

# **CHAPTER – I**

## **INTRODUCTION**

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

The dictionary meaning of issue is the act of supplying or making available things for people to buy or use. When we talk about the issue of the companies, we focus on the equity share or any other type of financial instruments produced by them for sale to the public. Although, issue can be of any debt or equity security, this study will focus on equity issues by operating companies. Hence issue of shares refers to the act of offering shares to the public.

The major concern of many countries of the world has been to accelerate their development process and thereby increase the welfare of their people. This can be done only through rapid industrial development. This would require gearing up savings, creating conducive and enabling investment atmosphere and developing efficient capital market to facilitate mobilization of both ownership and debt capital through appropriate instruments. Such a scenario will help to grow corporate enterprise capable of ushering into a high growth era. Besides, the development of corporate culture depends upon a sound financial system, a set of complex and closely connected or inter-mixed institutions, agent's process, markets, claims etc. in an economy.

With the worldwide move towards open and market oriented economic system in the world economy, it has led to growth and expansion of banking and financial system too. As a matter development of new financial instrument and improved and diversified financial services are taking place. One of the concrete financial services is merchant banking function. Under merchant banking function, financial institutions provide necessary information on the financial instruments to any industry or any concern involved in business, in addition to consultancy services on procedural formalities to use the instruments and all necessary management services.

Company Act 2063, has made clear provision for the establishment of companies in Nepal. According to this act both private companies as well as public companies can be established in Nepal. The private companies start out by raising equity capital from a small number (not more than 50) of investors, with no liquid market existing if the investors wish to sell their stock. As per this act, the private companies can not sell their securities to any other party than their own shareholders. Under this circumstance, if a company prospers and needs additional equity capital, at some point the firm generally will not have any other alternative than raising additional equity from the existing shareholders. According to the same Company Act 2063, public companies can be established with more than 7 members. The public companies must separate at least 30 percent of their issued share capital to public. Banks and financial institutions are the companies which have to start out as public limited companies.

According to Bank and Financial Institutions Act, bank and financial institutions are classified into A, B, C and D-class and as national level banks and financial institutions these companies should have started with minimum paid up capital of Rs. 1000 Million, Rs. 640 Million, Rs. 300 Million and Rs. 300 Million respectively. In course of time if the company prospers and needs additional fund at some point the company generally goes public, offering its shares to large number of diversified investors, that we call as the primary issuance of equity shares. When the securities are sold to the general public for the first time, with the expectation that a liquid market will develop, it is called an initial public offering (IPO). Investors use the relative performance information to buy the shares of the companies. The pre-issue performance of the issuer companies plays a very important role at the time of IPO.

Generally the companies having good pre-issue performance become successful in IPO. They can raise the capital easily. But those with poor pre-issue performance will not be able to raise adequate capital through IPO. This all happen because investors think that the companies having sound pre-issue performance are more likely have similar financial performance in the post-issue and are more likely to yield the same returns in the future. But the investors may not be always right. Things do not always go as per their expectation. Some of the companies have failed in maintaining similar

sound performance after going through IPO. The most probable reasons behind this can be, either they had poor pre-issue performance but managed to show the good statement at the time of IPO or the company was control with certain problem after the IPO.

Development and expansion of capital market are essential for the rapid economic growth of the country. Securities market is the mechanism that allows suppliers and demanders of fund to make key role in the purchase and sales activities of investors. Non securities market refers to the mobilization of the financial resources by the financial institutions in the form of deposits and loans. Stock market is a mechanism through which corporate sector mobilizes funds to finance productive projects by issuing shares in the market. One of the most valuable services performed by securities market is to maintain active trading of securities; so that investors can buy or sell securities immediately. A continuous market increases the liquidity of the securities traded there. This offers an investment opportunity for investors to invest in the long liquid cash before the maturity of the project. Further more they can invest their current income against future income thereby achieve their time preference of consumption. The liquid stock market also promotes primary issuance of share because investors participate in the issuance of share market for they can get back the fund easily. The primary market is positively and highly elastic with stock prices and liquidity in the secondary market.

In the context of Nepal, a capital market was initiated in the country with the establishment of Security Exchange Centre (SEC) in 1976 in the public sector according to the industrial policy. The establishment of Security Exchange Centre was also considered as the first foundation stone for the institutional development of securities market in Nepal. Its objectives were, among other, to assist public limited companies to raise capital through the issue of shares and debentures and to create a market place where purchase and sale of securities take place through intermediaries operating on the floor of the exchange. Planned development at this sector initiated only after the Eight Plan. SEC was converted into Nepal Stock Exchange (NEPSE) in 1994 and started its organized open-out-cry system in its trading floor.

The main objective of the capital market is to create opportunity for the maximum number of people to get benefit from the return obtained by directing the economy towards the productive sector by mobilizing the long term capital. The objective can be fulfilled only by rational and accountable behavior relating to the three sectors of capital market such as institutions, mediators and investors. (NPC; 1998).The effective role of institutions such as, government, central bank, and investors help to promote stock market. Nepal Stock Exchange Ltd. has been acting as secondary market in Nepal. The performance of companies listed in the NEPSE Ltd. plays an important role in the development and expansion of capital market in Nepal. It determines the participation of investors in the stock market. The better they perform, the better they can provide returns to the investors and, hence consequently, there is more attraction of people towards them. In addition to this, the awareness of the investors towards the mechanism of stock market, availability of the information about the performance of listed companies also determines the participation of investors in the stock market. But Nepalese stock market is characterized by a low trading volume, and limited information available to investors. Majority of the Nepalese people are not familiar towards the mechanism of stock market. Those who are familiar have limited information about the performance of companies. For getting optimal involvement of investors in the stock market, investors of large as well as small scale are to be made familiar with the mechanism of stock market, the information regarding pre-issue and post-issue performance of listed and non listed issuer companies should be made available. It is therefore very important to analyze the pre issue and post issue performance of issuer companies in Nepal.

According to NRB's regulation "Unlike commercial banks which are engaged mainly in long term loans to customers for whom they can offer current account, overdraft facilities, these finance companies can operate only fixed and saving deposits"(Unified Directives 2009) Since these finance companies are neither allowed to accept demand deposits nor operate current accounts including overdrafts, they have concentrated their funding activities in attracting fixed deposits from public on higher interest rates than commercial banks. It is mainly because of the higher interest rate they provide on fixed deposits they charge higher interest, in lending than commercial banks.

Historically, finance companies were created in the early 1960s and the real need for the creation of these finance companies were felt when commercial banks were unable to serve sectors of economy other than big business houses. The small savings were ignored so were their smaller credit requirements. Need of those institutions serving the deprived sectors were felt and it was that need that gave birth to institutions like finance companies. The history of non-banking financial institutions is not very old. When banking sector started carrying out current activities of finance company, a large number of finance companies were established and they expanded at a rapid pace in the developed countries like UK and USA in 1960s. Their growth was very rapid in comparison to commercial banks as they used to offer higher interest rate on deposits, lower interest rate on loans and swifter service than commercial banks. In Nepalese context there were few insurance companies and Karmachari Sanchaya Kosh working as non-banking financial institution before enactment of Finance Company Act 2042 BS. Need of Finance Company Act was felt because unorganized sector was collecting savings from the common public in the name of Upahar and Dhukuti programs.

People showed great interest in these programs but were cheated by most of the program organizers. Considering such interest, benefit of mobilizing such savings in productive sector, banking sector's inability to carry out capital market activities and to meet consumers' need for credit, government felt the need of finance companies and introduced Finance Company Act 2042 BS. However, no finance company was set up till 2049 BS because the act came into effect in 2049 B.S. after some amendments.

Nepal Awash Bikash Bitta Company Ltd is the first finance company established in 2049 BS promoted by Rastriya Beema Sansthan, Nepal Bank Limited, Rastriya Banijya Bank, and Agricultural Development Bank. In a short span of time, the non-banking financial institutions have grown up drastically. Now, the number of listed finance companies only is 73 in numbers. The reason for their speedy growth is higher interest rate on deposits, low administration cost, swift services, swift decision, less liquidity and high demand for consumer's credit.

Finance Company is a financial institution and its principle business is to receive the deposits under any scheme of arrangement or in any other manner and lending in any manner. Most finance companies specialize in consumer financing, leasing and assets based lending with strong preference in short term debt. The liabilities of finance companies comprise of fixed deposit and equity capital. The interest rates charged by these institutions for financial assistance are higher than those charged by commercial banks and other organized financial institutions. On the other side, they also offer higher rates of interest on deposit accepted by them.

Finance companies play a crucial role as a broker of the loan able funds. They act as the intermediaries between the ultimate savers and investors. These institutions reap a number of economies of specialization and scale in mobilizing savings and making investments. Finance companies provide loans in very short period of time and are also flexible in rules. These days some very big projects have been found financed by the finance companies.

Finance companies in Nepal have a very short history and in this short period, these companies have been able to contribute significantly towards the economy. Finance Company in general provides higher interest rate than the commercial banks, which has encouraged the people to save more and more. It is often seen that a considerable percentage of deposits being saved in the finance companies. The finance companies have been paying a considerable amount of money as in the form of tax as well. Finance companies being in higher tax brackets as commercial banks, the contribution made by them cannot be ignored.

In short what we can say is development of the national economy depends upon the development of financial and other non financial sectors. All round development of all the economic sectors is possible when the capital market of the country is well developed. For the healthy development of capital market of the country investors must be aware of the performance activities of the listed as well as non listed companies. So the study of the pre issue performance and post issue performance of issuer companies occupies very important place for the capital development of the country as it provides information regarding the overall performance of the issuer

companies. There is large number of issuer companies in Nepal. They can be categorized into financial and non-financial sector. The financial sector comprises of commercial banks, development banks, finance companies, microfinance group, co-operatives etc where as non financial sector comprises of manufacturing, hotel, trading sectors etc. But among them, only the listed five finance companies have been taken selected as the issuer companies for the study purpose. An attempt has been made here to make pre issue and post issue financial performance analysis of listed finance companies.

## **1.2 Introduction of Sample Finance Companies**

The following are the five sample finance companies selected as the issuer companies for the purpose of the study.

1. United Finance Limited. (UFL)
2. Siddhartha Finance Limited (SFL)
3. Standard Finance Limited. (STDFL)
4. Gorkha Finance Limited (GFL)
5. Butwal Finance Limited (BFL)

### **1.2.1 United Finance Limited (UFL)**

United Finance Limited (UFL) is a leading Consumer Finance Company in Nepal with excellent asset quality and strong growth potential. The company is promoted by the Chaudhary Group - the largest conglomerate in Nepal was established in 1992 as per the Companies Act of Nepal. The main objective of the company is to mobilize scattered savings into the consumer financing sector. The major promoters and shareholders of the company are the Chaudhary Group and Morang Auto Works. These groups among themselves hold 60% of the shares in the company with the remaining balance of 40% shares held by the general public. The shares of the company are actively traded at the Nepal Stock Exchange (NEPSE) and have been categorized in Category “A” by NEPSE for the last three years. Within a short span of its establishment, the company has been able to establish itself as one of the leading financial institutions in the country. The company’s vision is to become the number one finance company in terms of consumer financing. With an aim to provide highly professional banking & financial services, United Finance Ltd. has a

team of young and dynamic professionals to run the Company. The experience gained in various sectors of finance over the years has enabled United Finance Ltd. to serve its customers in a more reliable and efficient manner.

United Finance Ltd. has joined with National Payment Network (NPN) which has a large number of ATM and POS terminals in and outside the valley. United National Debit Card can be used in all the ATM terminals of NPN member banks as well as in ATM terminals of VISA consortium Members banks of Nepal Investment Bank. Similarly, this card can be used to make payment in stores, restaurants and any other POS who accepts the NPN VISA/ Visa Electron card. Its corporate philosophy is “To become a true market leader amongst finance companies in terms of sound risk asset portfolio, innovative product & services, financial health, and good corporate governance through a highly self motivated and innovative team with a visionary leadership”. The finance company has its corporate head office at Durbarmarg, Kathmandu. Altogether it has 6 branches inside and outside the valley. Its branches are located at Biratnagar, Butwal, Nepalgunj, Pokhara, Newroad (Kathmandu) and Narayangarh.

#### **Its share capital as at 32 Ashad 2068**

Authorized capital	Rs.1,000,000,000
Issued capital	Rs.350,801,200
Paid-up capital	Rs.350,801,200

#### **1.2.2 Siddhartha Finance Limited (SFL)**

Siddhartha Finance Limited (SFL) is the first national level finance company, which has been established at Bhairahawa (Rupandehi), the entry door of worldwide famous Lumbini, birthplace of Lord Siddhartha Gautam Buddha, with the purpose to make the country financially strong. SFL is inaugurated by former Prime Minister late Mr. Man Mohan Adhikari on 25<sup>th</sup> May, 1995. SFL has been working from 25<sup>th</sup> of May, 1995 with permission from Nepal Rastra Bank. SFL is a full fledged “C” category national level financial institution, the registered head office of the SFL, is located at Bhairahawa and branch offices at Kamaladi (Kathmandu), Parasi (Nawalparasi) & Chandrouta (Kapilbastu), rendering its services to all levels of people for their

individual as well as the overall development of the nation. SFL is conducting its entire financial service activities under the direct supervision of Nepal Rastra Bank. SFL has been succeed to prevent the deposit outgoing to Indian finance companies like SAHARA, PEERLESS, who are very strong, at that time to collect the deposit from door to door of our houses easily, with the help of our secured and attractive deposit scheme at its set up time. SFL feels very proud to announce to all the valued customers that it has completed fifteen years of its successful operation so far and now is shifting in their own building as 'SIDDHARTHA BHAWAN', the building is inaugurated by former governor Mr. Tilak Rawal on 11<sup>th</sup> June, 2003. As the purpose to provide the privileges and facility to the all Nepalese citizen, SFL has hired the highly skilled and experienced employee and full computerized system. SFL is promoted by prominent industrialists, businessman and professional, thoroughly experienced, confident and renowned personalities with sound financial experience.

Presently SFL is headed by Mr. Ram Gopal Goenka as chairman who has many years of fruitful experience in steel industry, whereas Mr. Ramesh Kumar Agrawal is heading as Managing Director. Over the years, customers and regulators have been in appreciation of the many financial products and innovations developed by us. SFL are now in a position to provide various products to serve all the valued customers' needs. SFL is full-fledged incorporated financial services mediator with a goal to provide the best financial services to its customers. SFL supports the entrepreneurs with required financial services right on time that helps to capitalize the opportunities created in the financial sectors. Siddhartha Finance Ltd. offers ATM for its customer at Bhairahawa (Rupandehi) and Chandrauta (Kapilvastu) and at Parasi branch is going to be opened shortly.

**Its Share capital as at 32 Ashad 2068**

Authorized capital	Rs.500,000,000
Issued capital	Rs.147,227,400
Paid-up capital	Rs.130,868,800

### **1.2.3 Standard Finance Limited (STDFL)**

Standard Finance Limited is renowned Finance Company with over 15 years experience on the financial sector. This finance company is in the process of expansion and has a network of 9 branches including one at its corporate office, Narayan Chaur, Naxal, Kathmandu. Standard Finance Limited has been providing financial services to both institutional and retail customers with high quality service. Standard Finance Limited's equity shares are listed in the Nepal Stock Exchange, the only Stock exchange in Nepal.

Standard Finance Limited was originally promoted in 1995. Initial Public Offering was made in 2003 which diluted the promoters' share holding to 60%. Since the inception of the company, Standard Finance Limited has been reinventing itself as per requirement of the market and changing economic scenario. It has been a pioneer in Margin lending business in Nepal and continues to explore areas of services where it can add value to both the customers and shareholders. STDFL is focused on enhancing shareholders wealth and providing customers with value-added services.

The vision of Standard Finance Limited is to become a preferred financial service provider in the country that provides one stop solution to all the customers on their financial services needs, while maximizing the wealth of investors. The mission statement of STDFL incorporates the following:

- a. Constantly assess client needs to find profitable ways to meet their requirements through high quality offerings.
- b. Act in a manner that demonstrates stability and promotes trust in the bank.
- c. Build a system of human resource management that:
  - ) Provides career development opportunities that increase the professionalism and technical proficiency of the employees.
  - ) Ensures a fair measurement and reward system encouraging the employees to provide the best possible service to the customers.

**Its Share capital as at 32 Ashad 2068**

Authorized capital	Rs.500,000,000
Issued capital	Rs.250,00,00,000
Paid-up capital	Rs.100,180,000

**1.2.4 Gorkha Finance Limited (GFL)**

Gorkha finance limited was started 17 years ago with an aimed to be recognized by the customers and stakeholders as the best and most trusted financial institution by providing healthy financial services of high efficiency at a reasonable price for widespread customer satisfaction. As for the growth of the company GFL have clear goals which are intense focus towards customer's satisfaction, strong team work as a garrison to resolve any problems of the valued customers. The Company has been working from 27 Falgun, 2051 with the permission from Nepal Rastra Bank on 32 Shrawan, 2051. GFL is full fledged "C" category national level financial institution; the registered head office of the GFL is located at Hattisar, Kathmandu.

The major promoters and shareholders of the company themselves hold 60% of the shares in the company with the remaining balance of 40% shares held by the general public. As the purpose to provide the privileges and facility to the all Nepalese citizen, GFL has hired the highly skilled and experienced employee and full computerized system to fulfill the needs of their valued customers.

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**Its Share capital as at 32 Ashad 2068**

Authorized capital	Rs.484,798,000
Issued capital	Rs.134,041,000
Paid-up capital	Rs.145,811,000

### **1.2.5 Butwal Finance Limited (BFL)**

Ever since the government of Nepal adopted the market oriented liberal economics policy for sustainable development, poverty alleviation, regional balance and resolving unemployment problem of the country, the involvement of private sectors in economic activities have increased substantially. The private companies play significant role to the economic progress of the country. Butwal Finance Company came into existence in the year 2055 B.S. with the view to accelerate the pace of economic development through active participation in socio-economic activities. Since its inception, BFL has made its earnest efforts to contribute to the country by undertaking various integrated economic projects. Hence BFL has completed thirteen years of its successful operation so far.

BFL aims to achieve excellence in financial sectors by rendering services to all levels of people for their individual as well as the overall development of the nation. BFL strives to provide its professional financial services know how to prosper in today's competitive environment. To achieve its goal, BFL has assembled the team of young and dynamic professional to look after the day to day operation. This company is fully equipped with sophisticated modern equipment including computers and other necessary office equipment in order to serve people according to their interest at much faster and reliable way. In order to cope with the present difficult situation of the country, BFL is planning to introduce security programmes to ensure security provisions for the customers. These security programmes will include - insurance policy, recruitment of security guards, extension of communication services, visual aids system etc.

The process of forwarding the nation in the path of development by economic liberation and market oriented policies, BFL has been established in the heart of Lumbini Zone, with the purpose to make the country financially strong and empowered and also to turn the nation into modernization. The Company has been working from 25th of Asadh 2055 with the permission from Nepal Rastra Bank on 7th Asadh 2055. BFL is full fledged “C” category national level financial institution, the registered head office of the BFL is located at Butwal and branch offices at Butwal, Kathmandu, Pokhara, Nepalgunj, Kapilvastu, Bardghat, and Kawasoti.

BFL has two remittance counters at Bhairahawa and Ghorai Dang. Its main objective is to provide facilities to the customers to undertake viable economic projects in order to improve quality of their life. In addition to the banking services like issuing loans, deposits etc the finance company also offers many other modern services to assist the valued clients.

### **Its Share capital as at 32 Ashad 2068**

Authorized capital	Rs.1,992,924,000
Issued capital	Rs.197,683,000
Paid-up capital	Rs.208,993,000

### **1.3 Statement of the Problem**

Stock market in Nepal is at early stage with high growth potential. To create right environment for the development of policies related to the securities market thereby facilitating the market structure consisting of regulators, stock exchange, market intermediaries, issuers and investors is the commitment demanded by the market today. There are various types of obstacles existing initial public offering stages in Nepal. In developed country, generally people are aware from public offering. However, in developing country like Nepal Initial Public Offering is still new phenomenon. More than 50 percent people are still uneducated. They do not know what public offering is. Why should they invest their money in Stock?

SEBON approves securities issue on the basis of their past performance and investors also make investment decision in the similar basis. Post issue activity is related to the secondary market development. Pre issue activities affect the post issue activities. Company issues securities to raise fund and to expand business in the broader level to achieve higher level profit growth. But, are the companies performing well after the issue? Jain and Kini (1994) investigated the change in operating performance of firms as they make the transition from private to public ownership. A significant decline in operating performance subsequent to the initial public offering (IPO) is found. Post-issue declines in the market-to-book ratio, price/earnings ratio, and earnings per share are also documented. The literature shows that many researchers have made comparative performance evaluation of the companies but there is no such study that

evaluates financial performance before and after going public. So, it is felt necessary to analyze the impact of public issue in the financial performance of the companies.

To sum up, this study deals with the following issues:

- How was the performance of issuer companies before going through IPO?
- What was the impact of public issue in the financial performance of the companies?
- How is the performance of issuer companies after going through IPO?
- Does the company's performance improve after the IPO?

#### **1.4 Objective of the Study**

The major objective of this study is to analyze the pre-issue and post-issue financial performance of issuer companies. Its specific objectives are as follows:

- To analyze the pre-issue financial performance of finance companies
- To analyze the post-issue financial performance of finance companies
- To compare the pre and post issue performance of the finance companies
- To provide necessary recommendation

#### **1.5 Limitations of the Study**

The study is related with the fulfillment of MBS (Master of Business Studies) degree in management so it is not a comprehensive study. The study covers only one sector out of nine sectors divided in the Nepal Stock Exchange (NEPSE). Hence the result cannot be generalized for all the sectors. It focuses to analyze the certain aspects of primary market in Nepal like pre issue and post issue performance of the issuer companies. The studies and references will be limited in the perspective of Nepalese capital market. Similarly, the study will be conducted within a limited time frame. The use of limited and the secondary data will be one of the most noted limitations of the study. So the major limitations of this study will be that only three finance companies have been selected for the purpose of conducting the study. So the major limit will be the sampling limit. So the generalization from this study cannot be made. Similarly, only the data of at least three-year history before and after public issue have been taken for the purpose of analysis i.e. extensive study till the date has not been done. So there has been a limit of data.

## **1.6 Organization of the Study**

The study has been divided into five chapters and which are organized in the following manner:

Chapter one deals with introduction of the study and which the statement of problems, objective of the study, limitation of the study and organization of the study.

Chapter two is the review of literatures. This chapter summarizes the different theoretical concepts and finding of researches done in related fields by researchers as well as students. Main themes of some articles published in different media such as journals, news paper and web sites are also incorporated in the chapter.

Chapter three deals with the research methodology in which the method employed in the study has been described. Concept of research methodology, nature and sources of data, population and sampling, data collection tools and procedures are explained. Methods applied for processing of raw data and presentation as well as analysis techniques are also described in the chapter.

Chapter four deals with the presentation and analysis of data. In this chapter the data collected during the study after being processed are presented in appropriate manner and the results are interpreted with analytical and descriptive method. The findings and results are thus inferred in the chapter.

Chapter five explains the summary, conclusions and recommendations of the study.

In addition to these chapters, bibliography and annexes have also been listed at the end.

## **CHAPTER-II**

### **REVIEW OF LITERATURE**

Review of literature means reviewing research studies of other relevant propositions in the related area of the study. So, that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. Thus, review of literature is stock taking of available literature in one's field of research.

Review of literature is a way to discover what other research in the area of our problem has uncovered. Scientific research must be based on the past knowledge. The previous studies cannot be ignored because they provide the foundation to the present study (Wolf and Pant, 1999:3).

This chapter reviews the existing literature on the topic "Financial performance and Operating Performance of Pre and Post issue of firms" concerns theories including review of the empirical evidence of previous studies. Review of literature is one of the most important chunks of thesis writing.

This part of the study highlights available literature related to this research, which makes base of knowledge for the study. Keeping in view the absence of the required research made comparing the pre issue and post issue performance of the issuer companies, basically the reviews have been extracted only from the post-issue performance of issuer companies.

#### **Concept of Financial Performance**

Although the word 'performance' is simple, its meaning is vast and vague. In general sense performance means the act or process of performing or doing something. It shows the way how well or bad something has been done. For the financial sector, it is equally hard to define the meaning of performance. It is because financial sectors carry out different functions. So the single word performance is not sufficient enough to give the clear meaning of the performance of financial sectors. When we talk about the performance of financial sectors, the performance can be in terms of its earning or

profitability or liquidity or assets management or it can be in terms of its creditworthiness, or social contribution or goodwill or services or in any other terms. Therefore, it is always good idea to define and analyze the performance of financial sector or any other sector in a specific term.

According to the international dictionary of Banking and Finance (Clark, 1999; 257), performance is the earnings or losses made on a security or by a company. Cottle (1960) analyzed performance of consumer finance in USA in terms earnings. This study measured the earnings to total investment ratio and compared with other 33 industrial groups as a whole. Similarly, the financial behaviours of Jute Industry in India was analyzed by Verma (1994) by using profits, dividends, fixed investments and borrowings. Income, growth rate, capitalization, number of companies, returns are analyzed by Brown and Goetzmann (1995) to study the performance of mutual funds in USA. The performance of public enterprise in Nepal was analyzed by Shrestha (1983) by using earning power ratio. Hence, it is clear that performance is a vague term. It has been defined and measured in different specific terms with the help of different variables as per the convenience of the researchers of different fields. When performance of any enterprises is analyzed and defined or explained in terms of its financial activities it is the analysis of financial performance.

Financial performance can be defined as the act or process of performing all the financial activities. How well or bad the financial activities of an enterprises have been performed is the financial performance of this enterprise. A well performed financial activities ensures the success of the enterprise where as a poorly performed financial activities indicate the failure. So, financial performance as a part of financial management is the main indicator of the success or failure of the enterprise. Better financial performance is always a point of attraction for all the stakeholders such as owners, managers, creditors, investors, employees, customer, tax authorities etc.

Financial analysis helps to know the financial performance of an enterprise. Financial analysis is a process of identifying the financial strength and weakness of a firm by properly establishing relationship between the items of balance sheet and profit and loss (Pandey, 1992: 109). Financial analysis is nothing but a means to get to the real picture of the financial performance of enterprise. According to Hampton “financial

analysis is the process of determining the significant operating and financial characteristics of a firm from accounting data and financial statement. The goal of such analysis is to determine the efficiency and performance of the firm's management, as reflected in the financial records and reports.

James C. Van Horne Writer of "Financial Management Policy" has written in his book about financial analysis in which he has divided financial ratio into four types i.e. liquidity ratio, debt ratio, profitability ratio and coverage ratio. These ratios are helpful for managerial control and for a better understanding of what outside suppliers of capital expect in financial condition and performance. He defines until and unless there is comparison, financial analysis is meaningless so it should be compared with own firm overtime an inter firm. (Van Horne, 1997: 759) Thus, financial analysis is the analysis of financial statements of the enterprise which is done to evaluate the performance of the enterprise.

## **2.1 Conceptual Framework**

Public limited companies by taking permission from concern authority can issue securities to the public to raise the needed fund. The period before going to the public is known as the pre-issue period and the period after going to the public is known as the post-issue period. The financial performance of the companies before and after the issue may change.

Finance is concerned with those activities related to money. Previously finance was limited for procurement of long-term fund. Due to industrialization, technological innovations and intense competition, there has been a vast change in the philosophy of management. Likewise the discipline of financial management has undergone an unprecedented change.

Financial management is that managerial activity which is concerned with planning and controlling of the firm's financial resources (Pandey, 2004). Evaluation of financial performance is a study of overall financial position of any organization. It is closely related to the decision-making. In the modern context, it gives vital support for the investment decisions, financing decisions and dividend decisions. Financial

performance analysis is undergone with the help of periodically made financial statements of the firm.

### **2.1.1 Capital Market**

A place where the long term lending and borrowing takes place is known as capital market. Therefore, the capital market is the market for long term borrowing and lending. The primary instruments of capital market are stocks and bonds (equity and debt).

Thus, the capital market is concerned with long-term finance. Broadly, it consists of a series of channels through which the savings of the community are made available for industrial and commercial enterprises and authorities. It is concerned with those private savings, individual as well as corporate, that are turned into investments through new capital issues and also new public loan floated by government and semi-government bodies. In capital market, demand for funds comes from agriculture, industry, trade and government while the supply of funds comes from individual or corporate savings, institutional investors and surplus of government. They can issue different types of securities to collect the required capital.

The investors can invest both through primary and secondary market. If they want to invest through primary market they can do so by investing at the time of initial public offerings. This is why primary market is called initial public offering (IPO) market. Securities already traded once through primary market are traded in secondary market. This market arranges liquidity in the securities that are already in the hands of general public. In fact, both the markets are inter-locked with national economic policy. If the government policy is favorable, the demand for securities will increase and the price of the securities in secondary market also increases. If not, the result will be just reverse. Because of this reason capital market especially the secondary market is called as the "economic barometer" of the country.

### **2.1.2 Meaning of Initial Public Offering / Primary Market**

The type of market where initial issuance takes place is known as primary markets. The primary markets are media through which new financial assets are issued or

generated. The "securities" being offered in the primary market includes common stock, preferred stock, debentures, bonds, convertibles etc. in a company to mobilize public savings and to establish and to operate it.

A public offering can be a hugely complicated affair. It is usually something that is not undertaken by a company until:

- The company has had a chance to prove itself and has a profitable business model that will scale too much larger operation on regional, nationwide or even international levels.
- The company must also have a strong business plan in place with clear objectives on why it wants to go public. These objectives may include raising capital to fund an expansion and growth of a very profitable business model.

Though the process of acquisition is unreasonably difficult and despite the fact that IPOs are perhaps the most expensive way to finance a company it is gaining importance because of the advantages that it offers.

IPO is the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately owned companies looking to become publicly traded. In an IPO, the issuer obtains the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market.

IPOs can be a risky investment. For the individual investor it is tough to predict what the stock will do on its initial day of trading and in the near future since there is often little historical data to analyze the company with. Also, most IPOs are of companies going through a transitory growth period and are therefore subject to additional uncertainty regarding their future value. ([www.investopedia.com/IPOs](http://www.investopedia.com/IPOs))

#### **2.1.2.1 Importance of Initial Public Offering**

- It serves as start-up to established companies. Start-up companies must demonstrate the potential to develop into profitable enterprises that will

deliver significant annual increases in sales and earnings. Established companies must also demonstrate significant future growth potential.

- Financing the expansion of manufacturing or service capacity or marketing activities that have immediate impact on earnings; also, providing a company with increasing sales, as a layer of working capital to fund growing inventory (if there is any) or accounts receivable. IPO funds can be used to finance research and development, but stock prices tend to decline during prolonged periods of product development, which in turn generates a new set of challenges for founders or senior management.
- A small business stands to gain through an initial public stock offering is access to capital. In addition, the capital does not have to be repaid and does not involve an interest charge. The only reward that IPO investors seek is an appreciation of their investment and possibly dividends. Besides the immediate infusion of capital provided by an IPO, a small business that goes public may also find it easier to obtain capital for future needs through new stock offerings or public debt offerings.
- A related importance of an IPO is that it provides the small business's founders and venture capitalists with an opportunity to cash out on their early investment. Those shares of equity can be sold as part of the IPO, in a special offering, or on the open market some time after the IPO. However, it is important to avoid the perception that the owners are seeking to bail out of a sinking ship, or the IPO is unlikely to be a success.
- Another importance of IPOs hold for small businesses is increased public awareness, which may lead to new opportunities and new customers. As part of the IPO process, information about the company is printed in newspapers across the country. The excitement surrounding an IPO may also generate increased attention in the business press.
- A related importance is that the public company may have enhanced credibility with its suppliers, customers, and lenders, which may lead to improved credit terms.
- Yet another importance of going public involves the ability to use stock in creative incentive packages for management and employees. Offering shares of stock and stock options as part of compensation may enable a small

business to attract better management talent, and to provide them with an incentive to perform well. Sharing in the company's success may motivate employees who become part owners through a stock plan. Finally, an initial public offering provides a public valuation of a small business. This means that it will be easier for the company to enter into mergers and acquisitions, because it can offer stock rather than cash.

### **2.1.2.2 Initial Public Offering in Nepalese Context**

Public offering in our context is at the evolving stage. The history of security market in Nepal began with the floatation of share by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Prior to the establishment of Securities Board, Nepal (SEBO), the then Securities Exchange Centre used to provide services regarding public offerings of securities. The securities exchange act of 1983 was amended in 1993 and Security Board of Nepal (SEBON) was established to regulate the securities market.

SEBO has been monitoring the performance of companies for past twelve years. SEBO reviews the public offering market and legal provisions from time to time in order to assess the performance of Initial public offering (IPO) of the various issuer companies.

Nepal Stock Exchange Ltd. (NEPSE) is the restructured form of Security Exchange Centre (SEC), which is working under SEBON. NEPSE is the sole organization for the operation of secondary markets for listed securities.

### **2.1.2.3 Regulation of Primary Market**

- Securities Exchange Act 2040 is the main law to regulate the securities market in Nepal. So far till now this act have been amended 3 times within the 13 years of its history. The 3<sup>rd</sup> amendment also took place. Under this act, Securities Exchange regulation 2050 and membership of stock exchange and transaction by law, 2050 have been formulated and enforced. Recently both regulations as well as by laws have been amended to suit the changing environment of the securities market.

- Companies Act 2021 has been replaced by new companies act, 2053 with a view to make simple transparency in formation, operation and administration of the companies. Various formats related with articles and memorandums of Association, prospectus, application form for purchase of shares, balance sheet and profit and loss account have been prescribed.
- Securities investment trust Act 2053 have been formulated and enforced for the operation of trust funds such as mutual funds and unit funds.

#### **2.1.2.4 Major Regulating Agencies**

##### **Company Registrars Office**

Company Registrar is only agency where companies are registered monitors the operations of the companies and makes arrangements for winding up of the companies when required. Approval on prospectus is granted by Company Registrars Office only. Before granting approval it obtains the advices, opinion from securities board and for banking and finance companies opinion advises on prospectus is taken from Nepal Rastra Bank too.

##### **Security Board of Nepal**

Securities Board strictly regulated Total regulation of market including new issue. It promotes and protects the interest of the investors by regulating the issuance, sale and distribution of securities and purchase, sale and exchange of securities, to supervise, look after and monitor the activities of the stock exchange and the other related firms on securities business, and to provide contribution to the development of the capital market by making securities transactions fair, healthy, efficient and responsible.

##### **Nepal Rastra Bank**

Nepal Rastra Bank, the central bank, approves prospectus when banks and finance companies propose public issue. It also gives permission to issue debentures in the public along with the approval on interest rate on debentures and bonds. Under NRB directives, bank and finance companies are required to issue shares equivalent to at least 30 and 40 percent in both situation if they have foreign joint venture stake. But while in debentures and bonds issue NRB get assured, by vetting the prospectus, about the size of the issue, interest rate, collateral and repayment of the loan.

### **Nepal Stock Exchange**

While issuing securities to the general public, consent should be obtained from the Nepal Stock Exchange. For this, issuing companies and issue managers are required to submit the prospectus. In the meantime, before concluding agreement, along with the 5% of commission amount should be forwarded to the Nepal Stock Exchange. This is applicable for underwriting arrangements too.

### **Insurance Board**

When an insurance company makes a public issue, insurance Board also performs the vetting of prospectus as it is done by Nepal Rastra Bank.

### **Concerned Ministers of Nepal Government**

The companies, which are incorporated by special acts, are required to get approval on the prospectus from concerned ministers. For example, companies such as Nepal Industrial Development Corporation, Citizen Investment Trust and Rastriya Beema Sansthan are under the preview of Minister of Industry and Minister of Finance. Thus, prospectus of these companies needs to be approved from Ministry of Industry and Ministry of Finance instead of Company Registrars office.

### **Issue Manager**

- Before the amendment of Securities Exchange Act and Securities Exchange Regulation, there were four major market makers namely, Citizen Investment Trust, NIDC Capital Markets Ltd., Banijya Bank and Gauri Shanker Finance Co. Ltd. Except Gauri Shanker Finance Co. Ltd all other market makers were actively involved in issue management activities. After the amendment in Act and Regulation, additional five organizations were permitted to provide issue management services. Among them the new entrants are Nepal Sri Lanka Merchant Bank Ltd., Nepal Merchant Banking and Finance Ltd., United Finance Ltd., Himalayan Securities and Finance Ltd., and Ace Finance Co. Ltd.
- Before the amendment in Securities Exchange Act and Securities Exchange Regulation, market makers were permitted to provide issue management services. In other words, one of the functions of market makers was to provide issue management services. However, this scenario has been streamlined by

second amendment in Securities Exchange Act and regulation by providing separate class of membership in Nepal Stock Exchange namely, Securities Dealer (Primary Market). As per the company Act 2053, all the companies are required to appoint issue managers for raising capital from the general public allotment and other related matters.

- Total capital base requirement to be eligible for markets and securities dealer is Rs.15 million as paid up capital. License for market making and securities dealer is issued to corporate bodies only. Securities Dealers are categorized into two viz. securities dealer (Primary Market) and Securities Dealer (Secondary Market).
- The role of securities Dealer (Primary Market) is confined to provide post issue management services, underwriting services and other related services.

#### **2.1.2.5 Major Participants**

##### **Bankers to Issue**

The concept of bankers to the issue is yet to be developed in the market. However, all the country accepts application money as deposits of issue managers. Application money is deposit off as when asked by issue managers. Primary issue guidelines issued by securities board clearly gives the directives to the issue managers that all the money should be kept under the custody of a commercial bank. Citizen Investment Trust is the only issue manager who keeps application money in a commercial bank under the separate account. For example, application money for a public issue is kept in the name of “CIT-XYZ Company Ltd. Amount collected in this account is deposited off only after the allotment of securities. Secondly, Citizen Investment Trust introduced the system of receiving application forms from the investors along with the application money through the help of Nepal Bank Ltd. Later on, this system was followed by Rastriya Banijya Bank Ltd. For rest of the other commercial banks, some of them are still reluctant to receive application forms. Thirdly, Commercial banks are still reluctant to provide bankers to the issue service with their own initiative by obtaining membership of Nepal Stock Exchange and/ or Securities Board. For this, no act, rules, by law or directives defines the roles and responsibilities of banks in public issue cases. Fourthly, banks generally feel uncomfortable with unwanted rush in their banks. In their opinion, these things hamper their normal

commercial banking activities. On the other hand, very few of them are positive towards the view that banks might have additional alternatives of the short-term funds. Therefore there should be change in concept and/or thinking of all commercial banks towards primary issue market. For this, securities board should conduct periodic symposium, workshop, and seminar and training programs for the officers of various levels. Nepal Rastra Bank can be proper channel/authority to issue separate directives to the commercial banks.

### **Underwriters**

Generally all commercial banks, finance companies and other financial institutions can provide underwriting service and are providing such services accordingly. But the public issues getting underwritten have become Herculean task. Almost all banks, finance companies and financial institutions are reluctant to underwrite the public issue since they feel that underwriting is most risky services among all. This type of reluctance has been strengthened more by some development cases. On other hand, there exist some anomaly in underwriting concept between New Company Act and securities exchange regulation. Company act defines issue manager as underwriters as well. Secondly, no acts and regulations clearly speaks about the qualification to be an underwriter, that is, who can underwrite the public issue and who cannot or whether banks, finance companies and financial institutions other than members of Nepal Stock Exchange can provide the underwriting services then there will be always deficient fund resources to meet the demand for underwriting. Thirdly, because of the insufficient resources and despite of the reluctance of commercial banks (who have enormous resources); issue managers are somehow managing the consortium of underwriting.

### **Stock Broker**

Actually, stockbrokers are retailers of the public issues. But most of the companies who have issued shares to the public views that broker's help in selling securities are not much of significance. However, they take part in investment and brokers' forum with full enthusiasm.

### **Printers Advertising Agencies**

Other important support agencies in the market are printers and advertising agencies. Though there are dozens of printing presses and advertising agencies, they are unable to provide prompt services, timely delivery of issue materials and designing attractive printing materials. Most of the times they have to be guided by issue managers. Because of lack of professional manpower, they are regulated by the regulating agency.

### **Registrar to the Issue**

Similarly, the concept of Registrar to the issue is not been fully developed. Issue managers are providing registrar to the issue services under the total issue management deal but not as separate service. Basically, registrar to the issue function is to be performed by a data processing firms, especially electronic data processing companies. There are number of such type of firms but are not established as an organized institution. No acts defines that registrar to the issue function is not the responsibility of an issue manager but of a separate entity. Therefore, if such firms could not provide reliable service and guarantee the accuracy of data, then there could arise big chaos in the market. Hence, issue managers are bound to provide these services. Secondly, appointment of registrar to the issue is not done before the issue is launched. When, applications are received in large numbers, then and there only issue manager searches for those firms, which can provide such services. Hence, name of the registrar to the issue is not disclosed publicly in the prospectus or in any issue notices.

#### **2.1.2.6 Preparation of Prospectus**

A prospectus is a legal document that institutions and businesses use to describe what they have to offer for participants and buyers.

The documents go into detail about a business; they give history of the company, lists of officers who operate such a business, any litigation that is taking place, financial data, and a list of operations. These documents, when used by businesses, are usually given out for potential investors as part of the IPO. Although usually very detailed,

the public prospectuses are usually very condensed compared to the registration statements filed with the Securities and Exchange Commission.

The company should publish prospectus prior to the issue of the shares. It should get approval from the Securities Board (SEBO). So, all public limited companies that wish to offer securities to the general public are required to publish duly approved prospectus under new company act 2053. And the directors are personally accountable for the matters contained in the prospectus. Preparation of the prospectus is guided by company act 2053; new issue guidelines of Securities Board and securities listing by laws of the Nepal Stock Exchange.

Company act 2053 has prescribed the format of the prospectus. Following 26 items are to be contained in the prospectus:

- Objectives of the company and main clauses contained in the memorandum and articles of association are available.
- Minimum number of shares to be subscribed to the director and salaries, allowance or remuneration fixed for them.
- Particulars regarding remuneration or prize paid or to be paid in cash to promoters or directors of the company.
- Arrangement regarding bonus shares.

Arrangement for reservation of shares for shareholders, employees or for any others:

- Introduction of directors.
- Reasons and justifications if shares are to be sold at premium to general public.
- Representation arrangement in board of directors from the general public.
- Minimum number of shares to be subscribed and advance payment amount for the shares.
- Reasons if loan has been raised by issuing debentures and number of debentures redeemed and outstanding loan amount.
- Brokerage charges on shares and debentures.
- Inherent economic risk factors in company activities.
- Financial arrangement and net worth of the company after adjusting all the liabilities.

- Name of the auditors and audit reports if any.
- If directors or promoters have any amount belonging in property purchased or to be purchased by the company, and the particulars regarding if promoter or company, the details of the same.
- Time when allotment of shares is to be published.
- Brokerage charges to be received by trust for being trustee for the transaction of securities, if any.
- If shares are being underwritten, particulars for the same and commission for the same.
- Name and address of the institution where securities are transacted.
- Name of the shareholders who have subscribed more than five percent of issued capital.
- Terms and conditions for preference shareholders.
- Other necessary things.

A new issue guideline of the Securities Board provides additional matters to be contained in the prospectus:

Purpose of the public issue of securities

- Description of market for goods/services if issuing the company is new.
- Particulars about pending litigation and disputes in agreements etc.

Some other aspects to be considered before issuing shares to the public or while prospectus is drafted:

- Type of securities for which guidelines are applicable, status of company for public issue.
- Underwriting of securities.
- Minimum shares to be subscribed by the public.
- Appointment of issue manager.
- Listing of securities in stock exchange.
- Minimum period of gap between publication of announcement and opening date.
- Minimum period of operating of subscription.
- Arrangement of minimum number of application collection centers.

- Lock in period of promoter’s shares.
- Allotment of securities.
- Management perception on risk factors.
- Validity of issue permission.

Arrangement for keeping allotment money and refund of excess application money Securities Listing Bylaw 2053 prescribes minimum size of the public issue for listing purpose, which is, must to be considered before drafting prospectus. According to the bylaws minimum sizes of public issue prescribed are as follows:

**Table No. 2.1**  
**Size of Capital and Issue Percentage**

S. No.	Size of the issued capital	Public issue percentage
1	Up to Rs. 10 million	25%
2	Rs. 10 million to Rs. 50 million	20%
3	Rs. 50 million to Rs. 100 million	15%
4	Rs. 100 million to above	Fixed with the approval of SEBON

**Source: Nepal Rastra Bank**

As per Company Act 2053, issuing companies are required to issue securities to the general public through the recognized institutions for sale of securities, allotment of securities, collecting money and other related activities. Similarly, as per Securities Exchanges Regulation 2050, issuing companies are required to enter into an agreement with issue manager for the management of public issues.

New issue guidelines made issue manager more responsible towards bringing prospectus more transparent, clear, reliable and correct to the fact. Hence, issue managers are required to analyze the issuing company’s every aspect and should be prime face, self-assured.

In many instances, prospectus are prepared and drafted by issuing companies themselves. Now after making issue manager more responsible, issue managers are

actively involved in drafting prospectus. Directors of the issuing company have to endorse the prospectus before filling to company Registers' Office for approval.

## **2.2. Issue Activities**

Company's capital mobilization activities can be classified into three stages:

### **2.2.1. Pre Issue Activities**

The activities, which are carried out prior to the issue of shares, are known as the pre issue activities. Pre issue is done for saving mobilization. It is called IPO .The pre issue activities can be lined up in the following steps:

- Establishing a company
- Deciding for the promoter's capital
- Hiring the issue manager
- Getting the approval of prospectus
- Appointing the Underwriter
- Selecting the banker to the issue
- Printing the forms/advertisements
- Deciding the timing for the issue
- Appointing the advisory

The preparation of the prospectus of the company is one of the most important pre issue activities of any company.

### **2.2.2. Issue Activity**

Actual issue takes place in this stage. They collect the distributed application form, deposit pre determined amount in the bank and submit the form and bank vouchers either to the issue manager or the co-issue manager. Once the issue period is over, all the collected forms need to be processed. Then if the oversubscription is made, allotment of securities is essential to determine the allotted, primary share certificates and others.

### **2.2.3. Post Issue Activity**

The basic concern here is to study and analyze the performance of the issuer companies before and after the public issue. They announce their targets to be achieved in future through prospectus and announcement. The basic question is whether they are able to achieve their projections that they have announced through these documents.

Recently, SEBON has made compulsory to publish the name and address of financial statement projector. It is done because they were publishing rosy picture initially to attract the attention of the investors.

Besides, SEBON has also given instructions to publish several risk factors to aware the investors. There is the provision that the risk involved should be printed out either in the front or back page of the prospectus. And if there is deviation of 20%  $\pm$ , then the reason should be clearly published later after the actual performance is checked.

### **2.3. Nepal Stock Exchange**

Nepal stock exchange is an organized secondary market for listed securities. This market has been started with licensed members such as member brokers and market makers since January 13, 1994. Since then, it has followed an open outcry system. Under this system, the licensed members are allowed to enter into the trading floor to make transactions on behalf of their clients.

#### **Listing of Securities**

Listing is one of the regular and continuous functions of the NEPSE. According to Securities Exchange Act, 1983 listing of securities of a public limited company is mandatory. The transactions of the securities cannot be made without listing. So, if the entrepreneurs have to arrange liquidity they have to enlist the securities with stock exchange. So, it is the process of registration of securities to make them eligible for trading.

### **Operating Trading Floor**

As mentioned above, listing is quite essential to make them eligible for trading. The listed securities will be traded through the licensed members. So it is the responsibilities of stock exchange to manage and operate the trading floor smoothly in a regulated manner. While operating trading floor, the stock exchange must be aware to disseminate the information timely and accurately. Such received information must be disseminated timely so that the insider trading and price manipulation can be checked for the healthy operation of the market. In the same way, the licensed members should be regulating in such a way so that they will be aware of their responsibilities. So, it the functions of a stock exchange to mobilize the licensed members for the service of the investors. This is because they will be rewarded for their efficient service that they will render to their clients.

### **Valuation of Securities on Daily Basis**

There are different methods for the valuation of securities. They are fundamental and technical analysis. These methods are unable to consider the investors' perceptions. Under the present situation, the licensed members receive buy and sale orders from the investors quoting the price they want to pay or receive. Different members gather in the floor and quote the price for transactions. The transactions will be completed on the basis of tough competition among the members. Generally, the buying brokers want to buy at the low price and the selling brokers want to sell at the high price. The negotiations continue among the brokers and the transactions will be done at the price where the price of buying and selling broker match. The price based on perfect competition reflects the actual worth of the price. This is why the calculated worth of the securities will be compared with the market price. So, stock exchange, by means of operating trading floor assists to value the shares daily.

### **Provide Advisory Services to the Government and Assist to Government to Implement the Policy**

HMG/N can ask several advisory assistances with the Nepal Stock Exchange regarding the development of the capital market and the necessary activities that are to be conducted. In this situation, it is the duty of stock exchange and its officials to provide the best advices to the best of their knowledge. In the same way, the

government can also decide to execute the policy through the organization. As for instance, HMG/N is collecting capital gain tax and income tax on members' income directly from the stock exchange. The budget speech of the F/Y 060/61 announced that the demutualization of several government owned organization would be done through Nepal Stock Exchange. In this way, government is executing its policy through the organized market.

### **Listing of securities**

One of the major components of the capital market is the secondary market for long-term securities. It is the second hand securities market where the securities already traded in the primary market are bought and sold on behalf of their clients. This market can be classified as over-the-counter market and stock exchange. In order to make the securities eligible for trading in stock exchange several criteria set by stock exchange are needed to attain. If the companies cannot meet, the criteria will be denied for listing. So listing is the primary step that the company has to cross to make their securities eligible for trading. The company can serve its shareholders by arranging liquidity through the completion of this process.

Listing means the registration of issued securities with stock exchange to make them eligible for trading. It is the creation of responsibilities towards shareholders and stock exchange and other governing entities. It is the process which generates the volume of jobs to the company because once the securities are traded they need to be transferred in the name of buyers. If the transfer process becomes lengthy, the shareholders will be unable to seize the market benefits. In order to minimize the time required for transfer and fraud and errors, the concept of central depository system has emerged and become popular. In our context, the issuing companies have to commit at the time of issue to the probable investors that they will enlist the securities with stock exchange after the allotment of securities issued. But there is not any provision that such clause is to be mentioned with the approval of stock exchange. Once the issue is approved and registered with Securities and Exchange Board of Nepal, it seems feasible for listing. In fact, it is unfair. This is because if the listing of such companies is denied by stock exchange what will be the status of Securities Board of Nepal? The securities exchange act, 1983 has clearly mentioned

that no securities of public limited company are tradable without listing. If transactions are done without listing, that will be illegal and void. On the other hand, if all the documents are not furnished or the stock exchange feels not feasible for listing, the stock exchange can deny enlisting the securities. Both these provisions are conflicting with each other. Nepal does not have OTC market and if the listing is rejected what will be the position of the investors. The question is unanswerable. If the listing is denied in foreign countries the securities will be traded in OTC market. This makes the listing compulsory because OTC market is still not developed in the country.

### **Pre-requisites for Listing**

As said above, all the companies are not worthwhile to enlist. This is very difficult to get the securities listed in abroad. Once the securities got listed, it makes them eligible for trading. So the factors to make the securities eligible for listing are provisioned below. In our context too, NEPSE has set aside the following pre-requisites for listing. The companies which do not attain the set criteria are not eligible for listing. The criteria set aside to enlist the shares are:

- The minimum paid up capital must of Rs. 25 million.
- The minimum number of shareholders should be 500. But if the company has not floated the shares at the time of submitting the application form for listing, then in this case listing can be done with the condition that the given number of shareholders will be attained within two years.
- The face value of the shares should be either Rs. 10 or Rs. 100.
- The floatation of shares

### **Listing Procedures**

All the stock exchanges have their own listing mechanism. But the general mechanism is to submit the application form in prescribed format along with all the required information, financial statements and listing and annual fees. On the basis of submitted information and financial statements if the stock exchange finds it is worthwhile to enlist the securities that will be listed making them eligible for trading in prescribed manner. Generally, stock exchange demands the documents to assess the profitability and feasibility of the company from the national point of view.

Only the feasible company can earn profit and protect the interest of the shareholders.

So the company has to submit the documents that reveal the following information.

- Names and addresses of the promoters, directors, and their respective holdings.
- Name and addresses of the shareholders holding more than 5 percent of the issued shares.
- Name and addresses of the managing director, chief executive, chief officers, accountants, auditor, company secretary and their holdings of shares, if any.
- Shareholders list.
- Documents that reveal the name and address of the company and the date of business commencement.
- Specimen of share certificate.
- Tax Registration Certificate.
- In case of existing company last three years audited balance sheet and profit and loss accounts and in case of newly established company projected balance sheet and profit and loss accounts for the next three years.
- Approval letter from SEBON for public issue (only if the listing is requested after going to the public) and in case of banks and financier institutions the approval letter from the central bank of the country i.e. NRB.
- Investment details of the company and promoters and directors, if associated with any other organizations.
- The names and addresses of associated organizations.
- Resolutions passed by the board of directors for listing of securities.
- Memorandum and Articles of Associations and Prospectus.
- If the organization is established under special act a copy of such act
- Others.

The company, which has to enlist the securities, must have to furnish the documents and listing and annual fees. The stock exchange goes through all these documents and if finds the listing is feasible and not against the interest of the nations makes decision to enlist. After making decisions the proposal will be forwarded to the Board of Directors. They then make thorough verification and if there is any enquiry the answers to such enquiries will be obtained from the concerned company. If the

members of the BOD are satisfied the company will be listed. But the management of NEPSE can enlist the right issue and bonus issue. The management of the NEPSE must be satisfied that the issue has been made by satisfying all the rules and regulation and the terms and conditions, if any, given by the concerned authorities. The structure of listing and annual fees is based on issued and paid up capital. The fees that the stock exchange uses to charge are as follows.

**Table No. 2.2**  
**Listing and Annual Fees in Case of Shares**

<b>Paid up Capital</b>	<b>Listing Rs.</b>	<b>Annual Rs.</b>
Up to Rs. 10 million	0.20 percent or minimum Rs. 15,000/-	Rs. 15,000/-
Above Rs. 10 million to Rs. 50 million	0.15 percent or minimum Rs. 45,000/-	Rs. 25,000/-
Above Rs. 50 million to Rs. 100 million	0.10 percent or minimum Rs. 75,000/-	Rs. 35,000/-
Above Rs. 100 million	0.075 percent or minimum Rs. 100,000/-	Rs. 50,000/-

*Source: Security Board of Nepal*

The fees that the stock exchange uses to charge for debentures, mutual funds, units, and group saving schemes are as follows.

**Table No. 2.3**  
**Listing and Annual Fee in Case of Debentures, Mutual Funds, Units, and Group Saving Schemes**

<b>Issued or paid-up capital</b>	<b>Listing</b>	<b>Annual Rs,</b>
Up to Rs. 10 millions	Rs. 15,000/-	Rs 15000/-
Above Rs. 10 millions to Rs. 50 millions	Rs. 45,000/-	Rs 25,000/-
Above Rs. 50 millions to Rs. 100 millions	Rs. 75,000/-	Rs 35000/-
Above Rs. 100 millions.	Rs. 100,000/-	Rs.50000/-

*Source: Security Board of Nepal*

After receiving all these required documents and fees the process will be initiated and if finds feasible to enlist that will be forwarded to the Board of Directors who in turn analyses the documents and makes decisions for listing.

## **2.4 Review of Related Studies**

Review of related studies is divided into two parts i.e. national and international context.

### **2.4.1 Review for Studies in International Context**

Large number of research work has been carried out elucidating different aspects of IPO's throughout the globe. However, only those works, which were accessible and considered relevant to this study have been included and excerpted below:

Lowry and Schubert (2002) carried out a study on, "IPO Market Cycles: Bubbles or Sequential Learning?" The study emphasized that both IPO volume and average initial returns are highly correlated. Furthermore, companies tend to go public following periods of high initial returns. The study revealed that there exist significant positive relation between average initial returns and subsequent IPO volumes. They concluded with the result, which showed that the dynamic behavior of initial returns and IPO issued is a complicated function of many factors. There are significant biases in IPO offer prices and arise from underwriters not fully incorporating all avoidable information when they set offer prices. These biases affect both the serial correlation in initial returns and the lead-lag relation between initial returns and IPO volumes. They also found that the serial correlation in initial returns is predominantly driven by information learned during the registration periods of recent IPO's but only partially incorporated into the registration periods of recent IPO's but only partially incorporated into the offer price. Furthermore, they found that its information learned during the registration period that is positively related to further IPO volumes. Investment bankers learning processes throughout this registration period causes monthly aggregate initial returns to be auto correlated and to be positively related to future levels of IPO actively.

Corwin and Schultz (2005) examined syndicates for 1638 IPO's from January 1997 through June 2002. Contrary to popular belief that the larger syndicate yields benefits, they discussed several factors that may limit syndicate size. They mainly examined how syndicate structure affects the likelihood and magnitude of offer price revisions in response to information revealed during the filling period. As a proxy for information, they used the total return from the midpoint of the filling price range to the closing price of the first day of trading. For the purpose, they collected an initial sample of 2146 IPO's issued from the Securities Data Company's (SDC) Global new issues Database. They found strong evidence of information production by syndicates members in IPO's underwritten by large syndicates and particularly by syndicates with a lot of co-manager, the offer price is more likely to be revised away from the midpoint of the filling price in respond to information. For large IPO's, they found underwriter who can provide coverage by a top-ranked analyst are more likely to be include in the syndicate. Similarly, even though the issuers benefit from increasing the number of syndicate members and especially the number of co-managers who underwrite their IPO, syndicate size is very much dependent upon the preference of book manager rather than issuers. Finally, they concluded that although the IPO proceeds increase from 1997-2002, syndicates grew smaller.

Baru and Fawcett (2006) study on "Initial Public Offerings; An Analysis of Theory and Practice". The study intended to extend the IPO literature by analyzing unique data from surveys of Chief Financial Officers (CFO's) to compare CFO perspectives to prevailing academic theory. Specifically, they examined the following seven issues; motivations for going public, timing of the IPO's, underwriter selection under pricing, signaling IPO process issues and the decision to stay private. In this regard, they surveyed three sub samples of firms, namely those that successfully completed an IPO, those that began the process but chose to withdraw the issue and those that are large enough to go public, but have not attempted an IPO. They surveyed 330 CFO's and their survey process followed Dill Man's (1978) total design method, which is a standard for conducting academic surveys. Their findings are summarized as: The most important motivation for going public is to create public shares for use in future acquisitions. Insiders are opportunistic especially at VC-backed firms. They seek to go public at a time that portends a high stock price. The underwriter selection process

is driven by a very small set of selection criteria namely underwriter reputation and IPO process expertise. CFO attributes most under pricing to market uncertainty and the need to reward investors for taking the risk of IPO. The most important positive signal is past historical earnings and may promote window dressing. CFO's strongly prefer firm commitment underwriting. Companies remain private to preserve decision-making control ownership.

Ritter demonstrated that, beginning with the first day closing price, IPOs underperform comparable non-issuing companies by 5.6% over the subsequent five-year period. IPOs in hot markets "markets with high IPO volume and high first-day returns" perform particularly poorly over the long run, which was recently confirmed by Wu (2005) in his study of 2,580 IPOs during the period 1986-1996.

Studies by Aggarwal and Rivoli (1990) Loughlin and Ritter (1995), and Welch and Ritter (2002) also demonstrate IPO underperformance. Recent work by Schulz (2003), Viswanathan and Wei (2004) and Gompers and Lerner (2003), however, suggest IPOs alleged underperformance is the result of the small sample effect, that there may be no IPO underperformance ex-ante, but we may have just drawn a small sample where too many IPOs perform very poorly ex-post (Hang, Gu, and Hachberg, 2004).

Gompers and Lerner, for instance demonstrated that for the period 1935-1972, IPOs did not underperform benchmarks, in contrast to the post-1970 sample examined by Ritter (1991). Hang, Gu, and Hachberg (HGH) studied just this question, uncovering new evidence supporting the existence of the IPO underperformance effect. HGH concluded that Schultz (2003) fails to find IPO underperformance in calendar time because he considers only a short 1-month holding period horizon, that calendar time IPO underperformance reappears with longer holding period horizons, and that IPO underperformance is highly unlikely to be the result of a statistical fluke, a theory which, in order to hold, would require that approximately 1 in 50 IPOs must at least triple their values every month.

Evidence from markets ex-U.S. and from foreign IPOs trading on U.S. exchanges is more supportive of the idea of investing in IPOs "but not much more. Callaghan,

Kleiman, and Sahu (1999) reported one-day and one-month outperformance of 5.29% and 2.3% for a sample of 66 ADRs issued by firms in 18 countries and traded on the NYSE, AMEX, and Nasdaq from 1986-1993.

But as was the case with non-ADR IPOs, other studies have found similar performance for short holding periods but very different performance for long-term holding periods. Foerster and Karolyi (2000), for instance, examined the performance of 333 ADRs from 35 countries for the period 1982-1996 and found that the sample group underperformed by 1% per month and 4% per year and that the underperformance expanded to 15% over a three-year period. Schaub and Highfield (2004) broke down a group of 152 ADR IPOs on the NYSE into two groups: those prior to June 1998 (129) and those after (23). The pre-June 1998 group underperformed the S&P 500 over a three-year period, while the post-June 1998 group outperformed, though the authors called the results statistically insignificant, probably due, at least in part, to inadequate sample size for the post-June 1998 group.

We find similar results in markets outside the U.S. Schuster (2003) reviewed the performance of 973 IPOs in the six largest European markets and Sweden for the period 1988-98 and found evidence of short-term out performance but no evidence of long-term underperformance. As so many before him have likewise concluded “ Logue (1973), Ibbotson (1975), Ritter (1984), Ibbotson, Sindelar, and Ritter (1988), and Loughran and Ritter (1995) “ the initial outperformance of IPOs” Ritter and Welch (2002) found the first-day return of 6,240 U.S. IPOs for the period 1980-2001 averaged 18.8% “ was robust to under pricing.

Schuster goes a step further. He even writes off his own findings of IPO long-run outperformance for his sample period as definitive testimony of the overriding influence of the New Economy during the 1990s. (New Economy IPOs accounted for 28% of his sample.)

Kooli and Suret (2002) reviewed 445 Canadian IPOs for the period 1991-1998 and found a first-day return of 20.57%, which, like Teoh, Welch, and Wong (1998) before them, they attributed to the myopia of investors, who are unable to fully grasp the extent to which IPO firms engage in earnings management.

It should be noted that several studies, either implicitly or explicitly “such as Kooli, Her, and Suret (2003) which, in reviewing the performance of 141 Canadian IPOs between 1996-2001, found significant over performance over the three years following the IPO for equal-weighted portfolios but no abnormal returns for value-weighted portfolios” parrot the cautionary words of Mitchell and Stafford (2000) that measuring abnormal long-term performance is treacherous. On the other hand, other studies found no difference in the results between equal weighting and value weighting.

This is, believe it or not, a brief sampling of the IPO literature, but we leave it at that. Suffice it to say; the preponderance of evidence suggests that if you’re lucky enough to get in on a new issue at a pre-IPO price, the smart move is to sell as soon as you can.

Of course, most of us can’t invest in IPOs anyway. That privilege is reserved for investors deemed worthy of the honor by big brokerage firms (who make enormous sums underwriting IPOs but not a cent on RTOs. Could that explain their derisive attitude toward the latter?). So for all practical purposes, the fact that IPOs across all global markets tend to underperform their respective broader markets and comparable non-IPO issues over the long run is irrelevant. But it does suggest that rather than having regrets at missing the latest hyped IPO, the appropriate response is, more often than not, a grateful when it is possible, however, for the average investor “you and me” to invest in the alternative IPO mechanism, the RTO. But should we?

Almost all academic literature on the subject of IPO performance comes to the same conclusion: If you have the opportunity to invest in an IPO and decide to do so, chances are you’re going to get screwed.

#### **2.4.2 Review of Major Studies in Nepal**

In this section, the previous work done about the performance of some financial institutions is reviewed. Very few studies have been conducted to access various aspects of banking and financial services in Nepal, taking into consideration of their post issue performance. Thinking that the conclusion drawn on such thesis work will

be relevant to justify my study, the review of some previous thesis have been made and presented in this section.

A study conducted by Mr. Prabin Manandhar (2002), article with “A comparative study on financial performance of financial companies”. He made comparative study of the financial performance of Lumbini Finance Company (LFCL), Universal Finance and Capital Markets Ltd. (UF&CM) , Nepal Housing and Merchant Finance Ltd (NHMF) and Himalayan Securities and Finance Ltd (HSFL). The major findings of his study were:

- ) The average mean current ratio over the study period maintained by all financial companies is higher than the desired current ratio of 2:1.
- ) Highly levered capital structure is found in all institutions. The debt financing within the capital structure of NHMF, LUFL and HSFL are found to be more than 8 times of their corresponding equity capital.
- ) The debt equity ratio is found to be very high and unusual due to inclusion of deposit in the debt capital.
- ) LUFL has paid comparatively the highest dividend out of the available earning per share.
- ) Out of that loans and advances, NHMF is comparatively found to be capable in maintaining good quality loan than the others.

On the basis of these findings, following suggestions have been recommended:

- ) It is suggested to maintain a reasonable credit investment in the area of consumer durable through Hire-purchase and housing loan.
- ) UFCL and LFCL’s growing amount of interest suspense account clearly reveals the deteriorating collection ability of the company. So it should initiate a dynamic action plan immediately in order to expedite the collection of account receivable.
- ) A violation of NRB directive by LFCL in respect of resource / deposit collection is observed. Since inefficient mobilization of excessive resources adversely affects the company’s financial position, the company should think about minimizing the collecting deposit.
- ) The companies are suggested to adopt a specific dividend policy.

- ) HS&FL is suggested to utilize its current assets more efficiently in productive sectors like agriculture and industry.

A study conducted by Mr. Rabin Kumar Karki (2004), article with “A comparative study on the financial performance of finance companies in Nepal”. His study is primarily based on the two finance companies i.e. Universal Finance and Capital Market Ltd and Nepal Housing and Merchant Finance Ltd. Its main objective is to find out comparatively the actual financial position of the finance companies and to suggest the necessary corrective action for the improvement of their performance. The problems of finance companies are financial problem, unfavourable economic situation, lack of investment opportunities and counseling services as well. The major findings of the study are:

- ) The mean current ratio of both finance companies is found to be below the standard ratio of 2:1 while the quick ratio is satisfactory.
- ) The activity ratio indicates that cash management and utilization of deposit of NH&MF is better than UFCM.
- ) The overall profitability of NH&MF is better than that of UFCM rather it is not found to be satisfactory. Debt equity ratio of UFCM is in better position than NH&MF as debt equity of NH&MF is found to be very high.
- ) Return on investment of NH&MF is in better position which means it has efficiency generated more profit from investment.
- ) NH&MF has contributed more than UFCM to the government for the development of nation.
- ) Major source of income for both companies is interest and operating expenses and interest expenses seems to be the major expenses of the companies.

On the basis of findings he has put forward some recommendations which are as follows:

- ) These finance companies are recommended to use the fund in new productive sectors to generate more profit and to utilize their resources more efficiently as well.
- ) They have to keep reasonable amount of liquidity to maintain their short term solvency position.

- ) The finance companies should actively participate on the social matters and programs in which today's finance companies are far behind.
- ) In future companies should explore the areas by expanding their business like leasing, bridge financing and venture capital financing.

A study conducted by Mr. Shree Ram Ghimire (2005), article with "A study on financial performance of finance companies in the context of Nepal". This study was conducted basically to provide a detailed analysis on the financial performance of some listed finance companies namely NHDFCO, NSMCO, KFC, NFCO & AFCO. The financial performance of these companies was examined in terms of liquidity, activity, profitability, leverage and capital adequacy and growth ratios. On the same ground he has tried to highlight on possible guidelines to improve the financial performance of finance companies. The major findings of the study are:

- ) Liquidity position of AFCO is comparatively better than that of other finance companies but is highly fluctuation liquidity position shows that the company has not formulated any stable policies.
- ) Regarding activity ratio NSMCO and AFCO are below the standard than that of other finance companies. It predicts that they have to tackle new techniques in coming days so that they can earn maximum return.
- ) Profitability position of NSMCO is comparatively not better than of others. NSMCO must maintain its high profit margin in future.
- ) Growth ratio of NSMCO has not been more successful to increase its net profit, earning per share and dividend per share in comparison to other finance companies so the NSMCO has not any effective strategy to win confidences of shareholders, depositors and all of its customers.

On the basis of findings, he has recommended some of his views for improvement of these companies:

- ) Finance companies have to canalize funds by gradually shifting priorities from hire purchase to trading and industry to help in the capital formation within the country.
- ) Legal and procedural improvement like unrestricted entry into the financial market and on-site supervision should be effective.

- ) Further statement improvement like joint promotion of finance companies, matching of assets and liabilities conducting trading seriously and positively impacting to public confidence.

A study conducted by Mr. Chandra Amatya (2005), article with “Financial performance of Lalitpur finance company” and found the company being run successfully for several years. The various financial indicators like liquidity ratio, leverage ratio, profitability ratio, return on equity capital, return on net worth, return on total assets and EPS were calculated and the financial position of the company was measured. These financial indicators show the company’s position is satisfactory except some mismatches in investment activities. The major findings are:

- ) The profitability ratio of LFC is not satisfactory. The profit ratios are not up to the expected level showing the company doing just average in terms of profit earned.
- ) High positive relationship between deposit and loans and advances and net worth and total assets have been found.
- ) With every increase in deposit, company is able to invest in different items of loans and advances.

On the basis of these findings following points of recommendation have been suggested:

- ) The company has been suggested to maintain its consistency liquidity position around the normal standard of 2:1 and so as its turnover ratio like loans and advances to total deposit, loans and advances to total fixed assets etc.
- ) The company is recommended to make appropriate mix of debt and owner’s equity which in turn will increase the value of the firm.
- ) The company is suggested to formulate marketing strategies carefully to serve the customers. It is suggested to introduce ATM facilities, credit card facilities and many more.

A study conducted by Mr. Jaya Karmacharya (2007), article with “Financial performance of financial companies in Nepal; a study in Kathmandu Valley” has included Nepal housing Development Finance Company Ltd (NHDFCO), National

Finance Company Ltd (NFCO) and Nepal Housing and Merchant Finance Ltd (NH&MF). Under this study the following are the major findings:

- ) The average current ratio of NHDFCO is higher, that of NFCO and NH&MF seem to be similar. All are far below the standard norms of 2:1.
- ) NHDFCO and NH&MF are utilizing the total deposit highly in lending activities while NFCO in investing activities.
- ) Profitability position of NFCO is comparatively not better than that of other finance companies except of its return on net worth.
- ) Use of debt is comparatively lower in NHDFCO. NFCO and NH&MF are following aggressively policy and utilizing higher debt.
- ) PE ratio of NH&MF is comparatively higher than that of other two FC's. Dividend pay ratio of NHDFCO is higher than others. It is paying higher amount of its income as dividend.

On the basis of these findings he has put forward the following points of recommendation:

- ) The current ratio of all these companies does not meet the standard level of 2:1. So FC's must identify the quality of current assets and current liabilities to develop their own standard current ratio.
- ) The FC's are suggested to employ their major source of fund i.e. deposit in more profitable sector so as to maximize the return and increase the net profit.
- ) NHDFCO and NH&MF seem to be unable in generating sufficient profit from its net worth. So management should use it more wisely.
- ) Return on investment of NFCO and NH&MF seem to be unsatisfactory, hence they must shift their investment from low income generating investment to the higher ones.
- ) NFCO and NH&MF seems to be highly leveraged which is symbol of risk.

A study conducted by Mr. Pankaj K.C (2010), article with "Financial performance of Paschimanchal Finance Company Limited" has disclosed following major findings:

- ) Liquidity ratio of the company is higher than the normal standard.

- ) The capital structure of the company is extremely leveraged. Total debt to asset ratio is remained always higher indicating excessive use of debt in financing assets.
- ) The fund for the capitalization of the company by outsiders is favourable to the other finance companies because interest payable to long term debt is very less than earning from shareholders.
- ) The company always wants to have high return by investing its assets in productive sectors. However, the return on assets ratio of the company is very low as the company has not been able to utilize its resources in more efficient way. The major portion of the assets is blocked in cash and bank balance and fixed assets which do not generate income.

He has put forward the following points of recommendation:

- ) The company is suggested to work together for building up the public confidence and enhancing their image in the minds of public at large.
- ) The company has to now think about consolidation the finance companies in some way or the other. By being very small it is very difficult to serve in the market.
- ) The credit monitoring wings should be made strong enough to ensure timely cash inflows from credit granted.
- ) The company should be alert enough to avoid imperfect practices inherited from the past mistake.

## **2.5 Research Gap**

Many researches have been carried out in the past on financial performance of finance companies. They are practically useful and various related persons including academicians, shareholders and general public appreciate all. Those researches have been successful in highlighting the strengths and weaknesses of the finance companies. The recommendations and suggestions given by them to improve the financial position of finance companies have provided some guidelines in decision-making process. But, all these researches are limited to the comparative financial performance of finance companies after initial public offering (IPO). This research attempts to explore the effect of IPO on the financial performance of finance

companies. Therefore, this research work includes comparative financial performance analysis before IPO i.e. pre-issue and after IPO i.e. post-issue.

Pre-issue and post-issue financial analysis of different finance companies has been made with the help of different financial ratios and their comparisons. This research thus will be helpful to all the stakeholders of different selected finance companies to know their strength and weakness, profitability, operating efficiency and many other important facts of both the time i.e. pre-issue and post-issue. It will be easier for the finance companies to evaluate their own performances by comparing their pre-issue and post-issue financial performances. This will help them to reformulate their policies and strategies. It will also be helpful to the general public to identify the good performing finance companies.

## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

This chapter states the methodology to accomplish the objective set in chapter one. It includes the research design, population and sample, nature and source of data, method of data analysis and tools used for the analysis.

#### **3.1 Introduction**

Stated simply, research means to search again. We study the social problems again and again to find out something more about the phenomena. The first look may not always be adequate. It may be prone to error. Therefore, we look into the phenomenon again and again and study the problem differently and thoroughly each time. This process of searching again and again is known as research. Research is a knowledge building process. It generates new knowledge, which can be used for different purpose. Research is undertaken not only to solve a problem existing in the work setting, but also to add or contribute to the general body of knowledge in a particular area of interest to the researcher. Thus research is an organized, systematic, data based, critical, scientific inquiry or investigation into a specific problem, undertaken with the objective of finding answers or solutions to it (Wolff and pant 2005:5).

Methodology is the research method used for investigation. Research Methodology is the way of doing and completing research work. It is the way to solve the research problem systematically. The systematic and well organized way of solving the research problem can be referred to as research methodology. The research methodology methods and techniques are convenient and appropriate for analyzing the data and information collected. This includes personal observation, questionnaire distribution, secondary data collection, annual report, previous study, websites of finance companies etc. Research methodology depends on the various aspects of research projects. The size of project, the objective of project, impact of project in various aspects of human life etc are the variables that determine the research methodology of the particular projects.

### **3.2 Research Design**

A research design is a plan or blue print of investigation for the collection and analysis of data. It helps the researcher in the right direction in order to achieve the goal. It includes nature of data, specification of the method of the proposed study and detail plan for carrying out the study with various empirical data for the analysis of problems etc. First the data are presented in table (or diagram), second presented data are analyzed by using various financial and statistical tools and at last analyzed data are compared and interpreted for the conclusion. Descriptive cum analytical research design is being followed to analyze the financial performance of the selected finance companies to achieve the prescribed result.

### **3.3 Nature and Sources of Data**

The nature of data required for this research work is secondary. The financial statements of the finance companies before and after going into public are the main sources of data. Besides these the annual reports published by Nepal Stock Exchange (NEPSE), Economic survey and NRB's publications are other sources of data. Other necessary information have been gathered from NRB, concerned finance companies, web sites, Libraries, Securities Board (SEBO) and many other sources.

### **3.4 Population and Sample**

All the 73 finance companies listed in NEPSE, which have issued shares in the public, are the population of this study. The three years financial statements of the finance companies before and after going into public are the main sources of data. The selected five finance companies have history of three years of financial statement before and after going public where other finance companies listed in NEPSE do not have relevant data. Sampling is the process of selecting the sample from the given population. So, random sampling method is used for the purpose of the study. The selected five finance companies whose IPO was in 2004/2005 and have at least three year history before and after public issue have been selected as sample. Selected companies comparative performance evaluation can be made through evaluating financial performance before and after going public. The selected finance companies are:

1. United Finance Limited. (UFL)
2. Siddhartha Finance Limited (SFL)
3. Standard Finance Limited. (STDFL)
4. Gorkha Finance Limited. (GFL)
5. Butwal Finance Limited. (BFL)

### **3.5 Method of Data Analysis**

For the purpose of analysis, financial statement of concerned finance companies, the profit and loss account and balance sheet have been used. Financial statement analysis is largely a study of relationship among the various financial sectors in the business as disclosed by the single set of statement and a study of these factors as shown in series of statement. It is a process of identifying the financial strength and weakness of the firm by properly establishing relationship between the items of balance sheet and profit and loss account. Thus, the analysis of financial statement is important and aid to financial analysis as well. It is helpful in assessing the financial position and profitability of the business concern (Pandey, 1992: 108).

Both financial as well as statistical tools have been used here for the analysis of collected data and which are described below.

#### **3.5.1 Financial Tools**

The available data are first summarized. Then the hidden facts put forth by financial statements are analyzed by using financial tools i.e. Ratio analysis.

#### **Ratio Analysis**

Ratio analysis is a technique of analysis and interpretation of financial statement. It is very much powerful tool of financial analysis. It provides guidance specially in spotting trends towards better or poor performance and in finding out significant deviation from any average or relatively applicable standard. It is considered as a tool for measuring the overall financial performance of any firm. It helps the researcher to make qualitative judgment about the firms' financial position and performance. In other words, ratio analysis gives mathematical products that work as the eye opener

for financial analysis. Following ratios have been used here in compliance to the objectives of the study.

- Liquidity Measures
- Activity/Turnover Measures
- Leverage/Capital structure Measures.
- Profitability Measures
- Valuation Measures

### **3.5.1.1. Liquidity Measures**

The ability of a firm to meet its obligation in the short term is known as its liquidity. It reflects the short-term financial strength of the business. "Liquidity is the ability to meet anticipated and contingent cash needs." The liquidity ratio measures the ability of a firm to meet its short-term obligation. In order to ensure short-term solvency, the company must maintain adequate liquidity. The following ratios are used to find out the short-term solvency of the selected finance companies.

#### **1. Current Ratio**

The current ratio indicates company's liquidity and short-term debt paying ability. It reflects the strength of the current assets available with the company over its current liability. Current ratio measures the short-term solvency i.e. its ability to meet short-term obligation or as a measure of creditors versus current assets. It can be calculated by dividing current assets by current liabilities. Thus

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Traditionally, the current assets of the company should be twice than current obligation to be technically solvent. For many types of business, 2:1 is considered to be an adequate ratio. If the current ratio of the firm is less than 2:1, the solvency position of the firm is not good".

#### **2. Cash and Bank Balance to Total Deposit Ratio**

This ratio is employed to measure whether bank and cash balance is sufficient to cover unexpected demand made by depositor. It can be stated as

$$\text{Cash and Bank Balance to Total Deposit} = \frac{\text{Cash and Bank Balance}}{\text{Total Deposit}}$$

Cash and bank balance are the idle money kept for day to day payments. A high ratio indicates the greater ability to meet their deposits and vice versa. Moreover, too high ratio is unfit as capital will be tied up and opportunity cost will be higher.

### **3. Cash and Bank Balance to Current Assets Ratio**

This ratio examines the finance companies liquidity capacity on the basis of its most liquid assets i.e. cash and bank balance. Here cash and bank balance is the idle money kept for day-to-day payment to be made by the firm. This ratio reveals the quantity of cash and bank balance maintained by the firm out of its total current assets. It is computed by dividing cash and bank balance by current assets.

$$\text{Cash and Bank Balance to Current Assets} = \frac{\text{Cash and Bank Balance}}{\text{Current Assets}}$$

A high ratio indicates sound ability to meet their daily cash requirements and vice versa. Both higher and lower are not desirable.

#### **3.5.1.2. Activity/Turnover Measures**

This ratio indicates how quickly certain current assets are converted into cash. The funds of creditors and owners are invested in various assets to generate sales and profit. Activity ratios are employed to evaluate the efficiency which the firm manages and utilizes its assets. The ratio indicates whether the funds employed have been used efficiently in the business activity or not. These ratios are called turnover ratios because they indicate the speed with which assets are converted or turn over into profit generating assets. Following ratios are used under activity ratio.

#### **1. Loans and Advances to Total Deposit Ratio**

This ratio assess to what extent the firm is able to utilize the depositor's fund to earn profit by providing loans and advances. Deposit is the main source of income of the finance companies and they should be utilized properly in order to generate further

profit. It is computed by dividing the total amount of loans and advances to total deposit funds.

$$\text{Loan and advances to Total Deposit} = \frac{\text{Loans and Advances}}{\text{Total Deposit}}$$

High ratio indicates higher or proper utilization of funds and low ratio is the signal of balance remained unutilized or idle.

## **2. Total Investment to Total Deposit Ratio**

Investment is one of the major forms of credit created to earn income. This implies the utilization of firms deposit on investment in government securities and share, debenture of other companies and bank. This ratio measures the extent to which the finance companies are successful in mobilizing total investment on total deposit. The amount of deposit should be soundly invested not only to provide interest on its deposits but also has to declare a handsome dividend to its owners i.e. shareholders. It can be computed by dividing total investment by total deposit.

$$\text{Total Investment to Total Deposit} = \frac{\text{Total Investment}}{\text{Total Deposit}}$$

## **3. Total Assets Turnover Ratio**

The total assets turnover ratio is calculated by dividing sales (revenue) by total assets. It measures the overall utilization of firm's assets.

$$\text{Total Assets Turnover} = \frac{\text{Revenue}}{\text{Total Assets}}$$

The high ratio indicates that the company is generating an adequate volume of business for the size of its asset investment. So, increasing ratio is preferable.

### **3.5.1.3. Leverage/ Capital Structure Measures**

A firm should have a strong short term as well as long-term financial position. "To judge the long term financial position of the firm, these ratios help to measure the

financial contribution of owners and creditors comparatively. These ratios indicate the situation of the capital structure, which is calculated to measure the company's capability of using debt for benefit of shareholders. The related leverage ratios are:

### **1. Debt Equity Ratio**

Debt equity ratio examines the relative claims of creditors and owners against the firm assets. Alternatively the debt to equity ratio indicates the contribution of debt capital and equity capital fund to the total investment. It can be stated as:

$$\text{Debt Equity Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

### **2. Debt Assets Ratio**

Total debt to total assets ratio shows that what portion of the capital assets are financed by outside funds and measures the financial safety/security to the outsiders. The outsiders or creditors prefer a low debt ratio as it provides a sufficient cushion against losses in the event of liquidation. It is calculated dividing total debt by total assets. This can be stated as:

$$\text{Debt Assets Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

A high debt to total assets ratio represents a greater risk to creditors and shareholders and vice versa. So, the decreasing ratio is preferable.

### **3. Times Interest Earned Ratio**

The ratio of earnings before interest and taxes (EBIT) to interest charges. It measures the ability of the firm to meet its annual interest payment. It can be stated as:

$$\text{Times Interest Earned Ratio} = \frac{\text{EBIT}}{\text{Interest Charge}}$$

### **4. Capital Adequacy Ratio**

The capital adequacy ratio is one of the most significant ratios, used specially to assess the firm's strength of the capital structure of the adequacy of the capital.

"Adequate capital is required to the efficient operation and functioning of the firm in the modern competitive environment" is always the matter of controversial debate. Capital refers to the paid up capital, general reserve and undistributed profits. So, capital adequacy is determined as

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital Fund}}{\text{Total Deposit}}$$

#### **3.5.1.4. Profitability Measures**

Profitability ratio shows the overall efficiency of the business concerns. The relation of the return of the firm to either its sales or its equity or its assets is known as profitability ratio. Profit is necessary to survive in any business field for its successful operation and further expansion. It measures management's overall effectiveness as shown by the return generated on sales and investment. Profitability positions can be evaluated through profitability ratios. Some of the important ones are as follows:

##### **1. Earning Power Ratio**

The ratio of EBIT to total assets is the earning power ratio. This ratio indicates the ability of the firm's assets to generate operating income.

$$\text{Earning Power Ratio} = \frac{\text{EBIT}}{\text{Total Assets}}$$

The increasing ratio is favorable for a company, which shows that the net profit is increasing.

##### **2. Return on Total Assets**

Net profit to total assets evaluates the efficiency of a company in utilization and mobilization of the assets and its survival. The ratio is computed dividing net profit (loss) by total assets. Net profit indicates the position of income left to the interval equities after all costs, charges, expenses have been deducted. The high return on total assets indicates the high profit margin and high turnover of total assets and vice versa. It can be stated as

$$\text{Net Profit to Total Assets Ratio} = \frac{\text{Net Profit after Tax}}{\text{Total Assets}}$$

### 3. Net Profit to Total Deposit Ratio

This ratio examines whether management has been capable to mobilize and utilize the deposits. In other words, it is used for measuring the internal rate of return from deposits. It also helps to know the overall performance and generation of profit of finance companies. Generally, higher ratio indicates better utilization of deposits and vice versa. It can be presented as:

$$\text{Net Profit to Total Deposit Ratio} = \frac{\text{Net Profit after Tax}}{\text{Total Deposit}}$$

### 4. Return on Net Worth/Net Profit to Net worth Ratio

Return on net worth is used to measure the profitability of the owner's investment or company's earning power against equity. This ratio is calculated by dividing net profit by net worth. Higher ratio indicates the high overall efficiency of the firm and vice versa.

$$\text{Return on Net Worth} = \frac{\text{Net Profit}}{\text{Net Worth}}$$

### 5. Return on Investment

Return on Investment is the major tool for measuring the capacity of the company to generate profit out of its total investment. Investment includes both long term and short-term investment. It can be computed dividing net profit after tax by total investment.

$$\text{Return on Investment (ROI)} = \frac{\text{Net Profit}}{\text{Total investment}}$$

### 6. Total Interest Earned to Total Working Fund Ratio

To depict the earning capacity of a finance company on its total assets/working fund, total interest earned to working fund ratio is very helpful and significant. A high ratio is an indicator of high earning power and better performance of the finance companies on its total working funds and vice versa. It can be stated as

$$\text{Total Interest Earned to Total Working Fund Ratio} = \frac{\text{Total Interest Earned}}{\text{Total Assets}}$$

### 7. Total Interest Paid to Total Working Fund Ratio

This ratio measures the percentage of total interest paid on liabilities with respect to total working fund. The interest paid comprises of total interest expenses on total deposits, loans and advances, borrowings and other deposit. A high ratio indicates high interest expenses on total working fund and vice versa. It can be stated as:

$$\text{Total Interest Paid} = \frac{\text{Total Interest Paid}}{\text{Total Assets}}$$

### 3.5.1.5. Valuation Measures

The valuation ratios indicate the market value of the firm as compared to the book value and measure the stock price relative to earnings. These ratio results the overall performance of the firm measuring the combined effect of risk and return. The following ratios are calculated under this group:

#### 1. Earnings per Share

The income of per common share is known as earning per share. It can be calculated by the following way.

$$\text{Earnings per Share} = \frac{\text{Net Profit after Tax} - \text{Preference Dividend}}{\text{Number of Common Shares}}$$

#### 2. Dividend per Share

The amount of earning which is distributed to the shareholders is known as dividend. The whole amount of earning may or may not be distributed to shareholders by a company. How much per share the dividend is distributed to common shareholders by a company can be known from this ratio. It can be calculated by following formula.

$$\text{Dividend per Share} = \frac{\text{Dividend Paid to Equity Shareholders}}{\text{Number of Common Shares}}$$

### 3. Dividend Payout Ratio

This ratio implies the relationship between earning belonging to the ordinary shareholders and dividend paid to them. It also shows the percentage of earning retained to them. It is calculated by dividing dividend per share by earning per share. Thus, dividend payout ratio is stated as

$$\text{Dividend Payout Ratio} = \frac{\text{Dividend per Shares}}{\text{Earning per Share}}$$

#### 3.5.2 Statistical tools

Statistical analysis is one particular language which describes the data and makes possible to talk about the relation and the difference of the variables. Without the adequate understanding of the statistics, the investigator in social science may frequently be like a blind man groping in a dark closed for a black cat that is not there. The method of statistics is useful in an every widening range of human activities in any field of thought in which numerical data may be. There are various statistical tools which can be used for the evaluation of financial performance of finance companies. Among them Hypothesis test (t-test) have been used in this study for the evaluation of financial performance of selected finance companies.

#### Hypothesis Test (t-test)

The steps in testing paired t-test for different of means are as follows:

##### Step – 1

Null hypothesis and alternative hypothesis is set up as follows:

**Null Hypothesis  $H_0$ :**  $\mu_x = \mu_y$  that means there is no significant difference in financial performance before and after IPO

**Alternative Hypothesis  $H_1$ :**  $\mu_x \neq \mu_y$  that means there is significance in financial performance before and after IPO

### Step – 2

Computation of the test statistics,

**Test Statistics:** Under  $H_0$ , the test statistic is

$$t = \frac{\bar{d}}{\sqrt{S^2/n}}$$

Where  $d = X - Y$  difference between two set of observations.

$$= \bar{d}/n$$

$$\text{And } S^2 = \frac{1}{n-1} [ \sum d^2 - (\sum d)^2/n ]$$

### Step – 3

The tabulated value of  $t$  for  $(n-1)$  degree of freedom at 5% level of significance according as whether the alternative hypothesis is one tailed test or two tailed test obtained.

### Step – 4

Decision is made by comparing the calculated value of  $t$  with the tabulated value of  $t$ . If calculated  $t >$  tabulated  $t$ , it is not significant and  $H_0$  is accepted. Otherwise, it is rejected.

## **CHAPTER - IV**

### **DATA PRESENTATION AND ANALYSIS**

This chapter explains the presentation and analysis of data required to meet the objectives stated in chapter one.

#### **4.1 Initial Public Offering Date of Sample Company**

The selected finance company whose IPO date is within 2004/2005 has been considered for data presentation. Out of them 73 finance companies, only five finance companies, which have at least three-year history before and after public issue, have been selected as sample. The selected finance companies with their IPO date are:

**Table 4.1**  
**IPO Date of Sample Company**

<b>Company</b>	<b>Date</b>	<b>Issue Manager</b>
<b>United Finance Limited (UFL)</b>	<b>8/5/2005</b>	<b>NMB</b>
<b>Siddhartha Finance Limited (SFL)</b>	<b>7/11/2004</b>	<b>NMB</b>
<b>Gorkha Finance Limited (GFL)</b>	<b>5/7/2004</b>	<b>NSML</b>
<b>Standard Finance Limited (STDFL)</b>	<b>1/7/2005</b>	<b>NMB</b>
<b>Butwal Finance Limited (BFL)</b>	<b>22/05/2005</b>	<b>NMB</b>

*Source: Security Board of Nepal*

#### **4.2 Liquidity Ratio**

Liquidity ratios are used to judge the ability of a company to meet short-term obligations. A high liquidity ratio shows the financial strength of the firm and vice versa. The following ratios are used to find out the short-term solvency of selected finance companies.

##### **Current Ratio**

Current ratio indicates company's liquidity position and short-term debt paying ability. It can be calculated by dividing current assets by current liabilities. Thus table 4.2 exhibits current ratio of the selected finance companies.

**Table 4.2**  
**Analysis of Current Ratio (in times)**

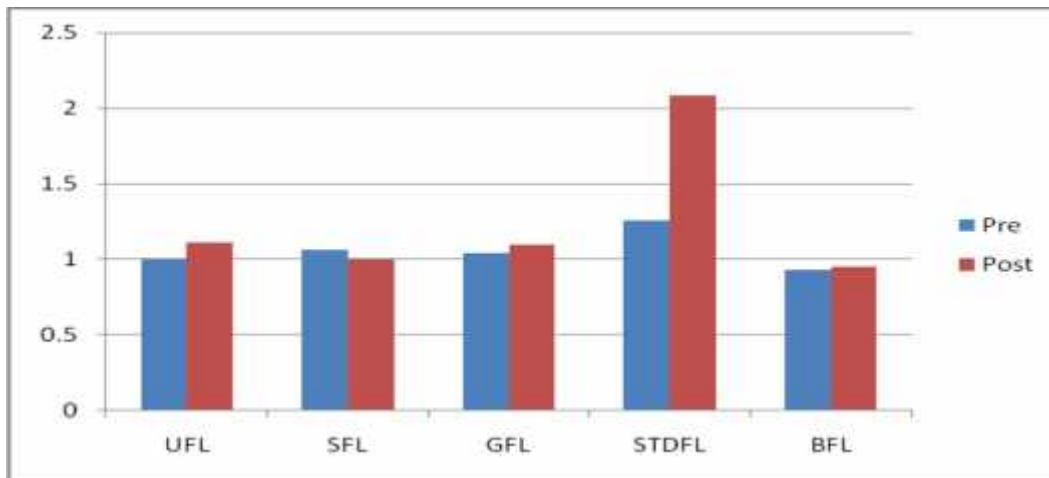
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	1.00	1.01	0.99	<b>1.00</b>	1.12	1.13	1.08	<b>1.11</b>
<b>SFL</b>	1.12	1.03	1.03	<b>1.06</b>	1.02	1.01	0.97	<b>1.00</b>
<b>GFL</b>	1.03	1.05	1.04	<b>1.04</b>	1.07	1.14	1.10	<b>1.10</b>
<b>STDFL</b>	1.02	1.03	1.74	<b>1.26</b>	1.75	2.26	2.24	<b>2.08</b>
<b>BFL</b>	0.85	0.93	1.00	<b>0.93</b>	0.85	0.92	1.08	<b>0.95</b>

*Source: Annual report*

Table 4.2 shows that the average current ratio of UFL, GFL and STDFL, have increased after IPO. The ratio has decreased in SFL where as the ratio of STDFL on the second year after IPO is the highest which is 2.26. Only the average ratio of STDFL after IPO is found to meet traditional the standard of 2:1. The ratio of all other finance companies is found below the traditional level.

Although, the current ratio 2:1 is considered to be traditionally satisfactory, firms below this standard also cannot be underestimated. They may be doing well by following aggressive policy and utilizing current assets properly in their operation. Current ratio is the test of quantity but not of quality of liquidity position. The pre-issue and post-issue average current ratio of the sample companies are presented in figure 4.1.

**Figure 4.1**  
**Average Current Ratio**



*Source: Table 4.2*

### Cash and Bank Balance to Total Deposit Ratio

Cash and bank balance to total deposit ratio is designed to measure the finance companies' ability to meet immediate obligation, mainly cash withdrawal by depositors. Lower ratio indicates that the companies might face a liquidity crunch while paying its obligations; whereas a very high ratio points out that the company has been keeping idle funds and not deploying them properly.

**Table 4.3**  
**Analysis of Cash and Bank Balance to Total Deposit (In Percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	6.52	13.58	15.96	<b>12.02</b>	4.15	14.20	2.91	<b>7.09</b>
<b>SFL</b>	9.17	10.30	10.30	<b>9.92</b>	13.39	17.07	9.27	<b>13.24</b>
<b>GFL</b>	9.92	17.35	13.08	<b>13.45</b>	22.95	24.89	13.00	<b>20.28</b>
<b>STDFL</b>	14.91	14.19	18.90	<b>16.00</b>	23.35	3.06	9.56	<b>11.99</b>
<b>BFL</b>	20.10	25.92	13.87	<b>19.96</b>	18.12	26.47	26.18	<b>23.59</b>

*Source: Annual report*

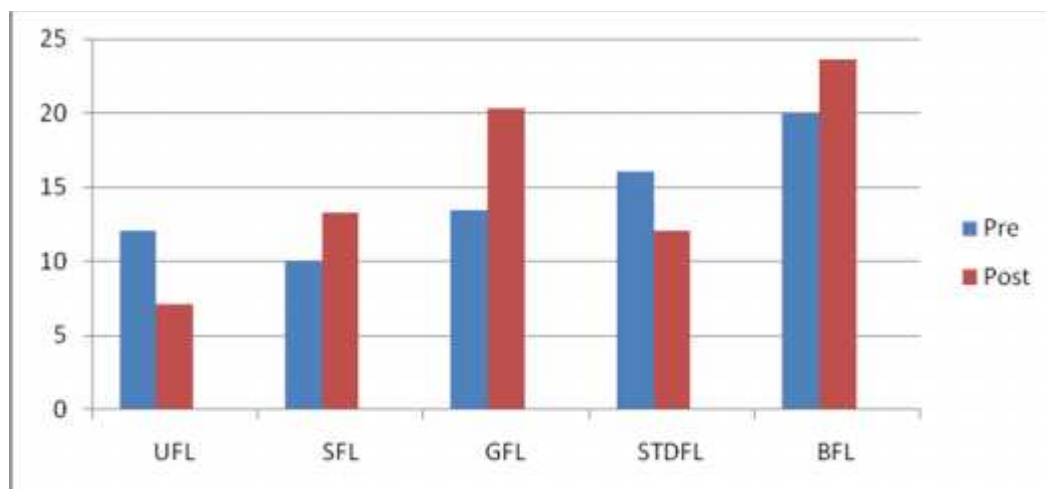
Table 4.3 shows that the cash and bank balance to total deposit ratio of all finance companies are in fluctuating trend over both periods. BFL has the highest average

ratio of 19.96 before IPO and it is also found to be fluctuating. The other FC's having higher average ratios before IPO are STDFL with average ratio of 16.00 and highest ratio of 18.90 on its first year. The other FC's with higher average ratios after IPO are GFL with average ratio of 20.28 and highest ratio of 24.89 on its second year after IPO. Cash and bank balance are the idle money kept for day-to-day payments.

A high ratio indicates the greater ability to meet their deposits and vice versa. Moreover, too high ratio is unfit as capital will be tied up and opportunity cost will be higher. This implies the inability of the company to invest its fund in income generating areas. However there is not any standard ratio in this aspect. The pre-issue and post-issue average cash and bank balances to total deposit ratios are presented through figure 4.2.

**Figure 4.2**

**Average Cash and Bank Balances to Total Deposit Ratio**



*Source: Table 4.3*

### **Cash and Bank Balance to Current Assets Ratio**

This ratio examines the finance companies liquidity capacity on the basis of its most liquid assets i.e. cash and bank balance. This ratio reveals the quantity of cash and bank balance maintained by the firm out of its total current assets. It is computed by dividing cash and bank balance by current assets.

**Table 4.4**

**Analysis of Cash and Bank Balance to Current Assets (In percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	5.88	12.31	15.36	<b>11.19</b>	3.17	11.21	1.68	<b>5.35</b>
<b>SFL</b>	7.34	9.15	9.15	<b>8.55</b>	10.70	13.80	7.98	<b>10.83</b>
<b>GFL</b>	8.94	14.93	11.43	<b>11.77</b>	19.82	20.29	11.02	<b>17.05</b>
<b>STDFL</b>	12.75	11.92	9.90	<b>11.52</b>	12.36	1.32	4.16	<b>5.95</b>
<b>BFL</b>	20.50	24.01	12.29	<b>18.93</b>	19.36	26.22	22.76	<b>22.78</b>

*Source: Annual report*

Table 4.4 shows that BFL has the highest average ratio, which are 18.93 before IPO, which are found to be maintaining good average ratio before IPO. BFL, GFL are found to be in good position after IPO. There is no any standard value for this ratio to be mentioned. A high ratio indicates sound ability to meet their daily cash requirements and vice versa. Both higher and lowers are not desirable. So, sufficient and appropriate cash reserve should be maintained properly. The pre issue and post issue average cash and bank balances to current assets are presented on following chart.

**Figure 4.3**

**Average Cash and Bank Balances to Current Assets**



*Source: Table 4.4*

### 4.3 Activity/Turnover Ratios

This ratio indicates how quickly certain current assets are converted into cash. The funds of creditors and owners are invested in various assets to generate sales and profit. Activity ratios are employed to evaluate the efficiency of a firm to utilize its assets to generate sales. The ratio indicates whether the funds employed have been used efficiently in the business activity or not. These ratios are called turnover ratios because they indicate the speed with which assets are converted or turnover into profit generating assets. Following ratios are used under activity ratio.

### Loans and Advances to Total Deposit Ratio

This ratio assess to what extent the firm is able to utilize the depositor's fund to earn profit by providing loans and advances. Deposit is the main source of fund of the finance companies and they should be utilized properly in order to generate further profit. A high ratio of loan and advances to total deposit is preferable.

**Table 4.5**

**Analysis of Loan and Advances to Total Deposit (In Percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st Year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	90.67	88.31	78.85	<b>85.94</b>	112.24	107.34	159.16	<b>126.25</b>
<b>SFL</b>	108.18	98.91	98.91	<b>102.00</b>	111.04	106.07	100.93	<b>106.01</b>
<b>GFL</b>	99.39	98.15	100.36	<b>99.30</b>	83.17	90.53	104.78	<b>92.83</b>
<b>STDFL</b>	87.44	96.75	83.81	<b>89.33</b>	84.69	72.89	101.01	<b>86.20</b>
<b>BFL</b>	77.94	82.01	91.72	<b>83.89</b>	67.68	66.25	81.02	<b>71.65</b>

*Source: Annual report*

Table 4.5 shows that the movement of loan and advances to total deposit ratio of all the finance companies are not in consistent trend. SFL has the maximum average ratio of 102% with highest ratio of 108.18% on its third year of before IPO. The other companies having higher average ratios are GFL with average ratio of 99.30. UFL seems to be highest utilized of its deposit fund as loan and advances after IPO. It has been able to maintain the highest average ratio of 126.25% and highest individual ratio of 159.16% ratio on its third year after IPO. The other companies having higher

average ratio are SFL with average ratio of 106.1%, GFL with average ratio of 92.83%. Hence it can be said that SFL is the highest utilized of its deposit fund as loan and advances and BFL is lowest utilized of it deposit fund as loan and advances as its loan and advance to total deposit is in decreasing trend after IPO. The pre issue and post issue loan and advances to total deposit are presented on following chart.

**Figure 4.4**

**Average Loan and Advances to Total Deposit Ratio**



*Source: Table 4.5*

**Total Investment to Total Deposit Ratio**

Investment is one of the major forms of credit created to earn income. This ratio implies the utilization of firms deposit on investment in government securities, shares and debentures of other companies and banks rather than in lending activities. A high ratio indicates that the finance company is efficient in mobilizing deposits in investing activities while low ratio indicates its inability to mobilize deposits on investing activities. It can be computed by dividing total investment by total deposit,

**Table 4.6**

**Analysis of Total Investment to Total Deposit (in percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	13.63	8.47	9.10	<b>10.40</b>	14.63	5.17	10.63	<b>10.15</b>
<b>SFL</b>	7.63	3.36	3.36	<b>4.79</b>	0.69	0.50	5.98	<b>2.39</b>
<b>GFL</b>	1.62	0.73	1.01	<b>1.12</b>	9.64	7.23	0.20	<b>5.69</b>
<b>STDFL</b>	14.63	8.08	11.62	<b>11.45</b>	9.78	12.80	7.04	<b>9.87</b>
<b>BFL</b>	0.00	0.00	7.30	<b>2.43</b>	7.81	8.23	7.80	<b>7.95</b>

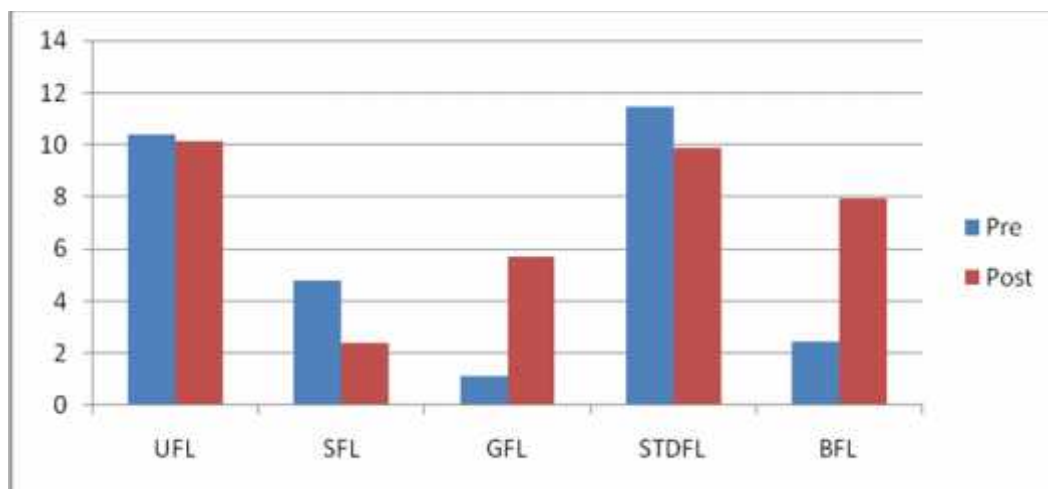
*Source: Annual report*

Table 4.6 shows that different companies have fluctuating trend in the mobilization of deposit as investment. STDFL appears to be the highest mobilized of the deposit fund as investment before IPO. The average ratio of total investment to total deposit of STDFL is 11.45%. GFL has the lowest average ratio of 1.12% whereas BFL is found not mobilizing its deposit as investment at all on second and third year of IPO.

SFL has the lowest average ratio of 2.39% whereas GFL is found with least ratio of 0.20% on its third after IPO. The pre issue and post issue total investment total deposit are presented on following chart

**Figure 4.5**

**Total Investment to Total Deposit**



*Source: Table 4.6*

### Total Assets Turnover Ratio

It measures the overall utilization of firm's assets. The high ratio indicates that the company is generating an adequate volume of business for the size of its asset investment.

**Table 4.7**

**Analysis of Total Assets Turnover Ratio (in percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	17.79	13.98	13.71	<b>15.16</b>	10.30	10.01	11.57	<b>10.63</b>
<b>SFL</b>	14.47	14.21	12.69	<b>13.79</b>	13.89	13.60	14.43	<b>13.98</b>
<b>GFL</b>	12.60	14.30	15.57	<b>14.16</b>	13.35	14.04	12.75	<b>13.38</b>
<b>STDFL</b>	12.59	13.66	6.11	<b>10.79</b>	6.72	5.51	4.30	<b>5.51</b>
<b>BFL</b>	18.07	16.48	12.79	<b>15.78</b>	15.26	13.61	11.12	<b>13.33</b>

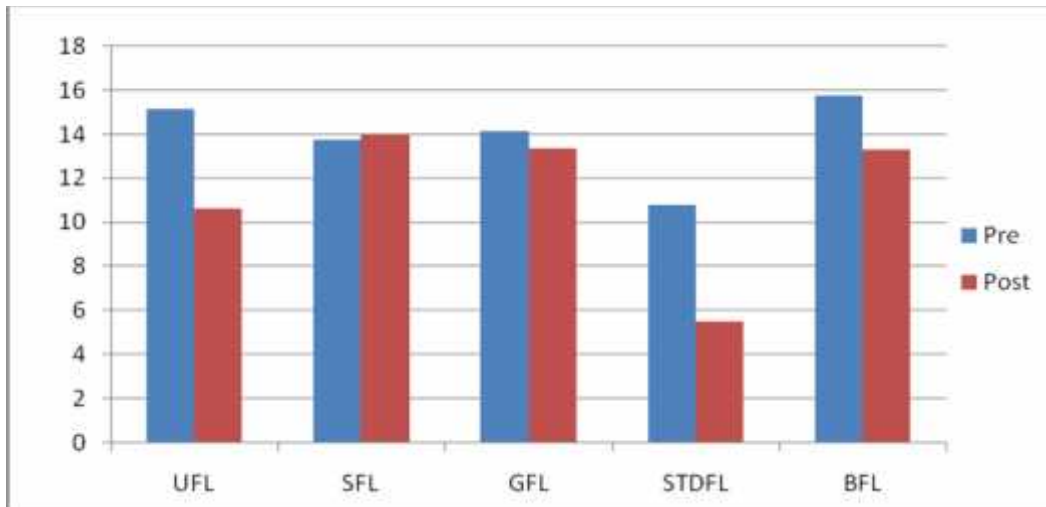
*Source: Annual report*

Table 4.7 shows that BFL has the highest average total assets turnover ratio of 15.78% with increasing trend from first year to third year before IPO. UFL also has the similar trend with average ratio of 15.16%.

SFL has the highest average ratio of 13.98% after IPO whereas GFL and BFL have average ratio of 13.38% and 13.3% respectively. STDFL has the lowest average ratio of 5.51%, which shows this company utilizing its assets less effectively. BFL has the 15.26% on the year first after IPO is the highest ratio among all. All the ratios are in fluctuating trend. Even though there is no any prescribed standard ratio, however the higher ratio is always preferable. The pre issue and post issue of total assets turnover ratio are presented on following chart

**Figure 4.6**

**Total Assets Turnover Ratio**



*Source: Table 4.7*

**4.4. Leverage/ Capital Structure Ratios**

Leverage ratio tells us the relative proportion of capital contribution by creditors and owners. The related leverage ratios are:

**Debt Equity Ratio**

This ratio measures the relationship between borrowed funds and owner's capital. Higher ratio indicates the higher contribution of debt capital than equity fund in the company. However a very high debt to equity ratio is unfavorable as debt are considered to be more risky which bears obligation towards creditors. Therefore an appropriate mix of debt and owners fund is desired by the finance companies. Debt to equity ratio can be calculated by dividing total assets by total equity.

**Table 4.8****Analysis of Debt Equity Ratio (in percentage)**

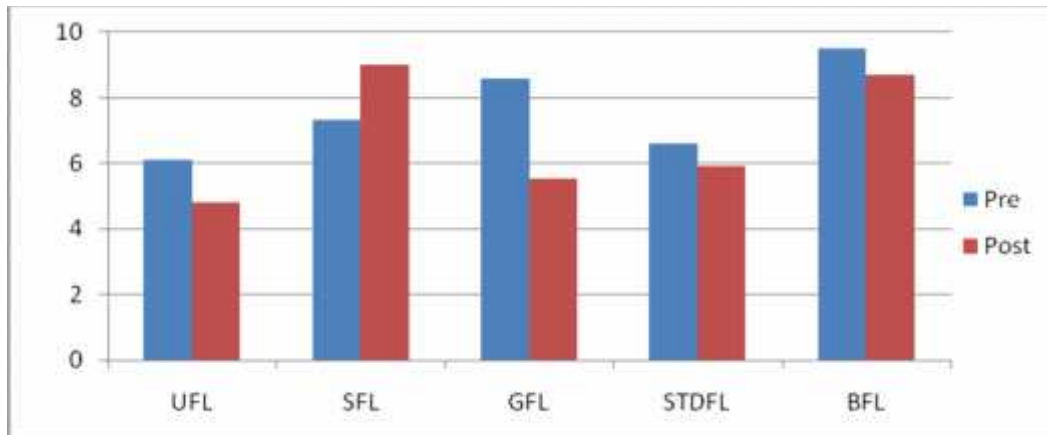
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	8.97	5.40	3.96	<b>6.11</b>	2.94	4.51	7.01	<b>4.82</b>
<b>SFL</b>	4.45	8.75	8.75	<b>7.32</b>	8.27	9.54	9.17	<b>8.99</b>
<b>GFL</b>	9.05	8.92	7.72	<b>8.57</b>	6.54	4.86	5.21	<b>5.54</b>
<b>STDFL</b>	5.79	6.11	7.93	<b>6.61</b>	5.76	5.27	6.74	<b>5.92</b>
<b>BFL</b>	9.44	8.56	10.57	<b>9.52</b>	8.15	9.09	8.86	<b>8.70</b>

*Source: Annual report*

Table 4.8 reveals that BFL has the highest debt financed than equity capital before IPO in comparison to others. Its average ratio is 9.52%. The other higher utilized of debt capital is GFL with average ratio 8.57%. UFL is the company, which appears to be the least debt financed for the same period.

UFL appears to be the least debt financed for the period with the average ratio of 4.82%. The highly debt financed companies indicate less utilization of owners fund in comparison to debt or credit fund. The greater debt equity ratio indicates the greater the risk to the creditor. A high proportion of debt in the capital structure would lead to inflexibility in operations of the company as creditors would exercise pressure and interference to the management. Also such company would be able to borrow only under very restrictive terms and conditions, which creates serious difficulties to raise fund in future. Some high debt equity ratio of these companies is not a good signal. The pre issue and post issue of debt equity ratio are presented on following chart

**Figure 4.7**  
**Average Debt Equity Ratio**



*Source: Table 4.8*

### Capital Adequacy Ratio

The capital adequacy ratio is one of the most significant ratios, used specially to assess the firm's strength of the capital structure of the adequacy of the capital. Holding excess capital keeps the firm in low profit position while on the other hand; inadequate capital limits the firm to meet the public demand of loan and low earning capacity. However, extremely high or low capital adequacy ratio is undesirable in terms of lower return and lower solvency respectively. Capital refers to the paid up capital, general reserve and undistributed profits. So, capital adequacy is determined by dividing net worth by total deposit.

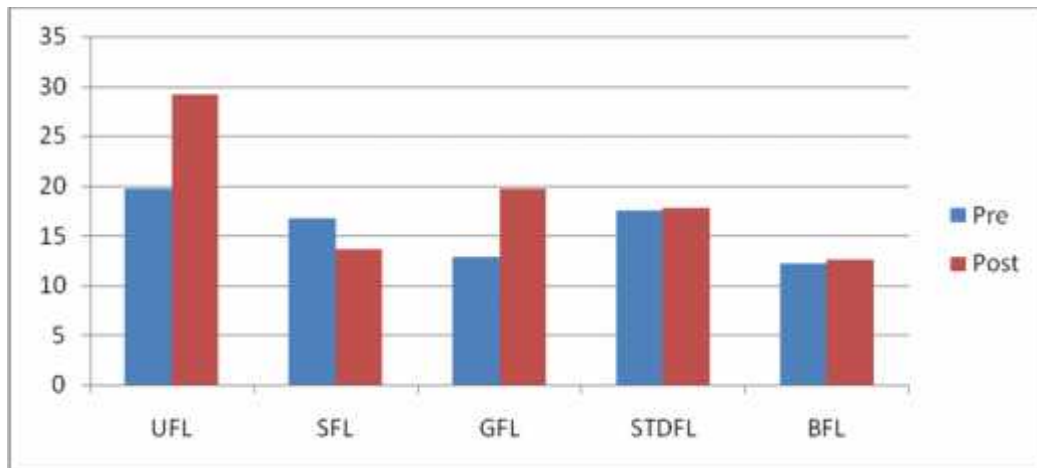
**Table 4.9**  
**Analysis of Capital Adequacy Ratio (in percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	12.38	20.26	26.42	<b>19.69</b>	39.97	24.80	22.88	<b>29.22</b>
<b>SFL</b>	25.10	12.46	12.46	<b>16.67</b>	14.78	12.85	13.06	<b>13.56</b>
<b>GFL</b>	11.89	12.41	14.21	<b>12.83</b>	16.51	22.14	20.54	<b>19.73</b>
<b>STDFL</b>	19.86	18.95	13.82	<b>17.54</b>	18.70	19.46	15.23	<b>17.80</b>
<b>BFL</b>	12.23	13.51	10.66	<b>12.14</b>	13.52	12.12	12.00	<b>12.55</b>

*Source: Annual report*

Table 4.9 shows that the average capital adequacy ratio of UFL is the highest 19.69% before IPO where as that of BFL is the lowest which is 12.14% before IPO. GFL has increasing trend before IPO where as STDFL show the decreasing trend. The others have zigzag trend. While referring to after IPO period, UFL is found with highest ratio of 29.22% and BFL with the lowest ratio of 12.55%. After IPO, the ratio of all the companies is found moving along zigzag trend. The pre issue and post issue of capital adequacy ratio are presented on following chart.

**Figure 4.8**  
**Average Capital Adequacy Ratio**



*Source: Table 4.9*

#### 4.5. Profitability Ratios

Profitability ratio shows the overall efficiency of the business concerns. The difference between total revenues and total expenses over a period is known as profit. Higher the profitability ratio implies better the financial performance of the company and vice versa.

#### Return on Total Assets

This ratio is also known as return on assets (ROA). Net profit to total assets evaluates the efficiency of a company in utilization and mobilization of the assets and its survival. The ratio is computed dividing net profit (loss) by total assets. Net profit indicates the position of income left to the interval equities after all costs, charges, expenses have been deducted. Total assets comprise those assets which appear in the

assets side of the balance sheet. The high return on total assets indicates the high profit margin and high turnover of total. The high return on total assets indicates the high profit margin and high turnover of total assets and vice versa.

**Table 4.10**  
**Analysis of Return on Total Assets (in percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	2.90	1.40	0.11	<b>1.47</b>	0.27	0.72	1.34	<b>0.77</b>
<b>SFL</b>	1.54	1.51	1.51	<b>1.52</b>	1.49	1.54	1.62	<b>1.55</b>
<b>GFL</b>	1.23	2.06	1.80	<b>1.70</b>	1.94	2.11	1.41	<b>1.82</b>
<b>STDFL</b>	0.24	2.48	0.89	<b>1.20</b>	0.56	0.56	0.33	<b>0.48</b>
<b>BFL</b>	1.97	1.66	1.00	<b>1.54</b>	0.87	1.08	1.14	<b>1.03</b>

*Source: Annual report*

Table 4.10 shows that GFL is the most efficient utilized of its total assets to generate profit in comparison to others before IPO. Its highest average ratio of 1.70% is the evidence to this fact. STDFL has the least average ratio of 1.20% before IPO. Though the average ratio of BFL is not so higher, its ratios are in increasing trend before IPO.

GFL has the highest average ratio of 1.82% after IPO. STDFL has the least average ratio of -0.48% as it could not made profit on its third year after IPO. UFL, SFL and BFL have been successful in performing better in this regard, for the period. The pre issue and post issue of return on total assets are presented on following chart.

**Figure 4.9**

**Average Return on Total Assets**



*Source: Table 4.10*

**Net Profit to Total Deposit Ratio**

This ratio examines whether management has been capable to mobilize and utilize the deposits. It also helps to know the overall performance and generation of profit of finance companies. This ratio identifies whether the organization is well efficient or not in mobilizing its total deposit, so that corrective action can be taken.

**Table 4.11**

**Analysis of Net Profit to Total Deposit Ratio (in percentage)**

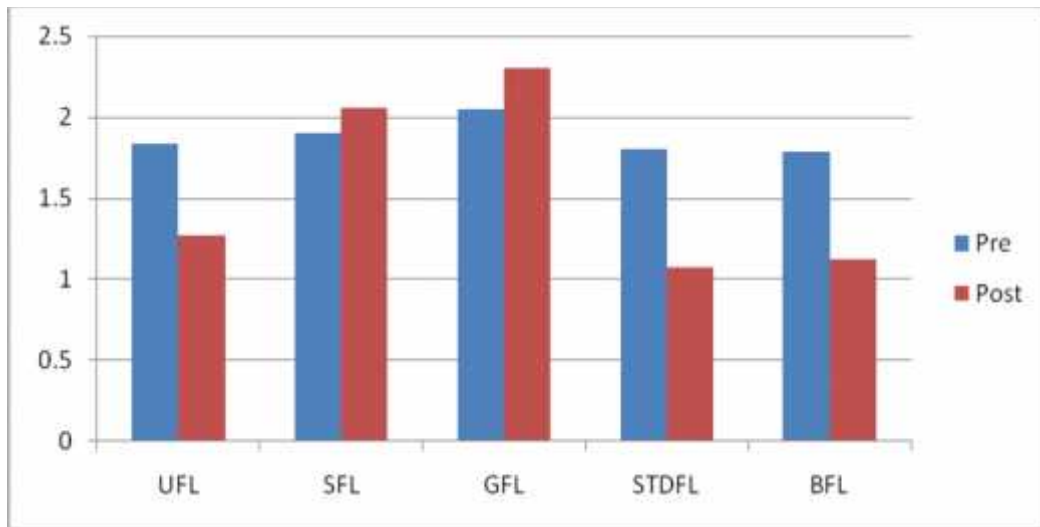
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	3.57	1.80	0.14	<b>1.84</b>	0.42	0.97	2.42	<b>1.27</b>
<b>SFL</b>	2.08	1.81	1.81	<b>1.90</b>	2.02	2.05	2.10	<b>2.06</b>
<b>GFL</b>	1.44	2.51	2.19	<b>2.05</b>	2.41	2.73	1.77	<b>2.30</b>
<b>STDFL</b>	0.31	3.33	1.77	<b>1.80</b>	1.10	1.33	0.77	<b>1.07</b>
<b>BFL</b>	2.12	2.01	1.23	<b>1.79</b>	0.87	1.13	1.35	<b>1.12</b>

*Source: Annual report*

Table 4.11 shows that the highest average net profit to total deposit ratio of 2.05% of GFL indicates that the company is most efficient in its deposit mobilization where other indicates its' satisfactory in deposit mobilization before IPO.

GFL has highest average ratio even after IPO which is 2.30% where as STDFL has the least average ratio of 1.07%. The increasing trend of BFL, UFL and SFL is remarkably good where as the decreasing trend of GFL have chances of leading into danger. The pre issue and post issue of net profit to total deposit ratio are presented on following chart.

**Figure 4.10**  
**Average Net Profit to Total Deposit Ratio**



*Source: Table 4.11*

**Return on Net Worth**

Return on net worth is used to measure the profitability of the owner's investment or company's earning power against equity. The excess amount of total assets over total liabilities is known as net worth. Net worth refers to the owner's claim of a finance company. It includes equity, preference share capital, past accumulated profits but excludes fictitious assets. This ratio is calculated by dividing net profit by net worth. Higher ratio indicates the high overall efficiency of the firm and vice versa.

**Table 4.12****Analysis of Return on Net Worth (in percentage)**

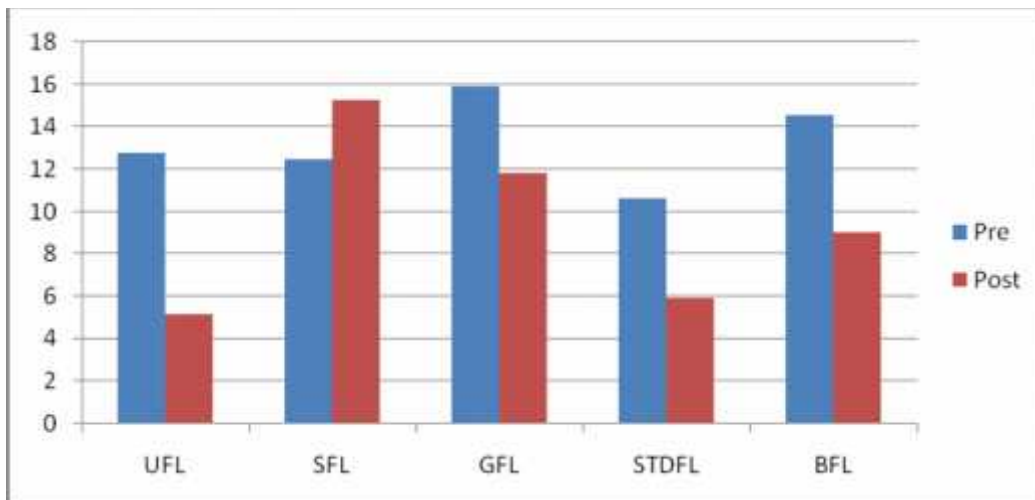
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	28.85	8.91	0.54	<b>12.77</b>	1.04	3.92	10.57	<b>5.18</b>
<b>SFL</b>	8.30	14.52	14.52	<b>12.45</b>	13.68	15.96	16.11	<b>15.25</b>
<b>GFL</b>	12.11	20.27	15.42	<b>15.93</b>	14.61	12.35	8.60	<b>11.85</b>
<b>STDFL</b>	1.54	17.57	12.81	<b>10.64</b>	5.90	6.84	5.05	<b>5.93</b>
<b>BFL</b>	17.33	14.87	11.54	<b>14.58</b>	6.47	9.35	11.21	<b>9.01</b>

*Source: Annual report*

Table 4.12 shows that GFL has the highest average ratio 15.93% before IPO compare to other companies. BFL successfully maintain the highest average ratio 14.58% indicates BFL's higher efficiency in mobilizing net worth towards generating profit before IPO.

Whereas SFL successfully maintain the highest average ratio 15.25% indicates SFL's higher efficiency in mobilizing net worth towards generating profit after IPO, Whereas GFL and STDFL ratios have been decreased. The decreased average ratio of most of the companies after IPO indicates that these companies have not been successful in mobilizing their increased volume net worth to increase profit volume simultaneously. So they need to work on finding out more productive opportunities for increased volume of net worth which will ultimately gives satisfactory return to its equity holders. The pre issue and post issue of return on net worth are presented on following chart.

**Figure 4.11**  
**Average Return on Net Worth**



*Source: Table 4.12*

### **Return on Investment**

Return on Investment is the major tool for measuring the capacity of the company to generate profit out of its total investment. It reflects only those attributes of the firm's performance that are actually under the control of the firm's operating management. It measures the company's return from investment. Here, return denotes net profit after tax. Investment includes both long term and short-term investment. It can be computed dividing net profit after tax by total investment.

**Table 4.13**  
**Analysis of Return on Investment (in percentage)**

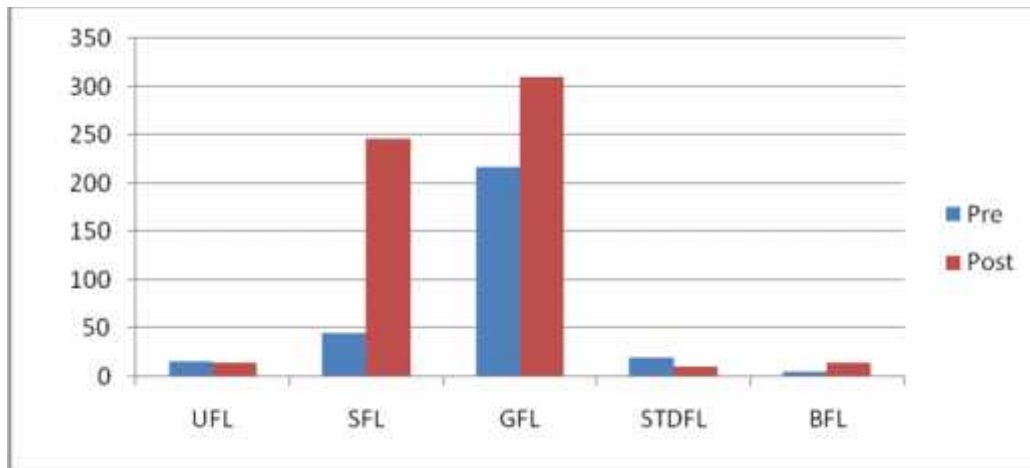
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	26.22	21.29	1.57	<b>16.36</b>	2.85	18.83	22.74	<b>14.81</b>
<b>SFL</b>	27.30	53.80	53.80	<b>44.97</b>	292.83	408.86	35.18	<b>245.62</b>
<b>GFL</b>	88.71	344.53	217.24	<b>216.83</b>	25.01	37.82	867.58	<b>310.14</b>
<b>STDFL</b>	2.09	41.19	15.23	<b>19.50</b>	11.29	10.39	10.92	<b>10.87</b>
<b>BFL</b>	0.00	0.00	16.86	<b>5.62</b>	11.19	13.76	17.25	<b>14.07</b>

*Source: Annual report*

Table 4.13 displays the ratio between net profit and investment of the finance companies. GFL has the highest average ratio 216.83% before IPO which indicates that the company's profit volume is higher than investment volume. The least average ratio is 5.62% of BFL before IPO.

GFL also has the highest average ROI after IPO indicating higher volume of profit than investment volume. However, STDFL has the lowest average ROI of 10.87% after IPO. The pre issue and post issue of return on investment are presented on following chart.

**Figure 4.12**  
**Average Return on Investment**



*Source: Table 4.13*

**Total Interest Earned to Total Working Fund Ratio**

This ratio reflects the extent on which the finance companies are capable to mobilize their total assets to generate high income as interest. A high ratio is an indicator of high earning power and better performance of the finance companies on its total working funds and vice versa.

**Table 4.14**

**Analysis of Total Interest Earned to Working Fund (in percentage)**

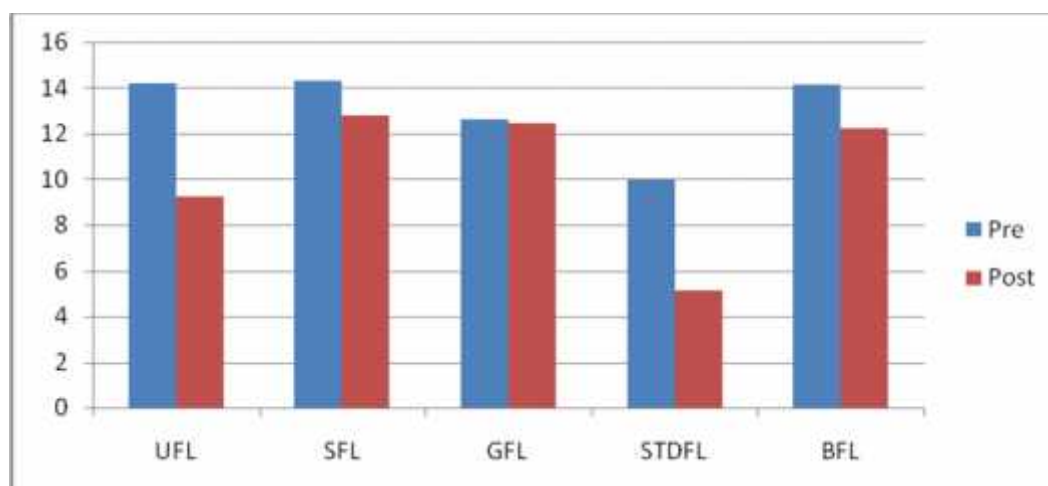
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	16.36	13.18	12.98	<b>14.17</b>	9.10	8.47	10.11	<b>9.23</b>
<b>SFL</b>	14.47	14.21	14.21	<b>14.30</b>	12.74	12.40	13.22	<b>12.78</b>
<b>GFL</b>	10.56	12.59	14.68	<b>12.61</b>	12.67	13.13	11.61	<b>12.47</b>
<b>STDFL</b>	11.44	12.69	5.73	<b>9.95</b>	6.26	5.23	3.95	<b>5.14</b>
<b>BFL</b>	15.86	14.67	11.95	<b>14.16</b>	14.18	12.24	10.34	<b>12.25</b>

*Source: Annual report*

Table 4.14 shows that SFL had the highest average ratio of 14.30% before IPO where as STDFL had the lowest average ratio. In that sense, ILFC seemed to be the efficient utilized of its working fund to generate higher income. The average ratio of all the companies is in decreasing trend after IPO. In that what we can say that the average ratio of all other companies has been decreased after IPO. The pre issue and post issue of total interest earned to working fund are presented on following chart.

**Figure 4.13**

**Average Total Interest Earned to Working Fund**



*Source: Table 4.14*

#### 4.6 Valuation Ratio

The valuation ratios indicate the market value of the firm as compared to the book value and measure the stock price relative to earnings. These ratio results the overall performance of the firm measuring the combined effect of risk and return. The following ratios are calculated under this group:

#### Earnings per Share

The income of per common share is known as earning per share. It can be calculated by the following way.

**Table 4.15**  
**Analysis of Earnings per Share (in Rs)**

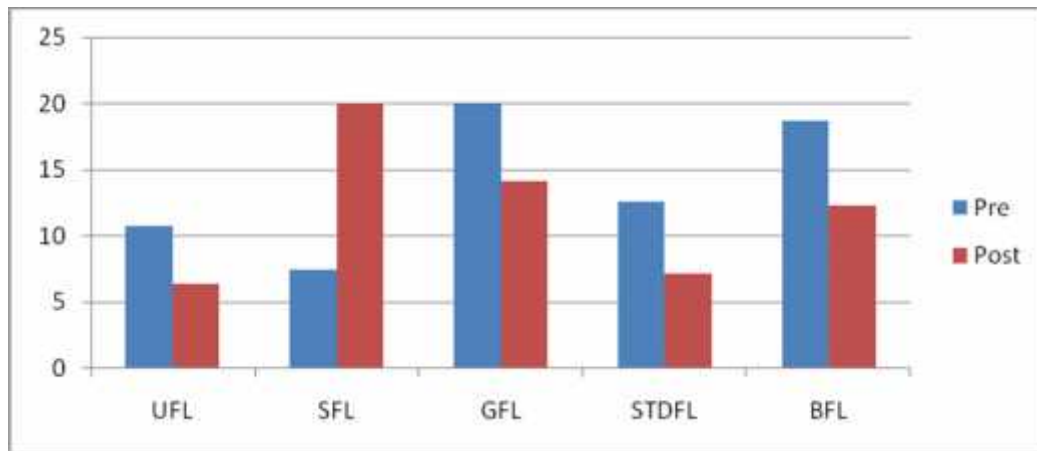
Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
UFL	21.06	10.38	0.72	<b>10.72</b>	1.14	4.65	13.41	<b>6.40</b>
SFL	4.55	8.97	8.97	<b>7.49</b>	14.70	20.53	24.77	<b>20.00</b>
GFL	13.43	23.52	23.19	<b>20.04</b>	16.55	14.50	11.35	<b>14.13</b>
STDFL	1.75	19.73	16.45	<b>12.64</b>	7.04	8.41	6.11	<b>7.19</b>
BFL	20.44	21.07	14.50	<b>18.67</b>	8.37	13.37	15.07	<b>12.27</b>

*Source: Annual report*

Table 4.15 shows that the average earning per share of GFL Rs. 20.04 is the highest average EPS among the finance companies under study before IPO where as that of SFL Rs. 7.49 was the lowest EPS. Whereas the EPS of UFL and BFL seemed to be in increasing trend. The other finance companies had fluctuating EPS before IPO.

SFL had the highest average EPS which is Rs. 20.00 after IPO where as that of UFL has the lowest average EPS of Rs 6.40 but it is increasing trend. The EPS of GFL, and STDFL seem to be in decreasing trend after IPO where as all other companies have increasing trend of EPS after IPO. In that sense GFL and STDFL seem to be work on check their decreasing trend of EPS. The pre issue and post issue of earning per share are presented on following chart.

**Figure 4.14**  
**Average Earnings per Share**



*Source: Table 4.15*

### Dividend per Share

The amount of earning which is distributed to the shareholders is known as dividend. How much per share the dividend is distributed to common shareholders by a company can be known from this ratio.

**Table 4.16**  
**Analysis of Dividend per share (in Rs)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	15.34	5.66	0	<b>7.00</b>	5	5	7.5	<b>5.83</b>
<b>SFL</b>	3.50	6.75	6.75	<b>5.67</b>	10.525	15	13.16	<b>12.89</b>
<b>GFL</b>	0.00	10.00	0	<b>3.33</b>	23	10	10.00	<b>14.33</b>
<b>STDFL</b>	0.00	16.00	0	<b>5.33</b>	16	21	10.53	<b>15.84</b>
<b>BFL</b>	15.00	0.00	16.67	<b>10.56</b>	0	15.79	10.53	<b>8.77</b>

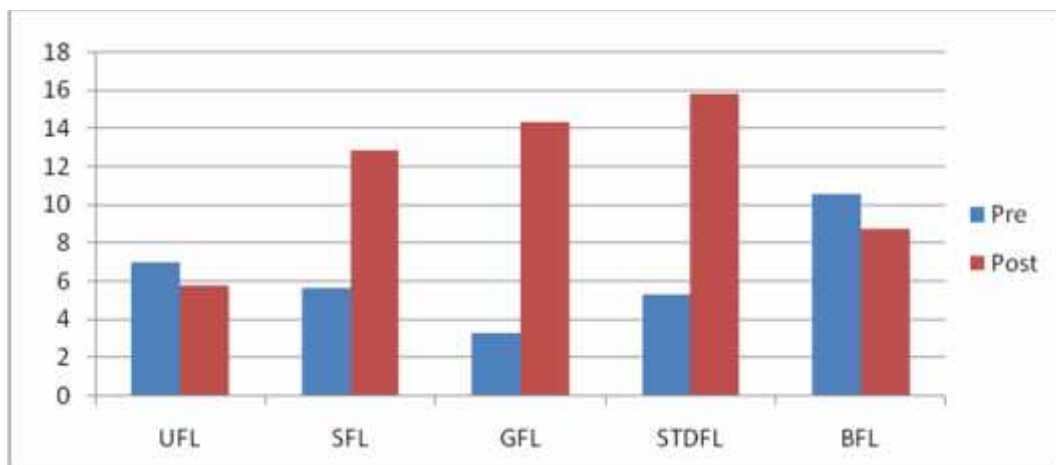
*Source: Annual report*

Table 4.16 shows that the dividend distributed by the finance companies before and after their respective IPO to their shareholders. It can be seen that the average DPS of BFL is the highest which is Rs 10.56 before IPO. However the trend of distribution of

dividend is not constant. It is fluctuating. STDFL has the highest average DPS after IPO also which is Rs 15.84.

Most of the other finance companies can be found distributing dividend to their shareholders after IPO. However the dividend distribution trend of all the finance companies can be seen fluctuating even after IPO. The pre issue and post issue of dividend per share are presented on following chart.

**Figure 4.15**  
**Average Dividend per share**



*Source: Table 4.16*

### **Dividend Payout Ratio**

This ratio implies the relationship between earning belonging to the ordinary shareholders and dividend paid to them. It also shows the percentage of earning retained to them. It is calculated by dividing dividend per share by earning per share. Thus, dividend payout ratio is calculated by dividing total dividend by total net profit.

**Table 4.17****Analysis of Dividend Payout Ratio (in percentage)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	72.82	54.58	0.00	<b>42.46</b>	437.32	107.49	55.94	<b>200.25</b>
<b>SFL</b>	76.92	75.28	75.28	<b>75.83</b>	71.60	73.08	53.12	<b>65.93</b>
<b>GFL</b>	0.00	42.52	0.00	<b>14.17</b>	138.96	68.98	88.12	<b>98.69</b>
<b>STDFL</b>	0.00	81.09	0.00	<b>27.03</b>	227.38	249.60	172.43	<b>216.47</b>
<b>BFL</b>	73.39	0.00	114.97	<b>62.79</b>	0.00	118.12	69.85	<b>62.66</b>

*Source: Annual report*

Table 4.17 shows that the dividend payout ratio of SFL is the highest before IPO which is 75.83% in average. However the ratio is not constant. Among all BFL has the highest ratio of 114.97% on its first year before IPO. SFL have average ratio of before IPO. This does not mean that these companies had not earned profit during the period. They had earned profit but the earned profit was retained by them.

However STDFL has the highest average ratio of 216.47% after IPO followed by UFL with the average ratio of 200.25%. The other finance companies have considerably made dividend distribution after IPO therefore the DPR of all the companies have increased after IPO. Even the finance companies whose DPR was 0 before IPO have increased their DPR after IPO. The pre issue and post issue of dividend payout ratio are presented on following chart.

**Figure 4.16**

**Average Dividend Payout Ratio**



*Source: Table 4.17*

### Net Worth per Share

Net Worth is calculated by subtracting all the liabilities from assets. It is the capital in which the equity holders have their ownership. It consists of equity, general reserve and surplus, retain earning, loan loss and different other provisions. It gives the book value of the shares. It shows the extent to which the paid up value of a share has been raised. Higher value is preferable. Net worth per share can be calculated by dividing total net worth by total number of shares.

**Table 4.18**

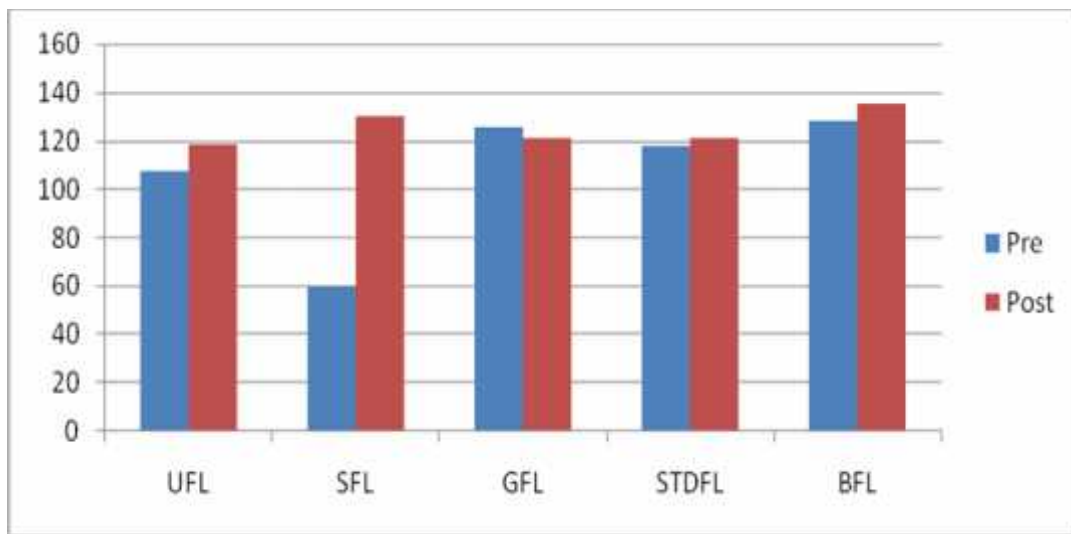
**Analysis of Net Worth per Share (in Rs)**

Company	Before IPO				After IPO			
	3rd year	2nd year	1st year	Average	1st year	2nd year	3rd year	Average
<b>UFL</b>	73.00	116.54	133.77	<b>107.77</b>	109.65	118.52	126.85	<b>118.34</b>
<b>SFL</b>	54.82	61.75	61.75	<b>59.44</b>	107.44	128.64	153.77	<b>129.95</b>
<b>GFL</b>	110.87	116.03	150.33	<b>125.74</b>	113.30	117.42	131.92	<b>120.88</b>
<b>STDFL</b>	113.82	112.27	128.43	<b>118.17</b>	119.25	123.08	120.98	<b>121.10</b>
<b>BFL</b>	117.95	141.71	125.67	<b>128.44</b>	129.44	143.03	134.41	<b>135.63</b>

*Source: Annual report*

Table 4.18 shows BFL having highest average net worth per share before IPO which was Rs. 128.44 where as SFL had the lowest average net worth per share of Rs. 59.44. BFL has highest average ratio also after IPO which is Rs. 135.63. It shows that BFL has good net worth per share among all finance companies under study. The above calculated pre issue and post issue analysis of net worth per share can be presented on following chart.

**Figure 4.17**  
**Average Net Worth per share**



*Source: Table 4.18*

#### 4.7 Hypothesis testing

This part of the study explains the test of the significance of difference in the financial performance before and after the initial public offering of the listed finance companies

**Table 4.19**

<b>United Finance Company Limited (UFL)</b>				
<b>S.N</b>	<b>Ratios</b>	<b>t-ratio (calculated)</b>	<b>Tabulated</b>	<b>Inference</b>
<b>A</b>	<b>Liquidity ratio</b>			
	1. Current ratio	5.37	4.303	Si.
	2. Cash & bank balance to total deposit	1.19	4.303	N.Si
	3. Cash & bank balance to current assets	1.48	4.303	N.Si
<b>B</b>	<b>Activity ratio</b>			
	1. Loan & advances to total deposit	2.01	4.303	N.Si
	2. Total investment to total deposit	0.17	4.303	N.Si
	3. Total revenue to total assets	2.89	4.303	N.Si
<b>C</b>	<b>Leverage ratio</b>			
	1. Debt to equity	0.54	4.303	N.Si
	2. Debt to total assets	0.49	4.303	N.Si
	3. Net worth to total deposit	1.12	4.303	N.Si
<b>D</b>	<b>Profitability ratio</b>			
	1. Net profit to total revenue	0.27	4.303	N.Si
	2. Net profit to total assets	0.63	4.303	N.Si
	3. Net profit to equity	0.69	4.303	N.Si
	4. Net profit to total deposit	0.36	4.303	N.Si
	5. Net profit to investment	0.12	4.303	N.Si
	6. Total interest earned to total assets	3.88	4.303	N.Si
<b>E</b>	<b>Valuation ratio</b>			
	1. EPS	0.46	4.303	N.Si
	2. DPS	0.23	4.303	N.Si
	3. Dividend payout ratio	1.53	4.303	N.Si
	4. Net worth per share	1.13	4.303	N.Si

*Source: Annual report*

Table 4.19 shows that there is significant difference in current ratio of UFL before and after IPO where as there is no significant difference in other ratio of UFL before and after IPO.

**Table 4.20**

<b>Siddhartha Finance Limited (SFL)</b>				
<b>S.N</b>	<b>Ratios</b>	<b>t-ratio (calculated)</b>	<b>Tabulated</b>	<b>Inference</b>
<b>A</b>	<b>Liquidity ratio</b>			
	1. Current ratio	1.23	4.303	N.Si
	2. Cash & bank balance to total deposit	0.74	4.303	N.Si
	3. Cash & bank balance to current assets	1	4.303	N.Si
<b>B</b>	<b>Activity ratio</b>			
	1. Loan & advances to total deposit	0.96	4.303	N.Si
	2. Total investment to total deposit	1.18	4.303	N.Si
	3. Total revenue to total assets	1.03	4.303	N.Si
<b>C</b>	<b>Leverage ratio</b>			
	1. Debt to equity	0.57	4.303	N.Si
	2. Debt to total assets	1.35	4.303	N.Si
	3. Net worth to total deposit	0.65	4.303	N.Si
<b>D</b>	<b>Profitability ratio</b>			
	1. Net profit to total revenue	1.28	4.303	N.Si
	2. Net profit to total assets	0.96	4.303	N.Si
	3. Net profit to equity	3.02	4.303	N.Si
	4. Net profit to total deposit	1.24	4.303	N.Si
	5. Net profit to investment	2.05	4.303	N.Si
	6. Total interest earned to total assets	1.31	4.303	N.Si
<b>E</b>	<b>Valuation ratio</b>			
	1. EPS	8.73	4.303	Si.
	2. DPS	11.77	4.303	Si.
	3. Dividend payout ratio	1.79	4.303	N.Si
	4. Net worth per share	14.04	4.303	Si.

*Source: Annual report*

Table 4.20 shows that there is significant difference in the EPS, DPS and Net worth per

share of SFL before IPO and after IPO where as there is no significant difference in the other ratio of the company before and after IPO.

**Table 4.21**

<b>Gorkha Finance Limited (GFL)</b>				
<b>S.N</b>	<b>Ratios</b>	<b>t-ratio (calculated)</b>	<b>Tabulated</b>	<b>Inference</b>
<b>A</b>	<b>Liquidity ratio</b>			
	1. Current ratio	4.54	4.303	Si.
	2. Cash & bank balance to total deposit	1.8	4.303	N.Si
	3. Cash & bank balance to current assets	1.62	4.303	N.Si
<b>B</b>	<b>Activity ratio</b>			
	1. Loan & advances to total deposit	1.08	4.303	N.Si
	2. Total investment to total deposit	1.68	4.303	N.Si
	3. Total revenue to total assets	0.74	4.303	N.Si
<b>C</b>	<b>Leverage ratio</b>			
	1. Debt to equity	5.88	4.303	Si.
	2. Debt to total assets	6.41	4.303	Si.
	3. Net worth to total deposit	1.23	4.303	N.Si
<b>D</b>	<b>Profitability ratio</b>			
	1. Net profit to total revenue	0.63	4.303	N.Si
	2. Net profit to total assets	0.78	4.303	N.Si
	3. Net profit to equity	4.59	4.303	Si.
	4. Net profit to total deposit	1	4.303	N.Si
	5. Net profit to investment	0.56	4.303	N.Si
	6. Total interest earned to total assets	0.09	4.303	N.Si
<b>E</b>	<b>Valuation ratio</b>			
	1. EPS	1.29	4.303	N.Si
	2. DPS	1.65	4.303	N.Si
	3. Dividend payout ratio	2.6	4.303	N.Si
	4. Net worth per share	0.72	4.303	N.Si

**Source: Annual report**

Table 4.21 shows that there is significant difference in the current ratio, debt to equity and net profit to equity of GFL before and after IPO where as there is no significant

difference in other ratios of the company before and after IPO.

**Table 4.22**

<b>Standard Finance Limited (STDFL)</b>				
<b>S.N</b>	<b>Ratios</b>	<b>t-ratio (calculated)</b>	<b>Tabulated</b>	<b>Inference</b>
<b>A</b>	<b>Liquidity ratio</b>			
	1. Current ratio	3.82	4.303	N.Si
	2. Cash & bank balance to total deposit	0.64	4.303	N.Si
	3. Cash & bank balance to current assets	1.89	4.303	N.Si
<b>B</b>	<b>Activity ratio</b>			
	1. Loan & advances to total deposit	0.26	4.303	N.Si
	2. Total investment to total deposit	0.5	4.303	N.Si
	3. Total revenue to total assets	2.84	4.303	N.Si
<b>C</b>	<b>Leverage ratio</b>			
	1. Debt to equity	1.99	4.303	N.Si
	2. Debt to total assets	3.1	4.303	N.Si
	3. Net worth to total deposit	1.02	4.303	N.Si
<b>D</b>	<b>Profitability ratio</b>			
	1. Net profit to total revenue	0.9	4.303	N.Si
	2. Net profit to total assets	1.3	4.303	N.Si
	3. Net profit to equity	0.34	4.303	N.Si
	4. Net profit to total deposit	0.61	4.303	N.Si
	5. Net profit to investment	1.86	4.303	N.Si
	6. Total interest earned to total assets	2.91	4.303	N.Si
<b>E</b>	<b>Valuation ratio</b>			
	1. EPS	1.01	4.303	N.Si
	2. DPS	3.31	4.303	N.Si
	3. Dividend payout ratio	9.97	4.303	Si.
	4. Net worth per share	0.54	4.303	N.Si

*Source: Annual report*

Table 4.22 shows that there is significant difference in the dividend payout ratio of STDFL before IPO and after IPO where as there is no significant difference in other ratios of the company before and after IPO.

**Table 4.23**

<b>Butwal Finance Company Limited (BFL)</b>				
<b>S.N</b>	<b>Ratios</b>	<b>t-ratio (calculated)</b>	<b>Tabulated</b>	<b>Inference</b>
<b>A</b>	<b>Liquidity ratio</b>			
	1. Current ratio	0.71	4.303	N.Si
	2. Cash & bank balance to total deposit	0.82	4.303	N.Si
	3. Cash & bank balance to current assets	1.11	4.303	N.Si
<b>B</b>	<b>Activity ratio</b>			
	1. Loan & advances to total deposit	6.93	4.303	Si.
	2. Total investment to total deposit	2.2	4.303	N.Si
	3. Total revenue to total assets	6.3	4.303	N.Si
<b>C</b>	<b>Leverage ratio</b>			
	1. Debt to equity	1.19	4.303	N.Si
	2. Debt to total assets	1.11	4.303	N.Si
	3. Net worth to total deposit	1.83	4.303	N.Si
<b>D</b>	<b>Profitability ratio</b>			
	1. Net profit to total revenue	1.65	4.303	N.Si
	2. Net profit to total assets	0.73	4.303	N.Si
	3. Net profit to equity	0.46	4.303	N.Si
	4. Net profit to total deposit	0.74	4.303	N.Si
	5. Net profit to investment	1.67	4.303	N.Si
	6. Total interest earned to total assets	7.26	4.303	Si.
<b>E</b>	<b>Valuation ratio</b>			
	1. EPS	1.73	4.303	N.Si
	2. DPS	0.19	4.303	N.Si
	3. Dividend payout ratio	0	4.303	N.Si
	4. Net worth per share	2.36	4.303	N.Si

**Source: Annual report**

Table 4.23 shows that there is significant difference in the loan and advances to total deposit, total revenue to total assets and total interest earned to total assets ratios of BFL before and after IPO where as there is no significant difference in other ratios of the company before and after IPO.

## **4.8 Major Findings**

The study was set out to analyze pre and post operating performance of selected companies. The data, which were obtained through Primary and Secondary sources, were analyzed using different tools and models which resulted in following findings;

### **Liquidity ratio**

- All the finance companies are found to maintaining average current ratio below the standard value of 2:1, except STDFL after IPO. However the ratios have been found increasing in UFL and GFL. The result shows that the liquidity position of STDFL is comparatively better than that of other finance companies. However the highly fluctuating ratios show that none of these finance companies have formulated any stable policy.

### **Activity ratio**

The activity ratios of selected finance companies reveal that:

- SFL has the maximum average loan & advances to total deposit ratio before IPO. Similarly, UFL seems to the highest utilize of its deposit fund as loan and advances after IPO
- GFL as the lowest mobilize of the deposit fund as investment before IPO and SFL have as the lowest mobilize after IPO. However the average ratio of SFL has been decreased after IPO and it has been increased in GFL.
- SFL has the highest average ratio after IPO whereas STDFL has the lowest average ratio for the same phase. However the average ratio has been increased in SFL after IPO. The ratios have been decreased in other finance companies. The above findings help to conclude the SFL is utilizing their deposit more in lending activities.

### **Leverage ratio**

- SFL has increased their debt proportion after IPO where as other companies have decreased. And UFL is the least debt financed after IPO in comparison to others.
- BFL is found with highest and STDFL with the lowest average total debt to total assets ratio before and after IPO. However the ratio has been increased in SFL and BFL and it has been decreased in other finance companies after IPO.
- UFL is found with highest average ratio after IPO. SFL has decreased their capital adequacy ratio after IPO where as other companies have increased.

The above findings show that SFL and BFL are following aggressive policy which indicates them to be riskier where as UFL and STDFL are making lower use of debt which indicates them to be less risky.

### **Profitability ratio**

The analysis of profitability ratio reveals that:

- UFL and BFL are the companies which are showing their better steps in making increasing trend in net profit after IPO.
- SFL has increased average ROE after IPO where as others have decreased average ROE after IPO.
- GFL has the highest average ROI before and after IPO where as ratio has been increased in SFL and BFL and it has been decreased in other financial companies.
- The average interest earned to total assets in SFL is highest and lowest in STDFL after IPO. Where as it has been decreased in other companies.

### **Valuation ratios**

The analysis of valuation ratios reveals that:

- The EPS of GFL is decreasing after IPO where as it is increasing in all the other companies after IPO.
- STDFL has the highest average DPR after IPO where as others have lower. The GFL is the one company whose net worth per share has been decreased after IPO.

## **Test of Hypothesis**

The test of hypothesis i.e. t-test at 5% level of significance of all the ratios of finance companies before and after IPO reveals the following findings:

- There is significant difference in the current ratio of UFL before IPO and after IPO where as there is no significant difference in the other ratio of the company before and after IPO.
- There is significant difference in the EPS, DPS and Net worth per share of SFL before and after IPO where as there is no significant difference in the other ratios of the company before and after IPO.
- There is significant difference in the current ratio, debt to equity and net profit to equity of GFL before and after IPO where as there is no significant difference in other ratios of the company before and after IPO.
- There is significant difference in the dividend payout ratio of STDFL before IPO and after IPO where as there is no significant difference in other ratios of the company before and after IPO.
- There is significant difference in the loan and advances to total deposit, total revenue to total assets and total interest earned to total assets ratios of BFL before and after IPO where as there is no significant difference in other ratios of the company before and after IPO.

## **CHAPTER - V**

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

After completing the basic analysis required for the study, the final and the most important task remained is to enlist findings, issues and challenges of the study and give suggestions for further improvement. This would be meaningful to the top management of the finance company to initiate action and achieve the desired result. Here, the objective is not only to point out errors and mistakes but also correct them and give directions for further growth and improvement. Thus, this chapter summarizes the whole part of this study. It includes summary, conclusion from the study and the recommendations.

#### **5.1 Summary**

The development of any country largely depends upon its economic development. Financial institutions play a dominant role in the process of economic development of the nation. The beginning and establishment of financial institutions depends upon the level of economic activities and monetary transactions in the country. In Nepalese context, the history of modern financial institutions begins with the establishment of NBL in 1937 A.D. Since then several financial institutions i.e. joint venture banks, domestic commercial banks, finance companies have come into existence which cater to the financial need of the country.

Finance companies stimulate savings by mobilizing idle resources on one hand and on the other, lend the resources or mobilize to those who have investment opportunities. Though the Finance Company Act was passed in 1985, it was brought into effect only in 1992 after the implementation of liberal economic policy. Within the short period, this sector has assumed greater importance. In a situation when commercial banks are not able to meet individual credit needs, it is timely that finance companies have grown to replace and have been brought as legal institutions within the regulation and control of NRB. Thus,

they have served as one of the institution for development, enhancement and promotion of economic activities in the country.

The present study regarding the pre-issue and post-issue financial performance of the selected finance companies has been conducted to present the hidden implications of the figures shown in the balance sheet with regard to financial performance of the companies and to identify their contributions to the national economy before and after their IPO. The objective of the study was to analyze the financial performance before and after the IPO. In the second part of the study, the literatures available in this field of the study have been presented. It has shown the gap between previous studies and need of this study. Research methodology accomplishes the objective set in chapter one. It includes the research design, population and sample, nature and source of data, method of data analysis and tools used for the analysis i.e. Ratio analysis

In order to carry out the study, the financial statement of the selected finance companies of the period three years before their respective IPO and three years after their respective IPO have been analyzed in the fourth part. This is the fifth part of the study and it summaries the whole part of the study.

- The study was set out to analyze pre and post operating performance of selected companies. The data, which were obtained through Primary and Secondary sources, were analyzed using different tools and models which resulted in following findings.
- UFL, GFL and STDFL have liquidity ratio in increasing trend after IPO. Whereas SFL have declined after IPO. Liquidity ratios are used to judge an ability of a company to met short-term obligations and also shows the financial strength of the firm.
- SFL maintain its turnover ratio after IPO. UFL is also in good position after IPO which implies they are efficient in utilizing their assets to generate sales.
- SFL has the higher debt equity ratio even after IPO which indicates the higher contribution of debt capital than equity fund in the company. However a very high

debt to equity ratio is unfavorable as debt are considered to be more risky which bears obligation towards creditors.

- SFL and GFL has earned very impressive profit and has maintain even after IPO, it's the outcome of maintaining good return on assets, return on investment and net worth.
- EPS of SFL is in increasing trend after IPO which indicate the market value of the firm is in good position.
- Dividend per share of SFL, GFL, STDFL and BFL is in increasing trend which shows they have distributed dividend.
- Net worth of UFL, SFL, STDFL and BFL has increased which shows the extent to which the paid up value of a share has been raised.

## **5.2 Conclusion**

Nepal is a developing country. It needs to strengthen its economic structure to achieve rapid overall development. Finance companies play catalytic role in the economic growth of any country. In Nepal too, they have been proved as prime move of the economic development. Nepalese finance companies face several problems related to fund mobilization and investment. They work with traditional approach. Finance companies have to revitalize their role which requires encouraging environment to be innovative and diversify their business to other prosecuted areas. They have to rework to find new methods of financing instead of depending only on time bound fixed deposit that can not always cope with the long term lending maturity structure. Finance companies should continue a gradual diversification of their functions by shifting a considerable portion of their assets.

On the basis of detail analysis of the performance of the sampled companies the following conclusions have been drawn: UFL, GFL and STDL have meet short-term obligations and also show the financial strength of the firm as their liquidity ratio in increasing trend after IPO. SFL is utilizing their deposit more in lending activities which implies they are efficient in utilizing their assets to generate sales. SFL and BFL are

following aggressive policy which indicates them to be riskier where as UFL and STDFL are making lower use of debt which indicates them to be less risky. Profitability position of SFL and GFL are found comparatively better performance after IPO, it's the outcome of maintaining good return on assets, return on investment and net worth. SFL appears with the highest average net worth per share after IPO which shows the extent to which the paid up value of a share has been raised. GFL and SIFL are the other two finance companies whose net worth per share has been decreased after IPO.

### **5.3 Recommendations**

From the findings and conclusions of this study, the following recommendations have been made to the concern companies to improve their performance.

- The current ratio of all the above selected finance companies does not meet the traditional standard level of 2:1 except that of STDFL after IPO. So, financial companies must identify the quality of current assets and current liabilities to develop their own standard current ratio.
- Though liquidity position of GFL and BFL seem to be favorable in terms of cash and bank balance, it seems to be more. Hence it is recommended to reduce the excessive non performing cash and invest on income generating current assets.
- All the finance companies are suggested to employ their major source of fund i.e. deposit in more profitable sector so as to maximize the return and increase the net profit.
- BFL is especially suggested to work on credit management and focus on recovering non performing loan.
- SFL and BFL are seemed to be highly debt financed. They are following aggressive policy which is the symbol of risk and inflexibility in the operation. In one hand, inadequate capital leads to failure of advancing loans and advances on the other hand excessive use of debt can also lead to bank rapt at the inability to meet the demand made by debt holders. In addition to this, excessive use of debt capital by these financial companies may cause to lower return to equity holders. So these finance companies are suggested to increase their equity capital by issue

of shares, expanding general reserves and retaining more earning. Furthermore, these finance companies must identify the investment opportunity and assort the risk assets portfolio carefully before accepting higher volume of deposits, especially high cost bearing fixed deposits.

- Total revenue to total assets ratio of BFL has been decreased but its interest expenses, operational expenses, staff expenses has been decreased during its 3<sup>rd</sup> year after IPO. Due to which it has suffered heavy losses. The company is suggested to reduce its outstanding interest income, non performing loan and operational cost.
- The higher ratio of ROI of GFL and SFL is not due to higher volume of profit earned but due to lower volume of investment. So, these companies are suggested to make better investment portfolio.
- UFL has to mobilize its working fund better to improve interest income.

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## APPENDIX 1

### Sample Calculation for Hypothesis

Let us represent current ratio before IPO and current ratio after IPO of UFL by X and Y respectively.

Null Hypothesis  $H_0: \mu_x = \mu_y$  That means current ratio before IPO and after IPO do not differ significantly.

Alternative Hypothesis  $H_1: \mu_x \neq \mu_y$  That means current ratio before IPO and after IPO differ significantly.

Test Statistics: Under  $H_0$ , the test statistic is  $t = \frac{\bar{d}}{\sqrt{S^2/n}}$

Where  $\bar{d} = \frac{\sum d}{n}$  and  $S^2 = \frac{1}{n-1} [ \sum d^2 - (\sum d)^2/n ]$

Calculation of  $S^2$ ,

Year	X	Y	d= X-Y	d <sup>2</sup>
1	0.99	1.12	-0.13	0.0169
2	1.01	1.13	-0.12	0.0144
3	1	1.08	-0.08	0.064
			d = -0.33	d <sup>2</sup> = 0.0953

We have,  $\bar{d} = \frac{\sum d}{n} = \frac{-0.33}{3} = -0.11$

$$S^2 = \frac{1}{n-1} [ \sum d^2 - (\sum d)^2/n ]$$

$$S^2 = \frac{1}{3-1} [ 0.0953 - 0.0363 ]$$

$$= 0.0029$$

$$\text{The test statistics is } t = \frac{\bar{d}}{\sqrt{S^2/n}} = \frac{-0.11}{\sqrt{0.0029/3}} = -5.37$$

Hence,  $|t| = 5.37$

The tabulated value of t for 2 d. f. at 5% level of significance for two tailed test is 4.303. Since calculated value of t is greater than tabulated value,  $H_0$  is accepted i.e. there is significant difference between Current ratio before and after IPO.

## APPENDIX 2

Let us represent current ratio before IPO and Cash and bank balance to total deposit ratio after IPO of UFL by X and Y respectively.

Null Hypothesis  $H_0$ :  $\mu_x = \mu_y$  That is the mean Cash and bank balance to total deposit ratio before IPO and after IPO do not differ significantly.

Alternative Hypothesis  $H_1$ :  $\mu_x \neq \mu_y$  That is the mean Cash and bank balance to total deposit ratio before IPO and after IPO differ significantly.

Test Statistics: Under  $H_0$ , the test statistic is  $t = \frac{\bar{d}}{\sqrt{S^2/n}}$

Where  $\bar{d} = d/n$  and  $S^2 = \frac{1}{n-1} [ \sum d^2 - ( \sum d)^2/n ]$

Calculation of  $S^2$ ,

Year	X	Y	d= X-Y	d <sup>2</sup>
1	15.96	4.15	11.81	139.476
2	13.58	14.20	-0.62	0.38
3	6.52	2.91	3.61	13.03
			d = 14.8	d <sup>2</sup> = 152.886

We have,  $\bar{d} = d/n = 14.8/3 = 4.93$

$$S^2 = \frac{1}{n-1} [ \sum d^2 - ( \sum d)^2/n ]$$

$$S^2 = \frac{1}{3-1} [ 152.886 - 73.013 ]$$

$$= 79.87$$

$$\text{The test statistics is } t = \frac{\bar{d}}{\sqrt{S^2/n}} = \frac{4.93}{\sqrt{79.87/3}} = 1.19$$

Hence,  $|t| = 1.19$

The tabulated value of t for 2 d. f. at 5% level of significance for two tailed test is 4.303. Since calculated value of t is less than tabulated value,  $H_0$  is rejected i.e. there is no significant difference between Cash and bank balance to total deposit ratio before and after IPO.