

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Financial instruments refers to the stock, bond, debenture and other financial assets those represents the right of the holder to receive future prospective benefits under the terms and conditions provided in the instrument(s). Financial instruments are traded in the financial market. Investors can buy or sell securities immediately at a price that varies little from the financial markets and facilitates the pricing discovery process. Buy and sell orders that flow from investors' demand and supply preferences determine the price of securities in the security market. Since securities market is the major component of capital market it is the need of today to address the investor's preferences as to the financial assets those are transacted in such markets. This study is a small attempt towards the end.

Financial market facilitates the transaction of financial assets like deposits, loan, bonds, securities, stocks, cheques, bills etc. Financial market refers to all the activities of financial institutions those transact on financial assets and liabilities.

Financial market is defined as place where fund supplier and fund borrowers are brought together with the help of financial intermediaries directly or indirectly. These intermediaries channel nation's savings into most productive uses. Lenders or suppliers of funds exchange money for other financial assets that tend to provide a better future return. The net effect such a transaction is that they buy a claim against some one's money holding at some future date. In fact, they create loanable funds in the financial market (Hemming and Pigott; 1975:11). Financial market is functional perspective is a rational system of collecting savings and allocating them efficiently to the ultimate users for investment in productive assets or current consumption (Kidwell and Peterson; 1981: 25). Like wise Mishkin (1992), Baye and Jansen (1996), Mayo (2002) consent that financial market is the arrangement that helps to allocate resources efficiently.

Financial market can be better understood with a full-fledged knowledge on their various types and categories. The lines of demarcation are not clear-cut in practice. Even then for the purpose of simplification and made it understandable, financial market is classified as Capital market, Money market, Primary market, Secondary market and Loan and security market etc.

Investment means the sacrifice of current rupees for the future rupees in which two different attributes are generally involved i.e. time and risk. The sacrifice takes place in the present and is certain. The reward comes later, if any and the magnitude is generally uncertain. In some cases the element of time predominates (for example government bonds). In other cases risk is the dominant attribute (for example call options on common stocks). In yet others, both time and risk are important (for example shares of common stock).

For the investors Primary issue of share is also an option. Primary issue of share occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop. Primary issue of share can be of any debt or equity security.

Primary market of securities which originates new issues of stocks and bonds avails cash to the issuer which may be invested in the business. Generally companies start out their business by raising equity capital from the small number of investors, and with the increment of the business activities it needs additional equity capital and desires to "go public" by selling to the general public. This kind of public offering includes cost that may be direct or indirect. The direct costs include legal, auditing, and underwriting fees. And the indirect costs include management of time and efforts as well as dilution of selling shares at below the price prevailing in the market. These kinds of direct and indirect costs affect the cost of capital for firms going public.

The people or institutions responsible for finding out investors for the primary issue share of the securities sold in the primary market are called the investment bankers or issue managers. Investment bankers are also called underwriters, they purchase new issues from security issuers and arrange for their resale to the investing public. Primary issue of share generally involves one or more investment banks as "Underwriters". The company offering its shares called the "issuer", enters a contract with an underwriter to sell its shares to the public. The underwriter then approaches investors with offers to sell these shares.

This study is based on the Policies and Practices for Primary issue of shares along with the problems and growth of the primary market in Nepal as well as to identify the role of investment bankers (issue managers) to analyze the pace of Primary issue of share, to identify the impact of financial institutional loans for IPO funding. At the end recommendations and suggestions regarding the primary share market have been made.

Security Exchange Center was converted into Stock Exchange Limited in 1993 and with this broker system for secondary market came in existence. The basic objective of Nepal Stock Exchange Ltd is to impart free marketability and liquidity to the government bonds and corporate securities. With the establishment of full fledged stock exchange. The shares which the public held for the decades became liquid.

Prior to the establishment of Securities Ordinance 2005, companies were required to get approval of their prospectus from Company Registrar's Office and then to receive approval from the SEBON in accordance with Securities Exchange Act, 1983 and the Companies Act, 1996. This new ordinance which came into effect since September 23, 2005, has incorporated a provision that requires the public companies to register with the SEBON all securities before their issuance. The ordinance also made mandatory for issuing companies to prepare prospectus, and publish it for the public after getting SEBON'S approval.

Development and expansion of capital market is essential for rapid economic growth of the country. Capital market helps economic development by mobilizing long-term capital needed for productive sector. Capital market is of two types: primary market and secondary market. Primary market indicates the market where new securities are bought and sold for the first time. A market where existing securities are traded is known secondary market. With the development of financial sector the corporate business organization come front adopting various policies and strategies to enable the investors to satisfy their diverse assets preference. This has made it possible to attract the external fund from the public by issuing shares. On the other hand, promoters' equity fund may not be sufficient for its financial requirement whether it is a new company or existing company seeking to expand and modernize. They can get loan from the bank and financial institutions, whether long term or short term but the bank and financial institutions will lend only a certain percentage of the company's equity or assets which may not be sufficient for the company. Also getting loan from bank and financial institution is not easy because there may be lengthy process and legal requirement involved.

Initial Public Offering (IPO) is a part of primary market mechanism. IPO is the process of selling stock to the public at large by a closely held corporation or its principal stockholder. Initial Public Offering is the first time issuance of securities to the public. The securities offered can be ordinary share, debenture, preference share etc. It provides all the investors an opportunity to acquire a portion of the financial claims. An initial public offering (IPO) occurs when a security is sold to the general public for the first time with the expectation that

a liquid market will develop. Public Offering is a security offering where all investors have the opportunity to acquire a portion of the financial claims being sold (Keown and Petty, 2002: 471). An IPO can be any debt or equity security.

Most of company starts out by raising equity capital from a small number of investors, with no liquid market existing if these investors wish to sell their stock. If a company prospers and needs additional equity Capital, at some point the firm generally finds it desirable to “go public” by selling stock to a large number of diversified investors. Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately held company. Through IPO, the founder simply wants to establish a value and liquidity for the stock (Van Horne, 2002:578). Existing shareholders can sell their share in open-market transactions. There are certain ongoing costs associated with the need to supply information on regular basis to investors and regulators for publicly traded firms. Furthermore, there are substantial one-time costs associated with initial public offering that can be categorized as direct & indirect costs. The direct costs include the legal, auditing and underwriting fees. The indirect costs are management time and effort devoted to conducting the offering, and the dilution associated with selling shares at an offering price that is, on average, below the price prevailing in market shortly after the IPO. These direct and indirect costs affect the cost of capital for firms going public. Firms going public, especially young growth firms, face market that is subject to sharp swings in valuations. The facts that the issuing firm is subject to the whims of the market makes the

1.2 Statement of the Problems

There is not any provision to present citizenship at the time of submitting their share application form. So, single investor can apply hundred of applications, showing dummy names. As a result they can capture large number of shares. When single investor captures large number of share, he can influence the company management and stock price also.

The study is meant to know the perception and perfection of the general investors regarding the investment in the securities through primary Market. The focus of the study is on the status of the general investor, the volume and portfolio of their investment and the decisive factors they consider while opting companies for investment. But the study is also highly concentrated on investment in the manufacturing and processing companies. The study aimed

at those factors which could be decisive from the investors view whether to invest or not in particular company.

There exist various types of obstacles in IPO. In this respect, there is the tendency, limitation of ownership and control of the enterprises within the close circle. On the other hand, there were no financial or other incentives for the firms to the public. Further more the existing strong barriers of socio-economics infrastructure and historical reasons made the successful flotation difficult.

Dealing in public issues of the primary market securities is subject to the directives and regulatory framework of the concerned governing bodies. Hence, the study is primarily deals with the process of managing the process of the public issues by the issue managers. Besides, Investment in the primary market instrument has gaining the interest of the general and corporate investors. Most of the public offerings have been successfully made since the investors have considerable concern and willingness for investment in these securities

Hence, study required to find out why there has been such variation in the responses by the public. The causes for this response must be analyzed so that new companies who would like to issue new shares can benefit from the conclusion drawn from this research.

1.3 Objectives of the Study

This study is being to evaluate the public response of the Initial Public offering or primary issue of shares in the context of Nepal.

- ✚ To analyze the pattern of public response to IPO.
- ✚ To identify the problem of IPO in the market.
- ✚ To analyze the procedure and mechanism of IPO
- ✚ To assess the growth of IPO.
- ✚ To suggest and recommend on the basis of major findings of the study

1.4 Significance of the Study

This research is very useful to all the parties like security businesspersons, market makers, brokers, companies and investors etc. who are directly or indirectly involved in the stock market because it provides the guidelines to the stock market and potential investors to make investment decisions. Issuer company may also take the advantage of the study by examining the investors' psychology towards the investment in different financial instruments.

The investors are the sovereigns of security market so their needs and desires must be identified so that they can rightly be rewarded for the sacrifice from their part. Academicians, research scholars, students and policy makers may be benefited from this study as it tends to give some practical insights that can be very useful to turn the theoretical knowledge into practical field.

1.5 Limitation of the Study

Although public response might be seen on other type of shares, however response in primary share issue is considered and other aspects have been neglected, as they are difficult to measure. Some companies have not disclosed the information despite the legal provisions of obtaining information regarding their financial position.

1. This study is mostly based on secondary data as well as primary Data.
2. Only a few companies are considered for the study.
3. The study is mainly based on Kathmandu valley only
4. The study is not covered recent changes because of limitation of data.

1.6 Organization of the Study

This research has been organized in five chapter as below:

Chapter I: Introduction:

The first chapter deals with introduction. This includes background, statement of problem, objectives of the study, significance of the study, limitation of the study.

Chapter II: Review of Literature:

Second chapter presents review of available literature. It includes review from book, reports, journal, previous thesis etc.

Chapter III: Research Methodology:

Third chapter incorporates the research methodology used in the study, which includes research design, sources of data population and samples, methods of data collection and analysis etc.

Chapter IV: Presentation and Analysis of Data:

The fourth chapter deals with data collected from different sources. Based on the data analysis of analysis of investors' preferences will be made using statistical and non-statistical tools. This chapter also includes major findings.

Chapter V: Summary, Conclusion and Recommendation:

The fifth chapter includes summary, conclusion and offers suggestions for further improvement.

CHAPTER - II

REVIEW OF LITERATURE

“Review of literature means reviewing research studies of other relevant proposition in the related area of the study so that all part studies, their conclusions and deficiencies may be know and further research can be concluded.”(Pantta & Wolf, 1999:234). This chapter deals with the literature, relevant to this study, this part of thesis will essential to know about the finding of other research which are appropriate to the study. The first part will consist conceptual framework and the remaining parts will consist the review of reports, articles, journals and dissertation.

2.1 Conceptual Review

2.1.1 Primary Market and Initial Public Offering

The primary market itself can be subdivided into seasoned an unseasoned issues. A seasoned issue refers to the offering of an additional amount of already existing securities, whereas an unseasoned new issue involves the initial offering of a security to the public. This unseasoned new issues are often refers to as Initial Public Offering (IPO).

When a company wants to raise funds from the public, it issues securities at first time and announce the public to exercise the offering and this announcement for the public raise funds is called Initial Public Offering. It is the raising of long term funds for governments or corporation from a fund sufficient public group in the primary market. The most important aspect of public offerings is its role as the single most effective means by which government and corporate entities can obtain long-term (debt or equity) on a permanent basis. Public issue mean, rising of capital directly from the public. Issue of equity obviously creates a value of company and no doubt it is the major sources of capital.

Thus Initial Public Offering involves rising of funds for governments or corporations from the public through the only issuance of various securities in the primary market and is often the only major source of obtaining large sum of fixed rate, long term fund.

2.1.1.1 Common Equity/Stock Offering

Common equity represents the ownership position in a company. The holders of common stocks, called shareholders or stockholders are the legal owners of the company. They are

entitled for dividends for the capital contributed by shareholders by purchasing common shares. The capital represented by common stock is called share capital.

Equities convey ownership of the corporation and are basically valued in line with expected future earnings. To date they have been relatively little affected by financial innovation (Gutam & Thapa, 2006:17).

Many companies have only one class of stock, often called common stock or ordinary shares. This class of stock carries residual ownership of the company, entitling the holder to unlimited interest in the earnings and assets of company after limited claims are paid. Dividends paid on stocks are usually unstable because they tend to vary with earnings and also less than earnings. The market price of common stock is often subject to wide fluctuations, because it depends largely upon investors expectations of future earnings.

Following are the most significant feature of equity shares.

1. Risk: -

Equity shareholders run the risk of receiving nothing if earnings are insufficient to cover all obligations (Srivastava, 1995:337).

2. Control: -

Every equity shareholder has the right to vote on every resolution placed before the company and his voting right on a pool is in proportion to this share of paid-up capital of the company (Srivastava, 1995:338).

3. Rights:-

The equity shareholder have the right of Voting, to transfer shares in the proceeds upon the liquidation of company, share in the profits when distributed as dividends etc.

4 Pre-emptive Right

The Company is under legal compulsion to offer new issues to the equity stockholders before placing them in the market for subscription. Such a right of equity stockholders to purchase newly issued equity stock is termed as ‘preemptive right’ or ‘right offering’.

5. Maturity

There is no stated maturity at which capital must be returned to the equity shareholders. So, equity shares provided permanent capital to the company.

2.1.1.2 Preference Shares

Preferred stock is a fixed income security and it is also the alternative sources of long term funds for the company. Preferred stock is similar to bonds in same respects and to common stocks in other ways preferred stock represents equity of a corporation but it has different from common stock because it has preferences over common stock in payment of dividends and in the assets of the corporation in the event of liquidation (Ross, Jaffe and Westerfield, 1993:402).

The preferred stock, though not a popular with investors as bonds and common stock, offers unique features that make it attractive under certain circumstances. First, it is hybrid security because it has characteristics of two types of securities: debt and common stock. Second, it is essentially a fixed income security. Preferred stock investors typically receive fixed dividends (Cheney & Moses, 1992: 404-405).

Preferred stock has a number of features, major features includes:

- It has priority of claim over common stockholders with regards to income. They are paid dividend at a fixed rate specified in the agreement.
- Preferred stockholder claims on assets are superior to equity Stockholder during the time of liquidation of company.
- Normally preferred stockholder do not have direct right to participate in the management through voting from directors and other matters.
- Unlike common stockholder, preferred stock always has a Par value.
- At their option preferred stockholders may be allowed (if mentioned in the corporation's charter) to switch over to equity stock.
- A call provision gives the issuing corporation the right to call in the preferred stock for redemption.
- Today, however most new preferred stock has a sinking fund and thus an effective maturity date.

2.1.1.3 Bonds/Debenture

Debenture as a debt security is the alternative sources of long-term fund for the company and given different names in different countries. In the United Kingdom, Nepal and India the term 'debenture' is popular, but in the US the term 'bond' is common (Srivastava, 1995:342). A debenture is an unsecured corporate debt, whereas a bond is secured by a mortgage on the corporate property. A debenture is an acknowledgement of a debt under the sale of a company and containing a contract for the repayment of the principal sum at a specified date

and for the payment of interest at a fixed rate percentage (Srivastava, 1995:343). A bond is a type of fixed-income security by a borrowing entity in which the amount to be paid to the investor is specified in the investment contract or indenture. Debentures have some important features such as interest rate, maturity date, redemption, indenture, security, converted ability, yield and claims on assets & incomes (Pandey, 1994:820).

In short, debenture is a formal evidence of debt and termed as the senior securities of a company. Certain distinguishing features of debentures are as follows:

- The debenture or bond has fixed maturity date. That means, the principal amount of bond must be repaid at the time of maturity.
- Debenture holder has priority on claim to income over preferred stockholder and common stockholder.
- Bondholders also have priority over stockholder in respect of their claims on assets.
- Debenture holders do not have controlling power through the vote for the election of directors but indirectly influence managerial decision through protective covenants in indenture.

2.1.1.4 Options

An option is probably the most popular derivative security in the world of investment. It is a contract between two people wherein one person grants the other person the right, but not obligation, to buy or sell a specified asset at a pre-determined price on or before a set expiration date. It is derivative security because it derives its value from an underlying security (Security for which the option has been written) such as a stock, a bond etc. In the securities industry, options are marketable security and can be bought and sold in the stock exchanges. So the option owner has the right to sell the option and any other investors can invest on it. An option buyer pays an option writer a premium for granting the option. After options have been created, they can be traded at determined premiums (or Prices) that fluctuate continuously (Gutam &Thapa, 2006: 7-1). Option is not in exercise up to now in Nepal.

The option is divided into two types i.e. Put and Call Option. Option to sell certain shares at predetermined price within or a certain later date called Put Option where as an option to buy certain share at a predetermined price with in or on certain future date is called call option (Bhattarai, 2006: 291).

Option has certain features which are given below.

- 1. Exercising Date:** - The fixed price stated in the option contract at which the underlying asset may be purchased or sold is the exercise price. It is also called strike price and denoted by E.
- 2. Expiration Date:** - The option has a certain maturity period. The option expires after its maturity period and the maturity date is the expiration date.
- 3. Exercising an option:** - The act of buying or selling the underlying asset through an option contract is called exercising an option.

2.1.1.5 Warrants

A warrant is a long-term option that gives the holder the right to purchase a stated number of shares of the company stock at a specified price within a stipulated period of time. Generally, warrants are distributed with debt and preferred stock, and they are used to induce investors to buy long-term debt and preferred stock with a lower coupon rate than would otherwise be required. Warrants are long-term call options that have value because holders can buy the firm's common stock at the exercise price regardless of how high the market price increases. Warrants are usually used by growing firms as sweeteners to reduce the cost of funds. Warrants may be detachable or non-detachable. Detachable warrants can be sold or purchased without selling or purchasing the security to which they are attached so that after the warrants have been exercised, the bond remains outstanding and total capital increases. Warrants are not exercised in Nepal till date.

2.1.1.6 Convertible

Convertible are bonds or preferred stock that can be exchanged for a stated number of common shares at the option of the holder within a stipulated period of time. A bond can be converted into preferred stock or common stock while the preferred stock can be converted into common stock only. Conversion features increase the marketability of the security. Unlike the exercise of warrants, the debt and preferred stock is simply replaced by common stock but does not provide additional capital (Gautam & Thapa, 2006: 64).

At first time in Nepal, the convertible preferred stock is issued by Everest Bank Limited some time ago but convertible bonds are not in practice till date.

Convertible Securities may have the following features;

- 1. Conversion Ratio:** - It is the ratio at which a convertible security can be exchanged for a common stock. It explains the number of shares into which a convertible can be converted
- 2. Conversion Price:** - It is the price per share that is effectively paid after the conversion of the convertible into common stocks. It is determined by dividing the par value of convertibles by the conversion ratio.
- 3. Conversion Value:** - Conversion value is the value of the convertible measured in terms of the market price of the common stock into which it can be converted. Conversion value can be found simply by multiplying the conversion ratio by current market price of the firm's common stock.

2.1.2 Money Market

Money market comprises of Short-Term Loans, Certificates of Deposit, Treasury-Bills, Banker Acceptances, Commercial Paper and Promissory Notes for short-term financial needs and practices in both primary & secondary market. Money market deals with short term instruments. Money market exists in other to bring together buyers and seller of securities meaning their mechanism is created to facilitate the exchange of financial assets (Sharpe, Alexander & Bailey, 2002: 9).

Money market brings together the supplier and the demander of short-term liquid fund. It is the type of market, which is meant for a short term and for highly liquid debt securities. Money market typically involves financial assets that have a life span of one year or less. Money market instruments include short-term marketable, liquid and low risk securities. Money market instruments, sometimes, are also called cash equivalents or just cash.

2.1.3 Capital Market

Capital market is the market where long term lending and borrowing takes place. The capital market is defined as a place where finance is raised by companies for meeting their requirement of funds for new projects, modernization, expansion programs, long-term working needs and for various others propose. Companies and the Government can raise funds for long-term investment via the capital market, which includes stock market, bond market and the primary market. The capital market mobilizes savings of individuals as investment in shares, debentures, units of mutual funds and other like financial instruments which are ultimately deployed for productive purpose in various sectors of the economy.

Capital market refers to the links between lenders and borrowers of funds, arranging of funds-transfer process to seek each other's benefit. The capital market serves as link between suppliers and demanders of long term funds maturities with more than one year to make transactions. It has wide term embracing the buyers and the sellers of securities and all those agencies and institutions which assists the sale and resale of corporate securities. The primary function of the capital market is to allocate resources optimally due to this; it is one with the lowest possible prices for transactions services.

The capital market also comprises two segments-the new issue of market that is known as the primary market and the secondary market where already issued securities are traded. For the purpose of this manual, only primary market would be dealt in detail. Capital market consists of non-security and securities market.

2.1.3.1 Non Security Market

In non-security market, the transaction or the exchange of the funds takes place between user and supplier without issuing securities. The fund is raised as long term in the market. The non-security market includes the financial transactions between the lending institutions such as development banks, business houses, banks or individual too. The contract between parties of capital exchange has loss liquidity due to restriction of liquidation of these loans in secondary market.

2.1.3.2 Security Market

A security market can be defined as a place for bringing together buyers and sellers of financial assets in order to facilitate the sale and resale of transferable securities. Securities markets major function is to provide line between saving and investment there by facilitating the creation of new wealth. Although, securities are concerned in few locations, they refer more to mechanism, rather than to place, designed to facilitate the exchange of securities by bringing buyers and sellers of securities together. Securities, such as equities, short and long term debt instruments, derivatives etc are the products that are traded in the markets institutions such as investment bankers and security firms, securities issuing institutions such as government and corporate bodies and the participants of the securities markets. Securities market is classified into two, the market at where the transactions of the securities issued for the first time take place is called primary market. Secondary market is the market for the existing securities where second hand securities are bought and sold in the market.

2.1.4 Primary Market

The term “Primary Market” is used to denote the market for original sale of securities by issuer to the Public. The primary market is the place where corporations and Government Issue new securities at first time to generate the money for real investment. All the securities, whether it is for short term or long term, are initially issued in the primary market. This is the only market in which the company or government bodies are involved in the transaction and receives direct benefits from issue that is the company actually receives the proceeds from the sale of securities (Bhattarai, 2005: 7).

The primary market itself can be subdivided into seasoned and unseasoned issues. A seasoned new issue refers to the offering of an additional amount of already existing securities, whereas an unseasoned new issue involves the initial offering of a security to the public.

In primary market the principal sources of funds is the domestic savings of individual and business, other supplies include foreign investors and governments. The ultimate supplies of funds are those sectors with a surplus of current incomes over expenditures (savings) and these funds flow to ultimate users, economic use securities to finance a surplus of expenditure over their current incomes.

2.1.5 Secondary Market

Secondary market involves the purchase and sale of securities which are already issued to the general public and traded in the stock exchange. Secondary market is created by brokers, dealers and market makers. Brokers bring buyer and seller together with themselves actually buying or selling, dealers set price at which themselves are ready to buy and sell (bid and ask price respectively). Brokerage and dealer come together organized market or in stock exchange (Gitman, 1992: 457). Nepal Stock Exchange (NEPSE), New York Stock Exchange (NYSE) and Bombay Stock Exchange (BSE) are the example of organized stock exchange (secondary market).

The secondary market is a very important element of the securities market. The existence of an organized secondary market can provide this level of confidence to holder of securities so that they can purchase securities in the primary market readily convert these securities to cash whenever they wish to do so. The benefit of secondary market is that it increases the investment opportunities. Person who may not have been able to acquire securities on the primary market have been able to acquire securities on the secondary market.

2.1.6 Initial Public Offering (IPO) Manual

Initial Public Offering (IPO) manual is the details procedure of handling initial public offering of the companies seeking 'go public' for the first time. This manual outlines all the activities and steps that to be observed by all issuing companies and issue manager in respect to initial public Offering (IPO). This manual has been prepared with a view to present, descriptive and step-by-step action sequences in the Initial Public Offering, relevant to all the companies shares to the general public. But, it is subject to periodic amendments and supplements.

The public Offering is not an easy task. There are many organizations involves during this periods. They are:

2.1.6.1 Issuing Company

Issuing company is the company that raising funds as the from of Debenture, Preference Share, Equity Share etc, from the general public through the process of public offering as per requirement of business activity. The company seeking for public offerings could be a new company or new company set by the existing company or by existing listed company. As per company Act, only public companies are liable to go for public offerings but not for private companies on it. NRB has made mandatory that financial institutions must go for common stock public offerings within specified time of operation commencement.

2.1.6.2 Merchant Bankers

Merchant bankers are the financial intermediary that specializes in selling new security issues and advising firms with regard to major financial transaction (Gitman, 2003: 316). The role of merchant bankers is to help create and expand securities underwriting and advising corporations and managing investment portfolio for the needing groups. They charge service charge to their client for intermediary and advisory role. The role of merchant banking in managing the public offerings comes under the heading of securities underwriting. For the working of merchant banking function in Nepal, Nepal Rastra Bank has set forth the working guidelines.

2.1.6.3 Issue Manager

Issue manager is an institution who is solely responsible to manage initial public offering. Financial institutions with the merchant banking operations, manage the overall issue process of any public company termed as issue manager. Issue managers are institutions holding license from Nepal Stock Exchange to manage public offering issues (Securities Exchange Act, 2063). Issue manager work as manager to the issue and underwriting for public issue of

securities (SEBON, 2006 September 22). Issue managers receive issue commission from issuing company for their services through the negotiation. NEPSE has authorized 16 companies to serve as issue manager given below.

Table 2.1
Name of Issue Manager in Nepal

S. N.	Name of Issue Manager
1	National Finance Co. Ltd.
2	Ace Development Bank Ltd.
3	NIDC Capital Markets Ltd.
4	NMB Bank Ltd.
5	Nepal Share Markets & Finance Ltd.
6	United Finance Ltd.
7	Citizen Investment Trust
8	Nepal Finance company Ltd.
9	Elite Capital Ltd.
10	Nepal Housing & Merchant Finance Ltd.
11	Vibor Bikas Bank Ltd.
12	DCBL Bank Ltd.
13	Nepal Srilanka Merchant Banking & Finance Ltd.
14	Tinau Bikas Bank Ltd.
15	Civil Capital Markets Ltd.
16	Investment Management Merchant Banker Ltd.

Sources: Annual Report of SEBON

2.1.6.4 Underwriter and Underwriting

The underwriters are investing-banking firms that act as financial midwives to a new issue (Brearley and Others, 2004: 370). In general, there are group of underwriters who handle an IPO. Among such group of underwriters one act as a lead underwriter and rest as selling group. The underwriters enable the issuing company to determine the range of price at which the securities are to be offered along with the numbers of shares to be sold. Underwriters sell the issued shares to the retail as well as institutional investors. These underwriters either work on best effort basis or underwriter the entire issue. In the best effort basis, the underwriter does not guarantee that the entire issue of company will be sold but it will just put forth its best effort to sell the issue.

Underwriting is an agreement between the issuing company and a financial institution like bank, merchant banker, broker or other person, providing for their taking up the shares or debentures to the extent specified in the agreement between them, if it is not subscribed by the public. The underwriting agreements ensure that the public issued is fully subscribed. The commission paid to the underwriters as consideration for the underwriting arrangement is known as underwriting commission.

2.1.6.5 Bankers to the Issue

Bankers to the issue are normally commercial banks and their main responsibility is to provide custodian service to the issuing company. They may or may not receive applications from the investors, issue acknowledgements for the same and enter application details in application schedules. They may also be involved in the process of realizing the proceeds of issue through cheques /drafts and release final certificates to the issue manager for the number of applications and amount collected.

2.1.6.6 Collection Centers

These are the authorized institution to collect application from the investors issue acknowledgement for the same proceed of issue through cheques/drafts. They also issue final certificates to the issue manager for the number of applications and amount collected. They are provided collection charges for their services, which are usually determined through negotiation and are based on number of applications handled and amount collected. Banks, finance companies or brokerage house mostly performs such roles.

2.1.6.7 Security Board of Nepal (SEBON)

Security Board of Nepal was established in June 7, 1993 under the provision of securities Exchange Act, 1983 (first amendment) and is now functioning as an apex regulator of securities market. Since its establishment, SEBO has been concentrating its effort on improving the legal and statutory frameworks which are the bases for the healthy development of the capital market (Bhattarai, 2006: 38). As per Securities Act, 2006, the major objectives of SEBON are to regulate issue and trading of securities and market intermediaries, promote market development and investors right (SEBON 2006 Sept. 22).

2.1.6.8 Nepal Stock Exchange Limited (NEPSE)

Nepal stock Exchange (NEPSE) is a non-profit organization and sole institutions to facilitate secondary market transactions established under Securities Exchange Act, 1983. It

commenced its regular operations on January 13, 1994 and had adopted Open-Cry cry system in past but now adopted Computer system for transaction of securities.

The history of securities markets began with the flotation of share by Biratnagar Jute Mills and Nepal Bank Ltd. in 1937. Under the Industrial Policy Security Market Centre was established in 1974 which is converted into Securities Exchange Centre (SEC) with the objective of facilitating and promoting the growth of capital market (Adhikari 2004, 75). Later when Securities Exchange Act was regulated in 1983, it started to operate under this act. Under a programmed initiated to reform capital market, Securities Exchange Centre (SEC) converted into Nepal Stock Exchange (NEPSE). The basic objective of NEPSE is to import free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries, such as brokers and market makers. Government of Nepal, Nepal Rastra Bank, Nepal Industrial Development Corporation and its member is the shareholder of NEPSE. Member of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and corporate securities.

2.1.6.9 Offices of the Registrar of Companies (ROC)

Registrar of Companies (ROC) is the governing body for any institution registered under Company Act. In its governing role, it observes and regulates any company going into public examining whether the process of 'going public' is in accordance with the rules and regulation set forth by the existing Company Act or not.

As per the Company ordinance 2062, before publishing prospectus, one copy of the prospectus needs to be submitted to ROC. In this process, ROC approves the prospectus to be published. While approving the prospectus, ROC makes sure that important information is not missed out and unnecessary information is not mentioned. Upon satisfactory changes ROC grants approval to issuing company to issue the prospectus. Apart from approving the prospectus to be published by the issuing company before going into public, ROC does not play other major role.

2.1.6.10 Nepal Rastra Bank (NRB)

Nepal Rastra Bank is the central banking authority in Nepal. It is the governing authority in setting guidelines to all the bank and financial institution regarding its area of operation. But, in the case of public offerings, its involvement is very minimal. Its role in the issue process is only to grant bank and financial institutions approval to be involved with different role in the issue process. If the issuing companies are financial institutions then they need to obtain approval from Nepal Rastra Bank as well, prior issuing their shares to public. Also for

different fund based activities of merchant banking, approval needs to be taken from Nepal Rastra Bank.

2.1.7 Securities Issue Procedure in Primary Market (Legal Rules, Regulations)

The securities issue in Nepal should have to make by abiding the securities Transaction Act 1983, Issue management guidelines, 1997 Securities registration and issue approval guidelines 2000. According to the provision mentioned in this legal framework, the procedure of securities issue in Nepal is as follows:

1. The issuing company should have to select the issue manager or underwriter to manager or underwrite the issue.
2. After the selection of the issue manager, the issue manager should have to prepare the prospectus of the issuing company as per the format designed by the company registration office and ministry of commerce and industry.
3. After the preparation of the prospectus, the issue manager should have to send the prospectus to the issuing company for getting an approval from the Board of Director (BOD).
4. After the approval from the BOD of issuing company, the prospectus should have to be sent to the company registrar for the approval. The registrar of Company (ROC) will send a company of prospectus to the SEBON, Nepal Rastra Bank (NRB) and Insurance Board in case of insurance company for the review of the prospectus.
5. The SEBON, Nepal Rastra bank (NRB) and Insurance Board will send the prospectus after the review.
6. The ROC will again make a correction to the prospectus with reference to the feedback received from the SEBON, Nepal Rastra Bank (NRB) and Insurance Board.
7. The ROC will send the corrected prospectus to the issue manager and the issue manager again sends the corrected prospectus back to the issuing company for the approval.
8. After the approval of issuing company the prospectus should have to send to the ROC for the approval.
9. After the approval of prospectus from ROC, the issue manager should have to register the security in the SEBO for issue after paying certain fee.

Table 2.2
Registration Fee on Issue

Amount of issue	Commission
Up to Rs 50,00,000	0.25%
Rs 50,00,000 to Rs 100,00,000	0.2%
Above Rs 100,00,000	0.15%

10. The SEBON will provide the approval for issue after the discussion of BOD of SEBON.
11. The issue manager should have to issue the securities within the 2 months of receiving the approval.
12. The issue manager should have to prepare the share issue announcement on the basis of the approved prospectus by ROC.
13. The announcement should have to publish in the National daily newspaper.
14. The issue of securities should have to open within a maximum of 15 days and minimum of 7 days of the announcement of the public issue.
15. The share should have to be issued for minimum of 5 days if the share is issued from minimum of 10 collection counters that will cover all 5 development region. If the above provision is not possible, the share should have to open for 7 days.
16. If the targeted amount is not collected within 7 days the company can extend the issue for next 30 days. After that if company thinks to open issue further, the company can extend for another 15 days after getting an approval from SEBON.
17. The issue manager should have to close the sale of share by providing per notice.
18. This issue manager collects the fund from the collection counter day by day.
19. The company has to allot the share according to the allotment guidelines of SEBON.

Table 2.3
The Allotment Period of Securities

Number of Securities	Time Period (in days)
Up to 15000	45
15000 to 60000	60
60000 to 100000	70
Above 100000	90

Sources: SEBON

20. The distribution of share certificate should have to commence within the 45 days to the allotment after completing the allotment of 50% of shares The Company also has

to list the securities in the stock exchange within this period. Similarly, if the company has to refund it has to be made within this period.

2.1.8 Issue Approval Guidelines

According to the Securities Transaction Act, 2003 the company willing to issue the securities should have to register the securities registration and issue guidelines, 2000 has provide various clutches for making the issuance more systematic, ease and procedural. The main provision of these guidelines is

1. The company, which has operated for at least a year, is only allowed for the public issue.
2. The company can sell the share in premium price.
3. The prospectus of the issuing company should have to be prepared by the professionals and they will be liable for the prospectus.
4. The companies relate with tourism, trade, transport, and manufacturing should have to underwrite their securities from the recognize institutions for the issue.
5. The promoters are only allowed to sell his securities only after the 3 years of the publication of prospectus and operation of the company.

2.1.9 Bank and Financial Institution Act 2063

2.1.9.1 Provisions regarding incorporation of Bank & Financial Institution (BFI) and its securities

Any person desirous to promote Bank and Financial Institutions(BFI) should incorporate public limited company and apply for NRB approval under section 4 together with MOA, AOA, feasibility study report, promoter's CV, promoter's agreement, if any, promoter's tax clearance certificate, and other documents as prescribed by NRB

NRB is to provide approval within 120 days and may reject if,

1. Already registered similar name
2. Name/activity against the public interest, religion, and tribes
3. Objective against the law
4. Technically not viable
5. NRB is of the view that the transaction will not be healthy and competitive
6. MOA and AOA not agreed to subscribe at least 1 pc share
7. Has not complied with other matters prescribed by NRB

2.1.9.2 Allotment of Shares

Minimum 30 percent for public of which maximum 5 percent for employees

Joint venture banks as prescribed by NBR

Call money percent at the time of issue

2.1.9.3 Ban on Transfer/Mortgage of Shares and Debentures

1. A promoter cannot transfer his shares up to 5 years of commencement of banking business.
2. After 5 years as per the terms and conditions approved by NRB
3. In case of BFI already in operation up to 5 years from the date of public issue,
4. BFI should not buy back its own share or disburse any loan on against guarantee of own share (section 10). However, can buy back own shares if following conditions are met?

2.1.9.4 Buy back is approved from NRB

1. Shares are fully paid up and listed with SEBO
2. Authorized by AOA and special resolution has been passed in this regard
3. Debt equity ratio is not more than 2:1 after buy back
4. Buy back should not exceed 20 percent of paid up capital and GR

2.1.9.5 Ban on Security Transaction

The following persons cannot buy, mortgage, transact in their own name or in the name of their family of firm/company controlled by them:

1. Director/CEO/Auditor/CS
2. Person engaged directly on management/accounting
3. Prohibition shall continue up to 1 year from the date of vacation from their position

2.1.10 Company Act 2063

The provision made under this act is especially relevant to the securities markets are provisions regarding the issuance and publication of the prospectus, which is necessary for public issue of security. As per the provision, the details of the content of the prospectus are prescribed and the prospectus are to be approved by the Company's Register's Office. Other legal provisions regarding the prospectus in the Company Ordinance are as follows:

2.1.10.1 Prospectus to be published

Every public company shall have to publish its prospectus before issuing its securities.

1. Prior to publishing the prospectus pursuant to sub-section (1), the Directors shall have to submit a copy thereof duly signed by them to the Office. In case of any important matter has been omitted in such prospectus or if contains unnecessary matters, the CRO

may cause such prospectus to be amended or altered as required, and grant approval for its application.

2. The matter that the Office has approved the prospectus shall be clearly mentioned while publishing such prospectus.

2.1.10.2 Particulars to be stated in Prospectus

The following particulars shall have to be set out in the prospectus:

The objective of the company and other main particulars set forth in the Memorandum and Articles can be obtained.

Minimum number of shares required to be subscribed to become the director, and the salaries or directors of the company.

Description of cash received or to be received as remuneration or reward by the promoters of directors of the company.

1. Provision on bonus shares.
2. Provisions, if any, regarding reservation of shares for any shareholders, employee or other person.
3. Identification of Directors.
4. If the shares are to be sold publicly by adding premium, reasons for and justification of, the addition premium.
5. Provisions on the representation of the shareholders subscribing the shares to be sold publicly in the Board of Directors.
6. The minimum number of shares required to be subscribed and the amount of advance required to be furnished along with the application.
7. While issuing the debentures, reasons therefore, and the number of the paid upon debentures and the total amount of outstanding loans have raised the loan.
8. Assets purchased from the proceeds of the sale of shares, the name of the seller of such assets and arrangement if any made for the exchange of shares or debentures instead of cash.
9. Brokerage on shares and debentures.
10. Estimates of expenditures required for the business of the company and that of its income for at least the next three years.
11. Possible financial risks involved in the business to be carried on by the company.
12. Financial arrangements of the company and net worth remaining after the shifting of all liabilities.

13. Names and addresses of auditors, and if an audit report is available, description of such a report.
14. Particulars as to whether any fund of a Promoter or a Director is involved in the assets purchased or intended to be purchased by the company and whether any Promoter or Director is involved in any other firm or partnership or company.
15. The time when the notice of allotment of the shares is to be published.
16. Details of preliminary expenses in the incorporation of the company, in case of a new company, and the real picture of the latest balance sheet in regard to a company already operation.
17. Breakage payable to any trust for being a trustee in regard to securities exchange.
18. The balance sheet and profit and loss account of the company.
19. Details of the underwriting of shares, if any and commission for underwriting shares.
20. Names and address of organization carrying on security exchange.
21. Name of shareholders having subscribed the shares in excess of five percent of the issued capital.
22. Privileges and restrictions of the preferential shareholders.

2.1.10.3 Other necessary matters

1. The format of the prospectus shall be as pre-scribed.
2. If the published prospectus contains a false statement made deliberately or with a mollified intension, the said Directors shall personally be liable to pay compensation to any person for any real loss or damage, if any, he has sustained by purchasing securities on the faith of the prospectus.
3. Provided that, a promoter who resigns before the decision made by the company to publish such prospectus, or who after having come to know about any false statement contained therein publishes a notice to that effect for the information of the general public prior to the sale or allotment of securities or who proves that he was ignorant of the false hood of statement set forth in the prospectus shall not be liable to such compensation.

2.1.11 Duties and Liabilities of the Company

It shall be the duty and liability of any company to abide by the matters set forth in the prospectus.

2.1.11.1 Responsibility for Particulars Contained in the Prospectus

The Directors signing the prospectus shall be held responsible for the matters contained in the prospectus.

2.1.11.2 Share Certificate

A share certificate in the prescribed format shall be issued to every shareholder in respect of each purchased by him, within 3 months of the allotment of the shares, and it shall bear the company signature of at least any two among any directors or administrative chief of the company or Company secretary, in the case of the public company. While issuing the share certificate in respect of any share held jointly by two or more persons, it may be issued by any one of them, by mentioning their names therein.

2.1.11.3 Face Value of Shares and Application

The face value of share of the company shall be of hundred rupees per share. In inviting application by a public company for the subscription of its shares, no amount exceeding 50 percent of the face value of each share shall be demanded with the application.

2.1.11.4 Allotment of Shares

1. Shares shall be so allocated within a maximum period of three months of the date of invitation made by a public company to the general public for the subscription of the shares that all the applicants may get shares, to the extent possible, and a notice to that effect shall there upon be sent to the shareholders, in the format as prescribed.
2. If the company submits an application explaining the reason for non-allotment of shares within the time limit set forth, in the said sub - section (1) owing to the reason mentioned in the proviso to sub-section within seven days after the expiry of that time limit, the CRO shall extend the time limit up to three months for the allotment of shares.
3. If the allotment of shares cannot be made even within the time limit set forth in subsection (1) or (2), the amount received after the expiry of such time limit as well as an interest thereon as prescribed up to the day of the refund of such amount shall be refunded.

2.1.11.5 Particulars of Shares to be submitted to CRO

Particulars of no. of shares allotted shares, the total value thereof, the names and addresses of shareholders, and the amount paid for as well as the amount due on, each share and where the shares of the company have been sold or distributed in any manner other than in cash, the duly issued copy of the agreement made in that connection shall be forwarded to the CRO with in 30 days of allotment of shares.

2.1.11.6 Transactions in Securities

While issuing the securities by a company to the general public, it shall deal with the securities only through an organization recognized to do security transaction including all such acts as the sale, allotment and recovery of the sum of such securities.

2.1.11.7 Registration Book of Shareholders and Debenture Holders

Each Company shall have to establish a registration book of shareholders or debenture holders in the format as prescribed and maintain it at ht registered office of the Company.

2.2 Review of Related Studies

This section of the study draws excerpts from International articles, Nepalese journal articles along with Masters Degree Thesis. International journals have been accessed through the different websites and newspapers. Similarly, Nepalese journals and Masters Degree thesis have been accessed from Library of Shanker Dev Campus, Tribhuvan University Central Library and SEBON Library.

2.2.1 Review of International Journals

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 Schuvert (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 bases 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.

Kviback (2001), done a study on, "Nepal survey: Issues in Local bond market Development." Major finding of his studies were: The financial market in Nepal is relatively underdeveloped. The government market is more developed, but prices are not market oriented. This state of development of equity markets indicates how well versed issuers, investors and intermediaries are in dealing with securities at the primary and secondary market levels. Nepal's overall market is still in its infancy, however. The Nepal Stock Exchange (NEPSE) is a late development, founded only in 1993. It is owned by the government and is a not-for-profit institution. The equity market of Nepal is relatively small from the international standards. With only 114 companies being listed in about 11 years of establishment of NEPSE, the equity market in Nepal requires more effort and contribution from the privately held companies as well as the investors. The status of Nepalese equity market is being elaborated in the following extraction of a report.

Kaserer and Kraft (2003) study on "How Issue Size, Risk and Complexity are Influencing External Financing Costs: German Initial Public Offering (IPO) analyzed from an Economics of scale perspective." The study is focused on the cost of raising capital in Germany. The study included a cross-sectional analysis of flotation cost data for 117 Initial Public Offering (IPO) over the years 1993-1998. The research mainly focused on two questions: how can the Initial Public Offering (IPO) flotation cost function be defined within the economies of scale view in order to capture the import of a set of economically relevant variables? In addition, what statistical methods will provide the most powerful estimation and does this function reveals economies of scale on the level of a single issue?

After the completion of study, they declared that there is no strong support for economies of scale in Initial Public Offering (IPO) financing activities. They also found these spreads to be higher for more risky and more complex offerings. Their major finding was that the fixed

costs are negligible as far as the underwriting fees are concerned. In fact the accounts on average underwriting cost 5-9%. Significantly, they also did not find evidence in support of the presumption that Initial Public Offering (IPO) spreads are clustered, which is in stark contrast to recent findings related to the U.S. market.

Derrien (2005) study on “Initial Public Offering (IPO) pricing in Hot Market Condition: who leaves money on the Table?” The researcher has assumed that Millers (1977) model holds for Initial Public Offering (IPO) and developed a model of Initial Public Offering (IPO) pricing in favorable market conditions. The model relies on the assumption that aftermarket price support is costly for the underwriter. The prediction of the model was tested using a sample of 62 Initial Public Offering (IPO) completed on the French Stock Exchange between 1999 and 2001. A sample of latest French offerings with a fraction of the shares reserved for individual investors supported the predictions of the model. It mainly analyzed the impact of favorable investor sentiment on the pricing initial return and long- term performance of Initial Public Offering (IPO) stocks.

It concluded that if noise traders bullish, they are ready to buy Initial Public Offering (IPO) shares at high prices. In this framework, Initial Public Offering (IPO) prices reflect the private information noise trader sentiment known at the time of offering. Initial Public Offering (IPO) is being over- priced in the positive initial returns. Hence, the companies going public in hot markets are not upset about leaving money on the table as they know that their shares are overpriced at the time of offering.

Corwin & 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 under-written 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. Simarly, 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.

Goergen (2006) study on “The strategy of Going Public: How UK firms choose their listing contracts”. It studied carried two objectives; the first objective was to derive potential factors that may influence the choice of Initial Public Offering (IPO) listing contracts from the few theoretical papers and empirical studies in the field. The second objective was to set how well those factors explain the choice of the listing contract for the case of UK Initial Public Offering (IPO). The study has focused on 240 flotation which were listed on the official list of London Stock Exchange during the period of 1991 to 1995. They used a binomial profit model to measure the impact of the variables on the contract choice. It is also found strong evidence that sponsor and creditor screening signals the quality of the Initial Public Offering (IPO) firm. Hence, firms which use highly reputable sponsors and those with high debt to assets ratios usually, choose public offer contracts. They also found that firm makes small issues find it cheaper to use placing contracts. Finally, they concluded that in general the decision to choose a placing rather than an offer or vice versa is taken by the firm within the framework of rational behavior.

Goergen & Others (2006), carried out a study on, “The Strategy of Going Public: How UK Firms Choose Their Listing Contracts.” The study carried two objectives: The first objective was to derive potential factors that may influence the choice of IPO listing contracts from the few theoretical papers and empirical studies in the fields. The second object was to test how well those factors explain the choice of the listing contract for the case of UK IPO’s. The study focused on 240 flotations, which were listing on the official list of London Stock Exchange (LSE) during the period of 1991 to 1995. They used a binomial profit model to measure the impact of the variables on the contract choice. As the study proposed that three types of factors essentially influence the choice of contract; ex-ante uncertainty, certification and the visibility/exposure of the issue, they found that the higher the firms choose a placing contract. They also found strong evidence that the sponsor and creditors screening signals the quality of the IPO firm. Hence, firms, which use highly reputable sponsors and those with high debt to assets ratios usually, choose public offer contracts. They also found that firm that make small issues find it cheaper to use placing contracts. Finally, they concluded that in general the decision to choose a placing rather than an offer or vice-versa is taken by the firm within the framework of rational behavior.

Baru & Fawcett (2006), performed a 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, this may promote window dressing. CFO’s strongly prefer firm – commitment underwriting. Companies remain private to preserve decision-making control ownership.

2.2.1 Review of Dissertations

Prior this, quite a few research has been carried out by various scholars covering different aspects of capital market. Yet there is dearth of research study in the area of IPO. However, few research studies that are considered relevant and accessible during study period have been excerpted below:

Adhikari (2005), has conducted a research on “An Analysis of Determinants of IPO Under pricing in Nepal.” The basic objective of the study was to analyze the under pricing of IPO’s in the context of Nepal. Beside the study also examined the trends of Public offering market and process of going public in Nepal. For propose of study data of the periods of 4 years from 1999/00 to 2003/04 were used.

The researcher concluded that under-pricing does not occur among Nepalese firms. The researcher also added that the result is not consistent with theory and different finding of

empirical studies conducted in different countries. IPO's market in Nepal does not enjoy any right to set the price of their issue. The price setting process is totally controlled by the regulatory body. Because of this reasons, Nepalese merchant banker could not play any role to influence the offer price of IPO's.

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

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

Shrestha (2007) on the "Public Response to primary Issue of Shares in Nepal" reveals that the scope of primary market in recent days in burgeoning by leaps and bounds. Event the general investors are boisterously pumping up their saving in the new issue of shares causing over subscription to a great deal. He found that capital market is encouraging since many public limited companies including joint venture banks have been successful in taping capital through the flotation of shares to the general public. The positive response of investors to the companies is a direct manifestation of the growing public confidence in the primary market.

Paudel (2008), who has done research on "Public Response to IPOs in Nepal", with the objective of: identify the dealing process of IPOs, analyze the pace of IPOs and analyze the public response to the IPOs.

He has concluded that general investors in Nepal do not have sufficient information regarding the primary market and in spite of this they are interested in investing money in the primary market. They are more interested in financial sector than non-financial sector.

He has also summarized that pace of initial public offering in Nepal seems to be irregular. Even though the organization's process of public offering is quite long, the service provided

to the investors seems to be satisfactory. Public response in stock market is high due to lack of opportunities for investment in other sector. Despite this, public are attracted towards shares to increase their value of investment.

Dangol (2009) entitled “A Study on Investors’ Perception in Nepalese Stock Market”. The main objective of his research is to “examine the impact on the stock market as per the change of investors’ perception and to examine whether investors perception leads to growth of the stock market”.

His study contributes to the importance of the investors’ perception and shows the change of investors’ perception impacts on the stock market and how the perception on investors leads to growth of the stock market. It shows that there is a negative impacted on the Nepalese stock market as per the changes of investors’ perception because there has been a negative effect on the perception on investors. This is also a main cause of the negative growth of the stock market.

Gautam (2010) has made study on the topic of "Analysis of Share Price Movement Attributed to Rights Offering Announcement".

The main objectives of his study were

- a) To find the effect or rights offering on the share price movement.
- b) To find out, if there is any problem in the primary issue of securities
- c) To analyze the adequacy of the contents of the company act 2053 in regard to section 21, that emphasis about that matter to be disclosed in the issue prospectus.

The major findings of his study were:

- a) Change in share price due to rights offering cannot be generalized.
- b) There is lack of legal provision in company act regarding the issue of right share.
- c) There is lack of investors protection act.
- d) Nepalese security market has failed to use various capital market instruments such as warrants, convertible, option etc.
- e) Security board has failed to establish one window policy to support the primary issue of shares.

To conduct the study, he had used correlation analysis between share price movement and NEPSE index, i.e. general market movement and t-statistics between share prices

before and after rights issue announcement. T-statistics was used to test if there was significant change in share price before and after the issue of rights. But he did not consider the value of rights, which is very important in share price determination after the issue of rights share. Further, his analysis only covers the data from FY 2052 to FY 2056. The result may not represent the present economic scenario. He had taken only three companies as sample to complete his study but here the researcher has taken three commercial banks issuing rights share and two finance co. till FY 2061/62 as sample to accomplish the study.

2.3 Research Gap

Even though numerous studies have been carried out in different part of the world covering different aspects of securities market, stock trading mechanism and stock pricing behaviors etc. including public response in primary issue of different securities. But there is still lack of research in the field of Initial Public Offering to the stock investment Few studies have analyzed existing state of IPO's in Nepal. However, none of the studies has been able to portray the complete picture of IPO's and their practices in Nepal. This study tries to understand the pace of initial public offering, investor response, procedures, rules, regulations and provisions as well as public awareness about it.

This study will be helpful to public companies (new and existing), issue manager, underwriter, investor, government organizations, general public, researcher and other parties related to IPO (Primary issue of different securities).

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is a systematic way to solve the research problem. In other words, research methodology describes the methods and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps (along with a rationale of each step) to be adopted by a researcher in studying a problem with certain objectives in view (Kothari, 1994:9). Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process, data collection procedure and data processing techniques and tools.

3.2 Research Design

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. The research design is the conceptual structure within which research is conducted. In this study first of all data are collected and presented in a tabular form and various financial and statistical tools will be used to analyze the data. The analysis data will be interpreted for the conclusions.

3.3 Nature and Sources of Data

The present study is based on primary as well as secondary data as per the objective and requirement of the study. For the characteristic of the study, the secondary data is collected from Nepal's leading issue managers NMB, CIT and NIDC Capital Markets. Similarly, the other sources of secondary data have been acquired from different libraries and journals as well as annual reports and websites of SEBON/NEPSE. The primary data have been collected through structured interviews and asked to the related staffs of SEBON and other general public who are investing their money in primary issues.

3.4 Population and Sample

Number of companies listed in Nepal Stock Exchange (NEPSE) by the end of FY 2008/09 has reached 159 and these companies are divided into eight sectors which include commercial banks, development banks, finance companies, trading companies, hotels and others (SEBON, Annual Report 2008/09). However, the study is focused on only those companies which have gone for IPO during the period of FY 1993/94 to 2008/09. To find out

the public response to the Initial Public Offering, this study has divided in to two sectors as Financial Institutions and Insurance Sector and Non Financial Sector. Due to unavailability of reliable data this study has completed upon the base of selected sample from each sectors. The sample have selected at random from each sector.

Table 3.1
Population and Sample for Study

S.N.	Institutions	Population	Sample Size
Financial Institutions and Insurance Sectors			
1	Commercial Banks	30	7
2	Development Banks	29	6
3	Finance Companies	78	7
4	Insurance Companies	17	5
Total(A)		154	25
Non Financial Sectors			
1	Manufacturing	18	5
2	Trading Companies	4	2
3	Hotels	4	2
4	Others	5	1
Total(B)		31	10
Grand Total(A+B)		159	35

3.5 Data Presentation and Analysis

For the sake of effectiveness, the data collected from various sources have been presented in the form of table, chart and bar graph as per the need of the study. The result obtained from the analysis has been clearly interpreted so as to depict the exact finding of the study. Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic. The empirical results have been extracted in this study by using annual data of listed companies from 1993/94 to 2008/09.

3.6 Tools for Analysis

To attain above mention objective on the basis of primary data collected from questionnaires and informal discussion with investors. The statistical tools are used as required by the study.

3.6.1 Statistical Tools

The appropriate statistical tools are used where ever required to extract the result from the data collected. The different tools are as follows;

3.6.1.1 Multiple Bar-Diagrams and Graphs

Diagrams and graphs help to shows the general trend of the rations in respect to the time periods of the analysis year. Out of various types of diagrams one of the most important from of diagrammatic presentation of data is multiple bar diagram which is used in cases where multiple characteristic of the same set of data have to be presented and compared.

3.6.1.2 Pie-diagram

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

3.6.1.3 Percentage Analysis

The percentage analysis is done to compare two or more data for general information. It is used to find out the portion of sample in favor of different choices.

3.6.1.4 Simple Arithmetic Mean

Simple arithmetic mean indicates the measure of the Middle of the data set and denoted by μ or \bar{X} . In other words it is just the sum of all the observations divided by the number of observations. During analysis, Mean or Average has been used by synonymous to equal weighted mean.

It is calculated by:

$$\text{Mean} = \frac{\text{Sum of total values}}{\text{Number of values}}, \bar{X} = \frac{\sum x}{N}$$

3.6.1.5 T- Test

Deal with the small sample for testing of hypothesis concerning population means difference between to population means and observed sample correlation coefficient etc. T- test based on exact sample test is used. The t-test for difference between to means is used to test whether two independent samples have been drawn from to normal populations having the same means and equal population variance or there is significant difference between population means from which the samples of drawn.

The following formula is uses to test an observed sample correlation coefficient:

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

$$\text{Similarly, } S^2_p = \frac{1}{n_1 + n_2 - 2} \left\{ \sum X_1^2 - \frac{(\sum X_1)^2}{n_1} + \sum X_2^2 - \frac{(\sum X_2)^2}{n_2} \right\}$$

Where, \bar{X}_1 = Mean of first Sample

\bar{X}_2 = Mean of second Sample

S^2_p = an unbiased estimate of the common variance and its value is computed

n_1 = Number of first sample

n_2 = Number of second sample

3.7 Limitation of the Methodology

Availability of data is a major concern. NEPSE is the sole authority to release data needed for analysis in this study but has not been able to provide them all. So the major portion of analysis especially stock price information has been based on daily newspapers and subsequently bounded to be influenced by their quality of presentation. The unavailability of data has also forced to limit the time frame of study into FY 1993/94 to FY 2008/09. The study has used stratified random sampling and descriptive and analytical research design, hence is subjected to their inherent biases.

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QUESTIONNAIRE

A Survey on Investors Response to Initial Public Offering in Nepal

Please tick () the correct answer. (Tick one or more, if applicable)

1. How did you get idea/Information to make investment into primary issue of securities?
 - a. From Friends and Relatives
 - b. From media
 - c. From Stock brokerage
 - d. From others
2. In which sector do you think public have better opportunities for investment?
 - a. Banking sector
 - b. Finance/ Development Bank
 - c. Insurance Companies
 - d. Manufacturing
 - e. Other
3. Do you have experience to investment in IPO?
 - a. Yes
 - b. No
4. Are you aware about the financial performance of companies?
 - a. Very much
 - b. Moderately
 - c. Little
 - d. Not at all
5. Are you have the satisfactions on the returns of your investment?
 - a. Yes
 - b. No
 - c. Don't know
6. By which special characteristics are you impressed (purpose) to invest your money in Public offering?
 - a. Dividend
 - b. Right Share
 - c. Capital Appreciation
 - d. No brokerage Commission
 - e. Company Performance

