

# **CHAPTER - I**

## **INTRODUCTION**

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

Capital market is a market for long-term securities having maturities greater than one year. They are vital to long term and prosperity of economy since they provide the channel through which needed fund can be raised. It is the mechanism through which public saving is canalized to industrial and business enterprises. The key instruments used in capital market are shares, debt, preference share, and bond & convertible issues. Some of the important members of capital markets are stock exchange, specialized financial institutions, bank and Investment Companies etc.

An efficient and effective capital market is crucial for developing the economy of a country. The growth of capital market in a country depends upon the saving available, proper organization of intermediary to bring the investors and business ability together for mutual interest. Capital market is organized market through which buyers and sellers of long term capital are met and the function of buying and selling takes place. Capital market is such a powerful marketing which gives opportunity to the investors to invest their savings in ordinary share, debenture and government securities.

Every firm constantly faces the financial problems from its very inception. A growing firm, thriving day by day, always remains in the destitute of funds either for expansion or diversification of business or to sustain in the competitive business environment. In order to cope with various financial situations, firm usually issue common stock to general investors or right offering to existing shareholders or preference share and various types of debentures as demanded by their target capital structure. This paper mainly focuses on the right offering to the existing shareholders. Right share are issued to the existing shareholders to increase capital if current reserve is not sufficient to issue bonus share. Company usually issues right share to raise the capital. Therefore, issue of right share represents the distribution of share in proportional to existing shareholders. The shareholder which has an option to

purchase a stated no of share at subscription price which is generally below the current market price within specified period of time.

Large number of corporate firms announces and issue right share to increase the capital base if the corporate management felt such need or to comply with the policy directives given by concern authority to increase the capital base from time to time. In Nepalese business environment, Nepal Rastra Bank issues the policy directives to the Financial Institutions to control and for the supervision of the establishment and operation of Financial Institutions in Nepal. Nepal Rastra Bank had already issued the policy provisions regarding the requirements of minimum paid up capital in Financial Institutions, which significantly affected the right share issuing practices of Financial Institutions in Nepal. A company issues right share under the principle of preemptive right of the shareholders. Under this right, the existing shareholders have the first priority to purchase any new equity share issued by the company.

Instead of selling a security issue to new investors, some firms offer the securities first to existing shareholders on a privileged subscription basis because of preemptive right (Van Horne, 2002).

If the new common stocks are issued giving the right to purchase first by the existing shareholders then 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 right. Each stockholders receives one right for each shares of stock owned (Weston and Copeland, 2005).

Right shares are issued to the existing shareholders as a result of increase in capital if current reserve is not sufficient to issue bonus share. Company usually issues right share to raise the capital. Therefore, issue of right share represents the distribution of share in proportional to existing shareholders. The shareholder which has an option to purchase a stated no of share at subscription price which is generally below the share current market price within specified period of time. The pre-emptive right entitles a shareholder to maintain his/her proportionate share of ownership in the company. The law grants shareholders the right to purchase new share in the same proportion as their current ownership. Thus, if shareholder owns 1 per cent of company's ordinary share,

he has pre-emptive right to buy 1 per cent of new share issued. The shareholders' option to purchase a stated number of new shares at a specified price during a given period is called rights. These right can be exercised at a subscription price which is generally much below the share's current market price, or they can be allowed expire, or they can be sold in the capital market.

Rights have intrinsic financial values because they are normally offered at a price somewhat lower than the current market price of stock. Consequently a market exists for the buying and selling of rights and once again we enter the world of speculator. An especially attractive speculative investment is using margin to buy rights with the hope that the value will rise.

## **1.2 Statement of the Problem**

Right offering announcement by a company serves good news to its existing shareholders. A shareholder, whose name is in the company book before record date, is entitled to have a proportionate number of new shares at price below the market. A view held by professional investor, finance directors and some academics is that, a right issue because it increases the supply of a company's shares, will have a depressing effect on the share price. It should consider some theoretical relationship in rights offering.

Right is a negotiable instrument, so it has certain value for sale. Theoretically, value of the right is determined using different equations and the value depend upon the market price of share, subscription price and number of rights required to purchase a new share. Immediately after the announcement of the right offering, the market price of the stock would increase by some amount but theoretically it is said that the right offering does not affect the value of shareholders. When the stock goes ex-right, the market price theoretically decline by the amount of value of each right. Hence, the positive or negative effect of the announcement to the right share in different points of the time i.e. before and after the book close date is another statement of the problem. Theoretically, the market price and the theoretical price after book close date of rights are to be equal. But in practice, it may differ. Hence, the market price and the theoretical price after the book close date are equal or not, is one important aspect of the statement of the problem of this research work.

When a company sells securities by privileged subscription, it should mail to its shareholders one right (i.e. legally transferable written instrument) for each share of the stock held with the common stock offering, this legal instrument called 'right' give shareholder the option to purchase additional shares according to the terms of offering. The holder of right has four choices i.e.

- Subscribe for new share (Exercise the rights)
- Sell rights
- Partially exercise the rights
- Do nothing at all

Hence, another research problem is the subscription rate of the right issue in the country and the how the investors perceive the right issue regarding the attractiveness. Keeping these views into the considerations, this study deals with the following issues:

- What is the relationship between right share issue and stock price movement?
- What are the theoretical and the actual price of the share after the book close date?
- What are the reasons behind price movement after announcement of right share?
- Are there any malpractices in issuing right share?

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

This study focuses on right issue and its effect on stock price movement of the sample financial institutions. The specific objectives are as follows:

- To present enlighten the existing practices of right issues.
- To explore the impact of right offering on market price of the stock before and after the book close date.
- To examine the theoretical value and market price of the stock after the book close date of right.
- To evaluate the adequacy of existing law on the matter of right share.

### **1.4 Focus of the Study**

In any firm, right share is taken as major financial decision that affects the value of firm. The main focus of this study is to examine the practice made by the sample

firms in regards to the right share and its impact on stock price movement. The purpose of this study is to provide a clearer understanding of the circumstances surrounding a right offering to analyze the result of the offer and improving its effectiveness. This study also examines the practice made by the Nepalese firm in this regard, stock price movement and current legal provision regarding right share issue.

### **1.5 Significance of the Study**

This right share issue is important decision of corporate for different point of view. It is a incredibly significant subject for all the concern people of the capital market. This can be said that this study is the novel for Nepalese capital market. Now a day's people are attracted to invest in shares for the purpose of getting greater return by considering the companies try to provide higher return and try to make value maximizations of the shareholders. Right share has become new concept to attract the investors as well as maintaining goodwill. Similarly, company lunch a new promotion strategy, right share is the major one of them. Right share provide existing shareholders the right to buy new shares in specified ratio. The practice of right share is very old in worldwide but in Nepal it is started from the fiscal year 2052/53. Only few researches regarding right issues have been prepared. So, this topic has been selected for the further study. This research will certainly help all the related bodies. It will also be beneficial to the scholars who really want to know about right share practice in Nepal and its impact on share price.

### **1.6 Limitations of the Study**

This study will have the following limitations.

- Only Twenty Five right issuing companies are taken as sample.
- Mostly secondary data are used.
- Sample firms are only taken from the fiscal year 2008/09, 2009/10 and 2010/11.
- Current right issues are not included in the study.
- Effect on share price movement through right share announcement is only considered.

## **1.7 Organization of the Study**

The whole study has been divided into five chapters:

### **Chapter I: Introduction**

This chapter deals with the introductory part of the study which includes introduction of capital market, background of the study, statement of the problems, objectives of the study, focus of the study, significance of the study, limitations of the study and organization of the study.

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

This chapter deals with review of the different literature in regards to the theoretical analysis and review of books, article and thesis related to the study field. Therefore, it includes conceptual framework and other related studies.

### **Chapter III: Research Methodology**

This chapter deals with research methodology used to carry out the research. It includes research design, population and samples, sources and techniques of data collection and data analysis tools.

### **Chapter IV: Data Presentation & Analysis**

This chapter is the main part of the study which includes analysis and interpretation of data using financial and statistical tools. Similarly this chapter also includes the major findings of the study.

### **Chapter V: Summary, Conclusion & Recommendations**

This chapter covers summary of the study, conclusion and possible suggestions.

In addition to these, there will be some Appendices for supporting the calculations

## **CHAPTER-II**

### **REVIEW OF LITERATURE**

This chapter deals with the literatures of previous studies on Right Share practice and its impact on share price. It includes the Conceptual Review and Review of related studies. Regarding the review of literatures, various books, journals, articles, thesis related with this topic will be reviewed. It covers both within and outside the country. Very few important researches regarding Right Share have been conducted in Nepal.

#### **2.1 Conceptual Review**

The most popular way of raising capital is the issue of common stock. When a company issues the shares for public, the stock is said to be initial public offering (IPO). But, when a company issues shares giving the right to the existing shareholders first, it is said to be Right Issue or Right Offering. Right Offering is a new phenomenon. It is relatively a new practice for Nepalese Organizations.

##### **2.1.1 Venture Capital**

Equity investment in the early stages of a business is often called venture capital. In other words, venture capital represents funds invested in a new enterprise. It is the key to the success of any growing business firm. Institutional investor especially financial institutions, wealthy individual investors and specialist investor organized in partnership are the major sources of venture capital. The investment in venture capital is very risky. Therefore, investors are rewarded with high rate of return in successful ventures. Unlike most equity investors, venture capitalists typically play an active role in selecting management and overseeing strategy.

"Venture capital investments are like inefficiently priced stocks, with two differences. First because there are no short-selling mechanisms, a venture capitalist, like a commodity investor, faces potential overpricing. Second, unlike stocks, which represent existing assets, an early-stage venture capital project may be an idea" (James H.Scott, Jr., "Managing Asset Classes," Financial Analysts Journal, February 1994.).

“Venture capital can also include managerial and technical expertise. Most venture capital comes from a group of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships. This form of raising capital is popular among new companies, or ventures, with limited operating history who cannot raise funds through a debt issue. The downside for entrepreneurs is that venture capitalists usually get a say in company decisions, in addition to a portion of the equity”(www.investopedia.com).

### **2.1.2 Initial Public Offering (IPOs)**

Most businesses begin life as proprietorships or partnership and the more successful ones, as they grow, find it desirable at some point to convert into company. Initially, these new corporations stock are owned by firms’ officers, key employees or very few investors. The company may decide at some points to go to public. If it chooses to go to public, the procedures and alternatives for raising equity fund will define significantly from this use by privately held company or a closely held company which is control by small group. “Going public means selling some of the company’s stock to outside investors and then letting the stock trade in public market, and desire to convert into corporations” (Brigham, Gapenski and Ehrhardt, 2001:698).

“Public offering of various securities like equity share (both ordinary as well as right share), debentures, bonds etc. to the general public by corporate as well as the Government are made through the Merchant Bankers (MBs). As such the MBs work as intermediates between the fund concerned groups (the general public and institutions) and the fund deficit group (corporate) to cater the needs of both through efficient fund mobilization. The MBs are mainly engaged in creating and expanding primary and secondary market for securities and money market providing advisory services to corporations as well as managing their investment for portfolio. Thus public offering involves rising of funds for Government or corporations from public through the issuance of various securities in the primary market and is often the only major sources of obtaining large sums of long term funds” (Vaidya and Parajuli, 2004:88).

By issuing publicly traded equity, the firm establishes both the value for the company and a market for the common stock. This enhance liquidity for the firm’s share allows

the company to raise capital on more favorable terms since it no longer needs to compensate investors for liquidity associated with a privately held firms. With these benefits, however, comes cost. In particular there are ongoing costs for publicly traded firms associated with the need to supply information on a regular basis to investors and regulators. Furthermore, there are substantial onetime costs associated with IPOs that can be categorized as either direct or indirect costs. Direct cost includes the legal, auditing, administrative and underwriting fees related offering, and the dilution associated with selling shares of an offering price that is, on average, below the price prevailing in the market shortly after the IPOs.

If the company plans to sell stock to raise the new capital, the new shares may be sold in one of five ways:

- On a pro-rata basis to existing shareholders through a right offering,
- Through investment bankers to the general public in a public offering,
- To single buyer (or very small number of buyers) in private placement,
- To employee through employee stock purchase plan and
- Through a dividend reinvestment plan

(Brigham, Gapenski and Ehardt, 1988:701).

### **2.1.3 Preemptive Right**

The common stockholders are the owner of a corporation and as such they have certain right and privileged. “Common stock holders often have the right, called the pre-emptive right, to purchase any additional share sold by the firm. In some states the pre-emptive is automatically included in every corporate charter, in other it is necessary” (Weston & Brigham; 1990:677). Under a pre-emptive right, existing common stockholders have rights to preserve their proportionate ownership in the corporation. If the corporation issues additional common stock they must be given right to subscribe to the new stock so that they maintain their pro-rata interest in the company. A pre-emptive right is the privilege of existing shareholders to participate in a right offering. Shareholders are granted pre-emptive right either by common law or explicitly by the corporate charter. A corporation may have the right to amend the article of it’s incorporation to limit or deny this pre-emptive right” (Hanley and Ritter, 1994:250).

Common stockholders often have the “pre-emptive right” to purchase any additional share sold by the firm. If the pre-emptive right is contained in a particular firm’s charter, the company must offer any newly issued common stock to existing shareholders. If the charter does not prescribe a pre-emptive right, the firm has the option of selling to its existing shareholder or to the public at large. If it sells to the existing shareholders, the issue is called a rights offering. “Each shareholder is issued an option to buy a certain number of new shares, and the terms of the option are listed on a certificate called a stock purchase right, or simply a right. If a stockholder does not wish to purchase any additional shares, then he or she can sell the rights to some other person who wants to buy the stock” (Brigham, Gapenski & Ehrhardt; 1988:607). Stock rights provide holders with the privilege to purchase additional shares of stock based on their number of owned shares. “Rights are an important tool of common stock financing without which stockholders would run the risk of losing their proportionate control of the corporation” (Gitman, 1988: 607).

#### **2.1.4 Offering Through Right**

Rights issues include the offering of additional shares to existing shareholders. They are offered to existing shareholders proportionately. When a company sells securities by privileged subscription, it mails to shareholders one right for share of the stock held. With common stock offering the rights give shareholders the option to purchase additional shares according to the terms of the offering. The term specifies the number of shares required to subscribe for an additional share of the stock, the subscription price per share, and the expiration date of the offering.

The holders of rights have four choices:

- Exercise them and subscribe for additional shares,
- Sell them, because they are transferable, or
- Partially exercise the rights
- Do nothing and let them expire.

The last option usually occurs only if the value of the rights is negligible or if the shareholder owns but a few shares of stock. Generally, the subscription period is about three weeks.

Under the right offering, the stockholder are provided a document called 'right' which describes all conditions about the right issue. Each shareholder receives right in the proportion of share currently held. Generally, "right" is a negotiable instrument and therefore transferable and negotiable because while somebody may have sufficient money to exercise the rights and they may actually exercise such rights but some others may not have the money to exercise all the rights, they can sell the rights or partially exercise the right. While observing the rights offering practices of Nepalese companies there is a complete absence of such negotiable rights.

### **2.1.5 Characteristics of Rights**

Some of the characteristics of right share are as follows;

- The number of rights is generally equal to no. of shares held.
- The right issuing company determines the number of rights required to subscribe to an additional share.
- The price per right share to be paid to the company is called subscription price and is generally less than market price of existing shares.
- Rights are negotiable financial instrument which is sellable.
- Rights have certain maturity periods. Beyond the period, the right holder cannot exercise the right.

### **2.1.6 Procedures of Right Offering**

Procedures of Right Offering consist of Declaration Date, Ex-right Date, Holder of Record Date and Subscription Date. They are briefly described below:

#### **a) Declaration Date**

This is the date when the Management or BoDs declare about the right shares which include the no. of right required to purchase one new shares, subscription price, holder of record date, subscription date.

#### **b) Ex-Right Date**

It is the date on and after which the right no longer goes to the stock. It means, the buyer of the shares on and after this date does not enjoy the right shares. This date is normally four days prior to the holder of record date. In Nepalese context, it is known

as the Book Close Date and there are 7 working days provision for holder of record date due to manual transaction.

**c) Holder of Record Date**

It is the date until which a person, who bought shares before ex-right date, must register his/her name in the company. It is the final date to transfer the title, meaning that the seller's name should be replaced by the buyer's name in the company's register till this date. Normally, it is after the four days from the ex-right date. But, in Nepalese context, it is after the 7 working days from the book close date or Ex-right date.

**d) Subscription Date**

It is the date on which company starts to sell the right shares to the shareholders those who have registered their name on and before the holder of record date.

**2.1.7 Procedures of the Issue of Right in Nepal**

Right issues are conducted in Nepal in accordance with provision mainly in Securities Issue Guidelines-2008 and Securities Registration and Issue Regulation-2008. The actual mechanics and the sequence of events in the case of rights issues are somewhat complicated and it will therefore be useful to outline briefly the actual procedure by which a right issue practice is typically made in Nepal. Company must follow certain rules and regulations as mentioned in the company act and their respective memorandum and article of association. In Nepal, the actual mechanism and sequence of events in the case of right issue are somewhat complicated. At present context, generally the following procedural are considered before right offering.

- The Board of Director (BOD) should consider about the determination of the quantum of further capital requirement and the corporations in which the rights issue might be offered to existing shareholders.
- Company should notify NRB, Nepal Stock Exchange, Office of the company Register and SEBON sufficiently with prospectus in advance of the date of board of record meeting at which the rights issue is likely to be considered, and should take permission from them.
- AGM should pass the proposal of BOD by its majority.

- Make announcement with prospects which gives a general indication of the reasons, which have made the issue desirable, the purpose for which the new money is to be used.
- Letter of provisional allotment or rights offering to the shareholders with prospects. This letter will advise the shareholders about the rights offered, the number of new shares allocated to each given number of old shares, the price at which shareholders will qualify for the right issue. This letter will be sent after the date of announcement.
- After the receipt of the letter of provisional allotment, the allotment must be accepted or renounced, and payment in full or partial, must be made for those shares which are renounce.
- The Certificates are distributed to the shareholders who participated in the rights offering announcement. Shareholders who have accepted and fully paid up their allotment can renounce the actual share certificate in favor of a third party.
- Listing of the shares in the NEPSE again with increased number which must be approved by the stock exchange after which an application for listed new share could be made.

The summarized description regarding issuance of Right Share in Nepal in “Securities Issue Guidelines-2008” is presented below:

Corporate bodies can only issue rights share if the previously issued shares have been fully paid up. Besides, they can issue rights share only once in a fiscal year; and while issuing rights share, it should have completed 180 days from the date of listing of the previously issued shares in Nepal Stock Exchange. The issuance of right shares to public should be opened only after the Directors of the corporate body which has applied for the issuance of the right shares have paid full amount equivalent to the right shares to be subscribed by them. However, if the Director of the corporate body does not subscribe the right shares required to be subscribed by him, the application for right shares may be made open to other shareholders disclosing the information regarding the same. If the director wished to transfer the right to any other person, the arrangement should be made for renouncement of this right and making payment against the right shares within seven days of opening of the applications. If right

shares are to be issued for the reason other than the regulatory provision related to its own business, the resolution for issuing right shares should be approved from the General Assembly mentioning the details including the objective of increasing the paid up capital with reason thereof, amount to be increased, proportion of right shares to be allotted and details regarding uses of capital. If all of the shares could not be sold on the duration of opening of right shares and are left out, such shares should be cancelled.

Furthermore, there are three sub-sections regarding Right Share in “Securities Registration and Issue Regulations, 2008” which are as follows:

**Rights Issue of Securities:**

1. The corporate body may increase capital through the issuance of shares to the existing shareholders through rights issue.
2. While making rights issue pursuant to Sub-regulation (1) the “Provisions and Disclosures Related to the Issue of Rights Shares” drafted in the format prescribed in the Schedule-5, shall require to be signed by all of the members of board of directors and be submitted to the Board through the Issue Manager which, after getting registered with and approved by the Board, shall be published.
3. While issuing rights shares pursuant to Sub-regulation (1) if the rights to be exercised by the existing shareholder is to be transferred wholly or partially to other nominee, the existing shareholder shall be required to apply to the issuer body corporate in the format prescribed in Schedule-6 having fulfilled the following conditions:
  - The memorandum or articles shall require to contain provision of transferring the rights of existing shareholder to other person.
  - The rights obtained by the shareholder shall have to be nominated wholly or partially to only one person or institution.
  - Provision of applying as nominee shall have to correspond to the trading lot fixed by the stock exchange.
  - Provision that a shareholder who has nominated others to exercise his / her rights shall not be a nominee to exercise the rights of others. However, those

who have exercised their own rights fully may exercise the rights as nominee of others.

- The nomination of the rights shall require being in compliance to the limit of shareholding prescribed by the memorandum or articles of the company or that prescribed, if any, by the related regulator and that the nominee shall not apply for the shares including the existing shareholding that result in exceeding the said limit.
- Provision of nomination shall be made to confirm to the same groupings of ownership and representation to the board of directors, if any, and if the exercise of rights after nomination brings changes in the structure of ownership and board of directors of the body corporate, shall be required to make the changes necessary to accommodate for the ownership limits within the groups and that there should be clear provision regarding the exercise of voting rights.
- The person or the institution so nominated shall not be in the black list and shall not be having any disqualification under the prevailing laws.
- Require having provision that the nominee shall exercise the rights within the period opened for rights subscription.

### **2.1.8 Significance of Right Offering**

There are many advantages or significances of the right offering. Some of them are:

- **Permanent Capital**

Since ordinary/right share are not redeemable, the company has no liability for cash outflow associated with its redemption. It is a permanent capital and is available for use as long as the company goes.

- **To Indicate Higher Profit**

Normally right share is an indication of higher future profits, right share usually declare only by board of directors who expect rise in earnings of offset the additional shares.

- **To Bring the Market Price of Share within more Popular Range**

Right shares effect to increase in the number of outstanding shares and to decrease in share price. A share has a strong performance that leads to an increase in market value

than popular range. Then the management of the firm determines that the price of the share is higher than (moving and of) the popular trading range and decides a right share would be useful to bring the high-priced share within the popular range.

- **To Increase the Number of Outstanding Shares**

Issue of right share obviously increases the number of outstanding shares which again promotes the active trading in the stock market.

- **To Have Positive Psychological Value**

The announcement of right is perceived as favorable news by the investors in that with growing earnings, the company has bring prospects and the investors can reasonably think for increase in future dividends. As the investors take the right share is an effort to invest cash for profitable investment opportunities, the share prices have positive psychological value. Instead of experiencing a drop in value after a right share, the price may actually rise. Pre-emptive right gives the stockholders the protection of preserving their pro-rata share in the earnings and control of the company.

- **To Retain Proportional Ownership for Shareholders**

“Right offering allows stockholders to maintain their proportionate ownership in the corporation and typically allow the corporation to raise new capital less expensively” (Gitman; 1988:613). Hence, the control position of the company due to the right offering is not changed.

- **To Decrease Flotation Cost**

“Raising fund through the stock of right issue rather than the public issue involves less flotation cost as the company can avoid underwriting commissions” (Pandey; 1999:1006). The flotation costs to issuer associated with a right issuing will be lower than the cost of public flotation.

- **To Be Successful on Subscription**

In the case of profitable companies, the issue is more likely to be successful since the subscription price is set much below then current market price.

- **To achieve a more Respectable Size in the Market**

After right share issue by a company, every shareholder receives additional share proportionate to original holding. Some of the old shareholders may sell their new shares. As a result a corporate firm may achieve a more respectable size in the capital market.

- **To Fulfill the Legal Requirement Imposed by the Authority**

In the context of Nepalese Banks, Nepal Rastra Bank impose legal requirement for increasing the equity base at certain standard level. To fulfill their legal requirement, Nepalese corporate firms practiced of raising the additional capital from existing shareholder because of the lower cost of fund, less flotation cost and to avoid the difficulties in raising public issues.

- **To Expand Company**

When a company wished to expand, it may well request extra cash from it's shareholders by way of right issue to finance that expansion.

### **2.1.9 Limitations of Right Offering**

Besides the significances, there are some limitations of the right share issues which are as follows:

- The company can't force its existing shareholders to buy any more shares in the company and hence it is granting them an option to buy these new shares.
- The shareholders who fail to receive or to exercise or to sell their rights, lose in terms of decline in their wealth. Most right issues are undersubscribed because there is no legal obligation on the part of shareholders to subscribe.
- It deprives new investor from becoming the shareholders of the company. The control over the management of the company is not diluted and the present management may misuse its position.
- The issue of right share dilutes the existing share's earnings per share if the profit do not increases immediately in proportion to the increase in the number of ordinary shares.

### 2.1.10 Market Vs Theoretical Value of Right

Right is a negotiable instrument so it has certain value for sale. Theoretically, value of right is determined using different equations and the value depend upon the market price of share, subscription price and number of rights required to purchase a new share. This value is also known as formula value. The market value of right is determined in the market place through the interaction of demand and supply. The following are the equations for determining the theoretical value of right:

$$\text{Value of a right (Vr)} = \frac{P_0 - P^s}{\# + 1}$$

Where,

$P_0$  = Market price of the stock, right on

$P^s$  = Subscription Price

$\#$  = Number of rights required to purchase one new share

This theoretical value is the minimum value to the seller and maximum value to the buyer. We should be aware that the actual market price of a right may differ somewhat from its theoretical value on account of transaction costs, speculation, and the irregular exercise and sale of right over the subscription period. However, arbitrage limits the deviation of actual value from the theoretical value. If the price of a right is significantly higher than its theoretical value, stockholder will sell the right and purchase the stock in the market. Such action will avert downward pressure on the market price of the right and upload pressure on the market price of the stock. If the price, the right is significantly lower than its theoretical value, arbitrageurs will buy the right; exercise their option to buy stock and downward pressure on its theoretical value. These arbitrage actions will contribute as long as they are profitable. The market price of right will generally differ from its theoretical value. The extent to which it will differ will depends on how the firm's stock price is expected to behave during the period when the right is exercisable. By buying right instead of the stock itself, investors can achieve much higher returns on their money when stock price rise.

In the context of the Nepalese capital market, right is attached with the stock and it cannot be separated from the stock and hence there is no separate value of the right; neither theoretical value nor market value.

### **2.1.11 Right Offering and Market Value of Share**

Immediately after the announcement of the right offering, the market price of the stock would increase by some amount but theoretically it is said that right offering does not affect the value of shareholders. When the stock goes ex-right, the market price theoretically declines because the investors no longer receive the rights to subscribe additional shares.

Ex-right value of stock = Right on value of stock – Value of each right

Theoretically, the market price is reduced by the value of each right. But the actual market price is determined in the market place or stock exchange through to the interactions of demand and supply of the shares.

In Nepal, there is only one Stock exchange i.e. Nepal Stock Exchange (NEPSE). All the listed securities are traded in NEPSE. The market price after the ex-right date can be clearly noticed and analyzed through the NEPSE.

### **2.1.12 Nepal Stock Exchange**

Nepal Stock Exchange, in short NEPSE, is a non-profit organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994. Government of Nepal, Nepal Rastra Bank, Nepal Industrial Development Corporation and members are the shareholders of NEPSE. Significant developments have been made in the secondary market i.e. in NEPSE in recent years, especially after the Nepal Government decided to reform the capital market. The computerized trading system has replaced the open-cry system. NEPSE has implemented the wide area network (WAN) to enable brokers to trade from their own offices. Trading through WAN has formally started from 13 Oct. 2007 NEPSE has started posting trading activities on its

website in order to provide investors and the general public with real-time information. Furthermore, the Nepal Government has made commitments to improve and develop the secondary market to enable it to encompass more corporate organization, investors and financial instruments.

### **History**

The history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the Company Act in 1964, the first issuance of Government Bond in 1964 and the establishment of Securities Exchange Center Ltd. in 1976 were other significant development relating to capital markets.

Securities Exchange Center was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Nepal Government, under a program initiated to reform capital markets converted Securities Exchange Center into Nepal Stock Exchange in 1993.

### **Members**

Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 23 member brokers and 2 market makers, who operate on the trading floor as per the Securities Exchange Act, 1983, rules and bye-laws.

Besides this, NEPSE has also granted membership to issue and sales manager securities trader (Dealer). Issue and sales manager works as manager to the issue and underwriter for public issue of securities whereas securities trader (Dealer) works as individual portfolio manager.

At present there are 11 sales and issue manager and 2 dealers (Secondary market). The tenure of the membership is one year. The license should be renewed within 3 months after the closure of the fiscal year. If not, it can be done within another three months by paying 25% penalty.

## **Trading**

NEPSE the only Stock Exchange in Nepal introduced fully automated screen based trading since 24th August, 2007. The NEPSE trading system is called 'NEPSE Automated Trading System '(NATS) is a fully automated screen based trading system, which adopts the principle of an order driven market.

To regulate the transactions of NEPSE, Security Board of Nepal (SEBON) was established in 1993 AD which is the apex body of security market in Nepal and responsible for promotion, enhancement, control and regulation of the security market of Nepal.

### **2.1.13 Securities Board Nepal (SEBON)**

Securities Board of Nepal (SEBON) was established by the Government of Nepal on June 7, 1993 as an apex regulator of Securities Markets in Nepal. It has been regulating the market under the Securities Exchange Act, 2006. The functions, duties and powers of SEBON as per the Act are as follows.

To offer advice to Government on matters connected with the development of the capital market.

- To register the securities of corporate bodies established with the authority to make a public issue of its securities.
- To regulate and systematize the issue, transfer, sale and exchange of registered securities.
- To give permission to operate a stock exchange to any corporate body desirous of doing so, subject to this Act or the rules and bye-rules framed under this Act.
- To supervise and monitor the functions and activities of stock exchange.
- To inspect whether or not any stock exchange is executing its functions and activities in accordance with this Act or the rules and bye-rules framed under this Act, and to suspend or cancel the license of any stock exchange which is not found to be doing so.
- To issue licenses to conduct the business of dealing in securities, subject to this Act, or the rules and the bye-rules framed under this Act, to companies or institutions desirous of conducting the business of dealing in securities.
- To supervise and monitor the functions and activities of securities-dealers.

- To grant permission to operate collective investment schemes and investment fund programs, and to supervise and monitor them.
- To approve the bye-rules concerning transactions in securities framed by stock exchanges and institutions engaged in the business of dealing in securities, and, for the purpose of making necessary provisions concerning the development of the capital market and protecting the interests of investors investing in securities, issue orders to have necessary alterations made in such bye-rules of stock exchange and institutions engaged in the business of dealing in securities.
- To systematize the task of clearing accounts related to transactions in securities.
- To supervise whether or not security dealers are behaving in the manner prescribed in this Act, or the rules and the bye-rules framed under this Act, while conducting business of dealing in securities, and suspend the license to conduct the business of dealing in securities in case any securities dealer is not found to be behaving accordingly.
- To make or ensure necessary arrangements to regulate the volume of securities transacted and the procedure of conducting such transactions in order to ensure the promotion, development and clean operation of stock exchanges.
- To make necessary arrangements to prevent insider trading or any other offenses relating to transactions in securities in order to protect the interest of investors in securities.
- To review or make arrangement for reviewing the financial statements submitted by the corporate bodies issuing securities and security dealers, and issue directives deemed necessary in that connection to the concerned corporate body.
- To systematize and make transparent the act of acquiring the ownership of a company or gaining control over its management by purchasing its shares in a single lot or in different lots.
- To establish coordination and exchange cooperation with the appropriate agencies in order to supervise and regulate matters concerning securities or companies.
- To discharge or make arrangements for discharging such other functions as are necessary for the development of securities and the capital market.

The Governing Board of SEBON is composed of seven members including one full time chairman appointed by the Government for tenure of four years. Other members of the Board include joint secretary of Ministry of Finance, joint secretary of Ministry of Law, Justice and Parliamentary Affairs, representative from Nepal Rastra Bank, representative from Institute of Chartered Accountants of Nepal, representative from Federation of Nepalese Chambers of Commerce and Industries, and one member appointed by the Government from amongst the experts pertaining to management of securities market, development of capital market, financial or economic sector.

There are seven departments and sixteen sections in the organization of SEBON. Under the Management Department, there are two divisions namely Human Resources Section and Finance Section. There are also four sections under the Planning and Development Department namely Research Section, Training Section, Information Technology Section and International Affairs Section. There are also two sections under the Corporate Finance Department namely, Public Issue Section and Collective Investment Scheme Section. Likewise, Under the Regulation Department, there are two sections namely, Stock Exchange Regulation Section and Market Intermediaries Regulation Section. There are also four sections under the Surveillance Department namely, Stock Exchange Surveillance Section, Market Intermediaries Surveillance Section, Trading Surveillance Section and Corporate Surveillance Section. Finally, under Legal Department, there are two sections Research and Investigation Section and Enforcement Section.

The major financial sources of SEBON are the government grant, transaction fee from the stock exchange and registration fee of corporate securities. Other financing sources include registration and renewal of stock exchange and market intermediaries and the income from mobilization of its revolving fund.

## **2.2 Review of Related Studies**

This part of the study includes review of related studies through review of Mini Research, review of Journals/ Articles and review of Masters' Thesis.

Ojha (2000), had done mini dissertation on Financial Performance and Common Stock Pricing. His study set out the following Objectives:

- To study and examine the difference of financial performance and stock price.
- To examine the relationship of dividend and stock price.
- To explore the signaling effect on stock price.

His Findings were following:

- Nepalese stock market is in infancy stage. In general it is very new and just started to develop.
- Dominance of banking sector is prevalent in the market due to other industries including finance companies, insurance and manufacturing is not encouraging.
- Due to the lack of the proper investment opportunity most of the investors have directed their savings towards the secondary stock market.
- Corporate firm with long history have a relatively stable profitability parameters than the firm established after the economize liberalization of 1990.
- Older firms have been issuing bonus share times than the new ones.
- Dividend per share is relatively more stable than dividend payout ratio. That's why payout ratio and dividend yield had highly fluctuating.

There is significant positive correlation between the dividend paid and stock prices of banking and manufacturing industries. All other industries have not the perfect correlation between the dividend paid and stock price.

Paul Marsh (1980), on his article "*The Journal of Finance*" has concerned with "UK companies raise virtually all of their new equity capital via the rights issue". Companies can guarantee the subscription of their issues having them underwritten and in recent years, this procedure has been adopted for 90% of UK rights issues. Underwriting is usually carried out on a fixed fee basis representing at least 1.25 % of the money raised, and hence it is clear that quite substantial sums of money are involved. Since underwriting is simply a put option giving the company the right to put a failed issue onto the underwriter. In this paper, describe an application of the Black and Scholes model to the valuation of rights issue underwriting agreements over the period 1962-1975. Model prices are compared with the fees charged in order to assess whether the letter represent competitive prices. In fact, over this period, companies appear to have overpaid for underwriting.

When a company makes a rights issue, it is a London Stock Exchange requirement that at least three weeks should elapse between the ex-right date and the date the offer expires. If the share price falls below the issue price by the last acceptance date, shareholders will not take up their rights, since shares could be bought more cheaply in the market. Since rights issue arrangements are costly, companies will clearly wish to avoid issues failing in this way. This can be achieved by having the issue underwritten. As an alternative to underwriting, companies can reduce the risk of a failed issue equally effectively by setting the issue price sufficiently low. This does not imply that underwriting is a waste of money, since if the issue is underwritten at a high enough price, there is a distinct possibility that the underwriters will be called upon to take up their commitment and buy shares from the company at a price above the ruling market price. The question is thus entirely one of whether or not companies pay a fair for underwriting the risks involved.

The underwriting decision is quite simply a problem in option valuation. When a company makes a rights issue, the company is in effect selling (giving) a short-term call option to its shareholders (i.e. to itself). The company's real objective however, is to new shares, and the only way in which the sale of a call can be converted into the sale of the underlying shares is for the company to simultaneously buy a put option. The latter is of course, precisely what occurs when the company arranges for its issues onto the underwriters. The underwritten in turn reduce their exposure by buying put options from the sub underwriters giving them the right to pass a failed issue onto the sub underwriters.

Shrestha (1992), states that though the size of the shareholders population in Nepal has been growing constantly the government seems to have not taken any initiative in formulating the separate act which protects the shareholders rights. In Nepal, the concerned officials seem to be not relevant as they interfere in the shareholders get ignored. In the annual general meeting, shareholders can amend the internal by laws elect directors, authorize the sale of assets enter into mergers, change amount of the authorized capital and so o. but in practice, many annual general meeting have undermined the collective rights of the shareholders. National Life and General Insurance Company had suppressed the collective rights of shareholders by not adhering to the consent of shareholders members in the board though the proposal

was put forward by the management. Same case is happened of Butwal Dhago Udhyog as the management wanted to have a control over the collective rights of shareholders.

When the rights are offered for raising funds, three major issues are involved. They are as follows.

- The number of rights needed to buy a new share,
- The theoretical value of a right, and
- The effect of rights offering on the value of the ordinary shares outstanding.

The Rights Issue Review Group based on market consultation recommends the following steps to improve on the efficiency and orderliness of rights issues:

Gautam (2001), had done research on “*An Analysis of Share Price Movement Attributed to Right Offering Announcement*”. This study has set out the following objectives:

- To analyze the inadequacy of the contents of the company act 2053 B.S. in regard to section 21 that explains about the matters to be disclosed in the issue prospectus.
- To find out if there is significant changes in share price after the announcement of right offering.
- To find out if there is any problem in the primary issue of securities.
- To prescribe some policies that will help to ratify the current problems in the issue in the issue of securities.

His findings were following:

- Company Act is not clear regarding the issue of rights offering and subsequent allotment of the rights share.
- Company Act has nowhere mentioned about necessity of legally transferable rights instrument called rights, which must be mailed to the stockholders for each stock held before the rights offering.

- SEBON has failed to establish a ‘one-window policy’ causing various imbroglios for the companies that want to go primary issue market for raising the capital.
- Till the date there is no enactment of the ‘Investors Protection Act’.
- Our capital market has made least of use the ‘capital market instrument’ contingent securities like warrants and convertibles, options, and other various kinds of debentures are not in practice.
- Companies Act with regard to the contents of the issue prospectus is deemed to be insufficient on the ground that, it does not mention the companies are required to specify on the issue prospectus about the risk category on which their businesses fall.

Gharti (2001), had done research on “*Bonus Share Announcement and Impact on Stock Price of Nepalese Corporate Firms*”. This study is being undertaken to analyze bonus share issue practices in Nepalese listed companies and its impact on share price. The main objectives of the study are

- To examine the relation between share price rise and Bonus ratio
- To examine the relation between share price rise and bonus share.
- To evaluate the relation of bonus share announcement and stock price.
- To remove some of widely held misconception about bonus share.
- To point out suggestions to the related bodies.

On the basis of analysis in his thesis, following major findings are observed

- The immediate share price rise after bonus announcement is significant. Bonus share announcement of banking sector is considering positively by the invertors but shown reluctant for the non-banking sector that the price decrease immediately after bonus announcement.
- The intention of issue bonus share of broad of directors leaks out before officially announcement. Therefore, the share price rises one month before the actual announcement due to the activities of the ‘insiders’.
- The share price, in most of the case, does not decrease after distribution of bonus according to bonus ratio as theory says. The reason behind the situation may be that the investors cannot interpret the information and data. There is a

great misconception about bonus share that the general investors think that they receive extra/ additional share with same value.

- The share price of the non-banking sectors shows inconsistency as compare to the banking sector. Therefore, investing on non-banking sector is more risky the banking sector.
- Long-term effect of bonus share issue, as well as immediate, is significantly positive. In most of the cases the aggregate market valuation of the corporate firms' equity capital increased as the result of bonus issue. 81.2 % of the bonus issue is recorded different level gain over the base date price, after adjusting of the general market movement in share pieces.
- Most of the corporate firms do not maintain their dividend quantum 62.5 per cent of the companies did not maintain their dividend quantum and of course not dividend rate.
- Nepalese capital market is speculative-oriented; therefore it takes more consciously bonus share announcement than the cash dividend announcement. Whatever the dividend policy of the company the immediate impact and a year are significantly positive.
- The companies announce bonus share without frequently cash dividend distribution, ultimately faces drastic fall in their share price.
- The Nepalese capital market did not show any response that whether the company is intended to increase future dividend (return) or not. The immediate response of the market is not sufficiently rational.
- The public, in most of the cases, was provided with provided with very little information about real motives behind an issue of bonus share.
- The adjusted share price of the bonus ratio above 30% to 50% (consisting only 1:2 bonus ratio) increased by 58 per cent one year after bonus share announcement with the least standard deviation of 6.6. Therefore, the bonus ration 1:2 has good response even one year after bonus announcement, which is firm's real equity capital increment.

Kharel (2002), has conducted a research on “*Stock Market Efficiency and the share price behavior in Nepal*”. The objectives of the study were:

- To provide the conceptual glimpse of Nepalese Capital Market and to analyze Nepalese Index Behavior.
- To examine whether stock price changes are normally distributed under the central limit theorem.
- To examine, test and determine serial correlation and filter rule and Bernoulli process in relation to price changes.
- To check whether the runs of the price changes are normally distributed or not.
- To determine the efficiency of the stock market through the theoretical model of Efficient Market Hypothesis (EMH) in Nepalese Stock Market.
- To provide feedback policy inputs towards institutional development of Nepalese share market.

The Major Findings were:-

- The successive price changes are not dependent random variables.
- Sophisticated investors can beat the average market return.
- Nepalese stock market is not an efficient stock market.

Niraula (2003), had done research on *“Impact on Dividend Policy on Market Price of the Stock”*. His study is based on dividend policy, impact on stock price movement.

The main objectives of his study are as follows:

- To Find out of dividend policy on market price of the stock.
- To find out is nay uniformity in DPS, EPS, MPS, and DPR in the sample firm
- To study the prevailing and effort made dividend policy in Nepalese firms with reference of sample firm.

His findings are as follows:

- From the descriptive analysis, there is no consistency in dividend policy amongst the sample firm’s dividend policy adopted by a firm also varies from year to year.
- We defined dividend strategy consistent with the objective of firms is still a need in Nepalese Corporate Firms.
- Analysis of the cost of capital and interest rate of return is not practiced while calculating dividend policy. Higher payout is made despite of high internal rate

of return. But in some cases retained earnings is quite lower than the cost of capital. This represents that share holder are not always treated fairly.

- Nepali Investor is actively participating in the capital market. Therefore, majority of them lack of financial knowledge are sill to analyze, the performance and future prospects of the firms. This has affected the market price of the entire firm.
- Efficient communication network and promotion of security market are major problems hindering the Nepalese capital market.

Lamichhane (2007), had conducted a research on “*Right Share & Its Impact on Market Price of the Stock*”. This study has set out the following objectives:

- To identify existing practices of right issues.
- To find out impact on changes in market price of the stock before and after the announcement of right offering.
- To examine the theoretical values of right and its practical effect of right on stock price.
- To analyzes the inadequacy of existing law, on the matter of right share.

There were 41 cases of Right Issues till the fiscal year 2062/63. Out of which the researchers had taken 11 sample companies. Secondary as well as Primary data had been used. Most secondary data had been extracted from SEBON and NEPSE and annual reports of the respected companies. Interview and Questionnaires methods had also been used wherever necessary.

Major Findings of the Study are as follows:

- Nepalese Capital Market is narrow in term of capital market instruments, only common stock, right share and to a very little extent, preference shares, debenture and few mutual funds are brought into practice. Contingent securities like warrants and convertibles, option and other securities are not brought into practice
- Nepalese equity market (primary as well as secondary) is dominated by financial sectors companies; the participation of the real sector (manufacturing, hotels etc.) is quite low or negligible.

- Rights share contribute, the second largest among various issues to raise the capital of the corporation approved by SEBON
- The practice of right share issue is in increasing trend.
- The maximum contribution of right offering in total public flotation is 82.84% and minimum is 6.81%
- The result of run test is positive, i.e. market price per share before 1 month of right share issue and after right share issue is found to follow randomness in price fluctuation.
- In majority of the cases, MPS after right share decrease. But some companies are not found to be following the rule. MPS of DCBL, FFCL and TRHL remain the same after the right share issue showing no effects of right share issue. MPS of KBL increase after right share issue.
- The theoretical and actual market price should be equal or actual market price should be slightly higher than theoretical price due to signaling effect but DCBL, KBL, JFCL, TRHL and MBL are not found to be following the rule. The actual market price of these companies after right share issue is lower than their theoretical value.
- Company Act has not mentioned about necessity of legally transferable rights instruments called right, which must be mailed to the stockholders for each stock held before the rights offering.
- Declaration of inappropriate holders of record date has caused dilution of wealth position of existing shareholders which is just opposite of the thereof rights offering (i.e. protecting dilution of wealth position of existing shareholders)
- Company Act has is silent regarding the issue of rights offering and subsequent allotment of the rights issue, most of the investors/shareholders also unaware about it.
- Regarding procedural aspects of rights offering, all the other procedure are same as IPO. Besides, rights issuing company (Issue Manager) should be mailed a document called a 'right' to the existing shareholders.
- Right appear as an obligation imposed on shareholders, otherwise he would suffer a loss in the form of decline in price of his holding.

- Under subscription of rights issue is common phenomena as rights is not transferable in Nepal, most of the companies unsubscribed give to the staff of the corporation, only some corporation have done underwriting.
- Because of under subscription, employee of rights issuing companies and issue manager are gaining on the expenses of the existing shareholders.
- Promotional role played by the issuing company and issue manager regarding to the rights offering is not sufficient.

### **2.3 Research Gap**

Right share is the major instrument for raising additional equity capital which contributes the largest portion on various issues approved by SEBON. However, there is still lack of complete and satisfactory research on right share. The purpose of this research is to provide clear picture on right share practice in Nepal including its all consequences and circumstances.

Only few researches have been made on the topic “Right Share practice in Nepal”. Most of them selected very few samples i.e. less than 10 which cannot be considered adequate. This study also based on both secondary as well as primary data. Moreover, the earlier studies on right offering have become old and need to be updated and validated, because of the rapid changes taking place in the capital market. Considering all these facts it is necessary to carry out a fresh study in Nepal. Finally, this study is expected to be useful for all those including financial scholars, managers, investors and regulatory bodies such as: NRB, SEBON, NEPSE.

## **CHAPTER- III**

### **RESEARCH METHODOLOGY**

This part of the study incorporates the overall research framework having research design, population and sample, sources and technique of data collection and method of analysis, tools used in the study.

#### **3.1 Research Design**

In this study, descriptive as well as analytical research design has been adopted to satisfy the objectives of the study. The study is based on historical data and an ex-post facto research because no variables are in the control and no variables in this research is manipulated during the study. Descriptive research design has been used for conceptualization, problem identification, conclusion and suggestion. Analytical research design is used for analyzing the data to find out the result.

#### **3.2 Population and Sample**

Nepal Finance & Saving Co. was the first company, who issued rights shares in Nepalese market in the fiscal year 1995/96. The company issued the right share of Rs. 2 million on 1995/12/1, the ratio was 4:1, each existing shareholders who had 4 shares owned were allowed to purchase each additional share issued by the company.

Since then, Nepalese corporate firms started to issue rights share. To this date (i.e. 2010/11) there are 217 cases of rights offering in Nepal. The details of all right issuing companies are presented in the Appendix-2. According to the table, 38 Banks, 49 Development Banks, 114 Finance Companies and 10 Insurance companies issued the right share and the rest 6 issues are from others. 25 sample firms are taken out of rights offering in the FY 2008/09, 2009/10 and 2010/11 which are judgmental. Mostly, right shares are issued by Financial Institutions. Hence, 9 Commercial Banks, 6 Development Banks, 8 Finance Companies, 1 Insurance Company and 1 Hydropower company are taken as sample for actual market measurement and valuable findings. They are presented as follows:

**Table 3.1**  
**Sample Firms**

SN	Company Name
	<b>Commercial Banks</b>
1	Nepal Bangladesh Bank Ltd.
2	Nepal Investment Bank Ltd.
3	DCBL Bank Ltd.
4	NMB Bank Ltd
5	Lumbini Bank Ltd.
6	Siddhartha Bank Ltd.
7	Bank Of Asia Nepal Ltd
8	Prime Commercial Bank
9	Sunrise Bank Ltd.
	<b>Development Banks</b>
10	Infrastructure Development Bank Ltd
11	Ace Development Bank Ltd.
12	Excel Development Bank Ltd.
13	Annapurna Bikash Bank Ltd
14	SanimaBikash Bank Ltd
15	ResungaBikash Bank Ltd
	<b>Finance Companies</b>
16	Annapurna Finance Co.Ltd.
17	Everest Finance Ltd,
18	Universal Finance Ltd.
19	World Merchant Bank Ltd
20	IME Financial Institution
21	International Leasing & Finance Ltd.
22	Prabhu Finance Ltd
23	Reliable Finance Ltd
	<b>Insurance Company</b>
24	National Life Insurance Company
	<b>Hydropower Company</b>
25	National Hydropower Co. Ltd.

### 3.3 Nature and Sources of Data

This study is heavily dependent on secondary data. Primary data will also be used as per need. Hence, the sources of data are as follows:

#### **a) Primary Source**

To identify the problems and prospects of rights share practice in Nepal, primary data are collected. Primary sources included in the study are the responses of the questionnaires, personal interview with concerned person such as Company Secretary, experts, brokers, investors, issue managers etc.

#### **b) Secondary Source**

Secondary Sources of data included in this study are the annual reports of SEBON, various publication of NEPSE and sample firms, statistical book of Nepal, published and unpublished documents, previous studies, dissertation, articles and foreign related journals as well. Newspaper, magazine, books and other reports such as ArthicAbhiyan, Economic Post, Kantipur, Gorkhapatra and New Business Age etc are useful sources of secondary data. Some other important information has been collected from Internet.

### **3.4 Data Collection Techniques**

Necessary data for this study are collected from various sources, out of them only related data are considered for the study. Primary data and secondary data are collected through following method.

#### **a) Questionnaire Method**

To get information about the right share and its different aspects, questionnaire method has been used. The questionnaire is designed in three groups. Group A contains a few multiple choice questions. Group B contains some ranking items questions and Group C contains a few opened-end questions where respondents can write their personal views about the research topic.

About 60 questionnaires are dispatched to the individual investors, brokers, issue managers, corporate firm and related experts and out of this, 50 responses were obtained.

#### **b) Interview Method**

Interview of some experts like Company Secretary, Business Securities persons, officers of NEPSE are taken to make the study more reliable. Unstructured interview

has been used for the data collection. Formal and informal discussions with students, teachers and representatives of some companies are also made as per need of study.

### **3.5 Method of Analysis**

Collected data from primary and secondary sources were edited, classified and compiled according to research. The data, therefore, will be presented in appropriate forms of table and charts. To analyze the data, financial as well as statistical tools will be used. The study focuses on share price movement before and after the Book Close Date of Right Share. The share price not only fluctuates through rights offering alone, various market information also affects the share price. So, some assumptions to remove the effect of information are used as follows:

#### **3.5.1 Allowance for Leakage of Information**

Information about the director's intention to issue right share may be found out in many cases before the date of directors' meeting. If it happens, the price rises as a result of impending decision that may take place much before the director's actual decision. There may be the cases of insiders taking advantage by making purchase in advance of the official announcement so that the market price begins to rise over before the actual announcement. For these reason, only going back at least some days before the formal announcement of the board's decision use the true price effect of right issue decision. Considering all the factors, it is decided to go back 90 days before from the book close date of right share. Thus for the study, share price before 90 days and 10 days prior to Book Close Date were taken.

#### **3.5.2 Removing the Effect of Market Movement**

Measurement of the price effects of the right shares issue involves a comparison of share of different point of time. In actual practice, general price movement also affects particular share price. If share price in general level moved up by 10%, and a particular share price is found to rise by 10%, this cannot be assumed to be the effect of right share Offering. On the other hand, if a particular share price just remains unchanged in the face of declining market trend, the strength may be due to right issue. Hence, the isolation of the effect of the right share issue necessarily requires the elimination of the general market movement.

To analyze the share price movement, five different times were selected. The book close date is taken as a base date to take the five points. The selected points are as follows:

**i) 90 Days Before Book Close Date**

In order to isolate the effects of rights offerings, it is necessary to make comparison with dated unaffected by the offering. New financing frequently becomes known in the financial community prior to its official announcement. 90 days lead-time appears adequate.

**ii) 10 Days before Book Close Date**

Few days before the Book Close Date, it is supposed that the information is publicly known that bring much influence on share price behavior of the stock.

**iii) The Book Close Date**

It is the date on and after which the right no longer goes to the stock. It means, the buyer of the shares on and after this date does not enjoy the right shares.

**iv) 10 Days After the Book Close Date**

After the book close date, the new purchaser doesn't get the right share. Thus, the price generally falls. After the book close date, there is less chance of share trading for 3-4 days. Hence, 10 days is reasonable for the price correction mechanism.

**v) 180 Days After the Book Close Date**

In order to assess the post offering effect of rights offering, it is necessary to have a price quotation sometime after the offering, yet not so much later that factors are vague. 180 days appears reasonable for this purpose.

### **3.6 Data Analysis Tools**

Brief explanations of data analysis tools used in this study are as follows:

**a) T- test**

T- Statistic is also used to test the significance of the difference between the theoretical and actual market price after the book close date. Since the sample size is few (i.e. less than 30 transaction), t-test is suitable tool for analyzing the significance of difference between the theoretical and actual price after the book close date.

**Null Hypothesis (H<sub>0</sub>):**

There is no significant difference between the theoretical and actual market price after the book close date.

**Alternative Hypothesis (H<sub>1</sub>):**

There is significant difference between the theoretical and actual market price after the book close date

**b) Valuation of Rights**

Rights have certain market value because the rights share is generally offered at lower than market price. The value of a stock right may be defined as the value at which the right should be quoted in the market. So, people are interested towards that particular share attached with rights. After rights offering, existing shareholders want to exercise that right to purchase new common stock and some want to sell rights. Though there is no provision to make right transferable in Nepal, but valuation of rights is very important to analyze the share price movement. After the closing date of rights share offering, the share price will drop to the extent of value of rights.

$$\text{Value of one right (Vr)} = \frac{P_0 - P^s}{\# + 1}$$

Where,

$P_0$  = Market Price (Right on)

$P^s$  = Subscription Price

# = Number of right required to purchase one new share

**c) Theoretical Price of the share after Right Share**

After the book close of the right issue, the market price theoretically decreases because the new buyers of the share don't enjoy the right share in subscribed price. Theoretically, the market price after the book close date is decreased to the extent of value of the right but the actual market price is determined in the market place with the demand and supply mechanism.

It is also known as ex-right price. Theoretical Price of share after right or ex- right price of the stock is given by the following equation.

$$\text{Ex- right price (P}_e\text{)} = P_0 - Vr$$

Alternatively,

$$P_e = \frac{P_0 \times \# + P^s}{\# + 1}$$

## **CHAPTER- IV**

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

This part of the study incorporates the presentation and analysis of the data. It incorporates Right share practice in Nepal, Right offering and its impact on share price, comparison of theoretical and actual market price of the share after the right share, Hypothesis test and the primary data analysis.

#### **4.1 Right Share Practice in Nepal**

Right share practice in Nepal includes security wise total public issue, Growth of right share in Nepal, Contribution of right share on total public issue in Nepal and issue manager wise right share issue in Nepal.

##### **4.1.1 Security Wise Total Public Issue**

Total public issue comprised of ordinary share, right share, debenture and preference share amounts to Rs.57066.23 million till 2010/11. The details of the public issue is shown below:

**Table 4.1**  
**Security Wise Total Public Issue up to FY 2010/11**

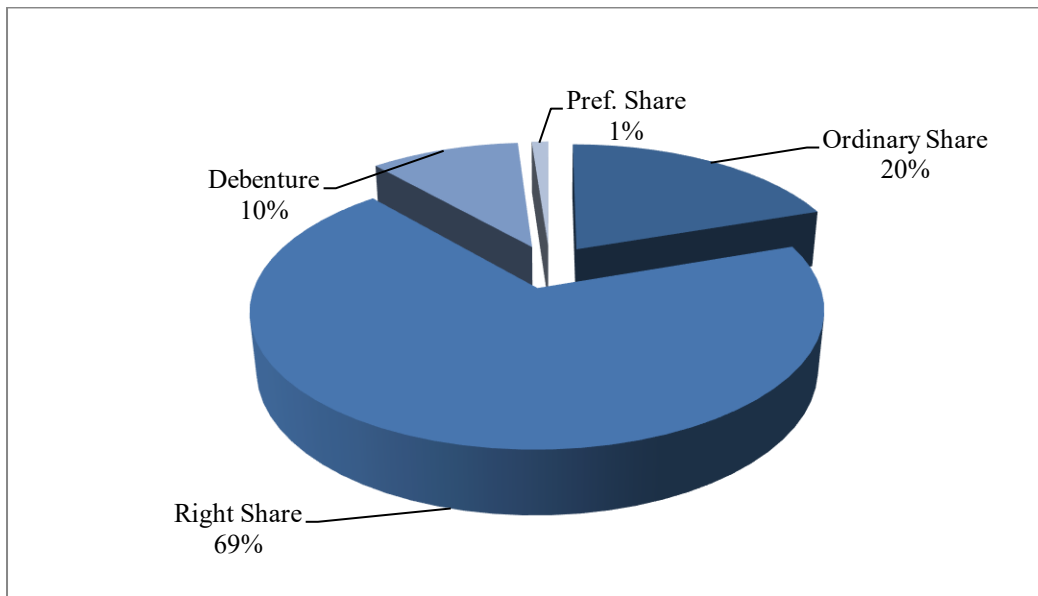
Rs. In Million

<b>Fiscal Year</b>	<b>Ordinary Share</b>	<b>Right Share</b>	<b>Debenture</b>	<b>Pref. Share</b>	<b>Total</b>
1993/94	227.90			16.50	244.40
1994/95	173.96				173.96
1995/96	224.74	69.00			293.74
1996/97	57.00	275.20			332.20
1997/98	119.40	249.96	93.00		462.36
1998/99	148.00	30.00		80.00	258.00
1999/00	202.26	124.60			326.86
2000/01	278.70	131.79			410.49
2001/02	319.46	621.87	340.00	160.00	1,441.33
2002/03	394.30	162.24			556.54
2003/04	657.50	70.00	300.00		1,027.50
2004/05	377.48	949.34	300.00		1,626.82
2005/06	579.83	1,013.45	850.00		2,443.28
2006/07	380.30	1,265.30	250.00	400.00	2,295.60
2007/08	924.80	6,793.40	2,950.00		10,668.20
2008/09	1,815.70	14,262.81	750.00		16,828.51
2009/10	2,649.37	8,173.04			10,822.41
2010/11	1,728.83	5,075.20	50.00		6,854.03
<b>Total Amount</b>	<b>11,259.53</b>	<b>39,267.20</b>	<b>5,883.00</b>	<b>656.50</b>	<b>57,066.23</b>
<b>Contribution in %</b>	<b>19.73%</b>	<b>68.81%</b>	<b>10.31%</b>	<b>1.15%</b>	<b>100 %</b>

*Source: Annual Report of SEBON 2009/10 and 2010/11*

According to the above table, at first, ordinary share and preference share had been issued in fiscal year 1993/94. And first right share was issued in Fiscal Year 1995/96 amounting Rs.69 million. The public issue trend was in increasing trend from FY 2003/04 to FY 2008/09. In FY 2008/09, there was the highest issue of public issue till FY 2010/11 which was Rs16,828.51 million. After FY 2008/09, the trend of total public issue started to decrease. The above table also shows the contribution of each type of security in total public issue. Right share has contributed the highest part i.e. 68.81% in total public issue till 2010/11. Ordinary share has contributed 19.73% and debenture and preference share has contributed 10.31% and 1.15% respectively. These figure can also be shown in the Pie- chart as below:

**Figure 4.1**  
**Security Wise Total Public Issue up to FY 2010/11**



#### **4.1.2 Growth of Right Shares in Nepal**

An establishment of Biratnagar Jute Mills in 1993 B.S. was first to initiate the issue of equity to the general public. Due to the absence of organized and legally established capital market, practices of issuing of equity and related function couldn't be exercised. It was only after 1976 A.D., Security Exchange Center was established which initiated various practice of equity financing. Security Exchange Center, after its establishment, has undergone various changes. These days, Security Board of Nepal (SEBON) and Nepal Stock Exchange incorporates, enhances, controls and manages all the activities regarding capital market.

The history of rights offering is not so long in Nepalese context. Nepal Finance & Saving Co. was the first company, who issued right shares in Nepalese market in fiscal year 1995/96. The company issued the right share of Rs. 2 million on 1995/12/1, the ratio was 4:1, each existing shareholders who had 4 shares owned were allowed to purchase each additional share issued by the company.

Since then, Nepalese corporate firms started to issue rights share. Up to now (i.e. 2010/11) there are 217 cases of rights offering in Nepal. Almost all of them were finance and banking companies who issued rights share in Nepalese capital market.

Large no. of bank and finance companies announced and issued rights share to increase the capital base if the corporate management felt such need to comply with the policy directives given by the concerned authority to increase the capital base from time to time. The details of all right issuing companies are presented in the Appendix 2.

According to the table, 217 right issues had been made by 2010/11. All the companies except Bottlers Nepal Ltd. issued right share in Rs.100 per share but Bottlers Nepal Ltd. issued right share in Rs.260 per share, this includes Rs.160 premium per share and the rest of the companies. No company had issued their right issue at discount because company ordinance does not allow them to issue in discount and they could not add premium due to the fear of under subscription them to sell the right share at discount. Most of the financial institutions issues right share in order to increase paid up capital as directed by NRB.

Generally, commercial banks had issued large amount of right shares. The largest amount of right share is 2424.18 million among all the right issues which is issued by General Finance Ltd.in 2009 and the issue manager was NCML. The second largest amount of right share was issued by Nepal Share Markets & Finance Ltd. amounting Rs. 1567.73 million in 2009 and the issue manager was CIT. Nepal Share Markets Ltd. issued six times right shares during the period totaling Rs. 1957.73million. Similarly, Nepal Investment Bank issued four times right share total amounting Rs.1356.86 million.

#### **4.1.3 Contribution of Right Share on Total Public issue in Nepal**

Total flotation of the country comprises ordinary shares, preference shares, Debentures and Right shares. Right share is an important part of the total flotation. Following table and figure clearly shows the contribution of right share issue in the total public flotation in each of the fiscal year.

**Table 4.2**  
**Contribution of Right Share in Total Public Issue in Nepal**

Rs. In Million

<b>Fiscal Year</b>	<b>Total</b>	<b>Right Share</b>	<b>% Contribution of Right Share</b>
1993/94	244.40	-	-
1994/95	173.96	-	-
1995/96	293.74	69.00	23.49%
1996/97	332.20	275.20	82.84%
1997/98	462.36	249.96	54.06%
1998/99	258.00	30.00	11.63%
1999/00	326.86	124.60	38.12%
2000/01	410.49	131.79	32.11%
2001/02	1,441.33	621.87	43.15%
2002/03	556.54	162.24	29.15%
2003/04	1,027.50	70.00	6.81%
2004/05	1,626.82	949.34	58.36%
2005/06	2,443.28	1,013.45	41.48%
2006/07	2,295.60	1,265.30	55.12%
2007/08	10,668.20	6,793.40	63.68%
2008/09	16,828.51	14,262.81	84.75%
2009/10	10,822.41	8,173.04	75.52%
2010/11	6,854.03	5,075.20	74.05%
<b>Total Figure</b>	<b>57,066.23</b>	<b>39,267.20</b>	<b>68.81%</b>

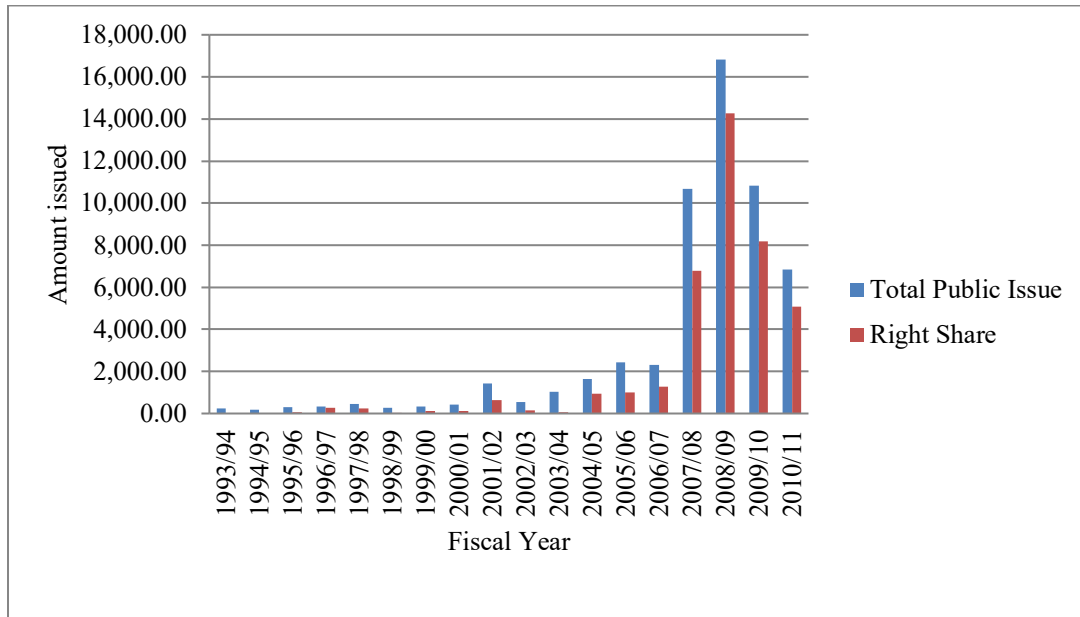
*Source: Annual Report of SEBON 2009/10 and 2010/11*

It is apparent from the table 3, there were no right issue approved in the FY 1993/94 and 1994/95. In the FY 1995/96, right share of 59 million issued which occupied 23.49% in total public issue in that FY. Considering the right share amount, the contribution of right share in total public issue is highest i.e. 84.75% in FY 2008/09 which amounts to 14,262.81 million. Contribution of Right share in total issue is the lowest during the FY 2003/4 which is 6.81% only.

The contribution of right share in total flotation can also be presented in figure which is as follows:

**Figure 4.2**

**Contribution of Right Share in Total Public Issue**



It is clearly apparent from the figure 4.1 that the contribution of right share is increasing gradually till 2008/09 but started to decrease since then. NRB directed Banks and Financial Institutions to increase the paid up capital. According to the NRB directives, the paid up capital of all the commercial banks in Nepal must be Rs. 2 billion. Similarly, the paid up capital of the Development banks must be Rs. 640 million. In the same way, the paid up capital of the Finance Companies must be Rs. 200 million. Most of BFIs started to issue right share in hurry. At that time, right share was the main attraction to the investors. NEPSE index was also in boom. Later on, the charming of right share decreased because investors have to deposit cash for right share at the moment. However, the contribution of right share in total public issue is still 68.81% upto FY 2010/11.

**4.1.4 Issue Manager Wise Right Share Issue in Nepal**

There are nine issue managers operating in security market in Nepal. All of them except United Finance Ltd. had issued different kind of instrument including right shares. Table 4.2 clearly shows the contribution of issue manager in right offering in Nepal.

**Table 4.3**  
**Issue Manager Wise Right Share Issue in Nepal**

Name of Issue Manager	Right Share issued		Percentage	
	Rs. in Million	No.	Rs. in Million	No.
Without Issue Manager	69	2	0.18%	0.92%
Ace	5420.21	36	13.84%	16.59%
AFC	655.29	7	1.67%	3.23%
CIT	5228.05	19	13.35%	8.76%
Civil Capital	2160.05	10	5.51%	4.61%
DCBL	330	1	0.84%	0.46%
Elite Capital	1874.36	9	4.79%	4.15%
Growmore	525.78	7	1.34%	3.23%
Nabil	842.23	4	2.15%	1.84%
NCML	12524.71	61	31.98%	28.11%
NFCL	33.01	3	0.08%	1.38%
NFS	1233.53	11	3.15%	5.07%
NMB	7774.36	40	19.85%	18.43%
NSLMB	389.92	2	1.00%	0.92%
NSM	107.58	5	0.27%	2.30%
<b>Total</b>	<b>39168.08</b>	<b>217</b>	<b>100.00%</b>	<b>100.00%</b>

*Source: Annual Report of SEBON (2010/11)*

It is apparent from the table, 69 million Rs. of right share had been issued without the issue manager. NCML is the largest right share issuer till 2010/11 which had undertaken 61 right issues of total Rs.12524.71 million and contributed 31.98 % in total right issue in Nepal. NMB is the second largest issue manager considering the right issues amount till 2010/11 which contributed 19.85% (i.e. Rs.7,774.36 millions) in total right issue. Similarly, DCBL is the smallest issuer which had undertaken only 1 right issue till 2010/11.

#### **4.2 Right Share Offering and its Impact on Share Price**

The main focus of the study is to evaluate the impact of Right Share Offering on its share price. To obtain the best result, different points of time period presented as I to V were selected for observing the price movement. The book close date is taken as the reference point as follows:

- 90 days before the book close date
- 10 days before the book close date

- The book close price (Closing Price)
- 10 days after the book close date
- 180 days after the book close date

Book close date itself is the ex-right date meaning that the share purchaser on book closes date and afterwards doesn't get right share so, the price is also reduced on and after the book close date. In this analysis, price of the share before the book close date (i.e. closing price for book close) is taken as the base price for price relative calculation.

Now, analysis of Share price movement of all 22 sample companies due to right share announcement is presented below:

#### **4.2.1 Analysis of Share Price Movement of Nepal Investment Bank Ltd.**

NIB issued 50% right share during 2008. Book close date for right share was 31<sup>th</sup> October 2008. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.4**

#### **Share Price Movement of Nepal Investment Bank Ltd.**

<b>S.No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	2781	131.80
2	10 days before Book Close Date	2125	100.71
3	Book Close Date (31 Oct 2008)	2110	100.00
4	10 days after Book Close Date	1310	62.09
5	180 days after Book Close Date	1145	54.27

It is apparent from the table that the book close share price of NIB is Rs. 2110. It was Rs.2781 before 90 as well as 10 days of the book close date which was 100.71% of book close price. After 10 days of book close date, the price decreased to Rs. 1310. Again, the share price decreased to Rs 1145 after 180 days of Book Close Date.

#### **4.2.2 Analysis of Share Price Movement of Nepal Bangladesh Bank Ltd.**

Nepal Bangladesh Bank Ltd. announced 150% right share during 2008. Book close date for right share was 21<sup>th</sup> November 2008. Prices on five different selected points

and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.5**  
**Share Price Movement of Nepal Bangladesh Bank Ltd.**

S.No.	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	900	122.62
2	10 days before Book Close Date	784	106.81
3	Book Close Date (21 Nov 2008)	734	100.00
4	10 days after Book Close Date	399	54.36
5	180 days after Book Close Date	290	39.51

It is apparent from the table that the book close share price of NBB is Rs. 734. It was Rs.900 before 90 days of the book close date. It was decreased to Rs. 784 before 10 days of book close date which was 106.81% of Book close Price. After 10 days of book close date, the price decreased to Rs. 399. Again, the share price decreased to Rs 290 after 180 days of Book Close Date which is 39.51% of the book close price.

#### **4.2.3 Analysis of Share Price Movement of DCBL Bank Ltd.**

DCBL bank announced 50% right share during 2009. Book close date for right share was 4<sup>th</sup> May 2008. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.6**  
**Share Price Movement of DCBL Bank Ltd.**

S. No.	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	564	98.60
2	10 days before Book Close Date	605	105.77
3	Book Close Date (04 May 2009)	572	100.00
4	10 days after Book Close Date	425	74.30
5	180 days after Book Close Date	321	56.12

It is apparent from the table that the book close share price of DCBL bank is Rs. 572. It was Rs.564 before 90 days of the book close date. It was increased to Rs. 605 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 425. Again, the share price decreased to Rs 321 after 180 days of Book Close Date.

#### 4.2.4 Analysis of Share Price Movement of NMB Bank Ltd.

NMB Bank announced 30% right share during 2009. Book close date for right share was 23<sup>th</sup> April 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.7**

##### **Share Price Movement of NMB Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	560	91.80
2	10 days before Book Close Date	606	99.34
3	Book Close Date (23 April 2009)	610	100.00
4	10 days after Book Close Date	471	77.21
5	180 days after Book Close Date	355	58.20

It is clear from the table that the book close share price of NMB is Rs. 610. It was Rs.560 before 90 days of the book close date. It was increased to Rs. 606 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 471. Again, the share price decreased to Rs 355 after 180 days of Book Close Date.

#### 4.2.5 Analysis of Share Price Movement of Lumbini Bank Ltd.

LBL announced 30% right share during 2009. Book close date for right share was 31<sup>st</sup> July, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.8**

##### **Share Price Movement of Lumbini Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	405	94.85
2	10 days before Book Close Date	420	98.36
3	Book Close Date (31 July 2009)	427	100.00
4	10 days after Book Close Date	615	144.03
5	180 days after Book Close Date	301	70.49

It is apparent from the table that the book close share price of LBL is Rs. 427. It was Rs.405 before 420 before 10 days of book close date. After 10 days of book close date, the price increased to Rs. 615. Again, the share price increased to Rs 301 after 180 days of book close date.

#### 4.2.6 Analysis of Share Price Movement of Siddhartha Bank Ltd.

SBL announced 50% right share during 2009. Book close date for right share was 27<sup>th</sup> December 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.9**

##### **Share Price Movement of Siddhartha Bank Ltd.**

<b>S No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	785	112.14
2	10 days before Book Close Date	680	97.14
3	Book Close Date (27 Dec 2009)	700	100.00
4	10 days after Book Close Date	450	64.29
5	180 days after Book Close Date	405	57.86

It is clearly seen from the table that the book close share price of SBL is Rs. 700. It was Rs.785 before 90 days of the book close date which was 112.14% of book close date. It was decreased to Rs.680 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 450. Again, the share price decreased to Rs 405 after 180 days of Book Close Date.

#### 4.2.7 Analysis of Share Price Movement of Bank Of Asia Nepal Ltd.

BOAN issued 50% right share during 2010. Book close date for right share was 2<sup>nd</sup> May 2010. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.10**

##### **Share Price Movement of Bank of Asia Nepal Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	420	132.49
2	10 days before Book Close Date	300	94.64
3	Book Close Date (02 May 2010)	317	100.00
4	10 days after Book Close Date	235	74.13
5	180 days after Book Close Date	290	91.48

It is apparent from the table that the book close share price of BOAN is Rs. 317. It was Rs.420 before 90 days which was only 132.49% of the book close price. It was Rs. 94.64 before 10 days of the book close date. After 10 days of book close date, the

price decreased to Rs. 235. Again, the share price increased to Rs 290 after 180 days of Book Close Date.

#### **4.2.8 Analysis of Share Price Movement of Infrastructure Development Bank Ltd.**

IDBL announced 150% right share during 2009. Book close date for right share was 19<sup>th</sup> February, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.11**

#### **Share Price Movement of Infrastructure Development Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	1590	98.94
2	10 days before Book Close Date	1549	96.39
3	Book Close Date (19 Feb 2009)	1607	100.00
4	10 days after Book Close Date	554	34.47
5	180 days after Book Close Date	486	30.24

It is apparent from the table that the book close share price of IDBL is Rs. 1607. It was Rs.1590 before 90 days of the book close date which was 98.94% of book close date. It was decreased to Rs.1549 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 554. Again, the share price increased to Rs 486 after 180 days of Book Close Date.

#### **4.2.9 Analysis of Share Price Movement of Ace Development Bank Ltd.**

ACEDBL announced 64% right share during 2009. Book close date for right share was 08<sup>th</sup> May, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.12**

#### **Share Price Movement of Ace Development Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	795	95.21
2	10 days before Book Close Date	836	100.12
3	Book Close Date (08 May 2009)	835	100.00
4	10 days after Book Close Date	550	65.87
5	180 days after Book Close Date	393	47.07

It is clear from the table that the book close share price of ACEDBL is Rs. 835. It was Rs.795 before 90 days of the book close date which was 95.21% of book close date. It was decreased to Rs.836 before 10 days of book close date which is 100.12% of book close date. After 10 days of book close date, the price decreased to Rs. 550. Again, the share price increased to Rs 393 after 180 days of Book Close Date which is 47.07% of the book close date.

#### **4.2.10 Analysis of Share Price Movement of Excel Development Bank Ltd.**

EDBL announced 300% right share during 2009. Book close date for right share was 26<sup>th</sup> May, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.13**

#### **Share Price Movement of Excel Development Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	799	63.61
2	10 days before Book Close Date	1015	80.81
3	Book Close Date (26 May 2009)	1256	100.00
4	10 days after Book Close Date	300	23.89
5	180 days after Book Close Date	350	27.87

It is apparent from the table that the book close share price of EDBL is Rs. 1256. It was Rs.799 before 90 days of the book close date which was 63.61% of book close date only. It was increased to Rs.1015 before 10 days of book close date which is 80.81% of book close date. After 10 days of book close date, the price decreased to Rs. 300. Again, the share price increased to Rs 350 after 180 days of Book Close Date.

#### **4.2.11 Analysis of Share Price Movement of Annapurna Bikas Bank Ltd.**

ABBL announced 220% right share during 2010. Book close date for right share was 29<sup>th</sup> Jan, 2010. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.14****Share Price Movement of Annapurna Bikash Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	430	114.67
2	10 days before Book Close Date	393	104.80
3	Book Close Date (29 Jan 2010)	375	100.00
4	10 days after Book Close Date	159	42.40
5	180 days after Book Close Date	131	34.93

It is clear from the table that the book close share price of ABBL is Rs. 375. It was Rs.430 before 90 days of the book close date which was 114.67% of book close date. It was decreased to Rs.393 before 10 days of book close date which is 104.8% of book close date. After 10 days of book close date, the price decreased to Rs. 159. Again, the share price decreased to Rs 131 after 180 days of Book Close Date.

**4.2.12 Analysis of Share Price Movement of Sanima Bikash Bank Ltd.**

SBBL announced 100% right share during 2009. Book close date for right share was 4<sup>nd</sup> May, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.15****Share Price Movement of Sanima Bikash Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	1060	102.42
2	10 days before Book Close Date	1075	103.86
3	Book Close Date (04 May 2009)	1035	100.00
4	10 days after Book Close Date	580	56.04
5	180 days after Book Close Date	560	54.11

It is apparent from the table that the book close share price of SBBL is Rs. 1035. It was Rs.1060 before 90 days of the book close date which was 102.42% of book close date. It was increased to Rs.1075 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 580. Again, the share price decreased to Rs 560 after 180 days of Book Close Date.

#### 4.2.13 Analysis of Share Price Movement of Annapurna Finance Co.Ltd.

AFC announced 160% right share during 2009. Book close date for right share was 31<sup>th</sup> July, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.16**

#### **Share Price Movement of Annapurna Finance Co.Ltd.**

S. No.	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	870	90.72
2	10 days before Book Close Date	935	97.50
3	Book Close Date (31 Jul 2009)	959	100.00
4	10 days after Book Close Date	500	52.14
5	180 days after Book Close Date	358	37.33

It is apparent from the table that the book close share price of AFC is Rs. 959. It was Rs.870 before 90 days of the book close date which was only 90.72% of book close date. It was increased to Rs.935 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 500. Again, the share price increased to Rs 358 after 180 days of Book Close Date.

#### 4.2.14 Analysis of Share Price Movement of Everest Finance Ltd.

EFL announced 100% right share during 2008. Book close date for right share was 10<sup>th</sup> June, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.17**

#### **Share Price Movement of Everest Finance Ltd.**

S. No.	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	460	104.07
2	10 days before Book Close Date	469	106.11
3	Book Close Date (10 Jun 2009)	442	100.00
4	10 days after Book Close Date	298	67.42
5	180 days after Book Close Date	430	97.29

It is clearly seen from the table that the book close share price of EFL is Rs. 442. It was Rs.460 before 90 days of the book close date which was 104.07% of book close date. It was increased to Rs.469 before 10 days of book close date. After 10 days of

book close date, the price decreased to Rs. 298. Again, the share price increased to Rs 430 after 180 days of Book Close Date.

#### **4.2.15 Analysis of Share Price Movement of Universal Finance Ltd.**

UFLK announced 100% right share during 2009. Book close date for right share was 30<sup>th</sup> March, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.18**

#### **Share Price Movement of Universal Finance Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	323	78.78
2	10 days before Book Close Date	367	89.51
3	Book Close Date (30 March 2009)	410	100.00
4	10 days after Book Close Date	259	63.17
5	180 days after Book Close Date	210	51.22

It is apparent from the table that the book close share price of UFLK is Rs. 410. It was Rs.323 before 90 days of the book close date which was 78.78% of book close date. It was increased to Rs.367 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 259. Again, the share price decreased Rs. 210 after 180 days of Book Close Date.

#### **4.2.16 Analysis of Share Price Movement of World Merchant Bank Ltd.**

WMBF announced 100% right share during 2009. Book close date for right share was 29<sup>rd</sup> April, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.19**

#### **Share Price Movement of World Merchant Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	856	111.17
2	10 days before Book Close Date	840	109.09
3	Book Close Date (29 April 2009)	770	100.00
4	10 days after Book Close Date	477	61.95
5	180 days after Book Close Date	430	55.84

It is apparent from the table that the book close share price of WMBF is Rs. 770. It was Rs.856 before 90 days of the book close date which was 111.17% of book close date. It was decreased to Rs.840 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 477. Again, the share price is decreased to Rs. 430 after 180 days of Book Close Date which was 55.84% of the book close date.

#### **4.2.17 Analysis of Share Price Movement of IME Financial Institution**

IMEFI announced 100% right share during 2009. Book close date for right share was 01<sup>st</sup> January, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.20**

#### **Share Price Movement of IME Financial Institution**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	2035	139.00
2	10 days before Book Close Date	1405	95.97
3	Book Close Date (01January 2009)	1464	100.00
4	10 days after Book Close Date	846	57.79
5	180 days after Book Close Date	910	62.16

It is apparent from the table that the book close share price of IMEFI is Rs. 1464. It was Rs.2035 before 90 days of the book close date which was 139% of book close price. It was decreased to Rs.1405 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 846. Then, the share price is increased to Rs. 910 after 180 days of Book Close Date.

#### **4.2.18 Analysis of Share Price Movement of International Leasing and Finance Co. Ltd.**

ILFC announced 210% right share during 2009. Book close date for right share was 24<sup>th</sup> Nov, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.21**

**Share Price Movement of International Leasing & Finance Ltd**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	544	114.29
2	10 days before Book Close Date	508	106.72
3	Book Close Date (24 November 2009)	476	100.00
4	10 days after Book Close Date	205	43.07
5	180 days after Book Close Date	205	43.07

It is clear from the table that the book close share price of ILFC is Rs. 476. It was Rs.544 before 90 days of the book close date which was 114.29% of book close price. It was decreased to Rs.508 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 205. And the share price is remained unchanged to Rs. 205 after 180 days of Book Close Date.

**4.2.19 Analysis of Share Price Movement of National Life Insurance Company**

NLICL announced 100% right share during 2009. Book close date for right share was 27<sup>th</sup> Feb, 2009. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.22**

**Share Price Movement of National Life Insurance Company**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	900	95.14
2	10 days before Book Close Date	952	100.63
3	Book Close Date (27 Feb 2009)	946	100.00
4	10 days after Book Close Date	970	102.54
5	180 days after Book Close Date	606	64.06

It is apparent from the table that the book close share price of NLICL is Rs. 946. It was Rs.900 before 90 days of the book close date which was only 95.14% of book close price. It was increased to Rs.952 before 10 days of book close date which was 100.63% of book close price. After 10 days of book close date, the price increased to Rs. 970. The share price is decreased to Rs. 606 after 180 days of Book Close Date which was 64.06% of the book close price.

#### 4.2.20 Analysis of Share Price Movement of National Hydropower Co. Ltd.

NHPC announced 100% right share during 2008. Book close date for right share was 15<sup>th</sup> July, 2008. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.23**

#### **Share Price Movement of National Hydropower Co. Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	260	116.07
2	10 days before Book Close Date	293	130.80
3	Book Close Date (15 July 2008)	224	100.00
4	10 days after Book Close Date	210	93.75
5	180 days after Book Close Date	127	56.70

It is apparent from the table that the book close share price of NHPC is Rs. 224. It was Rs.260 before 90 days of the book close date which was 116.07% of book close price. It was increased to Rs.293 before 10 days of book close date. After 10 days of book close date, the price slightly decreased to Rs.210. Again, the share price is decreased to Rs. 127 after 180 days of Book Close Date.

#### 4.2.21 Analysis of Share Price Movement of Prime Commercial Bank Ltd.

PCBL announced 100% right share during 2010. Book close date for right share was 29<sup>th</sup> October, 2010. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.24**

#### **Share Price Movement of Prime Commercial Bank Ltd.**

<b>S. No</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	131	100.77
2	10 days before Book Close Date	126	96.92
3	Book Close Date (29 Oct 2010)	130	100.00
4	10 days after Book Close Date	127	97.69
5	180 days after Book Close Date	99	76.15

It is clearly seen from the table that the book close share price of PCBL is Rs. 130. It was Rs.131 before 90 days of the book close date which was 100.77% of book close price. It was decreased to Rs.126 before 10 days of book close date. After 10 days of

book close date, the price slightly decreased to Rs. 127. Again, the share price is decreased to Rs. 99 after 180 days of Book Close Date.

#### **4.2.22 Analysis of Share Price Movement of Sunrise Bank Ltd**

SRBL announced 24% right share during 2011. Book close date for right share was 1<sup>st</sup> April , 2011. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.25**

#### **Share Price Movement of Sunrise Bank Ltd**

<b>S. No</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	219	136.02
2	10 days before Book Close Date	198	122.98
3	Book Close Date (01 April 2011)	161	100.00
4	10 days after Book Close Date	145	90.06
5	180 days after Book Close Date	138	85.71

It is apparent from the table that the book close share price of SRBL is Rs. 161. It was Rs.219 before 90 days of the book close date which was 136.02% of book close price. It was decreased to Rs.198 before 10 days of book close date. After 10 days of book close date, the price slightly decreased to Rs. 145. Again, the share price is decreased to Rs. 138 after 180 days of Book Close Date.

#### **4.2.23 Analysis of Share Price Movement of Resunga Bikash Bank Ltd**

RBSL announced 100% right share during 2011. Book close date for right share was 3rd June , 2011. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.26**

#### **Share Price Movement of Resunga Bikash Bank Ltd.**

<b>S. No.</b>	<b>Selected Points</b>	<b>Prices</b>	<b>Price Relatives of Share Price</b>
1	90 days before Book Close Date	280	150.54
2	10 days before Book Close Date	181	97.31
3	Book Close Date (03 June 2011)	186	100.00
4	10 days after Book Close Date	183	98.39
5	180 days after Book Close Date	179	96.24

It is apparent from the table that the book close share price of RBSL is Rs. 186. It was Rs.280 before 90 days of the book close date which was 150.54% of book close price. It was decreased to Rs. 181 before 10 days of book close date. After 10 days of book close date, the price slightly decreased to Rs. 183. Again, the share price is decreased to Rs. 179 after 180 days of Book Close Date.

#### **4.2.24 Analysis of Share Price Movement of Prabhu Finance Ltd.**

PRFL announced 33.33% right share during 2010. Book close date for right share was 1<sup>st</sup> Oct , 2010. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.27**

#### **Share Price Movement of Prabhu Finance Ltd**

S. No	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	378	112.84
2	10 days before Book Close Date	320	95.52
3	Book Close Date (01 Oct 2010)	335	100.00
4	10 days after Book Close Date	302	90.15
5	180 days after Book Close Date	206	61.49

It is clear from the table that the book close share price of PRFL is Rs.335. It was Rs.378 before 90 days of the book close date. It was decreased to Rs. 320 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 302. Again, the share price decreased to Rs 206 after 180 days of Book Close Date.

#### **4.2.25 Analysis of Share Price Movement of Reliable Finance Ltd**

RIBSL announced 100% right share during 2010. Book close date for right share was 25<sup>th</sup>Oct , 2010. Prices on five different selected points and price relative of share prices assuming book close price as the base price are given in the following table.

**Table 4.28**

#### **Share Price Movement of Reliable Finance Ltd.**

S. No	Selected Points	Prices	Price Relatives of Share Price
1	90 days before Book Close Date	312	80.00
2	10 days before Book Close Date	390	100.00
3	Book Close Date (25 Oct 2010)	390	100.00
4	10 days after Book Close Date	245	62.82
5	180 days after Book Close Date	209	53.59

It is clear from the table that the book close share price of RIBSL is Rs.390. It was Rs.312 before 90 days of the book close date. It was decreased to Rs. 390 before 10 days of book close date. After 10 days of book close date, the price decreased to Rs. 245. Again, the share price decreased to Rs 209 after 180 days of Book Close Date.

### **4.3 Comparison between Actual Market and Theoretical Price after the Book Close Date**

To find the impact of right share issue on market price per share, it is necessary to calculate the theoretical market price. The market price after ex right date is compared with theoretical market price to measure the effect of right share.

The table (Appendix -4) shows the book close price for the right share and the price of the stock 10 days after the book close date. 10 days is suitable for the price correction mechanism after the ex-right. Further, the theoretical value of the stock is also computed using the formula. Difference between the actual market price after ten days of book close date and the theoretical price is taken and the difference in percentage is also clearly shown.

Difference = (Market Price after 10 days of Book Close – Theoretical Value)

% change = (Difference/Market price) ×100%

Positive change in share price means share price after book close of the right share is higher than theoretical market price. This is good indicator for shareholder and company; it means they have good signaling effect. Negative change means share price after book close of right share is lower than theoretical price.

The table shows the percentage change in actual market price and theoretical price of share after book close of the right share. Theoretically, actual market price and theoretical price of the share after book close of the right share should be equal. The table shows that the book close price of NBB is Rs. 734 and the market price after book close date is Rs. 399 whereas the theoretical price is Rs. 353.6 which is Rs.45.40 lower than market price. The difference is (11.38%) of market price meaning that market price is 11.38% more than theoretical price after the right issue. The highest difference in rupees as well as in percentage is observed in case of NLIICL. The

market price of NLIICL is Rs. 970 but the theoretical price is Rs.523 only which is Rs. 447 or 46.08% less than market price. The market Price and Theoretical price is almost equal in case of Ace Dev Bank. These two prices are exactly same in case of Reliable Finance Ltd.

From the above analysis, it is found that out of 25 sample companies, 9 companies have theoretical market price higher than actual market price causing negative percentage change and the 15 companies have actual market price higher than theoretical market price causing positive change. The remaining 1 company has equal market and theoretical price.

The market price and the theoretical price after the book close of right share of only 1 company out of 25 sample companies is equal which indicates that the Nepalese share market is not efficient. It shows that, there is signaling effect in the Nepalese share market.

#### **4.4 Testing of Hypothesis**

Theoretically, the market price and the theoretical price after book close of right issue are to be equal. But in practice, due to inefficient market, it may differ also. The market prices of all the sample companies after 10 days of book close date are taken. Generally, there is less chances of share trading after the book close date for 3-4 days of the related companies and hence, 10 days is the suitable time period for the market price setting mechanism after the book close of the right share. 5% level of significance is assumed. Here, the summary of the Hypothesis setting is presented below and detail calculation of Hypothesis is presented in Appendix-6.

##### **Null Hypothesis (H<sub>0</sub>)**

$\mu_1 = \mu_2$  i.e. Actual market price and theoretical price after the book close date are equal. In other words, there is no significant difference between actual market price and theoretical price after the book close date of right share.

##### **Alternative Hypothesis (H<sub>1</sub>)**

$\mu_1 \neq \mu_2$  i.e. Actual market price and theoretical price after the book close date are not equal. In other words, there is significant difference between actual market price and theoretical price after the book close date of right share. (Two tail-test).

### **Test Statistic,**

Under  $H_0$ , the test statistic is:

$$t = \frac{\bar{X}_1 - \bar{X}_2}{\sqrt{S_p^2 \left( \frac{1}{n_1} + \frac{1}{n_2} \right)}}$$

Where,

$S_p^2$  = an unbiased estimate of the common population

Now, the calculated value of 't' is 0.3218. (Calculation is presented in Appendix-6)

### **Critical Value**

The tabulated value of 't' at 5% level of significance for two tail test and for 48 degree of freedom is 2.011

### **Decision**

Since the calculated value of 't' is less than critical value of 't', the null hypothesis  $H_0$  is accepted. Hence, we can conclude that there is no significant difference between actual market price and theoretical price after the book close date of right share.

The above calculation presents that the difference between the market prices and theoretical prices is not significant. It means, they are correctly priced in the market according to the hypothesis test.

## **4.5 Analysis of Data Obtained from Questionnaire and Interview**

As a primary source, questionnaire had been prepared and dispatched to about 60 respondents which include individual investors, brokers, issue managers and related experts and out of this, only 50 responses were obtained. In addition to the questionnaire, personal interviews of experts have also been taken when necessary.

There are two groups. Group A contains eight multiple choice questions. The summarized views of the respondents are as follows.

### **1. Getting Reliable and Adequate Information about the Right Issue**

According to the survey, out of 28 respondents, 56% of the respondents agreed that investors get reliable and adequate information from the company and issue manager regarding right share. 24% of the respondents don't think that investors get reliable

and adequate information from the company regarding right share. 10% of respondents said that investors get a little bit information and 10% of the respondents can't say about the matter.

**Table 4.29**

**Getting Reliable and Adequate Information about the Right Issue**

Options	A	B	C	D
	yes	No	A little bit	Can't say
No. of Respondents	28	12	5	5
Percentage	56%	24%	10%	10%

*Source: Field Survey, 2012*

**2. No. of Shareholders aware about the Right Share**

According to the survey report, out of 50 respondents, 50% of the respondents said that majority of the investors are well aware about the phenomena of right share and subsequent consequences involved there in. 40% of the respondents accepted that only a few investors know the phenomena and subsequent consequences regarding the right share.

**Table 4.30**

**No. of Shareholders Aware about the Right Share**

Options	A	B	C	D
	All of them	Majority of them	A few	Don't know
No. of Respondents	2	25	20	3
Percentage	4%	50%	40%	6%

*Source: Field Survey, 2012*

**3. Legally Transferability of the Right**

Out of 50 respondents, 70% of the respondents said that it should be transferable. 20% of the respondents are satisfied in the current provision and 10% respondents don't care about the matter.

**Table 4.31**

**Legally Transferability of the Right**

Options	A	B	C	D
	Current Provision is satisfactory	Should be transferred	Should not be transferred	Don't Care
No. of Respondents	10	35	0	5
Percentage	20%	70%	0%	10%

*Source: Field Survey, 2012*

#### 4. Most Preferred Sectors for Right Share

To explore the preferred sector of investors to invest in, four options were given as (A) Banking & Financial (B) Manufacturing & Trading (C) Insurance (D) Hotel & Others. Based on the survey,

**Table 4.32**

**Most Preferred Sectors for Right Share**

Options	A	B	C	D
	Banking / Financial	Manufacturing / Trading sector	Insurance sectors	Hotel /Other sectors
No. of Respondents	40	5	3	2
Percentage	80%	10%	6%	4%

*Source: Field Survey, 2012*

Here, 80% of the respondents chose the option A i.e. Banking & Financial in first choice. And, very few respondents proffered other sectors.

#### 5. Most Preferred Sector between the Financial Institutions

To investigate the most preferred sector between Financial Institutions, 4 options were given as (A) Commercial Banks (B) Development Banks (C) Finance Companies and D) Insurance Company Based on the survey, the following table presents the preference of the investors among the financial institutions.

**Table 4.33**

**Most Preferred Sector between the Financial Institutions**

Options	A	B	C	D
	Commercial Bank	Development Bank	Finance Company	Insurance Company
No. of Respondents	38	6	4	2
Percentage	76%	12%	8%	4%

*Source: Field Survey, 2012*

It is apparent from the table that 76% of the respondents chose option A i.e. Commercial Banking sector in first choice. 6% of the respondents preferred option B i.e. Development Banks Generally, most investors trust the commercial banks rather than finance companies and Insurance companies. So, most of the respondents preferred Commercial Bank.

## 6. Reason Behind Purchasing the Right Share

To explore the reason behind purchasing the right share, four options were given as (A) To increase the value (B) To increase the dividend (C) To maintain the control position of management (D) To increase the number of shares. Based on the survey, the following table presents the in-depth view points of the respondents.

**Table 4.34**

### Reason Behind Purchasing the Right Share

Options	A	B	C	D
	To Increase the value	To increase the dividend	To maintain the control position of management	To increase the number of shares
No. of Respondents	30	10	4	6
Percentage	60%	20%	8%	12%

*Source: Field Survey, 2012*

It is clear from the table that 60% respondents chose option A i.e. *to increase the value* in first choice meaning that most of them strongly believe that investors buy the right shares to increase the value. Option B was proffered by 20% of respondents. Remaining two options were proffered by few respondents.

## 7. Reasons behind Preferring the Right Share Instead of other Instruments by the Firms

To explore the reason behind preferring the right share instead of other instruments like bonds, preference shares etc by the concerned firms, four options were given i.e. (A) Easy process to collect the fund (B) To maintain control position in management (C) Low floatation cost (D) other causes.

**Table 4.35**

### Reasons Behind Preferring the Right Share Instead of other Instruments by the Firms

Options	A	B	C	D
	Easy process to collect the fund	To maintain control position in management	Low floatation cost	Other causes
No. of Respondents	25	4	15	6
Percentage	50%	8%	30%	12%

*Source: Field Survey, 2012*

It is clear from the table that the main cause to choose the right share is the option A i.e. easy process to collect the fund. 30% of respondents prefer the right share because of low flotation cost. Due to these merits, total right shares occupy the highest portion in total public floatation.

### 8. Factors Causing the Share Price Movement

To investigate the factors affecting the share price movement, four options were given. They are (A) Right share announcement (B) Growth prospects of the company (C) Economic condition of the country (D) Directives of the controlling agencies. Based on the survey, the following table clearly states the factors affecting the share price.

**Table 4.36**  
**Factors Causing the Share Price Movement**

Options	A	B	C	D
	Right share announcement	Growth prospects of the company	Economic condition of the country	Directives of the controlling agencies
No. of Respondents	12	10	20	8
Percentage	24%	20%	40%	16%

*Source: Field Survey, 2012*

It is clearly seen from the table that 40% of the respondents chose the option C i.e. Economic condition of the country is the vital for the share price movement. 40% of them think the economic condition of the country moves the share price a lot. 24 % of them think the right share announcement plays the vital role for the price movement and remaining 16% of respondents agrees the option D).

In the same way, Group B contained three opened-end questions. The summarized views of the respondents are as follows.

#### 1. Major Problems to Practice the Right Share in Nepalese Securities Market

There are so many problems shown by the respondents. The summarized views are as follows:

- Insider trading is also one of the major problem in Nepal. Board members can easily speculate the price movement during the right share announcement.

- The company having negative net worth are also issuing the right and collecting money from the shareholders. For example:- Nepal Development Bank Ltd has issued the right shares. The ignorant shareholders deposit the hard-earned money for the right. This type of investment is very risky.
- Board members and directors announce the portion of the right issue they are planning to issue which might affect the market price greatly. They again hearsay that they increase the paid up capital to 400 million or 500 million. As for example, Board members of KIST and NIB Bank had already declared to increase the paid up capital to 500 million but they have not issued the right yet.
- There is no transferability feature. So, an investor must subscribe the right share even s/he does not want the right or s/he does not have money for the right share purchase. If they don't exercise it, they lose the value. Here, Right appear as an obligation imposed on shareholders, otherwise he would suffer a loss in the form of decline in price of his holding. If there is the transferability feature, s/he can transfer the right and s/he holds the original portion of the share only without losing the value.

Currently, Securities Registration and Issues Regulation-2008 has clearly mentioned about the transferability feature in right issue. At present, some companies include the transferability feature while issuing the right share but some companies lack the feature. The company, previously transferability feature not included in the Company Memorandum, cannot add the feature at present soon. Most of the respondents said that there must be the transferability feature in right issue.

- Right share issue mechanism is too lengthy. First of all, passing from the BOD meetings, then sending the agenda to NEPSE, NRB and SEBON and again, putting the agenda in own AGM.
- There is less publicity about the right share compared to IPOs. In addition to this, the publicity is limited to newspapers and internet.
- Unsubscribed portion of right shares were used to distribute to the employees and promoters. There used to be a huge speculation on it. Afterward, SEBON stopped the way of distributing the unsubscribed part of the right shares.

Currently, the unsubscribed portion of right shares is sold in the market to the public through the auction meaning that the high price bidders are allotted the right shares.

## **2. Actions can be Taken by the Issuing Company and Issue Manager for Appropriate Subscription Rate**

According to the respondents, there are so many actions can be undertaken by the issuing company and issue manager to make high subscription rate of right issue. Specific points are as follows:

- First of all, the right issuing companies should have good performance in the market i.e. high profit, adequate cash flows, good image etc. Then, shareholders automatically subscribe the right share themselves.
- All the shareholders must be well informed about the right share. For this, they can use TV, newspaper, mailing, internet etc.
- They have to manage sufficient collection centers for the right issue.
- They should make and apply easily transferability features in right share.
- They can use extra ordinary database to know the full address of shareholders and use the blend of advertisement as per need.

## **3. Transferability Feature**

There is no transferability feature during the fiscal year 2007/08. But now, SEBON had enacted the “Securities Registration and Issue Regulation-2008” and clearly mentioned about the transferability feature. Currently, some companies include the transferability feature while issuing the right share but some companies lack the feature. The company, previously transferability feature not included in the Company Memorandum, cannot add the feature at present soon. Most of the respondents said that there must be the transferability feature in right issue.

Currently, there is transferability feature but actually, the rights cannot be sold in the market place. Nowadays, the right holder can only renounce the rights to his/her near and dear ones through mutual understanding.

#### **4. Problems and Prospects about the Right Share in Nepal**

- The main issue is to aware the investors about the share price movement mechanism and right share issue. NEPSE, SEBON, NRB can mutually assist the investors about the matter.
- The procedures of right share announcement, passing from BOD meeting, sending the agenda to NEPSE, SEBON, NRB, then finally approving from own AGM is too lengthy. So, there must be the time limit for each step.
- The companies having negative net worth should not be allowed to issue the right shares.
- The governing body should inspect about the insider trading during the right share announcement. It is heard that, board members are speculating when they declare right, bonus or cash dividend. But, it is not been heard yet about the action taken from the governing bodies to stop the insider trading.

#### **4.6 Major Findings of the Study**

Here, the effort has been made to present the major findings of the study in “Right Share Practice in Nepal and its impact on Share Price”. The Major findings of the study are presented below in the following sub headings; corresponding to the study objectives.

#### **Right Share Practice in Nepal**

- First right share was issued in Fiscal Year 1995/96 amounting Rs.69 million. The public issue trend was in increasing trend from FY 2003/04 to FY 2008/09. In FY 2008/09, there was the highest issue of public issue till FY 2010/11 which was Rs16,828.51 million. After FY 2008/09, the trend of total public issue started to decrease. The above table also shows the contribution of each type of security in total public issue. Right share has contributed the highest part i.e. 68.81% in total public issue till 2010/11. Ordinary share has contributed 19.73% and debenture and preference share has contributed 10.31% and 1.15% respectively.
- The history of the right share issue is not so long in Nepalese context. Nepal Finance & Saving Co. was the first company who issued right shares in Nepalese Share Market in fiscal year 1995/96 A.D. There are 217 cases of

rights offering in Nepal till 2010/11. Almost all of them were finance and banking companies who issued rights share in Nepalese capital market

- There were no right issue approved in the FY 1993/94 and 1994/95. In the FY 1995/96, right share of 59 million issued which occupied 23.49% in total public issue in that FY. Considering the right share amount, the contribution of right share in total public issue is highest i.e. 84.75% in FY 2008/09 which amounts to 14,262.81 million. Contribution of Right share in total issue is the lowest during the FY 2003/4 which is 6.81% only.
- NCML is the largest right share issuer till 2010/11 which had undertaken 61 right issues of total Rs. 12534.71 million and contributed 31.98% in total right share issues in Nepal. DCBL is the smallest issuer according the number of right share issue which had undertaken only 1 right issues out of total 217 right issue and NFCL is the smallest issuer in the basis of amount of right share issue. It has issued only 33.01 million which occupies only 0.08% amount in aggregate.

### **Right Offering and its Impact on Share Price**

Observing the share price movement of 25 sample companies, it is found that the announcement of right share greatly affect the share price. After the announcement of the right issue, the share price increases till the book close date and after the book close date, the share price decreases as per right share portion. Actually, the right share itself does not increase the value or the wealth of the shareholders.

### **Comparison between Actual and Theoretical Price after the Book Close Date**

It is found that out of 25 sample companies, 9 companies have theoretical market price higher than actual market price causing negative percentage change and the 15 companies have actual market price higher than theoretical market price causing positive change. The remaining 1 company has equal market and theoretical price.

### **Testing of Hypothesis**

- According to the hypothesis test, there is no significant difference between the actual market and theoretical price after the book close date of right share. It means, they are correctly priced in the market.

### **Analysis of Data Obtained from Questionnaire and Interview**

- Majority of the respondents agreed that investors get reliable and adequate information from the company and issue manager regarding the right share.
- Majority of the investors are well aware about the phenomena of right share and subsequent consequences involved there in.
- Investors who don't know about the transferability feature, they don't care about it and when they are made understood about the necessity and the procedures about it, they felt that the transferability feature is essential.
- Most preferred sectors for right share is Banking and Financial.
- Among the Financial Institutions, Banking is the most preferred sector for the right.
- The main purpose to purchase the right share is to increase the value.
- Nepalese corporate firms prefer right share instead of other instrument like bonds, preference shares because of easy process to collect the fund and low floatation cost.
- The main factors for the share price movement are economic condition of the country and growth prospects of the company.
- . Insider trading is major problem. The company having negative net worth are also issuing the right and collecting money from the shareholders. Board members and directors are announcing the portion of the right issue they are planning to issue which might affect the market price greatly. There is no transferability feature. Right share issue mechanism is too lengthy. First of all, passing from the BOD meetings, then sending the agenda to NEPSE, NRB and SEBON and again, putting the agenda in own AGM.
- There are so many actions can be undertaken by the issuing company and the issue manager to make high subscription rate of right issue. First of all, the right issuing companies should have good performance in the market i.e. high profit, adequate cash flows, good image etc. All the shareholders must be well informed about the right share. For this, they can use TV, newspaper, mailing, internet etc. They have to manage sufficient collection centers for the right issue. They should make and apply easily transferability features in right share.

They can use extra ordinary database to know the full address of shareholders and use the blend of advertisement as per need.

- There is no transferability feature during the fiscal year 2007/08. But now, SEBON had enacted the Securities Registration and Issue Regulation-2008 and clearly mentioned about the transferability feature. Currently, some companies include the transferability feature while issuing the right share but some companies lack the feature. Most of the respondents said that there must be the transferability feature in right issue.
- Simply, the theory says that the market price of a security increases as to declaration of right share announcement and the market price goes down after the book close date. The share market increased dramatically during 2007/08. Even after the Book Close Date, the share price increased dramatically. Generally, the share price should be equal or nearly equal to theoretical value of the share. In some cases, the share price is dramatically changed with compared to theoretical price of the share after the right share. It is all because of the ignorance of the investors. Most of the investors follow the rumor and invest in the share market. As a result, they are losing the money at present.
- It is found from the informal interviews with about 50 individual investors that most of them are illiterate of share market. They just make an investment of millions of rupees with hearsay and others' recommendations. It is also found that the new investors who don't have much knowledge about share market also have the addiction of investing in share market. Some investors only invest in those shares which are giving the right share in near future. But they don't have the idea of the phenomenon of the right share. Even they don't have an idea of procedure of right share distribution i.e. the announcement of right share, pass by the AGM, permission of the Security Board, book close date, right share issue, right share allotment, share certificate issue, listing of the right share, verify of the shares and at last selling procedures of the shares in share brokerage office. There is a long procedure of right share distribution. Again, after book close of the right share, the share price is declined by the value of right. Actually, the shareholders' position as well as the shareholders' equity are not affected by the right share distribution.

# **CHAPTER-V**

## **SUMMARY, CONCLUSION AND RECOMMENDATION**

### **5.1 Summary**

Nepal Share Market is in developing stage in comparison to other neighboring countries. It has practiced only few financial instruments such as equity share, right share, debenture, preference share, mutual fund etc. This study is concentrate on the various aspects of right offering with special references to the selected listed companies of Nepal. Right share are issued to the existing shareholders to increase capital in certain proportion. The main objective of the study is to examine the right share practice in Nepal and its effect on share price.

Research methodologies are strong in this study. Descriptive as well as analytical research design has been adopted to satisfy the objectives of the study. For simplicity and unbiased result, 25 sample firms are taken out of 114 rights offering during FY 2008/09, 2009/10 and 2010/11 which are judgmental. Mostly, right shares are issued by Financial Institutions. Hence, 10 Commercial Banks, 5 Development Banks, 8 Finance Companies, 1 Insurance Company and 1 Hydro Power are taken as sample for actual market measurement and valuable findings. Primary as well as Secondary data have been taken as per requirement. Primary sources included in the study are the responses of the questionnaires, personal interview with concerned person such as company secretary, experts, brokers, investors, issue managers, staffs of NEPSE etc. Secondary Sources of data included in this study are the annual reports of SEBON, various publications of NEPSE and sample firms, statistical book of Nepal, published and unpublished documents, previous studies, dissertation, articles and foreign related journals as well. Newspaper, magazine, books and other reports such as Arthic Abhiyan, Economic Post, Kantipur, Gorkhapatra and New Business Age etc are useful sources of secondary data. Some other important information has been gathered from internet. To analyze the share price movement, the price of 5 different points have been selected logically. To make the study valuable, various tools have been used as per requirements.

The history of rights offering is not so long in Nepalese context. Nepal Finance & Saving Co. was the first company who issued right shares of 2 million in Nepalese market in fiscal year 1995/96. Since then, Nepalese corporate firms started to issue rights share. There are 217 cases of rights offering in Nepal up to date (i.e. 2010/11). Almost all of them were finance and banking companies who issued rights share. The trend of right share issue is increasing. The major portion of total public issue from the FY 1993/94 to the FY 2010/11 is captured by right share which is 69% where as the contribution of both Ordinary share and Debenture is equal i.e. 30%. The rest portion is captured by preference share that is 1% only. There are 14 issue managers operating in security market in Nepal. All of them except United Finance Ltd. had issued different kind of instrument including right shares. It is apparent from the table, 69 million Rs. of right share had been issued without the issue manager. NCML is the largest right share issuer till 2010/11 which had undertaken 61 right issues of total Rs.12524.71 million and contributed 31.98 % in total right issue in Nepal. NMB is the second largest issue manager considering the right issues amount till 2010/11 which contributed 19.85% (i.e. Rs.7,774.36 millions) in total right issue. Similarly, DCBL is the smallest issuer which had undertaken only 1 right issue till 2010/11.

Observing the share price movement of 25 sample companies, it is found that the announcement of right share greatly affect the share price. After the announcement of the right issue, the share price increases till the book close date and after the book close date, the share price decreases as per right share proportion. Generally, the right share itself does not increase the value or the wealth of the shareholders. It is found that out of 25 sample companies, 9 companies have theoretical price higher than actual market price after book close date causing negative change and 14 companies have actual market price higher than theoretical price causing positive change. The remaining 2 companies have equal market price and theoretical price. According to the hypothesis test, there is no significant difference between the actual market and theoretical price after the book close date of right share which indicates that they are correctly priced in the market.

A lot of facts have been disclosed after primary data analysis and from personal interview. Majority of the investors are well aware about the phenomena of right share and subsequent consequences involved there in. Investors who don't know

about the transferability feature, they don't care about it and when they are made understand about the necessity and the procedures about it, they felt that the transferability feature is the must. Most preferred sectors for right share is Banking and Financial. Among the Financial Institutions, Banking is the most preferred sector for the right share. The main purpose to purchase the right share is to increase the value. Nepalese corporate firms prefer right share instead of other instrument like bonds, preference shares because of easy process to collect the fund and low floatation cost. The main factors for the share price movement are economic condition of the country and growth prospects of the company. There are a lot of problems about the right share practice in Nepalese capital market. Insider trading is another major problem. The company having negative net worth are also issuing the right share and collecting money from the shareholders. Board members and directors are announcing the portion of the right share they are planning to issue which might affect the market price greatly. There is no transferability feature. Right share issue mechanism is too lengthy. First of all, passing from the BOD meetings, then sending the agenda to NEPSE, NRB and SEBON and again, putting the agenda in own AGM. There are so many actions can be undertaken by the issuing company and the issue manager to make high subscription rate of right issue. First of all, the right issuing company should have good performance in the market i.e. high profit, adequate cash flows, good image etc. All the shareholders must be well informed about the right share. For this, they can use TV, newspaper, mailing, internet etc. They have to manage sufficient collection centers for the right issue. They should make and apply easily transferability features in right share. They can use extra ordinary database to know the full address of shareholders and use the blend of advertisement as per need. There is no transferability feature during the fiscal year 2007/08. But now, SEBON had enacted the Securities Registration and Issue Regulation-2008 and clearly mentioned about the transferability feature. Currently, some companies include the transferability feature while issuing the right share but some companies lack the feature. Most of the respondents said that there must be the transferability feature in right issue. Simply, the theory says that the market price of a security increases as to declaration of right share announcement and the market price goes down after the book close date. Generally, the share price should be equal or nearly equal to theoretical value of the share. In some cases, the share price is dramatically changed with compared to theoretical price of the share after the right share. It's all because of

the ignorance of the investors. Most of the investors follow the rumor and invest in the share market. As a result, they are losing the money at present. It is found from the informal interviews with many individual investors that most of them are illiterate of share market. They just make an investment of millions of rupees with hearsay and others' recommendations. It is also found that the new investors who don't have much knowledge about share market also have the addiction of investing in share market. Some investors only invest in those shares which are giving the right share in near future. But they don't have the idea and phenomenon of the right share. Even they don't have an idea of procedure of right share distribution i.e. the announcement of right share, pass by the AGM, permission of the Security Board, book close date, right share issue, right share allotment, share certificate issue and listing of the right share. There is a long procedure of right share distribution. Again, after book close of the right share, the share price is declined by the value of right. Actually, the shareholders position as well as the shareholders' equity are not affected by the right share distribution.

## **5.2 Conclusions**

There is no long history of right share offering in Nepal. There is no doubt that a lot of things are to be worked out to make the rights offering as effective instrument of raising fund in Nepal. Despite, the right share practice is being popular day by day and the trend of right share issue is increasing. The highest portion of total public issue is captured by the right share till 2010/11. According to the hypothesis test, there is no significant difference between the actual and theoretical price after the book close date of right share.

There are a lot of problems about the right share practice in Nepalese capital market. Many investors don't know the phenomena of right share issue and subsequent consequences. They just make an investment of millions of rupees with hearsay and others' recommendations. Some investors only invest in those shares which are giving the right share in near future. But they don't have the idea and phenomenon of the right share. Even they don't have an idea of procedure of right share distribution i.e. the announcement of right share, pass by the AGM, permission of the Security Board, book close date, right share issue, right share allotment, share certificate issue, listing of the right share, verify of the shares and at last selling procedures of the

shares in the share brokerage office. There is a long procedure of right share distribution. Again, after book close of the right share, the share price is declined by the value of right. Actually, the shareholders position as well as the shareholders' equity are not affected by the right share distribution. Insider trading is another major problem. The company having negative net worth are also issuing the right and collecting money from the shareholders. Board members and directors are announcing the portion of the right issue they are planning to issue which might affect the market price greatly. To avoid these problems, all related bodies like NEPSE, SEBON, NRB, Share Brokers, Issue managers, Share registrars, teachers and other private consultancies should mutually take actions so that the investors are aware about the share market and right share.

### **5.3 Recommendations**

Based on the findings, some corrective actions are recommended as follows:

- In order to make the capital market more efficient and systematic, market participants and academic institutions should jointly promote and undertake more research and market analysis activities.
- The procedures of right share announcement, passing from BOD meeting, sending the agenda to NEPSE, SEBON, NRB, then finally approving from own AGM, publishing about the book close date, appointment of issue manager, right share issue and finally listing of right share is too lengthy and takes around 6 months. So, there must be the time limit for each step and must be less time consuming.
- The companies having negative net worth should not be allowed to issue the right shares.
- The governing body should inspect about the insider trading during the right share announcement.
- To make high subscription rate of right share, the right issuing companies should have good performance in the market; all the shareholders must be well informed about the right share by TV, newspaper, mailing, internet etc; they should make and apply easily transferability features in right share.
- Currently, “Securities Registration and Issue Regulation-2008” has clearly mentioned about the transferability feature of the right issue but not all

companies are providing the transferability feature. So, it must be provided in all the right issues and must be easily exercised.

- Strict rules and regulations must be made to discourage board of directors and CEOs to announce the rights share to public before the board meetings.
- The rights must be made detachable to original one and then the right holder can easily transfer or sell the rights in the market taking benefits without exercising the rights.

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# APPENDIX

## Appendix-1 Research Questionnaire

Dear Respondent,

As a part of partial fulfillment of Master of Business Studies (M.B.S.), I am in course of Research on“ **Right Share Practice in Nepal and its impact on Share Price**”. This uestionnaire has been developed and presented towards you as a part of the study. I humbly request you to fill it up at the best of your knowledge. Your kind cooperation in this regard will be great value for me.

The data and information you supplied would be used only for the academic purpose and would be maintained confidential.

I shall be highly obliged for prompt responses as far as possible.

Thank you very much.

**SAMATA SHRESTHA**

Researcher

Master of Business Studies

Shanker Dev Campus

### **Background of the Respondent**

Name: - .....

Address: - .....

Occupation:-.....

Age :-.....

Gender:-.....

Date:- .....

No. of Sample Respondent :- .....

## Group A

**Instruction:** Please tick [ ✓ ] in an appropriate alternative.

- 1) Do you think that investor gets reliable and adequate information from the company regarding right share issue?  
a) Yes            b) No            c) A little bit            d) Can't say
- 2) How many shareholders are well aware about all the phenomena of right share issue and subsequent consequences involved there in?  
a) All of them            b) Majority of them            c) A few            d) Don't know
- 3) What is your opinion regarding legally transferable right share?  
a) Current provision is satisfactory            c) Should not be transferable  
b) Should be transferable            d) Don't care
- 4) In your opinion, which sector's right share issue do investors prefer most?  
a) Banking / Financial            c) Insurance sectors  
b) Manufacturing / Trading sector            d) Hotel /Other sectors
- 5) Among Financial Institutions, which sector's right share issue do investors prefer most?  
a) Commercial Banks            c) Finance Companies  
b) Development Banks            d) Insurance Companies
- 6) Why investors are interested to purchase the right share?  
a) To increase the value            c) To maintain the control position of management  
b) To increase the dividend            d) To increase the number of shares
- 7) Why do the Nepalese corporate firms prefer right share the most instead of other instrument like bonds, preference shares?  
a) Easy process to collect the fund            c) Low floatation cost  
b) To maintain control position in management            d) Other causes
- 8) Which factors are vital for the share price movement?  
a) Right share announcement  
b) Growth prospects of the company  
c) Economic condition of the country  
d) Directives of the controlling agencies

**Group B**

**Instruction:** Please put your views in opened and ended questions.

1) In your opinion, what are the major problems to practice the right share in Nepalese securities market?

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2) In your opinion, what actions the issuing company should take so that the subscription rate of right share is appropriate?

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3) Currently, right share practice in Nepal lacks transferability feature. What do you think about it?

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4) Finally, do you have any experience or problems & prospects about right share practice in Nepal that you want to share with us?

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