

**RIGHT SHARE ISSUE PRACTICES AND ITS EFFECTS ON
SHARE PRICE OF COMMERCIAL BANKS IN NEPAL**

Submitted by:

Shilpa Pradhan

Balkumari College

T.U. Regd No. : 7-2-241-475-2005

Roll No. 52 (2065-067)

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INTRODUCTION

The Nepalese capital market was established as Security Market Center (SMC) in 1976. In 1984, the SMC was renamed as Security Exchange Center (SEC). After converting SEC into Nepal Stock Exchange (NEPSE) in 1993, it brought new atmosphere in Nepalese capital market. NEPSE is non-profit making organization. It is one and only secondary market for Nepalese corporate securities, operating under Security Exchange act 1983. NEPSE opened its trading floor on 13th January 1994 and started to calculate the NEPSE Index since 12th February 1994. NEPSE plays vital role for developing the efficient capital market. Managing public issue is one of the important roles of NEPSE. The study is concentrated on the various aspects of right share offering with special to the references to the selected listed right share issuing commercial banks of Nepal as Nepalese stock market is highly dominated by commercial banks. However, to show the practice of right offering in Nepal, some data of other rights issuing companies also has been taken. It covers the period of 18 years from FY 1993/94 to 2010/11 regarding contribution of Rights issue in total public flotation. Although Nepalese security market is practicing the rights offering for a long time period, but it's every essence is not seemed to practice here. Only 217 cases are of rights offered by 125 companies, out of total listed companies 207 in Nepal till the FY 2010/11. In Nepal few cases of rights offering meets the theory. Mixed results have been obtained from the sample companies regarding rights offering theory in Nepal.

Main objectives of this study, is to examine the movement in share price before and after the announcement of rights issues and to analyze the rights issue practice in Nepal. Finding out the problem of rights issue in Nepal is another objective of this study. Till the date, many studies have been done related to the impact on market price by various variables such as EPS, DPS and signaling effects. But very few studies are directly concerned with rights issue in Nepal. Still it is really tried hard to make full effort to collect the related studies for review. This study is heavily based on secondary data. So useful data are

collected from SEBON and other related organization as well. Newspaper, annual reports of sample companies, journals and bulletins are important sources of secondary data in this study. Other information is collected through the internet as well.

Introduction of the Rights Issue

We can describe the right i.e. preemptive right, as the right of existing shareholders to buy the additional number of common stock or equity share if the company further issue the new share. The preemptive right gives the holders of common stock the first option to purchase additional issues of common stock. Thus, if the company sells the stock to the existing shareholders, the stock floatation is called right offering. Instead of selling a security issue to new investors, some firms offer such security issue first to existing shareholders on a privileged subscription basis. Some time the corporate charter requires that a new issue of common stock or an issue of securities convertible into common stock be offered first to existing shareholders because of their preemptive rights. (Van Horne, 2000:494)

If the new common stocks are issued giving the right to purchase first by the existing shareholders, than it is called rights offering. Each shareholder is issued an option to buy a certain number of new share and the terms of the option are contained on a piece of paper called right. Each stockholders receives one right for each shares of stock owned. (Weston & Copeland, 1992:906)

Usually, right shares are issued to the existing shareholders to raise the capital. Therefore, issue to right share represents the distribution of share in proportional basis to the existing shareholders for the purpose of raising the needed funds. The shareholder which has an option to purchase the stated number of shares at the subscription price, which is generally below the current market price of the share, can purchase such shares within the specified period of time.

So, right issue is a privilege given to the existing shareholders that helps to keep their control position proportionately equal and the issuing price will also be lesser than the market price. This lower price would help to maximize the capital gain of the shareholders. Right is the negotiable instruments. It has its expiration date. One of the advantages of right offering is the minimization of floatation cost. The procedure of right offering is similar to the non-right issue.

Theoretically right offering affects the share price because it has some value. They have value because generally they are offered at a subscription price somewhat lower than the market price of share. In the secondary market, investors prefer to buy the shares that have attached the preemptive right. Due to speculation, share price may go up and down.

Right issue practice in Nepal has no long history as compare to other developing countries. While looking the issue approval from the SEBON of Nepal researcher can easily notice an increasing trend of issuing right share. During the 18 years period, SEBON has granted right issue approval amounting Rs. 39,967.19 million out of total issue of Rs. 56,966.13 million of total public issue.

This amount comes to be the largest amount among various issue approved by SEBON. Right issue occupied 70.16% out of total issue approval out of total listed companies. In Nepal, Company Act 1997 has provisioned about the preemptive right of shareholder in the section 42 (4).It stated that if the right is contained in a firm's charter then the firm must offer common stock to existing shareholders. If not, the company has choice of right offering or public offering. But the law in India requires that new common stock must be issued first to the existing shareholders on a pro rata basis. In India right is negotiable but in Nepal there has not been any provision to make the right negotiable.

Focus of the Study

This study is concern with the right share practice and its impact on share price movement of commercial banks in Nepal. Basically this study has been focused on following topics:

- Procedure of rights issue in Nepal.
- Price movement before and after announcement of right share.
- Practice of rights issue and problem and prospects in Nepalese corporate firm.

Statement of the Problem

Right offering is a way of raising fund. An existing shareholder is entitled to have a proportion number of new shares at pre-stated price, which is somewhat lower than the market price of share. But to buy additional number of shares, the shareholder's name should be in the company book before the record date. If any shareholder purchases shares after record date he has no right to buy the additional number of shares. So, before record date there is high demand of shares in secondary market. Demand of shares increased because people rush to the secondary market in order to enlist their name in the company's book, before the record date. No doubt the price of the new share is also lower than market price. On the other side the existing shareholder generally have no willingness to sell the shares due to rights. Due to this double pressure, the price of share goes upward. On the other side theoretically, after announcement of right offering, the price of the share should be change. Similarly, after exercise of the right share, the price of the share should be decline by its value of right. But findings on the price effect of rights offering on market price of stock are inconsistent. Findings are different according to research conducted by researchers. Dolley, (1934) in his study concludes that in two out of three cases the market value of stock ex-rights plus the market value of the right will be greater on record date than the last preceding quotation on the rights-on. Most stock going ex-rights, fail to decline in market value by full value of right. At last, he said that investor is about as likely to lose, as he is to gain if he sells his stock at the announcement date and buys it back just prior to the record date. But he didn't explain what should be the actual share price before and after the announcement of rights offering. Likewise, the result of Nelson, (1980) indicates that there is a significant drop in the market price associated

with the announcement of rights offering. The evidence is inconclusive, however, for at least three different reasons. To begin with, the price effect could be attributable to announcements about earnings, dividends or other events. Second, the study did not focus on the announcement date but considered the date of record and dates six months prior and subsequent. Lastly, in adjusting for the market, all securities were assumed, implicitly, to be identical to each other and hence to market. In these study researchers did not explain, whether sample companies followed the theory of rights offering or not. So, here the main problem of the study is to identify whether the price behavior of sample companies meets the theory or not which is not proved in previous studies in the context of Nepal.

While offering the rights another problem of under subscription also arises there. Due to the lack of instrument of rights transfer, there arise a problem of under subscription of right share and finally this absence deprives the existing shareholders from enjoying the choice of selling the rights.

Beside this, there are other problems regarding rights offering in Nepal. Such as, no company can issue their right share at discount and premium thus all companies are issuing right share in par value. It causes vast deviation between market price per share and subscription price per share.

Objectives of the Study

The main objectives of this study are to examine the right share practice and its impact on share price movement of commercial banks in Nepal. The study covers two aspects of right issue (a) the characteristics of rights offering by the commercial banks (b) the share price movement associated with the rights offering. To achieve these basic objectives, the following specific objectives have also been considered in this study:

- To examine movement in stock price before and after the announcement of rights issue.
- To analyze the procedure of rights issue in the context of Nepal.

- To analyze practice, problems and prospects of rights issue in Nepal.
- To examine the relationship between stock price reaction and announcement of rights of issues.
- To analyze investor's awareness regarding stock price in NEPSE.

Research Questions

It deals with the following research questions:

- What will happen in the share price movement after announcement of right share?
- Is there, any problem regarding right issue practice in Nepalese capital market?
- What are prospects of issuing the right shares in Nepalese capital market?
- What is the relationship between stock price reaction and announcement of rights of issues?
- Is there investor's awareness regarding stock price in NEPSE?

Limitations of the Study

This study is required for the partial fulfillment of MBS Degree. Hence it is subject to some limitations, which affect the study. They are given below:

- The study has analyzed the last 18 years data beginning from 1993/94 to 2010/11.
- The study has analyzed the data limited to 90 days before the announcement of rights issuing and 180 days after the announcement of issue.
- This study has assumed that the related published and unpublished documents, such as; Journals, articles and other previous studies are realistic.

- Other variables that affect the stock price of sample companies are totally ignored while analyzing the share price movement.
- This study is based on primary data & secondary data but mostly on secondary data.
- Out of total right issuing companies only one sector i.e. commercial bank is considered, from which five banks are taken as sample for the study.

Research Gap

According to the theory of right offering, the price of shares increases after the announcement date and the price again decrease after the allotment of shares to the extent of value of rights. So, if the same things happen in the share market scenario, then the research like this seems to be unnecessary one. But in real practical life, the theory is not being followed.

Various studies have been done on the topic of share price and its determinations, but no one has given focus on right share as an important factor, which affects the market price of shares in share market significantly.

Though, few studies have considered right shares and its impact on share price movement in Nepalese share market, they fail to focus on right share as the highest instrument of share fund required for a company. Furthermore, previous studies had not tested the correlation of share price with general market movement.

Thus, with this several of research gap and weakness found in previous studies, this research has been conducted to find out value of right issuing companies. Though, there are eight different sectors, only one i.e. the commercial bank is selected for the research.

Population and Sample

In attempting this study, only stock rights issues are considered, all other cases being excluded. Accordingly, nothing but privileged subscriptions issued to common stockholders permitting them to subscribe for additional common

stock of identical corporation were included in the sample. Till the FY 2010/11, there are only 217 cases of rights offered by 125 companies out of total 207 listed companies. Similarly, out of 23 listed commercial banks in NEPSE, 20 banks issued rights to subscribe for additional common stock for there existing shareholders. Commercial bank controls the share market of Nepal. Many fluctuations in stock price of commercial bank directly affect the NEPSE index. Due to various limitation researcher cannot take all the companies as the sample. So, for this study out of 8 sectors of NEPSE, only one and important sector i.e. commercial bank has been taken for the study. Here, 5 commercial banks, issuing rights share has been considered for the study. Some commercial banks had issued rights share more than one time, but researcher takes the latest issue for the study. To measure the price movement of stock before and after the announcement of right share, some market price are required, which is based on purposive and judgmental sampling method.

Major Findings of the Study

Here, the effort has been made in to present major findings of the study in rights share practice in Nepal and its impact on share price movement of commercial banks. The major findings of this study are presented in following headings correspondence to the study objectives.

a) Share Price movement after the Announcement of Rights Share

From the analysis, the following results have been obtained:

- There is significant difference between share price of Kumari Bank Ltd. before and after the rights issue. Its market price was under priced.
- In case of Nepal Bangladesh Bank Ltd., share price decreased after allotment of the rights share and there was significant difference. But since the share price was around the ex-right price, researcher can say that stock of Nepal Bangladesh Bank Ltd, followed the theory of rights offering.
- In case of Nepal SBI Bank Ltd also, its share price decreased significantly after allotment of the rights share and there is significant difference.

- There is no significant difference between the share prices before and after share announcement of Nepal Investment Bank Ltd. and stock of NIBL does not follow the theory of rights offering. Its market price was overpriced.
- Finally in case of Prime Commercial Bank Ltd., there is no significant difference between share prices few days before and after the announcement of rights share. So share price movement of PCBL can not be attributed to the rights offering, Share price of PCBL was overpriced, so it does not follow the theory of rights offering.
- There is no uniformity in the impact of rights offering of share price.

b) Rights Share Practice in Nepal

- Rights offering have only eighteen years of history, so it is a growing practice for Nepalese companies,
- A rights offering in Nepal is in increasing trend in recent years. It occupied 70.16% in total public flotation, which is the largest position among all instruments.
- Out of total listed companies, there are only 217 cases of rights offered by 125 companies in Nepal. Most of the companies are issuing rights share in order to fulfill capital requirement as per the NRB directives,
- All the sectors except Trading has practiced rights share in Nepal. Commercial Banking sector occupies second largest amount of total rights offering among all sectors. It is about 33.66% of total rights issued amount. Till date study period, only 20 commercial banks have issued rights share for their existing shareholders. Nepal Bank Ltd. is the first commercial bank to issue rights share in Nepal though it is de-listed from NEPSE currently. Various banks have issued rights share more than one times, such as Nepal SBI Bank Ltd, Nepal Investment Bank Ltd., Kumari Bank Ltd., Siddhartha Bank Ltd., Sunrise Bank Ltd., NMB Bank Ltd., Machhapuchhre Bank Ltd.,

Laxmi Bank Ltd., Bank of Asia Ltd., Nepal Bangladesh Bank Ltd. and Lumbini Bank Ltd.

- All issue managers except United Finance Ltd. have underwritten the rights share in Nepal. NIDC is the largest issue manager among all issue managers and NSML is the smallest one.

c) Subscription of the Rights Share Issued

- Most of the rights issues were under subscribed in Nepalese companies. So, it is a common phenomenon in Nepal.
- Under subscription of rights share caused by various factors. Lack of investor's awareness, low performance of companies, and lack of effective flow of information, lack of provision for rights transfer, untraceable investors and financial problem of shareholders are the major causes of under subscription.
- There is no clear and easy provision regarding the sales of under subscribed rights share in Nepal.
- Subscription of rights share in recent years is in increasing trend.

d) Problem Regarding Rights Share in Nepal

As it is mentioned above, there are lots of things to be done to develop rights share practice in Nepalese security market. In this research, some problems has been found, which are given below:

- Subscription price of rights share is too low as compared to market price of share.
- There is no any provision to make rights free pricing
- Lack of separate rules regarding rights share is another problem.
- Lack of provision to make rights share negotiable, which is the main cause of under subscription of rights share,

- Most of the companies are suffering from under subscription of their rights share but there is no clear and easy provision regarding the sales of under subscription rights share.
- Poor financial condition of shareholders in Nepal.
- There is a large no. of shareholders holding small no. of shares in Nepalese share market who generally ignore rights issue.

Summary

A rights offering in Nepal and its impact on share price movement of commercial banks is an exciting and challenging study. A brief introduction of the study and the overall view of rights offering are presented in introductory chapter and available literature on rights issue is reviewed in the second chapter. The appropriate research methodology is presented in chapter third and the data are presented and analyzed in chapter four. Now, in this final chapter an attempt has been made to present summary of findings, issue and gaps observed and give some suggestion for future course of action.

This study is connected on the various aspects of rights offering with special references to the selected listed commercial banks of Nepal. It covers the period of 18 years from FY 1993/94 to 2010/11. It includes the data of mostly rights issuing commercial banks. But, to show the practice of rights offering in Nepal, researcher takes some data of all rights issuing companies.

Although, Nepalese security market is practicing the rights offering since 1995, almost for 18 years, but it's every essence is not seemed to practice here. Only 217 cases of rights offered by 125 companies, out of total 207 listed companies in Nepal till the FY 2010/11. In Nepal, few cases of rights offering meet the theory. Mixed results have been obtained from the sample companies regarding rights offering theory in Nepal. In case of Kumari Bank Ltd., Nepal Bangladesh Bank Ltd. & Nepal SBI Bank Ltd. mixed result was observed. But in case of Nepal Investment Bank Ltd., share price was Rs.1135 before the announcement date and it went up to Rs.1336 after the announcement of rights

shares and again fell down to Rs.1240 after allotment of rights share. Share price of Prime Commercial Bank Ltd. before rights share announcement was Rs. 275, but it went down to Rs. 270 at the time of announcement and again it fell down to 244.

This study has been done to fulfill some specific objectives. Main objectives of this study, is to examine the movement in share price before and after the announcement of rights issues and to analyze the rights issue practice in Nepal. Finding out the problem of rights issue in Nepal is another objective if this study. Till the date, many studies have been done related to the impact on market price by various variables such as EPS, DPS and signaling effects. But, very few studies are directly concerned with rights issue in Nepal, because rights issue is a growing phenomenon in Nepal. But, it is really tried hard to make full effort to collect the related studies for review in second chapter.

This study heavily based on secondary data. So, useful data are collected from SEBON and related organization as well. Newspaper, annual reports of sample companies, journals, and bulletins' are important source to get secondary data in this study. Other information is collected through internet as well. Primary data to make this study more reliable has been used to some extent. To collect primary data, personal interview and distribution of questionnaire to some specific people has been done. To conduct this study, Stastical as well as financial tools have been used.

Conclusion

Finally, it can be concluded that there is no long history of rights share in Nepal. So, it is a growing phenomenon in Nepal. There is no doubt that a lot of things to be worked out to make the rights offering as effective instrument of raising fund in Nepal. While analyzing the rights offering by Nepalese companies, there are very few companies, which has meet the theory of rights offering i.e. the share price has increased significantly after the announcement of rights share and then traced on ex-rights price. In our sample, the bank's entire share was either traded above ex-rights price or below it. Almost in all

cases of rights offering there exists some sort of under subscription of rights share. Some of shareholders even cannot get information about the rights share announcement made by their companies, other who are informed are not all aware of what the rights share means and what can be its impact on their wealth position. In Nepal, rights are not transferable, which is also one of the causes of under subscription of rights share. There is no clear and easy provisions regarding sales of under subscribed rights share and many companies are distributing it to their employees. The employees are gaining in the cost of existing shareholders. The large no. of shareholders is holding the few share and they generally ignore about the rights share.

While testing the hypothesis, mixed results have been obtained. In most companies, rights share affects the share price movement whereas in some it does not affect. Share price movement and general market movement in some cases positively correlated and in some cases it is negatively correlated. While analyzing share price movement during five periods, researcher has obtained different results. The legal provision and policies regarding of securities is not clear and the process of approval is lengthy. The formalities to be completed by issue manager before getting approval, is time consuming and lengthy. Some time it may take a fiscal year and in next fiscal year the essence of issue may not remain and this is the reason that in some cases of rights offering holders record date remains prior to the announcement date, which is not consistent with the theory of rights offering. The regulation of the calculation of premium is not clear and certain regulation requires company to issue rights share in par value that results in wide difference between market price per share and subscription price.

Thus, finally we can say that rights offering have some impact on share price that can be positive or negative. The generally market movement to greater extent in Nepal also influences the market price of share. The capital market is not matured and the rights issue has not practiced properly by all sectors and companies.

Recommendations

Based on the findings of the analysis and the issues and gaps mentioned above, the researcher has provided some practicable recommendation in the following points:

- 1) In Nepal all companies do not do rights share practice properly. So, government should positively motivate them by good governance and provisions regarding rights share.
- 2) Nepalese investors are not so well aware about rights offering. So, to increase the awareness of investors, some programs like; interaction, advertisement, videoconference, radio talk etc, should be managed by related companies, government and media as well.
- 3) The mechanism if information flow is not found to be appropriate and effective that results in heavy under subscriptions of rights share. Thus, effective alternative of information flow should be searched.
- 4) Free pricing concept should be implemented in rights offering to get rid off the problem of low subscription price of rights share.
- 5) Provisions regarding sales of under subscribed rights share should be made. The current practice to distribute them among the employees of the respective companies violates the very essence of the rights offering. The company act, should be quite clear in this regard.
- 6) Lack of Acts for the investors' protection, is another causes of under subscription of rights share. So, there should separate investors' protection Act, so that, investors can maintain their confidence, over their investment and feel secured.
- 7) One critical factor that affects the share price and subscription is the holder's record date. The investors who purchase the share after that date are unable to get share. So, right issuing companies should set the proper holder record date so the investors who want to enjoy the right offering can purchase the share issued by them.