

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the study

The world's economy is changing rapidly. Economic sector plays a vital role for developing the nation. Nepal is one of the least developed countries in the World. The paucity of the required capital resources is one of the main causes of underdevelopment. Nepal launched planned economic policy five decade ago. Now, it is actively trying to achieve the rapid pace of development through liberalization.

To attain the rapid pace of economic development of the country, there should be good environment for the establishment of corporations in the different sectors of the economy. The favorable environment to establish a corporation depends upon many factors. The ability of an organization to acquire the needed capital is one of the main factors for its success.

Financial companies occupies quite an important place in the frame work of every economy because it provides capital for the development of industry, trade and business investing the saving collected as deposits. Besides that these companies render a numerous services to their customer in view of facilitating their economic and social life. All the economic activities of each and every country are influenced by such kind of business in that country,

The increasing establishment and growth of the finance companies in the country is the result of economic liberalization policy of the government. In the eighth plan (1992-97), it has been clearly stated that “The vacuum in the present national financial system needs to be filled by institutionally developed capital market institutions like finance companies, investment companies, and leasing and housing finances in order to create a healthy, competitive financial sectors”. With this statement and the government policies, many finance companies have been registered. Out of them, 78 finance companies are in operation till date according to Nepal Rastra Bank. Now with the proper utilization of

small savings of the people, it will also contribute in the main agenda of tenth plan “Poverty alleviation”. As per government rules all the finance companies are public limited companies. Hence it is very essential to monitor and analyze the performance of these companies for the regular benefit of both public as well as nation. This study tries to analyze the investment policies of finance companies as far as possible on the basis of available data. The increasing number of domestic commercial banks, joint venture banks and financial institutions has created a competitive environment in financial sector. The investment opportunities of trade, industry, agriculture and other sectors have not comparatively been extended and on the other hand, Nepal Rastra Bank has declared that there must be Rs. 150 millions, 50 millions, 20 millions and Rs. 10 millions as paid up capital for leasing and finance company, only finance company based in Kathmandu, only finance company for outside the valley (Eastern, Central and Western Development Region), finance company that operates on only one district (Western and Far Western Development Region) respectively. Thus, it is clear that finance companies have to face numerous difficulties to mobilize their deposit funds on the profit making investment so that they can achieve sufficient return from the investment and satisfy their shareholders giving adequate return on their equity.

Nowadays, when any new financial company floats shares through capital market, very big congregation gathers to apply for owner certificate. It indicates their expectation on higher return of investment in shares. Most of the investor have little knowledge about the investment opportunities of such companies and having traditional concept that they can earn dividend from such shares and they forget the increasing no. of financial institutions and less possibility of investment opportunities. To mobilize their funds in a good manner, it should be invested in those potential sectors, which are appropriate from security, marketability, profitability and liquidity point of view.

Financial development is one of the key indicators of economic development of any country. Financial institution provides regular energy for investment, which is needed for economic development. In the financial sector, new institutions, instruments and financial innovations emerge in response to the need of national economy.

In Nepal the first public issue of ordinary shares took place more than 50 years back with the public issue of Biratnagar Jute Mills and Nepal Bank Limited in 1937 A.D. But the development of capital market started in 1976 A.D., after the establishment of Security Exchange Centre with the objective of facilitating and promoting the capital market in Nepal. It was the only capital market institution, which undertook the job of brokering, underwriting and managing public issue, market making for government bonds and other financial services. Securities Exchange Centre dealt in the securities as a broker as a broker as well as a regulatory body. The Centre used to take; buy and sale only on orders from interested investors and confirm them if a price and quantity matched. There was no time limit within which a deal took place. It normally took one day to three weeks. Due to this, general public faced problems while buying selling shares.

The Security Exchange Centre issued 62 companies' shares from the year of its inception to 1999 A D. Among these 23 companies were undersubscribed including Nepal Med. Ltd., Nirmod Pharmaceuticals Ltd, Harisiddi Brick and Tile Ltd., Himgiri Textile Ltd, Banswari Leather and Shoes Factory Ltd., Nepal Awas Bikash Bitta Company Ltd., and Yeti Finance Co. Ltd. etc. Although the secondary market was non-functional and public were not fully aware of on the working of the capital market. The public response to the new issue of shares of selected companies like bank and finance companies were overwhelming. Security Exchange Centre was converted into Stock Exchange Limited in 1994, and under its support, the broker system of secondary market was establishes. Until December 2009, out of 32 brokerage firms, 23 firms are doing their job regularly. Nepal Stock Exchange Limited is a non profit organization. It operates under Security Exchange Act 1983. The basic objective of the Nepal Stock Exchange Limited is to impart free marketability and liquidity to the government bonds and corporate securities. With the establishment of full fledged Stock Exchange, the shares, which the public had held for decades, become liquid. Capital market is gaining business attention since last few years. The NEPSE index, which shows the stock price trend of all the listed securities in the stock market, has been increasing in the recent fiscal years. Hence, the general investors are very keen to make investment in the securities of the companies, through both primary and secondary markets. In primary market, the investment is made through

public issues of ordinary shares, preference shares, debentures and right shares as well as mutual fund and units' scheme.

The study focuses on the response towards public offering by investors. It is also based on the dealing process of primary market. It also focuses on what investors want in IPO before they invest their sector performance, knowledge, ultimate goal for investment , sources of information etc.

## **1.2 Statement of the Problem**

Nepalese capital market is very small in comparison with other developed stock markets. There are a few numbers of brokers, limited number of listed companies, very few transactions and most importantly investors are unknown about the pros and cons of the stock market. If there occur a single malpractice in the functioning of securities market, the whole capital market may damage the national economy badly and if once the investors confidence were lost it would very difficult to bring it in original condition. There are various types of obstacles existing initial public offering stages in Nepal. In developed country, generally people are aware from public offering. However, in developing country like Nepal Initial Public Offering is still new phenomenon. Still more than half of Nepalese Citizens are under the line of literacy. And among the literate ones as well maximum do know nothing about the practice of stocks. They do not know what the securities mean at all. They do not know what public offering is. Why should they invest their money in Stock? And also because of the political instability known people hesitate to invest in the stock.

Therefore, many problems are found in the field of public offering in Nepalese stock market rather than other developed countries.

In the current situation single investor can apply hundreds of application showing dummy names. As a result they can capture large number of shares. When a single investor captures large number of share, he can influence the company management and stock price too.

Besides these, there are other factors, which slow down the pace of stock market growth in Nepal. They are:

- Unfavorable macroeconomic conditions,
- Unconfident investors,
- Weak tax system and slow privatization process,
- Lack of institutional investors,
- Lack of trained and qualified manpower and,
- Insufficient knowledge of investors about the security market.

### **1.3 Objectives of the study**

The main objective of the study is to analyze the feedback of investors on Initial Public Offering in Nepalese Primary Security Market.

1. To identify the procedure and mechanism of IPO.
2. To observe the pattern of public response to different securities and different sectors.
3. To assess the current pace of Initial Public Offering.
4. To analyze the growth of primary share issue market in Nepal.
5. To provide suggestions & recommendation on the basis of findings.

### **1.4 Significance of the Study**

This study seems to be helpful to the prospective investors and the organization in the field of public Offering as there is still lack of study regarding IPO in Nepal. This study will assist in the formulation of policy and will assist the policy makers to get the practical knowledge of existing rules and regulations.

From this study, investors will have more clear conception over their investment and they will be able to make a right choice. It will also be helpful to the students who want to make research in IPO.

This study will be significant to analyze the legal provision, possibilities, problems and prospects of IPO in Nepal. It will also be helpful to know the public response to IPO of different industries. The prospective offering company may also get significant knowledge from this study.

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

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

- The data is used only up to 2008/09.
- Few companies are selected for the study.
- The study heavily focus on the initial public offering and current legal aspects associated their in.
- The recent changes may not be included because of insufficient data.
- The sources of data may be varied from one to another.
- The study is fully based on the researcher's limited financial resources within a limited time period.
- The study is not a final study.

### **1.6 Organization of the Study**

The whole study is organized into five chapters in the following order:

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

This chapter includes overview, statement of the problem, objective the study, significance of the study, the limitations of the study and scheme of the study.

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

The second chapter reviews the pertinent literature related to this study: it includes the review of published books, journals, articles, theses and dissertations. Besides this, the laws, acts, policies, rules, and regulations relating to initial public offerings have also been reviewed under the study.

## **Chapter III: Research Methodology**

This chapter consists of introduction, research design, sources and nature of data, population and sample, method of data collection and analysis of data.

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

The fourth chapter deals with systematic presentation and analysis of data where various analytical tools and techniques are used to analyze and interpret the data. This chapter also deals with the descriptive procedure where analytical tools can not be used. This chapter is key chapter for the present study and findings from the analysis are mentioned.

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

The final chapter is summarizing the whole study. Recommendations, statement suggestions and problem solving suggestions are included. Basing on the findings, summary and conclusion are drawn.

Reference is attached at the end of the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

Literature review is basically a “Stock Taking” of available literature in one’s field of research. The literature survey, thus, provides us with the knowledge of the status of their field of research. Therefore, this chapter has its own importance in the study (Kothari, 1990: 10).

This chapter includes the review of previous studies, articles, and conceptual framework for the related studies. To present the real framework of the study, mere analysis is not enough and review of some related materials should be dealt with to give the research a clear vision. Knowledge of past study provides foundation to the present study. This chapter is mainly divided into two parts like conceptual framework and review of related studies.

#### **2.1 Conceptual framework**

##### **2.1.1 Public Offering**

A business can raise capital for its enterprise through the sale of securities, which include stocks, bonds, notes, debentures, or other documents that represent a share in the company or a debt owed by the company. When a company proceeds to issue the securities, it is called an offering.

There are two types of offering: private and public. A private offering is made to a limited number of persons who are so well-informed about the affairs of the company that the company does not need to file a registration statement with the state or federal government. In contrast, a public offering is made to the public at large and is governed by federal and state regulations.

Until the 1930s the public offering of securities was subject to minimal regulation. Investors had no reliable way of knowing whether the information they received about a public offering was correct and complete. Because of the lack of regulation, fraudulent public offerings were common, leading to the sale of worthless stock.

The Securities Act of 1933 (15 U.S.C.A. § 77a et seq.), enacted after the stock market crash of 1929 and the resulting Great Depression, set in place rules and regulations for



public offerings of securities in interstate commerce or through the mails. Before a public offering can be made, a company must file with the [Securities and Exchange Commission](#) a registration statement containing financial and other data, including the price at which shares will be offered to the public, commissions paid to those who underwrite the security, and any options to purchase that have been issued.

In addition to requiring the filing of a registration statement, the Securities Act of 1933 makes it unlawful to mail or transmit in interstate commerce any security for the purpose of sale or delivery unless it is preceded or accompanied by a [prospectus](#) (a written statement of information about the public offering) that fully discloses all material facts regarding the investment, including the financial status of the enterprise. Unless a company files a registration statement that is then approved by the commission, it cannot legally make the public offering (www.answer.com).

### **2.1.2 Financial Market**

Financial Markets provide a forum in which suppliers of loans and investments can transact business directly. The loans and investments of institutions are made without the direct knowledge of the suppliers of funds (savers), suppliers in the financial markets know where their funds are being lent or invested. The two keys of financial markets are the money and the capital market. Transactions in short term debt instruments, or marketable securities, take place in the money market. Long term securities (bonds and stocks) are traded in the capital market (Gitman, 1988:30).

### **2.1.3 Money Market**

Money market activities include primary and secondary market activities in short-term negotiable instruments such as Treasury Bills, Government Bonds, Certificates of Deposit, Banker's Acceptances and Commercial Paper or Promissory Notes.

The money market is founded on the large amounts of funds, which companies, banks and other financial institutions wish to hold in highly liquid form to meet short term fluctuations in their finance. Generally, the money market is divisible under two sectors- organized and unorganized. The organized market comprises Nepal Rastra Bank (the central bank of Nepal) and commercial banks. It is called organized because the activities

of commercial banks are systematically coordinated by the central bank. The unorganized market is largely made of indigenous bankers and moneylenders. It is unorganized because Nepal Rastra Bank does not systematically coordinate the activities of these indigenous bankers and money lenders.

Nepalese money market is not well developed in terms of securities dealt with and institutions involved in the market. Institutions that deal completely on money market instruments are absent. Similarly, many of the instruments which are popular in developed money market like commercial paper, and bankers acceptances, have not yet entered the Nepalese money market. Therefore, the institutions that operate in the money market are basically Nepal Rastra Bank and commercial banks and instruments dealt are treasury bills, commercial bills and short-term bank loan.

Treasury bill market is a major component of money market in Nepal, started in the year 1961-62. Since then, it has been an important source of short-term fund for the government except for few years taking from 1968 to 1974. But, because of low yield and absence of active secondary market with brokers, it remained mostly at the hand of the central bank. The holding of Treasury bill by commercial banks, though it was counted for the purpose of statutory liquid ratio, was uneven in the past particularly because of low yield. The interest rate was five percent until mid-November 1988. Since then the rate is determined through auction in the market. The weighted average (annualized) ratio on 91-day Treasury bill increased from 5.2 percent in 1988/89 to 10.93 percent in 1995/96 and again declined to 2.33 percent in 1998/99. It then slightly increased to 4.96 percent in 2000/01. Treasury bills are being held mostly by commercial banks. The role of other institutions is still insignificant in Treasury bill market.

Commercial banks are major borrowers and lenders in the short-term money market. Although, commercial banks have been dealing with commercial bills since long, the bill market has its position as underdeveloped in Nepal. Only a small amount of commercial banks' lending is against export and domestic bills and larger amount is invested in import bills and letters of credits and purchase of export bills. For examples, commercial banks lending in bill finance including letter of credit were Rs. 544 million in mid-July 1980, which increased to Rs. 1,406 million in 1990 to Rs. 11,802 million in 2001. It

accounted 19.62, 11.92 percent and 10.46 percent of the total loan and advances made by commercial banks in the respective years. The development of genuine bill market is beneficial both to borrowers and to lenders in a number of ways. For example, bills are normally self-liquidating and therefore offer greater liquidity to the holders. To the banks and financial institutions, it provides higher return than in treasury bills, and for borrowers, it costs less than under cash credit system. A well-developed bill market also helps in generating liquidity throughout the financial system. But Nepal has long way to go to realize the full advantage of bill market because it still lacks institutions like 'discount houses' and 'acceptance house' and traders prefer cash credit form of short-term financing. Besides treasury and commercial bills, short-term credit by commercial banks also forms another important part of money market in Nepal. Though short-term credit has not fully developed to encourage growth of money market in Nepal, even then it has been the convenient vehicle for lending and borrowings. This type of finance was largely the monopoly of commercial banks in the past but in recent years, NIDC and other development banks also provide such finance.

In Nepal, money market is in initial phase. It is underdeveloped in terms of securities dealt with and institutions involved in the market. Many money market instruments and institutions are still absent in Nepal. Treasury bill market and short-term credit by commercial banks form important components of money market. The commercial bill market is evolving steadily and slowly.

#### **2.1.4 Capital Markets**

A place where long term lending and borrowing takes place is known as capital market. The capital market is the market for long-term loans and equity capital. Companies and the government can raise funds for long-term investments via the capital market. The capital market includes the stock market, the bond market, and the primary market. Securities trading on organized capital markets are monitored by the government; new issues are approved by authorities of financial supervision and monitored by participating banks. Capital market refers to the links between lenders and borrowers of funds, arranging of funds-transfer process to seek each other's benefit.

Capital market consists of the various suppliers and users of long term finance. It is differentiated from the money market which embraces short-term finance. The capital market serves as a link between suppliers and users of finance. It is a mechanism for the mobilization of public savings and channeling them in productive investment. In this way, an important constituent of the capital market is the securities market. It has a wide term embracing the buyers and the sellers of securities and all those agencies and institutions which assists the sale and release of corporate securities.

The capital market is a financial relationship created by a number of institutions and arrangements that allows the supplier and demanders of long term funds (funds with maturities of more than one year) to make transactions. Included among long term funds are securities issue of business and government. The backbone of the capital market is formed by the various securities exchanges that provide a forum of debt and equity transactions. The smooth functioning of the capital market, which is enhanced through the activities of investment bankers, is important to the long-run growth of business (Gitman, 1992:456).

The history of capital market in Nepal dates back to the era of Rana Prime Minister JuddhaShamsher when Gunjaman Singh, the first secretary of Nepalese Embassy in England returned back to Kathmandu and set up the "Industrial Council." Nepal Bank Ltd. issued the shares in the securities market in 1937. The first issued of government bond in 1964 was important developments relating to capital market.

The government first established Securities Exchange Centre (SEC) in 1976. After the establishment of SEC under Company Act, institutional development of securities market in Nepal was started. It started secondary market for the corporate securities in 1984. Securities Board of Nepal (SEBON) was established on 26 May 1993 after the first amendment in the Securities Exchange Act 1983. On 16 May 1993, after eighteen years of incorporation, the government converted Security Exchange Centre into Nepal Stock Exchange (NEPSE). After the conversion of SEC into NEPSE, 25 brokers and 5 market makers were appointed. It started 'open cry out system' of trading through broker and market maker on 13th January 1994. Presently, NEPSE has 23 brokers and 18 issue managers. There are 163 listed companies. Although, the growth of stock market is

highly relative to the growth of economy, the contribution of corporate sector in the economy is still low due to negligible size of corporate sector. There should be automation for the efficient trading of the securities in the security market. Nepal Stock Exchange should also go towards automation.

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

Securities are marketable financial instruments that bestow on their owners the right to make specific claims on particular assets. An individual security provides evidence of either creditor-ship or ownership depending on whether it is a bond or a stock respectively. A bond is a loan that is paid off with interest; the investor lends money to the borrowing company that issued the bond. In contrast, stockownership represents a cash investment in the future of a corporation; the investor owns a part of the corporation and shares in its profits (Francis, 1998.p.26).

A firm either may have debt and equity in its capital structure or only equity but no any firm can operate without equity. So, equity is the compulsion of every corporation. The main characteristic of equity investment is that investor is liable only up to the amount they have invested.

Common stock has one important investment characteristic and another important speculative characteristic. Their investment value and average market price tended to increase irregularly but persistently over the decades as their net worth builds up through the reinvestment of undistributed earnings. However, most of the time common stocks are subject to irrational and excessive price fluctuations in both the decisions; as the consequence of the ingrained tendency of most people to speculate or gamble, i.e. to give way to hope, fear and greed (Chandra, 1995. p.47).

### **2.1.5 Security Market**

Security market sets a price for the securities it trades and makes it easy for people to trade them. Securities market facilitates the sale and resale of transferable securities. The

security market can be defined as a mechanism for bringing together buyer and seller of financial assets to facilitate trading. Securities market is classified into two; the market in which new securities are sold is called the primary market and the market in which existing securities are resold is called the secondary market. Secondary markets are created by brokers, dealers and market makers. Brokers bring buyer and seller together with themselves actually buying or selling; dealers set price at which they themselves are ready to buy and sell (bid and ask price respectively). Broker and dealer come together organized market or in stock exchange (Gitman, 1992:457).

Securities are traded in a market called securities markets. Although, securities markets are concerned in few locations, they refer more to mechanism, rather than to place, designed to facilitate the exchange of securities by bringing buyers and sellers of securities together. In other words, people and organizations wanting to borrow money are brought together with those having surplus funds in the securities markets. Securities, such as equities, short and long term debt instruments, derivatives etc are the products that are traded in the markets, institutions such as investment bankers and security firms, securities issuing institutions such as government and corporate bodies and the participants of the securities markets. Securities markets major function is to provide line between saving and investment there by facilitating the creation of new wealth. Securities markets covers both primary and secondary. The difference between the two markets is, the primary market consists of the companies making the issue of securities and the members of the public subscribing to them. hereas, secondary market involves the purchase and sale of securities already issued to the general public and is traded in the stock exchange. The primary market also comprises the offer of securities to the existing shareholders of the company on right basis. This study is only concerned with initial public offerings so, it deals with the process and activities incurred in rising of funds from the primary market. The operation of the secondary market, though is an important operation scope of the merchant banking, is not covered in this manual. Primary market and the secondary market are present in both the capital market and the money market.

#### **2.1.6 The Primary Market**

The primary markets are media through which new financial assets are issued or generated. They are the media through which the demands and suppliers of today's fund meet. In these primary markets financial assets are created and exchanged satisfying in the part of financial needs of both demands and suppliers of today's fund. It is the market for direct issuance of government securities. The primary market of country is dominated by the government securities due to the existence of insignificant new issue market for industrial securities. In the definition of primary market made above an addition is to be made. That is, depending upon the company offering securities for the first time or in succession, primary market can have public offerings as initial public offerings or the successive public offerings or so on.

### **2.1.7 Secondary Market**

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

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

### **2.1.8 Investment consideration to the potential investors in the primary market**

Rules and regulations alone would not be able to protect the interest of investors. They should be able to analyze and evaluate following aspects of the company before taking their investment decision.

Investors should select those companies share which are regarded as well operating and good future prospects, reliable management, beneficial sectors or higher growth. Investing in the shares of these companies is less risky than others. The investors who invest in stock, they must compare the price and the value or the share in the market and should select the share which has lower market price in comparison to its value. The investors should take information regarding company's promoters, size, growth, environment, board of directors, past statements and as well as budgeted statements, which can be obtained from memorandum, prospectus, articles of the concerned company.

### **2.1.9 Primary Market and Initial Public Offering**

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

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

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



### **2.1.9.1 Common Equity / Stock**

These are the offerings that entitle the holders or the buyers of the offerings the stake on the equity of the issuing company. In addition, they are entitled to:

- Voting right at the general meetings of the company and have the right to control the management of the company.
- Right to share the profits of the company in the form of distribution of dividend and bonus shares.
- In the event of the winding of the company, equity shares capitals are repayable only after repayment of the claims of all the creditors and preference shareholders.

### **2.1.9.2 Preference Shares / Preferred Stocks**

Preference shares capital mean, in the case of a company limited by shares, that part of the capital of the company, which

- Carries a preferential right to payment of dividend during the lifetime of the company;
- Carries, on a winding up, a preferential right to be repaid the amount of capital paid-up.

The different types of preference shares are:

- Cumulative Preferred stocks
- Non-cumulative Preferred stocks
- Redeemable Preferred stocks
- Non-redeemable Preferred stocks
- Convertible Preferred stocks

### **2.1.9.3 Bonds / Debentures**

Debenture includes debentures stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. Debenture is a document that either creates a debt or acknowledges it, and any document, which fulfils

either of these conditions, is debenture. The characteristic features of a debenture are as follows:

- It is issued by the company and is in the form of a certificate of indebtedness.
- It usually specifies the date of redemption. It also provides for the repayment of principal and interest at specified date or dates.
- It generally creates a charge on the undertaking or undertakings of the company.

The different types of debentures are:

- Secured debentures
- Unsecured debentures
- Redeemable debentures
- Perpetual debentures
- Convertible debentures

#### **2.1.9.4 Warrants**

The warrant gives a right to the holder to obtain equity shares specified in the warrant after the expiry of a certain period at a price not exceeding the cap price specified in the warrant. The warrant is a tradable and negotiable instrument and is also listed on the stock exchanges. It comes in different forms, mostly:

- Bonds with warrants
- Preferred stocks with warrants

Beside these instruments there is other instrumental mix available to the investment bankers to provide to the primary market investors. But, these are beyond the scope of this manual to describe.

#### **2.1.10 Initial Public Offering (IPO) Manual**

Initial Public Offerings (IPO) manual is the detail procedure of handling Initial Public Offerings of the companies seeking “going public” for the first time. This manual outlines all the activities and steps that have to be observed by all issuing companies and

issue managers in respect to Initial Public Offerings (IPO). This manual has been prepared with a view to present a detailed, descriptive and step-by-step action sequences in the Initial Public Offerings, relevant to all the companies offering shares to the general public. But, it is subject to periodic amendments and supplements.

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

#### **2.1.9.1 Issuing Company**

Issuing company is the company raising funds from the general public through the process of public offering. The purpose of public offerings is for the collection of funds from general public, a fund sufficient group, by the company as per its requirement of business expansion. The company seeking for public offerings could be a completely new company (initial public offerings), a new company set by the existing company (initial public offerings) or by existing listed company (successive public offerings).

As per the Company Act, only public companies are liable to go for public offerings. The Act specifically states that private companies are not allowed to sell their shares and debentures in the free market. For public company issuing debentures, the reasons for such issue, project to be financed and its estimated budget along with the information about secured or naked nature of the debenture, needs to be approved from the governing bodies. NRB has made mandatory that financial institutions must go for common stock public offerings within specified time of operation commencement. NRB has also set forth different minimum percentage of equity holding to be offered to the public shareholders. For commercial banks, minimum shares to be held by public is 30%; for finance companies, it is 40%; for development bank it is minimum 30% and maximum of 50%. In the case of foreign participation, their equity holding would be arranged from the percentage allocated for the public. For finance companies, in the event of foreign participation, the minimum percentage to be allocated to the general public is 25% of paid-up capital. For other public companies such compliance to go into public offerings of equity holding are absent. For such companies, going into public signifies the need of funds for the company rather than the obligation.

The provisions and conditions of Securities Registration and Issue Act, 2051 has set the guidelines that before going into public offerings, issuing company should take into consideration that

**a) If the issuing company is industrial institutions**

- The institution has bought the land or made other provisions in which necessary infrastructure like factory; office buildings, godowns etc. are already build in or made necessary arrangements for it.
- Necessary technology has been selected for which spare parts of machineries needed have been bought. If not, LC has been opened to buy the necessary technologies. Estimated budget has been proposed for the project to be implemented and for which if loans are required, such agreements are already made.
- In the absence of long-term loan agreement, issue securities are underwritten.
- Necessary approvals according to the existing Acts have been taken.

**b) If the issuing company is financial institutions**

- According to the nature of the business, required infrastructures are installed.
- Approval has been taken under the Company Act 2063.
- For commencing other activities, authority and approval from governing bodies based on existing Acts has been taken.

**2.1.10.2 Merchant Bankers**

Merchant bankers are intermediaries in which they work as mediators in the fund mobilization from the general public to the business groups. The funds are raised from the hypothetical market that comprises widely spread fund surplus groups, mainly the general public and the concentrated fund deficient groups, mainly the business groups. Funds are raised under different tool names that have long-term and short-term maturing period. According to such maturity period of the tools traded, market is identified as capital market for long-term and money market for short-term tools to be traded. The role of merchant bankers in this market is to help create and expand securities underwriting,

the secondary market for securities and money market. They also provide additional services in advising corporations and managing investment portfolio for the needing groups.

The concept of merchant banking differs from other commercial and development banks in respect that they do not require large funds to be invested as a principle. Their sources of income are basically the service charge they charge to their clients for playing intermediary role in the fund mobilization and their advisory role. Typically, the activities of domestically oriented investment banks can be grouped under:

- Securities underwriting
- The secondary market for securities
- The money market
- Corporate advisory services
- Investment portfolio management services, and also
- Venture capital
- Leasing / hire purchase
- Other services (insurance, real estate etc.)

The role of merchant banking in managing the public offerings comes under the heading of securities underwriting. The working process of which would be described comprehensively later. For the working of merchant banking function in Nepal, Nepal Rastra Bank (NRB) has set forth the working guidelines. Guidelines have identified working of merchant banking into two sets of functions. The first set is the non fund-based functions and the second set is fund-based functions. Fund-based activities identified for the merchant banking are:

- Bridging finance
- Underwriting
- Project finance
- Venture capital

- Acquisition and merger

Non fund-based activities identified for the merchant Banking are:

- Share issue management
- Mutual fund
- Portfolio management
- Corporate counseling
- Project counseling
- Debenture trusteeship
- Arranging international finance
- Investment advisor
- Advising corporate mergers

NRB has set the directives as for non fund-based activities of merchant banking, for underwriting and for bridging finance it is not necessary to take separate approval from NRB. But, for other fund-based activities of merchant banking, it is necessary to take separate approval from NRB for different activities to be undertaken. In Nepal, there are 7 merchant banks are already established. They are providing issue manager, lead underwriter, register, transfer of shares etc. services to other institutions.

### **2.1.10.3 Securities Board of Nepal (SEBON)**

The securities Board of Nepal (SEBON) was established in 7th June 1993 under the provision of Securities Exchange Act, 1983 (first amendment in 2040B.S.). Under the present Act, The SEBON is responsible for the supervision of NEPSE. The Board comprises of seven board members representing several governmental and private bodies for the operating management of the board.

"It was established with the objective of promoting and protecting the interest of investors by regulating the securities market. It is also responsible for the development of securities market in the country" (SEBON Annual Report, 2000/01. p.1).

Since its establishment, SEBON has been continuously concentrating its efforts to improve the legal and statutory frameworks, which are the bases for healthy development of the stock market. SEBON has been concentrating its efforts to improve the legal and statutory frameworks for the healthy development of stock market and to enhance the degree of investors' protection. After the second amendment of Securities Exchange Act on Jan. 1993, SEBON is acting as an apex regulatory body by bringing market intermediaries directly under its jurisdiction and made it mandatory for the corporate bodies to report annually as well as semi-annually regarding their performance. It also established direct relationship with market intermediaries and listed companies. SEBON'S regulatory interventions were targeted to discipline the market and to consolidate its position as central securities market regulator.

Under the present Act, SEBON is responsible for the supervision of NEPSE, its members, disclosure requirements for listed companies, and the licensing of I) Issue managers, II) Underwriters, III) Portfolio Manager, IV) Market Makers and V) Stock Brokers. Under the Securities Investment Trust Act 1997, it is also responsible for the registration and supervision of investment funds. "The securities Board was set up for the development of the securities market and to enhance the degree of investors' protection. Securities Board (SEBON) realized that capital market reforms needed to be looked into broader perspective vis-à-vis the growth of the private sector. Under the provision of Securities Exchange Act, 1983 and Securities Exchange Regulation, 1993 SEBON has been making attempt to develop an understanding with NEPSE on moving ahead in a coordinated way under which SEBO/N will act as an apex regulatory body and NEPSE as a frontline regulator" (SEBON Annual Report, 2000/01.p.37).

In order to develop the Securities Board as an effective regulatory body and forge ahead effectively, the board had put into implementation a medium term 4-year comprehensive managerial strategic plan, which had been implemented during the ninth plan period. SEBON, Annual Report (2000/01) also stress the strategic plan strives to attain the major policy development issues on:

- Improvement in the statutory and regulatory framework of the capital market.
- Development of market standard and information system.

- Development of widely participated capital market.
- Improvement in the securities Board institutional capacity

The initial draft of the strategic plan was circulated among the policy makers, expert, Government official, market operators, securities business persons, business community investors and has been improved based on available comments. This plan had already been approved by National Planning Commission and was being implemented in the year 1998-2002 during the ninth plan period.

SEBON has seven members including a chairman. NEPSE is not the member of SEBON and on the other hand, SEBON is not representing on the Board of Directors of NEPSE. It is also highly desirable that the government regulation over right function be kept separate from the operation and governance of stock exchange. This is essential to maintain public confidence. If the main government regulatory body is too closely identified with day -to - day functioning of the stock exchange, this could erode public confidence in the event of market failure.

Presently, there are 41 staffs in SEBON including chairman, two directors, five deputy directors, nine officers, seven assistants, seven support staffs and messengers, and there are ten staffs on contract basis.

This may not be an adequate numbers of staff to perform the different tasks assigned to SEBON such as: regulatory supervision, enforcement and market development. But the adequacy of funding for SEBON has important implications for the regulation and enforcement program as well as for training government regulators, self-regulators and market practitioner. Incomes from registration of corporate securities and registration as well as renewal of market intermediaries are the main financial sources of income of SEBON. In order to be a self-dependent institution it had created revolving fund from which it generated income that helps to cover part of its expenses.



## **Role of Securities Board in Issue of Securities**

In its approach to manage public issues of securities, the Board will bear in mind

A. Protection of rights and interests of the investor, especially,

The right to adequate, true and fair information

- The need for liquidity

Prompt, fair and equitable allotment

- Easy and efficient service in allotments and transfers

B. The need to encourage corporate entities to tap the securities markets for their diverse resources needs.

The Board would endeavor to evolve market and institutional structure, a set of instruments and methods of public offerings to cater the above objectives.

The legislative provisions relating to public issues of securities may be classified under:

- a. Capital control, governing issue of securities and the terms of their issues:
  - To regulate terms of issues of securities from the viewpoint of investor protection, issuers needs and overall development of the securities market; and
  - To promote sound capital structure of companies.
- b. Prospectus provisions, governing the disclosure of information at the time of issue of any security;
- c. Obligations of regular disclosure of financial and other information on entities making public issues;
- d. Listing requirements governing traded securities;
- e. Provisions governing allotment and transfer of securities:
  - Ensuring fair and equitable allotment; and

- Promoting speedier and more efficient service in matters of allotment and transfer.

#### **2.1.10.4 Nepal Stock Exchange (NEPSE)**

Nepal Stock Exchange, in short NEPSE, is established under the company act, operating under Securities Exchange Act, 1983.

The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994. Government of Nepal, Nepal Rasta Bank, Nepal Industrial Development Corporation and members are the shareholders of NEPSE.

The history of securities market began with the flotation of shares by Biratnagar Jute Mills Ltd. and Nepal bank Ltd. in 1937 AD. Introduction of the Company Act 1964, the issue of government bond in 1964 and the establishment of securities Exchange Center Ltd. in 1967 were among other significant developments resulting to capital markets. SecuritiesExchangeCenter was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange, it was the only capital market institution undertaking the job of brokering, underwriting

managing public issues, market making for government bonds and other financial services. Nepal Government, under a program initiated to reform capital markets converted SecuritiesExchangeCenter into Nepal Stock Exchange in 1993.

His Majesty's Government (presently changed into Nepal Government) under a program initiated to reform capital market, converted SecuritiesExchangeCenter into Nepal Stock Exchange (NEPSE) in 1993. NEPSE is a non-profit making organization, operating under Securities Exchange Act, 1983. The basic objectives of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries, such as brokers, market makers etc. NEPSE first opened its trading floor on 13th February 1994 through licensed members. Nepal Government, Nepal Rasta Bank, Nepal Industrial Development Corporation and the licensed members are the shareholders of the NEPSE as well. The Board of Directors (BOD), which will govern NEPSE, constitutes of members representing different sectors as per Securities Act 2006. At Present, the BOD constitutes

2 Members including a chairman from Nepal Government, 2 Members from Nepal Rasta Bank, 1 from NIDC. Moreover, one member will be nominated by BOD as an expert in capital market. General Manager of NEPSE will serve as a director on the BOD. The development of the stock market is directly linked with the development of the corporate firms and industries in the economy. Nepal's industrial history is not very long in comparison to other countries. So, the essential thing for the rapid growth of capital market is to encourage business firms to convert into public limited companies.

NEPSE performs several types of regulatory services including market surveillance and the on-going supervision of brokerage firms. Some of the functions of NEPSE are:

- Trading
- Listing
- Clearing and settlement
- Market surveillance

### **Brokering Services in NEPSE**

The role of brokers in Nepalese securities market is limited to advising their clients as to whether particular stock will be worth-investing or not. They should advise their clients by analyzing the company report and other information regarding the company which can affect the market and the companies concerned. Brokers are not obliged to offer advice to their clients, and even if they do, they cannot be held responsible for the quality of the information they offer. But the quality of the information works as a main source of their goodwill and uplift the moral responsibility towards their clients.

Brokers have to get license from SEBON and membership certificate from NEPSE before starting their services. Under the provision of securities legislation brokers have to renew their license before the expiry of each fiscal year.

Brokers are supposed to behave more legally and morally towards the fulfillment of the satisfaction of their clients. However, it is not the case in all and every situation. They were often intended to increase the trade volume and therefore are blamed for the stock price crash and thereby making profit by ignoring the clients' losses. The amount of commission is directly related to the amount of turnover (i.e. trading) in an investor's

account. This provides some temptation to recommend frequent changes in investor's holdings. Such behavior may be advantageous for them in the short run.

There were some conditions and circumstances seen in the stock market where the brokers have done some activities, which create the market disorders. These activities were performed to protect their sole interest and the mutual interest connected with very little number of clients.

Brokers are supposed to give the potential investors the adequate and real information about the different stock available in the market. But in reality they have also been criticized for the use of imaginary words to persuade them to buy and sell the security as immediately as possible.

Member of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 23 member brokers operate on the trading floor as per securities Exchange ACT 1983, rules bylaws of the exchange. There are many intermediaries are involving in the Nepal Stock Exchange for stock trading. Brokers are one of them. Brokers play an intermediary role on behalf of their client and receive certain commission for their service.

Besides this, NEPSE has also granted membership to issue and sales manager securities trader (Dealer). Issue and sales manager works as manager to the issue and underwriter for public issue of securities whereas securities trader (Dealer) works as individual portfolio manager. At presently there are 11 sales and issue manager 2 dealers (secondary market.)

The role of broker in Nepalese securities market is limited to advising their clients as to whether particular stock will be worth-investing or not. They should advice their clients by analyzing the company report and other information regarding the company, which can affect the market and the companies concerned. Brokers have to submit their annual report along with financial statement and trading report to SEBON within months after the expiration of the fiscal year.

Number of brokers in the NEPSE are also few to foster the competition. "A recent study commissioned by NEPSE has concluded that only five new brokers were allowed into the

market which already has 23 brokers while there have been more than a dozen aspirants to enter it. It seems that the existing brokers have prevailed over the study team to force it to put entry barriers for new brokers. The report has argued that the size of the market has not expanded and the volume is very low to justify entry of new brokers. But the arguments of the report are hardly acceptable, as the reality is a lot different from what the report has tried to project" (Ghimire, 2003). In his article he has also make some recommendation as "the solution to the problem cannot be found by blocking new brokers from coming to the market. Efforts should be focused on increasing listing of companies and the transactions in manufacturing sector shares. New brokers should be allowed to do the marketing for this purpose as the existing ones have clearly failed in this regard" (Ghimire, 2003).

He has further clarified that "the reason for non-participation by stock dealers cannot be attributed only to the market conditions. Lack of professional selection of those companies is equally important reason. And the underlying reason for the problems can be found in the passivity of the broker organizations that were indifferent to market development. IT utilization would enhance transparency and reliability in the transactions, but it is seriously lacking among the existing brokers. Neither their association nor the individual companies have organized any interaction and/or seminar to disseminate information or to formulate strategies for market expansion. Their main objective is only to get a larger share of the cake that has grown naturally. They have not been able to generate or create business or expand it systematically" (Ghimire, 2003).

Brokers participate directly in the trading activities in the floor of NEPSE but the dealer can not take part in trading activities of the floor. The service of broker is defined under the securities law.

### **Trading System of NEPSE**

NEPSE operates on the "NEPSE Automated Trading System" (NATS), a fully screen based automated trading system, which adopts the principle of an order driven market. The system adopts principle of order driven market. The best buy order is matched with the best sell order. An order may match partially with another order producing multiple trades. For order matching the best buy order is the one with the highest price and the

best sell order is the one with the lowest price. This is because the system views all buy orders available from the point of view of the sellers and all sell orders from the point of view of the buyers in the market. So, of all buy orders available in the market at any point of time, a seller would obviously like to sell at the highest possible buy price that is offered. Hence, the best buy order is the order with the highest price and the best sell order is the order with the lowest price.

### **2.1.10.5 Financial Institutions**

They are financial intermediaries like commercial banks, finance companies (merchant bankers), and development banks and cooperatives institutions. These institutions are established under the Company Act and Nepal Rastra Bank Directives. These financial institutions perform the role of intermediaries in the securities issue as per the authority received from the Securities Exchange Board. Financial Institutions are involved in securities issue process as:

Issue managers

Underwriters

#### **2.1.10.5.1 Issue Manager**

Issue manager in the primary market carry out all the function related to public issuance of securities on behalf of the issuing company. Presently there are 9 issue managers in the market. Which are as follows:

**Table 2.1**

#### **Name of Issue Manager of Nepal**

1. Ace Development Bank Limited
2. Citizen Investment Trust
3. NIDC Capital Markets Limited
4. Nepal Finance Limited
5. National Finance Company Limited
6. NMB Bank Limited
7. Nepal Sri Lanka Merchant Bank Limited
8. Nepal Share Markets and Finance Limited
9. Civil Capital Market Limited.
10. United Finance Limited



11. Elite Capital Limited
12. Nepal Housing and Merchant Finance Limited
13. ViborBikash Bank Limited
14. Development Credit Bank Limited
15. TinauBikash Bank Limited
16. Investment Management Merchant Banker Limited
17. Beed Investment Limited
18. Gromore Merchant Banker Ltd

*Sources: www.sebonp.com*

#### **2.1.10.5.2 Underwriters**

Generally all commercial banks, finance companies and other financial institution can provide underwriting services and providing such services accordingly. But the public issue getting underwritten has become Herculean task. Almost banks, finance companies and financial institutions reluctant to underwrite the public issue of shares because they feel that underwriting is risky business. This type of reluctant has been strengthened more by some development cases. On the other hands, these exit some anomaly in underwriting concept between New Company Act and securities exchange regulation. Company Act defines issue manager as underwriters a well. Secondly no acts and regulations clearly spells about the qualification to be an underwriter that who can underwrite the public issue and who can not or whether banks finance companies and financial institution other that member of Nepal Stock Exchange can provide the underwriting services that there is always deficient fund / resources to meet the demand of underwriting. Thirdly, because of the insufficient resources and despite of the reluctance of commercial banks (who have enormous resources), issue manager are somehow managing the consortium of underwriting.

#### **2.1.10.6 Offices of the Registrar of companies (ROC)**

Registrar of Companies (ROC) is the governing body for any institution registered under Company Act. In its governing role, it observes and regulates any company going into

public examining whether the process of ‘going public’ is in accordance with the rules and regulation set forth by the existing Company Act or not.

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

#### **2.1.10.7 Nepal Rastra Bank (NRB)**

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

#### **2.1.11 Investment consideration to the potential investors in the secondary market:**

Investors should be informed about the following matters before investing in the secondary market.

- Keep information of the companies return to the shareholders in the form of cash dividends, stock dividends, bonus shares etc. they should also be informed about Earning per share (EPS), book value of share (BVS), price earning ratio (P/E Ratio), future plan, growth expectancy of the company through the annual, quarterly and half-yearly performance reports, profit and loss account (P/L a/c), balance sheet (B/S) and annual reports.
- Analyze the price related information provided by SEBON and NEPSE about the listed companies.

- Study the trading statements and financial analysis of the listed companies published by NEPSE.
- Study articles related to the trading of shares and economic matters published in different newspapers and magazines.
- Study the annual report of SEBON.
- Study the act and regulation concerning to the shareholder's right.

Once the investors think of making investment, he approaches to the broker to choose a firm that is suitable for his needs of investments and to select a representative of the firm with whom he can work. The representative should be able to furnish the investor at all times, on reasonable choice, information on any specific company's securities.

#### **2.1.12 Timing of an Initial Public Offering**

Obviously, not all companies that would like to go public are in a position to do so. Factors relevant to a company's ability to successfully close an IPO include (i) its past financial performance, its financial projections for the future, and its ability to generate consistent increases in revenues and earnings, all of which are crucial for a public company to survive in the market place, (ii) the experience and depth of the company's management team, (iii) a solid product position in the market with growth potential, (iv) a focused mission set forth in a well written business plan to present to prospective underwriters, and (v) attorneys, accountants and public relations firms experienced in working with the SEC. Especially in the case of technology-based companies, the determining factor in the success of an IPO may ultimately be the receptivity of the stock market to new issuances in a Company's particular industry at the time that the IPO is undertaken.

The company will have to satisfy the underwriters that all of the above criteria are met, and even then the underwriter may insist on changes to the company's capital structure as a condition to its engagement. For example, the underwriters might require the company to affect a reverse stock split prior to the closing of the IPO in order to price the shares being offered in a typical IPO price range. If the underwriters do not feel that the company is offering a sufficient number of shares to ensure an acceptable "float" of

publicly traded shares, they might require that certain stockholders participate in the offering by selling some of their own shares (a "secondary offering"). The underwriters might also insist on fundamental changes in the company's means of conducting its business as a condition to its engagement, such as the cessation of insider transactions and perceived conflicts of interest and the appointment of outside directors. Companies which are not willing to make s

uch changes may not be able to attract an underwriter willing to manage the IPO. If the issuer belongs to a certain industry that is particularly attractive to investors at the time of the proposed IPO, it will have more leverage in choosing and negotiating with an underwriter. Conversely, if market conditions are unfavorable at the time of the offering, the issuer will have less flexibility in how the deal is structured and may have to postpone the IPO altogether.

### **2.1.13 Terms Involved in the Process of Initial Public Offerings of Common Stocks**

#### **2.1.13.1 Initial Public Offering (IPO)**

It is a process by which an institution raises desired capital through issuing of securities (common stock, preferred stock, bond, commercial paper and debentures) in the capital or money market for the first time. For the purpose of public offerings, Company Act has specified that the public issue process of any public company should be managed through the institution receiving authority from SEB. Internationally, financial institutions with the merchant banking operations, manage the overall issue process of any public limited company. Such institution managing the overall process of the public offerings is termed as an issue manager.

#### **2.1.13.2 Issue Manager**

Issue manager is the institution solely holding the responsibility of managing the public offerings of any issuing company. Securities Exchange Act, 2040 clause 18, has defined issue managers as institutions holding license from the Security Board to manage public offering process. The format of application letter and required information to be provided while registering for issue manager are given in the appendix.

#### **2.1.13.3 Lead Manager**

In the event of more than one issue managers managing the issue of securities of any company, the term lead manager is used to identify the individual issue managers. The existing Act and the Directives have not clearly identified the maximum number of lead managers managing securities issue of any company at the same time.

#### **2.1.13.4 Underwriting**

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

#### **2.1.13.5 Lead Underwriter**

Lead Underwriter is the one that arranges the whole underwriting process for the issuing company with the help of other sub-underwriters. The issuing companies and intermediaries should note that underwriting is a serious contractual arrangement having financial implications on the issuer and the underwriter. The business of underwriting, therefore, presupposes inherent financial strength on the part of the underwriters. In the process of identifying underwriters, therefore, issue manager must satisfy himself about the net worth of the underwriters and their outstanding commitments and disclose. In the event that the issued shares are not fully subscribed by general public, the distribution of unsold share to the underwriters would be held on the pro-rata basis based on the number of shares committed by them to underwrite.

#### **2.1.13.6 Underwriters or Sub-underwriters**

They are the smaller institution agreeing to underwrite fewer number shares. Underwriters and subunderwriters work under the management of the lead underwriter. Their financial responsibility remains within the total amount of shares agreed by them to undertake.

#### **2.1.13.7 Banker to the Issue**

Banker to the issue is normally a commercial bank, which provides the custodian service to the issuing company and keeps the subscription money. Banker to the issue may or may not receive applications from the investors, issue acknowledgements for the same, and enter the application details in application schedules. It also involves in the process by realizing the proceeds of the cheques/draft and issue final certificates to the issue manager for the number of applications and amount collected. Issuing company in consultation with the issue managers makes the appointment of banker to the issue. The banker to the issue generally comprises the consortium of bankers providing working capital finance to the company, the banks providing underwriting assistance for the issue, the bank associated with the issue managers and other banks which are regularly and efficiently handling public issue work.

#### **2.1.13.8 Collection Centres**

Collection Centres are normally financial institutions such as banks, finance companies, brokerage houses etc. Collection centres receive applications from the investors, issue acknowledgements for the same, and enter the application details in application schedules. They also realize the proceeds of the cheques / drafts and issue final certificates to the issue manager for the number of applications and amount collected. The appointment of collection centres is made in consultation with the issue managers

#### **2.1.13.9 Prospectus**

The prospectus is defined as, “any document described or issued as a prospectus and includes any notice, circular advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of shares in, or debentures of, a body corporate.” The Company Act 2063 has made mandatory that any public institution going into public offerings must issue the prospectus before issuing the securities to the public. According to the Act, before publishing for the public, the prospectus signed by the board of directors should be sent to and get approval from the Office of Registrar of the Companies and Securities Board. The requirement is made to make sure that the information provided to the public is as per requirement and is not manipulated to mislead the public. The prospectus published for the public should state in the publication the approval from the Office of Registrar of the Companies. The

Company Act 2063 has stated that matters referred in the prospectus are the liability and responsibility of company publishing it. Board of Directors signing the documents is answerable to the matters stated in the prospectus. In the event that, company has knowingly published false statement in the prospectus and believing on which if securities has been purchased and loss incurred, such loss coverage would be the personal liability of the directors signing the prospectus.

In short, prospectus is a legal document containing important features of Article of Association, Memorandum of Association, and important decision taken by the board of the company affecting the future of the company and important conditions to be obeyed by the general applicants. The main purpose of the publishing prospectus is to inform public about the company and the issue.

#### **2.1.13.10 Budget for the Issue**

Budget for the issue is a tentative figure of expenses that is estimated to incur in the process of public offerings. The budget is to be born fully by the issuing company, if not, according to the understanding reached between issuing company and the issue manager/s.

#### **2.1.13.11 Application Form**

It is a form provided to general public to apply for the issued securities by a company. The application forms needs to be filled both in English and Nepali. It contains information about the company, issue of shares, and space for applicants to fill in for the buyers'' detail information. Application form is the legal document that the investor provides to the company stating the number of shares of a company he/she is willing to accept. The applicants submitting the application forms would imply that he/she has accepted the terms and conditions stated in the application form with the full knowledge about the matters referred in the prospectus. Attached with the application form a photocopy of citizenship is collected as a proof to applicants'' acceptance to terms and condition and a remedy to possible discrepancies in identification. In case of minor applicants, citizen certificate of parents or guardian is to be attached.

#### **2.1.13.12 Bridge Financing**

It is a short term lending provided to the issuing company till the date of share allotment, backed by the collection from public issue. The company is to make the payment after receiving allocated shares money from public offerings. Normally financial institutions provide bridge loans to companies against their underwriting commitments. The said loans are adjusted against allotment of shares/debentures. The bridge finance is issued when Companies require meeting their immediate requirement of funds. If there is a substantial lead-time between making a public issue and commencement of commercial production.If issues is to be deferred to the most opportune time.

#### **2.1.13.13 Memorandum of Understanding**



In the process of issuing securities to the public, besides issuing company, different intermediaries are involved. Memorandum of Understanding is the legal agreement made between issuing company and different intermediaries. This agreement states the terms and condition in respect to the function and authority of the involved parties.

Different MOU to be signed in the process of issue offerings are,

- MOU between issuing company and the issue manager/ lead managers: This is required as the Company Act requires securities issue process of any public company is to be done through the registered issue manager. This legal agreement between issuing company and issue manager specifies terms and condition, responsibilities and the authorities of involved party.
- MOU between issue managers and the underwriters
- MOU between issue manager and the bankers to the issue
- MOU between issue manager and the collection centres.

#### **2.1.13.14 Issue Commission**

It is the commission charged by the issue manager to the issuing company for the service it has provided. Issue commission is paid for issue management process. The responsibility of issue manager in the issue process, for which issue commission is to be charged as demarcated in the agreement itself. The commissions are normally set as per the negotiation.

#### **2.1.13.15 Underwriting Commission**

Underwriting commission is the amount charged by the underwriters for underwriting the securities issued. The commissions are normally determined as per the negotiation.

#### **2.1.13.16 Collection Charges**

Collection charges are the amount charged by the collection centres for collecting the application forms and other documentation process. The collection charges are also charged on percentage of the amount collected. The percentage charged also depends upon the negotiation between issue manager on behalf of issuing company and the collection centres.

#### **2.1.13.17 Refund Charges**

Refund charges are the amount charged by the collection centres for refunding the oversubscribed money to the general investors. The refund charges are charged on percentage of the total amount refunded. The percentage charged depends upon the negotiation between issue manager on behalf of issuing company and the collection centres.

#### **2.1.13.18 Fix Charges to the Collection Centres – Finance Companies**

It is a fix charged given to the collection centres like finance companies for making required preparation for collecting application from the investors and conducting other required activities. The fix charge amount provided to the collection centres is also based on the negotiation.

#### **2.1.13.19 Pre Issue and Post Issue**

Pre-issue in the issue process is defined from the point of approach by the issue manager to the prospective issuing company to the point of allotment of securities and refund of oversubscribed money to the investors. This segregation has been made on the basis of Company Act, as it requires that the process of securities issue, allotment of securities, collection of subscription needs to be done through institutions approved to carry out issue management.

### **2.2 Review of Related Studies**

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

#### **2.2.1 Review of Books and journals**

These days internet become the most easily accessible medium to gain information in any subject matter. In the study period, different articles have been consulted.

Poul, (1960) in this article “The Review of International Capital Masters” published in journal “The American Economic review” has pleaded that the development of world capital market appears to be reaching the state where they can make significantly greater contribution to world economic growth and trade. More importantly, the groundwork has been laid for the healthy development and future growth of international capital markets. Barring the intervention of war or other major disturbances, world capital market give promise of being able to play and increasingly important, through no predominant role in the movement of capital internationally.

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

Lowry and Schuvert (2002),carried out a study on, “IPO Market 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 initial returns.

The study revealed that there exist significant positive relation between average initial returns and subsequent IPO volumes. They concluded with the result, which showed that the dynamic behavior of initial returns and IPO issued is a complicated function of many factors. There are significant biases in IPO offer prices and rises form 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 drive by information learned during 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 & Schultz (2005), examined syndicates for IPO’s form January 1997 through June 2002. Country 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 filing period. As a proxy for information, they used the total return from the midpoint of the filing price range to the closing price of the the first day of trading .For the purpose, they collected an initial sample of 2146 IPO's

Issued from the Security Data Company's (SDC) Global new issues Database found strong evidence of information production by syndicates 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 filing price in respond to information. For large IPO's, they found underwritten who can provide coverage by top-ranked analyst are more likely to be included in the syndicate. Similarly, even though the issues benefits from increasing the numbers of syndicate members and especially the number of co-manager who underwrite their IPO, syndicate size is very much dependent upon the preference of book manager rather than issue. Finally, they concluded that although the IPO proceeds increase from 1997-2002, syndicates grew smaller.

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

decision to choose a placing rather than an offer or vice-versa is taken by the firm within the framework of rational behavior.

**Baru and Fawcett (2008)**, performed a study on, “Initial Public Offerings; An Analysis of Theory and Practice.” The study intended to extend the IPO literature by analyzing unique data from surveys of Chief Financial Officers (CFO’s) to compare CFO perspectives to prevailing academic theory. Specifically, they examined the following seven issues; motivations for going public, timing of the IPO’s, underwriter selection under-pricing, signaling IPO process issues and the decision to stay private. In this regard, they surveyed three sub samples of firms, namely those that successfully completed an IPO, those that began the process but chose to withdraw the issue and those that are large enough to go public, but have not attempted an IPO. They surveyed 330 CFO’s and their survey process followed Dill Man’s (1978) total design method, which is a standard for conducting academic surveys. Their findings are summarized as:

The most important motivation for going public is to create public shares for use in future acquisitions. Insiders are opportunistic especially at VC-backed firms. They seek to go public at a time that portends a high stock price. The underwriter selection process is driven by a very small set of selection criteria namely underwriter reputation and IPO process expertise. CFO attributes most underpricing to market uncertainty and the need to reward investors for taking the risk of IPO. The most important positive signal is past historical earnings, this may promote window dressing. CFO’s strongly prefer firm – commitment underwriting. Companies remain private to preserve decision-making control ownership.

McGuiness, Paul B. (2009), this paper help to bring into focus a highly topical issue within the context of the Chinese equity market. The various provisions surrounding the eventual metamorphosis of non-tradable stock into an unfettered tradable form are clearly significant and numerous, and include the various lock-up arrangements imposed on controlling shareholders, the compensation plans for existing tradable A-share investors, the mobilization of voting rights of tradable A-share investors in relation to the support of reform proposals, the recent CSRC- initiative in including block-sale restrictions and

finally, measures to increase transparency surrounding the sales of recently converted shares.

For certain issues, a discernible risk premium has been building in the last year as particular parts of the moratoria imposed on controlling stakes have either lapsed or are set to do so in the very near future. While this raised the specter of large-scale-state-share disposal, the amount of activity in this area is likely to be heavily constrained through state intervention. Even where some level of ascent is granted, block-sales restrictions serve to limit or, at least, slow the scale of disposals, instead, the “split share structure” reform can be largely seen as one intended to simplify and streamline the old share configuration of the PRC-incorporated SOE.

Nonetheless, some significant disposals activities will inevitably occur. Prior related evidence in Chen et al.(2008) for transfers of controlling non-tradable stakes in SEO listed issuers between 1996 and 2000, points to positive earnings and stock price effect when domestic controlling stakes are acquired by private investors. While disposals (or transfers) through the form programme will be carefully scrutinized, the results in Chen et al. offer some comfort for existing tradable A-share investors. On a less positive note, Chen et al. (2008) found that earnings and stock price gains were generally not apparent for sales of parcels of stock between state-related parties.

While the reform is highly significant in terms of its remit, extending to over 1,500 A-listed issuers, it does nothing to streamline the various share types (A-B and H-) that currently exist. Even though the majority of listed issuers only have a single A-share listing the largest and perhaps most important of SOEs have concurrent A-(shanghai) and H-(Hong Kong) listing. Pricing differences between the two sets of stocks, largely as a result of trading restrictions that are brought-on by capital account restrictions relevant to mainland China, suggest that an attempt to merge the two stock types is some way off. The likelihood that China will retain significant capital account restrictions would suggest that the A- and H-markets will continue to serve separate sets of investors. As for the B-shares, rumors circulated from time to time as to possible further reform of the market. In a practical sense, the small number of issuers and the relatively small float and

market capitalization size of the B- market, mean that the authorities may continue to resist enlarging the market, and therefore extend the effective moratoria on B-share IPOS into perpetuity. With more and more listing wending their way through to the shanghai and Shenzhen A-share markets in coming years, the B-share market will likely be further marginalized in terms of its contribution to total listing number and overall market volumes.

### **2.2.2 Review of Master's Thesis**

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

**Shrestha (1996)**, has conducted a research study on, “Public Response to Primary issue of Share in Nepal”. The main objective of the study was to evaluate the primary market of shares, analyze the pattern of public response to the shares and to identify the problems of primary market in Nepal. He has used both primary and secondary data from 12 selected companies for the period of 3 years, from January 1993 to January 1996. He has employed simple average, chi-square test and coefficient for deduction.

The study conclude that public response to the issue of shares of banks, finance and insurance companies were better than that of manufacturing and processing, trading, hotel and other groups of companies. The success of response to the public issues largely depends on the response from within Kathmandu valley and to some extent, the issues of shares seem to attract from outside the valley.

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

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

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

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

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

### **2.3 Research Gap**

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

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



## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The Research Methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. It is necessary for the researcher to know not only the research method but also the methodology. When we talk about the research methodology, we not only talk about the research methods but also consider the logic behind the methods we use in the context of our research study and explain why we are using a particular method or technique and explain, why we are not using others so that research results are capable of being evaluated either by researcher himself or by others. The study of research methodology gives the student the necessary training in gathering materials and arranging them, particularly in field work required and techniques for collection of data appropriate to particular problems, in the use of statistics, questionnaires and recoding evidence, sorting it out and interpreting it.

The researcher for gaining the knowledge about method of goal achievement, when we desired, is known as research methodology. Research methodology is the way to solve systematically about the research problem.

This chapter incorporates research design, sources of data and study limitation.

#### **3.2 Research Design**

The research design is the conceptual structure within which research is conducted. It constitutes the blue print for the collection, measurement and analysis of data. As such the design includes an outline of what the researcher will do from writing the hypothesis and its operational implications to the final analysis of data. Research design is needed because it facilitates the smooth sailing of the various research operations, thereby making research as efficient as possible yielding maximal information with minimal expenditure of effort, time and money.

Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research question and to control variance (Kerlinger, 1980: 275). The plan is overall scheme or program of the research. A research design expresses both the structure of the research design problem and plan of investigation used to obtain evidence or relations of the problems.

To conduct this study there are two type of approach has been adopted, descriptive and analytical. Descriptive approach has been utilized mainly for conceptualization of problem. Analytical approach is used to find out the result employing financial as well as statistical tools. So, the present study emphasis on descriptive and analytical research.

### **3.3 Population and Sample**

Number of companies listed in Nepal Stock Exchange (NEPSE) by the end of FY 2008/09 has reached 159 and these companies are divided into eight sectors which include commercial banks, development banks, finance companies, trading companies, hotels and others (SEBON, Annual Report 2008/09, 6). However, the study is focused on only those companies which have gone for IPO during the period of FY 1993/94 to 2008/09. To find out the public response to the Initial Public Offering, this study has divided in to two sectors as Financial Institutions and Insurance Sector and Non Financial Sector. Due to unavailability of reliable data this study has completed upon the base of selected sample from each sectors. The sample have selected at random from each sector. Seven companies selected from each sector from financial institutions and insurance sectors where 5 from manufacturing, 2 from trading companies, 2 from hotels and one from others. The population and selected samples are shown in below.

**Table 3.1**

**Population and Sample for Study**

<b>S.N.</b>	<b>Institutions</b>	<b>Population</b>	<b>Sample Size</b>
<b>Financial Institutions and Insurance Sectors</b>			
<b>1</b>	Commercial Banks	<b>21</b>	<b>6</b>
<b>2</b>	Development Banks	<b>29</b>	<b>6</b>
<b>3</b>	Finance Companies	<b>61</b>	<b>10</b>
<b>4</b>	Insurance Companies	<b>17</b>	<b>6</b>
<b>5</b>	Manufacturing	<b>18</b>	<b>5</b>
<b>6</b>	Trading Companies	<b>4</b>	<b>1</b>
<b>7</b>	Hotels	<b>4</b>	<b>1</b>
<b>8</b>	Others	<b>5</b>	<b>2</b>
<b>Total</b>		<b>159</b>	<b>37</b>

**3.4 Sources of Data**

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

**3.5 Data Presentation and Analysis**

For the sake of effectiveness, the data collected from various sources have been presented in the form of table, chart and bar graph as per the need of the study. The result obtained

from the analysis has been clearly interpreted so as to depict the exact finding of the study. Analysis is the careful study of available facts so that one can understand and draw conclusion from them on the basis of established principles and sound logic. The empirical results have been extracted in this study by using annual data of listed companies from 1993/94 to 2008/09.

### **3.6 Tools for Analysis**

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

#### **3.6.1 Statistical Tools**

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

##### **3.6.1.1 Multiple Bar-diagrams and graphs**

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

##### **3.6.1.2 Pie-diagram**

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

### 3.6.1.3 Percentage Analysis

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

### 3.6.1.4 Simple Arithmetic Mean

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

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

### 3.6.1.5 T- Test

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

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

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

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

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

$\bar{x}_2$  = Mean of second Sample

$S_p^2$  = an unbiased estimate of the common variance and its value is computed

$n_1$  = Number of first sample

$n_2$  = Number of second sample

## **CHAPTER FOUR**

### **DATA ORESENTATION AND ANALYSIS**

#### **INTRODUCTION**

This chapter includes presentation of data to reach at a conclusion the primary data are used to analyze the public awareness, response, expectation, choice for investment etc. The secondary data are used to analyze the public response to the initial public offering per year and sector wise along with under subscription and oversubscription, growth of public offering and the behavior of general investors. The collected data are tested though suitable statistical tools. Collected data have been analyzed as in percentage, simple average, and correlation coefficient of two variables. The purpose of the analyses is to achieve the objectives set in the chapter one.

#### **4.1 Secondary Data Analysis**

##### **4.1.1 Amount of issue Approved**

The securities Exchange Act, 2063 has been made mandatory that the issuing company should register the securities in Security Boards of Nepal (SEBON) and get approval before going to public. For registration the company must submit its memorandum and prospectus with other securities related documents within prescribed format. After registering the securities the company must inform about any allotment or sale within seven days of allotment or sale. If the company is going to sell securities to more than 50 persons at a once, it must publish this information for public purpose. The provisions regarding application period price and allotment are as per specification made by SEBON. The issuing company must publish its prospectus after approval of SEBON at any easily assessable media for public purpose. The prospectus should consist of general information of company, capital, its product and services, legal provisions, economic condition of issuing authority, management, and information regarding its promoters. From the fiscal year 1993 to 2010/11 has approved 432 issues of securities amounting to Rs.56966.34 million. The detail situation of issue approved in different year is presented in the table and figure.

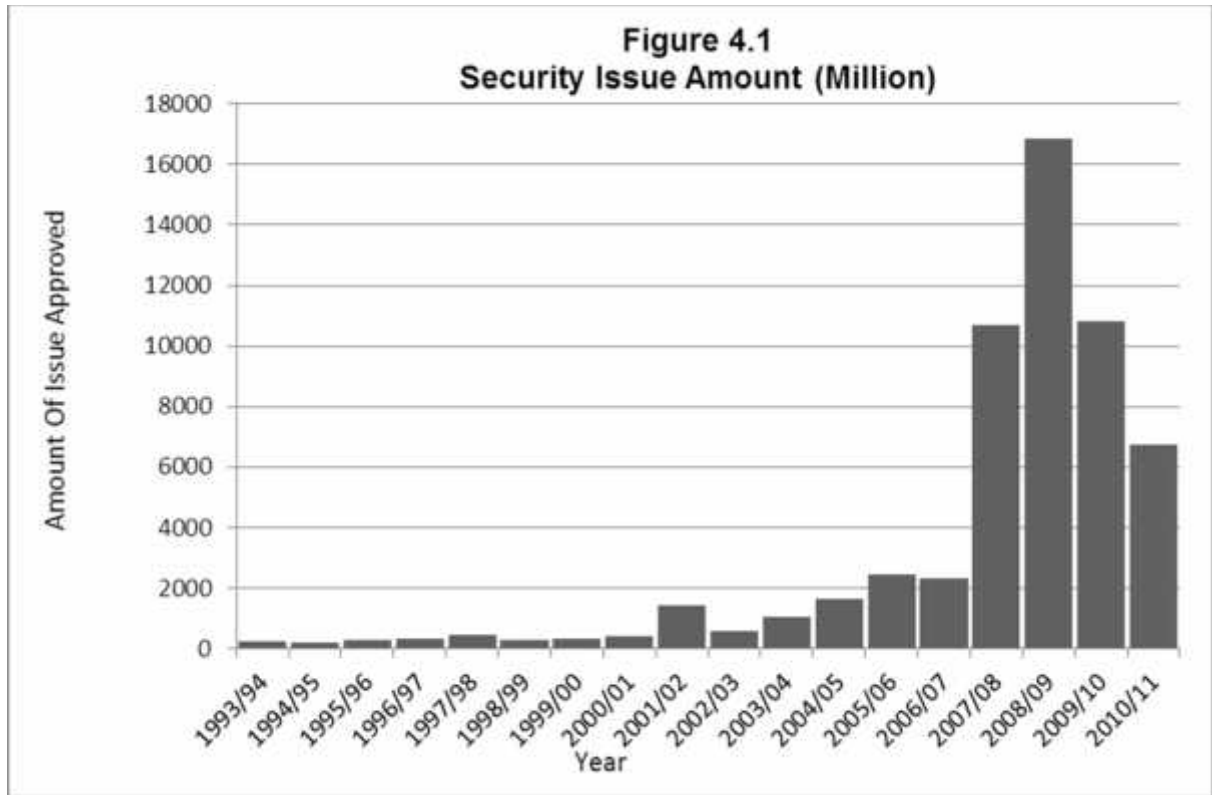




**Table: 4.1****Amount of issue approved**

Year	Approved ( Rs. In Million)	% of Issue Approved
1993\94	244.40	0.42
1994\95	173.96	0.31
1995\96	293.74	0.52
1996\97	332.20	0.58
1997\98	462.36	0.81
1998\99	258.00	0.45
1999\00	326.86	0.57
2000\01	410.49	0.72
2001\02	1441.33	2.50
2002\03	556.54	0.98
2003\04	1027.50	1.80
2004\05	1626.82	2.85
2005\06	2443.28	4.28
2006\07	2295.50	4.00
2007\08	10668.20	18.70
2008\09	16828.51	29.50
2009\10	10822.41	20.00
2010\11	6754.03	11.85
Total	56966.34	100.00

Sources: SEBON Annual Report



The table 4.1 and figure 4.1 shows that securities issue amount approved by SEBSON very during the period. The highest amount of issue approved was Rs.16828.51 million infiscalyear 2008\2009, which is 29.50 percentage of total issue till date. This is mainly because of IPOs and right issues made by financial sector. They have been issuing shares to fulfill capital requirement obligation enforced by central bank.

During last five years approved amount are in growing tends despite is fiscal year 2006\07, which indicates that companies are now interested in public offering of securities and right issues. Before the year 2001\02 issue amount is quite consistent and hovering around 150 million to 400 million. During this period Nepalese capital market was not so popular among investors. Only few investors of Kathmandu valley were trading. But, after 2002\03 more and more people entered in market. Specially, people who have been hard hit by Maoist people’s war found capital market as a good shelter for their



#### **4.1.2 Number of Issue Approved**

The number of issue approved is the total number of issue approved by the security Board of Nepal. Before issuing securities, the issuing company must make approval form Security Boards of Nepal (SEBON). For issue approval and registration, the company must submit required information within prescribed, format otherwise SEBON may reject it. After registration and issue approval, the company must open issue within three month of issue approval. In case if the issue couldn't be made, then after another date should be fixed consulting with SEBSON. The advertisement for application should consist all actual and real information. The advertisement should be able to identify application collection center and its duration.

The number of issue approved during the period of 1993\94 to 2010\11 various differently which is presented in the following table and figure.

Table: 4.2

## Number of issue approved

Year	Number of issue Approval	% of Issue Approval
1993\04	16	3.70
1994\05	10	2.30
1995\06	12	2.80
1996\07	5	1.16
1997\08	12	2.80
1998\09	5	1.16
1999\00	6	1.39
2000\01	9	2.08
2001\02	12	2.80
2002\03	18	4.17
2003\04	14	3.24
2004\05	14	3.24
2005\06	29	6.70
2006\07	34	7.86
2007\08	64	14.80
2008\09	64	14.80
2009\10	61	14.10
2010\11	47	10.89

Total	432	100.00
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Source: SEBON Annual Report

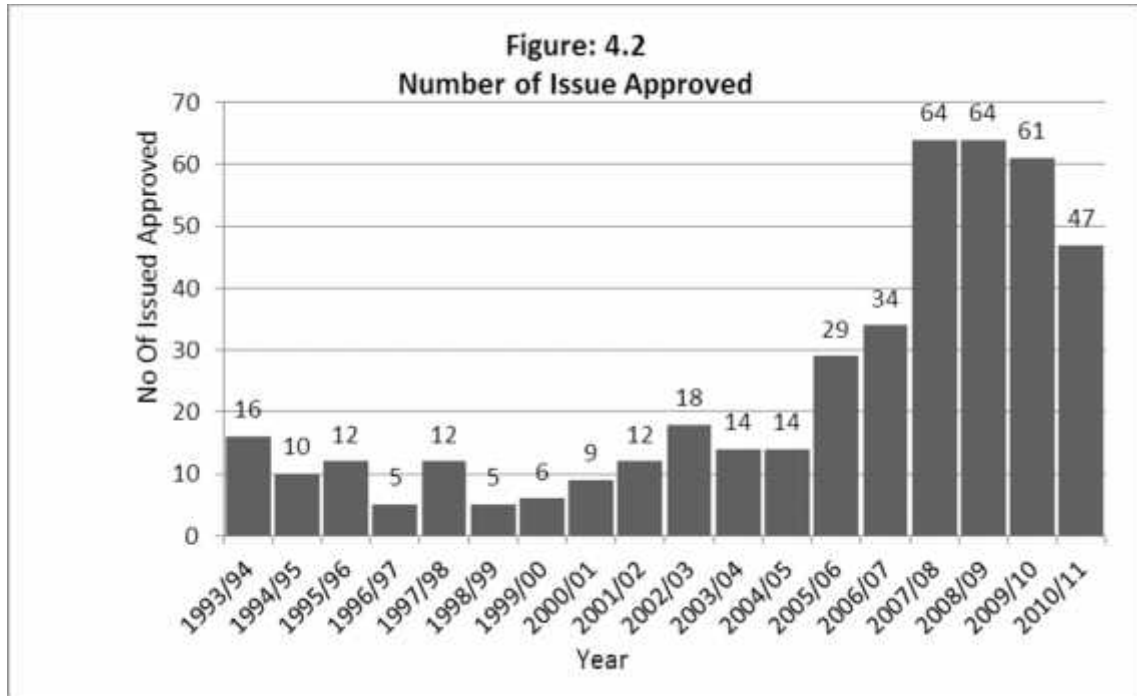


Table 4.2 and figure 4.2 depict number of issue approved. The numbers of issue approved were 16 in fiscal year 1993\94 but at the end of fiscal year 2010\11 the total number of approved issue was reached to the point of 432 issues. The highest number of issue approved is 64 that is equal to previous year’s figure. Over the five years period number of issues has increased significantly. This is because of establishment of new financial institution. Before the fiscal year 2003\04 numbers of issues are varying inconsistently.

#### **4.1.3 Right offering since 1993\94 to 2010/11**

The numbers of right offering during the period of 1993\94 to2010\11 various differently which is presented in the table below.

Table 4.3

## Right offering

Year	Number of issueApproved	Issue Approved (Rs.in Million)	% Approved	Total
1993/94	-	-	-	
1994/95	-	-	-	
1995/96	2	69	0.19	
1996/97	3	275.20	0.75	
1997/98	3	249.96	0.69	
1998/99	1	30	0.08	
1999/00	3	124.60	0.34	
2000/01	3	365.79	0.99	
2001/02	5	621.87	1.69	
2002/03	4	162.24	0.44	
2003/04	3	70	0.19	
2004/05	6	949.34	2.58	
2005/06	11	1013.45	2.73	
2006/07	17	1265.30	3.44	
2007/08	42	6087.10	16.54	
2008/09	49	9482.20	25.76	
2009/10	35	10962.75	29.79	
2010/11	31	5075.20	13.79	
Total	218	36804	100.00	

Source: SEBON Annual Report

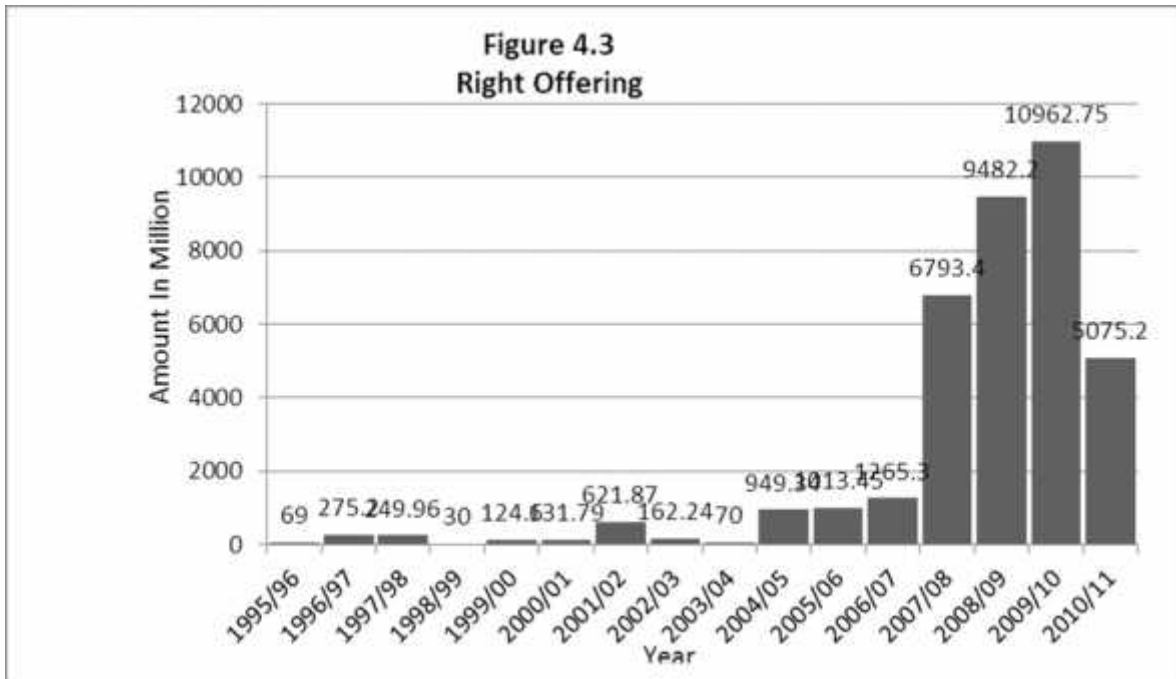


Table 4.3 and figure 4.3 shows that right offering of different companies during 1993/94 to 2010/11. In the 1993/94 and 1994/95 there were no any right offering. In the fiscal year 2010/11, 31 companies comprising 5 commercial banks, 11 development banks, 14 financial companies, and 1 insurance company listed their right share amounting to Rs.5075.20 million in NEPSE. In the fiscal year 1998/99 the lowest right offering (i.e. 30 million) was offered. In other periods the issued amount is moderate or fluctuating.

#### 4.1.4 Under and Over Subscription of Securities

At the time of issue the demand for securities may be greater or lesser than the issuing amount. When the demand of issuing of securities is higher than issued securities, the situation is called the case of oversubscription but if the demand of securities is lower than issued securities that situation is called under subscription of securities. Below table



4.4 shows the oversubscription & under subscription of different companies forms year 1993/94 to 2010/11, while issuing their ordinary share to general public.

Table 4.4

## Under and over subscription of Securities

Year	No. Of Issue Co.	Over Subscribed Co.		Under Subscribed Co.		Constant Co.	
		No.	Percentage	No.	Percentage	No.	Percentage
1993/94	14	14	100	0	0	0	0
1994/95	10	8	80	0	0	2	20
1995/96	10	5	50	5	50	0	0
1996/97	2	2	100	0	0	0	0
1997/98	8	6	75	1	12.5	1	12.5
1998/99	3	3	100	0	0	0	0
1999/00	3	3	100	0	0	0	0
2000/01	7	7	100	0	0	0	0
2001/02	5	4	80	1	20	0	0
2002/03	14	14	100	0	0	0	0
2003/04	10	10	100	0	0	0	0
2004/05	7	6	85.71	1	14.29	0	0
2005/06	14	14	100	0	0	0	0
2006/07	15	15	100	0	0	0	0
2007/08	16	16	100	0	0	0	0
2008/09	12	12	100	0	0	0	0
2009/10	28	28	100	0	0	0	0
2010/11	15	15	100	0	0	0	0

Total	193	182	92.67	8	5.33	3	2
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Source: SEBON Annual Report

Table 4.4 show that during the period of Fiscal Year 1993/94 to 2010/11 out the total listed companies only 150 companies issued their common stock for public and among them 193 companies (92.67%) have been oversubscribed and 8 companies (5.33%) have been undersubscribed and remaining 3 companies (2.00%) issue have been fully subscribed. Furthermore, those companies who issue shares to public in fiscal year 1994/95, 1995/96, 1997/98, 2001/02, 2004/05 were under subscribed. In these years issues of both financial and non-financial sectors were undersubscribed due to different reasons i.e. lack of information, limited number of investors etc. Similarly, all those companies who issued their common stock in Fiscal Year 1993/94, 1996/97, 1998/99, 1999/00, 2000/01, 2002/03, 2003/04, 2005/06, 2006/07, 2007/08, and 2008/09.2009/10,2010/11 have been oversubscribed.

subscribed. Furthermore, those companies who issued shares to public in fiscal year 1994/95, 1995/96, 1997/98, 2004/05 were under subscribed. In these years issues of both financial and non-financial sectors were undersubscribed due to different response i.e. lack of information, limited number of investors etc. Similarly, all those companies who issued their common stock in Fiscal Year 1993/94, 1994/95, 1995/96, 1996/97, 1997/98, 1998/99, 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 have been oversubscribed.

#### **4.1.5 Yearly Analysis of Securities**

The year wise analysis of different securities issued from the fiscal year 1993/94 to the fiscal year 2010/11 is shown in the following Table 4.5

**Table 4.5****Yearly Analysis of Securities**

Year	Ordinary Shares		Right Shares		Preference Shares		Debentures	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
1993/94	14	227.9	-	-	2	16.5	-	-
1994/95	10	173.93	-	-	-	-	-	-
1995/96	10	224.74	2	69	-	-	-	-
1996/97	2	57	3	275.2	-	-	-	-
1997/98	8	119.4	3	249.96	-	-	1	93
1998/99	3	148	1	30	1	80	-	-
1999/00	3	202.26	3	124.6	-	-	-	-
2000/01	7	278.7	3	365.79	-	-	-	-
2001/02	5	319.46	5	621.87	1	140	1	360
2002/03	14	394.3	4	162.24	-	-	-	-
2003/04	10	657.5	3	70	-	-	1	300
2004/05	7	377.48	6	949.34	-	-	1	300
2005/06	14	579.83	11	1013.45	-	-	4	850
2006/07	15	380.3	17	1265.3	1	400	1	250
2007/08	16	924.3	43	6087.10	-	-	5	2950
2008/09	12	1515.7	49	9482.2	-	-	2	750
2009/10	28	2649.37	35	10962.75	-	-	1	227.70

2010/11	15	1728.83	31	5075.20	-	-	1	50
Total	193	10959	217	36804	5	636.50	18	6130.70

**SEBON Annual Report**

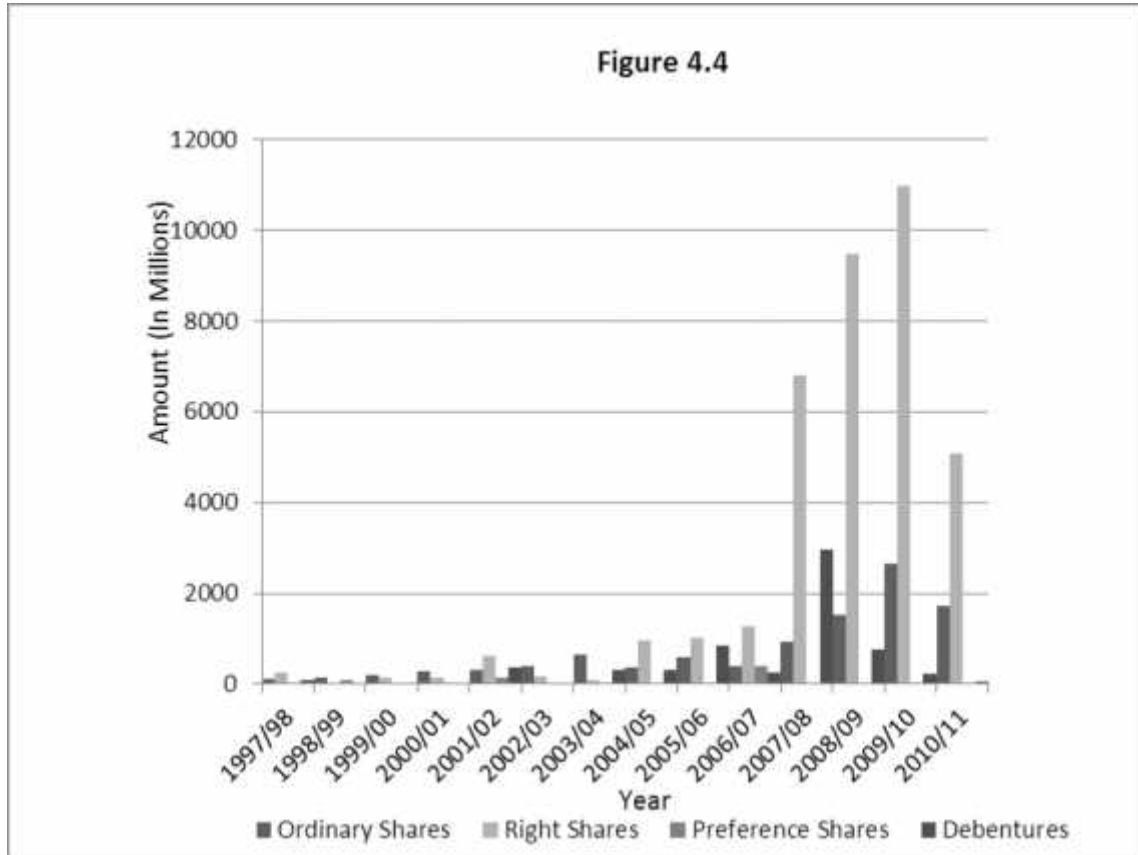


Table 4.5 and 4.4 show year wise analysis of different securities with their number and amount since 1993/94 to 2007/08. In fiscal year 1993/94 out of 16 different issues, 14 issues were ordinary shares of total amount of Rs.227.90 and 2 issues were preference shares of total amount of Rs.16.50 million. In the fiscal year 1994/95 out of 10 different issues, all 10 issues were ordinary shares total amount of Rs.173.96 million. In the fiscal year 1995/96 out of different 12 issues, 10 issues were ordinary shares of the total amount of Rs.224.74 and 2 issues were right shares of total amount of Rs.69 million. In the fiscal year 1996/97 out of different 5 issues, 2 issues were ordinary shares of the total amount of Rs.57 million and 3 issues were right shares of the total amount of Rs.275.20 million.

In the fiscal 1997/98 out of different 12 issues, 8 issues were ordinary shares of the total amount of Rs.119.4 million, 3 issues were right shares of the total amount of Rs.249.96 million and 1 issue was debenture of the total amount of Rs.93 million. In the fiscal year 1998/99 out of different 5 issues, 3 issues were ordinary shares of the total amount of Rs.148 million, 1 issue was preference shares of the amount of Rs.80 million and 1 issue was right shares of the amount of Rs.30 million, in the fiscal year 1999/2000 out of different 6 issues, 3 issues were ordinary shares of total amount of Rs.202.26 million and 3 issues were right shares of Rs.124.6 million. Similarly in fiscal year 2000/01 out of 9 issues, 7 issues were ordinary shares of Rs.278.7 million and 2 issues were right shares of Rs.131.79 million. In the fiscal year 2001/02 out of 12 issues, 5 issues were ordinary shares, 1 issue was preference shares, 5 issues were right shares, and 1 issue has issued debenture of Rs.319.46 million, Rs.621.87 million, Rs.140 million Rs.360 million respectively. Likewise, in the fiscal year 2002/03 out of 18 issues, 14 issues were ordinary shares of Rs.394.3 million and 4 issues have issued right shares of Rs.162.24 million. In fiscal year 2003/04 out of 14 issues, 10 issues were ordinary shares 3 issues were right shares and 1 issue was debenture of Rs.657.5 million, Rs.70 million, and Rs.300million respectively. In the fiscal year 2004/05 out of 14 issues, 7 issues were ordinary shares of Rs.377.48 million, 6 issues were right shares of Rs.949.34 million and 1 issue was debenture of Rs.300 million. In fiscal year 2005/06 out of 29 issues, 14 issues were ordinary shares, 11 issues were right shares and 4 issues were debenture of Rs.579.89 million, Rs.1013.45 million and Rs.850 million respectively. In the fiscal year 2006/07 out of 34 issues, 15 issues were ordinary shares, 17 were right shares, 1 was preference share, and another 1 was debenture of Rs.380.3 million, Rs.1265.3 million, Rs.400 million, and 250 million respectively. In fiscal the year 2007/08, out of 64 issues 16 were ordinary shares of Rs.924.8 million, 43 issues were right shares of Rs.6793.4 million and 5 issues debenture of Rs.2950 million. In fiscal the year 2008/09, out of 64 issues 12 were ordinary shares of Rs.1515.7 million, 49 issues were right shares of Rs.9482.2 million and 2 issues debenture of 750 million. In fiscal year 2009/10, out of 61 issues 28 were ordinary shares of Rs.2649.37 million, 35 issues were right shares of Rs.10962.75 million and 1 debenture issue of 227.70 million. In fiscal year 2010/11 out of

47 issues 15 were ordinary shares of Rs.1728.83 million, 31 issues were right shares of Rs.5075.20 and 1 debenture issue of 50 million.

## **4.2 Public Response to Initial Public Offering**

The total listed companies are divided into eight sectors by Nepal Stock Exchange Limited. Which are Commercial Banks, Finance Companies, Development Banks, Insurance Companies, Manufacturing and Processing Companies, Trading Companies, Hotels and Others sector. Investors have to decide in which sector they want to made Investment. As per objective, this study only concerned with the investors priority and response for the initial public offering.

### **4.2.1 Public Response to Financial sector**

Financial sector includes commercial banks, development banks, finance companies, insurance companies. Responses to the financial sector are presented below.

#### **4.2.1.1 Public Response to Commercial Banks**

According to the NEPSE Annual Report 2010/10, there are 2 commercial banks which are listed in the Stock Exchange. All of these had issued their share to public. Nepal Arab Bank Limited (NABL) is the first commercial bank to issue share to public. Public issues of commercial bank are highly appreciated by public. Investors give high priority and response to the public issue. From the population of total of 21 only 7 are taken as sample.



Table4.6

## Public Response to Commercial Banks

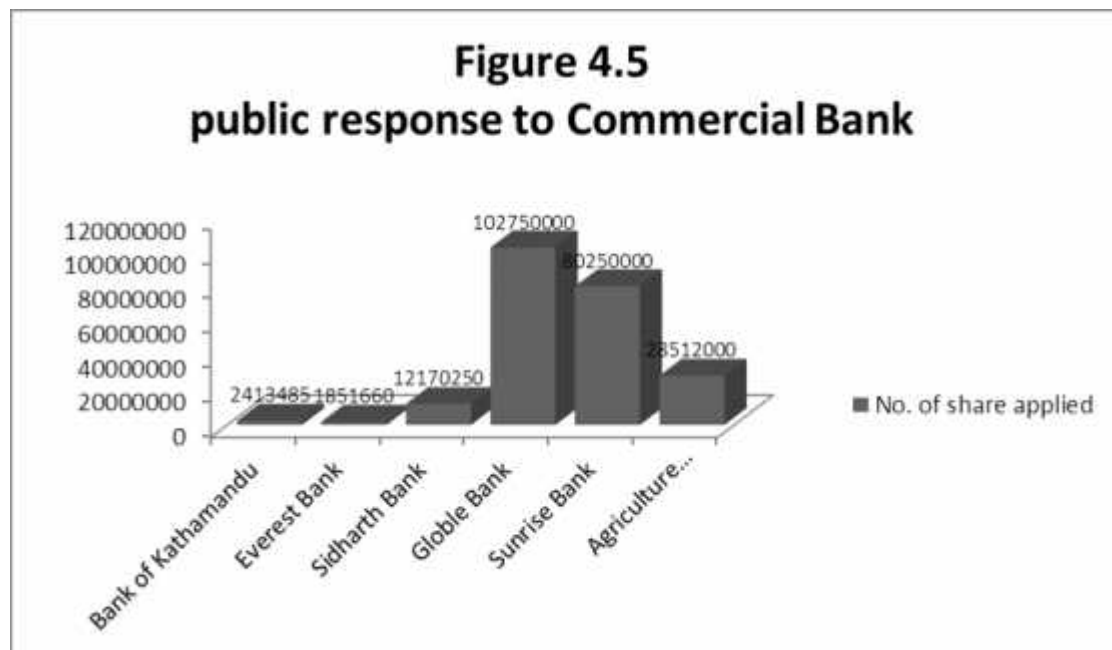
S. N.	Name of companies	Issued year	No. of shares	No. of share applied	Sub. times	Results
1	Bank of kathmandu	1996	4500000	2413485	5.36	Over Subscribed
2	Everest Bank	1995	360000	1851660	5.14	Over Subscribed
3	Kumari Bank	2003	1500000	12170250	8.11	Over Subscribed
4	Siddharth Bank	2005	1500000	27979950	18.65	Over Subscribed
5	Global Bank	2008	3000000	102750000	34.25	Over subscribed
6	Sunrise Bank	2009	3000000	80250000	26.75	Over subscribed
7	Agriculture development bank	2010	9600000	28512000	2.97	Over subscribed

The above table 4.6 shows the information of seven different commercial banks with their number of shares issued and oversubscribed in times by the general public to the company. The public response to these companies is also shown.

Bank of Kathmandu Limited had issued 450,000 units share to the public. The investors applied for 2,413,485 units share. Subscription was approximately 5.36 times. This shows

the medium response of the investors to the company. Similarly, Everest Bank issued 360,000 units share to the public. Public applied for 1,851,660 units share. Subscription was approximately 5.14 times. Public response to this bank was also medium. Like the way Siddhartha Bank and Kumari Bank both issued 15,00,000 units of shares. The investor applied for 27,979,950 units and 12,170,250 units for Siddhartha Bank and Kumari Bank respectively. Subscription was approximately 18.65 times and 8.11 times for Siddhartha Bank and Kumari Bank respectively. Similarly, Global Bank Limited issued 3,000,000 units shares for public. The applied units were 102,750,000 which very above the issue size. Subscription was about 34.25 times. Moreover, Sunrise Bank Limited issued 3,000,000 units shares for public. The applied units were 80250000 which are very above the issue size. Subscription was about 26.75 times. The Agriculture development bank issued 96,00,000 units shares for public and no. of applied shares were 2,85,12,000. Public response to this company can be considered to be very high.

Table 4.6 also shows that investors are more interested to purchase the shares of commercial banks. Banking sectors of Nepal seems to be more successful to attract the investors. The above information is also shown in the figure 4.5.



#### 4.2.1.2 Public Response to Development Banks

To analyze the public response to development banks, seven companies are chosen as sample, which are shown in the following table below.

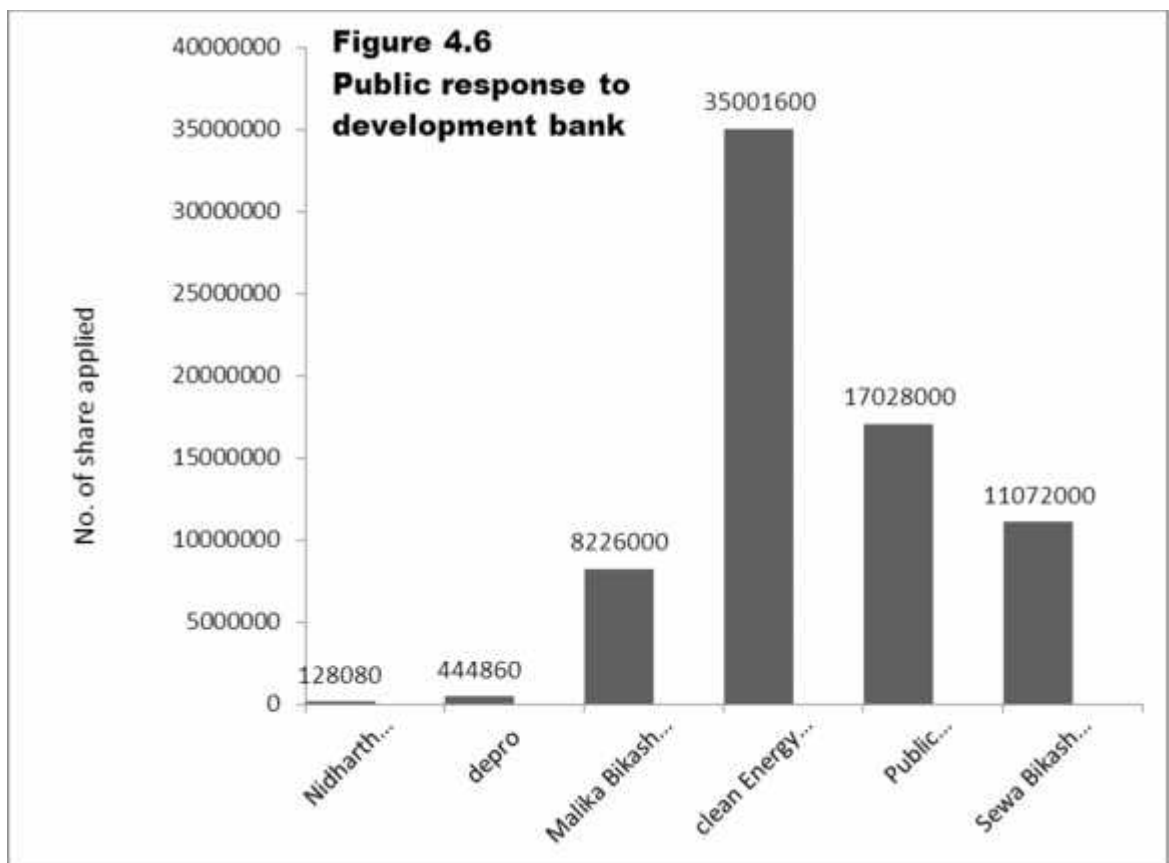
Table 4.7

Public Response to Development Banks

S. N.	Name of companies	Issued Year	No. of share	No. of share applied	Sub. times	Result
1	NirdhanUtthan Bank	2003	33000	128080	3.88	Over Subscribed
2	DeproxDevelopment Bank	2005	34800	90250	2.59	Over Subscribed
3	Siddhartha Bikash Bank	2006	200000	444860	2.22	Over Subscribed
4	MalikaBikash Bank	2007	150000	8226000	54.84	Over Subscribed
5	Clean Energy Development Bank	2008	960000	35001600	36.46	Over Subscribed
6	Public Development Bank	2009	600000	17028000	28.38	Over subscribed
7	SewaBikash Bank Ltd.	2010	400000	11072000	27.68	Over subscribed

Sources: Annual Report of SEBON

All the public issue of development banks we found over subscription all time. That means public are also interested in development banks shares. Among them NirdhanUtthan Bank had issued 33,000 units share to the public. The investors applied for 128,080 shares. Subscription was 3.8812 times. This shows the response of the investors to be company was medium. Same way Siddhartha Bikash Bank issued 200,000 units of share but the demand was approximately 36.46 times more. This is public applied for 3,500,160 units of shares. And in 2009 Public Development Bank issued 6,00,000 shares to general people, but the people applied for 1,70,28,000 shares which is 28.38 times greater than offered. Similarly, SewaBikash Bank Ltd. Issued 400,000 units of shares but the demand was 27.68 times and public applied was 11,07,20,00. These all show that the interested of the people in investing securities are favorable.



#### 4.2.1.3 Public Response to Finance companies

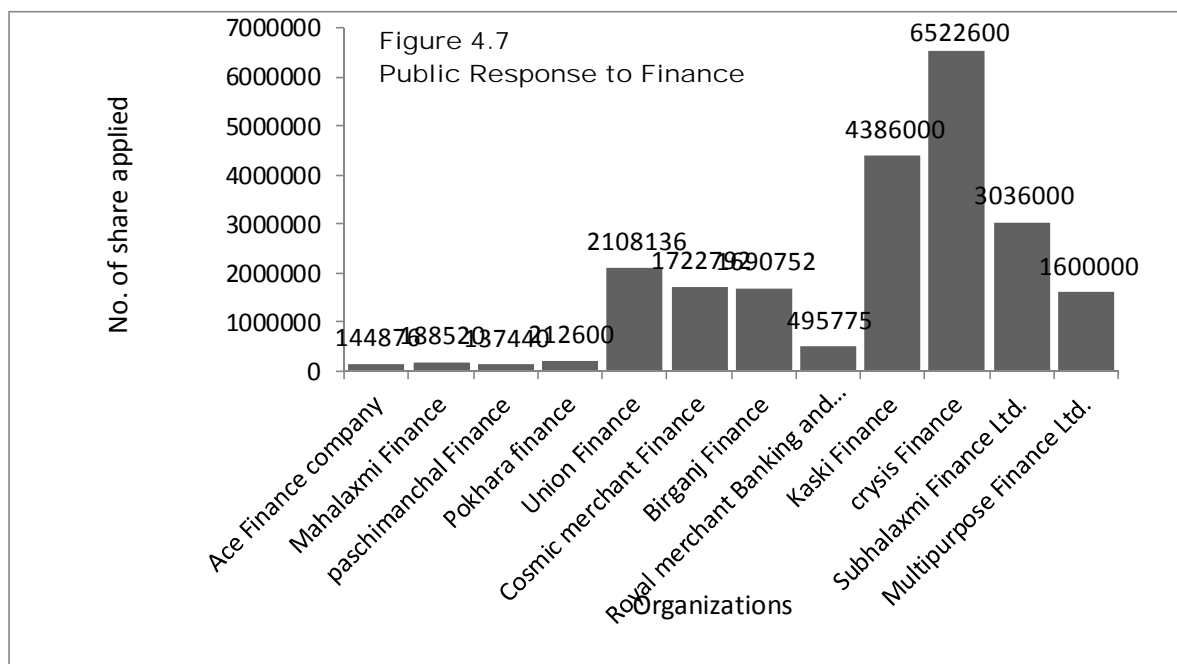
According to the Annual Report 2011, there are 70 finance companies which had issued share to the public and listed in the Nepal Stock Exchange Limited. Almost of these companies received good response from general public. Among 70 finance companies 12 are taken for public response.

Table 4.8

## Public Response to Finance Companies

S. N	Name of companies	Issued year	No. of Shares	No. of Shareapplied	Sub. times	Results
1	Ace finance company	1996	120000	144876	1.2073	Over subscribed
2	Mahalaxmi Finance	1998	100000	188520	1.8852	Over subscribed
3	Paschimanchal Finance	1998	80000	137440	1.718	Over subscribed
4	Pokhara Finance	1999	80000	212600	2.6575	Over subscribed
5	Union Finance	2002	240000	2108136	8.7839	Over subscribed
6	CosmicMerchant Banking and Finance	2003	240000	1722792	7.1783	Over subscribed
7	Birganj Finance	2004	240000	1690752	7.0448	Over subscribed
8	RoyaMerchant Banking Finance	2006	175000	495775	2.833	Over subscribed
9	Kaski Finance	2008	200000	4386000	21.93	Over subscribed
10	Crystal Finance	2009	210000	6522600	31.06	Over subscribed
11	SubhalaxmiFinance	2010	600000	3036000	5.06	Over

	Ltd.					subscribed
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12	Multipurpose Finance Ltd.	2011	100000	1600000	16	Over subscribed
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Source: Annual Report of SEBON

The above Table 4.8 and Bar Figure 4.7 shows the status of IPO of different finance company over the same period. All the IPO's presented in the Table are oversubscribed that shows the popularity of IPO made by finance companies. Among these companies three companies viz. Union Finance Company (UFC), cosmic Merchant Banking and Finance (CMBF), and Birganj Finance (BF)'s IPO are highest (240,000). These IPO's were highly oversubscribed by 8.78, 7.17, 7.05 times respectively. According to the table Crystal Finance's IPO was highly oversubscribed (31 times). Out of the 12 IPO's ACE's IPO received lowest attention from public, although it was oversubscribed by 1.21 times. Ace issued 120000 shares but received applications for 144,876 shares. Among these 12

finance company IPO, three IPO's were highly oversubscribed (31 ,16& 22 times), oversubscribed rate (more than one to 3 times). This shows that investors are more interested to purchase the shares of finance companies. Finance companies are also getting successful to attract investors.

#### **4.2.1.4 Public Response to Insurance Companies**

Out of 21 insurance companies, 7 were taken as sample, which are shown in the following table 4.9

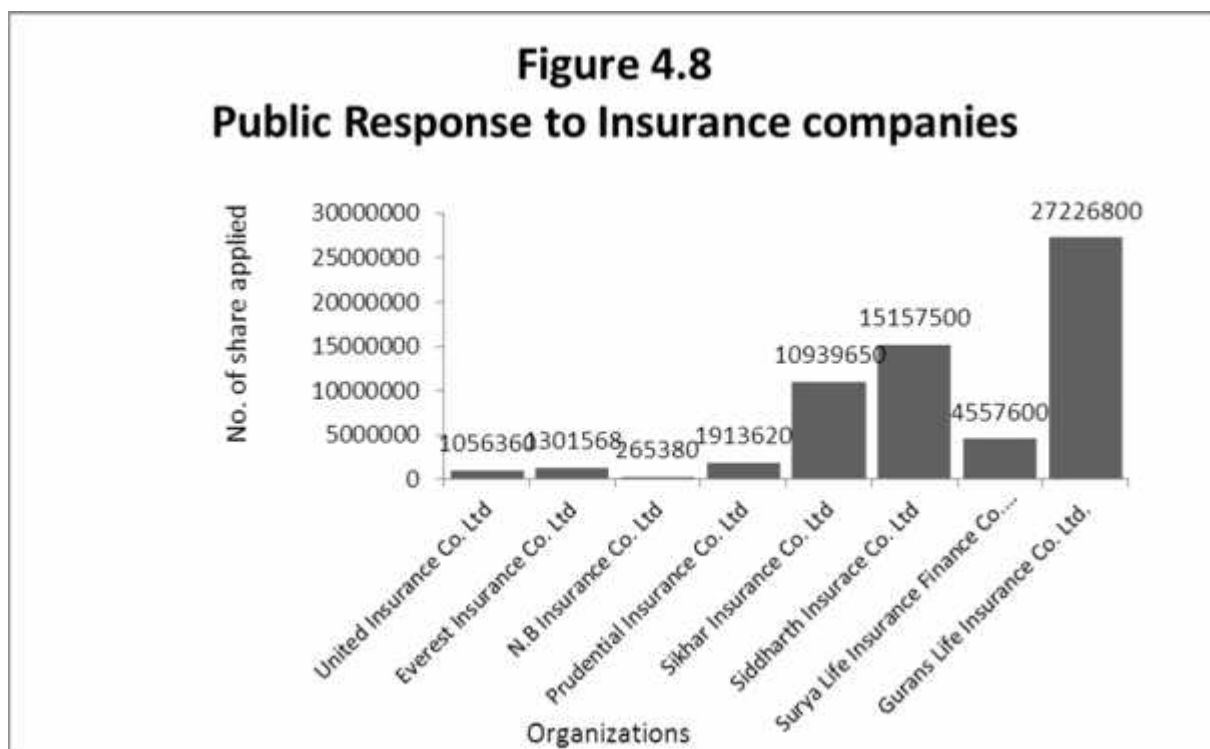


Table 4.9

## Public Response to Insurance companies

S. N.	Name of companies	Issued year	No. of shares	No. of share applied	Sub times	Results
1	United Insurance company	1994	240000	1056360	4.4015	Over subscribed
2	N.B. Insurance Co. Ltd.	2003	200000	265380	1.3269	Over subscribed
3	Prudential Insurance Co. Ltd.	2004	200000	1913620	9.5681	Over subscribed
4	Sikhar Insurance Co. Ltd.	2006	250000	10939650	43.7586	Over subscribed
5	Sidharth Insurance co. Ltd.	2007	250000	15157500	60.63	Over subscribed
6	Surya Life Insurance Co.Ltd	2010	1080000	4557600	4.22	Over subscribed
7	GuransLife Insurance Co. Ltd	2011	1080000	27226800	25.21	Over subscribed

Sources: Annual Report of SEBON



The above Table 4.9 and figure 4.8 show the public response to seven different insurance companies with issued and applied number of shares. According to the table all seven IPOs were oversubscribed. Table shows that among seven insurance companies three had medium public response (4.22, 4.4, and 9.57 times), one had low level (1.33 times) over subscription rate and three have high over subscription rate ( 25.21, 43.76 and 60.63 times). This shows that investors are more interested to purchase the shares of insurance companies. SHICL and SICL both received flood of application when they floated 250,000 shares in the year 2006 and year 2007 respectively. SHICL received applications for 10,939,650 shares which were 43.76 times of its issues. Similarly, SICL received application for 15,157,500 shares in response of 350,000; 60.63 times more than that issued shares. The main factor behind this over subscription was management and BOD of the companies and market sentiment. Well-known personalities of financial sector were involved in these companies and the stock market was in boom at that time. SICL and GICL received flood of application when they floated 10,80,000 shares in year 2010

and 2011 respectively. SICL received application for 45,57,600 shares which were 4.22 times of its issues and GICL received application for 2,72,26,800 shares which were 25.21 times of its issues. Contrary to these issues, NBICL received 265,380 shares for its 200,000 issue, just 1.33 times more than its size. Because of the promoters bad reputation in market it received few applications. And PICL received 9.57 times more applications and UICL received 4.40 times more application. UICL floated shares in 1994, at that time Nepalese security market was in its initial stage. Many people were not aware of IPO's and shares but these issues were acclaimed by investor that is because of the promoters and management team. These two issues made quite easy for PICL to raise capital through IPO.

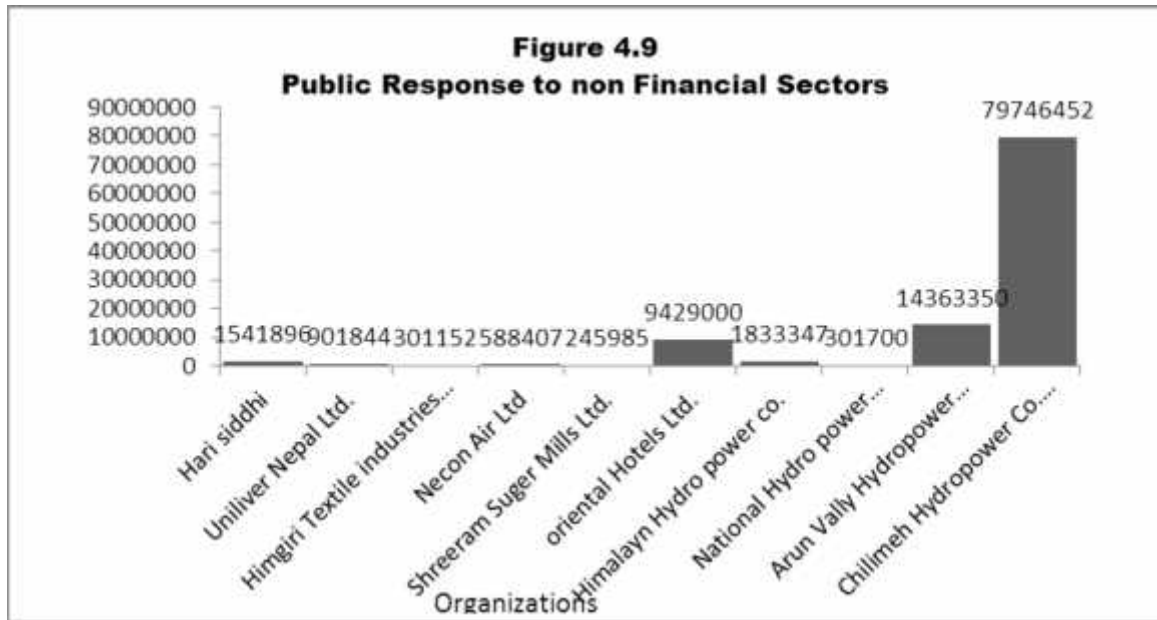
#### **4.2.2 Public Response to Non-Financial Sector**

In Nepalese context, non-financial sector does not seem to be performing well in the market in comparison to financial sector. Many such companies are not able to make profit. Some companies, like NeconAir Limited were already dissolved. Non-financial sector includes manufacturing and processing companies, trading companies, hotels and others (which also include hydropower sector). Up to the fiscal year 2010/11 end, there are 36 non-financial sector companies listed. Among them 10 are taken for research.

Table 4.10

## Public Response to Non-Financial Sectors

S. N	Name of Companies	Issued Year	No. of shares	No. of share applied	Sub times	Results
1	Harisiddhi Brick and Tile Factory Ltd.	1993	532000	1541896	2.8983	Over subscribed
2	Uniliver Nepal Ltd.	1994	138000	901844	6.5351	Over subscribed
3	Himgiri Textile Industries. Ltd	1994	192000	301152	1.5685	Over subscribed
4	Necon Air Ltd.	1994	165000	588407	3.5661	Over subscribed
5	Shreeram Sugar Mills Ltd.	1997	465000	245985	0.529	Over subscribed
6	Oriented Hotels Ltd.	2000	1500000	9429000	6.286	Over subscribed
7	Himalayan Distillery Ltd.	2001	1734600	183347	0.1057	Over subscribed
8	National Hydro Power Co. Ltd	2004	1400000	301700	0.2155	Over subscribed
9	ArunValley Hydropower Co. Ltd.	2009	51500000	143633500	27.89	Over subscribed
10	ChilimehHydropower Co. Ltd	2011	5488400	79746452	14.53	Over subscribed



The above Table 4.10 and figure 4.9 shows that the subscription of three companies under subscribed and rest 7 companies are over-subscribed. Hari siddhi Brick & Tile Factory Ltd. Had issued 532,000 unit shares and had received application for 1,541,896

units shares. The public response to this company was medium with 2.8983 times subscription. Uniliver Nepal Ltd. and Himgiri Textile industries Ltd. issued 138,000 units and 192,000 units shares, had received application for 901,844 units and 301,152 shares. The response to these companies was also medium with 6.5351 and 1.5685 times respectively. Necon Air Limited issued 165,000 unit shares for which application was received for 588,407 unit shares. This shows the subscription times to be 3.5661 and hence the public response was medium. Likewise, the public response was medium to the Oriental Hotels with subscription of 6.2860 times. This company had issued 1,500,000 unit shares and had received application for 9,429,000 units shares. Shreeram Sugar Mills Ltd. had issued 465,000 unit shares and had received application for 245,985 unit shares. The public response to this company was too low with 0.5290 times subscription. Similarly Himalayan Distillery Ltd. and National Hydropower company Ltd. Issued 1,734,600 units and 1,400,000 units shares and had received application for 1,833,347 units and 301,700 shares. The responses to these companies were too low with 0.1057 and

0.2155 times respectively. Arun Valley Hydropower Company Ltd. had issued 515000 units shares and had received application for 14363350 unit shares. The public response to this company was Highest among the non-financial sector with 27.89 times subscription. And Chilimeh Hydropower Co. Ltd. issued 5488400 units shares and had received application for 79746452 units shares with 14.53 subscriptions.

#### **4.3 Major Finding on Secondary Data**

The secondary data was taken to justify of the research on the topic. The major findings on secondary data are as follows:

- ) In the present circumstance, a single investor or a group of investor can adversely affect the market scenario. This is an underprivileged single to the development of capital market.
- ) In a year 2010/11, maximum, companies have got approval from SEBON. Minimum 5 companies have got approved from SEBON in each of the year 1996/97, 1998/99.
- ) Public response to the financial institutions and insurance sectors is higher than non-financial sectors.
- ) In the year 1995/96 it was poor response to primary issues. Major causes for poor response in that period were: interest rates were higher as compared to dividend yield, also the public companies were not performing well, and people did not know about the importance of investing in securities.
- ) In financial institutions and insurance sector, the subscription of commercial banks was 16.38 times in average, and of development banks was 21.40 times in average. This shows the public response to development banks were greater or more than commercial banks. Past data shows that the average subscription of finance companies was 8.63 times while average subscription of insurance company was 21.76 times. Which shows the most responded sector was insurance sector.

- ) In the non-financial institutions the average subscription was 5.51 times. It shows non-financial sector has got not such better response from the public. Last few years' experience shows that there are limited non-financial sectors available in the country.
- ) Now-a-days the public response is highly positive, because people are aware, money flow in the market is higher, people now realize the importance of share investment, people have seen that most companies are distributing dividends, and lack of better alternatives for investment.
- ) During the research period, Siddhartha Insurance Co. Ltd. and MalikaBikash Ltd. had issued their issued to the public and were significantly over subscribed by 60.63 times and 54.84 times respectively.

#### **4.4 Analysis of primary Data**

To make the study more realistic primary data has been taken for analysis. For this purpose a questionnaire (see appendix was designed. Questionnaire was distributed to 150 respondents (students, businessmen, bankers and others) for their responses . Among the 150 respondents 20% (30 ) students, 40% (60) are businessman 16.67% (25) are bankers, 3.33% (5) are brokers, and rest 20% (30) are others.

Investors have mixed feeling on the primary market in Nepal. For the primary data collection 150 respondent from bank, business, university student and brokerage firm and investors have been taken as sample.

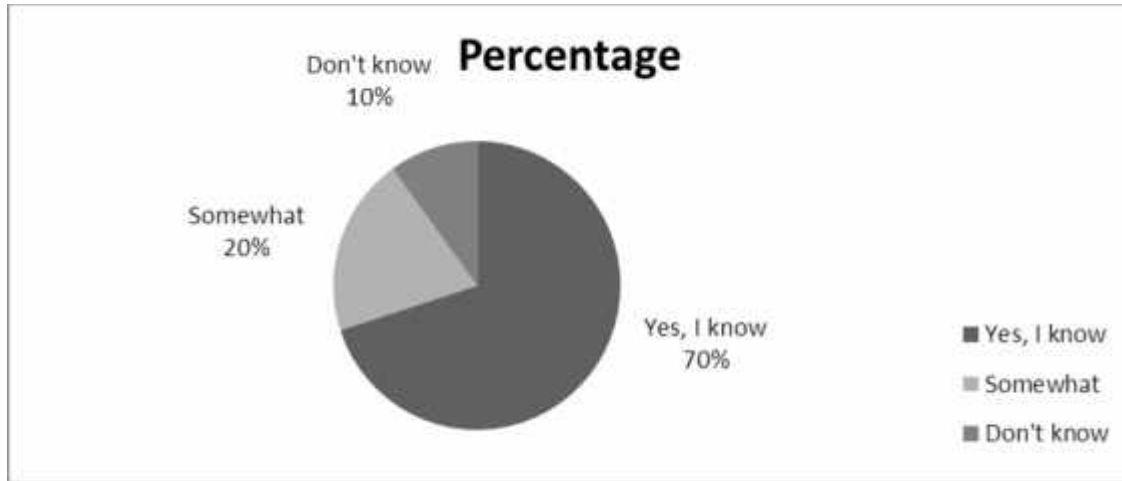
##### **4.4.1 Knowledge about IPO**

The survey reveals that majority of respondents known about IPO. They were asked either they have knowledge of IPO or not? The finding is presented below in the table and pie chart.

##### **4.11 Response from the participants**

S.N	Alternatives	Numbers	Percentage
1	Yes, I know	105	70

2	Somewhat	30	20
3	Don't know	15	10
	Total	150	100



These figures show that most of the people (70 percent) of the respondents have knowledge about IPO and 20 percent of respondent have little bit knowledge. Similarly, 10 percent of the respondents are completely unaware of IPO. A Chunk of University student and bank staffs were familiar with IPO. But, minority of them responded with negative answer. Similarly investors labeled their knowledge as “Somewhat” and “Yes”.

#### 4.4.2 Sources of information about IPOs

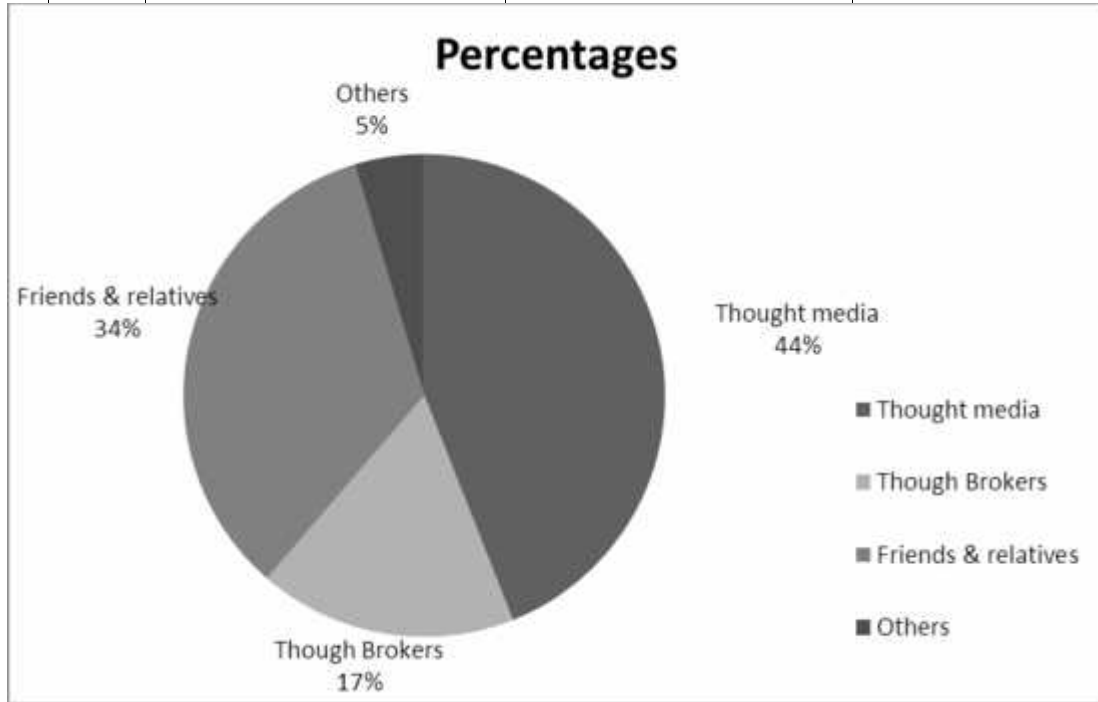
Out of 150 respondent most of the respondents 44%, get information through media, 34% through friends and relative and 17.33% and 4.67% through brokers and others sources respectively, which has been shown in the following table and figure .

#### 4.12 Sources of information about IPOs

S.N.	Alternatives	No. of response	Percentage
1	Through media	66	44.00
2	Through Brokers	26	17.33



3	Friends & Relatives	51	34.00
4	Others	7	4.67
Total		150	100.00



These Figure show that most of the investors (44%) get information about IPO through media. Similarly 34% gets through their friends and relatives. The percentage of investors get information through different Brokers are 17.33% and rest 5% get information through other sources.

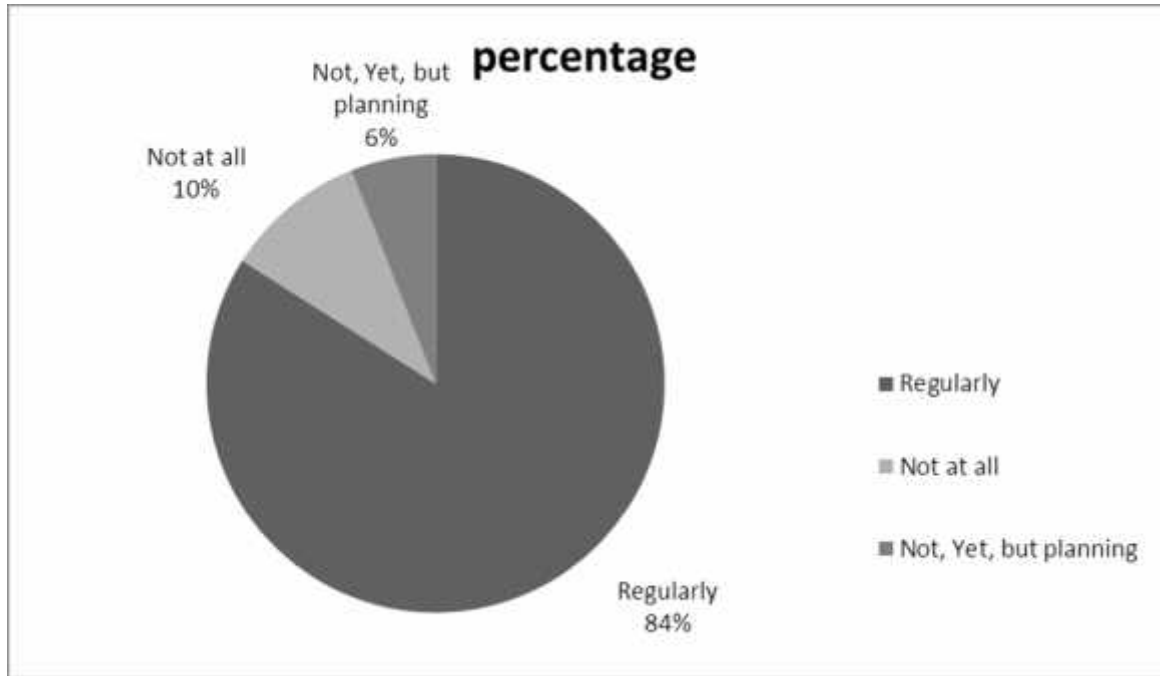
#### 4.4.3 investing through IPO

150 respondents were asked whether they are investing on IPO or not. The result shows, most of the respondents from different sector were investing in shares through IPO. The detail is shown in the table and figure below.

#### 4.13 Investing through IPO

S.N	Alternative	No. of Response	Percentage
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1	Regularly	110	84.33
2	Not at all	15	10.00
3	Not Yet, but Planning	25	5.67
Total		150	100



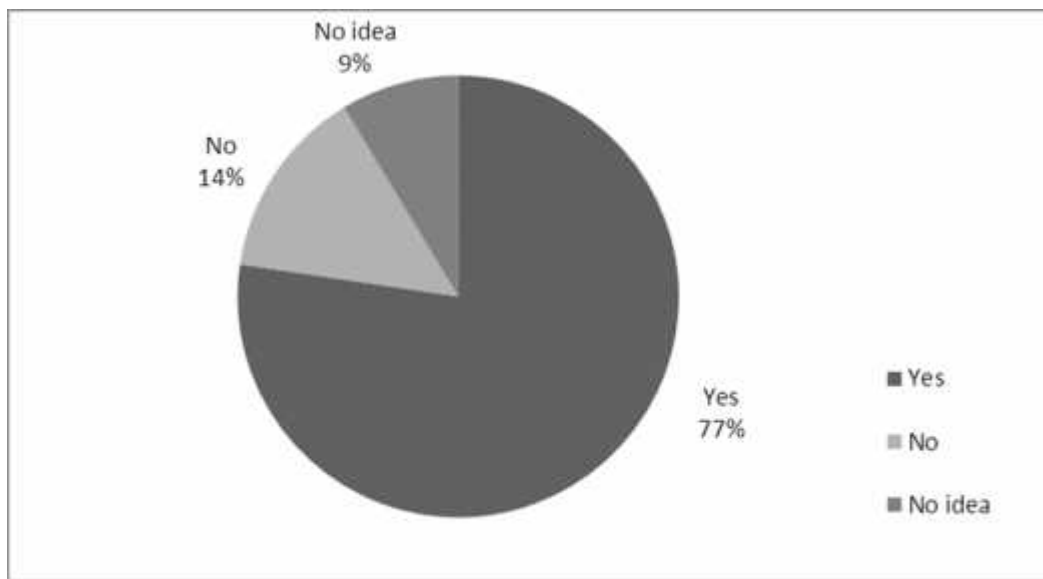
The above figure shows the respondents interest on Nepalese capital market through IPO out of 150 respondents 84.33% are investing regularly. 10% are not investing in IPO around 5% are planning for IPO.

#### 4.4.4 Habit of regarding prospectus before investment

**While** investing in shares issued by different companies everyone should have the habit of regarding prospectus of that particular company. The prospectus gives lots of information about the company. To know the prospectus regarding habit 150 respondents were asked the question. The results are shown in the table & figure below.

#### 4.14 Habit of regarding prospectus before investment

S.N	Alternatives	No. of Response	Percentage
1	Yes	116	77.33
2	No	21	14.00
3	No idea	13	8.67
		150	100



While going public Companies issue their prospectus, to show their image in the market. The question was related with this. The investor has asked do they read prospects before the investment. The reply is question satisfactory. 77.33% investor read the prospectus before they invest their money. 14% investor does not consider the prospectus while investing and 8.67 investors have no idea.

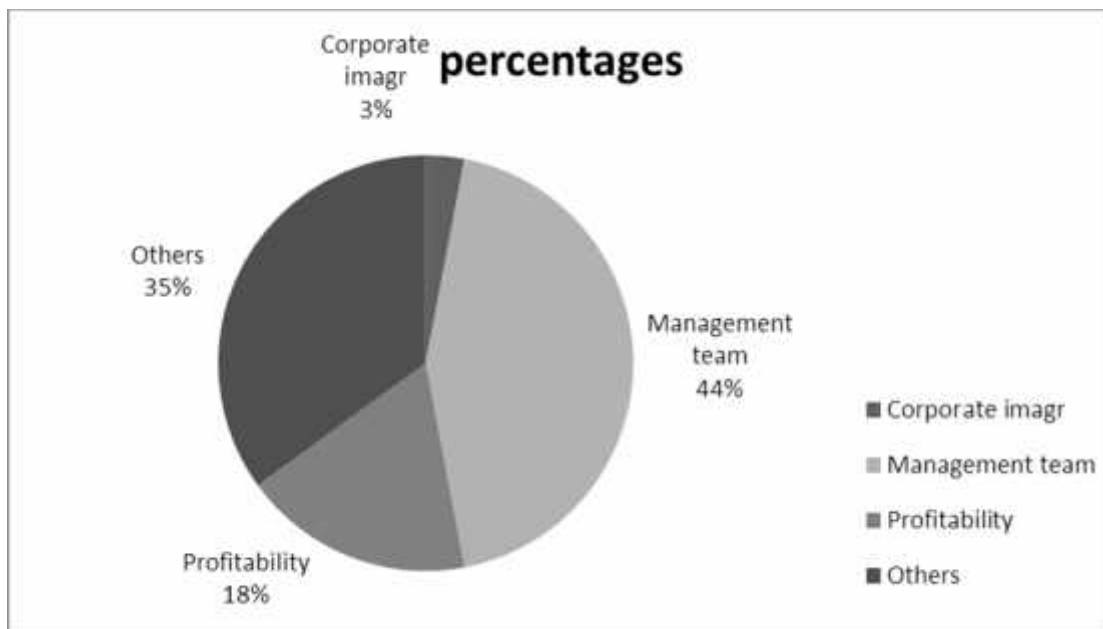
#### **4.4.5 Selection of Company Investment**

The question was asked to know why the investor chooses the particular company investment. This question was asked with four alternatives. The result is shown in the table & figure below.



#### 4.15 Selection of company for investment

S.N.	Alternatives	No. of response	Percentage
1	Corporate image	52	34.67
2	Management team	27	18.00
3	Profitability	66	44.00
	Others	5	3.33
Total		150	100



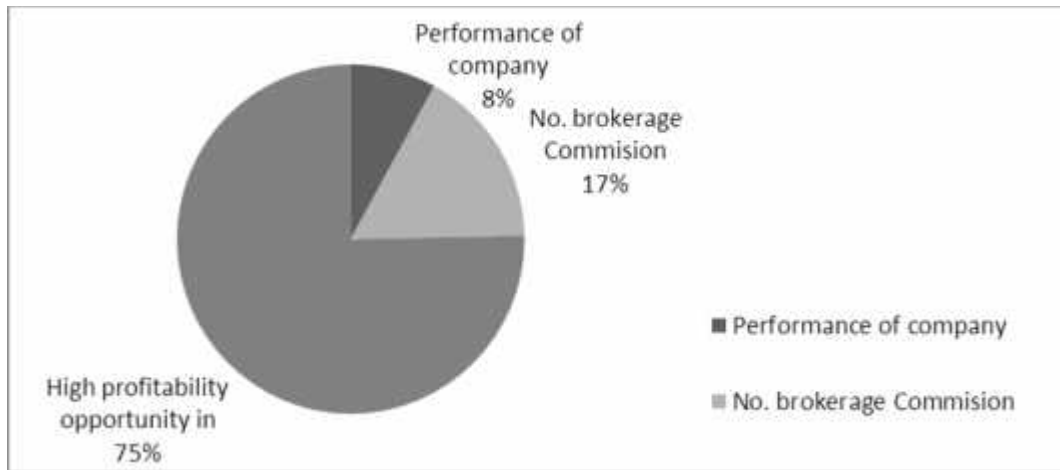
Out of 150 respondents most of team (44%) selects the team company for their profitability. 34.67% choose their company for their corporate image. Similarly 18% choose for the management team of the company and 3.33% select the company for other reasons. Which are shown in the above figure.

#### 4.4.6 Motivating factor for invest in IPO

The question was designed to know the motivating factor for investment. Most of the respondents said as their motivating factor for investment was high profitability opportunity in short period of time.

#### 4.16 Motivating factor for invests in IPO

S.N.	Alternatives	No. of Response	Percentage
1	Performance of company	12	8.00
2	No brokerage commission	25	16.67
3	High profitability opportunity	113	75.33
Total		150	100.00



While investing, the motivating factor plays a vital role. What factors really motivate the investor to invest in shares? Out of 150 respondents most of them, around 75.33% invest in IPO for high profitability in a very short period of time with a very low risk. 16.67% invest in IPO as there is no brokerage commission and 8% invest for the performance of the company.

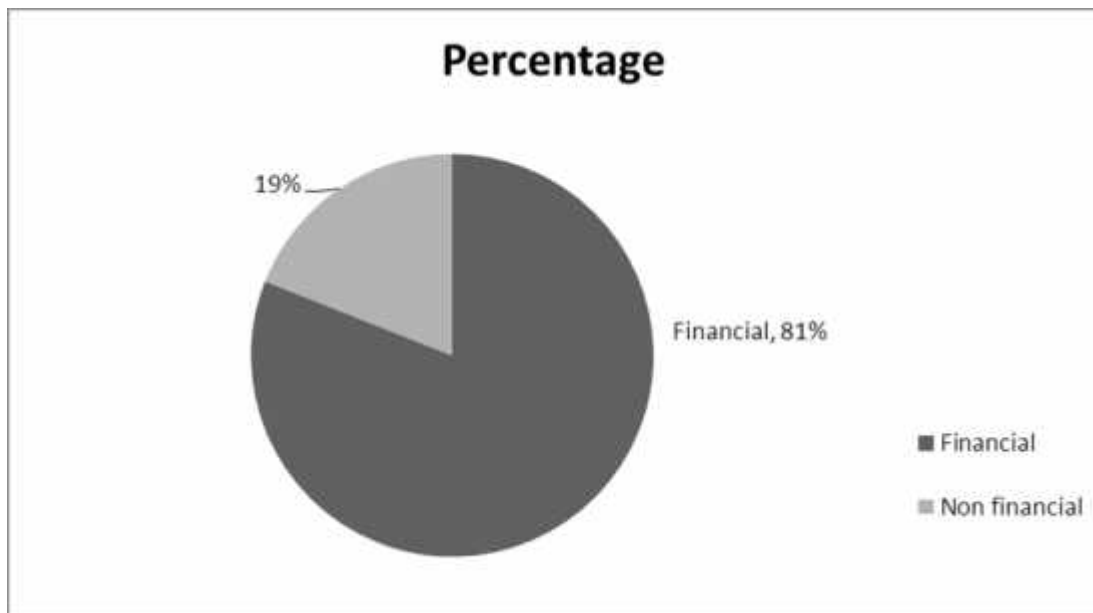
#### 4.4.7 Preferred Sector for Investment

150 respondents from different sector were asked which sector they prefer to invest in, the result is shown in the figure below.



#### 4.17 Preferred sector for investment

S.N	Alternative	No. of Response	Percentage
1	Financial	121	80.67
2	Non-financial	29	19.33
	Total	150	100



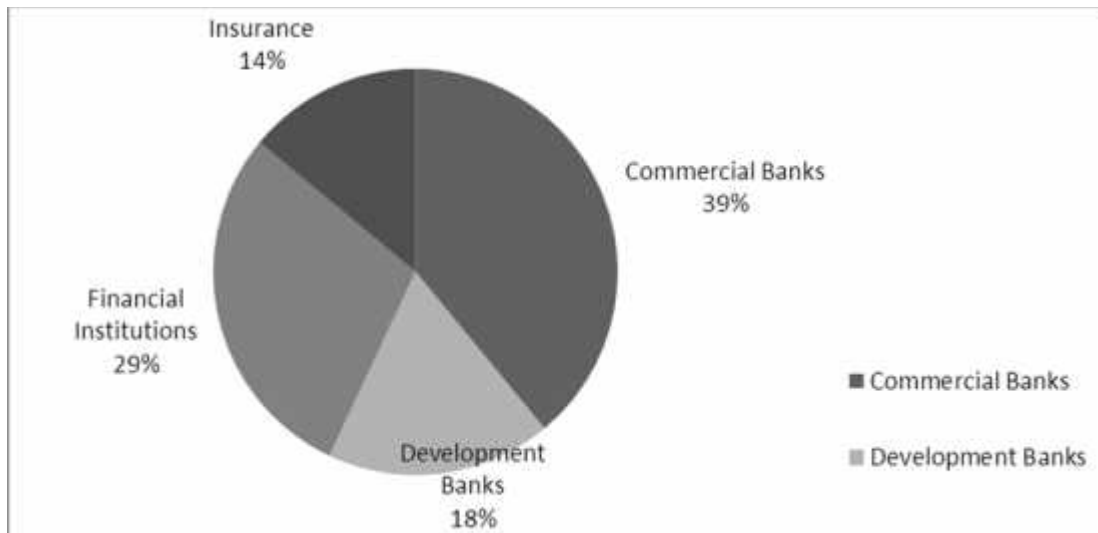
Most of the investors prefer to invest in the financial sectors rather than in non-financial sectors. Among 150, 80.67% said that they prefer financial sectors while 19.33% said they prefer non-financial sectors.

#### 4.4.8 Preferred Financial Sector for Investment

Among the 150 respondents 59 prefer commercial bank, 27 prefer development bank, 44 prefer finance company and only 20 prefer insurance company for investment in financial sector.

#### 4.18 Preferred financial sector for investment

S.N.	Alternative	No. of Response	Percentage
1	Commercial Banks	59	39.33
2	Development Banks	27	18.00
3	Financial institutions	44	29.33
4	Insurance	20	13.34
	Total	150	100



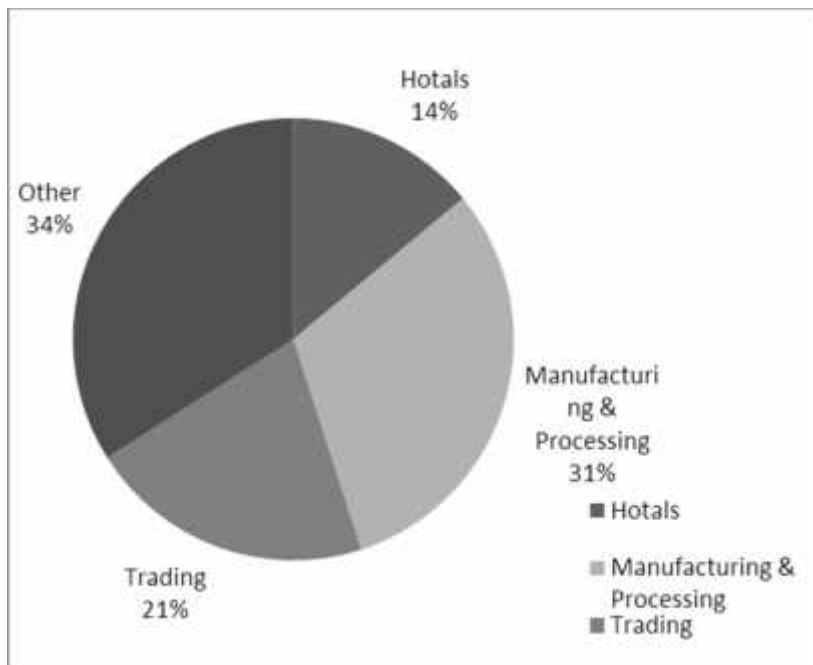
Most of the investors, 39.33%, said that they prefer to invest in Commercial Bank. 18% people said they prefer to invest in Development Banks. Investor preferring to invest in finance companies and insurance companies are 29.33% and 13.34% respectively.

#### 4.4.9 Preferred Non-financial Sector for Investment.

Among the 150 respondents for the question which non-financial world you prefer to invest in, the responses are as follows:

#### 4.19 Preferred non-financial sector for investment

S.N	Alternative	No of Response	Percentage
1	Hotels	21	14.00
2	Manufacturing	46	30.67
3	Trading	32	21.33
3	Others	51	34.00
Total		150	100



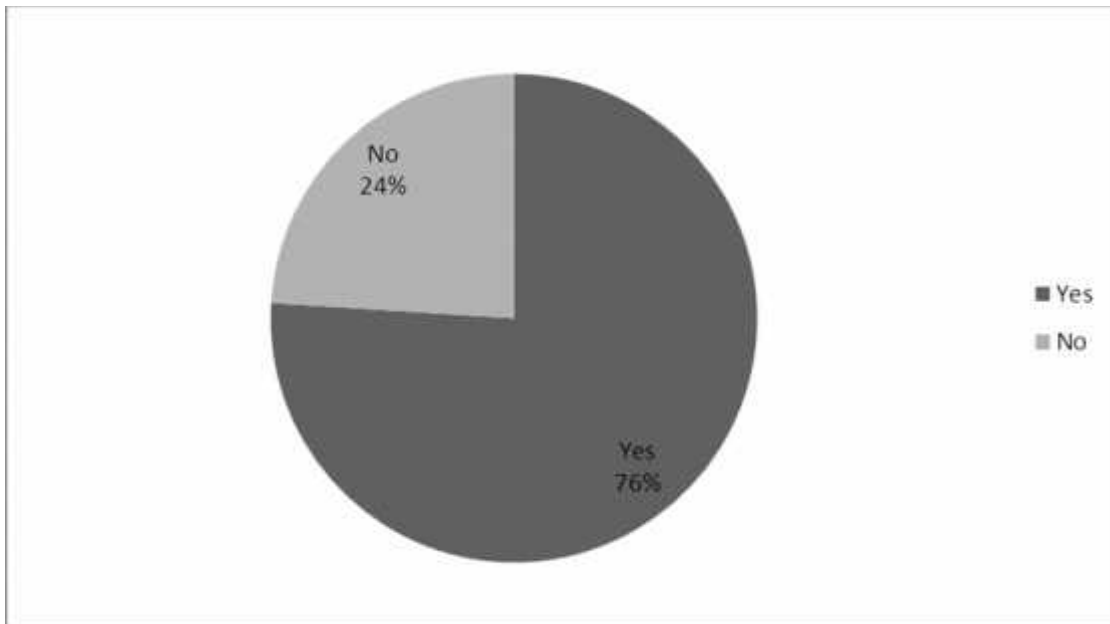
Among non- financial sectors, Others sector which include hydropower sector too were in investor's Preference. Survey done among 150 investors 34% said they prefer to invest in others. 30.67% said they prefer to invest in manufacturing and processing companies. 21.33% prefer to invest in trading and only 14% preferred for hotel sector.

#### 4.4.10 Is the present condition of Nepal is suitable for investment?

This question was designed to know the investors response for investment in the current situation. The result is shown in the figure below.

#### 4.20 Present situation for investment in Nepal

S.N	Alternative	No of Response	Percentage
1	Yes	114	76.00
2	No	35	24.00
Total		149	100



Economic and political factors have direct impact on capital market. As Economic and political factors are not stable these days here in Nepal so we asked 150 respondents that the present situation is suitable for investment. Out of 150 respondent 76% said yes and 24% said this is not the suitable situation for investment.

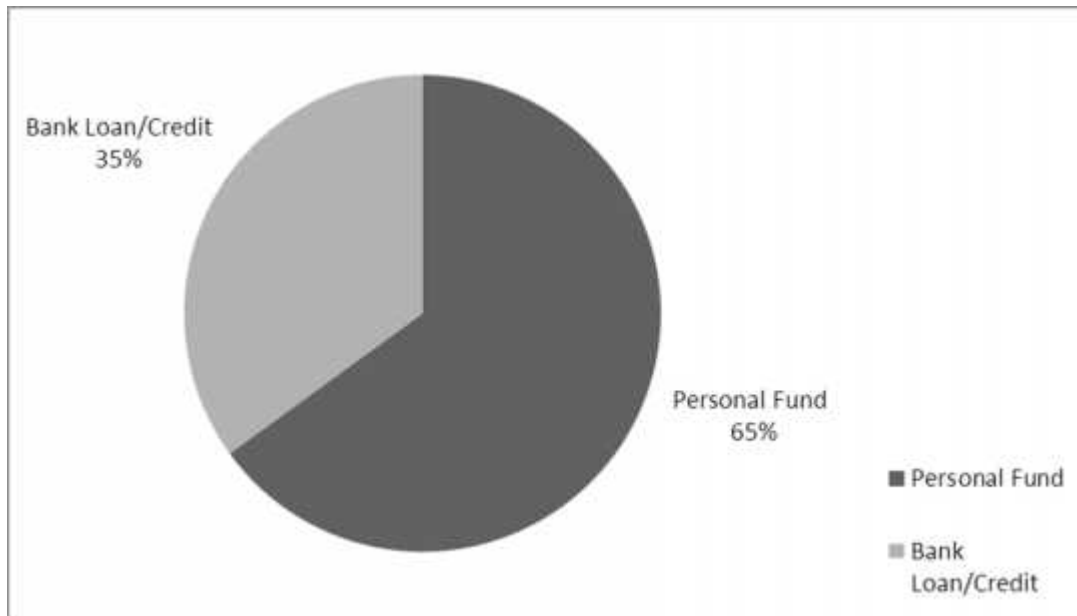
#### 4.4.21 Utilization of fund while investing in IPO

The question was asked to know whether the investor use personal fund or take bank loan for investment. The result is shown in table below and in figure.



#### 4.21 Utilization of fund while investing in IPO

S.N	Alternative	No of Response	Percentage
1	Personal Fund	98	65.33
2	Bank Loan/Credit	52	34.67
Total		150	100



65.33%, the majority of respondents said that they use their own fund to invest in primary market. But 34.67% people used Bank Loan for investment. It means 34.67 think they can earn more from investing in shares than the cost of loan or credit.

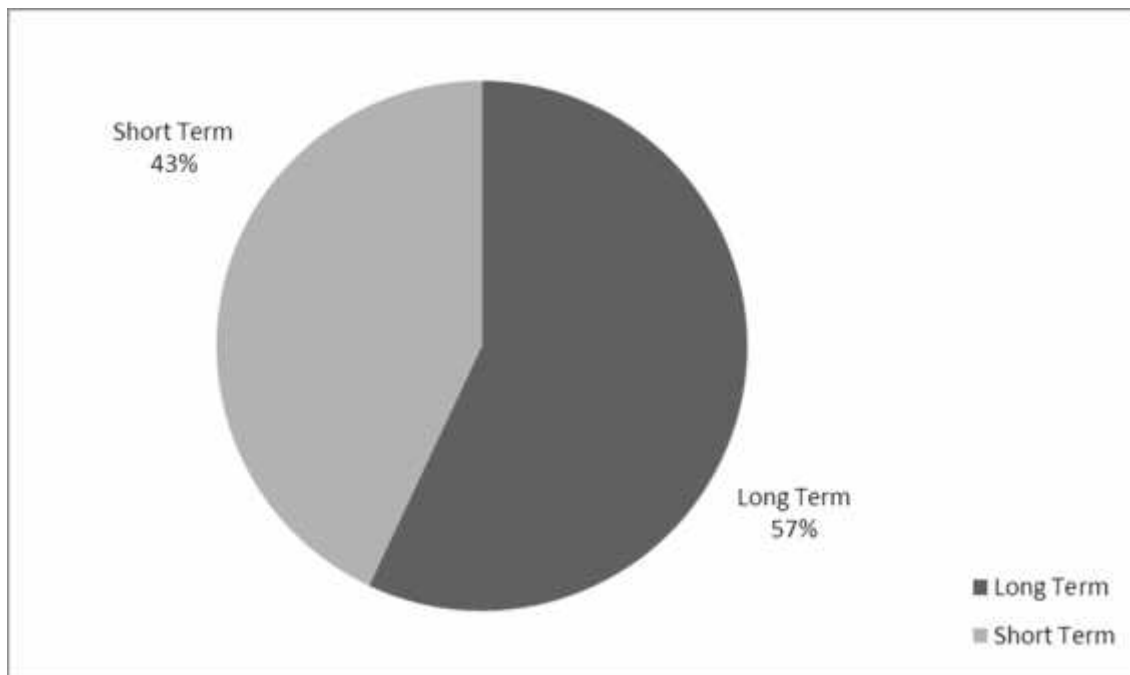


#### 4.4.12 What type IPO Investor are you?

The question was asked to know whether the investor investing in IPO for the long term purpose or the short term purpose. The result is shown in the table and figure below.

#### 4.22 Type of IPO investigator

S.N	Alternative	No of Response	Percentage
1	Long Term	85	56.67
2	Short Term	65	43.33
Total		150	100



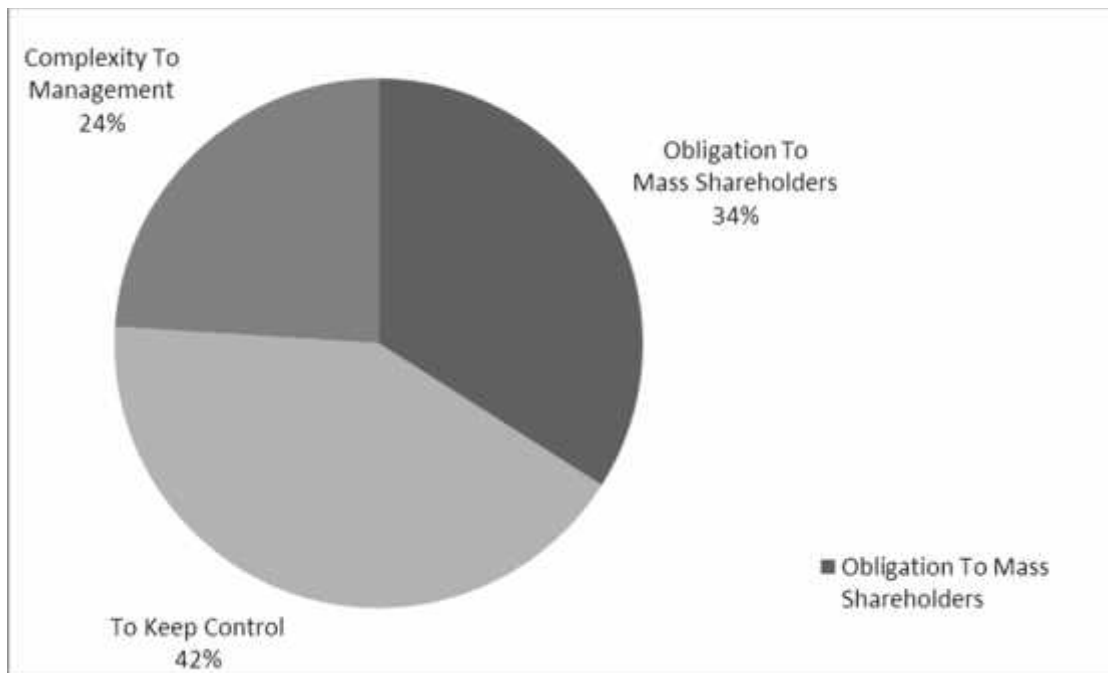
Out of 150 respondents most of the respondents (56.67%) investing in IPO for long term purpose, that is they want to hold the shares for long time to get more benefit. Rests 43.33% invest in IPO for short term purpose.

#### 4.4.13 Reasons that most of the firms do not like to go to public

This question was asked to know how the investors think about the reason for why the companies performing very well in the market do not like to go to the public. 150 respondents from different sector were asked. The result is shown in the table and figure below.

#### 4.23 Reasons for not going to public

S.N	Alternative	No of Response	Percentage
1	Obligation to mass shareholder	51	34.00
2	To keep control	63	42.00
3	Complexity in management	36	24.00
Total		150	100



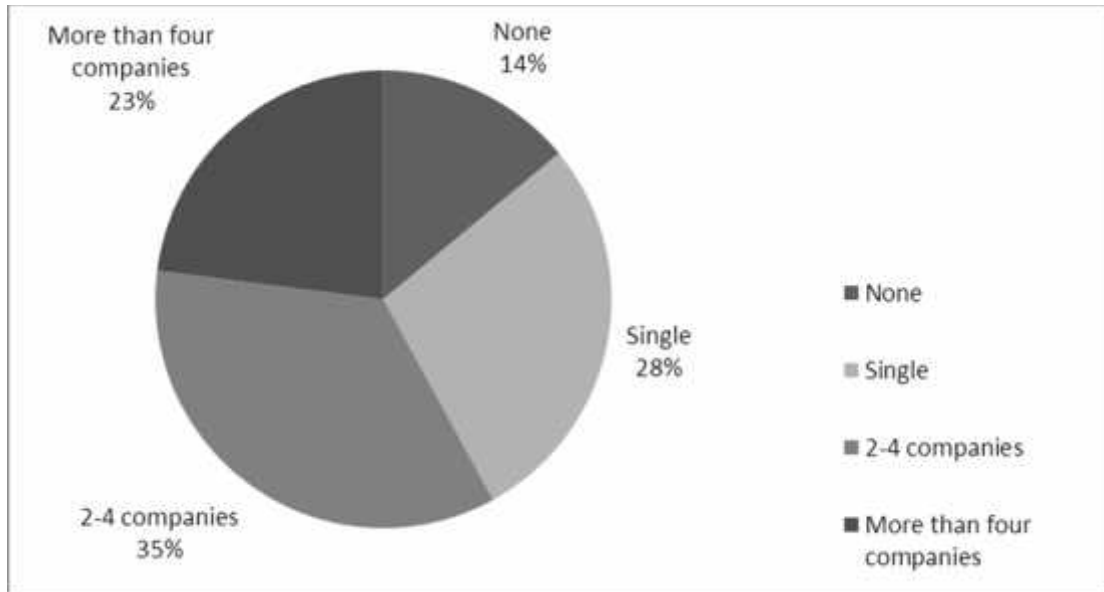
Most of the companies do not want to go to public. Among 150 respondents 42% thinks control is the major reason for not going to public. Other 34% think they do not want to bear the obligation to mass shareholders. And rest 24% thinks they don't want to go to public due to the Complexity in management.

**4.4.14 Number of companies invested.**

This question was designed to know the frequency of investment by different investors in the IPO. 150 respondents were asked. The result is shown in the table and figure below.

**4.24 No. of Companies invested**

S.N	Alternative	No of Response	Percentage
1	None	21	14.00
2	Single	42	28.00
3	2-4 Companies	53	35.33
4	More Than Four Companies	34	22.67
Total		150	100

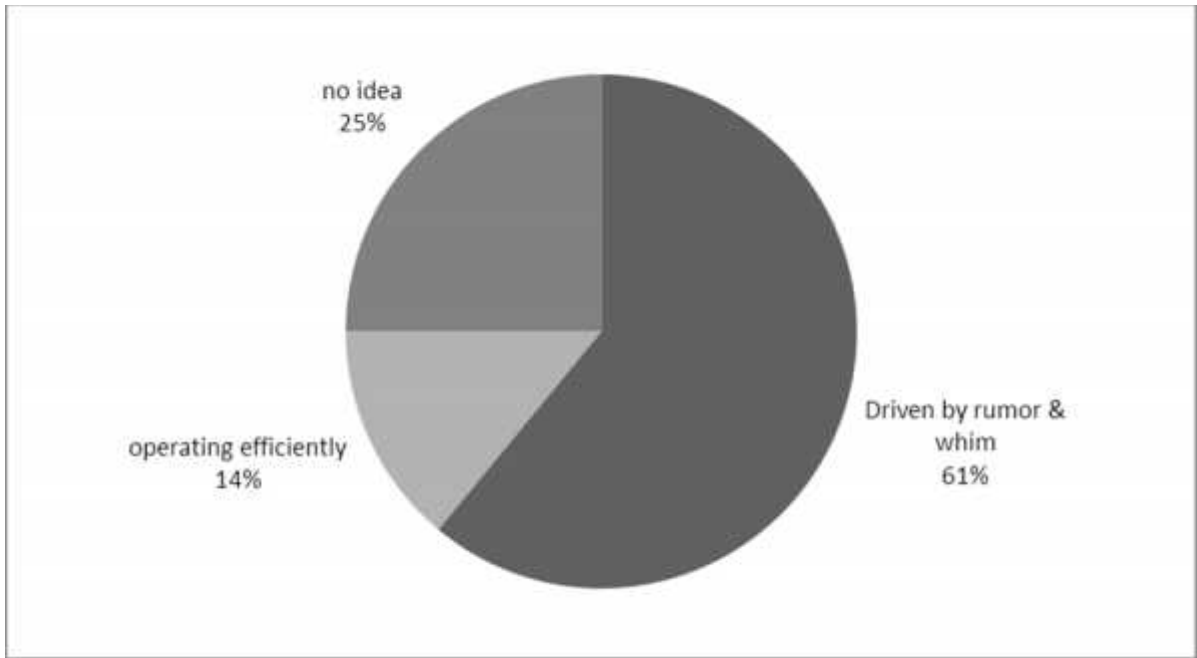


Out of the 150 respondents 35.33% said that they have invested in 2-4 companies. 28% said Single Companies, 22.67 said that they have invested in more than four company and 14% were found to invest in none of the organization.

#### 4.4.15 Public opinion about Nepalese Capital Market

This question was asked to different respondents to know their view about the Nepalese Capital Market. In the current situation most of the respondents thinks Nepalese Capital market is driven by rumor & whim. The result is shown in the table & figure below.

S.N	Alternative	No of Response	Percentage
1	Driven by rumor & whim	92	61.33
2	Operating efficiently	21	14.00
3	No Idea	37	24.67
Total		150	100



out of the 150 respondents most of the respondents 61.33% said our capital market is driven by rumor & whim. 24.67% said they have no idea and 14% said it is operating efficiently. With the response of different respondents in this question we may say that our capital market is driven by rumor & whim.

#### **4.5 Major finding on primary data**

Along with secondary data, primary data was taken to justify the study on the topic. Both interviews and questionnaires methods were implemented for this purpose. The major finding on primary data are as follows:

- ) Interviews are taken from the officials of Secondary Board of Nepal, citizen Investment Trust, NCML and questionnaires are distributed to the respondents from different sectors to collect the primary data. Most of them expressed happiness over the growth of primary market but were not satisfied with the current situation of secondary market.

Most of the people are investing in primary market for long term purpose that means they want to hold the shares. More than 56% people investing in primary market for such purpose. Rest of the people investing in primary market just to get the short term benefit.

- ) The primary source of data shows that the major source of information of public offering is media. Public getting information of IPO mostly from print media.
- ) People are getting aware to primary market to choose the right sector for investment. Investors are making portfolio of their investment, 35% investor invests their money in two to four companies.
- ) Most of the investor (more than 75%) read prospects of the company before investing their money in stocks.
- ) Profitability is the encouragement factor for investment. The investors think that those companies who are performing well in the market will do better in the future.
- ) People think that the present environment is suitable for investment. 80.67% people prefer to invest their money in the financial sector.
- ) This study has found that public response to the primary market is highly positive due to lack of opportunities for investment in other sector. Despite this, public are attracted towards shares to increase their value of investment.
- ) Pace of public offering is also increasing as amount of in approved continuously increase from 1993/94 (244.4 million) to 2010/11 (6754.03) million).

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATION

This chapter embodies three parts of the study: Summary Conclusion and Recommendations. The first part goes over with summarization of the whole study, the second part depicts the conclusion and the final presents recommendation in the light of its findings.

#### 5.1 Summary

primary market is the market for new securities. The key mechanism of primary market is initial public offering (IPO). The first time issuance of securities to the public is known as IPO. The securities market consists of new issue market and Stock Exchange. New securities are offered to the investors for the first time through Initial Public Offering. Primary market allows issuance of new securities in order to help the issuing companies to raise funds for starting new enterprise or for expansion and diversification of the existing ones. The securities market development in Nepal is in early stage of growth. The basic objective of this study is to assess public response to the initial public offering; this study also focuses on the dealing process and pace of the initial public offerings. The primary and secondary, both types of data are taken to analyze the objective of the study. Primary data are taken from direct questionnaire provided to the general investors. Secondary data are taken from the publication of SEBON, NEPSE and various merchant bankers.

The securities market plays a strong role in bringing into contact the firm and the individuals. So it can be said that the confidence of the public depends heavily on the functioning and the implementation of regulations of SEBON. Securities Board Nepal is the regulatory body of Nepalese stock market. Stock Exchange Limited is the trading body. Before going to the public, the company must be approved from SEBON. After getting approval, issuing company must give its information to the Nepal Stock Exchange Limited and Company Register's Office. Issuing company is free to choose one or more than one issue manager/s for the process of issuing the shares. Bankers to the issue also involve during this period. Issue manager has to publish a public notice in the

national daily newspapers to offer public for investment. The notice must be published seven days before the application form distribute date. The issue manager has to publish and distribute the prospects. Prospects make easy to the public to decide whether to invest their money in the share or not. The application period must not be more than one month. If issue managers think the required applications have been collected, they can close, anytime after one week, to receive application. If over application is received, the distribution of share should be decided through allotment procedure. For this purpose additional 40 to 90 days can be taken. After allotment within next 15 days the issue manager has to refund the money of those public whose application has not been accepted. Within 30 days of refund period the certificates has to be distributed.

According to Securities Board, 324 issues approval of different companies for public issue. There are 159 companies listed in Nepal Stock Exchange Limited. Ina year 2008/0, maximum, 64 companies have got approval from SEBON. Minimum 5 companies have got approved from SEBON in each of the year 1996/97, 1998/99. Public response to the financial institutions and insurance sectors is higher than non financial sectors.

In financial institutions and insurance sector, the subscription of commercial ban 16.38 times in average, and of development banks was 21.40 times in average. This shows the public response to development bank were greater or more than commercial banks. Past data shows that the average subscription of finance companies was 8.63 times while average subscription of insurance company was 21.76 times. Which shows the most responded sector was insurance sector.

In the nonfinancial institutions the average subscription was 5.51 times. It shows non financial sector has got not such better response from the public. Since, last few years' experience shows that there is a limited non financial sector available in the country.

The primary source of data shows that the major source of information of public offering is media, 44% gets information through media. Majority investors are seemed to be new in the market. 35.33% investor invests their money in two to four companies. These days , people are getting aware to primary market to choose the right sector for investment. They read prospects of the company before investing their money in stocks. More than 70% respondents read prospectus before investment. Corporate image and profitability is



the encouragement factors for investment. The investors think that those companies who are performing well in the market will do better in the future. More than 65% investors invest money in the primary market by using their own fund. 42% investors think that the companies do not like to go to public, the major reason they think is control. 76% people think that the present environment is suitable for investment in IPO. 80.67% people prefer to invest their money in the financial institutions and insurance sector. 70% people, investing in IPO having good knowledge of it.

Most of the respondents, about 61.33% are of the view that capital market is driven by rumor and whim. Also most of the respondents who are the investing in IPO for the long term purpose that is if they get the shares they want to hold. Rather few respondents hold shares for long time that is they want short term benefits. This study has found that public response to the primary market is highly positive because people are getting aware of stock market, flow of money in the market is higher, people have realized the importance of the investment in shares, people have seen that most companies are distributing dividends, share prices of most companies are increasing and a lack of better alternative for investment.

## **5.2 Conclusion**

most of the general investors in Nepal do not have sufficient information regarding the primary market but still they are interested to invest money in the primary market.

This is good sign to the expansion of the primary market. As per this study, almost every sector is getting good response from general public. Specifically financial institutions and insurance sector is more preferable for general public than non financial sector.

As per this study, almost every sector is getting good response from public. Specifically financial institutions and insurance sector is more preferable for public than non financial sector. Pace of IPO in Nepal seems to be irregular. The number of companies approved for public offering by SEBON in a single year varies from 34 to 5. The highest amount of issue approved by the SEBON was Rs.16828.51 m while the lowest amount of issue was Rs.173.96 m. If we see on the basis of sector, SEBON had granted 91.67% approval for financial sector and 8.33% approval for non financial sectors.

Even though the organization's process of public offering is quite long; the service provided to the investors seems to be satisfactory. If raising interest of the public in to primary market is one of the objectives, then the primary market of Nepal is fulfilling this role gradually.

The structure of both segments of the market Primary/New and secondary/stock exchange has witnessed significant change. Some of the important development in the primary market which deserve specific mention are the establishment of merchant banks, provision of speedy of allotment/refund, proportionate allotment of shares, allotment of financial institution, increase in minimum application amount of investment in primary issue such change have brought significant public response in new issue. Secondary market which presented an institutional mechanism that may be transparent, hardly regulate and rarely feared to investor's protection but not yet in practice. Among them are prescription of norms for intermediaries like broker in trading/settlement and the bound of stock exchange with participant from stock exchange members and investors. The exchange has made tremendous effect in the volume of transaction, share turnover, number of shareholders, public response and market capitalization.

### **5.3 Recommendation**

In spite of the limitations under which the study has been carried out it has been able to meet the objective of the study. On the basis of the study made following recommendations are made.

- ) Nepalese capital market is largely dependent on financial sector which is not good sign for overall development of IPO market and capital market as a whole. in this regard the regulatory body and the government should take a step forward and encourage public issues from others sector like manufacturing and processing by providing additional facilities like tax-concessions.
- ) Ordinary share is found to be the most used financial instrument while other financial instrument like preference shares and debentures are rarely issued. The fact that such ordinary shares carry maximum risk to investors one hand and also cause dilution of ownership to issuing company, seemed to be forgotten. In this

regard, its recommended that root cause beneath should be traced and tackled for good.

- J Public have shown faith on IPO's from financial sector while they do not have shown much faith on IPO's from non-financial sector. So non-financial sector companies are recommended that before IPO, they should inform public about their worthiness and regulatory body. Similarly, government should to come up with schemes which will attract good companies from non-financial sector to go for IPO.
- J There is no clear legal provision about security market, underwriting and underwriting commission, which should be fulfill for development of capital market. So, focus should be given for making and implementation of the existing acts, rules and provisions.
- J There are 18 issue manager and a few are actively doing their job limited only in Kathmandu valley. So take some action to establish more issue manager in the different part of the country and encourage involving more actively.
- J Regional stock exchange centre should establish so that more people will be involved in the investment activities on primary as well as secondary market.
- J To make the investment more attractive and affordable to the small investors, the Nepalese companies should introduce other types of securities such as options, warrants etc.
- J For increasing the public follow on primary as well as secondary market, there should make the provisions of over the counter market, encourage to establish securities investment consultant, doing more seminar, meeting, conference that increase the knowledge about the investment opportunity for the people.
- J To be successful in the stock market, investors should always be clear to his strengths, weakness, requirements, wishes, risk taking capabilities and how to react on different and ever changing market conditions and they should not buy the shares of a company until they know details about it.

- ) The issue manager should take initiative step to promote their business from non-financial sector also and should be equally effortful in developing the public offering market as an avenue for cost effecting financing.
- ) Issuing company's post issue compliance practice is found to be poor. The issuer companies should be made aware in complying with the post issue legal provisions at the time of public issue. Issue manager should also take the responsibility to make the issuer companies aware of compliance issue.
- ) Restriction on foreign direct and portfolio investment should be reviewed with a view toward the elimination of unnecessary impediments.
- ) The central Depository System (CDS) must be introduced to the current trade as soon as possible. This means that very high volume or trading can be cleared and settled in timely and cost-effective way there by supporting the overall development of NEPSE.

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