found to be under priced, there were few issues, which were found to be overpriced. This could have been due to the fact that regulations in the past and existing regulations too have not fully authorized investment bankers to determine price of their issues. In this regard, it is recommended that regulatory body should allow IPO market to set their offer price. Free market can cause competition among the issuing company forcing them to make their offer at lower price, which will attract more investors benefiting capital market in long term.
- ❖ Since the study has established that under pricing does exist among Nepalese IPO, it has opened new avenue for upcoming researchers. Here, researchers are recommended to analyze under pricing in detail by taking larger sample size and three sectors which were excluded from the study, should also be included. Furthermore, IPO-under pricing could also be analyzed from year-wise perspective. A part from that other empirically proven theory regarding IPO, long-run underperformance could also cautioned that obtaining reliable information needed to carry out such works will require some doing from them.
- ❖ The huge amount of securities traded in each fiscal year comes from financial sectors and rest few from non-financial sectors which is not

good signal for IPO market. The SEBO/N and other concern authorities should conduct public awareness and investors education programs to increase the level of investors' awareness.

- ❖ Large and inefficient government corporations should be privatized in order to develop the Nepalese stock market through the wide spread distribution of shares to the public investors.
- ❖ The information and financial statements of the companies should be disseminated properly and timely.
- ❖ The market intermediaries should be educated, trained and professionalized.
- ❖ The government should allow foreign investors to invest in Nepalese capital market.
- ❖ As investment bankers play a vital role in this process, they should try to give more transparent, fast hassles free service so that more public involve in the IPO market.
- ❖ Before investing in any company, all the investors must be aware about company's financial details, prospectus or other information otherwise they will be in difficulty if only going with the market rumors.
- ❖ Small investors are also the part of IPO market so initial public offering funding through financial institution should be strictly regulated to discourage the big investors who apply in names of relatives, friends etc.
- ❖ For gaining popularity, more and more advertisements need to be promoted and true picture should be showed to the public so that price does not fall after issue at the time of trading.
- ❖ Application from each corner of the country should be asked so that all interested candidates could apply. As it is found the most of the ordinary securities are concentrated in the valley only.

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**Appendix-I**  
**Per forma of Structured Questionnaire**

This study is undertaken as a partial fulfillment of the Masters of Business Studies, Shandar Dev Campus, Kathmandu. Your individual response will be kept confidential and will be used only in an aggregate level. I would be grateful if you could spare few minutes to respond to this survey questionnaire.

**Til Bahadur Rayamajhi**  
**Researcher**

Personal Information:

Name:.....

Occupation.....

Age/Sex.....

Education.....

Address/Phone

No.....

.....

Please tick ( ) only one option of the different alternatives:

**1) What is IPO? Do you have any idea?**

a) Yes, I know ( )

b) Somewhat ( )

b) Don't know ( )

**2) What are the sources of information about IPOs?**

a) Through Media ( )

b) Trough brooders ( )

c) Friends and relatives ( )

d) others ( )

**3) Are you investing in stocks through IPO?**

a) Regularly ( )

b) Not at all ( )

c) Not yet, but planning ( )

**4) Before the investment decision do you red prospectus of offering company?**

- a) Yes ( ) b) No ( )  
c) No idea ( )

**5) How do you select the company for investment? (Tick one or more, if applicable)**

- a) Corporate image ( ) b) Management team ( )  
c) Profitability ( ) d) other (please specify).....

**6) What is the motivating factor that you come to investment in public offering?**

- a) Performance of company ( ) b) No brokerage commission ( )  
c) High profitability opportunity in short period ( )

**7) Which sector would you prefer to invest?**

- a) Financial ( ) b) Non financial ( )

**8) Which sector would you prefer to invest in financial and insurance?**

- a) Commercial banks ( ) b) Development banks ( )  
c) Finance companies ( ) d) Insurance companies ( )

**9) Which sector would you prefer to invest in non-financial institution?**

- a) Hotel ( ) b) Manufacturing and processing ( )  
c) Trading ( )  
d) Other companies, please specify.....

**10) Do you think Nepal's present condition is suitable for investment in IPO?**

- a) Yes. ( ) b) No. ( )

**11) Which fund would you like to use while investing in IPO?**

- a) Personal fund ( ) b) Bank loan /credit ( )

**12) What type of IPO investor are you?**

- a) Long term ( ) b) Short term ( )

**13) What do you think most of the firms do not like to go to public? What may be the reason?**

- a) Obligation to mass shareholders ( ) b) To keep control ( )  
c) Complexity in management ( )

**14) How many companies have you invested in?**

- a) None ( ) b) Single ( )  
c) 2-5 companies ( )

**15) What do you think about the Nepalese capital market as an IPO investor?**

- a) Driver by rumor and whim. ( )      b) Operating efficiently ( )  
c) No idea ( )

**Thank you for your kind co-operation.**