

# **MERCHANT BANKING IN NEPAL**

(A Study of Citizen Investment Trust, NIDC Capital Markets Ltd.  
and Nepal Merchant Banking and Finance Ltd.)

## **A THESIS PROPOSAL**



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# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

The primary goal of any country, like Nepal, is rapid economic development to promote the welfare of the people and the nation as well. Nepal is trying to embark upon the path of economic development by economic growth rate and developing the sector of economy. So, the process of economic development is depends upon capital formation and its proper utilization plays a paramount role. The increase in capital has always been a sort of prime mover in the process of material growth and the rate of capital formulation has been the principal variable in setting the overall pace of economic. In this regard, the network of well- organized financial system of the country has great bear. It collects scattered financial resources from the masses and invests them among those engaged in economic and commercial activities of the country. In this way, financial institutions provide savers highly liquid divisible assets at a lower risk while the investors receive a large pool of resources.

Financial sector is often regarded as the lifeblood of national economy. Almost every economic activities pivot around varying degree of financial investment. The financial system of the country plays vital role in transferring resources from net savers to the deficit units of the economy. The development of the financial system is important in economic growth and an efficient financial system fosters the efficient mobilization of domestic saving and allocates resources to their optimum uses. Financial system contributes to greater accumulation of productive capital by increased mobilization of financial resources and sustained high investment levels.

A developed financial system is a hallmark of any free enterprises or mixed economy. The markets, instruments and institutions that comprise this system facilitate the efficient production of goods and services and thereby contributing the society's well being. The financial systems or markets perform this function by channeling the nation's saving into best uses. It does this by bringing together those who have surplus funds to lend and those who wish to borrow to finance their expenditure.

Financial institutions and financial markets compete as ways of providing borrower with access to capital and providing liquidity to investors. This financial market is broadly classified into two i.e. Money Market and Capital Market. Money market refers to a market where debt securities of less than one- year maturity are traded whereas capital market is the market for long-term debt and corporate stocks. The main function of money market is to provide short-term funds to deficit spender while capital market avails funds for long –term investment in fixed capital. The Money Market is the center of dealing mainly of short term character in monetary assets; it meets the short term requirement of borrowers and provides liquidity or cash to the lenders. It is the place where short term surplus investible funds at the disposal of financial and other institutions and individuals are bid by borrowers again comprising institutions and individuals and also the Government itself.

A capital market is an organized market for effective and efficient mobilization of money capital or investible funds from the numerous investing classes (individuals and institutional enterprises) to finance their business either in the private sector or in the public sector of our economy.

Capital market is further divided into two categories- securities market and non-securities market. Securities market refers to that market where financial assets such as share, debentures, bonds, etc. are traded in accordance with prescribed rules and regulations. Securities market is also divisible into primary and secondary market. The primary market facilitates to raise funds from the market for first time and is often known as ‘new issue market’. Secondary market, which is popularly known as “stock exchange” is concerned with the trading of already issued securities. And non-securities market represents the market where financial transactions are carried out between lender and borrower for a longer period without issuing any securities in the form of shares, debentures in the market. (Shrestha, 2002:1)

Nepal is a developing country. For the balanced development of the country, she has been adopting planned economic development, which requires a steady supply of medium to long term capital funds. Supply of capital markets are the institutions, which are engaged in mobilization of idle saving in productive opportunity. Development and expansion of capital market is essential for the rapid economic development by mobilizing the long term capital. (Ojha, 2000:26)

The capital market provides an important base for the development of industry, commerce and the economy. The main function of capital market is the collection of savings and their distribution for industrial investment, thus stimulation capital formation and, to that extent, accelerating the process of economic growth. The role of capital market has become crucial even in Nepal with the changes in the fundamental philosophy of the development process in the country i.e. shifting to free economy and the consequent liberalization /globalization of the economy.

Capital is the lifeblood of any organization. Capital structure is the combination or composition of the long term debt, preferred stock and common stock. The existence of an organized capital market plays an important role in collecting and mobilizing the investible resources to fulfill long term fund requirement of corporate sector. The role of capital market is significant when there is a high demand of funds. In this situation, merchant bankers bridge the huge gap between demand for funds by the institutions and supply of untapped public savings. They mobilize funds from savers to investors through various channels assuring promising return on investments.

Thus the development of merchant banking service is crucial for the growth of capital market. The development of merchant banking services is closely linked with worldwide move towards open and market oriented economic system. With the development of liberalized and market oriented economy, the banking and financial system is also expanding gradually, resulting with the introduction innovative financial services and instruments. As a result, the financial system has been experiencing and there is tough competition among the players of the financial system. Thus, “Merchant Banking activities” include all activities where merchant banker provides services for those institutions or individuals who need information of different financial resources, required procedure to achieve these resources or any other required managerial work for such activities. (Aryal, 2060: 63)

## **1.2 History of Merchant Banking**

The term ‘Merchant Banking’ was originated in the 18<sup>th</sup> and early 19<sup>th</sup> centuries in the United Kingdom when trade between countries was financed by bills of exchange drawn on the principle merchant houses. With the increase in international trade, the established merchants started the practice in lending their names to the new comers and accepting the bills of exchange on their behalf. They would charge a commission

for the purpose and thus acceptance business became the hallmark of Merchant bankers. Once these banks had gained the confidence of the government, they also entrusted with the job of issuing bonds in the London market. (Laxman & Naik, 2002: 88)

Merchant banking came into scene in USA in the early 19<sup>th</sup> century after the introduction of Blue Sky Laws to protect investors from fraudulent promoters and security salesmen. In India through merchant-banking activities originated before its independence they got systematized form only after restoration of independence. As a result of recommendations of Banking Commission in 1972, those Indian banks should start merchant banking services as part of their multiple services they could offer their clients; State Bank of India started the Merchant Banking Division in 1972.

In the context of Nepal though Merchant banking exists from the establishment of Nepal Bank Limited in 1990 B.S., its existence was in crude form. After the restoration of democracy in 2046 B.S., and an announcement of government's economic liberalization policy, private sector investors are attracted to invest in different organized commercial ventures. As a result numerous new private and public limited companies were established in a very short span of time to reap the benefit of economic liberalization policy of the nation. The development activity through the country had created excess demand for the sources of funds by the ever-expanding industry and trade, which could not be met all by the local banks and financial institutions. In these circumstances, the corporate sector enterprises had the only alternative to avail themselves of the capital market services for meeting long-term fund requirements through issue of shares and debentures. The growing demand for funds from capital market has enthused many organizations to enter into the field of merchant banking for managing the public issues.

The Finance Company Act 2042 gave birth to a new dimension to the merchant Banking Services as the act permits finance companies to sell and purchase the bonds issued by His Majesty's Government or securities issued by other companies or institutions, to underwrite them and to form syndicate for such purpose or to participate in such syndicates and to act as broker under the Securities Exchange Act, 1983. Similarly section 3 (g) of the same act permits them to perform functions of merchant banking with prior approval of NRB.

Citizen Investment Trust (CIT) is a pioneer merchant banker of the country followed by other finance companies viz. NIDC Capital Market, National Finance Co., Nepal Share Market, etc. At present few financial institutions (basically finance companies) are involved in different merchant banking activities. Out of wide range of various services provided by Merchant bankers, Nepali merchant bankers provide very few of them like issue management, underwriting, underwriting syndication, registrar to share etc. Other merchant banking activities still have to be developed with the development of merchant banking in Nepal.

### **1.3 Focus of the Study**

With the view to develop financial system in Nepal HMG/N has conducted various reforming activities especially after the restoration of democracy. Nepal is experiencing diversification in financial sectors with liberalized financial policies. Lots of banks, insurance companies, finance companies and co-operatives were established rapidly. With the growth of these sectors, merchant banking has also emerged.

Merchant banks work as a bridge, which provides every kind of financial assistance to industries and commerce. They play a highly significant role in mobilizing funds of savers to investible channels assuring of promising return on investments and thus can help in meeting the widening demand for investible funds for economic activity. Merchant bankers help the economic development of the country through its wide range of services.

The basic services provided by merchant banks are corporate counseling, project counseling, issue management, underwriting of public issue, portfolio management, bankers to the issue, loan or credit syndication, merger and takeover, arranging offshore finance venture capital, factoring, etc.

Thus the research is focused on the activity the financial institutions which are involved in merchant banking activities. Those financial institutions, even merchant banks, are found to be performing other financial services as their major function leaving merchant banking function only as a part of their subsidiary function. However, present study will not be concerned with other activities. It will be focused only in merchant banking activities performed by those financial institutions. It

studies and analyses the performance of all above- mentioned merchant banking activities performed by merchant banks in Nepal.

#### **1.4 Statement of the Problem**

Development of each and every country depends highly upon development of agriculture, industry, trade, tourism and all other financial sector. The development of these sectors are impossible until and unless the financial system of the country is strong. Financial system is strengthened through developed financial market that includes capital market as well as money market. And the strength of capital market is highly dependent upon developed merchant banking system. Merchant banks play a vital role in economic and financial development of the country. The development of merchant banking services is closely linked with worldwide move towards open and market oriented economic system.

In the context of Nepal where lots of financial systems are being slowed down due to insufficient capital, technical and financial support, merchant banks encourages them by its versatile services like project counseling, corporate counseling, portfolio management, venture capital, issue management, etc.

Though merchant banking has emerged in developing countries long before, it has got new dimension only after issue of finance company act 2042. Thus we are not having a long history of merchant banking in Nepal. As a result most of the Nepalese are still unknown about the meaning of merchant banking, services provided by merchant banks and difference between commercial banking and merchant banking. Thus, people are unaware regarding the importance of merchant banking in the development of Nepalese Capital Market and overall Nepal.

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However, Nepal is still lacking specific rules, regulations and guidelines regarding merchant banking. Though some acts like commercial bank act, finance companies

act, act for NIDC, CIT and other are permitted to undertake merchant banking activities, but none of these Acts gives clear definition of merchant banking. The question arises as to whether those merchant banking activities are under the regulatory control of Securities Exchange Act, or under Finance Companies Act.

Similarly there is also no separate entity to carry out the merchant banking activities in Nepal. These merchant banking activities are associated with other transactions of the finance companies. NIDC Capital Markets was the only merchant banker to render the merchant banking services at the time of its establishment. In the initial period NIDC Capital Market was focused on merchant banking activities later on it has diversified its services on other financial activities for its growth and survival of the company. Later on other financial institutions and banks also entered into the field to reap the benefit of merchant banking, the development of merchant banking is still in its infancy.

In spite of the importance of merchant banking services many of the merchant banking services in the country are still poor and only few merchant banking services are in practice in our country. The mainly rendered services are: Underwriting, Issue Management, Bankers to the issue and Leasing. Thus, merchant banking in Nepal is understood to be synonymous with issue managements, though globally this word is taken to mean everything in financial services.

The problem of the study is directed to find the solution of the following questions.

- i) Whether the problems and prospects of merchant banking in Nepal properly analyzed or not?
- ii) Whether the significance of merchant banking towards the development of Securities industry in Nepal studied or not?
- iii) Whether the performance of merchant bankers in Nepal evaluated or not?
- iv) Whether the growth of merchant banking in Nepal studied and analyzed or not?
- v) Whether the merchant banking activities are under the regulatory control of Securities Exchange Act, or under Finance Companies Act?

- vi) Whether the merchant banks play a vital role in economic and financial development of the country or not?

### **1.5 Objectives of the Study**

Financial activities grow with the improvement of economic situations. And, as the financial activities grow, the need of various merchant-banking activities will be felt. Merchant Banks have emerged in Nepal with the development of capital market. Merchant banking activities is one of the major supporting instruments for any ongoing business organization. Availing of the required merchant banking services help business sustain, develop, and prosper and so on. The purpose of this study will be as:

- i. To study the significance of merchant banking towards the development of securities in Nepal.
- ii. To evaluate the performance of merchant bankers in Nepal.
- iii. To study and analyze the growth of merchant banking in Nepal.
- iv. To analyze the problems and prospectus of merchant banking in Nepal.
- v. To provide suggestions and recommendations to the concerned organizations based on findings of the study.

### **1.6 Significance of the Study**

Merchant Banking is an unexplored field in Nepal. There is hardly very rare availability of research work, journal and articles on “Merchant Banking in Nepal”. In this context, present study will serve as a source of literature in the field of merchant banking. The study attempts to fill a serious gap in this important area of capital structure practices with focus on merchant banking Services. The research would be helpful to the regulatory authorities like Securities Exchange Board of Nepal, Nepal Rastra Bank and others. It would also be of interest to development banks, commercial banks, financial companies, merchant banks, etc. It may help the professionals in the industry to have better understanding on the impact of merchant banking activities in the securities industry and also it may help the academicians and the researchers who study in these areas.

In brief, this study will be important for the following group & individuals:

- i) It will be useful for University students of new generations.
- ii) The research will be useful for further researcher.
- iii) It will help financial managers & analysts.
- iv) It will also be very useful for regulatory authorities like Securities Exchange Board of Nepal, Nepal Rastra Bank and all financial institutions in Nepal.

### **1.7 Limitations of the Study**

This study will be done for the partial fulfillment for Master's of Business studies. The study will be conducted within certain limitations and constraints. They are:

- i. Though there are a lot of financial institutions in Nepal, the study is focused on those financial institutions that are the leading merchant bankers. It is only focused merchant banking activities.
- ii. The study is based on primary as well as secondary data. Any intentional default and reporting errors that may occur while obtaining the data will not affect the proposed study.
- iii. Research is mainly based on reports provided by listed financial institutions and responses made through questionnaires.
- iv. Only the data provided by the concerned organizations is taken for the analysis. Thus the years are not consistent and the data provided by them are not verified.
- v. The study is conducted under the limited time.

### **1.8 Organization of the Study**

The study will be divided into five different chapters, viz. Introduction, Review of literature, Research Methodology, Presentation and Analysis, Summary conclusion and Recommendation.

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

The first introduction chapter deals with the introductory framework of the study. This includes background, statement of the problem, objectives of the study, significance of the study, limitation of the study and organization of the study itself.

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

This chapter includes the review of literature available and review of related theoretical background of the relevant field of study, which aims at forming a conceptual framework to the objective mentioned previously.

## **Chapter III: Research Methodology**

Third chapter explains the research methodology used for the purpose of the study, which includes research design, sources of data, data gathering procedure, population and sample size of the study, data processing procedure and financial as well as statistical tools used for the analysis of data.

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

The fourth, which is the important chapter of the study, will include data classification, analysis, and interpretation regarding the primary as well as secondary data.

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

The final and last chapter contains findings in aggregate, conclusions drawn through the findings, and the probable suggestions and solutions as ‘recommendations’ enlightened through the study.

A bibliography and appendices will be attached at the end of the study.