CHAPTER-I
INTRODUCTION

1.1 Background of the Study

In the world, the major concern of many countries has been to accelerate their development process and thereby increase the welfare of their people which can be obtained through rapid industrial development. This would require gearing up savings, creating conductive 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.

The moment towards open and market oriented economic system in the world economy, 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 than can cope the need of the people..

Private companies start out by raising equity capital from a small number (not more than fifty) of investors, with no liquid market existing if the investors wish to sell their stock. As per this act, the private companies cannot sell their securities to any party other than their own shareholders. Under this circumstance, if a company prospers and needs additional equity capital, at some point of time the firm generally will not have any other alternative than raising additional

equity from the existing shareholders. According to the same Act, public companies can be established consisting at least seven members for the fulfillment of legal aspects.

A public company going into public must issue at least 30 percent of its paid up capital to the public. Banks and Financial institutions must start 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. 500 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 is 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.

What so ever, may be the reason information related to the performance of the issuer companies must be available. Investors must get to know the true information related to the pre-issue performance of the IPO going companies. They also must get to know the true and reliable information related to the post-issue performance of different issuer companies. The availability of all the true information enables investors to identify the companies having sound pre and post-issue performance, companies having better pre-issue performance but worse post-issue performance and also the companies having worse pre issue performance but better post issue performance. This facilitates healthy development of the capital market.

Development and expansion of capital market are essential for the rapid economic growth of the country. Capital market helps economic development by mobilizing long term capital needed for productive sector. It is vital to long term growth and prosperity of the economy since it provides the channel through which needed funds can be raised. The capital market can be decomposed into securities market and non-securities market.

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 major component of the securities market. Stock market is a mechanism through which corporate sector mobilizes funds to finance productive projects by issuing shares in the market. Similarly, stock market provides the best investment opportunity to the investors. It also imparts liquidity to the securities holders. 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. This offers an investment opportunity for investors to invest in the long liquid cash before the maturity.

Furthermore 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 per-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.

In short 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 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.

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 interests on deposits 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.

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. 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 BS 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, RastriyaBanijya 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 80 in numbers (www.karobardaily.com). 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. Moreover, they have curtailed Dhukuti and Upahar programs and demerits thereof.

Finance company has emerged with an aim to ease and facilitate people in financing business and other ventures. It was not very long ago when people had to spend a lot of time in arranging and getting the finance for their required needs. Finance companies provide loans in very short period of time and are also flexible in rules. Previously, many projects were even abandoned being delayed in providing loans from commercial and developments banks. 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.

The Finance companies are also playing an important role in providing employment directly in the companies itself and also employing in projects financed by them. The economy is well nourished with all the growing and developing prospects of finance companies.

1.2 Statement of the Problem

Nepalese stock market is at early stage with high growth potential. Creation of appropriate 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 and demand of today's market.

There are various types of obstacles existing in initial public offering stages in Nepal. In the context of developed country, generally people are aware from public offering. However, in developing country like Nepal Initial Public Offering is still new phenomenon. Most of the investors have no enough idea about security board of Nepal about public offering

Security Board of Nepal 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.

While reviewing the literature, it seems 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 through public offering. So, it is felt necessary to analyze the impact of public issue in the financial performance of the companies. The present study deals with the following issue as to explore the public offering issues.

- What was the performance of issuer companies before going through IPO?
- What are the processes and mechanism of IPO?
- What impact of public issue appears in the financial performance of the companies?
- How is the performance of issuer companies after going through IPO?
- Do the companies' performances improve after the IPO?

1.3 Objective of the Study

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

1. To explore the pre-issue financial performance of issuer companies
2. To analyze the post- issue financial performance of issuer companies
3. To make comparative analysis the pre and post issue performance of the issuer companies

1.4 Limitations of the 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 information for the study is of not as new that can be included due to the selection of financial companies. The use of secondary data will be one of the most noted limitations of the study. So the major limitations of this study will be that only five 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 six-year (three years before and three years after the IPO) have been taken for the purpose of analysis i.e. extensive study till the date has not been done.

1.5 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

Literature review chapter consist the review of existing literature on the topic “Financial Performance of Pre and Post issue of firms". Concerned theories including review of the empirical evidence of previous publication and studies has been include during the review. It holds a great role to complete the research.

This 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.

2.1 Conceptual Framework

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.

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.

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

Capital market is a place where the long term lending and borrowing takes place. The capital market is the market for long term borrowing and lending of securities. The primary instruments of capital market are stocks and bonds (equity and debt). Therefore, it includes both the new issues market and existing in the market.

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

The type of market where initial issuance takes place is known as primary market. 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 also must 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.

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/ipo)

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.

2.1.2.1 Advantage of IPO

- 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.
- 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.
- The primary advantage 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 advantage 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.
- 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 advantage is that the public company may have enhanced credibility with its suppliers, customers, and lenders, which may lead to improved credit terms.
- Yet another advantage 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 IPO 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.

SEBON has been monitoring the performance of companies for past twelve years. SEBON 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 3rd 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 CRO 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.

SEBON

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 NSE. 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 NSE. 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 HMG

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 mangers 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 sort-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.

New issue guidelines of the Securities Board provides additional matters to be contained in the prospects:

- 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 opening 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 By law 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: NRB Annual Report, 2010

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.

2.1.3 Secondary Market

Markets in which the existing or already outstanding securities are traded among the investors are called secondary markets. The secondary market provides "liquidity" for financial assets making them more attractive.

So, secondary market is a place where the securities once sold are purchased and repurchased to provide liquidity to the securities and the secondary market is operated by Securities Exchange Center. The trading of government securities in

secondary market is very thin because of limited distributors of the securities. Securities Exchange Center, in order to promote the market used to support the market even by involving itself in buying and selling activities, if necessary. The secondary market ever operated in the country was on DBs. The SEC initiated the secondary market in the fiscal year 1975-76. Since then the volume traded in is generally increasing year by year.

Stock market interchangeably known as secondary market is the other side of market segment under capital market. It includes all transferable securities issued previously by the corporate bodies such securities are also traded on the stock exchange. Here, Stock Exchange refers to the association, organization or body of individuals whether incorporate or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities [Indian Securities contract (Regulation) Act l956]. But Stock Market does not include securities of private companies as they are not capable of being dealt in on stock exchange and are not marketable securities due to the restriction on transferability. In order to get benefit from the securities markets, the corporate bodies should have listed the securities in the stock exchange. The companies that have listed their marketable securities on the stock exchange are known as listed companies. This means only the securities of listed companies are traded on the trading floor of the stock Exchange. Section 8 of securities Exchange Act l983 has laid down the provision of compulsory listing of securities before trading on the stock exchange. Securities not listed or declared void are not traded in this case. For trading purpose of the debentures or bonds of the companies, the maturity period of such instruments should not be less than two years and debentures having face value of Rs. 1000 each can only be traded.

A huge numbers of securities of existing financial, manufacturing, banking, service and production entities are traded daily via Nepal Stock Exchange in Nepal.

The securities market involved in both primary and secondary market of securities till 1993, later converted into Stock Exchange (NEPSE) according to Securities Exchange Act 1983, is providing a wide spectrum of secondary market services to

the varieties of organization so as to pave the way for the economic development in the country. Beside this, to safeguard the interest of shareholders, the stock exchange board, as designated by the act is performing the prescribed role. The Board incriminates the companies or concerned individuals who do not comply with the prevailing rules and regulations.

An exchange is defined as anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

The presence of an active secondary market actually promotes the growth of the primary market and capital formation because investors in the primary market are assured that a continuous market exists and when occasions arise, they can liquidate their investment in the stock exchange. Formal trading rules and communication networks for trading in securities link the participants in the secondary market.

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 underwriters
- 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% ±, 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 is the function 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.
- Names and addresses of the shareholders holding more than 5 percent of the issued shares.
- Names and addresses of the managing director, chief executive, chief officers, accountants, auditor, company secretary and their holdings of shares, if any.
- Shareholders' lists.

- 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[3] 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

Paid up Capital	**Listing Rs.**	**Annual Rs.**
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, 2010

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

Issued or paid-up capital	**Listing Rs,**	**Annual Rs,**
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 Nepal, 2010

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 Previous 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 behaviour 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.

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 underpricing, 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 (1991) 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.

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). 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.

It has been found 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 underpricing.

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.) From the 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 there is the opportunity to invest in an IPO and decide to do so, chances are going to get screwed.

2.4.2 Review of Major Studies in Nepal

Banks and financial institutions are the highly improved concern in Nepal. Number of banks and finance company increased rapidly after the adoption of liberalization policy. "Liquidity position of commercial bank was satisfactory. Comparatively, local commercial banks were highly leveraged than those of joint venture commercial banks. Profitability position of NABIL was stronger than that of other commercial banks" (Joshi, 1989). In the comparative study of Nepal Arab

bank and Nepal Indosuez Bank, the banks had adequate liquidity, and utilization of deposits was satisfactory, NABIL was more efficient in this regard "But Nepal Bank Ltd. has been unable to utilize its resources (i.e. deposits) on highly yielding investment portfolio to maximize returns. Operational efficiency of the bank is not satisfactory; this is indicated by operational losses

Analysis of financial performance of joint venture banks revealed that" the liquidity position of joint venture banks is not very poor. The banks have followed aggressive working capital policy. The trend of market value per share to book value per share ratios of the banks is generally fluctuating over different financial years. The trend of price earning ratio of individual banks has fluctuating order whereas average trend of the banks has increasing way over the last five years. The banks have successfully mobilized their deposits fund of different sectors for generating more income" (Mandal, 1998) Similarly, on the comparative study of Nepal Bangladesh Bank (NBBL) and Himalayan Bank (HBL), NBBL had better liquidity and activity ratios whereas HBL was stronger in capital structure, profitability, and investability ratios (Rai, 2000). Thus, comparatively one bank was better than other but as a whole, banking sectors were operating in a good financial track.

Insurance companies are other important sectors, which have contributed a lot to the financial market in Nepal. Almost all of the listed insurance companies are able to make net profit during fiscal year 2000/01 (SEBO/N, 2000/01). This shows the performance of insurance companies better. Evaluation of financial performance of Nepal Insurance Company Ltd. (NICOL) showed that the company is not in a position to settle its short-term obligation. The company management is not able to collect its outstanding premiums efficiently. The creditworthiness of the company is deteriorating with its reinsures. Yet, the operating profit margin is satisfactory. Net profit is continuously increasing year by year. The efficiency in utilization of total gross assets is satisfactory. The earnings per share and dividend per share are in increasing trend. The company is able to invest sufficient funds to various sectors. There is no stability in inflow of funds and its outflow.

Cooperative societies are other financial institutions, which are also growing in Nepal Performance analysis of Nepalese cooperative societies with special reference to District cooperative Association Ltd. Banepa, stated that “the association has sufficient liquid assets for all the years to meet short term obligation. The asset utilization position of the association is not satisfactory and it has not maintained its appropriate leverage position. The profitability position of the association over the period of study shows deterioration. Thus, the overall financial performance of the association is very weak” (B.K., 1993).

Similarly, finance companies are playing important role in the financial market of Nepal. The numbers of finance companies are increasing year by year. After the introduction of finance company Act, the rate of establishment has increased. The number of finance companies reached 48 in mid- January 2001, which was 45 in mid January 2000 (Economic Survey, 2000/01). The total resources of finance companies substantially increased by 17.2 percent (Rs. 2,106 Million) and reached Rs. 14,351 million in mid January 2001. Similarly, with the inclusion of investment in government securities, the overall liquidity to deposit ratio is calculated to be 21.7 percent against 27.7 percent as of mid- January 2000. Likewise, utilization of resources increased by 27.7 percent (Rs. 325 Million) and reached Rs. 1497 million by mid- January 2001 as compared to mid- January 2001.H (Economic Survey, 2000/01). This shows finance companies are in growing stage and performing well.

"Only 6-8 finance companies have floated shares to the investing public. The other fifteen finance companies have not yet floated shares to the public. The analysis of their lending and investment activities show only very few finance companies have aggressive investment strategy compared to most of them following conservative strategy. Major part of their lending is in consumer durable through hire purchase and then to housing loan. But, later on there has been a gradual shift in lending policy towards term loan that consists of business and industrial loan. The favorable impact of finance companies at a time when the commercial banks are proving inefficient and other one considering the negative impact of finance companies bringing no significant contribution to national

economy in a situation when they are encouraging imports to drain on scarce foreign exchange" (Shrestha, 1995). "Comparatively among five finance companies: Nepal Housing Development Finance Company Ltd. (NHDFCO), Nepal Share Markets Company Ltd. (NSMCO), Kathmandu Finance Company Ltd. (KFCO), National Finance Company Ltd. (NFCO), and Annapurna Finance Company Ltd.(AFCO); NHDFCO has the higher liquidity. NSMCO and NFCO are less successful in on-balance sheet and as well as off balance sheet operation, than others. Profitability of NSMCO is comparatively not better than others. NHDFCO is not riskier than others since it has low leverage ratios NSMCO has not been successful to increase its net profit, earning per share, dividend per share in comparison to other finance companies. However, almost all the listed finance companies have earned profit during FY 2000/01 (SEBO/N, 2000/01). This shows the performance of finance companies satisfactory.

Mutual fund provides collective investment opportunities to individual investors. Citizen Investment Trust (CIT), HIDC Capital Markets Ltd. is working as mutual fund companies in Nepal." The profitability condition of both companies is satisfactory for most of the years, but CIT is relatively earning more profit than NIDC Capital Markets. Earnings per share are positive for both companies but not satisfactory. The liquidity position of both companies is not good, rather comparatively, NIDC Capital Markets is better than CIT. NIDC Capital Market is better performance in collecting debt and its capital structure but turnover position of CIT is better. Both companies are generating profits, but CIT has relatively higher profit CIT is providing higher yield lower risk and more liquid than the other. Thus, the financial position of CIT is slightly better than NIDC Capital Markets LTD. In terms of profitability and activity ratios; but the liquidity and capital structure of NIDC Capital Markets Ltd. Is better than CIT (Adhikari, 2001).

But private manufacturing companies are in better financial position. It is evident from the performance of Surya Tobacco Company Pvt. Ltd. The profitability position of the company was continuously increasing due to increase in profit. The company was paying dividends to its shareholders regularly in increasing

amount. Production, sales, earnings, returns to assets were growing upward every year. But it had poor liquidity position, which may lead to cash flow problem, and it was not able to get benefit from the financial leverage since it had insignificant amount of debt in its capital structure.

In a comparative study of performance of two textile companies, one of public company and other of private company, the overall performance of private company was found better than that of public company (Pradhan, 1986). The profitability position of Shree Textile was better than that of Hedauda Textile because the Shree Textile has earned net profit where as Hetauda Textile incurred the net losses. The liquidity, long-term solvency and assets utilization of the Shree Textile was better than that of Hetauda Textile. Shree Textile had used debt and equity properly where as the Hetauda Textile had heavily relied on equity capital only. And the Shree Textile had also higher turnover ratio than the Hetauda Textile's.

"The financial performance of manufacturing public enterprises in Nepal is quite dismal. The enterprises have not been able to achieve their basic objective of augmenting internal resources required for speeding up the rate of economic growth. Most of public limited companies face the problem of limited knowledge. Limited productive capacity is one of the problems of Nepalese industries (Basyal, 2000). Furthermore he states that "Listed companies are not earning well mainly because of the lack of the utilization of resources due to inefficiency of management The dividend yield is not meeting the required return of the investors. Companies are not meeting any standard liquidity, leverage, and profitability ratios"

From the above, it is evident that performance of banks was good. The financial position of joint venture banks was better than that of local banks. Most of the insurance companies earned profits in the past. The performance of insurance companies could be regarded as good. The finance companies also contributed a lot to the financial market of Nepal. They were in growing stage. Cooperative societies were not in a sound financial position. Mutual funds (i.e. CIT and NIDC Capital Markets) were in good financial position. Private manufacturing

companies showed more efficient in comparison to other manufacturing companies in Nepal. Most of the public enterprises were suffering from losses and in poor financial condition. Most of the listed companies were not earning well Dividend. Listed companies were not earning well mainly because of the lack of the utilization of resources due to inefficiency of management The dividend yield is not meeting the required return of the investors. Companies are not meeting any standard liquidity, leverage, and profitability ratios.

Pandey (2003) writes in his article,he defined various functions in financial management in which raising of funds, investing them in assets and distributing return earned from assets to shareholders, which are respectively known as financing, investing and dividend decision. While performing these funding a form should balance cash outflow and inflow, which is known as liquidity decision he also added the list of important decisions.

Pradhan (2001) writes an ariticle entitle "Transaction Analysis of Finance companies in Nepal" has concluded that the finance companies are centered in the city as like commercial banks. If this trend remains, the central bank is to consider novel strategy. The central bank and government are expected to create or play a positive role in expanding Finance Companies Throughout the country.

Poudel (2003) writes an article has compared finance companies with the commercial banks. Interest rate is relatively higher that is provided and accepted by finance companies. He also says the FC's should learn from the drawbacks, failure and also from the success of the commercial banks and should introduce novel technology and equipment to collect deposits and investments.

Timilsina (2004) writes an aritcle in; he compared the projected financial statement with the actual financial statement of the issuer companies. He found out significant differences in the projection and actual achievement. He concludes that the companies deciding for IPO overstate their accounting figures. Therefore due considerations should be given either to improve the accuracy on projection or review the incorporation of financial projections in the prospectus of the issuing companies.

Neupane (2006) writes an article concluded that the finance companies with new financial instruments and innovation are highly needed in the country. There is still sample room for developing varieties of companies and financial instruments to attract small savings. This will provide investment opportunities to the small and medium savers. Nepalese people have the better experience of being cheated by the so-called UPAHAR, INSTALLMENT and other prize awarding schemes. Therefore, efforts could be made to create a sound institutional base so that freaks will not cheat people.

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Payment by the companies had not met the required rate of return. The average liquidity, leverage, and profitability position of the listed companies were not meeting any standard.

2.5 Research Gap

Many researchers 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 Research Design

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. Thus, the design is basically based on presentation, analysis and interpretation of result. 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.

3.2 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.

3.3 Population and Sample

Eighty finance companies of Nepal, (Karobar National Economic Daily, 2011/07/14) which have issued shares in the public, are the population of this

study. The six 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 six years of financial statement before and after going public where other finance companies listed in NEPSE do not have relevant data. So five finance companies whose IPO was in 2002/2003 and have at least six 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 sample finance companies are:

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

3.4 Method of Data Analysis

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

3.4.1 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.

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

3.4.1.1 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

$$\textbf{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilites}}$$

Traditionally, the current assets of the company should be twice than current obligation to be technically solvent. 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

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

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.

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

3.4.1.2 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.

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

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.

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

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.

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

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.

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:

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

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:

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

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:

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

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

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

3.4.1.3 Profitability Measures

Profitability ratio shows the overall efficiency of the business concerns. The relation of the return of the firm to either it's sales of its equity of its assets is known as probability 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. Net profit Margin on Sales (Revenue)

It is the ratio of net income available to common stockholders to sales (revenue). It measures income per rupee of sales.

$$\textbf{Net Profit Margin on Sales} = \frac{\text{Net Income}}{\text{Sales}}$$

The increasing ratio shows that the net profit is maximizing and operating cost is decreasing so the increasing ratio is good for a company.

2. 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.

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

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

3. 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

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

4. 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:

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

5. 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.

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

6. 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.

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

7. 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

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

8. 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

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

3.4.1.4 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.

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

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.

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

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

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

CHAPTER-IV

DATA PRESENTATION AND ANALYSIS

4.1 IPO Date of Sample Company

The selected finance company whose IPO date is within 2002/2003 has been considered for data presentation. Out of them, five finance companies, which have at least six-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

Company	Date	Issue Manager
United Finance Ltd. (UFL)	**8/5/2002**	**NMB**
Siddhartha Finance Limited (SFL)	**7/11/2000**	**NMB**
Gorkha Finance Limited. (GFL)	**5/7/2002**	**NSML**
Standard Finance Limited. (STDFL)	**1/7/2003**	**NMB**
Butwal Finance Limited. (BFL)	**22/05/2003**	**NMB**

Source: SEBON Annual Report: 2010

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

Current Ratio (in times)

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

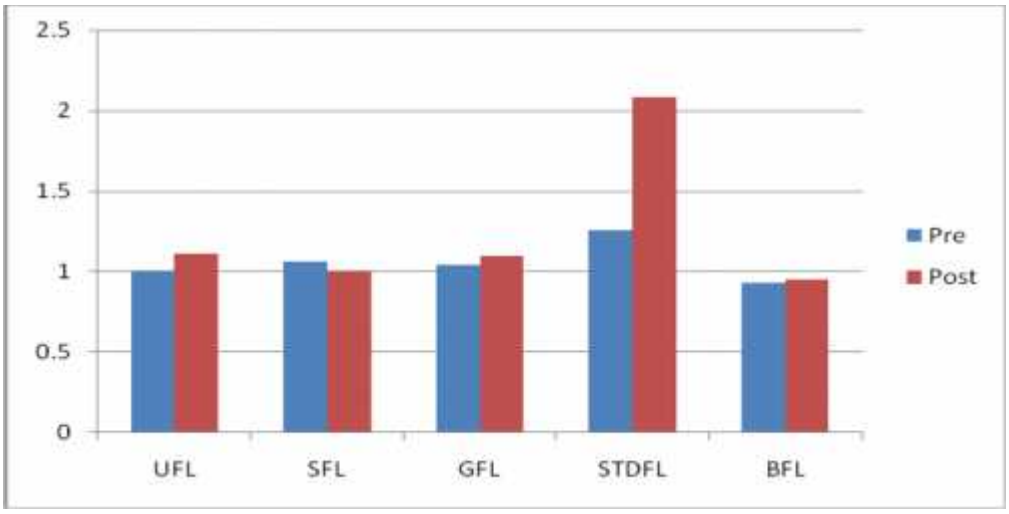
Source: Annex: I and II

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: Cash and Bank Balance to Total Deposit Ratio



Source: Table No: 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 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.

Table 4.3

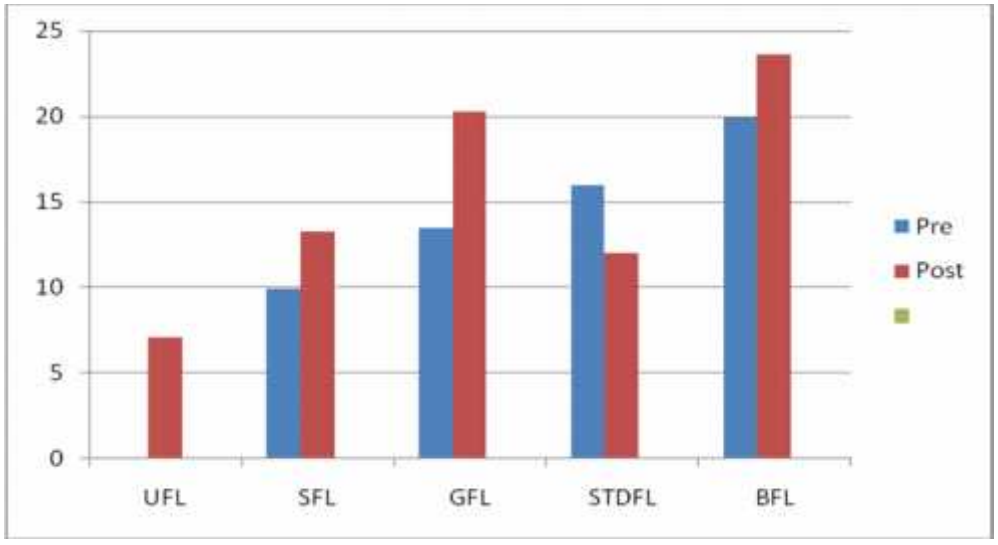
Cash and Bank Balance to Total Deposit

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

Source: Annex: I and II

Figure 4.2

Average Cash and Bank Balances to Total Deposit Ratio



Source: Table No: 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 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

Table 4.4

Cash and Bank Balance to Current Assets

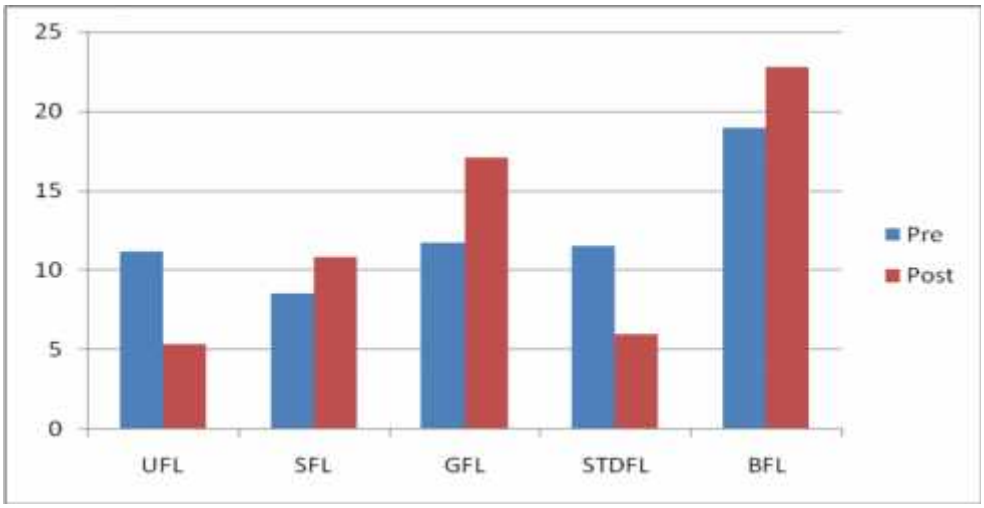
Company	**Before IPO**				**After IPO**			
	3rd year	**2nd year**	**1st year**	**Average**	**1st year**	**2nd year**	**3rd year**	**Average**
UFL	5.88	12.31	15.36	**11.19**	3.17	11.21	1.68	**5.35**
SFL	7.34	9.15	9.15	**8.55**	10.70	13.80	7.98	**10.83**
GFL	8.94	14.93	11.43	**11.77**	19.82	20.29	11.02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

Source: Annex: I and II

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 No: 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 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.

Table 4.5

Loan and Advances to Total Deposit

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

Source: Annex: I and II

Figure 4.4

Loan and Advances to Total Deposit Ratio

Source: Table No: 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

Total Investment to Total Deposit

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

Source: Annex: I and II

Figure 4.5

Total Investment to Total Deposit

Source: Table No: 4.6

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.

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

Total Assets Turnover Ratio

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

Source: Annex: I and II

Figure 4.6

Total Assets Turnover Ratio

Source: Table No: 4.7

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.

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

Debt Equity Ratio

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

Source: Annex: I and II

Figure 4.7

Debt Equity Ratio

Source: Table No: 4.8

Table 4.8 revels 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.

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

Capital Adequacy Ratio

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

Source: Annex: I and II

Figure 4.8

Capital Adequacy Ratio

Source: Table No: 4.9

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.

4.4 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.

Net Profit Margin

It measures net income generated by per rupee of revenue. The increasing ratio shows that the net profit is maximizing and operating cost is decreasing are good for a company.

Table 4.10

Net Profit Margin Ratio

Company	**Before IPO**				**After IPO**			
	3rd year	**2nd year**	**1st year**	**Average**	**1st year**	**2nd year**	**3rd year**	**Average**
UFL	16.31	10.05	0.81	**9.05**	2.57	7.22	11.55	**7.12**
SFL	10.63	10.60	10.60	**10.61**	10.73	11.30	11.19	**11.07**
GFL	9.78	14.43	11.57	**11.93**	14.54	15.01	11.06	**13.54**
STDFL	1.90	18.15	14.49	**11.51**	8.33	10.16	7.61	**8.70**
BFL	10.88	10.08	7.81	**9.59**	5.73	7.94	10.24	**7.97**

Source: Annex: I and II

Figure 4.9

Net Profit Margin Ratio

Source: Table No: 4.10

Table 4.10 shows that GFL has the highest average ratio of 11.93% followed by STDFL with the average ratio 11.51%.

GFL after IPO as it shows highest average ratio for the period which is 13.54%. UFL, SFL, STDFL and BFL are the companies that are showing their better steps in making increasing trend after IPO.

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 4.11

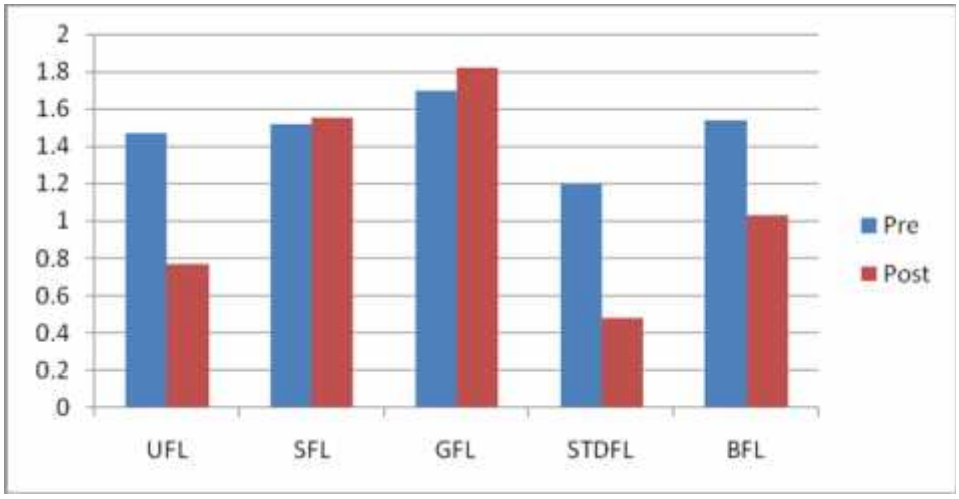
Return on Total Assets

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

Source: Annex: I and II

Figure 4.10

Return on Total Assets



Source: Table No: 4.11

Table 4.11 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.

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 4.12

Net Profit to Total Deposit Ratio

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

Source: Annex: I and II

Figure 4.11

Net Profit to Total Deposit Ratio

Source: Table No: 4.12

Table 4.12 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.

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 4.13

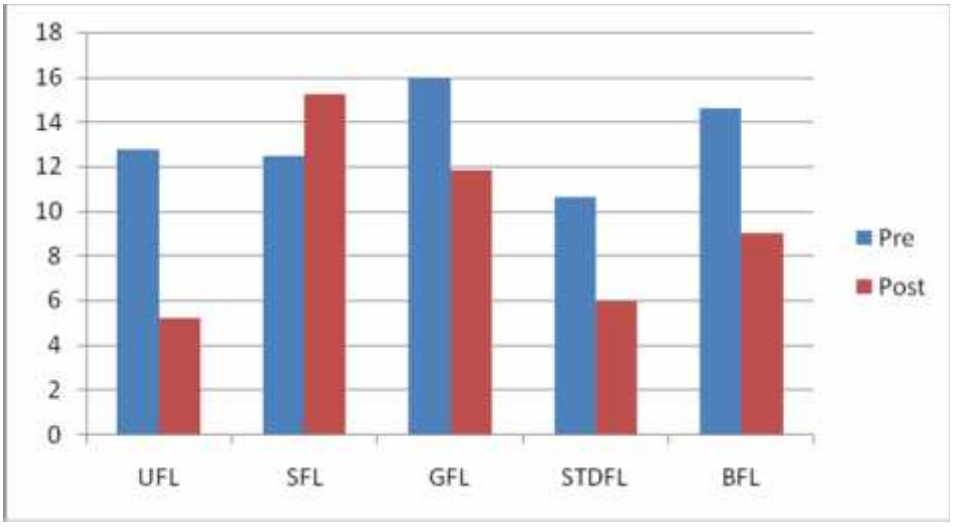
Return on Net Worth

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

Source: Annex: I and II

Figure 4.12

Return on Net Worth



Source: Table No: 4.13

Table 4.13 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.

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 firms 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 4.14

Return on Investment

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

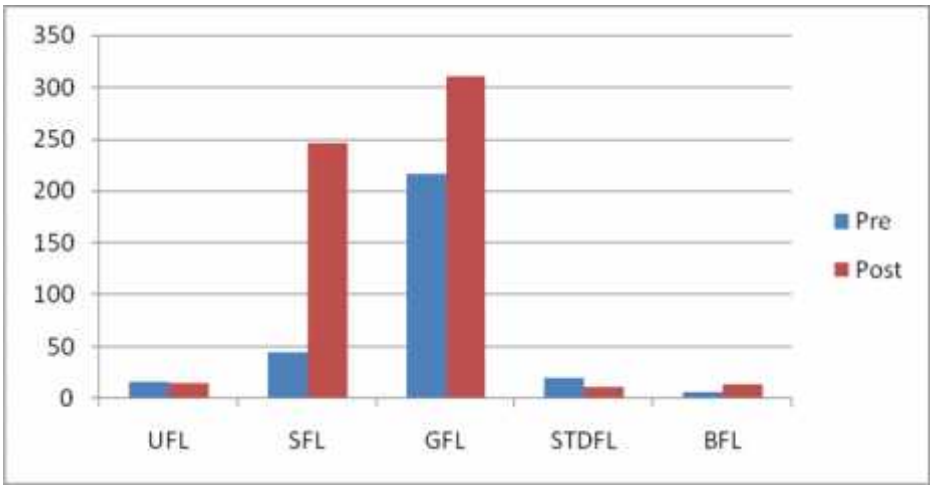
Source: Annex: I and II

Table 4.14 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.

Figure 4.13

Return on Investment



Source: Table No: 4.14

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 4.15

Total Interest Earned to Working Fund

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

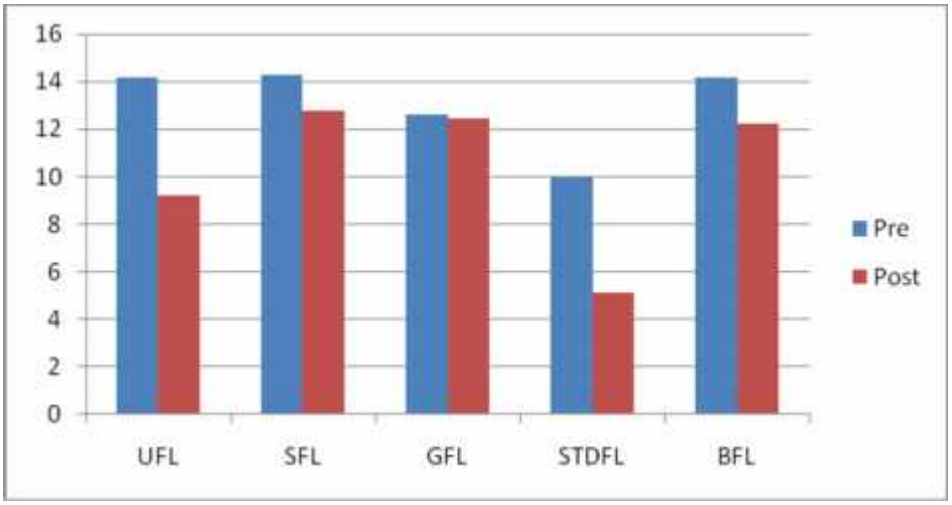
Source: Annex: I and II

Table 4.15 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.

Figure 4.14

Total Interest Earned to Working Fund



Source: Table No: 4.15

4.5 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.

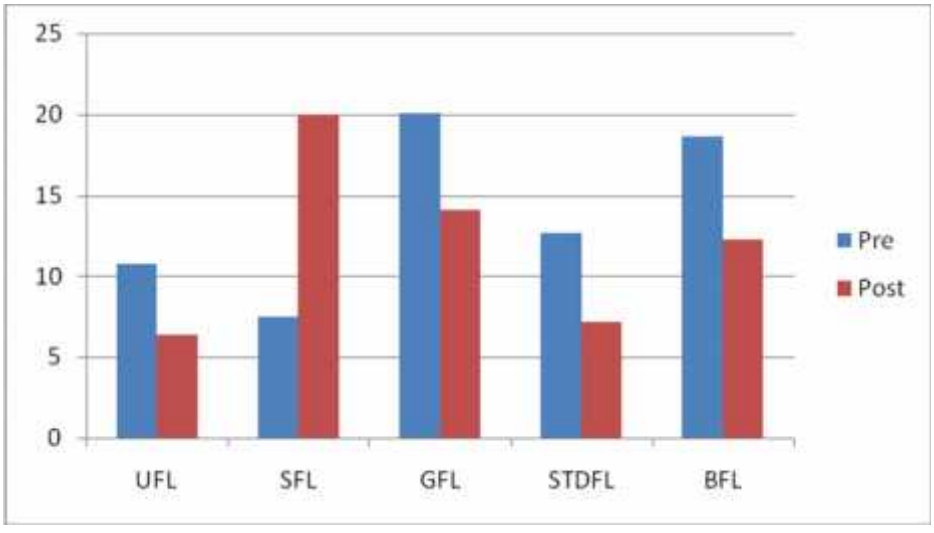
Table 4.16
Earnings per Share "in Rs"

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	**10.72**	1.14	4.65	13.41	**6.40**
SFL	4.55	8.97	8.97	**7.49**	14.70	20.53	24.77	**20.00**
GFL	13.43	23.52	23.19	**20.04**	16.55	14.50	11.35	**14.13**
STDFL	1.75	19.73	16.45	**12.64**	7.04	8.41	6.11	**7.19**
BFL	20.44	21.07	14.50	**18.67**	8.37	13.37	15.07	**12.27**

Source: Annex: I and II

Figure 4.15

Earnings per Share



Source: Table No: 4.16

Table 4.16 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.

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 4.17

Dividend per share

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

Source: Annex: I and II

Figure 4.16

Dividend per share

Source: Table No: 4.17

Table 4.17 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.

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 4.18

Dividend Payout Ratio

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

Source: Annex: I and II

Figure 4.17

Dividend Payout Ratio

Source: Table No: 4.18

Table 4.18 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

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 4.19

Analysis of Net Worth per Share

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

Source: Annex: I and II

Figure 4.18

Analysis of Net Worth per share

Source: Table No: 4.19

Table 4.19 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.

4.6 Concluding Remarks

- 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 and SIFL have declined after IPO. Liquidity ratios are used to judge a ability of a company to meet 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.

- SIFL 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.

CHAPTER-V
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The development is a regular and continuous phenomenon. Every country in the world makes their effort for the rapid development which largely depends upon its economic development. Financial institution play dominant role in the process of economic development and upliftment 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 in to existence which cater the financial need of the country. Finance companies stimulate savings by mobilizing idle resource in 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 has been brought as legal institution 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.

This study regarding the pre-issue and post-issue financial performance of the selected five finance companies has been conducted to present the hidden implications of the figures shown in the balance sheet and income statement 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. The research gap has been presented for the identification the gap between previous studies and need of this present 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 six years (3-3 years before and 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;

- 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 STDL 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 meet 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.
- SIFL 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

The conclusion is 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

The recommendation is the outcome of findings and conclusions of this study, the following recommendations can be drawn form the analysis of information used for the study.

- 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, FCs 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 FCs 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 NSMBFL has been decreased but its interest expenses, operational expenses, staff expenses has been decreased during its 3rd 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.
- And it is also recommended UFL has to mobilize its working fund better to improve interest income.

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APPENDIX-I

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

Null Hypothesis Ho: $\mu x = \mu y$ That is the mean current ratio before IPO and after IPO do not differ significantly.

Alternative Hypothesis H1: $\mu x \neq \mu y$ That is the mean current ratio before IPO and after IPO differ significantly.

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

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

Calculation of S^2,

Year	X	Y	d= X-Y	d^2
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
			$\Sigma d = -0.33$	$\Sigma d^2 = 0.0953$

We have, $\bar{d} = \Sigma d/n = -0.33/3 = -0.11$

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

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

$= 0.0029$

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, Ho is accepted i.e. there is significant difference between Current ratio before and after IPO.

APPENDIX-II

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 Ho: $\mu x = \mu y$ That is the mean Cash and bank balance to total deposit ratio before IPO and after IPO do not differ significantly.

Alternative Hypothesis H1: $\mu x \neq \mu y$ That is the mean Cash and bank balance to total deposit ratio before IPO and after IPO differ significantly.

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

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

Calculation of S^2,

Year	X	Y	d= X-Y	d^2
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
			$\Sigma d = 14.8$	$\Sigma d^2 = 152.886$

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

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

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

$= 79.87$

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, Ho is rejected i.e. there is no significant difference between Cash and bank balance to total deposit ratio before and after IPO.