

CHAPTER – 1

INTRODUCTION

1.1 Background of the Study:

Capital Market is a mechanism to create to facilitate the exchange of financial securities or asset by bringing together buyers and sellers of securities. Capital market provide an effective way of producing long term funds by issuing shares and debentures or bonds for corporate enterprise and government and same time provide an investment opportunity for individual and institution. Thus, the market place for these financial securities is called capital market, which is further subdivided into primary and secondary market. The primary market deals with the issuance of new securities whereas secondary market deals with the transaction of listed securities. Companies, government or public sector institutions can obtain funding through the sale or bond issue. Secondary market deals with the trading of securities that have already been issued in an initial or public offering. Alternatively, secondary market can refer to the market for any kind of used goods.

Initial Public Offerings are a part of primary market mechanism. IPO occurs when company first sell its shares to the public. It is the first sale of stock by a private company to public. It is simply referred as a public offering. IPOs are often issued by smaller, younger companies seeking capital to expand, but can also e done by large privately owned companies looking to become publicly traded. Public offering is a security offering where all investors have the opportunity to acquire a portion of the financial claims being sold (Keowen and Petty; 2002, 471).

In an IPO, the issuer may obtain the assistance of an underwriting firm, which helps it to determine what type of security to issue (Common, debenture or preferred), best offering price and time to bring it to market.

IPOs can be a risky investment. For the individual investor, it is tough to predict what the stock 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. In addition, most IPO share of companies going through a transitory growth period and they are therefore subject to additional uncertainty regarding their future value. The IPO volume has grown significantly over the years, in not only the developed economies of US or the European Union but also emerging and developing economies such as the economies of South East Asia, Latin America and also Africa. China has seen some of the largest IPOs in the past few years leading to a huge growth in the domestic stock market capitalization. The privatization of the state enterprises has also contributed to the growth in the IPO volume.

In Nepal the first public issue of ordinary shares took place with the public issue of Biratnagar Jute Mills. However, the development of capital market started in 1976 A.D. after the establishment of Security Exchange Center with the objective of facilitating and promoting capital market in Nepal. It was only capital market institution, which undertakes the job of brokering, underwriting and managing public issue, market making for government bonds and other financial service. The center used to make buy and sale only on orders from interested investors and confirm them if a price and quantity matched. There was no time limit within which deal took place. Due to this, public face problems while buying and selling shares.

With the investor facing the problem and due to the world trend of privatization and economic liberalization the operation of Securities Exchange Center was felt to change to make compatible with changing economic system. As a result, HMG Nepal brought about change in the structure of Securities Exchange Center by dividing it into two distinct entities. Securities Board of Nepal (SEBON) and Nepal stock exchange (NEPSE) at policy level in 1993, and then they are operating as the main constituents of securities market in Nepal.

Now the SEBON has come up with Securities Exchange Act 2006, which has incorporated a provision that requires the public companies to register with SEBON all securities before their issuance. The act also has made it mandatory for issuing

companies to prepare prospectus and publish it for the public after getting SEBON approval.

Capital market is gaining business attention. The NEPSE index, which shows the stock price trend of all listed securities in the stock market, has been increasing in the recent periods. Hence, the general investors are very keen to make investment in the securities of the companies through primary and secondary market. In the recent times, we can see investor gathering as a crowd whenever the primary shares are issued.

In short, when an institution raises capital from public through issuance of its securities for the first time, then it issues to the public are termed as initial Public offering. The IPO of a company serves as significantly liquidity opportunity for early investors, including founders and the venture capital investors. The main purpose of an IPO is to raise capital for the corporation. The securities offered can be ordinary share, debenture, preference shares and mutual fund.

1.2 Focus of the Study

Mass Participation in the economic liberalization process is possible through efficient capital market promotes efficient collection of small and scattered savings and provide returns.

It plays a key role in allocating capital to corporate sector that will have a real effect in the economy. In this context, IPO an important capital market mechanism enables not only business entities, but also government at occasions to raise long-term funds while on the other hand , it provides investment opportunity to the investor of public. This ensures that there exist equilibrium between fund surplus group and fund deficit group.

One commonality of all these recent IPOs is that they have been oversubscribed by multiple times, indicating an overwhelming response from the investors, particularly towards financial institutions. It can be referred to mainly three reasons. First, the financial institutions listed with Nepal Stock Exchange (NEPSE), are earning higher rates of returns. Second the financial institutions gain public credibility as they are monitored and controlled by the Nepal Rastra

Bank (NRB). The NRB makes it mandatory for them to publish their financial statements quarterly that helps investors to evaluate their investment plans and take corrective actions. Finally, IPOs offer investment opportunities which the people are always looking for.

1.3 Statement of Problem

Many of Nepalese citizens are under the line of literacy; among the literate ones, as well maximum people do not know about the practice of the stock and stock market. Although, the foundation of stock market development was laid back in 1976 A.D still Nepalese stock market is in its infant stage. Its contribution to GDP is still nominal. Nepalese stock market has very limited offerings, that too regulated by government to large extent. The reasons for the stagnant Nepalese stock market can be attributed to unstable political condition, lack of rational investor, poor state of information disclosure and poor corporate governance to name the few. Hence, IPO an important mechanism of stock market is bound to be order their perspective the stud has focused on analyzing different aspects of IPO in Nepal. More specifically the study has bought to the following research question:

-) What is the existing state of IPO in Nepal?
-) Does there exist under pricing in Nepalese IPO?
-) What is the subscription pattern for IPO?
-) Does the Nepalese investor are aware towards IPO or not?

1.4 Objectives of the study

Capital market of Nepal is still immature. IPO and its practices are also very limited. In this regard, the basic objective of the study is to analyze perspective of Nepalese IPO. To be more specific, this proposed study keeps the objectives:

-) To analyze existing state of IPO in Nepal
-) To determine whether under pricing does exist in Nepalese IPO or not,
-) To analyze whether the Nepalese investor are aware towards the IPO or not,

) To analyze whether the Nepalese investor have knowledge towards IPO.

1.5 Significance of Study

IPO is one of the crucial factors for general investor and public company. This study might serve to be crucial information for this respective institution taken as a sample for the study in IPO procedure. This study will assist in the formulation of policy and will assist the policy makers to get the practical knowledge of existing rules and regulation. The study will also help to know to different aspect of Nepalese IPOs.

This study will be significant to analyze the legal provision, possibilities and Problems of IPO in Nepal. It will also be helpful to know public knowledge and their awareness towards the IPO. Similarly, it will also be helpful to investor and the student who want to make research in IPO.

1.6 Limitation of Study

The time is the major limitation of the study. As this is the study for the partial fulfillment for the degree of Master of Business Studies, there is very limited time for this study. The other limitations are:

1. The scope of study is limited within the framework of IPO only, which are issued in Nepalese security market.
2. This study is only a case study; hence the conclusion drawn from the study does not ensure wide applicability in all types of security market running worldwide.
3. Major portion of analysis and interpretation have been done on the basis of available secondary data and information. Thus reliability of the study is based on trueness of collected data and information.
4. In this study, only selected financial and statistical tools and techniques are used.

5. Any disclosures that firms provided in other venues (e.g conference calls, analyst meetings etc.) were not included in the present analysis, which might limit the generalization of the findings.

1.7 Structure of the Study

To simply understand and give precise output, this study has been organized into five chapters each devoted to some aspects of the study of Performance of Nepalese IPOs.

Chapter 1: Introduction

This is very first chapter of discussion which includes background, focus of the study and statement of the problems, objectives of the study, significance of the study, limitations of the study and finally structure of the study.

Chapter 2: Literature Review

This is the second chapter of the study, in which various books, journals articles, periodicals reports and other publication has been studied and reviewed. This chapter broadly consists of two segments-conceptual review and review of related studies. Conceptual reviews are made to sheds light on conceptual aspects of IPO and its different features. Likewise, Review of related studies are reviewed in separate segment, to show what types of studies were made in this field and what results were generated by prior research.

Chapter 3: Research Methodology

This is third chapter, which includes Research design, Population and sample, sources of data, process of data collection and data analysis tools.

Chapter 4: Data presentation and analysis

This is the fourth chapter in which results are found out using several statistical tools. The calculated data, figures charts and other analyzed result are presented in this chapter.

Chapter 5: Summary, Conclusion and Recommendation

The whole study is summarized and concluded in the final chapter. Similarly, recommendations derived from the analysis are also presented in this chapter.

A list of Bibliography is presented at the end of chapter 5 and the necessary supplements are presented in the final segment as the appendices.

CHAPTER -2

LITERATURE REVIEW

2.1 Conceptual View

2.1.1 Financial Market

Financial market is a mechanism that allows people to buy and sell (trade) financial securities (such as stocks and bonds), commodities (such as precious metals or agricultural goods), and other fungible items of value at low transaction costs and at prices that reflect the efficient-market hypothesis.

Financial markets have evolved significantly over several hundred years and are undergoing constant innovation to improve liquidity. Both general markets (where many commodities are traded) and specialized markets (where only one commodity is traded) exist. Markets work by placing many interested buyers and sellers in one “place”, thus making it easier for them to find each other. An economy, which relies primarily on interactions between buyers and sellers to allocate resources, is known as a market economy in contrast either to a command economy or to a non-market economy such as a gift economy.

In finance financial market facilitate-

-) The raising of capital (in the capital market)
-) The transfer of risk (in the derivative markets)
-) International trade (in the currency market)

In addition, are used to match those who want capital to those who have it.

Therefore, financial markets could mean, Organizations that facilitate the trade in financial products, i.e stock exchange facilitate the trade in stocks, bonds and warrants. The coming together of buyers and sellers to trade financial products, i.e stocks and shares are traded between buyers and sellers in a number of ways including: the use of

stock exchange: directly between buyers etc. Financial markets can be domestic or they can be international.

Types of Financial Markets

The financial markets can be divided into several sub types:

-) Stock Market which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof.
-) Bond markets, which provide financing through the issuance of Bonds and enables the subsequent trading thereof.
-) Commodity market, which facilitate the trading of commodities.
-) Money markets, which provide short term debt financing and investment.
-) Derivatives Markets, which provide instruments for the management of financial risk.
 - o Futures markets, which provide standardized forward contracts for trading products at some future date; see also forward market.
-) Insurance markets, which facilitate the redistribution of various risks.
-) Foreign exchange markets, which facilitate the trading of foreign exchange.

The capital markets consist of primary markets and secondary markets. Newly formed (issued) securities are bought or sold in primary markets. Secondary markets allow investors to sell securities that they hold or buy existing securities.

2.1.1.1 Primary Market

The primary market is that part of capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of new stock issue, this sale is an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.

Features of Primary markets are:

-) This is the market for new long-term capital. The primary market is the market where the securities are sold for the first time. Therefore, it is also called New Issue Market (NIM).
-) In a primary issue, the company issues the securities directly to investors.
-) The company receives the money and issues new security certificates to the investors.
-) Primary issues are used by companies for setting up of new business or for expanding or modernizing the existing business.
-) The primary market performs the crucial function of facilitating capital formation in the economy.
-) The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as 'going public.'

Methods of issuing securities in the primary market are:

-) Initial public offering
-) Right Issue (for existing companies), and
-) Preferential issue

2.1.1.2 Secondary Market

The secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. Alternatively, secondary market can refer to the market for any kind of used goods. The market that exists in a new security just after the new issue is often referred to as the after market. Once a newly issued stock is listed on a stock exchange, as market makers provide bids and offers in the new stock.

In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market be highly liquid

(Originally), the only way to create this liquidity was for investors and speculators to meet at a fixed place regularly; this is how stock exchanges originated, History of the stock exchange).

Secondary market is vital to an efficient and modern capital market. Fundamentally, secondary markets mesh the investor's performance for liquidity (i.e, the investor's desire not to tie up his or her money fro a long period of time, in case the investor needs it to deal with unforeseen circumstances) with the capital user's preference to be able to use the capital for an extended period of time. For example, a traditional loan allows the borrower to pay back the loan, with interest, over a certain period. For the length of that period, the bulk of the lender's investment is inaccessible to the lender, even in cases of emergencies. Likewise, in an emergency, a partner in a traditional partnership in only able to access his or her original investment if he or she finds another investor willing to buy out his or her original investment if he or she finds another investor willing to buy out his or her interest in the partnership. With the securitized loan or equity interest (such as bonds) or tradable stocks, the investor can sell, relatively easily, his or her interest in the investment, particularly in the loan or ownership equity has been broken into relatively small parts. This selling and buying of small parts of a larger loan or ownership interest in a venture is called secondary market trading.

Under traditional lending and partnership arrangements, investors may be less likely to put their money into long-term investments, and more likely to charge a higher interest rate (or demand a greater share of the profits) if they do. With secondary markets, however, investors know that they can recoup some of their investment quickly, if their own circumstances change.

2.1.2 The concept of Initial Public Offering

2.1.2.1 The definition of Initial Public Offering

The concept of an IPO is straight forward. It is the first public offering of equity share in corporation. IPO refers to the offering of stock in a company to the public through a public market. The IPO under pricing is defined as the premium that subscribing investor

receives at the initial stager of market trading, being the difference between subscription price and the first day closing price. In other words, an IPO has no trading history in the stock market; therefore it is difficult for the company and its underwriter to determine an appropriate price for the new offer. The interesting phenomenon of IPO is that the offer price of IPO is normally lower than the closing market price of the first trading day, meaning that the subscribing investor can enjoy abnormally high investment return from an IPO. Because of the large return IPO are referred to as being “under priced”.

Numerous empirical studies (Ibotson, 1975; Aggrawal et al. 1993; Loughran and Ritter, 2000) indicate that, on average IPO are underpriced. A typical IPO of Common Stock generates large short-run returns for investor fortunate enough to purchase the stock at the offer price. However, the result of the long run performance of an IPO return is very different from the short-run performance. The empirical evidence from the US and the other countries suggest that IPO underperforms in the long run relative to overall market (Ritter, 1991; Lewis 1993; Aggrawal et al. 1993). However, recent development in the field of measuring long-run returns suggests that measurement errors make these controversial areas (Fama, 1998 ; Barber and Loyn, 1999). Numerous attempts have been offered to explain the underpricing and long run performance phenomena because of the unusual after market performance.

2.1.2.2 Why Go Public?

There are several common reasons that can explain why a company enters the new market. One main reason is to refinance the firm. After several years of successful operation, the founder and insider shareholders might want to convert their holdings into cash for other expenditure. The second reason is to obtain new funds for further business extension or to pay back their borrowings.

Company can reach a stage where the financing of further growth is beyond the capacity of the existing shareholder. Equity funds raised from the IPO are available for expanding operations, increasing working capital or reducing borrowing. A successful IPO can establish a market for the company’s securities, create a broader shareholder base for

further capital raisings and generally enable the company to satisfy its financial requirements on more favorable terms. Companies can enjoy many other benefits by going public, such as enhance corporate image, advertise trademarks and products, attract and retain key person. Furthermore, Going public raises cash, and usually a lot of it. Being publicly traded also opens many financial doors. Because of the increased scrutiny, public companies can usually get better rates when they issue debt. As long as there is market demand, a public can usually get better rates when they issue debt. Thus, the mergers and acquisitions are easier to do because stock can be issued as part of the deal. Similarly, Trading in the open markets means liquidity. This makes it possible to implement things like employee stock ownership plan, which help to attract top talent. In addition, once a company is listed, it will be able to issue further shares via a right 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.

Ritter and Welch (2002) stated that while companies go public primarily to raise equity finance and to create a public market in the entity's securities, there are additional issuer-specific and market factors that influence decision to list on a stock exchange. It is possible that a company grows to a stage in its life cycle where it is optimal to go public (Chemmanur and Fulghieri, 1999). However, the optimal development stage for a company to go public might differ across economies and industries.

There are some disadvantages associated with going public as well. For example, existing owners might face a weakening of control as obvious consequences following a public flotation. Directors of a public company would take additional responsibilities and are morally and legally obliged to act in the best interest of all shareholders. Maksimovic and Pichler (2001) showed that listing on a stock exchange could result in a loss of some competitive advantages by having to reveal private information during the process of going public. According to Security Exchange Act, public companies might disclose detailed information of the company's operations, which will place companies at

a competitive disadvantage situation. There are also heavy cost associated with a public flotation, including initial cost associated with a public flotation, including initial cost of conversion to a public listed company, underwriting fees and brokerage, accounting and legal fees, listing fees, share registry cost and many other continuing expenses such as the increase cost of producing annual reports.

In short, approaching the equity market still is one of the most efficient ways to obtain large sum of the most efficient way to obtain large sum of funds, even if it has disadvantage. Ritter and Welch (2002) state that the motivation of going public is stronger in some situations or times than in others.

2.1.2.3 Hot IPOs

When an IPO is “hot” appealing to many investors, the demand for the securities far exceeds the supply of shares. The excess demand can only be satisfied once trading in the IPO shares begins. It is clear how “hot” the offering will be until close to the time when the shares start trading. Since “hot” IPOs are in high demand, underwriters usually offer those shares to their most valued clients.

2.1.2.4 Pricing

Historically, IPOs both globally and in the US have been underpriced. The effect of initial underpricing an IPO is to generate additional interest in the stock when it first becomes publicly traded. This can lead to significant gains for investors who have been allocated shares of the IPO at the offering price. However, underpricing an IPO results in “money left in the table” lost capital that could have been raised for the company had the stock been offered at a higher price.

The danger of overpricing is also important consideration. If a stock is offered to the public at a higher price than the market will pay, the underwriters may have trouble meeting their commitments to sell shares. Even if they sell all of the issued shares, if the

stock falls in value on the first day of trading, it may lose its marketability and hence even more of its value.

Investment banks, therefore, consider many factors when pricing an IPO, and attempt to reach an offering price that is low enough to stimulate interest in the stock, but high enough to raise an adequate amount of capital for the company. The process of determining an optimal price usually involves the underwriters (“syndicate”) arranging share purchase commitments from lead institutional investors.

2.1.2.5 Pricing Difference

We may have found that there can be a large difference between the price of an IPO and the price when an IPO shares trading in the secondary market. The pricing disparities occur when an IPO is “hot” or appeals to many investors. When an IPO is “hot”, the demand for the securities far exceeds the supply of shares. The excess demand can only be satisfied once trading in the IPO shares begins. The imbalance between supply and demand generally causes the price of each share to rise dramatically in the first hours or days of trading. Many times the price falls after this initial flurry of trading subsidies.

2.1.2.6 Issue Price

A company that is planning an IPO appoints lead managers to help it decide on an appropriate price at which the shares should be issued. There are two ways in which the price of an IPO can be determined: either the company, with the help of its lead managers, fixes a price or the price is arrived at through the process of book building.

2.1.2.7 Quiet Period

Quiet Period refers to a period of time in which a company enters following an IPO’s first day of public trading. During this time, insiders and any underwriters involved in the IPO are restricted from issuing any earnings forecasts or research reports for the company. The quiet period is in effect for specific calendar days. When the quiet period is over, generally the lead underwriters will initiate research coverage of the firm.

2.1.2.8 IPO Procedure

IPOs 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:

-) Dutch auction
-) Firm commitment
-) Best efforts
-) Bought deal
-) 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.

Multinationals 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 E.U 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.

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 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's 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 always allows the underwriters an option to increase the size of the offering by up to 15 percent under certain circumstance known as the green shoe or over allotment option.

2.1.2.9 Largest IPO

-) Industrial & Commercial Bank of China \$ 21.6 Billion in 2006
-) NTT Mobile Communications \$ 18.4 Billion in 1998
-) Visa \$ 17.9 Billion in 2008
-) AT & T Wireless \$ 10.6 Billion in 2000
-) Rosneft \$ 10.4 Billion in 2006

2.1.3 IPO Characteristics

Often Characteristics, such as the underwriting costs as the proportion of the offer value and other underwriter activities (oversubscription provision and share trading by underwriters in the immediate IPO aftermarket) could contribute to better understanding of IPO listing day returns.

2.1.3.1 Direct cost in Equity offers

Aggrawal and Ravioli (1991) documented that direct cash expenses incurred by firms going public in the US (during the 1977-1987 period) are 12.3 percent for firm commitment offers and 15.3 percent for best efforts offers. Chen and Rittler (2000) documented that underwriting fees paid by more than 90 percent of US IPOs between 1995 and 1998 were exactly seven percent. Torstila (2001) reported that fees charged by underwriters of European IPOs are than those in the US. The lower level of service that small, less reputable underwriters provide to issuing firms influenced lower costs. Torstila (2001) examined the distribution of fees between the members of the IPO syndicate for initial equity offers in the US during the 1990s. Similarly, to the average gross spread (underwriting fee) of seven percent (as documented by chen and Ritter, 2000), there appears to be standard division of this gross spread within the syndicate into 20 percent management fee, 20 percent underwriter fee and 60 percent selling concession. While quite common by the end of the 1990s, the 20/20/60 standard was applied by only a third of the syndicates, and is much less frequently applied rule than the seven gross spread rule. The lead underwriter received a small share of underwriting fee, but a relatively large proportion of the selling concession. First day returns are positively related to selling concession. Therefore, underwriters are motivated to underprice an IPO, which generates higher trading volume and results in higher commissions (as documented by Ellis, Michaely and O'Hara , 2000)

Contrary to Chen and Rittler (2000), How and Yeo (2000) found that underwriting fees for IPOs in Australia between 1980 and 1996 are not fixed at a certain percentage. Instead, percentage underwriting fees differ across issue size and overtime, while there is some clustering of underwriting fees at three, four and five percent. Additionally, no evidence of underwriter collusion was found in the fee determination process.

Schultz and Zaman (2001) found that internet related IPOs in the US were not charged higher fees than non-internet IPOs, suggesting that underwriters alleviate their risks in equity offers using other strategies, possibly by providing indirect support for the offer through their market making activities in the immediate IPO aftermarket.

2.1.3.2 Underwriters' Market Making Activities in IPOs

Ellis, Michaely and O'Hara (2000) used a sample of 306 NASDAQ IPOs and found that the lead underwriter is the dominant market maker in post-IPO trading. While compensation for underwriting an IPO comes from the gross spread, trading and inventory profits on average contribute positively to underwriters' overall proceeds. Thus, provision of liquidity in the aftermarket is not subsidized from the underwriting fees. Consistent with Torstila (2001), Ellis et al. (2000, figure 6, p. 1069) found a significant positive relationship between underpricing and underwriters' trading profits. Therefore, underwriters are motivated to underprice not only to avoid risks embedded in overpricing an issue, but also to generate higher trading commissions in the aftermarket. Ellis et al, found that, by rule, underwriters take a short position in IPOs prior to listing. That is, underwriters oversell an offer by approximately 15 percent, which is equivalent to the size of the over allotment (oversubscription) option. Underwriters take on this sort position to stimulate demand for the offer. If the aftermarket price is greater than the offer price, lead underwriter covers the short position by exercising the over allotment option (effectively buying the shares back at offer price), and does not exercise the allotment process. Thus, it is evident that the over allotment option reduces the risk of price support activities and inventory position risk for the underwriter.

The result of Ellis et al. (2000) were confirmed by Aggrawal (2000), who found that underwriters used the combination of over allotment option, penalty bids and aftermarket short covering to provide price support for IPOs and to minimize their costs of price support. In the sample of 137 IPOs between May and July 1997, Aggrawal found no evidence of pure stabilization; that is, posting a bid at or below the offer price. Underwriters avoided this pure price stabilization due to regulatory constraints in the US. Instead, underwriters restricted the supply of shares to provide price support for IPOs with relatively weak investor demand.

The above evidence indicates that over allotment (oversubscription) provision in the initial public offer may have effect on listing day returns. Therefore, listing day returns.

Therefore, listings that permit oversubscriptions of shares need to be examined in the IPO context.

2.1.4 Theoretical Justification for IPO Underpricing

Underpricing is the premium that subscribing investor would receive during the initial stage of market trading and is usually defined as the difference between that subscription price and the first trading day closing price. As many authors have pointed out (Baron, 1982; Rittler, 1984; Levis, 1993), IPOs on average are underpriced. Several theories seeking to explain this premium have emerged. These are the Winner's Curse' (Rock, 1986), Principal-agent theory (Baron, 1982), Underwriters Reputation Theory (Carter and Manaster, 1990), Signaling theory (Leyland and Plye, 1977), The Partial Adjustment Theory (The market Feedback Theory) (Ibbotson et al, 1988), Litigation Avoidance Theory (Tinic, 1988), Cascades Theory (Welch, 1992), Divergence of opinion under uncertainty (Miller, 1997), Incomplete Spanning of Primary Issue (Mauer and senbet, 1992), Manager strategic underpricing Explanation (Aggarwal et al, 2002).

Collectively, these theories suggest that underpricing is not a market anomaly, but a proof of market efficiency, in that it reflects a risk premium caused by uncertainty (Miller, 1997). Incomplete Spanning of Primary Issue (Mauer and senbet, 1992), Manager Strategic underpricing Explanation (Aggarwal et al, 2002).

Collectively, these theories suggests that underpricing is not a market anomaly, but a proof of market efficiency, in that it reflects a risk premium caused by uncertainty, that is, the unavailability that is easily obtainable for already listed seasoned firms.

2.1.4.1 The Winner's Curse'

Kevin Rock (1986) develops one of the most famous theories on underpricing. He assumes that neither the underwriter nor the issuers have perfect information concerning the value of the issue. In the market, on the other hand, some investors concerning the value of the issue. In the market, on the other hand, some investors are perfectly

informed while the others find themselves at the same informational disadvantage as the issuer and underwriter. The informed investors will have high demand for underpriced issues, and no demand for overpriced issues. The uninformed investors will subscribe to all available issues, and consequently the underpriced issues will be oversubscribed and the overpriced issues will be undersubscribed. The uninformed investors will thus, on average, receive a larger portion of the oversubscribed issues, and hence their average return will be weighted towards the overpriced offerings. This is referred to as the 'winner's curse'. It implies that if the investors that are at an informational disadvantage relative to the others receive all the shares they request, the reason for this is that the informed investors did not want them. If the majority of the issues are overpriced, the uninformed investors will find it unprofitable to stay in the market, and they will therefore withdraw from it. To keep the uninformed investors in the market, the underwriters deliberately underprice their issues. This will not eliminate the allocation bias, but the uninformed investors will no longer expect a negative average return.

Welch (1989) and Benveniste and Spindt (1988) are critical to Rock's model. Welch argues that the issuer can either withdraw the offering, or compensate the uninformed investors if the informed investors do not show any interest in the issue. Benveniste and Spindt state that the winner's curse only exists if the allocation is symmetrical. That is, if the issuer (or underwriter) can choose how to allocate the issue, the adverse selection problem is eliminated.

Beatty and Ritter (1986) extend Rock's model, arguing that there is positive relationship between the expected underpricing, and the ex ante uncertainty regarding an IPO. Some investors will analyze the issues to determine which are likely to give positive initial returns. This creates a winner's curse problem for those who are trying to free ride. The free riders will not subscribe to issues unless they are, on average, underpriced. As ex ante uncertainty increases, so does the winner's curse, leading the free riders to demand an enhanced underpricing. This is what constitutes Beatty and Ritter's (1986) proposition number one:

“The greater is the ex ante uncertainty about the value of an issue, the greater is the Expected underpricing”

2.1.4.2 Principal-Agent Theory

Baron (1982) applied the principal agent theory to explain underpricing of IPOs assuming information asymmetry between the issuer and the investment banker (where the latter is better informed about the capital market), decision about the offer price are delegated to the investment banker, who underpriced the issue to avoid under subscription. Baron maintained that firms conducting IPOs would accept a lower price larger the uncertainty about investors' demand for that offer. Therefore, uncertainty about the issue is positively related to underpricing. It is therefore necessary to examine whether IPOs are underwritten and whether there is a relationship between post listing returns and underwriting.

Muscasella and vestsuppens (1989) tested Baron's (1982) model of asymmetric information between the issuer and the underwriter by examining investment banks own IPO between 1970 and 1987. These offers were predicted to have less underpricing because the same entity is both the issuer (principal) and the underwriter (agent); thus, no information asymmetry should occur in a self marketed firm commitment IPO. However, Muscasella and vestsuppens found significant underpricing of investment bank's own IPOs: they found initial returns of 7.12 percent on average, measured as return to subscribing investors at the close of first trading day. In the group where the issuing firm (investment bank) is also the lead manager, average underpricing was 13.23 percent. Ritter and Welch (2002) speculated that underpricing of investment banker's own IPOs might have been deliberate in order to justify past and future underpricing of client's IPO by the investment banks. Nevertheless, this underpricing is consistent with Baron's model and necessitates alternative explanations such as Tinic's (1988) litigation avoidance, signaling hypothesis.

2.1.4.3 Underwriter Reputation Theory

Underwriter Reputation theory proposed that specialization of underwriters by IPO 'quality class' and contract type (firm commitment or best efforts) explains a relatively wide range of predicted average initial returns. That is underwriter specialization signals the quality of the IPO firm. This model is developed by Carter and Manaster (1990) and has references to the model of Rock (1986), Beatty, and Ritter (1986). They argue that as underpricing is expensive, companies of high quality want to reveal their low risk to the equity market, and as a result suffer less underpricing of their IPOs. One way of showing their superior quality is to engage a prestigious underwriter who can serve as a certifying intermediate and thus reduce the underpricing. Carter and Manaster find empirical evidence that underwriter reputation is negatively related to underpricing. Later, studies of Beatty and Welch (1996) and Cooney et al (2001) have reported the opposite, namely that underwriter reputation is positively related to underpricing. The research in this area is thus inconclusive.

2.1.4.4 Signaling Theory

The basic idea of this theory is that issuer has better information about their firm, future performance than outsiders investor do. Leyland and Plye (1977) use a signaling model to value projects and claim that retained ownership is a good signal of firm (project) quality to outside investors. In their model, issuer's fractional holding of the firm's equity signals its expected future cash flows: a higher fractional signals larger cash flows. In addition, the issuer can sell their shares at higher price later.

Welch (1989) presents a model in which high quality firms underpriced IPOs in order to obtain a higher price at a seasoned offering. He points out that the information asymmetry between the firm owners and investors produces underpricing, and high quality firm's value underpricing as a signaling device, so firms have no incentive to avoid underpricing. Consequently, a higher price at a seasoned offering eventually compensates firms for intentionally low IPOs price. This model strongly suggests IPO firms to pursue a multiple issue strategy when they choose both the price and the proportion of the firm they offer at their IPO. Welch suggest that high quality firms'

owners can signal their superior information to investors because their marginal cost of underpricing is lower than marginal cost of underpricing for low quality firm owners. To imitate high quality firms, low quality firms would not only have to incur the signaling costs but also expand the resources to imitate the observable real activities and attributes of high quality firms. However, the market may discover the true quality of firms between IPO and seasoned offering and therefore force imitating firms to bear some of the imitation expenses whose only purpose was to deceive investors. Higher signaling cost then increases the attractiveness of low quality firm's alternative revealing themselves as low quality firms. In other words, the IPO underpricing can drive an additional wedge between the costs and benefits of low quality firms' imitation tradeoff to induce low quality firms to reveal themselves.

Grinblatt and Hwang (1989) combined the underpricing and the promoters of shares sold in the IPO to derive signaling hypothesis. Thus, both the offer (subscription) price and the promotion of retained ownership by original investor signal the IPO firm's value. Grinblatt and Hwang proposed that underpricing is positively related to retained ownership by issuers, and that the value of the issuing firm is positively related to the degree of underpricing. Their model is consistent with other signaling model, as well as with empirical evidence in IPOs (Beatty and Ritter, 1986; Ibbotson, 1975; Ibbotson and Jaffe, 1975; Ibbotson et al, 1988; Ritter, 1984).

Consistent with Welch (1989), and Grinblatt and Hwang (1989) Allen and Faulhaber (1989) developed another equilibrium-signaling model of firm quality. Allen and Fulhaber assumed that the firm itself has the best information about its future prospects. They distinguished two types of issues market-A separating and a pooling equilibrium. A separating equilibrium, the so called 'hot issue' market, is a period when good quality issues are able to signal their superiority to investors with offer price and percentage of retained ownership after the IPO. In other market conditions the pooling equilibrium exists with no underpricing (good qualities IPOs are unable to distinguish themselves from other IPOs by signaling their values). Allen and Faulhaber predicted that separating equilibrium of hot issues markets would be related to the expected industry profitability

of entry would result in temporary time and industry clustering of IPOs. Allen and Faulhaber argument that underpricing occurs at certain industries has been evidenced by events in the internet IPO market (Ljungquist and Wilhelm ,2003; Ritter, 2006).

2.1.4.5 The Partial Adjustment Theory (The Market Feedback Theory)

Ibbotson et al (1988) introduce the partial adjustment phenomenon'. It refers to the fact that the issuer does not increase the offer price to equal the company's market value of equity on the day of the flotation. The price is merely partially adjusted, and as a result, higher levels of underpricing have been observed for issues with positive alterations to their offer prices.

He uses this theory to develop a model for setting the offer price and determine the allocation of shares in an offering. In addition, they explain why the offer price is only partially adjusted to demand. During the offer period, investors are encouraged to truthfully reveal information regarding the issue. For the investors with positive information to be motivated to make this information publicly available, they must be compensated so that they are better off by telling the truth than by giving no, or false portion of the issue, but simultaneously the offer price is increased. Thus, the profit from the enhanced allocation must exceed the decrease in expected initial returns, and therefore the truth-tellers will be better off than the liars (Hanley, 1993) will. When an issue is oversubscribed, the underwriter needs to ration the shares. In this case, the investors who reveal good information will be favored, and those providing false negative information, risk having their allotment significantly reduced. When issues are rationed, underpricing is also used to compensate the investors who reveal positive information, if the demand from these investors exceeds the number of shares to be issued. Benveniste and Spindt argue in their theorem number one that '*Underpricing is directly related to the level of interest in the pre market*' (p. 353). They also claim that '*issues priced in the upper part of the offer range are likely to be more underpriced than other IPOs*' (p. 353)

2.1.4.6 Litigation Avoidance Theory

Another explanation for underpricing was given by Tinic (1988), who found a low level of underpricing for US IPOs during the pre-1930 period, compared with underpricing after passing of US securities Act in 1933. Tinic, explains that underpricing reflects underwriters' effort to avoid legal liability that could arise if the offer price were overpriced. However, avoidance of legal liability (not only in US but also in other countries) is most likely to be only one of the factors that influence underpricing because initial returns in the US are not large by international terms; thus implying that litigation avoidance is not a major cause of underpricing. While underpricing can prove to be a costly advertising campaign to signal issuing firm's quality, the issuer is directly rewarding investors for participation in the IPO. Thus, it is the least complicated way of signaling future prospects of the IPO firm, which concurrently reduces the probability of litigation. Litigation avoidance theory also seems to be able to explain why seasoned equity offerings are less underpriced than IPOs. As much less uncertainty about the issue is associated with a seasoned offer, less underpricing is required. Welch (1991) empirically tested the lawsuit avoidance theory of Tinic (1988) and found some evidence for lawsuit avoidance behavior. That is, riskier offers are associated with larger direct compensation through higher underwriting fees. However, underpricing is not related to the number of statements in the prospectus for which the underwriter could be held liable (Welch, 1991).

2.1.4.7 Cascades Theory

Welch (1992) observed that IPO shares are sold sequentially, rather than all at once to all investor. Therefore, later investor has the benefit of information about earlier investors' demand behavior. These late investor tend to ignore their private information, and act on information of early investor, which produces a chain reaction that Welch call 'Cascade'. It is therefore in the underwriter's interest that early investor communicate positive signals about the issue, especially within a relatively homogenous market where communication between investor is easy. If the initial information about the demand for the offer is not favorable, issuers might attempt to distribute the offer over segmented markets, and in that manner prevents communication between investors. However, the

usefulness of this model depends on the ability to observe early investor's demand behavior.

2.1.4.8 Divergence of Opinion Under Uncertainty

Miller (1997) predicts that in markets for securities where short selling is restricted and there are wide variations in investors' valuation of securities, a minority of most optimistic investor will form market price. Divergence of opinion is greatest when stock is issued for the first time. Additionally, the supply of IPO share is restricted because underwriters attempt to control the amount of short selling in the immediate aftermarket (through their market making activities or share lock up provision), which result in unavailability of IPO share to be borrowed from the brokers for the purpose of short sale. Consequently, if underwriters set the offer price according to the valuations of the average informed investor, the IPO will be underpriced. This is due to the excess demand for the IPO in the immediate aftermarket, which becomes dominated by the most optimistic investors. With the time, variance in options decreases and optimistic investor revise their valuation towards the mean, resulting in lower market price. Divergence of options could therefore result in larger underpricing in Small IPOs with relatively few investors, which are characteristics of many new economy IPOs.

Houge, Loughran, Suchank and Yan (2001) provided support for Miller's (1977) divergence of opinion hypothesis using a sample of 2,025 US IPOs between 1993 and 1996. Houge et al documented that higher divergence of opinion and uncertainty, approximated by higher flipping activity (selling of IPO shares by subscribing investor in the immediate aftermarket), later opening of trade on the listing day, and wider bid asks spread, can result in larger initial returns and greater long-run underperformance. Additionally, Ofek and Richardson (2003) documented substantial restriction to short selling of US IPOs January 1998 to February 2000. Thus, miller's predictions received support from price behavior of new economy IPOs during the hot issue market until 2000, where high uncertainty and divergence of opinion, coupled with difficulties to obtain IPO shares for short selling the securities, resulted in dominance of the most optimistic investors.

2.1.4.9 Incomplete Spanning of Primary Issues

Mauer and Senbet (1992) explained that investors have limited success in subscribing for IPO shares and that there are few, if any, substitute investments for IPOs in the secondary market. That is, unlike other theories that explain underpricing as a consequence of information asymmetry between parties in the offer process, Mauer and Senbet stated that it is the incomplete spanning of IPOs and limited access to the primary market that explain underpricing. Thus, no securities in the secondary market can stimulate the risk and return characteristics of new equity issues. This results in a primary market risk premium. Mauer and Senbet predicted that underpricing is unrelated to systematic risk, and that industries will be characterized with a difference in the level of underpricing with new industries (such as those in the new economy sector) having underpriced IPOs.

2.1.4.10 Manager Strategic Underpricing

Aggrawal et al. (2002) develop a model that highlights the manager's benefit from the IPO underpricing, which provides another explanation of this interesting phenomenon. Based on the empirical findings of this paper, Aggrawal et al. (2002) argue that managers strategically tend to underprice IPOs to maximize their personal wealth from selling shares at lockup expiration. The high rate of the first trading day produces positive information to attract attention of investors and thereby shifting the demand curve for the stock outwards. Therefore, managers may take this advantage to sell shares at the lockup expiration at a higher price than they would otherwise obtain. In addition, the first day underpricing is positively correlated with the manager's ownership, also positively correlated with stock returns and insider selling at lockup expiration. Chemmanur (1993) argues that owner-managers of high quality firms tend to underprice the IPO to induce investors to produce positive information about the firm, which allows the firm to sell shares in the secondary offering at a higher price. Some other studies, such as Bradley et al. (2001), Rajan and Servaes (1997) produce similar empirical results.

In summary, several theories or hypotheses have been offered in answer to the IPO underpricing phenomenon. However, it is fair to say that no single hypothesis has

received overwhelming empirical support to reject reasonable alternative explanation. Some of the simplistic explanations end up raising more question than providing convincing answers. Others that are based on rigorous theoretical analyses offer important insights and testable propositions but are supported weakly from the empirical test. It seems that there are many factors, which can affect the IPO underpricing. Again, this suggests that further study is still needed to explain the mystery of IPO underpricing.

2.1.5 Empirical Justification of IPO Underpricing

2.1.5.1 Short- Run Returns

Many empirical studies have revealed that the existence of high initial returns on IPOs at an international level. Ibboston (1975) finds that the initial IPO returns to subscribing investor are on average 11.4 percent during the period 1960 through 1969 and the opportunity of loss is much smaller than that of a origin, so the IPO still is attractive to common investors. The work of Ibboston set in motion a train of empirical studies that continues this day.

Ibboston and Jaffe (1975) document a hot issue phenomenon. The hot issue market is defined by them as periods in which the average first month performance (or aftermarket performance) of new issues is abnormally high. They find a 16.8 percent average excess return relative to the market in hot issue periods and suggest that from 'issuers' side, firms should go public in a cold issue market for more capital. On the other hand, investors should buy the offerings issued in the market because of the higher investment return, so they conclude that the price volatility is highly affected by whether the IPO market is hot or cold. Ritter (1984) examines the hot issue market from January 1980 to March 1981. During this period, the average initial first day return of 48.4 percent is recorded, compared to 16.3 percent during the rest of data period (1977-1982). He concludes that the hot issue market of 1980 is attributable to the sudden appearance of natural resources firms going public, which implies that the hot issue market might occur at a particular period and only in particular industries.

Finn and Higham (1988) are generally recognized as the first significant academic study of Australia IPOs by using a sample of 93 new issues from July 1966 to June 1978. An average return of 29.2 percent on the first trading days was found in this study. Aggrawal et al. (1993) focus on Latin American market in their study based on the sample of 62 Brazilian offerings in 1980-1990, 36 Chilean IPOs in 1982-1990 and 44 Mexican IPOs in 1987-1990. According to their research result, initial one-day returns are found to be 78.5 percent, 16.7 percent and 2.8 percent for Brazil, Chile and Mexico. Ibbotson et al. (1988) find an average return of 16.4 percent for 4534 IPOs from 1977 to 1987, computed from the offer price to the closing price of the first day of trading in US. Similar result has been found in many other countries, such as Great Britain (Jenkinson, and Mayer, 1988), Spain (Rahnema et al, 1993), Finland (Keloharaju, 1993). Switzerland (Kunz and Aggrawal, 1994), Belgium (Giudici and Roosenboom, 2004), Turkey (Kiyamaz, 2000), Japan (Cai and Wei, 1997; Beckman et al. 2001), Malaysia (Dawson, 1987), China (Yu and Tse, 2003), India (Ghosh, 2004) and Singapore (Koh and Walter, 1989; Firth and Liao-Tan, 1997).

Habib and Ljungqvist (2001) find that the US IPOs are underpriced by 13 percent on average; Chinese IPOs are underpriced by 42 percent whereas the Malaysian IPOs are under price by 6 percent. They found that some IPOs are more underpriced than others are because their owners have less reason to care about underpricing depends on how much they do well at the IPO. It is because the promoters who sell very few shares to the public suffer less from underpricing than those who sell large portion of the share. They predict that issuers can reduce the underpricing by spending more in the IPOs promotion. They consider both the underpricing and IPO promotion cost are the part of the costs of going public. They illustrate the US and Canadian IPO mechanisms where issuers can choose between a best efforts offering which is cheap in terms of cash expenses but typically leads to high underpricing and a firm commitment book building, which is expensive in terms of fees leads to lower underpricing.

Kennedy, Siva Kumar and Vetzal (2006) argued that the entrepreneurial losses model of Habib and Ljungqvist (2001) is the most plausible explanation for underpricing of IPOs

in their sample of US IPO between 1991 and 1998. Kennedy et al. documented that insiders become progressively more concerned about underpricing (the money left on table) larger the proportion of their (secondary) shares offered in the IPO. Thus, the more shares insiders sell in the IPO, the greater their incentive to engage in activities that may include the promotion of the offer and making more information available about the IPO, or hiring prestigious auditors or underwriters. Kennedy et al's results are also consistent with the Aggrawal, Krigman and Womack (2002) information model, which proposes that IPO underpricing is used to 'advertise' the offer, generating a momentum of interest in the form of increased research coverage, in order to produce an upward shift in the demand curve for IPO shares in the aftermarket.

Loughram et al. (1994) confirm the IPO underpricing phenomenon in 25 countries, and conclude that the IPO underpricing is a universal phenomenon, not a country specific issue. In addition, they also find that on an average developing and under developed countries have higher IPO underpricing than in developed countries, which provides the motivation for this study and future research.

2.1.5.2 Long-Run Returns

As outlined above, numerous empirical studies indicate that IPOs of common stock on average generate large short-run returns, for investors fortunate enough to purchase the stock at the offer price. However, the long-run return of IPO is a very different story. The empirical evidence in the US and other countries seems to suggest that IPO underperforms in the long-run relative to the overall market.

A seminal article by Ibboston (1975) reported a negative relation between initial returns at the IPO and long-run share price performance for a sample of US IPOs issued during the period 1960-69. He reported that there was a general positive performance in the first year, negative performance in the next three years and a general positive performance in the fifth year. Ritter (1991) analyzed the performance of US IPOs issued between 1975-84 and reported that they underperformed the benchmark (NASDAQ and AMEX-NYSE) by about 29 percent in the three year period after their launch. Rajan and Servaes (1997)

showed that over a five-year period following their IPO, companies underperform the market benchmarks (NYSE/AMEX) by 17 percent to 47.10 percent. More recently, Carter et al. (1998) showed that over a three-year period after the IPO, the US firms underperformed the market (NYSE/AMEX/NASDAQ) by 19.92 percent. Work in other countries has shown that long-run market adjusted returns are negative with the notable exceptions of Korea (Kim et al. 1995) and Sweden (Loughram et al. 1994) where IPO companies outperformed the market by 91.6 percent and 1.2 percent respectively. The degree of under-performance has been highest in Australia (51.0 percent, Lee et al 1994) followed by Brazil (47.0 percent, Aggrawal et al. 1993). Lower, nonetheless significant under-performance has been documented in Canada, Chile, Finland, Germany and Switzerland to name a few.

In the UK, Levis (1993) investigated the long-run performance of a sample of 712 UK IPOs issued during the 1980-88. He reported long-run returns based on three alternative benchmarks: The financial Times Actuaries All share (FTA) Index, the Hoare Govett Small companies (HGSC) Index and the All share EquallyWeighted(ASEW) Index. His work confirmed the findings of long-run underperformance in the UK market. While, for the US market, Ritter (1991) reported under-performance of up to 29 percent over the last three years after the IPO, for the UK market, Levis found performance between 8 percent to 23 percent depending on the benchmark used.

Espenlaub et al. (1998) re-examined the evidence on the long-run returns of IPOs in the UK over the period 1985-95. Like Levis, they compared abnormal returns using a number of alternative benchmarks and confirmed that in the long-run the IPO firm underperforms the market. They found that typically a one-pound investment after the IPO was worth less than 85 pence after the three years. This finding was remarkably similar across four of the five alternative methods that they used to calculate abnormal returns.

Theoretical explanations for the long-run underperformance of IPOs are less than abundant. The explanations put forward can mainly be placed into three groups. The first

group identifies the existence of underperformance and provides behavioral and expectations-based explanations for the phenomenon. A sub group within this group tries to explain long-run underperformance using under-pricing models. A number of hypotheses have been put forward and have been extensively tested. Weiss (1993) tested the hypothesis that companies priced at the upper end of the initial price range should perform better than those priced at the lower end, but found no support for it. Hughes and Thakor (1992) proposed that the under-performance is due to failure to include value of legal damages in performance evaluation, but Alexander (1993) pointed out that the risk of litigation is not significant in most of the developed countries. Some researchers have put forward the price support hypotheses for explaining the long-run under performance. The hypothesis is based on the assumption that underwriters keep the initial trading prices artificially high once the price support has been withdrawn, the prices will adjust downwards to their true market value. Following the approach advocated by Rudd (1993). Ljungqvist (1996) tested implications of this hypothesis and found that the evidence was partly inconclusive.

Miller (1977) suggested that the marginal, most optimistic investor sets share prices. As information flows increases with time, the divergence of expectations decreases and thus the prices are adjusted downwards, i.e long-run performance is negatively related to the extent of divergence of opinion. It is difficult to test this hypothesis because it is difficult to measure the divergence of opinion. Ritter (1991) and Rajan and Servaes (1994) among others argued that firms go public when investors are over-optimistic about the growth prospects of IPO companies. Investors overpay initially but mark prices down as more information becomes available hence expected long-run returns therefore decrease with the decrease in initial investor sentiment.

The second group provides explanation for the poor long-run performance using the agency costs hypothesis. Jain and Kini (1994) and Mikkelsen et al. (1997) investigated if there is a relation between long-run performance and ownership. Using data from the US market, they found different results. Mikkelsen et al. found that in general, the long run performance both within one year of offering and during the first ten years of public

trading is unrelated to the ownership structure. However, Jain and Kini found a significant positive relation between post-IPO operating performance and equity retention by the original shareholders.

The third group explains under-performance as a mis-measurement. Thus, it appears either because we fail to control properly for risk or due to the problems related to measurement of returns over long horizons. Under-performance could also be because of the wrong choice of benchmarks. The risk measurement hypothesis proposes that the long-run under performance may be due to a failure to adjust returns for time varying systematic risk. Ritter (1991), Keloharaju(1993) and Ljunquist (1995) have found that the newly listed firms under-perform. The literature on the problems related to measurement of returns over long horizons is not recent. Sefcik and Thomson (1986), Brav (1997), Barber and Lyon (1997) and Kothari and Warner (1997), among argue that several aspects of the long-run event study create serious statistical difficulties. Statistical inference conducted using testing methods, such as t-tests is mis-specified because of potentially important violations of the underlying statistical assumptions. Recently, Eckbo et al. (1998) showed that for seasoned equity offerings there is no under-performance when using multi-factor return benchmarks. Brav et al. (1998) also questioned the under performance of IPOs and find that IPO firms perform similarly to non-issuing firms matched on the basis firm size and book to market ratios.

Dimson and Marsh (1986), Ritter (1991), Gregory et al. (1994) and Fama and French (1996) and Fama (1998) among the others demonstrated that the measurement of the long-run performance of the IPOs is sensitive to the benchmark employed. Therefore, the possibility remains that imperfect benchmarking lies behind the poor long run returns.

Schultz (2003) proposed a novel explanation for IPO return's underperformance in the long run. Schultz explained that increase in company market value also increase the probability that the management will decide to issue equity thus the higher the company's share price in the market, the more likely it is to offer shares, regardless of whether the company insiders have market timing ability. Therefore, in appreciating share markets an

increase volume of IPOs will be observed. The increase in equity volume is interrupted after the market value peaks; ex-post observation of the equity issue volume with market performance indicates that this clustering of equity offers around market highs increase the probability of observing long-run returns underperformance. Using IPO and market returns between 1973 and 1997, Schultz documented that the equity issuer return underperformance of more than 25 percent in first five years after listing is not unusual, and does not imply market are insufficient.

In recent years, the analysis of long-run returns of IPOs is directed towards a methodological approach. The method of long-run returns of IPOs has become one of the most debated topics in financial economics. As Fama (1998) argues, long-run returns anomalies are sensitive to methodology. Barbet and Lyon (1997), Lyon et al. (1999). Loughram, and Ritter (2000) state that the method of performance measurement influences the returns as well as the size and power of the statistical test. In general, four methods of IPO long-run performance measurement are widely cited within the finance long-term performance literature. They are cumulative Abnormal Returns (CARs), Buy and Hold Returns (BHRs) and the Mean Monthly Calender Time Portfolio based on the Fama and French (FFM). In general, it is hard for us to say which methodology is better, because each of them has received wide criticism. Barbet and Lyon (1997) and calculate long-run abnormal returns are conceptually flawed and/or lead to misspecified test statistics due to bias arising from new listing, rebalancing of benchmark portfolios, and Skewness of multiyear abnormal returns. The different methodologies provide inconclusive results, and Lyon et al. (1999) conclude, “The analysis of long run abnormal return is treacherous”.

In Summary, similar to the evidence on IPO underpricing, long-run underperformance of stock issues is a role rather than the exception in developed, emerging and transition economies.

2.1.6 Recent IPO Trends

IPO Underpricing discounts increased during the 1990s. Ritter documented above average IPO listing day returns during 1999 and 2000 (compared with average initial returns between 1990 and 2005). Moreover, Mola and Loughram (2004) provided evidence that IPOs in United States between 1986 and 1999 were offered at increasing discounts to their market place. While Mola and Loughram found some evidence of information asymmetry the parties in the offer process, they argued that increased standardization of the underwriting process and fees charged in the United States seem a more plausible explanation for underpricing of equity offers. This Standardized underwriting process in the United States resulted in the following:

-) Underwriting expenses (the gross spread) clustering around 7 percent (chen and Ritter, 2000).
-) The standard division of the gross spread into 20 percent management fee, 20 percent underwriting fee, and 60 percent selling concession (Torstila, 2001).
-) Over allotment option of 15 percent on average (Aggrawal, 2000; Ellis et al, 2000)
-) Lock-up provision of 180 days un many initial offers, restricting firm' insiders from selling shares (or any other securities transferable into common shares) in the immediate post-IPO market without written consent from the underwriters (Brav and Gompers, 2000; Field and Hanka, 2001; Mohan and Chen, 2001).

This standardization of underwriting process during the 1990s reduced equity issuers' bargaining power; they then accepted relatively higher levels of underpricing and selected underwriters based on analyst and research coverage, as documented by Krigman et al. (2001).

Mola and Loughram (2004) explained that around 29 percent of seasoned offering announced between 1986 and 1989 had offer prices rounded down to integar values, while this practice increased to 44 percent of seasoned offerings during the 1996-99 period. Mola and Loughram further documented that the proportion of IPOs priced at integar values during the above two periods are 56 and 93 percent respectively.

Additionally, IPO underpricing increased from 8.9 to 21.4 percent on average between the two periods. Underwriters claimed that issues with integer offer prices are better accepted by investors and easier to sell. Nevertheless, downward revision of the offer price could also reduce underwriters' marketing and selling costs, and enable underwriters to favor their preferred clients with shares from underpriced offers. However, Kandel, Sarig and Wohi (2001) found that even bid orders submitted by investors directly to shares issuers in IPO auctions have rounded prices. Kandel et al. examined 27 IPO auctions in Israel, and found that investors submit orders with the last digit rounded to Zero (in 20.8 percent of submitted bids) or five (15.1 percent). Because the offer price is not specified by underwriters or issuers, these results indicate a certain proportion of investors prefer rounded prices.

2.1.6.1 Trends in Underpricing

Listing day returns change over time, evident from the occurrence of hot and cold issue periods. The most recent hot issue market of 1999 and early 2000 in the United States were predominantly related to Internet and high technology stocks. Loughram and Ritter (2004) documented that number (and proportion) of high technology and Internet related firms going public has rapidly increased during the 1990s and during the 1999 and 2000 in particular. Loughram and Ritter examined the changes in IPO listing day returns between 1980 and 2003 using the changing risk composition hypothesis, the realignment of incentives hypothesis, and changing issuer objective function hypothesis.

First, the changing risk composition hypothesis, introduced by Ritter (1984), assumes that underpricing arises as the equilibrium condition where listing day returns reflect the risk of the offer, related to either evaluation uncertainty or technological uncertainty. Second, similar to changing risk composition hypothesis, the realignment of incentives hypothesis, introduced by Lungquist and Wilhelm (2003), asserts that the changes in the characteristics of ownership caused the changes in the level of underpricing overtime. The realignment of incentives hypothesis accepts that listing day returns are not only determined by investors' demand. Company insiders (management and Venture capitalists) tolerated higher underpricing because of decreased incentives to negotiate a

higher offer price. These changed incentives include a lower proportion of ownership by insiders, more fragmented ownership of the company, decrease in existing (secondary) share sales in the IPO, and increased allocations of IPO shares to related parties, such as family and friends, suppliers and venture capitalists.

Third, Loughram and Ritter (2004) propose a new hypothesis, the changing issuer objective function hypothesis, to explain variations in listing day returns between 1980 and 2003, the changing issuer objective function hypothesis states that, holding the firm and offer characteristics constant, issuing firms are willing to sacrifice a part of the offer proceeds ('leave the money on the table') in order to obtain alternative outcomes.

Loughram and Ritter stated that the first alternative objective was to obtain analyst coverage (the analyst lust hypothesis), while the second reason was the corrupt practices of underwriters (such as indirect payments to company insiders) during the 1990s. The analyst lust hypothesis states that issuers would accept increased underpricing if underwriters can arrange favorable coverage of the IPO by a highly ranked analyst. The corruption hypothesis asserts that, during 1990s, underwriters made side-payments to company insiders, who were involved in the decision making process of going public, thus directly reducing their willingness and ability to demand a higher offer price. These indirect payments also create an incentive to select underwriters with a reputation for high underpricing, rather than avoid them.

Loughram and Ritter (2004) state that only a small proportion of increase in underpricing in the United States during 1999 and 2000 can be attributed to the changing risk composition of IPO firms. Moreover, they found that the realignment of incentives hypothesis is unable to explain the large increase in IPO listing day returns. Loughram and Ritter argue that changing issuer objective function hypothesis (analyst lust and corruption hypothesis) can explain underpricing during the Internet related hot issue period.

2.1.6.2 Package Offers

Package IPOs combine ordinary shares options to buy more shares in the company. Term 'share options' is used in Australian prospectus, while they are termed warrants in the US. In Australia, these share options are typically non-callable (Lee, Lee and Taylor, 2003). Lee et al. (2003) used a sample of 394 offers between 1976 and 1994 (66 of which were package IPOs) and found that Australian package IPOs experienced similar underpricing to share only IPOs. Lee et al. found that package IPOs is riskier, retain lower percentage of ownership and use less prestigious underwriters. Consistent with the Welch (1989) signaling model, Lee et al. found a significantly positive relationship between underpricing at IPO and a decision to conduct a seasoned equity offering. How and Howe (2001) and Lee et al. found evidence for both agency costs and signaling explanations. Lee et al. concluded that the firm's decision to include options in IPO is driven by Signaling considerations rather than solely being a mechanism designed to reduce agency costs; while How and Howe are unable to fully explain why some firms choose to issue options as well as shares.

2.1.7 Historical Perspective of Nepalese Securities Market

The history of capital market in Nepal dates back to 1936 in which year the shares of Biratnagar Jute Mills Ltd was floated. In 1937, Tejarath was set up to facilitate loans to the government employees and was converted into Nepal Bank Ltd. HMG Nepal introduced the Company Act in 1964 and the first issue of government bonds made in the same year through Nepal Rastra Bank to collect the developmental expenditures. It carried 6 percent rate of interest and had the maturity period of five years (Shrestha 2038). HMG Nepal announced the Industrial Policy in 1974 and under this policy, an institution named Securities Marketing Center (SMC) was established to deal in government securities-development bonds and national savings bonds, and corporate securities of few companies. The government has the virtual monopoly over the security market. Then, Securities Exchange Center (SEC) was established in 1976 with an objective of facilitating and promoting the growth of capital market. It was the only capital market institution in Nepal. Securities Exchange Act came into force in 1984. Since then SEC started to operate under this act. The purpose of this act was to provide

systematic and favorable market environment for securities ensuring and protecting the interest of individuals and institutional investors as well as to increase the public participation in various firms and companies (Gurung 1999).

SEC had provided facilities to trade the government securities and few of corporate securities like shares and debentures. Only the shares of 10 companies were listed in SEC and there was involvement of no broker and dealer in the securities in the market. Therefore, SEC itself was undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services (NEPSE 1998). Apart from this, there was the absence of effective secondary market to ensure liquidity to the securities.

The interim government (1990/91) initiated financial reform program and two indirect investment vehicles-Citizen's Investment Fund and NIDC Capital Markets Ltd- were established with the collective investment schemes in the corporate sector (Gurung 1999). Then due to the world whim of privatization and economic liberalization, the operation of SEC was felt to change to make it compatible with the changing economic system. As a result, HMG Nepal brought about change in the structure of SEC by dividing it into two direct entities-Securities Board Nepal (SEBON) and Nepal Stock Exchange Ltd(NEPSE) at the policy level in 1993. Since then they are operating as the main constituents of securities market in Nepal.

SEBON was established on June 7 1993 with its mission to facilitate the orderly development of a dynamic and competitive capital market and maintain its credibility, fairness, efficiency, transparency and responsiveness under the Securities Exchange Act 1983. It is an apex regulator of the securities market in Nepal. It registers the securities and approves the public issues. Moreover, SEBON frames the policies and programs required to monitor the securities market, provides license to operate stock exchange business and stockholders, supervises and monitors the stock exchange operations and securities businesspersons. Now, it has been regulating the market under the securities Exchange Act, 2006.

2.1.8 Parties involved in IPO

IPO being complex and time consuming process often needs the participation of a number of entities. In this reference, generally those parties or institution, which do plays some role during the process of IPO in Nepal are discussed here;

2.1.8.1 Issuing Company

Issuing company is the company that raises funds in the form of debenture, preference share, equity share etc, from the public through the process of public offering as per requirement of business activity. The company seeking for public offering could be a new company or new company set by the existing company or by the existing listed company.

As per the company Act, 2063 only public companies are liable to go for public offerings. The act has specially stated that the private companies should not issue their shares or debentures to the public. NRB has made mandatory that financial institution must go for common stock public offering within specified time of operations commencement. Furthermore, as per provisions of Bank and Financial institution Act, 2006, banks and finance companies should set a side minimum 30 percent of their issued capital, to be allocated to the public of which maximum 5 percent for employees.

2.1.8.2 Merchant Bank

Merchant Bankers refer to an organization that underwrites corporate securities and advances such corporate securities and advise such clients on the issue like corporate mergers etc involved in the ownership of commercial ventures. Merchant Bankers are the financial intermediary that specializes in selling new security issue and advising firms with regard to major financial transaction (Gitman, 2003;316). The role of merchant bankers is to help create and expand securities underwriting and advising corporations and managing investment portfolio for the needing groups. They charge service charge to their client for intermediary and advisory role. The role of merchant banking in managing the public offering under the heading of securities underwriting.

2.1.8.3 Issue Manager

Issue Manager is an institution who is solely responsible to manage IPO. Financial institution with the merchant banking operations, manage the overall issue process of any public company termed as issue manager. Issue manager are institution-holding license from NEPSE to manage public offering issues (Security Exchange Act 2063). Issue Manager receives issue commission from issuing company for their services through the negotiation. Issue Mangers are required to submit their annual reports including profit and loss account, balance sheet, cash flow statements and securities trading report to sebon within four months of the expiry of the fiscal year. The issue managers of Nepal are presented in table below:

Table 2.1
Issue Manager of Nepal

S. No.	Nepal Issue Manger
1.	Nepal Merchant Bank(NMB)
2.	DCBL Bank Ltd
3.	National Finance Co Ltd
4.	Ace Development Bank Ltd
5.	Nepal Finance & Saving Co. Ltd
6.	Nepal Share Markets. Co Ltd
7.	Citizen Investment Trust
8.	NIDC Capital Markets Ltd
9.	Elite Capital Ltd
10.	Civil Capital Markets Ltd
11	Growmore Merchant Bank Ltd

Role of Issue Manager

Issue Manager has a great role in developing and promoting the primary market of securities. They not only help issuer companies to raise funds but also help investor to make informed investment decision in IPO. Their services are more pronounced in bringing transparency in the public offerings. In addition, they support regulators in

regulating primary market. Services such as preparing prospectus and fulfilling other procedural aspects required for the public issue provided by issue managers to the issuer companies make fund raising process more easy and certain. Generally, the situation of market, perception of investors and procedure relating to issuing securities are the major areas of support provided by the issue managers to the issuer companies. Issue managers could also suggest the types of instruments to be issued through joint discussion with the issuer companies. As issue, managers are more tuned to the general perception of investor, market trend, and advantages and disadvantages of a particular instrument, their suggestion greatly help the issuer companies to select the right type of instruments.

The principal function of an issue manager are issue advising, helping to prepare prospectus with the required disclosure and helping allotment and refunding, listing of securities and assisting in compliance with the issue related legal provision. In practice, issue managers also provide services relating to register to the issue and underwriting.

2.1.8.4 Underwriting and Underwriter

Securities underwriting is the way business customers are assessed by investment houses for access to either equity or debt capital. This is a way of placing a newly issued security, such as stocks or bonds, with investors. A syndicate of banks (the lead managers), underwrite the transaction, which means they have taken on the risk of distributing the securities. Should they not be able to find enough investors, then they end up holding some securities themselves.

The underwriters enable the issuing company to determine the range of price at which the securities are to be offered along with the numbers of shares to be sold. Underwriters sell the issued share to retail as well as institutional investor. These underwriters work on either best effort basis or underwrite the entire issue. In best effort basis, the underwriter does not guarantee that entire issue of company will be sold but it will just put forth its best effort to sell the issue. Underwriters make their income from the price difference, or underwriting spread, between the price they pay the issuer and what they collect from investors.

The Underwriting Process

The IPOs of all but the smallest of companies are usually offered to the public through an “underwriting syndicate”, a group of underwriters who agree to purchase the shares from the issuer and then sell the shares to investors. Only a limited number of broker-dealers are invited into a syndicate as underwriters and some of them may not have individual investors as clients. Moreover, Syndicate members themselves do not receive equal allocations of securities for sale to their clients.

The underwriters in consultation with the company decide on the basic terms and structure of the offering well before trading starts, including the percentage of shares going to institutions and to individual’s investors. Most underwriters target institutional or wealthy investors are better able to buy large blocks of IPO shares, assume the financial risk, and hold the investment for the long term.

2.1.8.5 Bankers to issue

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

2.1.8.6 Collection Centers

These are the authorized institution to collect application from the investor issue acknowledgement for the same and the proceed of issue through cheques or drafts. They also issue final certificates to the issue manager for the number of applications and amount collected. They are provided collection charges for their services, which are usually determined through negotiation and are based on number of applications handled

and amount collected. Banks, finance companies or brokerage house mostly perform such roles.

2.1.8.7 Security Board of Nepal (SEBON)

Securities Board of Nepal (SEBON) was established by the Government of Nepal on June 7, 1993 as an apex regulator of Securities Markets in Nepal. It has been regulating the market under the Securities Act, 2007. The functions, duties and powers of SEBON as per the Act are as follows.

- J To offer advice to Government on matters connected with the development of the capital market.
- J To register the securities of corporate bodies established with the authority to make a public issue of its securities.
- J To regulate and systematize the issue, transfer, sale and exchange of registered securities.
- J To give permission to operate a stock exchange to any corporate body desirous of doing so, subject to this Act or the rules and bye-rules framed under this Act.
- J To supervise and monitor the functions and activities of stock exchange.
- J To inspect whether or not any stock exchange is executing its functions and activities in accordance with this Act or the rules and bye-rules framed under this Act, and to suspend or cancel the license of any stock exchange which is not found to be doing so.
- J To issue licenses to conduct the business of dealing in securities, subject to this Act, or the rules and the bye-rules framed under this Act, to companies or institutions desirous of conducting the business of dealing in securities.
- J To supervise and monitor the functions and activities of securities-dealers.
- J To grant permission to operate collective investment schemes and investment fund programs, and to supervise and monitor them.
- J To approve the bye-rules concerning transactions in securities framed by stock exchanges and institutions engaged in the business of dealing in securities, and, for the purpose of making necessary provisions concerning the development of

- the capital market and protecting the interests of investors investing in securities, issue orders to have necessary alterations made in such bye-rules of stock exchange and institutions engaged in the business of dealing in securities.
- J To systematize the task of clearing accounts related to transactions in securities.
 - J To supervise whether or not security dealers are behaving in the manner prescribed in this Act, or the rules and the bye-rules framed under this Act, while conducting business of dealing in securities, and suspend the license to conduct the business of dealing in securities in case any securities dealer is not found to be behaving accordingly.
 - J To make or ensure necessary arrangements to regulate the volume of securities transacted and the procedure of conducting such transactions in order to ensure the promotion, development and clean operation of stock exchanges.
 - J To make necessary arrangements to prevent insider trading or any other offenses relating to transactions in securities in order to protect the interest of investors in securities.
 - J To review or make arrangement for reviewing the financial statements submitted by the corporate bodies issuing securities and security dealers, and issue directives deemed necessary in that connection to the concerned corporate body.
 - J To systematize and make transparent the act of acquiring the ownership of a company or gaining control over its management by purchasing its shares in a single lot or in different lots.
 - J To establish coordination and exchange cooperation with the appropriate agencies in order to supervise and regulate matters concerning securities or companies.
 - J To discharge or make arrangements for discharging such other functions as are necessary for the development of securities and the capital market.

The major financial sources of SEBON are the government grant, transaction fee from the stock exchange and registration fee of corporate securities. Other financing sources include registration and renewal of stock exchange and market intermediaries and the income from mobilization of its revolving fund.

2.1.8.7 Nepal Stock Exchange Ltd (NEPSE)

Nepal Stock Exchange, in short NEPSE, is a non-profit organization, operating under Securities Exchange Act, 1983 and is only the sole institution to facilitate secondary market transactions. Trading of securities is considered illegal, if issuing company is not listed in NEPSE. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13 January 1994. Government of Nepal, Nepal Rastra Bank, Nepal Industrial Development Corporation and members are the shareholders of NEPSE.

Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 23 member brokers and 2 market makers, who operate on the trading floor as per the Securities Exchange Act, 1983, rules and byelaws.

Besides this, NEPSE has also granted membership to issue and sales manager securities trader (Dealer). Issue and sales manager works as manager to the issue underwriter for public issue of securities whereas securities trader (Dealer) works as individual portfolio manager.

2.1.9 Nepalese Legal Provision for IPO Market

The performance of Nepalese IPO market has made it an attractive market for the investor. Shrestha (1992) observe that whenever the public limited companies issue new shares, the stock market gets busy with crowds of share applicants. It is evident by the heavy oversubscription and very good initial market returns in the NEPSE, the only organized stock exchange for the listing and trading of outstanding shares. The Nepalese IPO market gives issuers and underwriters a choice of either to issue the ordinary shares at Par or at Premium incase the annual general meeting (AGM) of the company decides to do so. However only those having higher net worth than the total liabilities profit record and distribution of dividends for the last three years subsequent years can issue

shares at premium. Companies can issue their shares at discount only when a special resolution is passed by the general meeting to do as per the provision under the circumstances specified in the company Act 2063. The face value of share shall be Rs 100 or any amount above it that is divisible by Rs. 10 for any public companies. The application money should not exceed 50 percent of the face value of share for the companies whose audited financial statement of three subsequent years has been published. But generally now the total facevalue of the shares is taken at the time of application. The allotment of the shares has to be done within the two months from the last day of subscription of shares.

Securities Registration and Issue Approval Guidelines, 2000, as per the provision of Section 2(10), requires the disclosure of economic, physical, managerial and trading aspects of the issuer company to be factual. It also states that the financial forecasting of the company should be realistic. The guideline in section 2.11 states that the issuing company at the time of registering its securities in SEBON, along with the application should also submit the remarks of the experts, stating that he/she is satisfied with the projected balance sheet, profit and loss account and other financial information included in the prospectus and with the basis for projection. Section 6.2(f) states that the prospectus should contain the forecast figures of networth, profit and loss account and balance sheet for the following three years. Section 18 provides the allotment and refunding scheme for the issue, which is presented in table below:

Table 2.2

Allotment and Refunding

Number of Application	Allotment and Refunding Period
Up to 15,000	45 days
15,001-60,000	60 days
60,001-100,000	75 days
1,00,001 and above	90 days

Section 9 (1) of the Securities Registration and Issue Approval Guidelines, 2000, state that the issue should be opened within 2 months of issue approval. If the issue is not

opened within the said period, section 9(3) requires issue manager to incorporate the changes, if any, relating to technical, financial, economic and managerial aspects in the prospectus and to take issue permission for the same from SEBON. Section 19.1 states that provision for trading of securities should be made within 45 days of securities allotment for those securities issued publicly or by circular method. Section 19.2 states that if the issuer company applies with justification for delay in listing SEBON could provide additional time not exceeding one month.

Issue Management Guidelines, 1998 defines the role and responsibility of issue managers regarding the issue. The issuing company appoints the issue manager as the mandatory provision by law in order to the SEBON for the approval of public issue. The issue manager submits the due diligence certificate regarding the proposed issue along with the prospectus and necessary documents. Section 6.6 states that while submitting application in SEBON for issue approval, issue manager should take into account whether the issuer company's managerial, technical, economic aspect and future prospect as well as other information presented justify the public issue. Section 14.5 states that in case of over subscription of public issue, issue manager should submit the criteria and report of allotment to SEBON within 7 days of allotment. Section 17.2 states that issue manager should submit the report relating to issue within 90 days of closure of issue. Section 18 states that while providing issue approval, SEBON can prescribe additional conditions to the issue manager and Issuer company. The issue manager or any other financial institutions may underwrite IPOs. However, underwriting of IPOs is compulsory only for the manufacturing companies.

The share allotment, refund and distribution of share certificate should be completed from 45 days to 90 days as mentioned above. The companies apply to NEPSE for the listing. Generally, listing has to be done within 45 days from the date of allotment. The companies failing to meet listing requirements and de-listed companies can trade their shares in over-the counter (OTC) market.

Similarly, a share certificate in the prescribed format should be issued to every shareholder in respect of each purchased by him/her, within 3 months of the allotment of the shares. It should bear the company signature of atleast any two among any directors or administrative chief of the company or company secretary, in case of public company. While issuing the share certificate in respect of any share held jointly by two or more persons, it can be issued to any one of them, by mentioning their names therein.

2.1.10 New SEBON Rule

SEBON has come up with regulations that make it mandatory to produce the original citizenship while applying for shares during the IPO. It has also compelled investors to produce the original citizenship certificate to get share certificates during an IPO. SEBON has directed investors to mention their bank accounts, if they are applying for the IPOs. The money when returned to investors after the allotment of shares will be paid through account payee cheques. Similarly, money collected by the collection centers and deposited at bankers to the issue should be deposited in an account in the Nepal Rastra Bank within five days of the closing of IPOs for a minimum six days. The applicants will also get the interest, though a nominal, until the date, the shares are allotted. The main aim of this rule is to remove the existing loopholes that allow players to submit large numbers of share applications by using other people's names. However, many investors have complained that the issue managers have not been abiding by the regulations due to the lack of regular inspection.

SEBON at this time, very cautious about the citizenship certificates and other rule, as its monitoring unit had last time raided and confiscated the Employment Promotion and Development Bank (EPDB) IPO application form from different collection centers with suspicious citizenship certificates. The EPDB had received 5,85,000 applications amounting to over eight billion rupees that it claimed to be oversubscribed. The eight billion rupees claimed to be collected was not "the cash". The collection of cash did not exceed half a billion and the amount was only in the papers. Similarly, due to the fake citizenship issue of EPDB, over 3,11,000 applications were dumped.

2.2 Review of Related Studies

The studies in this section have been drawn from the various international articles, Nepalese journals have been accessed through various websites. Similarly, Nepalese journals and Master dissertation have been accessed from National Campus Library, Tribhuvan University Central Library and SEBON Library.

2.2.1 Review of International Journals

Finance literature is filled with research studying the pricing of IPOs as well as the short run and long run performance of new issues. This section summarizes the relevant literature.

Shailesh Jaitly and Ruchira Sharma, (2004) conduct a study on “Pricing of IPOs and their after Issue Performance in the Indian Equity Market”. They investigate the pricing of new issues in the Indian equity market during the period shortly following the deregulation of the market for new issues. They evaluate the importance of book value and market value estimates in determining issue prices as well as prices on the first day of trading. They also use variables that may reduce uncertainty (age to proxy for awareness of the company) and information asymmetry (the extent of the promoter’s contribution to the new issue) in order to test whether uncertainty and information asymmetry have an impact on pricing of new issues. Results indicate that pricing of new issues appears to be consistent with rational decision-making.

They also examine the extent of underpricing of IPOs in India by calculating the rate of return earned by the subscribers on the first day the shares trade publicly. The first day return is, on average, 72 percent. They then stimulates what this return would have been if the government regulations had still been in place. With government restrictions, the first day’s return would have been 160%. These results are consistent with the exceptions that removal of restrictions results in lower returns to subscribers and lower cost of capital for the issuing firm.

Finally, they examine whether there are differences in the first day returns or other variables for companies that issue shares at a price below the benchmark. Results indicate that there are no significant differences in first day returns between the two groups of companies. There are, however, significant differences between the groups with respect to relative size of the issue and the difference between the forecasted and current book value. This indicates that the CCI price might be used as a benchmark, which is , then adjusted upward or downwards to place greater emphasis on expected performance.

Francois Derrien (2005) conducts a study on “IPO pricing in Hot Market conditions: 2005 who leaves Money on the table?” His paper explores the impact of investor sentiment on IPO pricing. Using a model in which the aftermarket price of IPO shares depends on the information about the intrinsic value of the company and investor sentiment, he can show that IPOs can be overpriced and still exhibit positive initial return. A sample of recent French offerings with a fraction of the shares reserved for individual investors supports the predictions of the model. Individual investors’ demand is positively related to market conditions. Moreover, large individual investors’ demand leads to high IPO prices, large initial returns and poor long-run performance.

Ashley Burrowes and Kevin Jones (2004) present a paper on “Initial Public Offerings: Evidence from the UK”. Their investigation into the performance of IPOs on the new Alternative Investment Market (AIM) reveals that the evidence in their study does not support the expected high level of underpricing that is usually associated with the risky nature of small, young and growing companies. Raw and material adjusted figures reveal that IPOs listed on AIM at the London Stock Exchange appear to be only conservatively mispriced when contrasted to main board IPO listings in the US, UK and otherwise risky nature of these small, young and growing companies. Finally, AIM discussed in terms of meeting its own targets and its ability to attract international listings.

Brau and Fawcett (2006) performed a study on “Initial Public offerings; An analysis of Theory and Practice.” The study intended to extend the IPO literature by analyzing unique data from surveys of chief Financial Officers (CFOs) to compare CFO

perspectives to prevailing academic theory. Specifically, they examined the following seven issues, underpricing, signaling IPO process issues and the decision to stay private. In this regard, they surveyed these sub samples of firms, namely those that successfully completed an IPO, those that began the process but choose to withdrawal the issue and those that are large enough to go public, but have attempted an IPO. They surveyed 330 CFO's and their survey process followed Dill Man's (1978) total design method, which is a standard for conducting academic surveys. Their findings are summarized as: The most important motivation for going public is to create public shares for use in future acquisition. Insiders are opportunistic especially at venture-backed firms. They seek to go public at a time that portends a high stock price. The underwriter selection process is driven by a very small set of selection criteria namely underwriter reputation and IPO process expertise. CFOs are well informed regarding expected underpricing. They attribute most underpricing to market uncertainty and the need to reward investors for taking the risk of IPO. The most important positive signal is past historical earnings, this may promote widow dressing. CFO strongly prefers firm-commitment underwriting. Companies remain private to preserve decision-making control ownership.

Finally, they concluded that CFO survey responses indicate that academic theory regarding the IPO process is generally well grounded. However, the CFO, perspectives suggest a need to revisit and refine several ideas that are commonly held in the IPO literature.

Paul A. Gompers and Josh Lerner (2008) carried out study on “The Really Long-Run Performance of Initial Public Offerings: The Pre-NASDAQ Evidence.” The found financial economists have intensely debated the performance of IPOs using data after the formation of NASDAQ. They present paper that sheds light on this controversy by undertaking a large, out of sample study. They examine the performance for five years after listing of 3,661 U.S. IPOs from 1935 to 1972. The sample display some underperformances when event-time buy and hold abnormal returns are used. The underperformance disappears, however, when cumulative abnormal returns are utilized. A calendar time analysis shows that over the entire period, IPOs return as much as the

market. The intercepts in CAPM and Fama-French regressions are insignificantly different from Zero, suggesting no abnormal performance.

Marco Pagano, Fabio Panetta and Luigi Zingales (1998) conduct a study “why do Companies Go Public. An Empirical Analysis”. Using a large database of private firms in Italy, they analyze the determinants of initial public offerings by comparing the ex ante and ex post characteristics of IPOs with those of private firms. The likelihood of an IPO is increasing in the company’s size and the industry’s market-to-book ratio. Companies appear to go public not to finance future investments and growth, but to rebalance their accounts after high investment and growth. IPOs are also allowed by lower cost of credit and increased turnover in control.

Winston Sahi and Stephen L Lee presents Academic papers (2000) on “The initial return performance of UK property company IPOs”. They present empirical evidence for a sample of 48 UK property company initial public offerings over the period 1986-1995. They found several conclusions that can be drawn. First, property companies in general show a significantly positive average first day return. Second, property investment companies’ average first day return is not significantly different from Zero. Third, property trading companies’ average first day return is significantly positive. Fourth, the higher average first day return of property trading companies over property investment companies is significant.

Chandrasekhar Krishnamurti and Pradeep Kumar (2002) made a study on “The initial Listing Performance of Indian IPOs”. They found that, underpricing is a ubiquitous phenomenon: the process of going public is not identical in different countries. There are important differences in the regulatory environment, the state of the development of the primary and secondary markets, the types of investors that allow interesting comparisons to be made across countries. In their study, they describe the institutional arrangements of the public issue process of unseasoned equity offerings (IPOs) in India. They show evidence regarding the widespread underpricing of Indian IPOs and relate them to potential factors. Principal among them are; the lack of a formal

mechanism for gauging the extent of demand from potential investors, the regulatory restrictions on pricing of new firms without a track record, and the large delay between the approval date and the actual opening date of the public issue.

Nickolaos V. Tsangarakis conducted a study on “The price performance of Initial Public offerings in Greece”. They examine the price performance of Greek IPOs in the period 1993-1997. The Greek IPO market presents several particularities in respect to regulation and procedural arrangements that make its study interesting in the context of the international evidence regarding IPO price performance. They find that Greek IPOs had on average large positive initial returns, an evidence of underpricing. This evidence is also supported by the positive one-year returns in relation to offer prices. Returns computed one year after listing in relation to the first trading day price are positive, inconsistent with international evidence. Annual analysis reveals, however, differential patterns in price behavior.

M. Banu Durukan, Faculty of Business, Dokuz Eylul University, Turkey conduct a study on “The Relationship between IPO Returns and Factors influencing IPO Performance: Case of Istanbul Stock Exchange”. Their study aimed to investigate the IPO returns by the data generated by an emerging market, namely ISE, for the period from 1990 to 1997, in two stages. In the first stage, the relationship between the returns is analyzed by comparing mean returns and by univariate regression analysis. In the second stage, the determinants of returns are examined by cross sectional analysis and multivariate regression analysis. The findings of their study provide evidence to the fads hypothesis and the Winner’s curse hypothesis. Moreover, the factors that decrease the uncertainty associated with the IPOs are found to lead to lower returns. It must also be emphasized that the findings of the study does not provide evidence of long-term underperformance.

Goergen and Others (2006) carried out a study on “The strategy of Going Public; How UK firms choose their listing contracts”. The study carried two objectives; the first objective was to derive potential factors may influence the choice of IPO listing contracts

from the few theoretical papers and empirical studies in the field. The second objective was to test how well those factors explain the choice of the listing contracts of the case of UK IPOs. The study focused on 240 flotations, which were listed on the official list of London Stock Exchange (LSE) during the period of 1991 to 1995. They used a binomial profit model to measure the impact of the variables on the contract choice. The study proposed that three types of factors essentially influence the choice of contract; ex-ante uncertainty, certification (by the sponsor, creditors and venture capitalist) and the visibility of the issue. They found that the higher the ex-ante uncertainty at the time of IPO, the greater the probability that the firms choose a placing contracts. They also found strong evidence that sponsor and creditor screening signals the equality of the IPO firm. Hence, firms which use highly reputable sponsors and those with high debt to assets ratios usually, choose public offer contracts. They also found that firm that make small issues find it cheaper to use placing contracts. Finally they concluded that in general the decision to choose a placing rather than an offer or vice-versa is taken by the firm within the framework of rational behavior.

2.2.2 Review of Thesis

Dhital P. Sanjeev (2007), Study of Investor Preference on Financial Instrument. An unpublished Master Degree Thesis, Faculty of Management, Tribhuvan University, Nepal Commerce Campus.

Objectives:

- To explore different financial instrument position in the security market.
- To find out whether the investor are adequately aware or not regarding investment in security market.
- To forecast the investment trend in the security market of Nepal
- To suggest and recommend to the concerned bodies with the help of major findings of the study.

Findings:

- Common Stock holds the major portion of security issue in Nepalese Stock market.
- The level of investor's awareness in the securities is very low.

- Nepalese investor invest in security market only for the capital gain.
- Existing Rules & Regulation of government are not sufficient to protect the investor's investment.
- Unfavourable political Condition.

Recommendations:

- Pace of economic development should accelerate in order to have positive impact in the economy
- The broker should also act as an important and responsibly for the development of the sector.
- Flexibility in the directives to avoid passiveness in the secondary market.

Khadka Uddhav (2008), Factors affection Share Price in NEPSE. An unpublished Master Degree Thesis, Faculty of Management, Tribhuvan University, Nepal Commerce Campus.

Objectives:

- To identify major indicators which affect on determining the Market Value Per Shares (MVPS).
- To examine and evaluate the relationship of MVPS with various financial indicators like EPS, BVPS and DPS.
- To identify the stock of sampled companies are overpriced or equilibrium priced.
- To analyze investor's awareness regarding stock price in NEPSE.

Findings:

- Positive fluctuation shall bring positive changes in MVPS and viceversa.
- Signaling factors play major role in determining NEPSE index.
- Dividend plays a major role in determining the price of share in NEPSE.
- Adequate knowledge and information regarding capital market is lacking in Nepalese investor.

Recommendations:

- Providing accurate and timely information to the investor regarding the investment strategies.
- Diversification of investment in other sector should be done by taking action against lower trading industries such as manufacturing, trading, insurance and other.
- Signaling factor should be analyzed by the member of NEPSE as well industries so that future price can be predicted from the side of analyst and from the side of investor.
- Investor should have the detail study of the financial indicators before investing and trading stocks of any company.

Bhatta Shristee (2009). Public Response to IPO in Nepal. An unpublished Master Degree Thesis, Faculty of Management, Tribhuvan University, Nepal Commerce Campus.

Objectives:

- To identify the performance of the investment bankers (issue manager) in the process of IPO.
- To analyze the growth of primary share issue market in Nepal.
- To analyze the public response to IPO.

Findings:

- Public response to the financial institutions and insurance sector is higher than non financial sector.
- Among the financial sector most of the investor choose commercial banks.
- Still most of the people lack information regarding stock so limited number of people are investing in primary market.

Recommendations:

- Investment bankers should play a vital role in the IPO process, they should try to give more transparent, fast, hassle free services so that more public involve in the IPO.
- Before investing in IPO, all the investor should go through the prospectus and financial details of the company.
- For getting hot IPO's more and more advertisements need to be promoted and true picture should be allowed to the investor.
- Investors are becoming speculators rather than rational investors due to asymmetric information. They should know the whole stock valuation process.
- Application from each corner of the country should be asked so that all the interested candidates could apply

Pantha Meena (2010). Stock Price Behaviour of Listed Companies in Nepal. An unpublished Master Degree Thesis, Faculty of Management, Tribhuvan University, Shankar Dev Campus.

Objectives:

- To study and analyze the stock price trend and volume of stock traded on the secondary market.
- To study and analyze the investors views regarding the decision on stock investment.
- To analyze the behaviour of NEPSE index.
- To study and examine the factors that impact on stock price with the help of NEPSE index.

Findings:

- Among the listed companies finance companies are the highest.
- It is found that the annual turnover and market capitalization is increasing. Total number of share traded is fluctuating but the amount of securities is increasing.

- The complementary measure of market capitalization ratio is value traded ratio that shows the liquidness of the market in term of value of share to gross domestic product. This ratio in developed stock market is found to be 0.4 and in less developed stock market is 0.1. In Nepalese stock market it is 0.4 so the market can be found enough liquid to contribute national economy and meets the liquidity standard of common norms of international standard.

Recommendations:

- Since, most of the time theory and assumptions of technical analysis match with the Nepal's stock market. So, the investors, brokers, and other related to Nepal's stock market are strongly recommended to focus more on technical tools for analyzing the share price movement.
- Brokerage companies must provide good counselling service as regards to stock investment. Small investors are also encouraged to participate in active stock trading.
- The investors should be educated, self aware and informative regarding the daily stock price behaviour. They should be extremely careful before making the investment decision.
- Investors must be familiar with fundamental analysis of the stock investment so as to make best stock investment

CHAPTER-3

RESEARCH METHODOLOGY

Research Methodology is a way to systematically solve the research problem. It refers to the various sequential steps that are to be adopted by a researcher during the course of studying to examine the degree of underpricing for Nepali IPO and the importance of various variables to determine the degree of underpricing. Similarly, this study attempts to analyze the relation between different variables of IPO and public knowledge towards IPO.

3.1 Research Design

The research design is the conceptual structure with which research is conducted. It constitutes the blue print for the collection, measurement and analysis of data. Research design is the plan, structure and strategy of investigation conceived to obtain answers to research question and to control variance (Kerlinger, 1980:275). The plan is overall scheme or program of the research. A research design expresses both the structure of the research design problem and plan of investigation used to obtain evidence or relations of the problems.

The study is based on descriptive and analytical research design. Analytical research design is used to analyze existing state of IPOs in Nepal. Further more, same design is extended to analyze IPOs underpricing in Nepal and to know public knowledge towards IPO. Similarly, descriptive research design is used to analyze subscription patterns and its relation with issue patterns.

3.2 Population and Sample

Number of companies listed in NEPSE by the end of 2009/10 has reached 179 and these companies are divided in eight sectors which include Commercial Bank, Development Banks, Finance Companies, Insurance Companies, Hotels, Manufacturing and Processing Companies, Trading companies and other Companies. However, the study is focused on only those companies which have gone for IPOs during the period

2005/06 to 2009/10. The study has also highlighted in the issuance of IPOs from 1993/94 to 2009/10.

3.3 Sources and Nature of Data

The study is based on primary and secondary data as per the objective and requirement of the study. The secondary source like NEPSE reports, SEBON reports, NRB reports, reports of Issue managers etc are used. Similarly, annual reports and other publications are used to find the data of sampled companies. On the other hand, to know the investors Knowledge about IPOs, primary data are collected. The primary data has been collected through unstructured interview from the related staffs of SEBON and NEPSE and from other public who are investing their money in primary issue. The public was also asked to fill the structured questionnaire that was supplied to them as per necessity. Discussions, interviews and informal talks were held to know much about investor knowledge, with investors, brokers and analyst to improve the effectiveness of the study.

3.4 Data Analysis Tools

Different relevant statistical tools are used to find out the best appropriate result as per the designated objective of the study. The study has used the mix of tools, as per the requirements, their suitability and to reach the meaningful result. Different software and technologies are also used for the efficiency of study. The tools are applied to analyzed the Secondary data. Various Tables and bar Charts has been presented to show the amount wise and number wise issue approved. For this the date from 1993/94 to 2008/09 has been taken. But to Calculate the Underpricing of IPO we have considered the data for the last 5 Fiscal year i.e from 2005/06 to 2009/10. The underpricing has been calculated as below:

3.4.1 Underpricing

For the purpose of the study, the degree of underpricing is calculated on two levels; namely, the raw underpricing and the market adjusted underpricing. The raw underpricing is the return earned on the 1st day of trading on the stock exchange and is defined as follows:

$$UP = (P_1 - P_0) * 100 / P_0$$

Where,

UP= Raw Underpricing

P_1 = The closing pricing on the day of listing of the IPO

P_0 = The offer price of the IPO

The market adjusted return is calculated by adjusting the market return over the same period to the raw underpricing. The market return is the return earned on the market portfolio over the same period as that of the raw underpricing and is defined as follows;

$$R_m = (I_1 - I_0) * 100 / I_0$$

Where,

R_m = Market Return

I_1 = Nipse Index on the 1st day of trading

I_0 = Nipse Index on the day of offering

The market adjusted underpricing is the difference between the raw underpricing and market return and is defined as follows:

$$UP_{mk} = UP - R_m$$

Where,

UP_{mk} =market adjusted return

CHAPTER 4

DATA PRESENTATION AND ANALYSIS

This chapter put forward the analysis of Secondary and Primary data along with their results and interpretations. The chapter starts with the analysis of Secondary data concerned with existing state of IPOs in Nepal, analysis of IPO underpricing, analysis of subscriptions patterns of IPOs offered etc. Similarly, the Primary data are used to analyze the public awareness, response, expectation, choice for investment etc.

4.1 Secondary Data Analysis

4.1.1 Amount of Public Issue Approved

As per the provision of Securities Exchange Act, 2063, the company must get issue approval from SEBON prior to make their offer to public. From the FY 1993/94 to 2009/10 SEBON have approved 396 issues of Securities amounting to NPR 53,497.14 Million. The situation of issue approved in different years is presented in Table 4.1

Table 4.1 shows that the amount of issues approved by SEBON varied during the period. The highest amount of issue approved was NPR 16,828.51 mio(31.46%) during the year 2008/09 which was followed by NPR 14,107.45mio(26.37%) in the year 2009/10, NPR 10,668.20 mio(19.94%) in the fiscal year 2007/08, NPR 2,443.25 (4.57%) in the fiscal year 2005/06, NPR 2,295.20 mio(4.29%) in the fiscal year 2006/07, NPR 1,626.82(3.04%) mio in the fiscal year 2004/05, NPR 1,441.43(2.69%) in the fiscal year 2001/02 and so on.

Table 4.1
Amount of Issue Approved

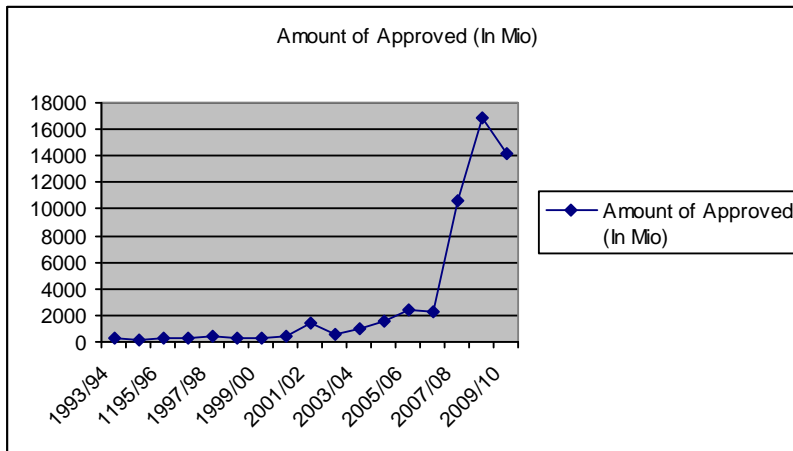
Year	Amount of Approved (In Mio)	Percentage of Issue Approved
1993/94	244.40	0.46
1994/95	173.96	0.33
1195/96	293.74	0.55

1996/97	332.20	0.62
1997/98	462.36	0.86
1998/99	258.00	0.48
1999/00	326.86	0.61
2000/01	410.49	0.77
2001/02	1,441.33	2.69
2002/03	556.54	1.04
2003/04	1,027.50	1.92
2004/05	1,626.82	3.04
2005/06	2,443.28	4.57
2006/07	2,295.50	4.29
2007/08	10,668.20	19.94
2008/09	16,828.51	31.46
2009/10	14,107.45	26.37
Total	53,497.14	100.00

Source: SEBON Annual Report

The figure 4.1 shows the fluctuations of amount issued approved by SEBON during the period. In the early stage the amount was fluctuating as in some year it was increasing and in some year it was decreasing but over the last 2 years it has been in the increasing trend.

Figure 4.1



4.1.2 Number of Issue Approved

The number of issue approved during the period of 1993/94 to 2009/10 varies differently which has been presented in the table 4.2

Likewise, the amount of public issue approved, the number of issues approved in a fiscal year also had not shown any consistent trend over the study period. Total number of issue approved by SEBON during the period of FY 1993/94 to 2009/10 was 396. During the study period the lowest number of issue approved in a year were 5 (1.54%) on two fiscal years, FY 1996/97 and FY 1998/99. The second lowest number of issue approved in a year is 6(1.85%) in the FY 1999/2000. Similarly the highest number of issue approved over the study period is 72(18.18%) in the FY 2009/10 and the second highest was 64 during the FY 2007/08 and FY 2008/09.

**Table 4.2
Number of Issue Approved**

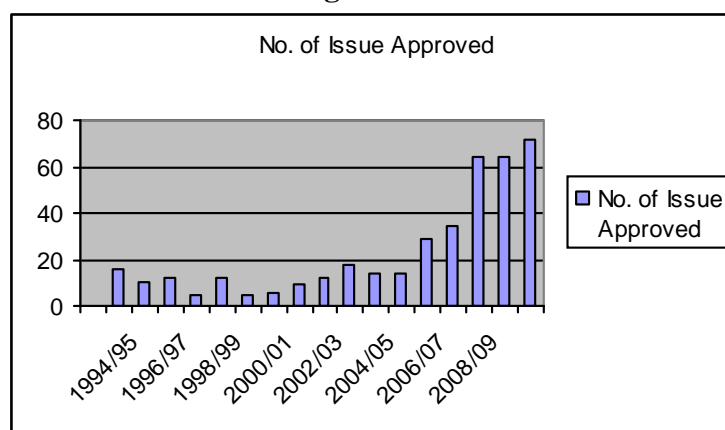
Year	No. of Issue Approved	Issue Approved (In Mio)	Average Size (In Mio)	% of Issue Approved
1993/94	16	244.40	15.275	4.04
1994/95	10	173.96	17.396	2.53
1995/96	12	293.74	24.48	3.03
1996/97	5	332.20	66.44	1.26
1997/98	12	462.36	38.53	3.03

1998/99	5	258.00	51.60	1.26
1999/00	6	326.86	54.48	1.52
2000/01	9	410.49	45.61	2.27
2001/02	12	1,441.33	120.11	3.03
2002/03	18	556.54	30.91	4.55
2003/04	14	1,027.50	73.39	3.54
2004/05	14	1,626.82	116.20	3.54
2005/06	29	2,443.28	84.25	7.32
2006/07	34	2,295.50	67.51	8.59
2007/08	64	10,668.20	166.69	16.16
2008/09	64	16,828.51	262.95	16.16
2009/10	72	14,107.45	195.94	18.18
	396	53,497.14	135.09	100.00

Source: SEBON Annual Report

The diagram shows that the number of issue approved during the study period is not consistent. In the first year 1993/94, 16 issues were approved whereas in the preceeding year the number of issues were 10 ,12, 5, 12, 5, 6, 9, 12, 18, 14, 14 respectively till 2004/05. However, the number of issue has increased by more than 200% in the year 2007/08. Amount wise the largest issue was in the FY 2008/09 which is around 16,828.51 mio and the smallest issue was 1994/95 when only 173.96 mio amount of shares were issued. Due to the increase in the financial institutions over the last 5 years, the number of shares approved by SEBON to be issued in the market has increased drastically. Moreover, the companies are also more concerned in increasing the capital which makes them to issue the right shares because of which the amount and number of issue increases in the market.

Figure 4.2



4.1.3 Sector Wise Issue Approved

SEBON approved different types of securities of different sectors for public issues since FY 1993/94 to F 2008/09. The total amount of issue approved is 39,389.90 mio during this period. The most intriguing aspect of this approved amount is the contribution from financial sectors that includes commercial banks, development banks, finance companies and insurance companies and then the non financial sectors that includes manufacturing and processing, trading, hotels and other companies as revealed from the table 4.3.

The table shows that SEBON accepted the various sector issued for going to public. The highest issue during the period is that of 173 issues (43.69%) that of Finance sector and 94(23.79%) issues that of Development bank Sector. Similarly Banking Sector had 67 issues (16.92%) and Insurance companies had 26 issues (6.57%). The issues include the ordinary shares, right shares, preference shares and debentures.

Table 4.3
Sector Wise Issue Approved

Sector	No. of Issue Approved	% of Issues Approved
Banking	67	16.92
Development Bank	94	23.74
Finance Companies	173	43.69
Insurance	26	6.57
Manufacturing	17	4.29
Trading	4	1.01
Hotel	4	1.01
Other Sector	11	2.78
Total	396	100

Source: SEBON Annual Report

4.1.4 Publicly Issued Companies

In the fiscal year 2009/10, with the listing of 20 new companies, the total number of listed companies remained to be 179 while it was 159 in the fiscal year 2008/09. The sector wise details of listed companies till the fiscal year 2009/10 is presented in the table.

Table 4.3
Sector Wise Listed Companies

S. No	Sector	Listed Companies	Percent
1.	Commercial Banks	24	13.41
2.	Development Banks	42	23.46
3.	Finance Companies	62	34.64
4.	Insurance Companies	19	10.61
5.	Hotels	4	2.23
6.	Manufacturing & Processing	18	10.06
7.	Trading Companies	4	2.23
8.	Hydropower	4	2.23
9.	Other Companies	2	1.18
	Total	179	100.0

Source: SEBON Annual report

As per the provision of "Securities Listing Byelaws, 1996", the listed companies that have earned profit for the last three consecutive years, book value higher than paid up value, submitted their financial statements to NEPSE within six months of the expiry of fiscal year, paid up capital at least Rs.20 million, and has at least 1000 shareholders can be categorised in group 'A' and remaining of the listed companies can be categorised in group 'B". In the fiscal year 2009/10, NEPSE categorized 78 companies in group 'A' comprising 15 commercial banks, 15 development banks, 36 finance companies, 10 insurance companies, one manufacturing and processing company and one other company.

4.1.5 Instrument – Wise Public Issues

As many other emerging markets Nepalese Markets also provides limited variety of investment instruments, which mainly includes common stock, preferences shares, right shares, debenture and few issues from collective investment schemes like mutual fund. Over a period, Nepalese Stock market has been relying on few financial instruments such as common stock and right shares that cannot be considered good sign regarding overall development of Nepalese stock market.

Table 4.4
Instrument wise Public Issues approved

Fiscal Year	Ordinary Share		Pref. Shares		Right Shares		Debenture	
	No of Issue	Amt (In Mio)	No of Issue	Amt (In Mio)	No of Issue	Amt(In Mio)	No of Issue	Amt (In Mio)
1993/94	14	227.90	2	16.50				
1994/95	10	173.96						
1995/96	10	224.74			2	69.00		
1996/97	2	57.00			3	275.20		
1997/98	8	119.40			3	249.96	1	93.00
1998/99	3	148.00	1	80.00	1	30.00		
1999/00	3	202.26			3	124.60		
2000/01	7	278.70			2	131.79		
2001/02	5	977.54	1	140.00	5	621.87	1	360.00
2002/03	14	394.30			4	162.24		
2003/04	10	647.50			3	80.00	1	300.00
2004/05	7	377.48			6	949.34	1	300.00
2005/06	14	659.83			11	933.45	4	850.00
2006/07	15	380.20	1	400.00	17	1,265.30	1	250.00
2007/08	16	924.80			43	6,793.40	5	2,950.00
2008/09	12	1,815.70			50	14,262.81	2	750.00
2009/10	37	3,144.70			35	10,962.75		
Total	187	10,754.01	5	636.50	188	36,911.71	16	5,853.00

Source: SEBON Annual Report

As shown in the table 4.4 out of total offers in the security market, 187 were offered for ordinary shares, 5 for preference shares, 188 for right shares and 16 for the debentures. The right shares were mostly issued by the financial institutions in pursuit of increasing their paid up capital. Among the financial institutions, the most number of right shares were issued by the finance companies being their number high in the Nepalese Market. So, from the table we conclude that the public shares issued by the financial institutions were the most preferred means of instrument.

From the amount of issue perspective, the amount of right shares account for 68.16% of the total issue in the market, whereas the Ordinary shares accounts for 19.86% of total issue in the market followed by debenture with 10.81% and preference shares with 1.18% of issue.

The most striking aspect of the analysis is that the preferences shares have been issued only 5 times and debentures only 16 times. This shows that the Nepalese Stock market is heavily over dependent on few financial institutions issuing ordinary shares and right shares. This over dependency limits the boundary of investment opportunities to the public on one hand and on the other hand, limits the overall development prospect of Nepalese Stock Market.

4.1.6 Analysis of Subscription Pattern of Issues

4.1.6.1 Overall Subscription Pattern during the study period

When a company offers its issue to the public, the demand received from public is bound to vary. When demanded number of securities is higher than the offered number of securities, it is called over subscription of shares and when the demanded number of securities is lower than the number of securities offered, it is called under subscription. Similarly when the offered numbers of securities are equal it is the case of full subscription. More information regarding it has been presented in table 4.6

In the FY 1993/94, 14 companies issued their ordinary shares through IPO and all of them were oversubscribed and 2 companies issued preference shares one oversubscribed, other had no information. In the subsequent year, FY 1994/95 10 company went for IPO through ordinary share, out of which 7 companies issue were oversubscribed, 2 of them issue were fully subscribed and remaining 1 issues were undersubscribed. Similarly in the FY 1995/96 out of 12 issues; 10 companies issued their ordinary shares through IPO and among these 5 issues were oversubscribed, 5 issues were undersubscribed and the other 2 companies issue were right shares in which 1 was undersubscribed and remaining 1 was unknown. In the FY 1996/97, 5 companies issued their securities and out of these 2 companies that issued ordinary shares experienced oversubscription, 3 issues were right shares and among these 1 was undersubscribed and remaining 2 was unknown. In the FY 1997/98, 12 companies issued their securities; 8 issues were through ordinary shares in

which 5 experienced over subscription, 3 issues experienced under subscription, other 3 companies issued right share in which 2 was undersubscribed and one was not known while 1 company issued debenture which was undersubscribed. Similarly in FY 1998/99 out of 5 issues, 3 companies issued ordinary shares in which 2 were oversubscribed and 1 company issued preference shares which was oversubscribed. In FY 1999/00, out of 6 issues; 3 companies issued ordinary shares, which were oversubscribed; 3 companies issued right share in which 1 was oversubscribed 1 was fully subscribed while 1 was undersubscribed. This pattern was repeated in FY 2000/01, out of 9 issues; 7 companies issued ordinary shares in which all experienced oversubscription and remaining 2 companies issued right shares in which one was oversubscribed and 1 was undersubscribed. During the period of FY 2001/02 out of 12 issues; 5 companies issued ordinary shares in which 4 issues were oversubscribed, 1 issue was undersubscribed: 5 companies issued right share in which 2 were fully subscribed and remaining 3 was undersubscribed; one company issued preference share which was oversubscribed and the remaining 1 company issued debenture which was unknown. Similarly, in FY 2002/03 out of 18 issues; 14 companies issue ordinary shares which were oversubscribed; 4 companies issued right share in which 3 issues were under subscribed and remaining 1 was unknown.

Table 4.5
Subscription Pattern of Issues

Year	Total no. of Issued	Over Subscription		Under Subscription		Fully Subscription		Un Known	
		No	%	No	%	No	%	No	%
1993/94	16	15	93.75	-	-	-	-	1	6.25
1994/95	10	7	70	1	10	2	20	-	-
1995/96	12	5	41.67	6	50	-	-	1	8.33
1996/97	5	2	40	1	20	-	-	2	40
1997/98	12	5	41.67	5	41.67	1	8.33	1	8.33
1998/99	5	3	60	1	20	-	-	1	20
1999/00	6	5	83.33	1	16.67	-	-	-	-

2000/01	9	8	88.89	1	11.11	-	-	-	-
2001/02	12	5	41.67	4	33.33	2	16.67	1	6.25
2002/03	18	14	77.78	3	16.67	-	-	1	6.25
2003/04	14	12	85.71	2	14.29	-	-	-	-
2004/05	14	6	42.86	7	50	1	7.14	-	-
2005/06	29	17	58.62	10	34.48	2	6.9	-	-
2006/07	34	16	47.06	14	41.18	4	11.76	-	-
2007/08	64	34	53.12	21	32.81	9	14.06	-	-
2008/09	64	21	32.81	30	46.88	13	20.31	-	-
2009/10	72	37	51.39	23	31.94	12	16.67		
Total	396	212	53.53	130	32.83	46	11.62	8	2.02

Source: SEBON Annual Report

Moreover in FY 2003/04, total 14 companies issued their securities and out of them 10 companies issued ordinary share, in which all were oversubscribed; 3 companies issued right share in which 2 issues were undersubscribed 1 was oversubscribed; and 1 company issued debenture which was oversubscribed. In FY 2004/05 out of 14 issues, 7 companies issued ordinary share in which 6 were oversubscribed; 6 companies issued right share in which all issues were under subscribed and 1 company issued debenture which was fully subscribed. Similarly in the FY 2005/06, out of 29 issues, 14 companies issues ordinary shares in which all were oversubscribed; 11 companies issued right shares in which 10 issues were undersubscribed 1 was oversubscribed and 4 companies issued debenture in which 2 was oversubscribed and remaining 2 was fully subscribed. Again in FY 2006/07, 34 companies issued their securities; 15 companies issued ordinary shares in which all were oversubscribed; 17 companies issued right shares in which 14 issues were undersubscribed and 3 issues were fully subscribed; 1 company issued debenture which was fully subscribed and remaining 1 company issued debenture which was oversubscribed. Similarly in the FY 2007/08, out of 64 issues 16 companies issued ordinary shares of which all were oversubscribed; 43 companies issued right shares of which 13 companies issues were oversubscribed, 21 were undersubscribed and 9 were fully subscribed; out of 5 debenture issued all were oversubscribed. In the FY 2008/09

out of 64 issues; 12 issues were ordinary shares which were all oversubscribed; 50 issues were right shares of which 7 were oversubscribed, 30 were undersubscribed and 13 were fully subscribed; out of 2 debenture issued both were oversubscribed. In the FY 2009/10 out of 72 issues; 37 were Ordinary Shares and 35 were right shares. All the issues of Ordinary Shares were oversubscribed whereas 23 right shares issues were under subscribed and remaining 12 were fully subscribed.

Hence from the 396 issues 212 issues were oversubscribed representing 53.53 percent of total issues, 130 issues were undersubscribed representing 32.83 percent; 46 issues were fully subscribed representing 11.62 percent and 8 were unknown which were 2.02 percent of the total issues. On the instrument wise basis, the ordinary share was oversubscribed almost all the time in comparison to other securities. The right shares were undersubscribed because the right shares are issued to the existing shareholder and they cannot apply more than their rights because of which the right shares get undersubscribed because of lack of information to the existing shareholder. Similarly most of the preference share was also oversubscribed but still the number of issue was small. Debenture was also issued several times which were also oversubscribed in majority of the occasions.

4.1.6.2 Sector wise Analysis of Subscription Pattern

Nepalese IPOs have been found to be heavily oversubscribed. From the table 4.5 it is shown that, the investors have a very high degree of attraction to the IPOs. The growth of Nepalese IPOs in terms of issues and subscription has been bumpy during the study period. The table shows that the entire sample companies which have gone for the IPOs have been oversubscribed. In the recent IPO issued of 4 commercial banks i.e Citizens Bank International Limited, Bank of Asia Nepal Ltd, Sunrise Bank Ltd and Prime Commercial Bank Ltd all were heavily oversubscribed. The IPO of Citizens Bank was oversubscribed by 20 times, Bank of Asia by 18 times, Sunrise Bank by 24 times and Prime commercial Bank by 36 times. And thereafter still the craze of Nepalese people in

IPO has not increased as the IPO subscription are still heavily oversubscribed if issued by any financial institution.

In the case of IPO issued by Non-financial institution, the demand is not in the same category. As for example, the shares issued by Nepal Telecom which is the most profitable institution in Nepal but still the IPO issued by it were undersubscribed. The reason behind the under subscription of shares of Nepal Telecom were because they were issued at premium price of NPR 600 which attracted less people.

4.1.7 Analyzing Underpricing of IPOs in Nepal

4.1.7.1 Description of the Data

This part of the research study will describe in details about the data that was used for the purpose of the studying Underpricing in Nepal. Table 4.6 shows that the distribution of IPOs by year of the last 4 fiscal year. It can be seen from the table that number of IPO issued per year has stayed reasonably stable in the 4 fiscal year from 2005/06 to 2008/09. But in the FY 2009/10 nearly 37 companies have issued IPO. The biggest IPO in the history of Nepal was also issued in the same year by Agriculture Development Bank Ltd of NPR 960 million. The majority of the issuance of IPO has been of the financial institution.

Table 4.6
Distribution of IPOs by Year

Year	Issue Amount (Rs in Million)	No. of IPOs
2005/06	659.83	14
2006/07	380.20	15
2007/08	924.80	16
2008/09	1,815.70	12
2009/10	3,144.70	37
Total	6,925.23	94

Table 4.7 shows the distribution of IPOs by gross proceeds. As we can see from the table, most of the IPOs are relatively small having proceeds of less than NPR 100 mio. 73.40% of the total IPOs issued over the last 5 years are less than 100 mio and 17.02% are between 100M to 200M. Only 9.58% of the IPO issued are more than NPR 200 mio. The big issued are normally done by the Commercial banks in Nepal. The smaller issue mostly constitutes the issued made by the finance companies and regional development banks of Nepal which require less capital than commercial banks.

Table 4.7
Distribution of IPOs by Gross Proceeds

Year	No. of Issue	Percentage
Size<100M	69	73.40
100M<=200M	16	17.02
Size>=200M	9	9.58
Total	94	100.00

Table 4.8 shows the age of the company at the time of the issuance of IPO over the last 5 fiscal years. Relatively young firm issues most of the IPOs, which were in existence for less than 5 years. Approximately, 80% of the companies issue shares after coming into operation for less than 5 years and only 6.38% of the companies were of age of more than 10 years.

Table 4.8
Distribution of IPOs by Age of the Company

Age of the Issuing firm	No. of Issues	Percentage
Age<5 years	79	84.04
5 years<Age<10 years	9	9.58
Age>=10 years	6	6.38
Total	94	100.00

4.1.7.2 Initial Returns

Table 4.9 presents the initial returns of the IPOs over the time studied. It shows some interesting results. The degree of underpricing has fluctuated considerably during the period of study.

Table 4.9
Under pricing Across Year

Year	Number	Average Initial Return
2005/06	14	42%
2006/07	15	100%
2007/08	16	82%
2008/09	12	110%
2009/10	37	75%
Total	94	79.73%

Table 4.10 classifies the initial returns of the IPOs based on whether the IPO was issued by a commercial bank or other than Commercial bank. The results shows higher degree of underpricing associated with banking stocks. Banks are thought to be more organized and stable compared to other financial sector.

Table 4.10
Under pricing on the Basis of Industry

Sector	No. of Issues	Underpricing
Commercial Bank	5	120%
Other than Commercial Bank	89	77.47%
Total	94	79.73%

Table 4.11 shows the initial return of the IPO based on the age of the issuing company. The table shows that higher the age of the issuing company lesser the initial returns of the issuing company.

Table 4.11
Under pricing by age of the Issuing Company

Age of the Issuing Company	No of issues	Underpricing
Age<5 years	79	84.35%
5 years<=Age<10 years	9	64.30%
Age>=10 years	6	42.11%
Total	94	79.73%

4.1.8 Analysis of Primary Data

Along with the Secondary data, primary data were taken for the study purpose. Questionnaires survey was made among investors of different nature randomly for this purpose. The total number of subjects or cases is 150. Details of descriptive statistics are shown in Appendix-3. In questionnaires method, number of question was put up by means of copies of questionnaire. Categorically, the question rose were three types, namely, Yes/No question, multiple choice question and Open-end question. The questionnaires were distributed to find out the first hand information from the investor regarding the IPO. The investor has mixed feeling on the IPO and the primary market and their responses are analyzed as follows.

4.1.8.1 Knowledge about IPO

When people were asked in which category of investor they belong to; regarding the knowledge about IPO, 6 percent of the respondent replied that they belong to unknowledgeable investor, 68 percent of the respondent replied that they belong to Knowledgeable investor, 22.67 belong to the well knowledgeable investor and rest 3.33 percent belongs to the professional investor.

Table 4.12
Knowledge about IPO

Research Variables	No. of Respondent	Percentage
Unknowledgeable Investor	9	6
Knowledgeable Investor	102	68
Well Knowledge Investor	34	22.67
Professional Investor	5	3.33
Total	150	100

4.1.8.2 Interest to invest in IPO

Only 6.67 percent of respondents are found to be risk averter i.e they do not want to take risk at all form investing in IPO. 18 percent stated that they want to invest if had money. 34.67 percent stated that their interest to invest depends upon the sector and company. Rest 40.66 percent stated that they are willing to invest in IPO even with loan if they do not have cash.

Table 4.13
Interest to Invest in IPO

Research Variables	No. of Respondent	Percentage
No risk at all	10	6.67
If had money	27	18
Depends in Sector/Company	52	34.67
Yes, Even with Loan	61	40.66
Total	150	100

4.1.8.3 Category of Investor

Out of the 150 respondents, 53.33 percent said that they belong to small investor, regarding the amount of investment. Similarly, 36.67 percent said that they belong to medium investor and 10 percent said that they belong to large investor regarding the investment in IPO.

Table 4.14
Category of Investment

Research Variables	No. of Respondent	Percentage
Small Investor	80	53.33
Medium	55	36.67
Large	15	10
Total	150	100

4.1.8.4 Source of Information

Out of 150 respondents, 41.33 percent said that they get information about IPO from Media, 31.33 percent said from Relatives or friends. Similarly, 18 percent respondent said that they get information from stock brokers. There were 9.33 percent people who get information as Self-education.

Table 4.15
Source of Information

Research Variables	No. of Respondent	Percentage
Media	62	41.33
Relatives/Friends	47	31.33
Stock brokers	27	18
Self-Education	14	9.33
Total	150	100

4.1.8.5 Past Experience of Primary Issues

The objective of this question was to find out the investor's past experience of investment in primary issue or primary market of then. With respect to the evaluation of experience, 61.33 percent investors have the experience of primary market where rest of the respondent 38.67 percent has no past experience of primary issue. This is the good sign for the development of primary market that the newly investor are trying to invest their money in the primary issue (IPO).

Table 4.16
Past Experience of IPO

Research Variables	No. of Respondent	Percentage
Yes	92	61.33
No	58	38.67
Total	150	100

4.1.8.6 Number of Companies Invested

Out of 150 respondents 14.67 percent said that they invested in only one company, 41.33 percent said two to five companies. Similarly, 36.67 percent said that they have invested in five to ten companies and rest 7.33 percent were found to invest in more than ten companies.

Table 4.17
Number of Companies Invested

Research Variables	No. of Respondent	Percentage
Single Company	22	14.67
Two-Five Company	62	41.33
Five-Ten Company	55	36.67
More than Ten Company	11	7.33
Total	150	100

4.1.8.7 Preferred Sector for Investment

For the question whether to choose financial sector to invest or non- financial sector , 88 percent choose financial sector and rest 12 choose the non-financial sector. The IPO of any financial institutions get oversubscribed by many times in comparison to the IPOs of the non financial sector.

Table 4.18
Preferred Sector for Investment

Research Variables	No. of Respondent	Percentage
Financial Sector	132	88
Non-Financial Sector	18	12
Total	150	100

4.1.8.8 Preferred Financial Sector

From the 150 respondent 34.67 percent prefer commercial bank, 32 percent prefer development bank, 19.33 percent prefer finance companies and only 14 percent prefer insurance companies for the investment in the financial sector.

Table 4.19
Preferred Financial Sector

Research Variables	No. of Respondent	Percentage
Commercial Bank	52	34.67
Development Bank	48	32
Finance Companies	29	19.33
Insurance Companies	21	14
Total	150	100

4.1.8.9 Preferred Non-Financial Sector

From the 150 respondents for the question which non-financial would you prefers to invest, the response was 43.33 for manufacturing and processing company, 32 percent for trading companies and 9.33 percent for hydro sector. Similarly, the responses were 8.67 percent for other company and 6.67 percent for hotel companies.

Table 4.20
Preferred Non-Financial Sector

Research Variables	No. of Respondent	Percentage
Manufacturing and Processing Company	65	43.33
Trading Sector	48	32
Hydro Sector	14	9.33
Hotel	10	6.67
Other Companies	13	8.67
Total	150	100

4.1.8.10 Preferred Financial Instrument

Study had Considered Common Stock, Preference Shares, Debentures and other instrument that are mostly issued in Nepalese financial sector. The question was asked to the investor about their preference in specific instrument. In this connection, 62.27 percent respondents refers that the common stock is their first priority. Similarly, 22.6 percent prefers Preference shares, 10 percent prefers debentures and 4.67 prefer other instrument.

Table 4.21
Preferred Financial Instrument

Research Variables	No. of Respondent	Percentage
Common Stock	94	62.66
Preference Stock	34	22.67
Debentures	15	10
Other Instrument	7	4.67
Total	150	100

4.1.8.11 Purpose for Investment in IPO

Investors were asked for their purpose to invest their money in public offering that if they were interested with dividend, capital gain, right share, bonus share, high returns. 25.33 percent said that they were more interested in dividend income, 16 percent replied in favor of capital gain, 21.33 percent in favor of high returns, 22 percent in favor of bonus shares and remaining 15.34 percent in favor of right shares.

Table 4.22
Purpose to Invest in IPO

Research Variables	No. of Respondent	Percentage
Dividend	38	25.33
Capital Gain	24	16.00
Right Share	23	15.34
Bonus Share	33	22.00
High Returns	32	21.33
Total	150	100

4.1.8.12 Habit of Investor to Read the Prospectus of the Company

When investor were asked whether they read the prospectus of the company before investment in the primary issue, 60 percent replied that they read it whereas 40% replied that they have no idea regarding this

Table 4.23
Habit to read the Prospectus

Research Variables	No. of Respondent	Percentage
Yes	90	60
No	60	40
Total	150	100

4.1.8.13 Performance of Companies

When investors were asked whether they are aware or not about the financial performance of companies, 12 percent replied that they were very much known about the financial performance of the companies they have interested or have invested upon. Similarly, 43.33 percent replied that they are moderately known, 14.67 percent replied that they know little about the company performance and rest 30 percent replied that they have no knowledge about company performance in which they have invested or are going to invest.

Table 4.24
Performance of Companies

Research Variables	No. of Respondent	Percentage
Very Much	18	12
Moderately	65	43.33
Little	22	14.67
Not at all	45	30
Total	150	100

4.1.8.14 Sources of Funds

When investors are asked for their sources of investment in IPO, 72 percent replied that they used Loan/Credit for investment in IPO and the rest 28 percent replied that they used their own funds for investment.

Table 4.25
Sources of Funds

Research Variables	No. of Respondent	Percentage
Loan	108	72
Personal Loan	42	28
Total	150	100

4.1.8.15 Level of Satisfaction

When investors were asked whether they are satisfied with their returns, they are getting from investment in IPO. 73.33 percent replied they are satisfied with their return, 16.67 percent replied they are not satisfied and 10 percent said they do not know.

Table 4.26
Level of Satisfaction

Research Variables	No. of Respondent	Percentage
Yes	110	73.33
No	25	16.57
Don't Know	15	10
Total	150	100

4.1.8.16 Influenced by Whim and Rumors

When the investor were asked , in what extent does the Nepalese investor are influenced by whim and rumor, 53.33 percent said that Nepalese investor are highly influenced, 30 percent said that Nepalese investor are medium influenced and 16.67 percent said they lowly influenced. Most of them were saying that since our market itself is very much affected by whim and rumor, they also could not be set apart from it. They have to make trade or hold decision based on those whim and Rumor.

Table 4.27
Influenced by Whim and Rumors

Research Variables	No. of Respondent	Percentage
High	80	53.33
Medium	45	30
Low	25	16.67
Total	150	100

4.1.8.17 Level of Awareness in Share Investment

When the investor were asked for their awareness in Share Investment, 20.67 percent said they are highly aware of Share market, 65.33 percent said they are medium aware about share market and the rest 14 percent said they are not aware of share market.

Table 4.28
Level of Awareness in Share Investment

Research Variables	No. of Respondent	Percentage
High	31	20.67
Medium	98	65.33
Low	21	14
Total	150	100

4.1.8.18 Satisfaction with Regulating body

When the investor were asked for whether they are satisfied with the regulating body that maintains the share practices in Nepal, 62 percent said they are not satisfied with the regulating body and the rest 38 percent said they are satisfied but still some works must be done more.

Table 4.29
Satisfaction with Regulating Body

Research Variables	No. of Respondent	Percentage
Yes	57	38
No	93	62
Total	150	100

4.2 Major Findings

4.2.1 Findings from the Study of Secondary Data

- J The amount of issue approved has increased from 244.40 mio in the FY 1993/94 to NPR 14,107.45 mio in FY 2009/10. During the same period the number of issue approved increased from 16 in FY 1993/94 to 72 in the FY 2009/10. Similarly the average size of issued approved increased from NPR 15.275 mio to NPR 262.95 mio.
- J Among the eight different sector Finance Companies sector has accounted for 43.69 percent of total issued approved while the lowest contributor trading and hotel sector has accounted for only 1.01 percent.
- J As far as instrument wise offer is concerned, out of 396 issues approved, 188 i.e 47.47 percent offers have been through right shares, followed by ordinary shares with 187 i.e 47.22 percent, debentures 16 i.e 4.04 percent and Preference Shares 5 i.e 1.26%. However from the amount perspective, right share accounted for 68.16 percent of total amount, followed by ordinary shares with 19.86 percent, debenture with 12.65% and Preference Shares with 1.18 percent.
- J During the entire period of FY 1993/94 to FY 2009/10 396 issues were approved of which 212 i.e 53.54 percent were oversubscribed, 130 i.e 32.83 percent were undersubscribed , 34 i.e 11.62 percent were fully subscribed and 8 i.e 2.02 percent were unknown. The majority of the Undersubscribed were the right shares which has to be claimed by only the existing shareholder, therefore it generally gets undersubscribed. On the issuance of Ordinary shares, it always gets oversubscribed.
- J The study shows that Nepali IPOs typically have small issue size, reflecting the strength and size of the economy. Moreover, relatively young companies without a very long operating history issued IPOs. This study also shows that the IPO owners do not offer a very high

percentage of shares to the public as is shown in the high ownership ratio post IPO.

4.2.2 Findings from the Primary Data

-) Most of the respondents replied that they belong to knowledgeable investor and only few replied that they belong to unknowledgeable investor.
-) 53.33 investor replied that they belong to small investor, regarding the amount of investment. Similarly, 36.67 percent and 10 percent said they belong to medium and large investor respectively.
-) 88 percent of the investor choose financial sector for investment while only 12 percent choose the non-financial sector. This shows the influence of financial sector in the IPOs.
-) The interest of the investor has been divided evenly among the person for dividend income, capital gain, bonus shares or right shares.
-) Nepalese Investors are highly influenced by Whim and Rumor in terms of investment.
-) Most of the investors are not satisfied with the regulating body that maintains the share practices in Nepal.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

An initial public offering (IPO) is the first sale of stock by a company to the public. Broadly Speaking, companies are either private or public. Going public means a company is switching from private ownership to public ownership. Going public raises cash and provides many benefits for a company. The process of underwriting involves raising money and investors by issuing new securities. The IPOs play a significant role to contribute the overall pool of capital supplied to the industry. The volume of IPO has grown significantly. The privatization of the state enterprises has also contributed to the growth in the IPO volume. In Nepal, Banks and financial sector is comparatively more active than other sector. More than 65 percent of the total paid up capital is being contributed by Banking and financial institution. It seems very important to encourage manufacturing, infrastructure and other service sectors to utilize the stock market for capital mobilization to the maximum extent, if the sustainable and balanced growth of the stock market is to be achieved.

As far as practices in Nepal are concerned there exist two institutions which guide and influence securities market. They are SEBON and NEPSE. SEBON is the regulatory body, which looks after the securities market transaction including IPO. According to SEBON, till 2009/10 396 public issues has been approved of which 187 were for ordinary shares issued for the first time by the company. Likewise, Nepal Stock Exchange (NEPSE) is the sole exchange of Nepal which provides liquidity and marketability to the securities being offered. By the end of FY 2009/10 altogether 179 companies were listed in NEPSE.

Before going to the public, the company must get approved from SEBON. Issuing company is free to choose one or more than one issue managers for the process of issuing

the securities. Issue manager must publish a public notice in the national daily newspaper to offer public for investment seven days before the applications forms distribute date. Similarly, they have to publish and distribute the prospectus which make public to analyze company performance and to decide whether to invest their money or not. The application period must be more than one month.

Even though the foundation of capital market development was laid in 1976 A.D with the establishment of Security Exchange Center, still it is in developing stage. Moreover, there is dearth of research work covering different aspects of capital market in Nepal. In this context, this study is carried out with the objective of finding the different perspectives of Nepalese IPOs, their practices, the subscription patterns, the underpricing of IPOs and the public awareness and Knowledge towards IPOs.

The study has used both the primary and secondary data for meeting the objectives of the study. The analysis of the issues being offered and number of issues being offered have revealed that Nepalese IPO sector has grown. Instrument wise analyses of offered issues have identified ordinary shares as the most preferred instrument. The analysis also revealed that most of the issues offered during the study period were oversubscribed. Similarly, the study identified the degree of underpricing of IPOs in banking and financial sector issued during the period of 2005/06 to 2009/10. Most of the IPOs issued during the study period were relatively young. About 84 percent of the IPOs came from firms which were in existence for less than 5 years. The result of the study showed that issues from the commercial bank sector were more under priced than those from other financial sector. The underpricing of the bank IPO was 120% percent compared to 77% for the other financial institution.

The primary source of data showed that the majority of the investor were Knowledgeable and most of them were small investor regarding investment in IPO. The major sources of information about IPO were from Medial and from Relatives or Friends. Majority of the investor preferred financial sector for investment and they took the money in loan for the investment. Most of the investors were saying that since our market is very much affected

by whim and rumor, they also could not be set apart from it. They have to make trade or hold decision based on those whim and rumor.

With development and economics at the forefront to the national agenda we expect to have many more IPOs to be issued to the general public. Therefore, this study becomes timely in the sense that it provides the regulators as well as the issuers and investors to reflect back on the nature of IPOs in the country and thereby take necessary steps to eliminate shortcoming of the current system in place.

5.2 Conclusion

Although history begins from 1936 with the issues of Jute Mill, the scenario of Nepalese financial system has not developed significantly. Firstly, it took very long to give financial market a well-structured organized shape. It is only since 1993 that the capital market of Nepal had regulated and organized shape. The ten years of history might not be a long history for a capital market. Nevertheless, in this today's globalize world how can we just follow wait and watch methodology. It is high time to think over the better performance of financial market of Nepal. History shows that in Nepal only four types (Common stock, preference shares, debentures and mutual fund) of the securities were issued at varying time. Nepali security market is completely dominated by the equity shares. Investors have not more choice so they are pouring their savings on those instruments. There are very less number of professional institutional investor. The major of the investor are knowledgeable towards the IPOs and most of them are small investor. The investors are investing in the IPOs by taking the loan. Many of the investors have just invested due to the influence of friends and relatives. They just follow the whim and rumor of the market.

Similarly, the study shows Nepalese IPOs have been found to be heavily oversubscribed. It shows that the Nepalese investors have a very high degree of attraction to the IPOs. The study shows that growth of Nepalese IPOs in terms of issue and subscription has been dumpy. The study shows that the IPOs investors make 79.63 percent market adjusted returns leading to the conclusion that Nepalese IPOs are highly underpriced and the investor do make money from the Nepalese IPOs.

5.3 Recommendation

-) Nepalese capital market is largely dependent on financial sector, which is not good sign for overall development of IPO market and capital market as a whole. In this regard the regulatory body and the government should take step forward and encourage public issues from other sectors like manufacturing and processing by providing additional facilities such as tax-concessions.
-) Ordinary share is found to be the most used financial instrument while other financial instruments like preference shares and debentures are rarely issued. The fact that such ordinary shares carry maximum risk to investor on one hand and also cause dilution of ownership to issuing company, seemed to be forgotten. In this regard, it is recommended that root cause beneath should be traced and tackled for good.
-) Regional stock exchange center should be established so that more people will be involved in the investment activities on primary as well as secondary market.
-) SEBON needs operational autonomy as, at present it has to get approval from Ministry of Finance for the issuance of necessary regulations.
-) On line trading system and central depository system (CDS) of securities needs to be established. The practice of keeping physical certificated of securities has created various hurdles. The infrastructures like on line trading and CDS are must before opening the markets for foreign investors and NRNs.
-) There is need to professionalize the market intermediary services by inducting new market intermediaries like underwriters, share registers, portfolios manager, investment advisors with adequate monitoring and supervision mechanisms.
-) There is need to adopt free pricing and proportionate allocation system in public issues of securities. The fair and transparent allocation of securities of public issue is needed.
-) The allocation system presently followed is weighted allocation system giving more weight to the applicant applying for small number of shares. It has led to a high practice of making ineligible application for subscribing public issue and

- thereby restricting mass participation in the stock market. Mass participation in stock market will lead to a sustainable and healthy practice and reduces chances of fair play.
-) There is need and challenge to introduce and encourage the use of different types of securities instrument. The diversity in securities market instrument will attract the investor of various risk return preferences and thereby promoting the size of the market.
 -) Investors should be made more equipped, Knowledgeable and resourceful to judge investment value and thus make a rational decision on buying and selling securities.
 -) Reforms in related laws needed to be carried out to pave the way for coming up with corporate governance codes for listed companies. These codes should in general focus on segregation of the role of CEO and the board, conduction of board meeting, effective functioning of the independent directors, audit and other internal committees, disclosure and compliance, protection of the interest of minority shareholders. The codes should be made mandatory to all.
 -) Investors should try to be well informed of the alternative prevailing in investment environment. They should not be carried away by whim and rumor. They should develop the habits of studying related publications, periodicals and reports.
 -) As a remedial step under the existing IPO system, authorities should make IPO application forms available on and downloads for the internet so that the crowd and hassles in collecting application forms will significantly decrease. Secondly, they should increase application collection centers in view of the volume of expected applications.
 -) It is high time that in addition to remedial steps, the capital market also went for proactive measures through the re-engineering of the IPOs application procedure. Of the re-engineering steps, firstly, developing each individual investor's profile and codifying them with the investor's identity number for all of their IPO applications; this reduces the time to fill up and process the forms. Secondly, the form should be accepted through the electronic version (through home-page of

issue managers and concerned company) with an electronic payment system; it reduces administration hassles at the collection centers and investor's time as well as the risks in carrying cash. More importantly, it brushes aside fake applicants and encourages genuine investors.

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Annexure

Questionnaire Regarding the investment in IPO of Nepal For the Thesis on “Performance of Nepalese IPOs”

Name:.....

Address:.....

1. What Kind of Knowledge do you have regarding Investing in IPO?

- | | |
|--------------------------------|-----------------------------|
| A. Knowledgeable Investor | B. UnKnowledgeable Investor |
| C. Well Knowledgeable Investor | D. Professional Investor. |

2. What is the factor that determines your investment in IPO?

- | | |
|----------------------|------------------------|
| A. No Risk at all | B. If had Money |
| C. Depends in Sector | C. Yes, Even with Loan |

3. Which category of investor do you belong?

- | | | |
|-------------------|--------------------|-------------------|
| A. Small Investor | B. Medium Investor | C. Large Investor |
|-------------------|--------------------|-------------------|

4. What are the various source of information regarding IPO?

- A. Media
C. Stock Brokers
- B. Relatives/Friends
D. Self-Education
5. Do you have the Past experience of Primary Issue?
A. Yes
B. No
6. How many companies do you have invested?
A. Single
C. Five-Ten company
- B. Two – Five Company
D. More than Ten Company
7. Which is the Preferred Sector for Investment?
A. Financial Sector
B. Non-Financial Sector
8. Of the Financial Sector which is the most preferred one?
A. Commercial Banks
C. Finance Companies
- B. Development Banks
D. Insurance Company
9. Which is the most preferred Non-Financial Sector for Investment?
A. Manufacturing & Processing Co.
C. Hydro Sector
- B. Trading Sector
D. Hotel
10. Which is the most preferred financial instrument for investment?
A. Common Stock
C. Debenture
- B. Preference Share
D. Other-Instrument
11. What is your's main purpose for investment in IPO?
A. Dividend
C. Right Shares
- B. Capital Gain
D. Bonus Shares
12. Do we read the prospectus of the company before investing in IPO?
A. Yes
B. No

13. Do we take into account the past performance of the Co. before investing?

- A. Very Much
- B. Moderately
- C. Little
- D. Not at all

14. What are your main sources of fund for investment?

- A. Personal Fund
- B. Borrowing from Friends/Relatives
- C. Loan from Banks
- C. Others

15. What is your Level of Satisfaction from investment in IPO?

- A. Yes
- B. No
- C. Don't Know

16. How much are you influenced by Whim and Rumors for investing in IPO?

- A. High
- B. Medium
- C. Low

17. How much aware are you in terms of your investment?

- A. High
- B. Medium
- C. Low

18. Are you satisfied with the regulating body?

- A. Yes
- B. No

Thank You

For the purpose of Thesis Submission

By: Manish Dahal

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