

**A Research Proposal on
PRACTICE OF ISSUENCE OF RIGHT SHARE
BY COMMERCIAL BANKS IN NEPAL
AND IT'S IMPACT ON SHARE PRICE**

**In Partial Fulfillment of the Requirements for the Degree of Master of
Business Studies (MBS)**

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1. INTRODUCTION

1.1 Background of the Study

For the entire development of any country each and every sector should be strong and capable. Among them, capital market is one of the major sectors. A healthy capital market is a crucial element in the development of national economy. Capital market helps to national economy by mobilizing long-term capital needed for productive sector. Development and expansion of capital market is essential for rapid economic growth of the country. The significance of capital market in the economic development of developing country like Nepal is so great.

The Nepalese capital market is in very early stage of development. There are various inconsistencies and hindrances exist on the way to run the market smoothly. The Nepalese capital market was established as security market center (SMC) in 1976. In 1984, the SMC was renamed as Security Exchange Center (SEC). After converting SEC into Nepal stock Exchange (NEPSE) in 1993, it brought new atmosphere in Nepalese capital market. NEPSE is a non-profit organization, one and only secondary market for Nepalese corporate securities, operating under security Exchange Act 1983. NEPSE opened its trading floor on 13th January 1994 and started to calculate the NEPSE Index since 12th February 1994. NEPSE plays a vital role for developing the efficient capital market. Managing public issue is one of the important roles of NEPSE.

For sound and effective operation of the corporate firm, it requires adequate fund. Fund is the lifeblood of corporate firm. There are various alternatives to raise the fund. These alternatives are called as financial instruments, such as common stock, preferred stock, bond, debenture, right, derivatives and so on.

1.2 Introduction of the Right Share

Right share is an important source of fund as mentioned above. "It is selling of securities first to existing shareholders on a privileged subscription basis. Some time the corporate charter requires that a new issue of common be offered first to existing shareholders because of their preemptive right" (Van Horne, 2002) "If the new common stocks are issued giving the right to purchase first by the existing shareholders than it is called right offering. Each shareholder is issued an option to buy a certain number of new share and the terms of the option are contained on a piece of paper called a right. Each stockholder receives one right for each shares of stock owned." (Weston and Copeland, 1992).

So right issue is a privilege given to the existing shareholders that helps them to keep their control position proportionately equal and the issuing price will also be lesser than the market price. This lower price would help to maximize the capital gain of the shareholders. Right is the negotiable instruments. It has its expiration date. One of the advantages of right offering is the minimization of flotation cost. The procedure of right offering is similar to the non-right issue.

Right issue practice in Nepal has no long history compare to other developing country. By looking the issue approval from the SEBO of Nepal, researcher can easily notice an increasing trend of issuing right share. During the 14-year period, SEBO has granted right issue approval amounting Rs.4962.75 million. This amount comes to be the largest among various issue approved by SEBO. Right share occupied 41.73% of total issue approval out of 135 companies, given the issue approval only 49 companies issued right share to raise fund.

In Nepal, company act 1997 has provisioned about the preemptive right of shareholder in the section 42(4). It states that if the right is contained in a firm charter then the firm must offer any new common stock to existing shareholders. If not the company has choice of right offering or public offering. But the law in India requires that new common stock must be first issued to the existing shareholders on a prorata basis. In India right is a negotiable but in Nepal there has not been any provision here to make the right negotiable.

Right has intrinsic financial values because they are normally offered at some lower price than the current market price of stock. Theoretically before and after rights the total wealth of the shareholders remains same if they exercise full right or sell their rights. But in case of letting them to expire or partially exercise, the wealth would be affected. This proposal is going to be submitted to study the right issue practice and its impact on share price movement of listed companies in Nepal.

1.3 Statement of the Problem

Theoretically, after announcement of right offering, the price of the share should change. Similarly after exercise of the right share, the price of the share should decline by its value of right. But in practice, the share price of Nepalese companies does not change according to theory. For example, the price of Bank of Kathmandu before announcement of right was Rs. 815 and after the announcement its price went to Rs. 460. In case of Nepal SBI Bank Ltd. Share price had increased after the announcement of right from Rs. 332 to 376.

In Nepal, the right issue is increasing trend but the companies of all sector does not issue the rights. Among various sector, Finance companies are ahead in the right issue practice. The process of issuing the right is lengthy and complicated in Nepal. To issue the right share, the company should take permission from SEBO and also should register their shares. Here are underlined some specific research problems which are desired to research:

-) What will happen to the share price after announcement of the right share?
-) What is the right share practice in Nepalese capital market?
-) What are the problems to issue the right share in Nepal?
-) What are the prospects of issuing the rights share in Nepalese capital market?

1.4 Objectives of the Study

The study has two main objectives one is the characteristics features of rights offering by the listed companies especially commercial banks and second is analysis of share price movement associated with the right offering. The specific objective of this study will be:

1. To measures the significant movement in stock price before and after the announcement of right share with the focus in commercial banks.
2. To analyze the procedure and mechanism of right issue in the context of Nepal.
3. To identify the problem regarding under subscription of right share.
4. To identify the problems associated with rights issue in Nepal.

1.5 Statement of the Hypothesis

To analyze the data available, t-statistics will be used to test the significance of the difference between the share prices under the following hypothesis.

1. Null hypothesis (H₀): There is no significant different in the share prices before and after the announcement of the right offerings.
2. Alternative hypothesis (H₁): There is significant difference in the share prices before and after the announcement of the right offering.

1.6 Limitation of the Study

Normally in each study, there is certain limitation. The following limitation will be found in this research:

1. This study will be based on the last 14 years data beginning from F/Y 1993/94 to F/Y 2007/08.
2. This study will assume that the related published and unpublished documents, journals, articles and other previous studies are realistic.
3. This study will be mostly based on secondary data.
4. Only 6 right share issues of commercial banks will be considered for the study.
5. The study has to be completed within the time frame of the academic session. Also there was non availability of various references and sources.
6. The main causes for these limitations are due to technical and time constraint.

1.7 Focus of the Study

This study will concern with the right share practice and its impact on share price movement of listed company in Nepal with the focus in commercial banks. This study will explain theoretical as well as practical aspect of right offering in Nepal. Basically the study will focused on following topics:

1. Price movement before and after announcing the right share.
2. Practice of rights share in Nepalese corporate firm.

1.8 Significance of the Study

This study will be important and valuable for those who are interested to the security market of Nepal. Basically investors, business organizations, security board, brokers, potential researchers, students and teachers will be benefit from this study. This will also enable the investors to identify the right time to invest in the share market. Researcher hopes that this study will help to government and other institutions to make their policies and programs.

2. LITERATURE REVIEW

Review of related literature is an essential part for every research. The object of this chapter is to review some of the basic literature on rights share practice and its impact on share price of listed company in Nepal concerning theories including review of empirical evidence of previous studies. This chapter will be subdivided into following sections:

1. Conceptual review
2. Review of article and journals
3. Review of previous research

Till the date, many studies have been done, related to the impact on market price by various variables such as EPS, DPS and signaling effects. But out of them very few thesis directly consider the rights issue to study the impact on share price.

-) *Gautam* has conducted a study on the topic, 'Analysis of Share Price Movement Attributed to Rights Offering Announcement' in 2001. One of the main objectives of his study were to find the effect of rights offering on the share price movement. In his study he concluded that Nepalese security market has failed to use various capital market instruments such as warrants, convertible option etc.
-) In 2003 a study by *Aryal* on the topic "Equity Rights Issue, its Practice and Impact in Nepal' had been conducted. The main objectives of his study are to examine the relationship between stock price reaction and announcement of rights issues and to analyze the relationship between rights share and equity share and rights share and NEPSE Index. At last he concludes that firstly company issues rights share for increasing equity capital and to invest it in company's diversification and expansion. Secondly they issue rights share to increase capital to meet the level prescribed by Nepal Rastra Bank. The rights share and equity share has low degree of positive correlation. The correlation coefficient between right share and NEPSE has also positive correlation.
-) *Lamichhane* conducted a study related to the rights offering and its impact on market price in 2004 in the Nepalese context. His objectives in this study is to identify the significant change in share price after announcement of rights offering and to recommend some policies that will help to rectify the current problems in the right issue of securities. In

this study his major findings were difference between share price before and after the rights issue of sample companies is significant. He further states that rights share issue is new practice in Nepal; sample companies are unable to increase the market capitalization through rights issue, as the practice does not follow the theory. Under subscription of rights share is common problem. Company act 2053 is not adequate for this and issues procedure of rights shares.

) *Lamsal* had conducted the study on impact of information on share price in 2002. In this study his objective was to determine the impact of information, such as dividend declaration, return on equity and EPS on share price. In this study he finds that there is significant difference in share prices of four samples companies out of five, because of information of divided declaration. It is found that share price of the sampled organization has decreased significantly after the issuance of directives made by NRB. In most cases MPS is negatively correlated with EPS, DPS & ROE.

3. RESEARCH METHODOLOGY

3.1 Research Design

Research design means an overall framework or plan for the collection and analysis of data "Research design is a plan, structure and strategy of investigation conceived so as to obtain answer to research

question and to control variances." (Kerlinger, 1978). To conduct the study, descriptive and analytical research design will be adopted.

3.2 Sources of Data and Collection Procedure

This study will heavily base on secondary data. Primary data will also be taken in some extent. So, qualitative and quantitative data will be taken for the study. The sources of data and collection procedure will as follows:

1. Primary data:

It will be collected through direct interview and questionnaire method which will be collected from experts, investors and other concern people. Opened, closed and mixed questionnaire methods will be used for the questionnaire. Similarly, structured and unstructured interview will be used for data collection informal talks with concerned person.

2. Secondary data:

It will be collected from published and unpublished documents. Annual reports, prospectus and bulletin of SEBO, NEPSE and other related commercial banks reports, newspapers, magazines, books and other statistics would be taken into consideration. Useful information will also be collected from Internet as well.

3.3 Population and Samples

Stratified and random sampling method will be taken for the study. There are 135 companies listed in NEPSE at the research period. Out of them, only 49 companies have issued right share. Out of them 10 are commercial banks and we will focus our study on the right share issue of only 6 commercial banks. This means size of population will be 10. But

researcher cannot take all institutions so only six cases of right issue have been taken as samples for the study. So the sample of the study will be at most at institutions based on data available and including all the sector of NEPSE, sample institutions will be:

1. Kumari Bank Ltd.
2. Everest Bank Ltd.
3. Bank of Kathmandu Ltd.
4. Nepal Bangladesh Bank Ltd.
5. Nepal SBI Bank Ltd.
6. Nepal Investment Bank Ltd.

3.4 Method of Analysis

Collected data from primary and secondary sources will be edited, classified and compiled according to research. Then the data will be presented in appropriate forms of table, charts and figures. The data will be analyzed by using financial as well as statistical tools. Different kinds of parametric and non-parametric statistical tools will be applied for the test of hypothesis. Mean, standard deviation, correlation, percentage and various test models will be adopted for analyzed the data.

3.5 Organization of the Study

This study will be organized into 5 chapters. Each devoted to some aspects of the study on right share practice and its impact on share price

movement of listed company in Nepal. The chapter one to five will consists of following:

Chapter I: Introduction

In this chapter the researcher will discuss about the development in the Nepalese capital market and its importance to the economy.

Chapter II: Review of Literature

This chapter will cover some articles and research work of other researchers.

Chapter III: Research Methodology

This chapter will throw some light on the plan for the collection and analysis of data collected through primary and secondary sources.

Chapter IV: Data Presentation and Analysis

The data will be presented in appropriate forms of table, charts and figures. The data will be analyzed by using financial as well as statistical tools

Chapter V: Summary, Conclusion and Recommendation

The last chapter will summarize the whole report and conclusion based on the research work will be given by the researchers.

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