CHAPTER – I

INTRODUCTION

1.1 Background of the Study

A milestone for any company is the issuance of publicly traded stock. While the motivations for an initial public offering are straightforward, the mechanism for doing so is complex. When a company wishes to make a public offering, its first step is to select an investment bank to advise it and to perform underwriting functions in connection with the issue. The selection process relies on the investment banker's general reputation and expertise as well as on the quality of its research coverage in the company's specific industry. The selection also depends on whether the issuer would like to see its securities held more by individuals or by institutional investors (i.e., the investment bank's distribution expertise). Prior banking relationships the issuer and members of its board (especially the venture capitalists) have with specific firms in the investment banking community also influence the selection outcome. Often, the selection process is a two-way affair, with the reputable investment banker choosing its clients at least as carefully as the company should choose the investment banker.

The most common type of underwriting arrangement involved with large issues is the "firm commitment" underwriting. In a firm commitment underwriting, the underwriter purchases the entire issue of securities from the issuer and then attempts to resell the securities to the public. The difference between the price at which the underwriter buys and subsequently sells the issue is called the gross spread.

Public offerings can be managed by one underwriter (sole managed) or by multiple mangers. When there are multiple managers, one investment bank is selected as the lead or book-running manager. The lead manager almost always appears on the left of the cover of the prospectus, and it plays the major role throughout the transaction. The managing underwriter makes all the arrangements with the issuer, establishes the schedule of the issue, and has the primary responsibility for the due diligence process, pricing and distribution of the stock. The lead manager is also responsible for assembling a group of underwriters (the syndicate) to assist in the sale of the shares to the public. Members of the syndicate are paid a portion of the gross spread for their participation.

Public offerings are primarily sold to institutional investors, but some shares are also allocated to the underwriters' retail investors. The client pays no commission to purchase the shares of a public offering; the purchase price simply includes cash. The issuer usually allows the underwriters an option to increase the size of the offering by up to 30% under certain circumstance known as the allotment option.

Initial Public Offering (IPO) is a part of primary market mechanism. When an intuition raises capital from public through issuance of its securities for the first time, then its issue to the public is termed as Initial Public Offering (IPO). The securities offered can be ordinary share, debenture, preference share and mutual fund schemes. Initial Public Offering (IPO) role plays an important and often the only major source of obtaining large sum of fixed rate and long term funds. Initial Public Offering (IPO) can either be underwritten or sold to general public or to be sold to the company’s existing investors through a preemptive right offering. To reduce the offering costs of the shares, the old companies (those which have already issued shares) issue them through right offering. And the procedure of issuing the securities through right offering is the same as that of registering the non- right issue.

Initial Public Offering (IPO) being an important component of capital market is bound to be influenced by the size and level of development of capital market. But, Nepal doesn’t have long history of capital market.

1.2 Statement of the Problem

In many countries stock exchange has a long history of more than one century. For example Indian stock market has a history more than 130 years. The stock exchange of Nepal has not so long history, though has faced many up and downs during this short history. Establishment of NEPSE has given an opportunity to investors to invest in the enterprise sector and participate in the secondary market. The company used different rules and regulation in stock market development. The stock market in Nepal is operating in immature stage. The market has inseparable part of liberal economy, existing imbalances, political instability and ineffective implementation of liberal economic policy. Therefore this study is carried out to analyze the market share prices of the Nepalese stock market in relation to banking sector and to recommend for the improvement.

The performance of the stock exchange has improved gradually due to the low priority in financial sector. Many problems have arised in the market like unstable political situation, lack of rational behaviors, lack of information to investors, poor corporate governance, handle by large investors in the stock market and whim wrong information to investors. Although the Nepalese stock market is still in its infant stage and contribution to GDP is still nominal. But the Initial Public Offering (IPO) plays an important role in the stock market. Under this study it has focused Initial Public Offering (IPO) role in the stock market.

a. What is the existing state of Initial Public Offering (IPO) in Nepal?
b. What is the growth position of the public issuance?
c. What behavior has shown by the investors in IPO?
d. What are the advantages and disadvantages of IPO for issuing company?
e. What major risk is associated in IPO?

1.3 Objectives of the Study

The main objective of this study is to analyze different aspects of Initial Public Offering (IPO) in Nepal. The specific objectives of this research are as follows.

a. To analyze the existing state of Initial Public Offering (IPO).
b. To examine the growth of public issuance.
c. To measure the behavior of investors in IPO in terms of over/under subscription.
d. To trace out the advantages and disadvantages of IPO to the issuing company.
e. To ascertain the major risk factors and risks associated with IPO.

1.4 Significance of the Study

This study is very beneficial to all parties involved in the stock market. Because every investors will not have well knowledge about the real financial strength and weakness of the companies. Therefore, this study focuses on the disclosure and performance of the listed companies in Nepal. The market is dominated by individual investors and most of them are not making informed investment decisions rather driven by market rumors.

The capital market of Initial Public Offering (IPO) is practices are very limited in Nepal. This study will be helpful to government, organizations, shareholders, investors, researcher, and students and to the general public. In a market mechanism of capital market, Initial Public Offering (IPO) and its practices are very limited in Nepal.

The significance of this study is as follows:

- To contribute literature to further researcher in this area.
- To useful for university students who are curious to know about the stock price behavior.
- To draw attention from every corner of investors and also other interested parties. For all researchers and parties can be benefited.

1.5 Limitation of the Study

This study has been conducted with certain limitations which are follows.

a. The stock market of Nepal is limited.
b. Research is based on the data of NEPSE official records and the data are not verified.
c. The data is used from the secondary data from the period FY 2001/02-2009/10.
d. The reliability of the primary data depends absolutely on the responses of the respondents.
e. The study concerns only with the initial public offering and does not cover other performance in stock exchange.

1.6 Organization of the Study

The present study will be divided in the following steps:

Chapter – I: Introduction

The first chapter would complete the introduction being studied, the statement of problem, and objective of study, need of study and limitation of study. This chapter would serve to present the topic within the general area of interest and would be used to provide a preliminary focus upon the topic with a wider scope.

Chapter – II: Review of Literature

This chapter would include the reviews of previous writings and studies relevant to the problem being explored and writhen the framework of the theory structure.

This chapter deals with review of different literature of the study field. Therefore this includes the review of major books, journals, research work and thesis etc. along with conceptual framework.

Chapter – III: Research Methodology

The third chapter research methodology would include research design, sampling procedure, sources of data, data gathering process, variable and measurement and tools used for documentation

This chapter elaborates the research methodology and it includes research design, population and sample, source and technique of data collection, data analysis tools.

Chapter – IV: Data Presentation and Analysis

This chapter comprises research design, sources of data, method of analysis and its descriptive presentation. This chapter adopted the methodology of research. This chapter includes analysis and interpretation of the data using financial and statistical tools .This also include the major findings of the study.

Chapter –V Summary, Conclusion & Recommendations

This chapter includes summary of the study, conclusion and recommendations with bibliography. The fifth and final chapter is concerned with the suggestive framework that consists with the summary, conclusion and recommendation

CHAPTER – II
REVIEW OF LITERATURE

Review of literature sheds light on the process of making research. Under this section, the concepts and the previous studies related to the initial public offerings have been reviewed. This section of the study has been mainly divided in four major sections; conceptual framework, review of journals and articles, review of thesis and research gap.

2.1 Conceptual Framework

2.1.1 Initial Public Offering

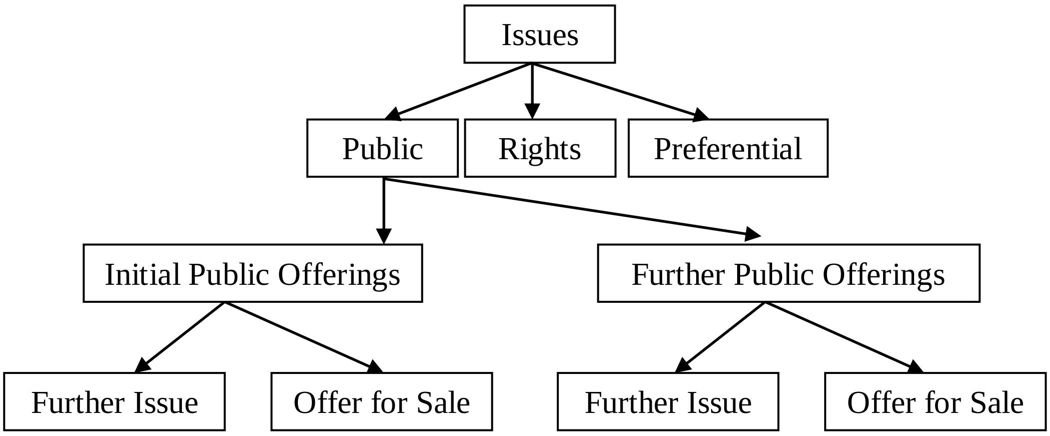
"Initial public offering (IPO), also referred to simply as a "public offering", is when a company issues common stock or shares to the public for the first time.
They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies looking to become publicly traded. In an IPO, the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market. Initial Public Offering (IPO) means the selling of the shares of a company, for the first time, to the public in the country's capital markets. This is done by giving to the public, shares that are either owned by the promoters of the company or by issuing new shares." *(Beatty and Ritter; 1986: 216-217)*

"During an Initial Public Offer (IPO) the shares are given to the public at a discount on the intrinsic value of the shares and this is the reason that the investors buy shares during the Initial Public Offering (IPO) in order to make profits for themselves. IPO is done through various methods like book building method, fixed price method, or a mixture of both. The method of book building helps the company to find out the demand and price of its shares. A merchant banker is nominated as a book runner by the Issuer of the IPO. The company that is issuing the Initial Public Offering (IPO) decides the number of shares that it will issue and also fixes the price band of the shares. All these information are mentioned in the company's red herring prospectus.” *(Dewenter and Malatesta; 1997: 167-168)*

“During the company's Initial Public Offering (IPO), normally an electronic book is opened for at least five days. During this period of time, bidding takes place which means that people who are interested in buying the shares of the Company makes an offer within the fixed price band. Once the book building is closed then the issuer as well as the book runner of the Initial Public Offering (IPO) evaluate the offers and then determine a fixed price. The offers for shares that fall below the fixed price are rejected. The successful bidders are then allotted the shares IPO’s can be a risky investment. For the individual investor, it is tough to predict what the stock or shares will do on its initial day of trading and in the near future since there is often little historical data with which to analyze the company. Also, most IPO’s are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value.” *(Rock; 1986: 203)*

Figure 2.1

Different Kind of Issues



2.1.2 Reasons for Listing

“When a company lists its shares on a public exchange, it will almost invariably look to issue additional new shares in order to raise extra capital at the same time. The money paid by investors for the newly-issued shares goes directly to the company (in contrast to a later trade of shares on the exchange, where the money passes between investors). An IPO, therefore, allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The company is never required to repay the capital, but instead the new shareholders have a right to future profits distributed by the company and the right to a capital distribution in case of dissolution." *(Michaely and Womack; 1998: 61)*

"The existing shareholders will see their shareholdings diluted as a proportion of the company's shares. However, they hope that the capital investment will make their shareholdings more valuable in absolute terms. In addition, once a company is listed, it will be able to issue further shares via a rights issue, thereby again providing itself with capital for expansion without incurring any debt. This regular ability to raise large amounts of capital from the general market, rather than having to seek and negotiate with individual investors, is a key incentive for many companies seeking to list." *(Baron and Holmstrom; 1980: 42-43)*

2.1.3 Advantages of IPO

a. Increased Capital: "A public offering will allow a company to raise capital to use for various corporate purposes such as working capital, acquisitions, research and development, marketing, and expanding plant and equipment." *(Aggarwal; 1988: 35)*

b. Liquidity: "Once shares of a company are traded on a public exchange, those shares have a market value and can be resold. This allows a company to attract and retain employees by offering stock incentive packages to those employees. Moreover, it also provides investors in the company the option to trade their shares thus enhancing investor confidence." *(Aggarwal; 1988: 35)*

c. Increased Prestige: “Public companies often are better known and more visible than private companies, this enables them to obtain a larger market for their goods or services. Public companies are able to have access to larger pools of capital as well as different types of capital.” *(Aggarwal; 1988: 36)*

d. Valuation: “Public trading of a company's shares sets a value for the company that is set by the public market and not through more subjective standards set by a private valuator. This is helpful for a company that is looking for a merger or acquisition. It also allows the shareholders to know the value of the shares.” *(Aharony, Chi-Wen and Wong; 2000: 107)*

e. Increased wealth: “The founders of the company often have the sense of increased wealth as a result of the IPO. Prior to the IPO these shares were illiquid and had a more subjective price. These shares now have an ascertainable price and after any lockup period these shares may be sold to the public, subject to limitations of federal and state securities laws.” *(Aharony, Chi-Wen and Wong; 2000: 108)*

2.1.4 Disadvantages of IPO

a. Time and Expense: “Conducting an IPO is time consuming and expensive. A successful IPO can take up to a year or more to complete and a company can expect to spend several hundreds of thousands of dollars on attorneys, accountants, and printers. In addition, the underwriter's fees can range from 3% to 10% of the value of the offering. Due to the time and expense of preparation of the IPO, many companies simply cannot afford the time or spare the expense of preparing the IPO.” *(Aharony, Chi-Wen and Wong; 2000: 110)*

b. Disclosure: “The Securities and Exchange Commission (SEC) disclosure rules are very extensive. Once a company is a reporting company it must provide information regarding compensation of senior management, transactions with parties related to the company, conflicts of interest, competitive positions, how the company intends to develop future products, material contracts, and lawsuits. In addition, once the offering statement is effective, a company will be required to make financial disclosures, public companies required to file quarterly statements containing unaudited financial statements and audited financial statements annually. These statements must also contain updated information regarding nonfinancial matters similar to information provided in the initial registration statement. This usually entails retaining lawyers and auditors to prepare these quarterly and annual statements. In addition, a company must report certain material events as they arise. This information is available to investors, employees, and competitors." *(Allen and Faulhaber; 1989: 82)*

c. Decisions based upon Stock Price: "Management's decisions may be effected by the market price of the shares and the feeling that they must get market recognition for the company's stock." *(Allen and Faulhaber; 1989: 83)*

d. Regulatory Review: "The Company will be open to review by the Securities and Exchange Commission (SEC) to ensure that the company is making the appropriate filings with all relevant disclosures." *(Allen and Faulhaber; 1989: 83)*

e. Falling Stock Price: "If the shares of the company's stock fall, the company may lose market confidence, decreased valuation of the company may affect lines of credits, secondary offering pricing, the company's ability to maintain employees, and the personal wealth of insiders and investors." *(Lui and Wende; 2001: 34)*

f. Vulnerability: "If a large portion of the company's shares are sold to the public, the company may become a target for a takeover, causing insiders to lose control. A takeover bid may be the result of shareholders being upset with management or corporate raiders looking for an opportunity. Defending a hostile bid can be both expensive and time consuming. Once a company has weighed the advantages and disadvantages of being a public company, if it decides that it would like to conduct an IPO it will have to retain a lead underwriter to sell the securities, an attorney to assist in the preparation of a registration statement, and auditors to prepare financial statements." *(Lui and Wende; 2001: 34)*

2.1.5 The Risk Factor

"Investing in IPO is often seen as an easy way of investing, but it is highly risky and many investment advisers advise against it unless you are particularly experienced and knowledgeable. The risk factor can be attributed to the following reasons:

a. Unpredictable: The Unpredictable nature of the IPO's is one of the major reasons that investors advise against investing in IPO's. Shares are initially offered at a low price, but they see significant changes in their prices during the day. It might rise significantly during the day, but then it may fall steeply the next day.

b. No Past Track Record of the Company: No past track record of the company adds further to the dilemma of the shareholders as to whether to invest in the IPO or not. With no past track record, it becomes a difficult choice for the investors to decide whether to invest in a particular IPO or not, as there is basis to decide whether the investment will be profitable or not.

c. Potential of Stock Market: Returns from investing in IPO are not guaranteed. The Stock Market is highly volatile. Stock Market fluctuations widely affect not only the individuals and household, but the economy as a whole. The volatility of the stock market makes it difficult to predict how the shares will perform over a period of time as the profit and risk potential of the

IPO depends upon the state of the stock market at that particular time." *(Ritter and Welch; 2002: 13-17)*

2.1.6 Risk Assessment

"The possibility of buying stock in a promising start-up company and finding the next success story has intrigued many investors. But before taking the big step, it is essential to understand some of the challenges, basic risks and potential rewards associated with investing in an IPO. This has made Risk Assessment an important part of Investment Analysis. Higher the desired returns, higher would be the risk involved. Therefore, a thorough analysis of risk associated with the investment should be done before any consideration. For investing in an IPO, it is essential not only to know about the working of an IPO, but we also need to know about the company in which we are planning to invest. Hence, it is imperative to know:

- The fundamentals of the business
- The policies and the objectives of the business
- Their products and services
- Their competitors
- Their share in the current market
- The scope of their issue being successful." *(Su and Fleisher; 1998: 8-10)*

"It would be highly risky to invest without having this basic knowledge about the company. There are mainly three kinds of risks involved in investing in IPO:

a. Business Risk: It is important to note whether the company has sound business and management policies, which are consistent with the standard norms. Researching business risk involves examining the business model of the company.

b. Financial Risk: Is this company solvent with sufficient capital to suffer short-term business setbacks? The liquidity position of the company also needs to be considered. Researching financial risk involves examining the corporation's financial statements, capital structure, and other financial data.

c. Market Risk: It would beneficial to check out the demand for the IPO in the market, i.e., the appeal of the IPO to other investors in the market. Hence, researching market risk involves examining the appeal of the corporation to current and future market conditions." *(Grinblatt and Hwang; 1989: 48-50)*

2.1.7 Analyzing an IPO Investment

2.1.7.1 Potential Investors and Their Objectives

"Initial Public Offering is a cheap way of raising capital, but all the same it is not considered as the best way of investing for the investor. Before investing, the investor must do a proper analysis of the risks to be taken and the returns expected. He must be clear about the benefits he hope to derive from the investment. The investor must be clear about the objective he has for investing, whether it is long-term capital growth or short-term capital gains. The potential investors and their objectives could be categorized as:

a. Income Investor: An 'income investor' is the one who is looking for steadily rising profits that will be distributed to shareholders regularly. For this, he needs to examine the company's potential for profits and its dividend policy.

b. Growth Investor: A 'growth investor' is the one who is looking for potential steady increase in profits that are reinvested for further expansion. For this he needs to evaluate the company's growth plan, earnings and potential for retained earnings.

c. Speculator: A 'speculator' looks for short-term capital gains. For this he needs to look for potential of an early market breakthrough or discovery that will send the price up quickly with little care about a rapid decline." *(Booth and Chua; 1995: 296-297)*

2.1.7.2 Investor Research

"It is imperative to properly analyze the IPO the investor is planning to invest into. He needs to do a thorough research at his end and try to figure out if the objective of the company match his own personal objectives or not. The unpredictable nature of IPO's and volatility of the stock market adds greatly to the risk factor. So, it is advisable that the investor does his homework, before investing. The investor should know about the following:" *(Datar and Mao; 1998: 123-124)*

a. Business operations:

- What are the objectives of the business?
- What are its management policies?
- What is the scope for growth?
- What is the turnover of the labor force?
- Would the company have long-term stability?

b. Financial Operations:

- What is the company's credit history?
- What is the company's liquidity position?
- Are there any defaults on debts?
- Company's expenditure in comparison to competitors.
- Company's ability to pay-off its debts.
- What are the projected earnings of the company?

c. Marketing Operations:

- Who are the potential investors?
- What is the scope for success of the IPO?

- What is the appeal of the IPO for the other investors?
- What are the products and services offered by the company?
- Who are the strongest competitors of the company?

2.1.8 IPO Investment Strategies

“Investing in IPOs is much different than investing in seasoned stocks. This is because there is limited information and research on IPOs, prior to the offering. And immediately following the offering, research opinions emanating from the underwriters are invariably positive. There are some of the strategies that can be considered before investing in the IPO:

a. Understand the Working of IPO: The first and foremost step is to understand the working of an IPO and the basics of an investment process. Other investment options could also be considered depending upon the objective of the investor.

b. Gather Knowledge: It would be beneficial to gather as much knowledge as possible about the IPO market, the company offering it, the demand for it and any offer being planned by a competitor.

c. Investigate Before Investing: The prospectus of the company can serve as a good option for finding all the details of the company. It gives out the objectives and principles of the management and will also cover the risks.

d. Know your broker: This is a crucial step as the broker would be the one who would majorly handle your money. IPO allocations are controlled by underwriters. The first step to getting IPO allocations is getting a broker who underwrites a lot of deals.

e. Measure the Risk Involved: IPO investments have a high degree of risk involved. It is therefore, essential to measure the risks and take the decision accordingly.

f. Invest at your Own Risk: Finally, after the homework is done, and the big step needs to be taken. All that can be suggested is to 'invest at your own risk'. Do not take a risk greater than your capacity." *(Mok and Hui; 1998: 51-54)*

2.1.9 Pricing of an IPO

"The pricing of an IPO is a very critical aspect and has a direct impact on the success or failure of the IPO issue. There are many factors that need to be considered while pricing an IPO and an attempt should be made to reach an IPO price that is low enough to generate interest in the market and at the same time, it should be high enough to raise sufficient capital for the company. The process for determining an optimal price for the IPO involves the underwriters arranging share purchase commitments from leading institutional investors." *(Taranto; 2001: 85)*

a. Process

"Once the final prospectus is printed and distributed to investors, company management meets with their investment bank to choose the final offering price and size. The investment bank tries to fix an appropriate price for the IPO depending upon the demand expected and the capital requirements of the company. The pricing of an IPO is a delicate balancing act as the investment firms try to strike a balance between the *company* and the *investors.* The lead underwriter has the responsibility to ensure smooth trading of the company's stock. The underwriter is legally allowed to support the price of a newly issued stock by either buying them in the market or by selling them short." *(Taranto; 2001: 87-88)*

b. IPO Pricing Differences

"It is generally noted, that there is a large difference between the price at the time of issue of an Initial Public Offering (IPO) and the price when they start trading in the secondary market. These pricing disparities occur mostly when an IPO is considered "hot", or in other words, when it appeals to a large number of investors. An IPO is "hot" when the demand for it far exceeds the supply. This imbalance between demand and supply causes a dramatic rise in the price of each share in the first day itself, during the early hours of trading." *(Taranto; 2001: 90)*

2.1.10 Underpricing and Overpricing of IPO's

2.1.10.1 Underpricing

"The pricing of an IPO at less than its market value is referred to as 'Underpricing'. In other words, it is the difference between the offer price and the price of the first trade. Historically, IPO's have always been 'underpriced'. Underpriced IPO helps to generate additional interest in the stock when it first becomes publicly traded. This might result in significant gains for investors who have been allocated shares at the offering price. However, underpricing also results in loss of significant amount of capital that could have been raised and the shares been offered at the higher price." *(Brennan and Franks; 1997: 50)*

2.1.10.2 Overpricing

"The pricing of an IPO at more than its market value is referred to as 'Overpricing'. Even "overpricing" of shares is not as healthy option. If the stock is offered at a higher price than what the market is willing to pay, then it is likely to become difficult for the underwriters to fulfill their commitment to sell shares. Furthermore, even if the underwriters are successful in selling all the issued shares and the stock falls in value on the first day itself of trading, then it is likely to lose its marketability and hence, even more of its value." *(Brennan and Franks; 1997: 52)*

2.1.11 IPO Procedure

"IPO's generally involve one or more investment banks as "underwriters." The company offering its shares, called the "issuer," enters a contract with a lead underwriter to sell its shares to the public. The underwriter then approaches investors with offers to sell these shares. The sale (that is, the allocation and pricing) of shares in an IPO may take several forms. Common methods include:

- Best efforts contract
- Firm commitment contract
- All-or-none contract
- Bought deal
- Dutch auction
- Self distribution of stock

A large IPO is usually underwritten by a "syndicate" of investment banks led by one or more major investment banks (lead underwriter). Upon selling the shares, the underwriters keep a commission based on a percentage of the value of the shares sold. Usually, the lead underwriters, i.e. the underwriters selling the largest proportions of the IPO, take the highest commissions—up to 8% in some cases." *(Gu; 2001: 21-23)*

"Multinational IPOs may have as many as three syndicates to deal with differing legal requirements in both the issuer's domestic market and other regions. For example, an issuer based in the EU may be represented by the main selling syndicate in its domestic market, Europe, in addition to separate syndicates or selling groups for US/Canada and for Asia. Usually, the lead underwriter in the main selling group is also the lead bank in the other selling groups. Because of the wide array of legal requirements, IPOs typically involve one or more law firms with major practices in securities law, such as the Magic Circle firms of London and the white shoe firms of New York City." *(Loughran, Ritter and Rydqvist; 1994: 115)*

“Usually, the offering will include the issuance of new shares, intended to raise new capital, as well the secondary sale of existing shares. However, certain regulatory restrictions and restrictions imposed by the lead underwriter are often placed on the sale of existing shares. Public offerings are primarily sold to institutional investors, but some shares are also allocated to the underwriters' retail investors. A broker selling shares of a public offering to his clients is paid through a sales credit instead of a commission. The client pays no commission to purchase the shares of a public offering; the purchase price simply includes the built-in sales credit.

The issuer usually allows the underwriters an option to increase the size of the offering by up to 15% under certain circumstance known as the green shoe or over allotment option. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded. In an IPO, the issuer obtains the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), the best offering. *(Welch; 1989: 63-64)*

2.1.12 Parties Involved in Initial Public Offering (IPO)

Initial Public Offering (IPO) is being complex and time consuming process often needs the participation of a number of entities. In this reference, generally those parties or intuitions which play role during the process of Initial Public Offering (IPO) in Nepal are discussed as follows.

a. Issuing Company

It refers to the company, which is committing Initial Public Offering (IPO) to raise capital from public. As provision of Company Act, 2063 B.S. only public limited companies are allowed to go for Initial Public Offering (IPO). The Act has specifically stated that the private companies should not issue their shares or debentures to the public. Similarly, as per NRB rules and regulations banks and finance companies had to go for Initial Public Offering (IPO) within the certain time. Furthermore, as per provisions of Banks and Financial Intuitions Act, 2006 A.D. banks and finance companies should set aside minimum of 30% of their issued capital to be allocated to the public. However, 5% of such shares could be allocated to their employees.

b. Issue Manager

Issue Manager is an intuition who is solely responsible to manage Initial Public Offering (IPO). As per Securities Act, 2062 A.D. issue managers are institution holding license from the Nepal Stock Exchange to manage public offering issues. So far, NEPSE has authorized nine companies to serve as an issue manger. Issue Managers receive issue commission from issuing company in return of their services. Such issue commissions are decided through negotiation although, Securities Issue by laws, 2054 B.S have the conditions maximum limit for it.

c. Underwriting and Underwriter

Underwriter is an intuition authorized to render insurance to the securities issued during Initial Public Offering (IPO) and to accept liability for specified risk. As far as practices in Nepal are concerned issue form manufacturing and processing and banks have to be underwritten, but such provisions have been relaxed for finance companies. Furthermore, in the event that the issued shares are not fully subscribed by public, the unsold issues have to be distributed among the underwriters on pro-rata basis to the extent of their commitment. They can receive maximum 3% underwritten amount as their service charge as per provision Securities Listing by laws, 2054 B.S.

d. Bankers to the Issue

Banker to the Issue is normally commercial banks and their main responsibility is to provide custodian service to the issuing company. They may or may not receive applications from the investors, issue acknowledgement for the same and enter the application detail in application schedules. They may also be involved in the process of realizing the proceeds of issue manger for the number of applications and amount collected.

e. Collection Centers

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

f. Others

Various Other intuitions like Securities Board of Nepal, Nepal Stock Exchange (NEPSE), Nepal Rastra Bank (NRB) and Company Registrar's Office (CRO) also do play same role influencing Initial Public Offering (IPO). As per provisions of Securities Act, 2063 B.S. issuing companies should get issue approval from Securities Board of Nepal (SEBON). The companies should also get issue approval from Company Registrar's Office (CRO). If the issuing companies are financial intuitions then they need to obtain approval from Nepal Rastra Bank (NRB) as well for prior issuing their shares to the public. Trading of securities is considered illegal, if they are not listed in Nepal Stock Exchange (NEPSE).

2.1.13 Legal Aspects and Process of Initial Public Offering in Nepal

Any institution that goes for Initial Public Offering (IPO) needs to work as a guideline by various laws, acts and regulations. Generally Company Act, 2053 B.S. and Securities Exchange Act, 1983 A.D. used to guide Initial Public Offering (IPO) activities in the past. However these acts have been replaced by Company Act, 2063 B.S. and Securities Act, 2063 B.S. respectively. So, the companies need to consider the guidelines mentioned acts and their provisions. As well as their also exist other legislation and guidelines such as Security Registrations and Approval Guidelines,2000 A.D., Securities Allotment Guideline 1994 A.D., Securities Listing by laws, 1996 A.D. to ensure that Initial Public Offering (IPO) process become transparent and disciplined.

The first and foremost step in the process of Initial Public Offering (IPO) is to get an authorized investment banker or issue manager i.e. authorized from Nepal Stock Exchange(NEPSE) to handle the whole process as per provision of Securities Registration and Issue Approval Guidelines,2000 A.D. After appointing, the issue manager conducts through investigation of the issuing company that is mentioned in the proposal for the public issue like nature of business, its financial position, plans, management and strengthens position. If the proposal is satisfied, the issue manager prepare detail document along with the prospectus to be submitted into the Company Registrar's Office (CRO).

Company Registrar's Office (CRO) receiving such prospectus, it analyses its various aspects in consultation with Securities Board of Nepal (SEBO/N) and only after being satisfied grants issue approval . After receiving the issue approval from Company Registrar's Office (CRO), the issue manager further need to register the prospectus along with other necessary documents in Securities Board of Nepal (SEBO/N) and to obtain the issue approval as per provisions of Securities Act 2063 B.S. The prospectus should contain detailed information regarding name of the company, its address, and objective of its establishment, share capital value, potential risk involved, and name of the promoters, the chief executive officer introduction and various other information which will enable investors to make rational decision. In the case of financial intuitions they need to get issue approval from Nepal Rastra Bank (NRB).

Priority will give to issue approval Securities Board of Nepal (SEBO/N) analyses the validity of the information presented in the prospectus and the other documents. Due Diligence Report submitted by the issue manager often becomes basis for such analysis. After receiving issue approval from both Company Registrar's Office (CRO)/Securities Board of Nepal (SEBO/N), the issue manager on behalf of issuing company is now legally authorized to make public issue. The issuing company should open its issue to public within two months from the date of approval by Securities Board of Nepal (SEBO/N) Securities Registration and Issue Approval Guidelines, 2000 A.D.

2.1.13.1 SEBON Regulations

The Securities Board of Nepal has made following provisions regarding the issuance of securities and right share;

Public Issuance of Securities

a. If a Corporate Body intends to sale and distribute its securities to more than fifty persons at a time, it shall be required to make public issuance of securities. While selling securities through public offering the Corporate Body shall be required to set aside at least thirty percent of its issued for public subscription.
b. The corporate body making public issue pursuant to Sub-regulation (1) shall be required to have completed a minimum of one year of business operation under it objectives and also require to have already published the audited financial reports for the period.
c. The application for publicly issued shares pursuant to Sub-regulation (1) shall have citizenship certificate verified by the applicant attached thereto and also shall have to mention the name, address of the bank or financial institution where the applicant has maintained account and account number and the Issue Manager require to have arranged the refund of application money to be deposited in the bank account. Provided, however, that

applicants subscribing for more than Rs. 50,000 require depositing the application money compulsorily through account payee check.

d. In case the application money so received has been deposited with the Banker to the Issue for interest, eighty percent of the interest so received shall be required to be given to the applicant in a proportion al basis for the days from the application date to the day before the allotment date and the Board shall be informed of such arrangement.
e. The body corporate while making public issue of securities pursuant to these regulations may reserve up to five percent of the share to the working staffs and up to five percent for the local residents depending on the nature of business like hydropower, production or processing, out of the shares set aside for public issue. However, the shares reserves as such shall not be eligible to be sold or transferred within a minimum period of three years from the date of allotment.
f. Other provision related to the public issuance shall be prescribed by the Board under its directives.
g. In case a body corporate has issued securities without making public issue as prescribed by these regulations such securities shall not be eligible for trading through the stock exchange or an alternative trading system.
h. The Issue Manager shall be required to cancel any authorized application that it detects to have stated false information thereon. In case the Board finds that such application is not cancelled and the securities are distributed, the Board may impose fine equivalent to the same amount on the Issue and Sales Manager. The Board is required to use the proceeds only for the development of capital market.

2.2 Review of Journals and Articles

Sherman (2006), in his article, *"Global Trends in IPO Methods: Book Building vs. Auctions with Endogenous Entry",* has stated that book building is less risky than a sealed bid auction because someone is managing the process, making sure that at least a certain minimum number of investors carefully evaluate the offering. If too many investors want to participate, the underwriter can guarantee that serious regular investors receive enough shares so that their time evaluating the offering is not wasted. Standard sealed bid auctions cannot ensure that a reasonable number of investors will ever take the time to seriously evaluate an IPO.

Surprisingly, increasing the number of potential bidders in an auction may make the issuer worse off, in terms of both underpricing and the risk of failure. More potential bidders lead to more risk and to potentially lower returns for each bidder, thus discouraging both entry and evaluation. Auctions open to large numbers of potential investors may lead to inaccurate pricing, high aftermarket volatility and wide variation in the number of bidders. Moreover, underwriters allocate shares in hot issues to regular investors based on their general relationship, rather than allocating based exclusively on the current issue, or even based exclusively on repeated IPO participation. This also is not, by itself, a problem for issuers because any side-benefits that an underwriter expects to receive from handling an IPO should be factored into the general package of fees and services that it offers to an issuer, if underwriters compete for investment banking business. If, on the other hand, underwriters can win investment banking business by spinning (allocating hot IPO shares to the personal accounts of executives at potential client firms), then the book building system is seriously flawed.

Lowry and Schwert (2007), in their article, "*Biases in the IPO Pricing Process",* have examined the entire IPO pricing process to study the apparent biases in the pricing of new offerings. The study revealed that there are significant biases in these expected offer prices. Specifically, the price update, defined as the percent difference between the midpoint of file range and the final offer price, is predictably related to publicly known firm- and offer-specific characteristics. Apparently, companies and their investment bankers do not incorporate all available information when setting this price range. While significant relations between such characteristics and the initial return have been interpreted as supportive of information asymmetry theory, it is difficult to similarly explain the predictability of the price update.

The study further investigated how information that becomes available during the book-building period is incorporated into the offer price. The results showed that companies and their underwriters update the offer price in response to recent market returns. However, this adjustment process does not seem to be directly related to the date on which the initial price range is first revealed. Underwriters appear to consider the past three months of market returns when they update the offer price, irrespective of when the initial price range was first revealed. This finding provides additional evidence that all available information is not incorporated into the initial price range. Also the response of the final offer price to information is asymmetric, with negative information being more fully incorporated than positive information. This is consistent with investment bankers trying to avoid losses on overpriced issues, but sharing the gains on underpriced issues.

Eckbo and Norli (2008), in their article, *"IPO Market Cycles: Bubbles or Sequential Learning?"* have stated that the dynamic behavior of initial returns and IPO issues is a complicated function of many factors. There are significant biases in IPO offer prices (as forecasts of secondary market trading prices) that arise from underwriters not fully incorporating all available 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 volume.

At first glance, the cycles in initial returns suggest that underwriters fail to account for the market's valuation of recent IPOs in their pricing of new offerings, resulting in avoidable high first-day return 'bubbles'. However, the serial correlation in initial returns is predominantly driven by information learned during the registration periods of recent IPOs but only partially incorporated into the offer price. Although investment bankers do not fully incorporate information learned during the registration period into the offer price, they do seem to fully incorporate the market's valuation of recent IPOs into their pricing of new offerings. The average initial returns at the time a company files an IPO contain no information about the extent to which that company will be underpriced. Thus, there exists no evidence that companies can achieve lower underpricing by filing IPOs during periods of low versus high average initial returns.

Ranjan and Madhusoodanan (2009), in their article, *"IPO Underpricing, Issue Mechanisms, and Size",* have stated that IPOs in India have yielded abnormal returns in the very short term. The abnormal performance is also indicative of pricing errors in the issue process. The issues are under-priced whether the mechanism is fixed price or book building; and small size issues are more likely to be under-priced than larger issues. The study formulated a model with homogenous investor beliefs to show that size is an important factor and that the underpricing is inversely proportional to size. This mechanism also suggests that IPOs will always be underpriced.

However, in the presence of informed investors, a signaling equilibrium doesn't exist and optimally high value firms don't signal their value as aggressively as the lower value firms. Despite such aggressiveness, the lower value firm ends up leaving money on the table, while the high value firm issue doesn't leave money on the table. The model can explain hot (cold) markets by increased (decreased) sensitivity of the uninformed investor to the signaling by the firm. The hot/cold markets also influence the probability of a high/low value firm coming up with an IPO as imputed by the wider market.

Ellis, Michaely and O'Hara (2010), in their article, *"The Variability of IPO Initial Returns"*, have documented the monthly dispersion of IPO initial returns, and demonstrated that the volatility of initial returns is large on average and varies considerably over time. The dispersion of initial IPO returns each month has a strong positive correlation with average initial returns each month (underpricing) over the study period. This relation is stronger in data from the IPO bubble period (September 2004 to August 2006), but persistently positive across all sub-periods analyzed, and contrasts markedly with the negative correlation between the volatility and mean of secondary-market returns.

The large and time-varying volatility of IPO initial returns documented in this study suggests that underwriters have great difficulty in accurately valuing the shares of companies going public through IPOs. The process of marketing an issue to institutional investors, for example during the road show, appears unable to resolve much of the uncertainty about aggregate market demand for the stock of IPO firms. If anything, the opposite: issues for which the most learning occurs during the registration period (large absolute price updates) also have higher volatility of initial returns (i.e. pricing errors). Furthermore, consistent with the notion that the complexity of the pricing problem in traditional firm-commitment offerings contributes to IPO initial return volatility, the study reports greater pricing errors (dispersion of initial returns) when a larger fraction of high information asymmetry firms (young, technology firms) goes public and during hot markets

Hoque and Lasfer (2010), in their article, *"Insider Trading before IPO Lockup Expiry Dates: The UK Evidence",* have examined the insider trading behavior before the lockup expirations in detail and addresses some important corporate finance issues related to lockup contracts in context of going-public procedure by using a unique data over the period 2001-2009. The study finds that in fourteen percent of examined firms, insiders sell equity prior to the expiration of the lock-up. Further firms with venture capital backing and which have done well in the past are likely to be released from the commitment. Also, insiders increase their holdings in 31% of sample while they are subject to lockup.

Firms which have underperformed and firms with venture capitalist presence are positively related to insider purchases before lockup expiry. Trading by corporate insiders provide further evidence which is consistent with commitment as well as signalling quality hypothesis. Furthermore, the notion that lock-ups serve as a commitment device to overcome potential adverse selection at the offering as well as signal firms' quality. Firms that are unprofitable, where institutional investor is not present, go public with lower quality underwriters, and are not venture capital-backed have significantly longer lock-ups.

In general, the negative abnormal returns at the lockup expiration date are consistent with theoretical predictions based on informational asymmetries and reduced incentive alignment involving insiders and general shareholders. These results are appealing as the lockup expiration date is public information, yet significant abnormal returns occur in the days just prior to and on the expiration of the lockup date. The results of the cross-sectional regression points out on characteristics that affect market returns around the lockup expiration date. Eventually, asymmetric information induced by the future actions taken by corporate insiders' is related to negative abnormal returns.

Cao (2011), in his article, *"IPO Timing, Buyout Sponsors' Exit Strategies and Firm Performance of RLBOs",* has stated that buyout sponsor's LBO restructuring duration is affected by IPO timing: when facing favorable IPO conditions or high industry valuations, buyout sponsors tend to shorten the time to restructuring LBOs privately. As a consequence of such IPO timing, RLBOs with shorter duration experience more deterioration in operating performance following their IPOs. Most particularly, buyout sponsors (quickly) flip LBOs to time both operating performance and market conditions. Hence, compared to other RLBOs, quick flips experience worse operating performance and greater probability of bankruptcy post IPO. However, RLBOs as a whole do not exhibit greater declines in operating performance or poorer stock performance than comparable firms.

IPO timing drives RLBO decision but does not affect sponsor's exit post-IPO, while Lockup provisions and concern for reputation help align buyout sponsor incentives to public investors. The study finds that sponsors sell few IPO shares and maintain a significant long-run post-IPO presence and that they make decisions about their post-IPO presence based on company fundamentals and market conditions. Across RLBOs, sponsors choose to maintain a longer presence in firms with higher cash flows and are more likely to exit RLBOs via facilitating takeover when their ownership is greater but via share distribution when the RLBO valuation is higher. Nonetheless, more reputable buyout sponsors are more likely to facilitate takeovers.

Ritter (2011), in his article, *"Initial Public Offerings",* has stated that companies going public, especially young companies, face a market that is subject to sharp swings in valuations. Pricing deals can be difficult, even in stable market conditions, because insiders presumably have more information than potential outside investors. To deal with these potential problems, market participants and regulators insist on the disclosure of material information. Three patterns have been documented for IPOs in the U.S. and many countries: i) new issues underpricing, ii) cycles in volume and the extent of underpricing, and iii) long-run underperformance. In some respects, the poor performance of IPOs in the long run makes the new issues underpricing phenomenon even more of a puzzle. The U.S. IPO market is enormous in comparison with that of most countries. The contrast with continental Europe is especially noteworthy.

Part of the difference is undoubtedly cultural: the willingness of U.S. employees to work for young, unstable companies makes it easier to start a firm. Venture capitalists are willing to finance these firms, knowing that an active IPO market will allow them to cash out if the startup firm succeeds.

Because of the immense number of U.S. IPOs, a large infrastructure has developed to create and fund young companies, especially in the high technology sector. In addition to liquid labor markets, the large volume of IPOs in the U.S. can be partly attributable to a legal system that protects, albeit imperfectly, minority investors. Yet another factor may be the willingness of U.S. investors to, on average, overpay for IPOs. There is evidence that in the choice between an additional round of venture capital financing and going public, firms have some success at choosing periods when the public market is willing to pay the highest valuations. As a result, when the IPO market is most buoyant, investors frequently receive low long-run returns.

2.3 Review of Thesis

Rajbahak (2006), in his thesis, *"Primary Issuer of Share in Nepal",* has the main objective to find out the reaction of public to the primary issuer of the country. The other specific objectives of the study are;

a. To identify the problems of primary share issue market.
b. To assess the growth of primary issue market.
c. To analyze the pattern of public response to shares and to find the reason for variation.

The major findings of the study are;

a. Public response in primary market is high due to lack of opportunities for investment in other fields.
b. No public are attracted towards shares than other securities basically to increase their value of investments, be it dividend gain or bonus shares.
c. It can be seen that public response to primary issues on Banking and financial sectors is normally higher than that of the manufacturing and services sector. There was poor response because interest rates are higher as compared to dividend yield, the public companies were not performing well, and people were unaware about the importance of investing in securities.

Bastola (2007), in his thesis, *"Public Response to IPO in Nepal",* has the main objective to find out the responses of the investors toward the IPO. The specific objectives of the study are;

a. To identify the dealing process of IPO.
b. To analyze the pace of IPO.
c. To analyze the public response to the IPO.

The major findings of the study are;

a. General investors in Nepal do not have sufficient information regarding the primary market and in spite of this they are interested in investing money in the primary market. They are more interested in financial sector than non-financial sector.
b. The pace of initial public offering in Nepal seems to be irregular. Even though the organization's process of public offering is quite long, the service provided to the investors seems to be satisfactory.
c. Public response in stock market is high due to lack of opportunities for investment in other sector. Despite this, public are attracted towards shares to increase their value of investment.

Neupane (2007), in his thesis, *"Underpricing of Initial Public Offerings: Evidence from Nepal",* has the main objective to ascertain the reasons for underpricing. The other specific objectives of the study are;

a. To analyze the degree of underpricing for Nepali IPOs over the study period
b. To examine the sample on a number of basis such as age of company, gross proceeds, industry , leverage, ownership concentration, etc and thereby evaluate underpricing
c. To evaluate the importance of the variables in explaining the degree of underpricing through the application of multiple regression model.

The major findings of this study are:

a. The study, which is a first of its kind in Nepal, documents the degree of underpricing in the context of Nepal, a developing economy. Similar to degree of underpricing documented in other developing economies, the degree of underpricing is substantially higher than the developed economies.
b. The study also tries to reflect the characteristics of typical IPO in Nepal. Although the period covered under the study is not very long, it does help us to identify what an IPO in Nepal offers. Nepali IPOs typically have small issue size, reflecting the strength and size of the economy. Moreover, they are relatively young companies without a very long operating history. The study also shows that pre IPO owners do not offer a very high percentage of shares to the public as is shown by the high ownership ratio post IPO. One more interesting aspect
c. The study shows that the information asymmetry model does not explain underpricing for the firms and time period covered under this study.
d. A notable feature of the Nepali IPO is the practice of fixed price mechanism for pricing the IPOs. Pricing mechanism has important implication of the degree of underpricing. A possible reason for the high degree of underpricing could be this particular mechanism.
e. Nepali capital market is highly dominated by the banks and financial institutions. Over 65% of the paid-up value is being contributed by the banks and financial institutions. During 2000-2005 of the research period, almost all of the IPOs were from the financial sector.

Uprety (2008), in his thesis, "*A Study under Investors' Response to Initial Public Offering of Nepal",* has the main objective to evaluate the public response of the Initial Public Offering or primary issue of shares in the context of Nepal. The specific objectives of the study are;

a. To analyze the procedure and mechanism of IPO.
b. To assess the growth of IPO.

c. To analyze the pattern of public response to IPO.
d. To identify the problem of IPO in the market.

The major findings of the study are;

a. Pace of IPO in Nepal can be considered to be good. In the FY 2005/06, the number of companies whose issue was approved by SEBON was 34, that is the highest number of companies issue approved in single year.
b. The amount of issued approved has increased from Rs. 344.40 millions in the FY 1993/94 to Rs. 2757.50 in the FY 2006/07. During the same period, the number of issue approved increased from 16 to 31.
c. Among eight sectors, finance sector has accounted for 45.07% of total issued approved while the lowest contributor, trading sector has accounted for only 0.98% of the total issued approved. Again, financial sector that includes commercial bank, finance company, development bank and insurance companies has accounting for 81.68% (183 Issued Approved) of total issued amount.
d. The primary analysis shows that the primary issue of securities is in increasing trend. This increasing trend of Primary issue indicates the importance of Merchant Bankers and Merchant Banking of securities market.
e. The view of most of respondents that the main cause of over application in IPO is due to lack of investment opportunity and dividend distribution where as limited number of people involved in IPO is due to the lack of money, information and knowledge.

Singh (2009), in his thesis, *"Public Response to Primary Issue of Share in Nepal",* has the main objective to analyze the reaction of investors in the IPO. The specific objectives of the study are;

a. To examine the trend of primary issue of share.
b. To check whether the over/under subscription has occurred.
c. To detect the factors affecting the initial public offering.

The major findings of the study are;

a. The scope of primary market is recent days in booming. Even the general investors heavily invest their saving in the new issue of shares causing over subscription to a great deal.
b. The growth of the primary market in encouraging since many public limited companies including joint venture banks have been successful in tapping capital through the floatation of shares to the general public.
c. The positive response of the investors to the companies is a direct manifestation of the growing public confidence in the primary market. The general public simply taps everything that comes on their way, regardless of the promoter's background and company feasibility.
d. Each company come into the market has been successful in tapping the capital from the market and the issue closed within the minimum stipulated time of seven days with huge over subscriptions.

Ojha (2010), in her study, *"Public Response to Initial Public Offering in Nepal",* has the main objective to analyze the initial offering or primary issue of shares in perspective of Nepal. The specific objectives of the study are;

a. To identify the performance of the investment bankers in the process of IPO.
b. To analyze the growth of primary share issue market in Nepal.
c. To analyze the public response to IPO.

The major findings of the study are;

a. Public response to the financial institutions and insurance sector is higher than non financial sectors. In case of financial sector among the 23 sample only one is undersubscribed whereas in non financial sector 3 are undersubscribed.
b. Among the financial sector, people about 34.67% chose commercial banks and in non financial sector 44.67% chose manufacturing and processing company.

c. Among the 9 issue manager in the year 2005/06, only 5 have managed the issue. Even among them, NCML and NMBL are to be the dominant ones as they both rank first and second respectively in terms of highest number of issue managed and highest amount of issue managed.
d. 44.67% are interested in company's performance while 14.67% are eager about reputed promoters. Most are seen to invest in company if performing well. And less give preference to the company's promoters.

Chand (2010), in his thesis, *"Increasing Interest of People in IPOs and Its Impact on Interbank Rate",* has the main objective to investigate the increasing interest of people in IPOs and its impact in interbank rate. The specific objectives of the study are;

a. To analyze the relation of IPOs with interbank rate.
b. To examine the pattern of public response to different sector.
c. To find out people consciousness about IPOs and interbank loan rate.

The major findings of the study are;

a. Majority of the people information source about IPO is media. And it has been also found that Nepalese investor's expectation behind investment in IPO is bonus share.
b. The people's knowledge about IPO is well. Whereas, it has been found totally different result about the knowledge of interbank rate. Among the respondents it has been observed that the respondents who are working in banking sector and who are graduated in related subjects are familiar with it. Beside these, the general people don't have any knowledge regarding interbank rate. Although the study has found the respondents who have already graduated, they also don't know about it.
c. The amount of issued offered has increased from Rs. 244.40 million in FY 1993/94 to Rs. 16828.51 million in FY 2008/09. During the period, the no. of issues offered increase from 16 in FY 1993/94 to 64 in FY 2008/09.

Research Gap

Although numerous studies have been carried out in different part of the world covering different aspects of IPOs, they are vague and truncated. So, it is difficult to analyze from these research. However, the previous studies cannot be ignored because they provide foundation to the present study. Very few studies have analyzed people response to IPOs in Nepal. Since, underpricing has been the main problem of IPOs, none of the studies have been able to find out the reasons behind it. Also, the previous studies have omitted the risk factor and risk associated with the IPO, and also neglected the main reason behind the issuance of IPO. Therefore to fulfill this gap, this research is selected. To complete this work many books, journals, articles and various published and unpublished dissertation are followed as guideline to make the research easier and smooth.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Research Design

A research design is a plain, structure and strategy to obtain the objectives of the study. The research is based on the secondary as well as primary data and information. Hence, the explanatory or descriptive as well as analytical research design has been used. The variables related with the performance of the company, market information and relevant subjects are included in the study.

3.2 Population and Sample

The population for this study comprised of all public limited companies of various sector viz. banking sector, development bank sector, finance sector, insurance sector, manufacturing and processing sector, trading sector, hotels, and other sector. Therefore all the companies whose securities are approved by SEBON for going to public are taken as sample and the required data have been collected from the various.

3.3 Nature and Sources of Data

The required data for the study are collected from the primary and secondary sources. Securities Board Nepal and Nepal Rastra Bank are the main institutions which provide most of the data required for the study. The web site of the respective institutions and their annual reports are the major sources of secondary data. Besides, necessary data also collected from the annual reports of the selected companies, concerned issue managers, and annual report of Nepal Stock Exchange. More concisely, the secondary data has been collected mainly through the annual reports of SEBON, and the primary data has been collected through conducting the questionnaire, containing 16 questions, to the investors and issue managers.

3.4 Data Collection Procedure and Methods of Analysis

Analysis is the careful study of available facts so that one can understand and drew conclusion from them on the basis of established principles and sound logic.

3.4.1 Financial Tools

A) Growth of Public Issue

Under this section, the trend of the public issues approved by SEBON from the fiscal year 2001/02 to 2009/10 has been analyzed. Further, the growth of the public issue has also been computed.

$$\text{Growth Rate} = \frac{\text{Public Offerings in Current Yr.} - \text{Public Offerings in Last Yr.}}{\text{Pulic Offerings in Last Yr.}}$$

B) Total IPO to Securities Issues Approved

To analyze what percentage of the securities issues has been covered by the initial public offering, this ratio has been calculated. Further, this section also presents the trend of IPO during the observed periods. Greater the ratio indicates that more companies are interested to go to the public.

$$\text{Total IPO to Securities Issuance} = \frac{\text{Initial Public Offerings}}{\text{Total Securities Issued}}$$

C) Number of Public Issue Approved

The number of public offering enables to identify the exact number of offers made by various listed and to be listed companies to the general public in each fiscal year.

D) Over and Under Subscription of Ordinary Shares

When a company offers its issues to public, the demand received from public is bound to vary. When demanded number of shares is higher than the offered number of shares, it is called over- subscription and when the demanded number of shares is lower than then number of shares offered, it is called under-subscription.

3.4.2 Statistical Tools

To draw the conclusion by analyzing the collected data simple statistical tool like arithmetic mean, multiple bar diagram, pie-chart are used and tabulation are use to implicit the comparative results.

A) Arithmetic Mean Average

The central values that represent the characteristics of the whole distribution or the values around which all items of the distribution tend to concentrate are called average. Arithmetic mean or arithmetic average is one of the important statistical measures of average. The arithmetic mean of a given set of observation is their sum divided by the number of observations.

$$\text{Mean} = \frac{\sum X}{N}$$

B) Standard Deviation

Standard deviation is a widely used measure of the variability or dispersion, being algebraically more tractable though practically less robust than the expected deviation or average absolute deviation. It may be thought of as the average difference of the scores from the mean of distribution, how far they are away from the mean. A low standard deviation indicates that the data points tend to be very close to the mean, whereas high standard deviation indicates that the data are spread out over a large range of values.

$$\text{Standard Deviation } (\sigma) = \sqrt{\frac{\sum (X - \bar{X})^2}{N}}$$

C) Coefficient of Variation

The coefficient of variation represents the ratio of the standard deviation to the mean, and it is a useful statistic for comparing the degree of variation from one data series to another, even if the means are drastically different from each other.

$$\text{C.V.} = \frac{\text{Standard Deviation x 100}}{\text{Mean}}$$

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

4.1 Secondary Data Analysis

Under this section of the study, the historical data related to the initial public offering in total and in sector-wise, and the condition of over or under subscription of the offering have been analyzed.

4.1.1 Growth of Public Offering

Securities Exchange Act has made mandatory that the issuing company should register the securities in SEBON and get approval before going to public. Since first year of the observed periods, FY 2001/02, it has given issued approval to 396 issues amounting Rs. 5666.13 million till FY 2009/10.

Table: 4.1

Growth of Public Offering

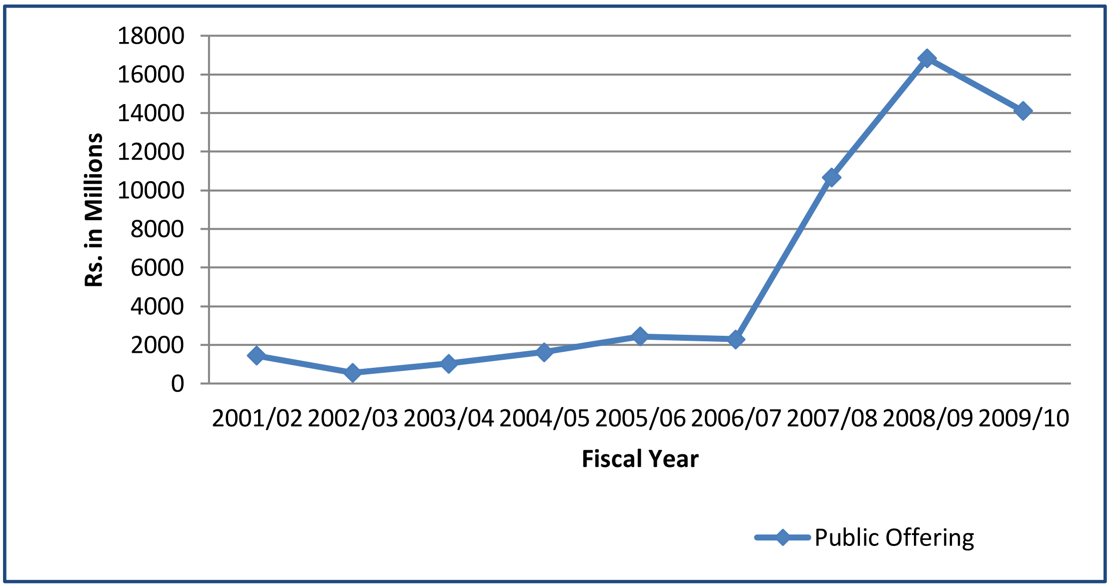
Fiscal Year	Securities Issued	Growth %
2001/02	1441.33	251.12
2002/03	556.54	-61.39
2003/04	1027.50	84.62
2004/05	1626.82	58.33
2005/06	2443.28	50.19
2006/07	2295.50	-6.05
2007/08	10668.20	364.74
2008/09	16828.51	57.74
2009/10	14107.45	-16.17
Mean	**5666.13**	
S.D.	**6368.02**	
C.V.%	**112.39**	

(Source: SEBON, Annual Report 2009/10)

Table 4.1 shows that the amount of issued approved by SEBON varies during the period. In most of the fiscal years, the securities issued amount has increased. The highest amount of securities issued is Rs. 16828.51 million in the fiscal year 2008/09 and it is followed by Rs. 14107.45 million in the fiscal year 2009/10. Similarly, the least issue approved for the period is Rs. 556.54 million in fiscal year 2002/02 and it is followed by Rs. 1027.50 million in fiscal year 2003/04. Likewise, the highest growth rate of securities issues approved is 364.74% in the fiscal year 2007/08. Within the 9 years of observed periods, the average public offering approved is Rs. 5666.13 millions and the variation in such issuance is 112.39%. Undoubtedly, the public issuance of securities has increased mainly in the recent periods, which indicates the greater increment in the charming of public offering among the public.

Figure: 4.1

Growth of Public Offering



4.1.2 IPO to Total Securities Issuance

To make the capital of the companies robust, the listed companies augment the capital by issuing the securities, which includes initial public offering, debenture issue and right issue. To examine the practices of initial public offering in augmenting the capital, the ratio of initial public offering to securities issuance is crucial.

Table: 4.2

IPO to Total Securities Issuance

Fiscal Year	IPO	Securities Issued	Ratio
2001/02	319.46	1441.33	22.16
2002/03	394.30	556.54	70.85
2003/04	657.50	1027.50	63.99
2004/05	377.48	1626.82	23.20
2005/06	579.83	2443.28	23.73
2006/07	380.20	2295.50	16.56
2007/08	924.80	10668.20	8.67
2008/09	1815.70	16828.51	10.79
2009/10	3144.70	14107.45	22.29
Mean			**29.14**
S.D.			**22.44**
C.V.%			**77.01**

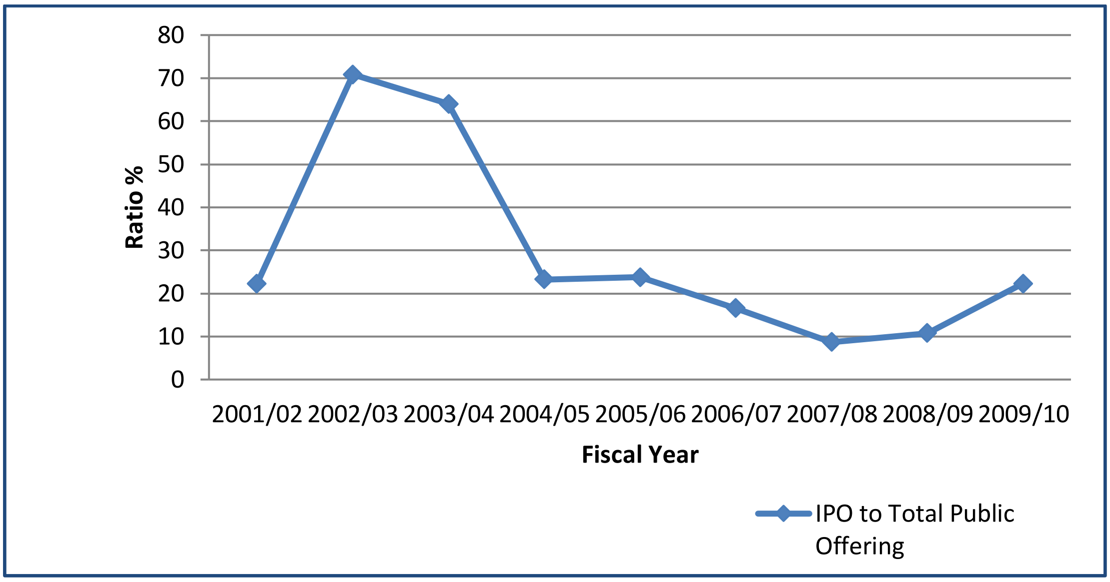
(Source: SEBON, Annual Report 2009/10)

The above table presents the representation of capital accumulation through initial public offering on the total securities issuance, which includes right share, ordinary share, preference share and debenture. The table shows that the initial public offering of the listed companies of NEPSE is in oscillating trend, and thus has ranged from Rs. 319.46 millions in the fiscal year 2001/02 to Rs. 3144.70 millions in the fiscal year 2009/10. Similarly, the total public offering, either in the form of right share or other, of the listed companies has ranged from Rs. 556.54 millions in the fiscal year 2001/02 to Rs. 16828.51 millions by the end of the fiscal year 2008/09.

Moreover, the preponderance of the IPO on total public offerings has also oscillated within observed periods. The initial public offering to total public offerings has ranged from 8.67% in the fiscal year 2007/08 to 70.85% in the fiscal year 2002/03. It seems that the listed companies have chosen other than initial public offerings as the major source for capital expansion, as a result the weight of the IPO on total securities issuance has fluctuated continuously. In average, the IPO covered 29.14% of the total securities issuance within the observed periods and the variance on such representation is 77.01%.

Figure: 4.2

Total IPO Issue to Securities Issuance



4.1.3 Number of Company's Public Offering Approved

The number of public offering enables to identify the exact number of offers made by various listed and to be listed companies to the general public in each fiscal year. Table 4.3 reveals the number of issues offered in each fiscal year during the study period.

Table: 4.3

Number of Company's Public Offering Approved

Fiscal Year	No. of Offering	Growth %
2001/02	12	33.33
2002/03	18	50.00
2003/04	14	-22.22
2004/05	14	0.00
2005/06	29	107.14
2006/07	34	17.24
2007/08	64	88.24
2008/09	64	0.00
2009/10	72	12.50
Total	**321**	

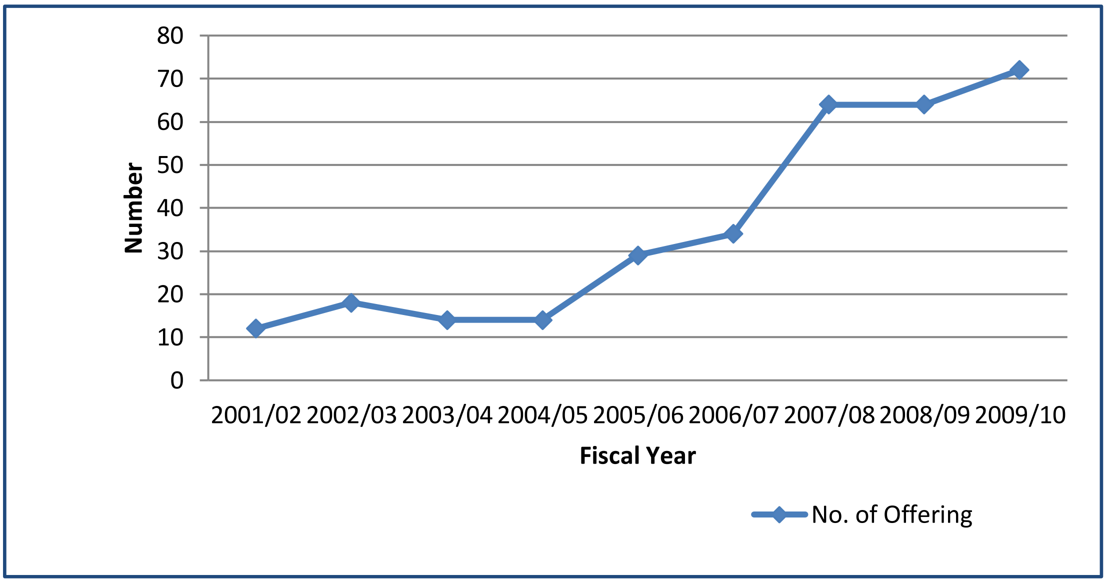
(Source: SEBON Annual Report 2009/10)

The table shows that the amount of public offerings, the number of public offering in a fiscal year also has not shown any consistent trend over the study period. During the entire study period, the lowest number of issue offered is 12 in the fiscal year 2001/02. The highest number of public offering is 72 in the last fiscal year of the study period, FY 2009/10.

The annual growth of public offering has also been in fluctuating trend. The highest growth in number of public issue was 107.14% in FY 2005/06, whereas the least growth in number of public issue was -22.22% in the fiscal year 2003/04. In total, 321 public offerings have been conducted since 2001/02.

Figure: 4.3

Number of Company's Public Offering Approved



4.1.4 Sector Wise Public Issue Approved

During the period of 2001/02 to 2009/10 SEBON approved different types of securities of different sector for public issue. The detail of the issues approved of such sectors has been presented in table 4.4.

Table: 4.4

Sector Wise Public Issue Approved from 2001/02 to 2009/10

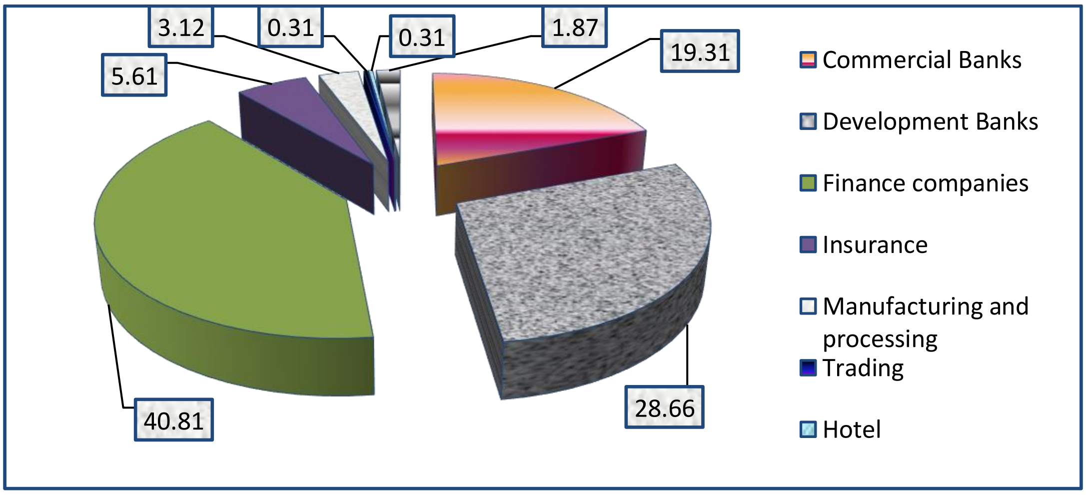
Sector	No. of offering approved	% of issue
Commercial Banks	62	19.31
Development Banks	92	28.66
Finance companies	131	40.81
Insurance	18	5.61
Manufacturing and processing	10	3.12
Trading	1	0.31
Hotel	1	0.31
Other	6	1.87
Total	**321**	**100**

(Source: SEBON Annual Report, 2009/10)

The table shows that SEBON accepted the various sector's issues for going to public. The highest issue approved by SEBON during the period of fiscal year 2001/02 to 2009/10 is 131 issues (40.81%) of Finance sector and it is followed by 92 issues (28.66%) of development banking sector, 62 issues (19.31%) of commercial banking sector. Similarly, the least issues approved during the period is 1 issue (0.31%) of trading sector and hotel business each, and it is 6 issues (1.87%) of other sector.

Figure: 4.4

Sector Wise Public Issue Approved from 2001/02 to 2009/10



4.1.5 Over and Under Subscription of Ordinary Shares

When a company offers its issues to public, the demand received from public is bound to vary. When demanded number of shares is higher than the offered number of shares, it is called over- subscription and when the demanded number of shares is lower than then number of shares offered, it is called under-subscription. Similarly when the offered number of shares and demanded number of shares are equal it is the case of full subscription.

Table: 4.5

Subscription Pattern of the Ordinary Shares

Fiscal Year	Total no of Issues	Over Subscribed		Under Subscribed	
		No.	**%**	**No.**	**%**
2001/02	5	4	80	1	20
2002/03	14	14	100	0	0
2003/04	10	10	100	0	0
2004/05	7	6	85.71	1	14.29
2005/06	14	14	100	0	0
2006/07	15	15	100	0	0
2007/08	16	16	100	0	0
2008/09	12	12	100	0	0
2009/10	37	37	100	0	0
Total	**130**	**128**	**98.46**	**2**	**1.54**

(Source: SEBON Annual Report)

In FY 2001/02, out of 5 issues, 4 issues are oversubscribed while remaining one issue is under subscribed. However, the trend of 100% oversubscription has recurred in two subsequent FY 2002/03 and FY 2006/04. All 14 issues in FY 2002/03 and 10 issues in FY 2003/04 are oversubscribed but the trend is distorted in subsequent year, 2004/05, when out of 7 issues, 1 issue is undersubscribed while remaining all 6 issues are oversubscribed. The table further shows that during the period of FY 2005/06 and FY 2009/10 all the issues are oversubscribed.

Hence, from the total of 130 issues, 128 issues representing 98.46% of total issues are oversubscribed, and 2 issues accounting 1.54% are under subscribed. These figures illustrate that most of the companies, which issued their ordinary shares through IPO during the study period experienced oversubscription of their issues. That fact may hint out why most companies prefer common shares to raise capital from general public rather than other securities. However, the diffidence in the investors toward the lucrative of securities investment, the availability of other enticing investment sector and the non generosity in the flow of information could be the reasons behind the occurrence of under subscription.

4.1.6 Sector Wise Public Response to IPO

4.1.6.1 Public Response to Commercial Banks

Out of total commercial banks, only 7 banks are taken as sample. To make the result more effective as possible as sample are taken from each fiscal year.

Table: 4.6

Public Response to Commercial Banks

S.N.	Bank	Issued FY	Share Issued ('000')	Subscription (Times)	Result
1	Machhapuchchhere Bank Ltd.	2002/03	165	1.98	Over Sub
2	Kumari Bank Ltd.	2003/04	150	8.11	Over Sub
3	Lumbini Bank Ltd	2004/05	150	7.21	Over Sub
4	Siddhartha Bank Ltd.	2005/06	150	18.65	Over Sub
5	Global Bank Ltd.	2007/08	300	34.25	Over Sub
6	Prime Commercial Bank Ltd.	2008/09	300	29.85	Over Sub
7	NMB Bank Limited	2009/10	715	11.25	Over Sub

(Source: SEBON Annual Reports, 2009/10)

The table shows the issued share of commercial bank along with subscription times. In all the seven cases, it has been ascertained that the subscription times is higher than one i.e. all the issues are oversubscribed. The range of over subscription is between 1.98 to 34.25 times. For the 3000,000 shares issued by

GBL in FY 2007/08, 102,750,000 shares have been applied that means it is oversubscribed by 34.25 times. Similarly, 29.85 times subscription incase of PCBL, 18.65 times in the SBL, 11.25 times in NMB, 8.11 times in KBL, 7.21 times in LBL, and 1.98 times in case of MBL.

From above, it is clear that commercial banks share issues are getting good response from public. Public are found to be interested in IPO of commercial banks. The average subscription times of commercial banks in the above sample are 15.90 times.

4.1.6.2 Public Response to Development Banks

From the total development banks, only seven development banks are taken as sample.

Table: 4.7

Public Response to Development Banks

S.N.	Development Banks	Issued FY	Shares Issued '000'	Subscription Times	Result
1	Development Credit Bank Ltd.	2001/02	480	14.10	Over Sub
2	Chhimek Bikas Bank Ltd.	2003/04	30	1.39	Over Sub
3	Deprose Dev. Bank Ltd.	2004/05	34.80	2.59	Over Sub
4	Siddhartha Dev. Bank Ltd.	2005/06	200	2.22	Over Sub
5	Malika Bikas Bank Ltd.	2006/07	150	54.84	Over Sub
6	Clean Energy Dev. Bank Ltd.	2007/08	960	36.46	Over Sub
7	Public Dev. Bank Ltd.	2008/09	600	28.26	Over Sub
8	Diyalo Bikas Bank Ltd.	2009/10	350	17.46	Over Sub

(Source: SEBON Annual Reports, 2009/10)

In all the public issue of development banks, over subscription has been ascertained in all the time. That means public are also interested in development banks shares. Among them, MBBL is highly subscribed in FY 2006/07, the subscription times is 54.84 times. For the 150,000 share issued of IPO, there is application for 8,226,000 shares. Similarly CEDBL is oversubscribed by 36.46 times, PDB is oversubscribed by 28.26 times, DBBL is oversubscribed by 17.46 times, DCBL is oversubscribed by 14.10 times, DDBL is oversubscribed by 2.59 times, SDBL is oversubscribed by 2.22 times and the least subscribed but still over-subscribed is in the case of CBBL by 1.39 times.

4.1.6.3 Public Response to Finance Companies

Out of total finance companies, issued share only 8 finance companies are taken as sample.

Table: 4.8

Public Response to Finance Companies

S.N.	Finance Companies	Issued FY	Shares Issued '000'	Subs. Times	Result
1	United Finance Company Ltd.	2001/02	240	10.56	Over Sub
2	Cosmic Merchant Banking Finance Ltd	2003/04	240	7.18	Over Sub
3	Everest Finance Ltd	2004/05	80	5.40	Over Sub
4	Srijana Finance Ltd	2005/06	40	1.21	Over Sub
5	Emporial Financial Institution Ltd.	2006/07	195	25.68	Over Sub
6	Prabhu Finance Company Ltd.	2007/08	480	77.30	Over Sub
7	Crystal Finance Ltd	2008/09	210	31.06	Over Sub
8	Himalaya Finance Ltd.	2009/10	560	12.43	Over Sub

(Source: SEBON Annual Reports, 2009/10)

The table shows that during the periods of 2001/02 to 2009/10, all of the public offerings have been fully subscribed. The over subscription range is between 1.21 to 77.30 times. In the sample, highest over subscription of 77.30 times is in case of PFCL where 3,710,400 shares are applied for only 48,000 shares. There is 31.06 times subscription in the case of CFCL, 25.86 times in case of EFIL, and 12.43 times over subscription in case of HFL. Similarly, there is 10.56 times in case of UFCL, 7.18 times in case of CMBFL, 5.40 times in case of EFL, and 1.21 times in case of SFL. This all shows that public is interested in shares of finance companies as well.

4.1.6.4 Public Response to Insurance Company

For the research, only 4 insurance companies are taken as sample.

Table: 4.9

Public Response to Insurance Company

S.N.	Insurance Company	Issued FY	Shares Issued '000'	Subs. Times	Results
1	Nepal Life Insurance Company Ltd.	2001/02	500	7.56	Over Sub
2	Prudential Insurance Company Ltd.	2003/04	200	9.57	Over Sub
3	Lumbini General Insurance Company Ltd.	2007/08	250	71.73	Over Sub
4	Asian Life Insurance Company Ltd.	2009/10	1080	35.46	Over Sub

(Source: SEBON Annual Reports, 2009/10)

The table shows the public response to insurance companies ranges from 7.56 to 71.73 subscription times in the period between 2001/02 to 2009/10. In the sample, highest over subscription is 71.73 times in case of LGICL. Similarly, the over subscription is 35.46 times in ALICL, 9.57 times in PRICL, and 7.56 times in NLICL. All this substantiates that people are interested to invest in insurance company's ordinary share and they have a greater expectation from the investment.

4.1.6.5 Public Response to Non-Financial Sector

Non-financial sector includes manufacturing and processing companies, trading companies, hotel, hydropower sector and others. Out of the total only 2 are taken as sample.

Table: 4.10

Public Response to Non- Financial Sector

S.N.	Company	Issued Fiscal Year	Shares Issued '000'	Subs. Times	Result
1	National Hydro Power Co. Ltd.	2004/05	1400	0.22	Under Sub
2	Chilime Hydro Power Co. Ltd	2005/06	2374.10	5.10	Over Sub

(Source: SEBON Annual Reports, 2009/10)

The table has ascertained that between the periods of 2001/02 to 2009/10 in non-financial sector, only two companies have made offering of ordinary share. However, only the shares of Chilime Hydor Power Co. Ltd. have been over subscribed. The over subscription rate of CHPCL is 5.10 times, indicating that company received 12,107,910 applications for the 2,374,100 initial public offerings. In contrast, the offerings of National Hydro Power Co. Ltd. faced under subscription, and thus, the subscription rate is just 0.22 times, indicating that the NHPCL received 308,000 applications for 1,400,000 offerings. Thus, it can be said that the expectation of the investors on non financial sector, especially on hydro power, is not so strong.

4.2 Primary Data Analysis

To understand the opinion of the people regarding the initial public offerings in Nepal, the primary data analysis is equally significant. For the primary data analysis, a questionnaire containing 12 questions has been prepared and distributed to 15 investors and 10 personnel of issue managers. The responses obtained from them have been analyzed in tabular form.

4.2.1 Best Method to Expand the Capital

The expansion of capital depends upon the policy of the firms, whether to raise fund from external financing or internal financing. Among them, initial public offering, right offering, debenture issue and further public offering are the major sources. To investigate the suitability of each of the aforementioned source to increase capital, the respondents are asked to express their views.

Table: 4.11

Best Method to Augment the Capital

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Right Offering	4	27	3	30	7	28
Debenture Issue	1	7	0	0	1	4
IPO	5	33	4	40	9	36
Further Public Offering (FPO)	5	33	3	30	8	32
Total	**15**	**100**	**10**	**100**	**25**	**100**

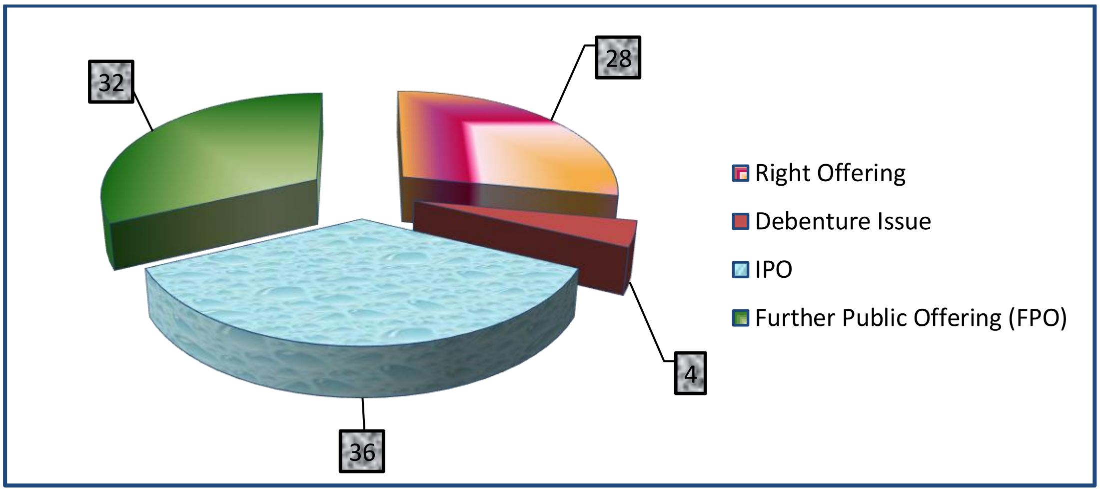
(Source: Opinion Survey, 2011)

The table shows that the 33% of the investors have opined that the company should increase its share capital by further public offering, whereas 30% of the issue managers have supported this view. While other 33% of the investors favored initial public offering as the best method for capital augmentation, the majority of the issue managers, 40%, have buttressed this opinion. Similarly, 27% of the investors and 30% of the issue managers have avowed that the company should increase its share capital through the right offering phenomenon. Likewise, only 7% of the investors have stated that the debenture issue is the best method for the augmentation of the company's capital.

It seems that each category has chosen the option that serves one's interest. Whatever, the overall majority, 36%, clarifies that the company should mainly focus in issuing initial public offering to expand capital, and 32% have stated that the company should expand the capital by further public offering, 28% of the total respondents have stated that the company should issue right share and only 4% have stated that the company should increase its capital by issuing debenture. Considering the overall majority, it can be concluded that issuing initial public offering would be the best option for the company to augment its capital.

Figure: 4.5

Best Method to Augment the Capital



4.2.2 Risk Factor in IPO

An IPO can be a risky investment. For the individual investor it is tough to predict what the stock or shares will do on its initial day of trading and in the near future since there is often little historical data with which to analyze the company.

Table: 4.12

Risk Factor in IPO

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Unpredictable	8	54	4	40	12	48
No Past Record of the Company	5	33	5	50	10	40
Potential of Stock Market	2	13	1	10	3	12
Total	**15**	**100**	**10**	**100**	**25**	**100**

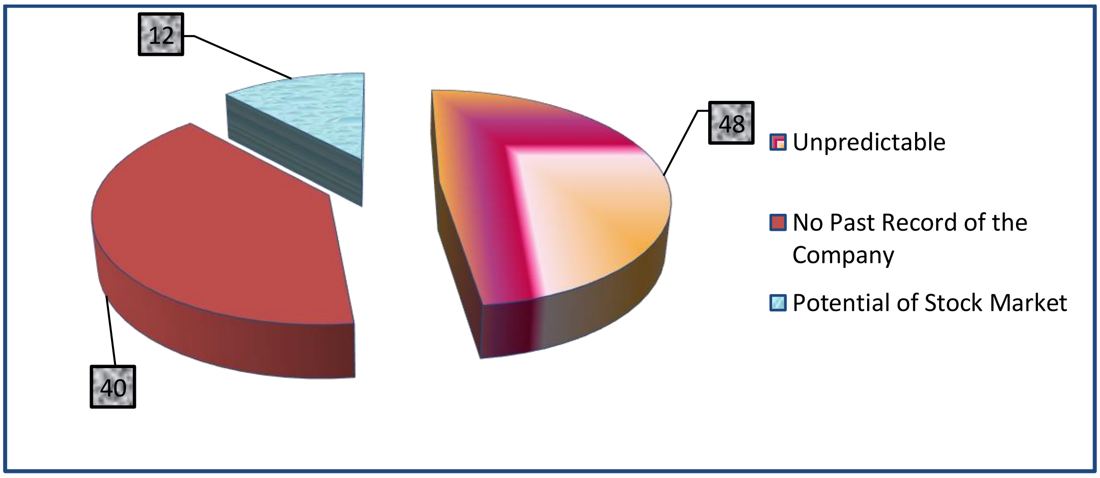
(Source: Opinion Survey, 2011)

The table reveals that the majority of the investors, 54%, have stated that the major risk factor in IPO is that the share price is unpredictable; however, only 40% of the issue managers have supported this risk factor. Likewise, 33% of the investors, and 50% of the issue managers have stated that since the young firm is involved in IPO, the unavailability of the past record of the company is the major risk factor in IPO. In contrast, 13% of the investors and 10% of the issue managers have stated that the profit and risk potential of the IPO depends upon the state of the stock market at that particular time.

In total, 48% of the total respondents have opined that the unpredictable nature of the performance of the share of IPO is the major risk factor. However, 40% of the total respondents have stated that the unavailability of past record of the company that goes for IPO is the major risk factor. And, 12% of the total respondents have avowed that the dependency of the performance of IPO on the situation of the stock market is the major risk. Hence, considering the overall majority, it can be concluded that the difficulty in the prediction of the share price is the major risk factor in IPO.

Figure: 4.6

Risk Factor in IPO



4.2.3 Assessment of Risk in IPO

A successful investor pre analyzes the risks before making the investment. Since, IPO is also vulnerable to various kinds of risk, an investor needs to make assessment of risk. But, on which risk the investors should be more concerned is questionable.

Table: 4.13

Assessment of Risk in IPO

Response	Investors		Issue Manager		Total	
	No.	**%**	**No.**	**%**	**No.**	**%**
Business Risk	4	27	3	30	7	28
Financial Risk	4	27	2	20	6	24
Market Risk	7	46	5	50	12	48
Total	**15**	**100**	**10**	**100**	**25**	**100**

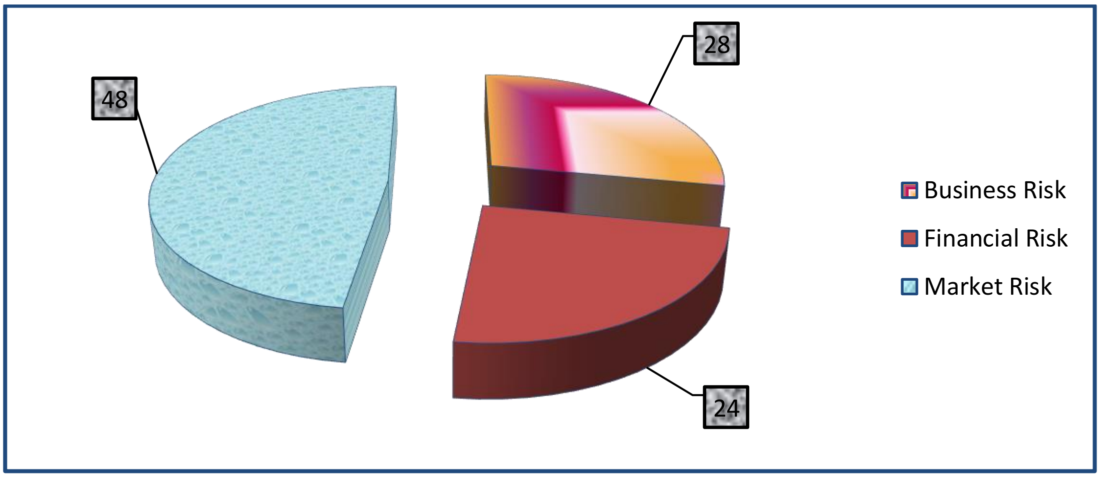
(Source: Opinion Survey, 2011)

The table delineates that the majority of the investors, 46% (7 out of 15), and the majority of the issue managers, 50% (5 out of 10), have stated that the investors should assess the market risk, examining the appeal of corporation to current and future market condition of IPO, before making investment in IPO. Likewise, 27% of the investors (4 out of 15) and 30% of the issue managers (3 out of 10) have said that the assessment of business risk, examining the business models and management policies that are consistent with the standard norm, would be more beneficial to the investors. Similarly, 27% of the investors (4 out of 15) and 20% of the issue managers (2 out of 10) have said that the investors should assess the financial risk, examining the company's financial statement, capital structure and other financial data, before making the investment decision in IPO.

In aggregate, the majority of the total respondents, 48%, have suggested that the assessment of the market risk has greatest magnitude in IPO investment. However, only 28% of the total respondents have stated that the assessment of business risk is the crucial part in the IPO investment. Further, 24% of the total respondents have said that the investors should scrutinize the financial risk of the company before making IPO investment. Considering the overall majority, it can be inferred that the market risk has greater preponderance than other risks in IPO investment, and thus such risk should be addressed first.

Figure: 4.7

Assessment of Risk in IPO



4.2.4 Type of Investor Participating in IPO

Different investors are related with different types of investment. To examine what type of investors mainly awaits the promulgation of the IPO of the company, the respondents are asked to enlighten on this issue.

Table: 4.14

Type of Investor Participating in IPO

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Income Investor	5	33	3	30	8	32
Growth Investor	8	54	5	50	13	52
Speculator	2	13	2	20	4	16
Total	**15**	**100**	**10**	**100**	**25**	**100**

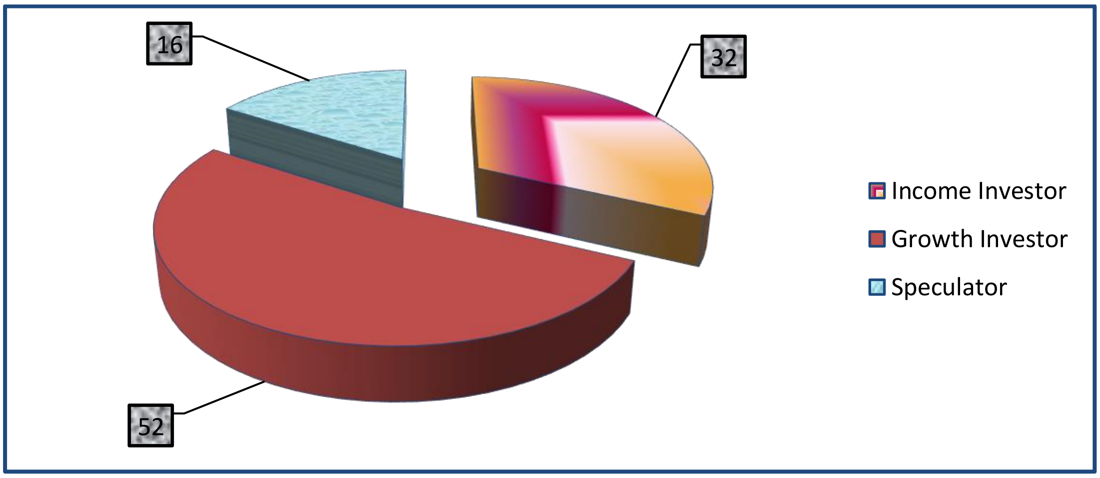
(Source: Opinion Survey, 2011)

The table shows that the majority of the investors, 54%, and the majority of the issue managers, 50%, have stated that mainly the growth investor, who steadily looks for potential increase in profits that are reinvested for further expansion, invests in initial public offering. While, 33% of the investors and 30% of the issue managers have said that mainly income investor, who is looking for steadily profit that will be distributed to shareholders regularly, makes investment in IPO. Likewise, 13% of the investors and 20% of the issue managers have opined that mainly the speculators who look for short term capital gains invest in IPO.

In aggregate, 52% of the total respondents have stated that the growth investors make investment in IPO. Similarly, 32% of the total respondents have opined that income investors are more aggressive in making investment in IPO. Whereas, only 16% of the total respondents have stated that the preponderance of speculators is higher than other type of investors in making investment in IPO. Certainly on the basis of the total majority, it can be concluded that the investors who make investment in IPO are mainly growth oriented.

Figure: 4.8

Type of Investor Participating in IPO



4.2.5 Crucial Strategy in IPO Investment

Investing in IPO is much different than investing in seasoned stocks, since there is limited information and research on IPOs, prior to the offering. Thus, the investors are obliged to adopt different strategy in making IPO investment. To examine the crucial strategy, the questionnaire has been conducted.

Table: 4.15

Crucial Strategy in IPO Investment

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Understanding the working of IPO	4	27	2	20	6	24
Gather Knowledge	2	13	1	10	3	12
Investigate Before Investing	2	13	4	40	6	24
Knowing the Broker	1	7	0	0	1	4
Measuring the Risk Involved	6	40	3	30	9	36
Total	**15**	**100**	**10**	**100**	**25**	**100**

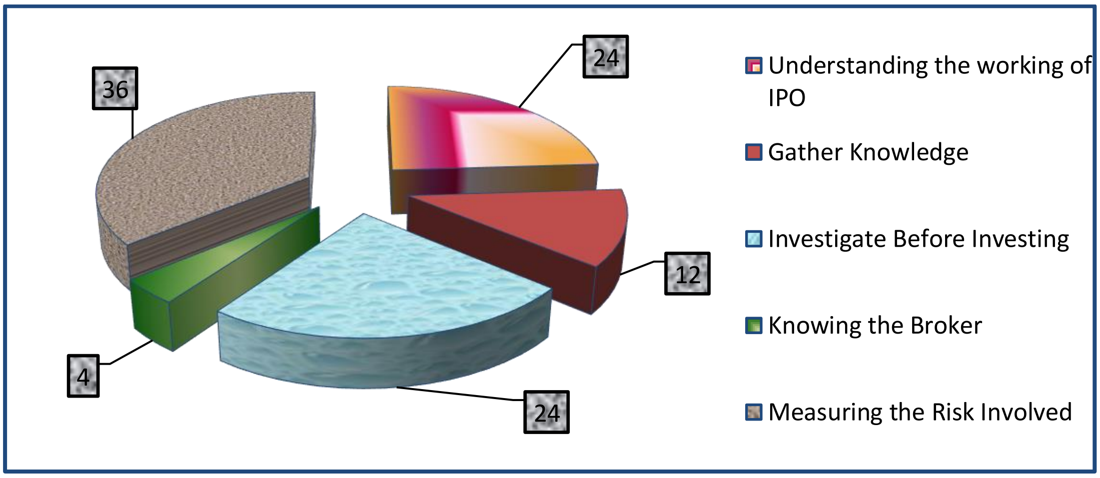
(Source: Opinion Survey, 2011)

The table reveals that 27% of the investors and 20% of the issue managers are in the opinion that understanding the working of IPO, which comprises basic investment process, is the best strategy needed to followed by the investors before making IPO investment. In addition 13% of the investors and 10% of the issue managers have stated that gathering as much knowledge on IPO as possible, such as the demand for the IPO and the offer being planned by the competitor, is the best strategy before making investment. Further, 13% of the investors and 40% of the issue managers have stated that the investigation about the company offering IPO, such as the analysis of the prospects of the company, could be the better strategy needed to be adopted by the investors. Also, 7% of the investors and 0% of the issue managers have said that knowing the brokers, who handle the money of the investors and facilitates the investors in getting the IPO allocations, is the crucial step in investment. Finally, 40% of the investors and 30% of the issue managers have stated that measuring the risk involved in the initial public offering is the best strategy in making IPO investment.

In total, 24% of the respondents have said that understanding the working of IPO is the best strategy for the investment. While, 12% of the total respondents have stated that gathering knowledge as much knowledge as possible is the best strategy. Similarly, 24% of the total respondents have opined that the investigation of the company before investing is the best strategy. Further, 4% of the total respondents have said that knowing the broker and 36% of the respondents have affirmed that examining the risk associated is the best strategy for IPO investment. Consequently, on the basis of the majority, it can be inferred that definitely scrutinizing the risks associated with the IPO investment is the best strategy.

Figure: 4.9

Crucial Strategy in IPO Investment



4.2.6 Reason behind Under Subscription in IPO

The secondary data analysis shows that in few cases there is under subscription on initial public offering. To examine what factors mainly causes the under subscription of the IPO, the respondents are asked to express their opinions.

Table: 4.16

Reason behind Under Subscription in IPO

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Investors' Diffidence on New Firm	7	46	6	60	13	52
Lack of Knowledge on the Firm	3	20	2	20	5	20
Inadequate Legal Provision	1	7	0	0	1	4
Insufficient Promotion	4	27	2	30	6	24
Total	**15**	**100**	**10**	**100**	**25**	**100**

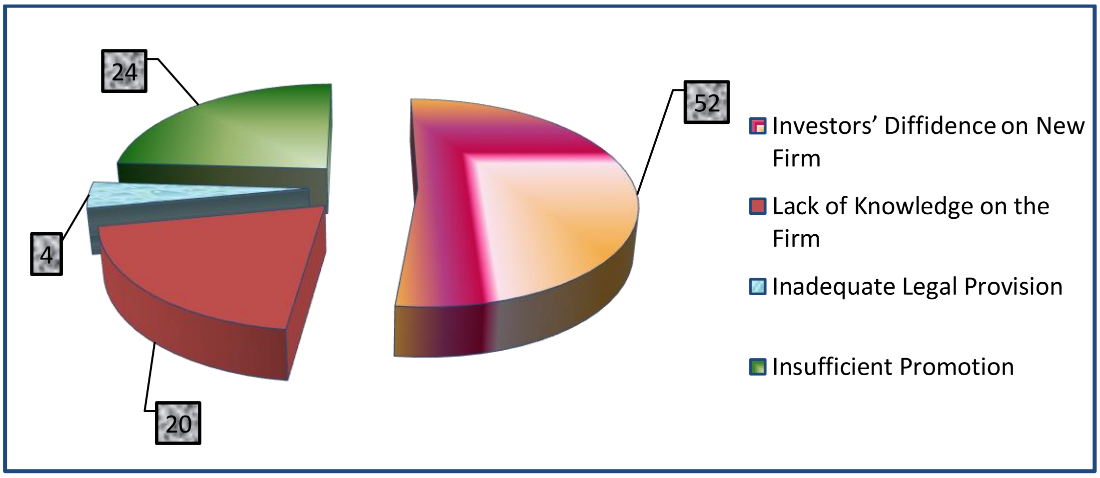
(Source: Opinion Survey, 2011)

The table shows that the diffidence of the investors on the new firm issuing IPO is the main reason behind the under subscription of the IPO. About 46% of the total investors and 60% of the issue managers have supported this view. However, 20% of the investors and 20% of the issue managers have stated that since the younger companies go for IPO, it is difficult to get information about them, and thus such difficulty has resulted for the under subscription of the IPO. Likewise, 7% of the investors and 0% of the issue managers have stated that the inadequate legal provision for protecting the investors who invest in IPO is the main reason for under subscription. Finally, 27% of the investors and 30% of the issue managers have stated that the insufficient promotion by the company to entice the investors for the investment is the major cause behind the under subscription.

However, in total, 52% of the total respondents, 13 out of 25, have stated that the losing investors' confidence on the new firm is the major reason for under subscription. In contrast, 20% of the total respondents have blamed the lack of knowledge on the firm adopting IPO is the main reason. While,

Figure: 4.10

Reason behind Under Subscription in IPO



4.2.7 Most Responsible Party in Preventing Under Subscription

Smooth operation of IPO and the protection of investors' interest are the crucial element for the success of IPO. However, various risk factors hinder this desirable outcome and causes the under subscription. To prevent the under subscription of IPO, the different parties involved it should be responsible. To examine which party should be most responsible to prevent under subscription, the respondents are asked on this issue.

Table: 4.17

Most Responsible Party in Preventing Under Subscription

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Issue Company	6	40	4	40	10	40
Issue Manager	4	26	4	40	8	32
Underwriting and Underwriter	1	7	1	10	2	8
Bankers to the Issue	1	7	0	0	1	4
Collection Centers	2	13	1	10	3	12
Others	1	7	0	0	1	4
Total	**15**	**100**	**10**	**100**	**25**	**100**

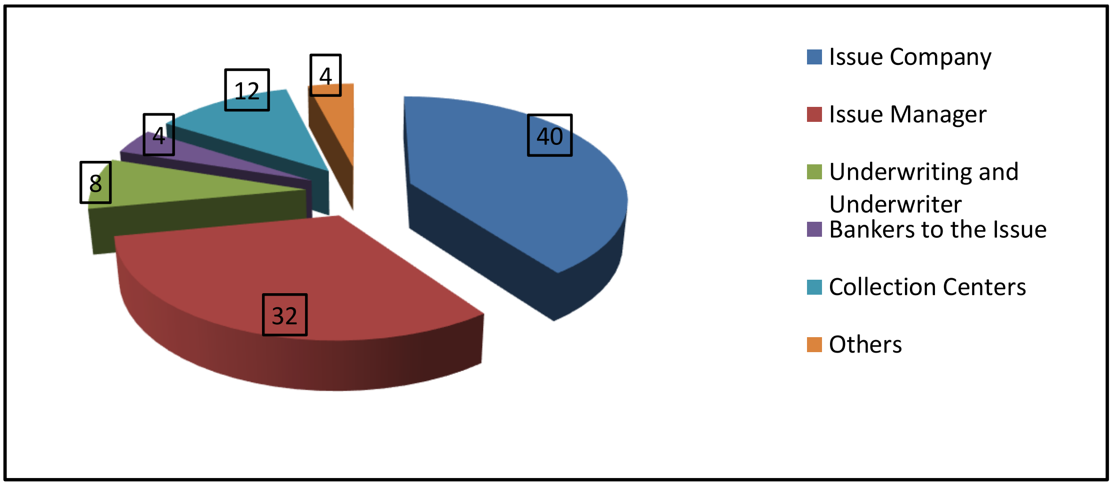
(Source: Opinion Survey, 2011)

The table delineates that 40% of the investors and 40% of the issue managers have blamed that the company committing initial public offering should be responsible for preventing the under subscription. However, 26% of the investors and 40% of the issue managers have claimed that the issue managers should be most onus to thwart the under subscription. In contrast, 7% of the investors and 10% of the issue managers have opined that the underwriting and underwriter who render insurance to the securities issued during the IPO should be most responsible to prevent the under subscription in IPO. Similarly, 7% of the investors and 0% of the issue managers have stated that the bankers to the issue which provide custodian service to the managers should be most responsible to avoid the under subscription in IPO. Further, 13% of the investors and 10% of the issue managers have opined that the collection centers, which is the authorized intuition to collect application from the investors, should be most responsible for preventing the under subscription. Finally, 7% of the investors have claimed that the others like Securities Board of Nepal, Nepal Stock Exchange, Nepal Rastra Bank, and Company Registrar's Office should be most responsible for barricading the under subscription.

In aggregate, 40% of the total respondents blamed issue company, 32% of the total respondents have claimed issue manager, 8% have stated underwriting and underwriter, 4% of the respondents have affirmed bankers to the issue, 12% of the respondents have said collection centers, and 4% of the total respondents have avowed others to be the most responsible for preventing the under subscription. Thus, on the basis of the total majority, it can be concluded that the IPO issuing company should be most onus for the avoidance of under subscription.

Figure: 4.11

Most Responsible Party in Preventing Under Subscription



4.2.8 Expectation of Investors

Ubiquitously investors of the share market continuously seek the opportunity. But to know in what form the opportunity should be, is the major matter for discussion. Thus, the respondents are asked to assert the main expectation that the investors quest while making investment.

Table: 4.18

Expectation of Investors

Response	**Investors**		**Issue Manager**		**Total**	
	No.	**%**	**No.**	**%**	**No.**	**%**
Right Share Offering	3	20	1	10	4	16
Bonus Share Offering	6	40	6	60	12	48
Cash Dividend Offering	1	7	0	0	1	4
Further Public Offering	5	33	3	30	8	32
Total	**15**	**100**	**10**	**100**	**25**	**100**

(Source: Opinion Survey, 2011)

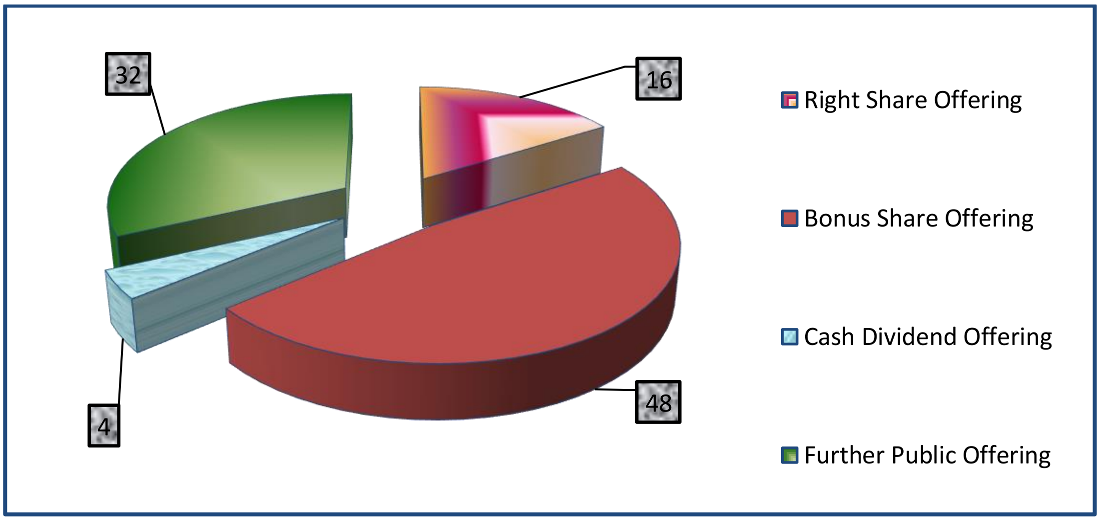
The table delineates that the majority of each category of respondents, 40% of the investors and 60% of the issue managers have stated that the investors expects bonus share offering most from the company. Next to it, 33% of the investors and 30% of the issue managers have opined that the investors quest further public offering from the company. Similarly, 20% of the investors and

10% of the personnel of issue managers are in the view that investors await right share offering from the company. Likewise, 7% of the investors have opined that the investors expect cash dividend offering from the company.

In overall, 48% of the total respondents have robustly stated that the investors expects bonus share offering from the company. Similarly, 32% of the total respondents have stated that the investors expects further public offering, 16% of the total respondents have opined that investors seek right share offering and only 4% of the respondents have affirmed that the investors expects cash dividend offering. Thus, it can be concluded that further public offering is the second motive, next to bonus share, for investors.

Figure: 4.12

Expectation of Investors



4.2.9 Collection of Information on IPO Issuance

To understand the initial public offering issuance, it is necessary that the investors collect information regarding the issuance. To examine whether investors collect information on IPO, the respondents are requested to express their opinions.

Table: 4.19

Collection of Information on IPO Issuance

Response	Investors		Issue Manager		Total	
	No.	%	No.	%	No.	%
Yes	10	67	8	80	18	72
No	3	20	1	10	4	16
Don't Know	2	13	1	10	3	12
Total	**15**	**100**	**10**	**100**	**25**	**100**

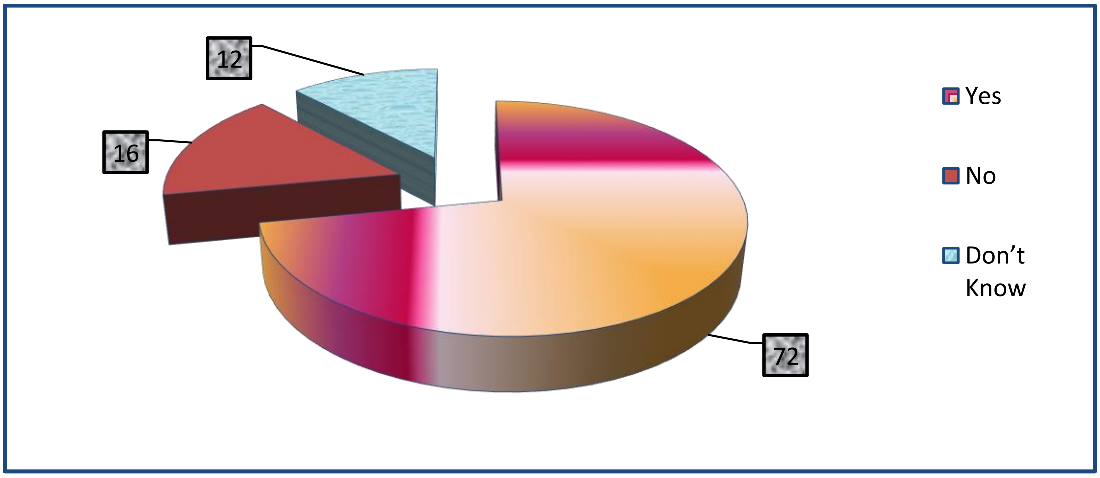
(Source: Opinion Survey, 2011)

The table depicts that the majority of the respondents of each category, 67% of the investors and 80% of the issue managers have opined that the investors do collect information on initial public offering of the company. However, 20% of the investors and 10% of the issue managers have stated that the investors are not interested in collecting information on initial public offering. While 13% of the investors and 10% of the issue managers have stated that they have no idea on this matter.

In overall, 72% of the respondents have affirmed that investors do quest information on initial public offering, 16% of the respondents have stated that investors do not collect information, and 12% of the respondents have stated that they have no idea on the collection of information by investors on initial public offering. Considering the overall majority and the majority of each category of respondents, it can be assumed that the majority of the investors are agog in collecting information about initial public offering.

Figure: 4.13

Collection of Information on IPO Issuance



4.2.10 Main Source of Information

The investors get information through various medium. To examine the main source of information of information that the investors rely on and collect information, the investors have been requested to disclose the source of information from which the investors mostly collect information.

Table: 4.20

Main Source of Information

Response	Investors		Issue Manager		Total	
	No.	**%**	**No.**	**%**	**No.**	**%**
Newspapers	4	27	2	20	6	24
Experts	3	20	2	20	5	20
Friends	7	46	3	30	10	40
Issue Company	1	7	3	30	4	16
Total	**15**	**100**	**10**	**100**	**25**	**100**

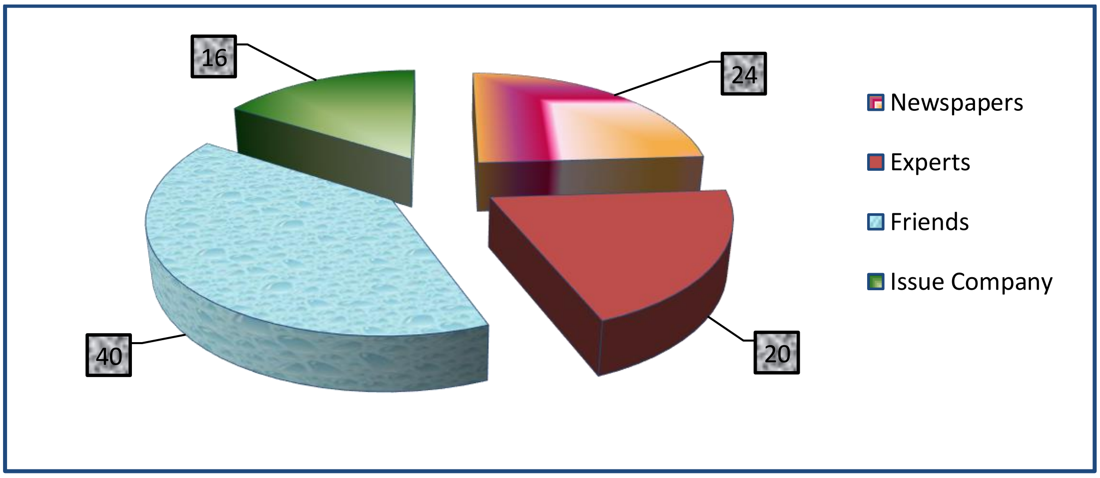
(Source: Opinion Survey, 2011)

The table presents that the majority of both the investors and issue managers have stated that friends are the major source of information for the investors on the public offering issuance. About 46% of the investors and 30% of the issue managers have opined that the friend is the main source of information. In contrast, 27% of the investors and 20% of the issue managers have stated that newspaper is the main source of information on initial public offering issuance. Similarly, 20% of the investors and 20% of the issue managers have opined that the share known expert like broker, market makers and other professional is the major source of information. However, only 7% of the investors and 30% of the issue managers have stated that the investors gather information of IPO directly from the issuing company.

In overall, 24% of the respondents pointed out newspaper, 40% of the respondents have stated friends, 20% of the respondents have pointed out experts, 20% of the respondents have avowed issuing company as the main source of information. Comparatively, it can be concluded that the friend is the most useful source of information for investors on initial public offering.

Figure: 4.14

Main Source of Information



4.2.11 Appropriate Time for IPO Issuance

As per the securities regulations, the young companies are allowed to announce IPO only if the company has completed at least one fiscal year period. To investigate whether such barricade is appropriate, the respondents are requested to express their opinions.

Table: 4.21

Appropriate Time for IPO Issuance

Response	Investors		Issue Manager		Total	
	No.	%	No.	%	No.	%
Precisely at Least 1 Year	6	40	3	30	9	36
At Least 2 Year	8	53	7	70	15	60
At Least Six Months	1	7	0	0	1	4
Total	**15**	**100**	**10**	**100**	**25**	**100**

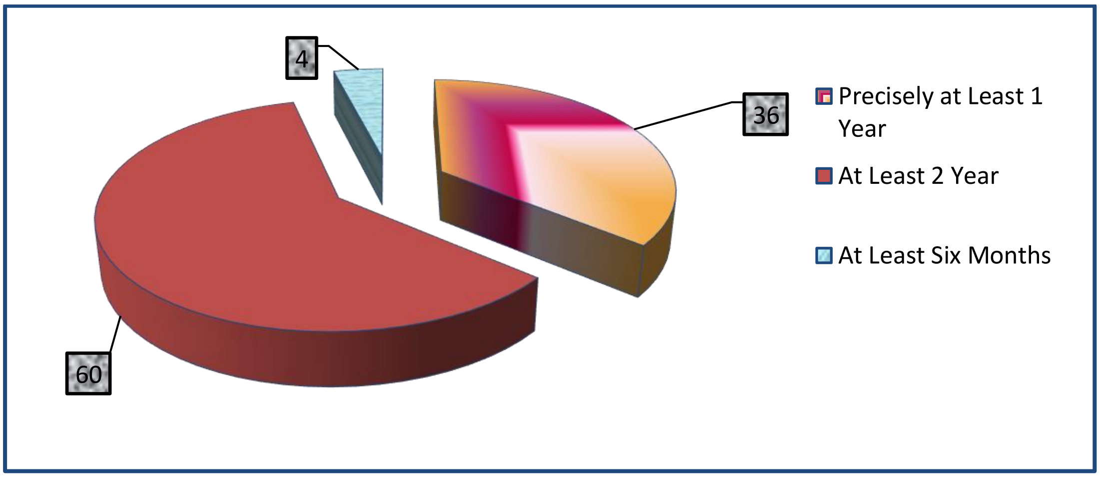
(Source: Opinion Survey, 2011)

The table shows that the majority of the respondents, 60%, are in the opinion that there should be provision of at least 2 years operation of the company before the issuance of IPO. In contrast, 36% of the respondents have argued that the current provision that mandates at least one year performance of the company before going to IPO is appropriate. Likewise, 4% of the total respondents have opined that the existing period should be reduced to at least six months.

Looking each category, it has been ascertained that the majority of the investors, i.e. 53%, and the majority of the issue managers, i.e. 70%, have stated that the company should have completed at least two fiscal years before going to the IPO. Whereas 40% of the investors and 30% of the issue managers have asserted that precisely at least one year is the appropriate period for initial public offering. While 7% of the investors and 0% of issue managers have opined that the provision should be at least six months only. Considering the opinions of the respondents, it can be assumed that it would be worthwhile if the legislation indulges the company that have completed at least two years before going to the IPO.

Figure: 4.15

Appropriate Time for IPO Issuance



4.3 Major Findings of the Study

From the above analysis, the following major findings have been drawn;

Findings from Secondary Data Analysis

- The public issue of the securities is in fluctuating trend. The public issue is highest, Rs. 16828.51 millions, in the fiscal year 2008/09 and lowest, Rs. 556.54 millions, in the fiscal year 2002/03.
- The IPO offering, which is in oscillating trend, is highest, Rs. 3144.70 millions, in the fiscal year 2009/10, and lowest, Rs. 319.46 millions, in the fiscal year 2001/02. Likewise, the IPO to public issue ratio is highest, 100%, in the fiscal year 2002/03.
- The number of public issue approved is highest, 72, in the fiscal year 2009/10, and lowest, 12, in the fiscal year 2001/02. Out of 321 public issues, 130 issues are IPO within the observed periods.
- Out of 321 public issues, 131 issues belong to finance companies, 92 issues belong to development banks, 62 issues to commercial banks, 18 issues to insurance companies, 10 issues to manufacturing and processing, and 1 issue to trading company.
- The over subscription of IPO is rampant in the securities market of Nepal. The under subscription has been noticed only in one fiscal year,

however, such observation is minimal in comparison to over subscription.

- The IPO of all of the observed sample commercial banks has been over subscribed. The subscription rate is 34.25 times in highest. Similarly, the IPO of development banks has also been over subscribed and the subscription rate is 54.84 times in highest.
- Likewise, the subscription rate of IPO is highest, 77.30, in finance companies, and 71.73 times in insurance companies, and 5.10 times in non-financial sector.

Findings from Primary Data Analysis

- The majority of the respondents, 36%, have stated that IPO is the best method for expansion the capital of the company. 28% of the respondents have said that the main advantage of IPO is that it increases the capital of the company. Similarly, 36% of the respondents have pointed that the vulnerability to market risks is the major disadvantage of IPO.
- Likewise, 48% of the total respondents have stated that the difficulty in the prediction of the market price of the IPO is the major risk factor in IPO investment. Similarly, 48% of the total respondents have said that market risk is most rampant in IPO investment.
- 52% of the total respondents have said that the growth investors show more interest in the investment in IPO.
- Further, 36% of the total respondents have opined that the measurement of the risk involved in IPO is the best strategy in IPO investment. Likewise, 52% of the total respondents have said that the diffidence of the investors' on new firm is the main reason behind under pricing of IPO.
- Likewise, 40% of the total respondents have said that the issue company itself should be most responsible for preventing the under pricing of

IPO. And, 48% of the total respondents have said that the investors await bonus share offering rather than initial public offering.

- Finally, 72% of the respondents have said that the investors do collect information regarding IPO issuance, and 40% of the respondents have said that friends are the major source of information. While 60% of the respondents have said that the company should wait at least 2 year before the issuance of IPO.

CHAPTER - V

SUMMARY, CONCLUSION & RECOMMENDATIONS

5.1 Summary

An initial public offering (IPO) occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop. Most companies start out by raising equity capital from a small number of investors, with no liquid market existing if these investors wish to sell their stock. If a company prospers and needs additional equity capital, at some point the firm generally finds it desirable to 'go public' by selling stock to a large number of diversified investors. Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately-held company. Existing shareholders can sell their shares in open-market transactions. With these benefits, however, come costs. In particular, there are certain ongoing costs associated with the need to supply information on a regular basis to investors and regulators for publicly-traded firms.

Furthermore, there are substantial one-time costs associated with initial public offerings that can be categorized as direct and indirect costs. The direct costs include the legal, auditing, and underwriting fees. The indirect costs are the management time and effort devoted to conducting the offering, and the dilution associated with selling shares at an offering price that is, on average, below the price prevailing in the market shortly after the IPO. These direct and indirect costs affect the cost of capital for firms going public.

Firms going public, especially young growth firms, face a market that is subject to sharp swings in valuations. The fact that the issuing firm is subject to the whims of the market makes the IPO processes a high-stress period for entrepreneurs. Because initial public offerings involve the sale of securities in closely-held firms in which some of the existing shareholders may possess non-public information, some of the classic problems caused by asymmetric information may be present. In addition to the adverse selection problems that can arise when firms have a choice of when and if to go public, a further problem is that the underlying value of the firm is affected by the actions that the managers can undertake.

This moral hazard problem must also be dealt with by the market. This study describes some of the risks that should be assessed by the investors while making IPO investment. In addition, the reasons behind the underpricing have been tried to detect out. Further, the study encompasses the trend of IPO and the public offering in total and in sector-wise, along with the major terms related to the IPO.

5.2 Conclusion

Analyzing the secondary data, it can be inferred that the securities market of Nepal has been smoothly developed after the operation of SEBON. The public issuance, though fluctuating, is comparatively higher at the end of the observed periods than that at the inception of the period. Likewise, the initial public offering, though oscillated, has also increased in most of the years. Thus, it can be said that more and more companies are going to public. Further, two fifth of the securities issuance is represented by the initial public offering. Since, the finance companies are extremely higher than the other financial institutions in Nepal, the greater IPO issuance of finance companies is ubiquitous. Although there is only minimal occurrence of under subscription, it can be said that the public have shown positive response to the IPOs of financial sector. However, the public are less interested in non-financial sector in comparison to that in financial sector.

Analyzing the primary data, it can be concluded that it can be said that the small company find it difficult to go to the IPO. Further, it can be avowed that the unpredictability of the share price of IPO is the major risk factor in IPO investment, and the thus the investor needs to analyze the market risk most before making investment in IPO. In addition, it has been found that mainly the growth investor awaits the promulgation of the company to go for IPO. Since, the company going IPO is new to the public, it has been ascertained that the diffidence of the investors on such new company is the main reason behind the occurrence of under subscription. Thus, the IPO issuing company should be more liable to prevent the under subscription by disclosing the financial performance and convincing the investors. Also, it can be said unawareness can also be the reason for deteriorating the confidence of the investors. However, friends have become the reliable source of the information to the investors regarding the facts related to the initial public offering.

5.3 Recommendations

After drawing out the major findings and the conclusions, the following recommendations have been provided;

- The concerned authorities should conduct various research studies and disseminate the information relating to the share trading activities to increase the understanding of investors in using financial tools to estimate the intrinsic value of shares of a company before making investment decision.
- Regional stock exchange centre should establish so that more people will be involved in investment activities on primary market as well as secondary market.
- There should be an effective co-ordination among the primary market's regulators: CRO, SEBON, Insurance Board, NRB and Ministry of Finance. Each of them should be clear on their respective jurisdiction. Formulation of contradicting policies should be avoided.

- As investment banker play a vital role in the IPO process, they should try to give more transparent, fast, hassles free service so that more public involve in the IPO.
- Before investing in any company, all the investors must go through that company's financial details, prospectus, or they will be in difficulty if only go with the market rumors.
- Most underwriters target institutional or wealthy investors in IPO distribution, which is ethically as well as logically very wrong. The allotment process must be pro-rata basis rather than lucky-draw, so that all investors may get share.
- Investors are becoming speculators rather than rational investors due to asymmetric information. They should know the whole stock valuation process and only then initiate to invest.
- While choosing the issue Manager Company should choose that are in which general investors could believe fairly.
- Application from each corner of the country should be asked so that all interested candidates could apply. As it is found that most of the IPOs are concentrated in the valley only.

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