

**DETERMINANTS OF INITIAL PUBLIC OFFERING (IPO)
UNDERPRICING IN NEPAL**

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RECOMMENDATION

This is to certify that the thesis

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**DETERMINANTS OF INITIAL PUBLIC OFFERING (IPO) UNDERPRICING IN
NEPAL**

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DECLARATION

I hereby declare that the work reported in this thesis entitled DETERMINANTS OF INITIAL PUBLIC OFFERING (IPO) UNDERPRICING IN NEPAL submitted to Shanker Dev Campus, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's Degree in Business Studies (MBS) under the guidance and supervision of respected Dr. Pitri Raj Adhikari of Shanker Dev Campus.

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ABBREVIATIONS

| | | |
|-----------|---|---|
| AGM | : | Annual General Meeting |
| B/S | : | Balance Sheet |
| BOD | : | Board of Director |
| BVS | : | Book Value of Share |
| CIT | : | Citizen Investment Trust |
| CV | : | Coefficient of Variation |
| EPS | : | Earning Per Share |
| HMG | : | His Majesty's Government |
| HRL | : | Himalayan Reinsurance Limited |
| IPO | : | Initial Public Offering |
| LSE | : | London Stock Exchange |
| NAP | : | Net Assets per Share |
| NATS | : | NEPSE Automated Trading System |
| NCML | : | NIDC Capital Market Ltd. |
| NEPSE | : | Nepal Stock Exchange Limited |
| NIFRA | : | Nepal Infrastructure Bank |
| NIM | : | New Issue Market |
| NMBL | : | Nepal Merchant Banking & Finance Ltd. Co. |
| NRB | : | Nepal Rastra Bank |
| NRIC | : | Nepal Reinsurance Company Limited |
| P/E Ratio | : | Price Earnings Ratio |

| | | |
|---------|---|----------------------------------|
| P/L a/c | : | Profit and Loss account |
| P0 | : | Issue Price |
| ROC | : | Registrar of Companies |
| SEB | : | Securities Exchange Board |
| SEBON | : | Securities Board of Nepal |
| SEC | : | Security and Exchange Commission |
| SMC | : | Securities Marketing Center |
| UK | : | United Kingdom |
| WAN | : | Wide Area Network |

CHAPTER-I

INTRODUCTION

1.1 Background of the study

An Initial Public Offering (IPO) is a primary market mechanism where a private company sells its shares to the public for the first time, becoming a public entity. This process, also known as a public offering, allows the company to raise capital for expansion, reduce debt, and enhance its value. The types of securities available for offering may consist of common shares, debentures, preferred shares, and units of mutual funds. IPOs are essential for obtaining significant long-term funds and have been utilized by companies in various industries in Nepal, such as banking, trading, manufacturing, and hydropower, to raise capital. The decision to go public is a critical milestone, involving significant changes and opportunities for the company's future.

For a company to go public, it needs to form an IPO team that typically includes a primary investment bank, an accountant, and a legal firm. The underwriting firm assists in deciding the type of securities to issue, setting the most suitable offering price, and determining the optimal timing for market entry. From an investor's perspective, participating in an IPO offers the chance to purchase securities with the expectation of establishing a readily tradable market. IPOs can involve debt or equity securities and are pursued for various reasons, including raising capital, expanding the business, and increasing the company's value. Following their initial sale in the primary market, these securities can be traded on the secondary market, where transactions are conducted through organized exchanges such as the Nepal Stock Exchange Limited (NEPSE). The IPO process provides liquidity for existing shareholders and opportunities for growth, but it also carries risks and rewards for both public investors and the company.

1.2 Statement of the problem

Before an IPO is issued in the stock market, several uncertain factors can negatively affect its performance. To attract potential investors and ensure a successful IPO, issuers often initially undervalue their IPOs. Higher uncertainty about the firm typically leads to greater underpricing. Theoretical explanations such as the winner's curse theory (Rock, 1986), signaling model (Grinblatt & Hwang, 1989), informational cascades (Welch, 1989), and lawsuit avoidance (Hughes & Thakor, 1992) are also critical for understanding IPO dynamics.

In Nepal, studies on the operational performance of IPO firms are rare due to the concept's novelty in the region. This gap has stimulated interest in researching this area. The primary aim of this study is to examine the underpricing of IPOs on the Nepal Stock Exchange (NSE) from 2005/2006 to 2023/2024. The study seeks to inform people about the NSE, particularly regarding the process of going public, the extent of IPO underpricing or overpricing across different sectors, and the factors influencing these outcomes. By analyzing underpricing and stock price behavior, this research will provide valuable insights for prospective investors about potentially profitable IPOs.

The Nepalese capital market has unique characteristics, making it exciting to explore the extent and factors influencing underpricing. The study addresses the following key questions:

- i. What is the current status of IPOs in Nepal?
- ii. What is the subscription pattern for IPOs?
- iii. Does underpricing in Nepalese IPOs exist?

This study aims to close gaps in the literature, provide useful information for market players, and advance knowledge of the dynamics of initial public offerings (IPOs) in the Nepalese capital market.

1.3 Objectives of the study

As noted, there has been limited research on Nepalese IPOs. Therefore, this study aims to gain a deeper understanding of IPO underpricing and the factors contributing to this phenomenon. Specifically, this research seeks:

- i. To assess various securities, including their numbers, amounts, and paid-up capital.
- ii. To examine the subscription patterns of issues.
- iii. To analyze underpricing in IPOs across different sectors in Nepal.

1.4 Focus of the study

In the investment landscape, there are numerous alternatives, such as real assets, different ventures, or starting one's own company. This study focuses specifically on IPOs available to Nepalese investors, examining their responses to IPOs, pricing, and valuation. It explores what investors seek in an IPO before committing, including their sector preferences, knowledge

levels, attitudes towards various investment aspects, and the performance of issue managers. Additionally, it considers secondary market pricing, company financial status, and other related topics.

The study also addresses the IPO distribution process, restrictions on margin lending, and the practice of funding IPOs via financial institutional loans, which can obscure a company's true value. It discusses the pricing of IPOs at a par value of Rs.100 instead of a premium, the perception of IPOs as quick money-making opportunities rather than long-term investments, and the influence of whims and rumors on the Nepalese IPO market. Moreover, it highlights issues such as single applicants submitting multiple applications using different individuals' identification documents to secure a large number of shares, thereby influencing company management and the stock market.

1.5 Significance of the study

IPOs are essential for public corporations as well as regular investors. This study aims to provide valuable insights for institutions involved in IPO procedures. The research is significant in the following ways:

- i. It will be beneficial for general investors and organizations directly or indirectly involved in IPOs.
- ii. It will offer practical insights into existing rules and regulations, aiding policymakers in developing IPO-related policies.
- iii. It will guide investors in making informed decisions about investing in the right opportunities at the right time.
- iv. It will help the general public gain a better understanding of IPOs.

1.6 Limitations of the study

While public responses to other types of shares exist, this study focuses on primary share issues, neglecting other aspects due to measurement difficulties. Some companies have not disclosed required financial information, affecting the study's accuracy. Key points include:

- i. The research's accuracy depends on the reliability of published data and does not account for recent changes due to data limitations.

- ii. The study primarily relies on secondary data and considers only a few companies for analysis.
- iii. The focus is on initial public offerings, current legal aspects, and data variations from different sources.
- iv. The study covers data from 2005/06 to 2022/23, excluding data before and after this period.

1.7 Organizations of the study

There are five chapters in this research study:

Chapter I: Introduction

The main concerns with initial public offerings (IPOs) in Nepal are covered in this chapter. It covers the general background, a description of the issues, the study's objectives, its significance, its limitations, and its overall research plan.

Chapter II: Literature Review

This chapter presents a review of relevant literature for this study. It discusses the conceptual framework and key studies concerning IPOs, providing an overview of previous research conducted in this field.

Chapter III: Research Methodology

This chapter describes the methodologies utilized in the study, specifying the data sources and the approaches employed for data collection and analysis.

Chapter IV: Presentation and Analysis of Data

This chapter focuses on the presentation and analysis of the collected data. It describes the various tools and techniques used for data analysis.

Chapter V: Summary, Conclusion, and Recommendations

The final chapter presents the study's summary, conclusions, and recommendations. It includes the findings and offers suggestions based on the research outcomes.

CHAPTER – II

REVIEW OF LITERATURE

This chapter reviews the research on the factors that contribute to underpricing in initial public offerings in Nepal. The various approaches employed in this study are derived from different literature surveyed in this chapter. The review of various books, research studies and articles have been used to make clear about the determinants of initial public offering underpricing in Nepal. This chapter has been divided into four sections. The first section is Conceptual Review. Similarly, the second section is Review of Journal and Articles, the third section is Review of Previous Research Studies and the fourth section is Research Gap.

2.1 Conceptual Review

2.1.1 Financial Market

The financial market is a mechanism that enables people to purchase and sell commodities, such as agricultural products or precious metals, financial securities, and other fungible goods at prices that represent market efficiency and low transaction costs. Over hundreds of years, financial markets have evolved and continuously innovate to improve liquidity. These marketplaces might be specialized, where just one kind of commodity is traded, or general, where a variety of commodities are traded. Their mode of operation involves gathering a large number of buyers and sellers in one "place," which makes transactions easier.

In finance, financial markets play critical roles in:

- Raising capital (in capital markets)
- Transferring risk (in derivatives markets)
- Facilitating international trade (in currency markets)

Therefore, financial markets can be viewed as organizations that enable the trading of financial products, such as stock exchanges that facilitate trading in stocks, bonds, and warrants. Financial markets can be either domestic or international.

Types of Financial Markets

There are various categories within the financial markets:

- Capital markets: These market consist of:
- Stock markets: Provide funding by issuing common stock or shares and enabling trading in them afterwards.
- Bond markets: Offer financing through the issuance of bonds and facilitate their trading.

- Commodity markets: Enable the trading of various commodities.
- Money markets: Offer opportunities for short-term debt financing and investments.
- Derivatives markets: Provide tools for hedging and managing financial risk.
- Futures markets: Offer standardized contracts for trading commodities or financial instruments at specified future dates.
- Insurance markets: Enable the redistribution of risk among policyholders.
- Foreign exchange markets: Facilitate the exchange and trading of different foreign currencies.

The capital markets include both primary and secondary markets. Primary markets involve the issuance of new securities, whereas secondary markets enable investors to buy and sell existing securities.

2.1.1.1 Primary Market

The primary market is a component of the capital market where newly issued securities are offered for the first time. Companies, governments, or public sector institutions utilize this market to raise funds through new stock or bond offerings, usually facilitated by a syndicate of securities dealers. The sales method, called underwriting, involves dealers earning a commission built into the security offering price, as detailed in the prospectus.

Characteristics of primary markets include:

- Acting as the venue for new long-term capital.
- Facilitating direct issuance of securities to investors.
- Providing capital for new business setups or business expansion and modernization.
- Performing the crucial function of capital formation in the economy.

Approaches to issuing securities in the primary market:

- Initial public offerings (IPOs)
- Rights offerings (for existing companies)
- Preferential offerings

2.1.1.2 Secondary Market

The secondary market is where already issued securities are traded. This market allows investors and speculators to trade securities, providing liquidity. Once a new stock is listed on a stock

exchange, it can be traded easily as market makers provide bids and offers. The secondary market facilitates the sale and transfer of securities between investors or speculators, thereby enhancing liquidity.

2.1.2 The Concept of Initial Public Offering

2.1.2.1 Definition of Initial Public Offering

An IPO represents the initial public offering of equity shares in a corporation, marking the process of making stock in a company available to the public through a public market. IPO underpricing is characterized by the gap between the subscription price and the closing price on the first day, which offers subscribing investors a premium. This phenomenon, where the offer price is often lower than the first trading day's market price, enables investors to achieve high returns, reflecting a common pattern of underpricing.

2.1.2.2 Why Go Public?

There are several typical reasons why companies choose to enter new markets. After operating successfully for a number of years, founders and key shareholders may choose to convert their holdings into cash for other uses. Another motive is to secure additional funds for expanding business operations or repaying debts. Sometimes, a company reaches a stage where its current shareholders cannot fully finance further growth. Proceeds from an Initial Public Offering (IPO) can be utilized to expand operations, reinforce working capital, or reduce debt. Furthermore, a public company can continually issue more shares as long as there is demand in the market.

Ritter and Welch (2002) stated that the main reasons corporations go public are to create a market for their securities and raise equity capital. Several issuer-specific and market-related factors could influence a company's decision to list on a stock exchange. However, the optimal stage of development for a company to initiate its public offering may vary across diverse economies and industries.

In summary, accessing the equity market continues to be a highly effective method for securing substantial funds, despite potential drawbacks. Ritter and Welch (2002) emphasize that the rationale for pursuing an initial public offering can vary in strength depending on specific circumstances or economic periods.

2.1.2.3 Pricing of IPOs

Historically, IPOs are often underpriced to generate interest and ensure successful trading when shares become publicly traded. Underpricing benefits early investors but results in potential "money left on the table" for the issuing company. Overpricing, on the other hand, can lead to issues in selling shares and a drop in value on the first trading day, reducing marketability. Investment banks consider multiple factors to price an IPO correctly, aiming to balance stimulating interest and raising sufficient capital.

2.1.2.4 Pricing Differences

A significant price difference between the IPO offer price and the secondary market trading price is common, especially for "hot" IPOs with high demand. Excess demand can drive up prices dramatically in initial trading days, often followed by a price drop once the initial excitement subsides.

2.1.2.5 Issue Price

The issue price of an IPO is determined by lead managers through two methods: fixed pricing or book building. The chosen method affects the pricing strategy and the final offer price.

2.1.2.6 IPO Procedure

Initial public offerings (IPOs) generally involve one or more investment banks acting as underwriters. The company (issuer) engages a lead underwriter to facilitate the sale of shares to the public. The underwriter then reaches out to investors, and the sale can be structured in several ways, such as through Dutch auctions, firm commitments, best efforts, bought deals, or direct distribution of stock. Large IPOs often involve a syndicate of investment banks, with commissions earned based on shares sold. Regulatory restrictions and lead underwriter-imposed restrictions may apply to the sale of existing shares.

2.1.2.7 Largest IPOs in Nepal

Himalayan Reinsurance Limited (HRL), 104 million shares, 2023

Nepal Infrastructure Bank (NIFRA), 216 million shares, 2020

Nepal Reinsurance Company Limited (NRIC), 128 million shares, 2020

2.1.3 IPO Characteristics

IPOs possess unique attributes, including underwriting expenses and activities like oversubscription provisions and share trading by underwriters, contributing to the understanding of IPO listing day returns.

2.1.4 Theoretical Justification for IPO Underpricing

Underpricing in initial public offerings (IPOs) refers to the phenomenon where the subscription price is lower than the closing price on the first day of trading, resulting in a premium for subscribing investors. Many researchers (Baron, 1982; Ritter, 1984; Levis, 1993) have observed that IPOs tend to be underpriced on average. Various theories have been proposed to explain this underpricing. These theories include "The Winner's Curse" (Rock, 1986), Principal-Agent Theory (Baron, 1982), Underwriter's Reputation Theory (Carter and Manaster, 1990), Signaling Theory (Leland & Pyle, 1977), Partial Adjustment Theory (also known as 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 & Senbet, 1992), and Managerial Strategic Underpricing Explanation (Aggarwal et al., 2012).

Collectively, these theories suggest that underpricing is not merely an anomaly in the market but rather reflects market efficiency. It represents a risk premium associated with uncertainty, particularly the lack of readily available information typically accessible to established firms in the market.

2.1.4.1 The Winner's Curse

Rock (1986) suggested that both underwriters and issuers lack perfect information regarding the value of the issue. Within the market, some investors possess superior knowledge, while others face the same informational challenges as the issuer and underwriter. Informed investors seek underpriced issues, whereas uninformed investors subscribe to all available offerings. This results in oversubscription for underpriced issues and undersubscription for overpriced ones, leading to a "winner's curse" for uninformed investors, who receive a larger portion of the less desirable issues.

2.1.5 Historical Perspective of the Security Market in Nepal

The Biratnagar Jute Mill stands as Nepal's largest and oldest jute mill, established during the tenure of Prime Minister Juddha Shamsheer Rana in 1936 A.D. Initially operated by the government, it was later transferred to private ownership for management.

Nepal's capital market history traces back to 1937 when shares of Biratnagar Jute Mills Ltd. were first issued. In the same year, Tejarath was founded to provide loans to government employees, eventually evolving into Nepal Bank Ltd. The Company Act was enacted by the Nepalese government in 1964, and government bonds were first issued by Nepal Rastra Bank with a five-year maturity period and 6% interest rate (Shrestha, 2038). The Securities Marketing Center (SMC) was established under the Industrial Policy of 1974 and is responsible for trading government securities, national savings bonds, development bonds, and some company securities under government oversight. The sole capital market entity, Securities Exchange Center (SEC), was established in 1976 to foster and promote capital market growth, operating under the Securities Exchange Act of 1984. This legislation aimed to provide a structured and favorable market environment while safeguarding the interests of investors and increasing public participation in various firms and companies (Gurung, 1999).

SEC facilitated the trading of government and limited corporate securities, with only shares from ten companies listed and no involvement of external brokers or dealers. It engaged in activities such as brokering, underwriting, managing public offerings, and market-making for government bonds and other financial services (NEPSE, 1998). However, liquidity in the securities market was hindered by the absence of an effective secondary market. The interim government of 1990/91 initiated financial reforms, establishing two collective investment schemes—the Citizens Investment Fund and NIDC Capital Markets Ltd. to stimulate indirect investments in the corporate sector (Gurung, 1999).

In response to global trends in privatization and economic liberalization, the structure of SEC was reformed in 1993. The Government of Nepal divided SEC into two separate entities: The Securities Board of Nepal (SEBON) and the Nepal Stock Exchange Ltd. (NEPSE). SEBON, established on June 7, 1993, serves as the apex regulator of Nepal's securities market, ensuring the orderly development of a dynamic and competitive capital market under the Securities Exchange Act of 1983. SEBON registers securities, approves public issues, frames market

policies, licenses stock exchange operations and brokers, and supervises and monitors securities market activities, now operating under the Securities Exchange Act of 2006.

NEPSE Ltd., a non-profit organization operating under the Securities Exchange Act of 1983, aims to enhance marketability and liquidity of government and corporate securities. It facilitates transactions through its trading floor using market intermediaries such as brokers and market makers. NEPSE inaugurated its trading floor on January 13, 1994, initially utilizing an open outcry system for securities transactions. Subsequently, on August 24, 2007, NEPSE transitioned to a fully automated screen-based trading system known as the NEPSE Automated Trading System (NATS), which operates on an order-driven market principle. NEPSE has also authorized brokers to conduct online trading of shares via the Wide Area Network (WAN), enabling them to buy and sell shares from their offices without physical presence in the capital market.

2.1.6 Nepalese IPO Market

The Nepalese IPO market has gathered significant attention from investors, evident through the frequent oversubscription of new share issues and notable initial market returns on the Nepal Stock Exchange Ltd. (NEPSE), the sole organized stock exchange for listing and trading outstanding shares. Public limited companies in Nepal can issue ordinary shares either at par or at a premium, depending on the decision made during their annual general meeting (AGM). However, issuing shares at a premium is restricted to companies with higher net worth than total liabilities and a record of profitability and dividend distribution over the last three consecutive years. Shares can only be issued at a discount when a special resolution is passed in accordance with the Company Act 2063.

For public companies, the face value of a share must be Rs.50 or any amount greater, divisible by Rs.10. The application money for shares should not exceed 50% of the nominal value, except for banks and finance companies, and those with published audited financial statements for three consecutive years. The allocation of shares must occur within three months from the last subscription date.

By law, issuing companies must appoint an issue manager to apply for public issue approval from the Securities Board of Nepal (SEBON). The issue manager is responsible for submitting a due diligence certificate, the prospectus, and other necessary documents. While IPOs may be

underwritten by the issue manager or other financial institutions, underwriting is mandatory only for manufacturing companies. Once SEBON approves the public issue, IPOs must be offered within two months, failing which the company must reapply for approval. IPOs are offered at a fixed price approved by SEBON and must remain open for at least five working days.

2.1.7 Timing of an Initial Public Offering

Not all companies are prepared for an initial public offering (IPO). Key factors that influence a company's readiness to successfully complete an IPO include:

- Historical financial performance, future financial projections, and the ability to consistently grow revenues and earnings.
- The experience and competence of the company's management team.
- A strong market position for its products with potential for growth.
- A clear and focused mission outlined in a comprehensive business plan.
- Support from experienced legal advisors, accountants, and public relations firms.

For technology-based companies, the stock market's receptivity to new issuances in the specific industry can significantly impact IPO success. Companies need to meet all criteria required by underwriters, who may request adjustments to the company's capital structure, such as a reverse stock split, to ensure shares are priced within a standard IPO range. Underwriters may also require certain stockholders to participate in the offering by selling some of their own shares.

How does an IPO get Valued?

The price of a newly issued stock is determined by supply and demand forces. Analysts play a crucial role in evaluating stocks, determining their worth, and deciding whether to buy, hold, or short-sell based on perceived market value.

What Are Some Good Methods for Analyzing IPOs?

IPOs are unique as they lack historical trading data. Methods for analyzing IPOs include:

- Understanding why the company is going public and its plans for the raised funds.
- Analyzing the competitive landscape and the company's position within it.
- Assessing the company's growth prospects and profitability.

- Evaluating the management team's experience and qualifications.
- Reviewing the company's operating history, if available.

2.1.8 Primary Market Instrument

Since the formation of the Securities Board of Nepal in 1993, Nepalese corporations have employed various instruments to raise capital from the primary market.

a. Common Stock

Common stock offerings provide holders with equity stakes in the issuing company and entitle them to:

- Voting rights at the company's general meetings.
- Profit sharing through dividends and bonus shares.
- Repayment after creditors and preference shareholders in the event of company winding up.

b. Preferred Stocks

Preferred shares offer:

- Preferential right to dividend payments.
- Preferential right to capital repayment upon winding up.
- Types of preferred stocks include cumulative, non-cumulative, redeemable, non-redeemable, and convertible preferred stocks.

2.1.9 Bonds/Debentures

Debentures include various securities that may or may not constitute a charge on the company's assets. Characteristics of debentures include:

- Issuance by the company as a certificate of indebtedness.
- Specified dates for principal and interest repayment.
- Potentially creating a charge on company undertakings.
- Types of debentures include secured, unsecured, redeemable, perpetual, and convertible debentures.

2.1.10 Initial Public Offering (IPO) Manual

The IPO manual outlines the detailed procedures for handling IPOs, including steps and actions required by issuing companies and issue managers. This manual is subject to periodic updates and amendments.

2.1.11 Merchant Bankers

Merchant bankers act as intermediaries in fund mobilization, raising funds from the general public and channeling them to businesses. Their roles include securities underwriting, secondary market activities, corporate advisory services, and investment portfolio management. Merchant banking activities in Nepal are categorized into fund-based and non-fund-based functions, with certain activities requiring separate approval from Nepal Rastra Bank (NRB).

2.1.12 Issue Manager

An issue manager is responsible for managing the IPO process. Financial institutions with merchant banking operations manage public offerings and must be licensed by NEPSE. Issue managers negotiate issue commissions with issuing companies, and NEPSE has authorized several institutions to serve as issue managers.

2.1.13 Securities Board

The Securities Board was established under Clause 3 of the Securities Exchange Act, 2040, to serve as an independent statutory body overseeing the securities market. Its creation was necessitated to ensure the healthy and orderly development of securities markets and to provide sufficient protection for investors. The establishment of the Securities Exchange Board (SEB) aims to foster markets that uphold the following principles:

- **Fairness:** Promoting integrity, high standards of conduct, and ethical business practices in all market transactions.
- **Efficiency:** Ensuring that market operations are conducted by knowledgeable professionals who provide high-quality services at reasonable costs.
- **Confidence:** Building trust and confidence among investors and issuers, fostering active participation in and reliance on the securities markets.

- Flexibility: Developing adaptable and innovative markets that continually adjust to meet the changing requirements of all market participants.

Role of Securities Board in Issue of Securities

The Securities Board plays a crucial role in overseeing the issuance of securities, guided by several principles:

- Protecting the rights and interests of investors, including the right to receive accurate and comprehensive information.
- Guaranteeing liquidity through timely and impartial allocation procedures.
- Streamlining services for allocation and transfer efficiency.
- Promoting the use of securities markets by corporate entities to meet a variety of capital requirements.

To achieve these objectives, the Board aims to develop market structures, instruments, and methods for public offerings. Legislative provisions pertaining to public securities issues encompass:

- Capital controls governing the issuance and terms of securities.
- Regulations ensuring investor protection, meeting issuer requirements, and fostering overall market development.
- Promotion of robust corporate capital structures.

Specific provisions include:

- Prospectus requirements ensuring comprehensive disclosure during securities issuance.
- Obligations for regular disclosure of financial and operational information by entities issuing securities.
- Listing criteria for traded securities.
- Regulations governing the allotment and transfer of securities, emphasizing fair and equitable processes.
- Measures to expedite and streamline allotment and transfer services.

2.1.14 Offices of the Registrar of Companies

Registrar of Companies (ROC) oversees and regulates public companies, ensuring compliance with the Company Act. Public companies must submit a prospectus to ROC for approval before

issuing securities. ROC reviews the prospectus to ensure all relevant information is included and grants approval once satisfactory changes are made.

2.1.15 Stock Exchange Market

A stock exchange is a body that assists in buying, selling, or dealing in securities. In Nepal, the Nepal Stock Exchange Limited (NEPSE) operates as the sole stock exchange market under the Securities Exchange Act of 1983. NEPSE facilitates secondary market transactions and requires companies to be listed before their shares can be traded.

2.1.16 Securities Board of Nepal

Established on June 7, 1993, the Securities Board of Nepal (SEBON) regulates the securities market. SEBON aims to regulate securities issuance and trading, promote market development, and protect investor rights (SEBON, 2006).

Financial Institutions

Financial intermediaries like commercial banks, finance companies, and development banks play roles in the securities issue process as issue managers and underwriters. These institutions operate under the regulations specified in the Company Act and directions issued by the Nepal Rastra Bank.

Nepal Rastra Bank

Nepal Rastra Bank (NRB), as Nepal's central banking authority, establishes guidelines for financial institutions. In the case of public offerings, NRB grants financial institutions approval to participate in various roles and oversees fund-based merchant banking activities.

Securities Issue Procedure in Primary Market: Legal rules, Regulations

In Nepal, the process for issuing securities adheres to the Securities Transaction Act of 1983, the Issue Management Guidelines of 1997, and the Securities Registration and Issue Approval Guidelines of 2000. Key steps include:

- Selecting an issue manager or underwriter.
- Preparing a prospectus as per regulatory requirements.
- Obtaining approval from the issuing company's Board of Directors.
- Submitting the prospectus to the Company Registrar for approval, who reviews it in consultation with SEBON, NRB, and the Insurance Board for insurance companies.

- Investment Consideration for Potential Investors in the Primary Market
- Investors should select shares of well-operating companies with good future prospects and reliable management. It is crucial to compare market prices and share values, and gather information from company documents, such as the memorandum, prospectus, and articles of association.

Red Herring: An initial prospectus without the offer price and issue date.

Lock-Up Period: A period during which insiders are prohibited from selling their shares.

Flipping: It refers to the practice of reselling IPO shares shortly after acquiring them, aiming to make a rapid profit.

Quiet Period: The period between the submission of regulatory documents and their approval, characterized by restrictions on promotional activities.

Investment Consideration for Potential Investors in the Secondary Market

Investors should receive updates on company returns, financial ratios, future plans, and performance reports. They should analyze information provided by SEBON and NEPSE, study trading statements, and follow economic articles in the media. Before making investments, investors should choose a suitable broker and ensure they receive reliable information on specific companies.

Pricing Differences

Price differences typically arise when an IPO generates substantial investor interest or is considered highly attractive. During such "hot" IPOs, demand for the securities often surpasses the available supply of shares. This excess demand is usually met only after trading commences in the IPO shares. This imbalance frequently leads to a significant initial increase in share prices during the initial hours or days of trading. However, these elevated prices often stabilize or even decline after the initial trading frenzy subsides. Consequently, there can be considerable disparities between the IPO price and the price at which IPO shares begin trading in the secondary market.

IPO by Private Company to the Public

IPOs are frequently issued by smaller, newer companies seeking capital for expansion, or by large privately owned companies aiming to go public. During an IPO, the issuer collaborates

with an underwriting firm to decide on the type of security to issue (common or preferred), determine the optimal offering price, and determine the timing for market entry.

Risky Investment

Investing in IPOs can be risky. Individual investors face challenges in predicting how a stock will perform on its debut and in the early stages, as there is often limited historical data available for analysis. Moreover, many IPOs involve companies in transitional growth phases, adding further uncertainty about their future value.

Pricing

Historically, IPOs have often been underpriced initially. Underpricing an IPO can create additional demand for the stock when it debuts on the public market, potentially resulting in significant gains for investors who acquire shares at the offering price. However, there is also a risk of overpricing. If a stock is priced higher than what the market is willing to pay, underwriters may struggle to fulfill their commitments to sell shares. Even if all issued shares are sold, a decline in the stock's value on the first day of trading could diminish its market appeal and further erode its value. Investment banks, therefore, carefully weigh various factors when determining an IPO's price, aiming to set a price that stimulates investor interest while ensuring sufficient capital is raised for the company.

The Underwriting Process

"Underwriting is an agreement between the issuing company and a financial institution, such as a bank, merchant bank, broker, or other entity. This agreement specifies that the financial institution will purchase shares or debentures up to a predetermined amount. Acquiring shares in a popular IPO can be very challenging, if not impossible, due to the underwriting process involved in conducting an IPO."

When a company decides to go public, its first step is typically to engage an investment bank. While a company could theoretically sell its shares independently, in practice, an investment bank is almost always necessary. Underwriting involves raising capital through either debt or equity, with underwriters acting as intermediaries between companies and the investing public. In Nepal, major underwriters include Nepal Merchant Banking & Finance Ltd. (NMBL), Citizen Investment Trust (CIT), and NIDC Capital Market Ltd. (NCML).

The company and the investment bank will initially negotiate the terms of the deal, discussing the amount of capital to be raised, the type of securities to be issued, and the specifics of the underwriting agreement. The deal can take various forms; for instance, in a firm commitment, the underwriter guarantees to raise a specified amount by purchasing the entire offering and then selling it to the public.

To ease risk, investment banks often form a syndicate of underwriters, believing that institutional and affluent investors are better equipped to purchase large blocks of IPO shares and hold them long-term. Once a deal is agreed upon, the investment bank prepares a registration statement to be filed with the SEC. This document includes comprehensive details about the offering, along with company information such as financial statements, management backgrounds, legal issues, the use of funds, and insider holdings.

Following submission, there is a mandatory cooling-off period during which the SEC reviews the registration statement to ensure all material information is disclosed. Upon SEC approval, a date known as the effective date is set for the public offering. Before this date, an initial prospectus is issued, containing all pertinent information about the company except for the offer price and effective date, which are finalized later.

As the effective date approaches, the company and underwriter collaborate to determine the offer price, a critical decision influenced by the company's profile, the success of the roadshow, and prevailing market conditions. Finally, the securities are offered for sale on the stock market, and the capital is collected from investors.

2.2 Review of Journal and Articles

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

Goergen (2006) stated that the study had two main objectives: first, to identify potential factors influencing the selection of IPO listing contracts based on existing theoretical frameworks and empirical research; and second, to empirically test these factors within the context of UK IPOs. The research focused on 240 initial public offerings listed on the official list of the London Stock Exchange between 1991 and 1995. Utilizing a binomial probity model, the study assessed the impact of various variables on contract choice. The study proposed that three key factors influence contract selection: ex-ante uncertainty, certification, and the visibility/exposure of the

issue. It provided compelling evidence that signals from sponsors and creditors can indicate the quality of the IPO firm. Hence, firms, which use highly reputable sponsors and those with high debt to assets ratios usually, choose public offer contracts. They also found that firm that make small issues find it 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 made by the firm within the framework of rational behavior.

Shrestha (2009) said that IPOs serve as signals of a company's health. They provide these signals in two main stages: upon announcement and at the commencement of trading. Oversubscriptions of IPOs upon announcement signal robust company health, while underpricing suggests strong investor interest seeking quick gains. However, the availability of loans from financial institutions can distort this picture, as even those with limited stock valuation knowledge may seek loans to capitalize on short-term IPO performance.

The study highlighted challenges related to data availability based on occupation. It suggested that utilizing opinion surveys, questionnaires, and interviews would enhance research quality. To comprehensively gauge public market response, the study recommended incorporating both qualitative and quantitative research methods. However, it acknowledged biases inherent in relying solely on quantitative analysis of public response.

Regarding the secondary market, the study suggested its significant role in boosting the primary market. Critically, it noted shortcomings in the study's justification of secondary market conditions and emphasized the absence of analytical market share prices and company dividend distributions. Consequently, it cautioned against attributing failures in the primary market solely to issues in the secondary market.

Robert and Nardin (2010) presented evidence that the determinants of the cross-section of expected stock returns were stable in their identity and influence across periods and countries. The factors influencing stock returns included risk, liquidity, price level, growth potential, and historical stock price performance. Predictions of expected returns using out-of-sample methods, specifically using moving average values for these firm characteristics, proved consistently accurate. Their study stood out in contemporary literature for two main reasons. Firstly, stocks with higher expected and realized returns were consistently found to be less risky than those with lower returns. Secondly, they identified that the key determinants of expected stock returns were remarkably similar across major global equity markets.

Shrestha (2011) stated that monetary policy directly affects stock prices. Taking all example of monetary policy announcement in 2011/012, according to this study “NRB Monetary Policy had an impact on the performance of stock market as investors were lured into buying shares of commercial banks at higher market price with the expectation that banks would issue bonus shares to increase its capital based to Rs.100 million. As a result, there had been tremendous demand for share of commercial banks in every day transaction raising stock market index to unexpected highs”.

Bhandari (2015) conducted a study on the efficiency of securities market intermediation services within the Nepalese context, an area relatively underexplored by individual researchers. The findings highlighted several key points:

- Over the study period, there were notable changes in the structure of market intermediaries, with a decreasing trend in their total numbers and frequent shifts in their composition.
- The study spanned a decade and observed increases in the number of listed and traded companies, paid-up capital, market capitalization, and the NEPSE index, albeit with some exceptions. These indicators suggest improving efficiency compared to previous years.
- However, the number of licensed brokers decreased during the study period, and some brokers held licenses without submitting financial and transaction reports to NEPSE on time.
- While other sectors of the Nepalese economy did not show significant progress, the capital market experienced abnormal growth in recent years.

Pandey (2015) highlighted that investors often realize substantial capital gains when purchasing stocks through IPOs and selling them in the short term. The extent of underpricing, however, hinges largely on financial considerations, influenced by factors such as the underwriter's reputation and the pricing methods employed in IPOs. The study concludes that IPOs typically perform well in the short term from an investor's perspective. However, from the issuer's standpoint, excessive underpricing can be costly. The study suggests that a moderate level of underpricing can be acceptable if it enhances attractiveness and facilitates ease of market entry.

Dahal (2015) found that Nepalese IPOs consistently experience heavy oversubscription, indicating a strong investor interest in these offerings. The study observed fluctuating growth in Nepalese IPOs in terms of both issuance and subscription levels over the study period. It was

noted that IPO investors in Nepal achieved a market-adjusted return of 53.25 percent, suggesting significant underpricing of Nepalese IPOs.

The study highlighted that while investors benefit financially from Nepalese IPOs, excessive underpricing can lead to wealth loss for promoters. This phenomenon may deter potential issuers from entering the public market, potentially depriving the economy of increased investment and productivity gains from these companies.

Gouldey (2016) found that there is a clear indication that an IPO which is oversubscribed during its pre-market sale is likely to experience a short-term price increase in the secondary market. This demonstrates a positive correlation between IPO performance and oversubscription.

KC (2017) suggested that financial development is crucial and that stock markets can significantly boost economic growth. Over the past decade and a half, Nepal's financial sector has undergone substantial changes despite encountering numerous challenges. The study emphasizes that these advancements have predominantly benefited the banking sector. However, it also points out that Nepal's stock market, due to its small size, is subject to manipulation and price rigging. Additionally, indicators such as low turnover ratio, low value traded ratio relative to volatility, and a high concentration ratio suggest that the Nepalese stock market is characterized by high illiquidity and risk. Consequently, the stock market has been a less reliable avenue for raising funds for Nepalese firms.

2.3 Review of Previous Research Studies

The importance of the primary market has been increasingly acknowledged in recent years. It serves as a crucial avenue for corporations to raise necessary funds, which can be channeled into productive sectors, thereby fostering economic growth at the national level.

Paudel (2010) conducted a study focusing on investing in shares of commercial banks in Nepal. The study aimed to achieve the following objectives:

- Analyze the dynamics of the primary market for commercial banks.
- Evaluate the risks and returns associated with investments in commercial bank shares in Nepal.

Key findings from the study include:

- Commercial bank shares in Nepal are actively traded on the stock market and play a pivotal role in determining stock exchange indicators.

- The average mean return on the market portfolio, as measured by percentage changes in the NEPSE index, was 5.51% during the study period.
- All shares examined showed higher returns compared to the market portfolio. However, their risk-return profiles varied.
- Most of the shares were categorized as defensive stocks, indicated by beta coefficients less than 1, except for Bank of Kathmandu Limited. Nepal Arab Bank Limited notably showed a negative correlation with market portfolio returns, leading to a negative beta coefficient.

Sharma (2011) conducted a study on the challenges and prospects of the primary and secondary markets in Nepal. The primary objectives were:

- To evaluate the challenges encountered by the Nepalese stock market.
- To investigate the current status of both primary and secondary markets.

Major findings from the study revealed:

- Resolving current challenges requires improved public understanding of market operations.
- Investors need enhanced information to make informed decisions beyond simply holding shares.

Kafle (2011) conducted research on the impediments of the primary and secondary markets in Nepal. The study aimed to:

- Assess developments in both markets.
- Analyze existing market barriers.

Key findings highlighted:

- Overcoming challenges hinges on public comprehension of market dynamics and investment considerations.
- Investors must prioritize thorough analysis of firm financials over market rumors to make sound investment choices.
- These studies collectively underscore the evolving landscape of Nepal's capital markets, emphasizing the need for informed investor participation and market transparency to sustain growth and stability.

Nepal (2012) conducted a study focusing on the Analysis of Determinants of IPO Underpricing in Nepal. The study aimed to achieve the following objectives:

- To investigate the phenomenon of underpricing in IPOs within the Nepalese context.
- To scrutinize the procedures of public offering and the process of becoming a publicly traded entity in Nepal.

Key conclusions from the study included:

- It was found that underpricing is not observed among Nepalese firms, opposing to theoretical predictions and findings from studies in other countries.
- The study highlighted that IPO pricing in Nepal is entirely governed by regulatory authorities, and companies do not have autonomy in setting their own IPO prices.
- Nepalese merchant bankers were found to have limited influence over the pricing of IPOs.

In summary, Nepal's study shed light on the unique dynamics of IPO underpricing and pricing mechanisms within the Nepalese market, offering insights that differ from international norms and theories.

Paudyal (2013) conducted a study on the developments, obstacles, and challenges in the Nepalese stock market. The primary objectives of the study were:

- To assess the evolution of the Nepalese stock market.
- To analyze the barriers hindering its growth.
- To identify the challenges confronting the Nepalese stock market.

Key findings from the study included:

- The Nepalese stock market remains in its early stages of development.
- Ambiguity regarding developmental direction, market reform priorities, and the operational autonomy of SEBON (Securities Board of Nepal) are significant factors contributing to this situation.
- Initiatives such as integrating information technology into SEBON and establishing an online reporting system within Nepal's securities data management system are initial measures aimed at bolstering SEBON's regulatory capabilities. These efforts are expected to expand opportunities for improving disclosure practices in the stock market.

Pandey (2013) conducted a study on Initial Public Offering (IPO) practices in Nepal. The study aimed to achieve the following objectives:

- Assess the current status of primary market issuances.
- Investigate the evolutionary trends in the primary market.
- To analyze the practices of initial public offerings across various sectors.

Key findings from the study included:

- The development of the securities market in Nepal is still in its early stages, with notable differences in public response between financial institutions and insurance sectors compared to non-financial sectors.
- There is increasing awareness among investors regarding the primary market, leading to higher capital flows. This growing awareness underscores the increasing recognition of the importance of investing in shares.
- The pace of initial public offerings and the approval process for issues across different sectors in Nepal appears to be inconsistent.

Thapa (2014) conducted a study on Risk and Return Analysis of Common Stock Investments.

The primary objectives of the study were:

- To examine the correlation between risk and return and identify critical factors influencing investment decisions, specifically within insurance companies.
- To pinpoint challenges encountered by individual investors and insurance firms in the realm of stock investments.

Key findings from the study included:

- There exists a limited understanding among the public regarding the stock market, often accompanied by misconceptions about its risks. Inadequate education and insufficient sources of information pose significant barriers to the development of Nepal's stock market.
- Many investors are attracted to common stocks due to their higher expected returns.
- When comparing risk and return across different sectors, the finance and insurance industry stands out for offering the highest expected returns despite a higher level of risk. In contrast, the trading industry generally offers lower returns coupled with minimal risk.

Poudel (2014) conducted a study on the Share Price Movement of Joint Venture Commercial Banks in Nepal. The primary objectives of the study were:

- To identify the primary factors influencing fluctuations in stock prices in Nepal.
- To analyze the behavior of risk-averse and risk-seeking investors.
- To examine the trends in share price movements among Nepalese Joint Venture Commercial Banks.
- The researcher utilized both primary and secondary data sources for the study.

Key findings from the study included:

- The market value per share does not fully reflect all available historical information.
- The beta coefficient, which measures the relative riskiness of individual securities, indicated that none of the shares from the eight sampled banks were considered risky. This finding suggests that even risk-averse investors could consider investing in shares of these banks.

Dahal (2014) conducted a study on Subscription of Corporate Securities in Initial Public Offering in Nepal. The main objectives of the study were:

- To investigate the growth trends in the primary market within the Nepalese capital market.
- To analyze the subscription patterns of securities, focusing on the most oversubscribed and undersubscribed IPO issues, as well as the extent of underpricing.
- To investigate the correlation between subscription patterns and initial returns in IPOs within the Nepalese market.

Key findings from the study included:

- Both the quantity and variety of issues offered indicated growth in the Nepalese IPO sector during the study period.
- The analysis indicated that a significant number of issues offered during the study period were oversubscribed. In recent years, there has been a shortage of non-financial sector opportunities that meet investor criteria in the country.
- IPOs in the financial sector were frequently oversubscribed, whereas those in the manufacturing and trading sectors tended to be undersubscribed. Furthermore, the first day of trading for such IPOs often yielded higher profits compared to subsequent days.

Tamang (2015) conducted a study on Public Response to Primary Share Issues in Nepal. The main objectives of the study were:

- To identify the challenges associated with primary share issues and assess their growth.
- To analyze the patterns of public response towards shares.

Key findings from the study included:

- There is a high public response in the primary market attributed to limited investment opportunities in other sectors and a lack of comprehensive investment analysis.
- There is a need for better understanding of market dynamics, price fluctuations, and informed decision-making to maximize returns.
- Potential investors should carefully evaluate their options before investing in the share market.
- Investors have few alternatives to holding shares, underscoring the importance of informed investment decisions.

Ojha (2016) conducted a study on Determinants of Stock Price Fluctuation in Nepal. The primary objectives of the study were:

- To identify the key factors influencing fluctuations in stock prices in Nepal.
- To assess the volume of stock traded in the market.
- To investigate investor awareness of the stock market.
- To analyze the pace of Initial Public Offerings (IPOs) and evaluate public responses to IPOs.

Key findings from the study included:

- The volume of stock traded exhibited fluctuating trends over the study period.
- Signaling factors played a significant role in determining stock prices.
- Investor awareness of the stock market was found to be inadequate.
- Dividends and earnings were identified as critical factors influencing share price fluctuations and contributing to underpricing in IPOs.

Joshi (2017) conducted a study on the Structure of Public Debt in Nepal, focusing on the significance of internal borrowing amid the economic challenges posed by the nation's natural topography and behavioral constraints.

The main goals of the study were:

- To examine the distribution of public issues across different sectors, emphasizing the prevalence of IPOs from the financial sector in the Nepalese market.
- To assess the availability and investor satisfaction with non-financial sectors in Nepal based on recent trends.

Key findings from the study included:

- An examination of the subscription patterns of securities, including the identification of the most oversubscribed and undersubscribed IPOs, and an analysis of underpricing levels.
- Identification of lengthy processes in organizations' public offering procedures.

Shrestha (2018) conducted a study on The Public Response to Primary Share Issues in Nepal.

The main objectives of the study were:

- To investigate the scope and potential of the primary market.
- To evaluate the growth patterns within the primary market.
- To analyze public perceptions and reactions towards Initial Public Offerings (IPOs)

Key findings from the study included:

- The scope of the primary market has shown significant expansion in recent times.
- General investors enthusiastically invested their savings in new share issues, resulting in substantial oversubscription.
- The primary market has shown significant growth, with many public limited companies and joint venture banks successfully raising capital through share offerings. This indicates an increasing level of confidence among the public in the primary market.

2.4 Research Gap

However, there has been limited research conducted on IPO underpricing in Nepal, investors' objectives regarding long-term investment versus quick returns, and the significant impact of whim and rumor on investment decisions affecting the share market. Previous studies have also overlooked testing hypotheses related to investor responses. Given that most investors in Nepal tend to be risk-averse, this thesis examines whether individuals prefer personal funds or loans for investments.

This research also aims to analyze the factors influencing investments in IPOs and the role of whim and rumor in investors' decisions. Current practices show that many investors apply

under multiple names to increase their chances of obtaining more shares in IPOs. This study seeks to gather individual investor responses regarding preferences for distribution methods, such as pro-rata basis versus lucky draw.

Nepalese investors often rely on rumors and lack comprehensive information about various securities. This study aims to assess the pace of Initial Public Offerings (IPOs), IPO pricing dynamics, secondary market pricing, procedural regulations, and public awareness. There is a growing interest among Nepali investors in the primary market, which has shown rapid growth. While many IPOs are heavily oversubscribed, investing in IPOs offers potential returns but also involves risks that investors need to understand thoroughly.

This research aims to fill gaps identified in prior studies by examining IPO pricing, the effectiveness of issue managers in the IPO process, sector preferences in investments, investor preferences regarding company performance and market information, and reactions to restrictions on margin lending. It intends to conduct primary data analysis involving participants from various sectors including banking, universities, and business.

CHAPTER - III

RESEARCH METHODOLOGY

This chapter details the research methodology employed to analyze collected data and draw conclusions. It defines the methods and procedures utilized throughout the study, tailored to effectively meet the research objectives. The chapter details various sequential steps that researchers should follow when studying a problem with specific objectives in mind. Essentially, research methodology guides the regular and procedural aspects of conducting research.

The methodology involves several key processes applied across the study. It includes defining research design, selecting and determining sample size, outlining data collection procedures, processing collected data, and defining variables. Additionally, it discusses the meaning and application of statistical tools used in the analysis.

The chapter is structured into five sections for clarity. Section 1 focuses on explaining the research design adopted for the study. Section 2 addresses population and sample selection considerations. Section 3 discusses the sources from which data is gathered. Section 4 elaborates on the methods of analysis and data collection procedures employed. Finally, Section 5 defines the specific data analysis tools utilized.

Each section contributes to a comprehensive understanding of the methodology employed in this research, ensuring transparency and rigor in achieving the study's objectives.

3.1 Research Design

The research design serves as the conceptual framework guiding the execution of research. It encompasses the comprehensive process of planning and conducting a research study, including the strategies and structures employed to address research questions and manage variability. It commands the arrangements for data collection and analysis.

In this study, a descriptive research design is employed. This design is chosen to analyze two main aspects: the underpricing of IPOs in Nepal and public perceptions regarding IPOs. Moreover, it seeks to explore subscription patterns and their relationship with issue patterns.

3.2 Population and the Sample of the Study

By the conclusion of FY 2079/080, Nepal Stock Exchange (NEPSE) had 189 listed companies distributed across ten sectors: commercial banks, development banks, finance companies, life and non-life insurance companies, manufacturing and processing companies, hotels, trading companies, the hydro sector, and other sectors. This study specifically focuses on companies that conducted Initial Public Offerings (IPOs) between FY 2070/71 and FY 2079/80 (2013/014 to 2022/023). To achieve this aim, a random sample of 14 IPOs has been selected from the total number of IPOs conducted during this period.

Table 1

Population and Sample of the Study

| Sector | Population of the Study | Sample of the Study | Percentage (%) |
|------------------------------|--------------------------------|----------------------------|-----------------------|
| Financial Sector | | | |
| Commercial Bank | 20 | 8 | 40.00% |
| Development Bank | 16 | 9 | 56.25% |
| Finance Companies | 20 | 10 | 50.00% |
| Life Insurance Companies | 8 | 3 | 37.50% |
| Non-Life Insurance Companies | 13 | 5 | 38.46% |
| Total | 77 | 35 | 45.45% |
| Non-Financial Sector | | | |
| Mfg. and Pro. Co | 19 | 4 | 21.05% |
| Trading Co. | 4 | 1 | 25.00% |
| Hotels & Tourism | 7 | 1 | 14.29% |
| Hydro power | 79 | 3 | 3.80% |
| Other | 3 | 1 | 33.33% |
| Total | 112 | 10 | 8.82% |
| Grand Total | 189 | 44 | |

Source: SEBON Annual Report 2079/080

Table 1 illustrates the sampling approach for different sectors:

- Among the 20 listed commercial banks, 8 banks (40.00%) were sampled.
- For development banks and finance companies, 9 (56.25%) and 10 (50.00%) samples were respectively taken from populations of 16 and 20.
- From the 21 insurance companies, 8 (36.36%) were selected as samples.
- Within the non-financial sector, a total of 10 companies were sampled from a pool of 112 (8.92%).
- Additionally, for primary data collection, 59 respondents from various backgrounds- banking, business, academia, and brokerage firms-were sampled. This group consisted of 14 students, 22 businessmen, 16 bankers, and 7 brokers.

3.3 Nature and Sources of Data

The study employs a combination of primary and secondary data sources aligned with its objectives and specific needs. Secondary sources include NEPSE reports, SEBON reports, NRB reports, and reports from issue managers. Furthermore, data from annual reports and other publications of sampled companies are also utilized.

For understanding investor knowledge about IPOs, primary data are collected through unstructured interviews with SEBON and NEPSE staff, as well as from members of the public investing in primary issues. Participants were also asked to complete structured questionnaires as needed. Discussions, interviews, and informal talks with investors, brokers, and analysts further contributed to enhancing the study's effectiveness.

Both primary and secondary data are integrated to fulfill the study's objectives comprehensively.

3.3.1 Primary Data

Primary data provides the substantive foundation for this study. To gather this data, discussions and informal interviews were held with current investors, NEPSE and SEBON staff, bankers, brokers, and other relevant stakeholders. Additionally, a structured questionnaire was developed specifically for this research. This questionnaire was distributed to 59 respondents comprising students, businessmen, bankers, and brokers, in accordance with the research requirements, to solicit their replies.

3.3.2 Secondary Data

To meet its objectives, this research integrates secondary data for evaluating historical performance and primary data for assessing qualitative information. The secondary data was gathered from a variety of published and unpublished documentary sources including:

- Annual reports from NEPSE and SEBON
- Reports from Nepal Merchant Banking & Finance Company Ltd.
- NIDC Capital Market Reports
- Citizen Investment Trust reports
- Quarterly Economic Bulletins from NRB
- Information from relevant websites
- Previous research studies dissertations, and articles on the subject.

3.4 Data Presentation and Analysis Method

After completing the data collection phase, it is crucial to analyze and interpret the results. Raw data obtained from various sources may need verification and simplification before utilization. The collected data should be categorized and presented in suitable formats, aligned with the nature of the data and the specific requirements of the study. Given the use of both primary and secondary data, various analysis techniques have been employed. Data analysis serves to enhance clarity for readers and facilitates drawing conclusions.

This study utilizes a blend of tools selected based on their suitability for the research objectives and their potential to yield meaningful results. Additionally, different software and technologies have been employed to ensure the effectiveness of the study.

3.5 Necessary Tools and Techniques

Various statistical tools have been employed in this study to achieve the designated objectives effectively. Throughout the course of the research and analysis, several hypotheses were formulated and tested. The study utilizes a range of statistical tools, financial metrics, diagrams, tables, charts, and descriptive methods as needed and appropriate for the research objectives. The techniques applied in this study include:

Underpricing

In this study, underpricing is assessed using two metrics: raw underpricing and market-adjusted

underpricing. Raw underpricing denotes the initial return observed on the first day of trading on the stock exchange. The calculation is as follows:

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

Where,

UP = Raw Underpricing

P_1 = the closing price on the day of listing of the IPO

P_0 = offer price of the IPO

The market-adjusted return is calculated by adjusting the market return over the same period as the raw underpricing. The market return represents the performance of the market portfolio during the identical timeframe as the raw underpricing, and it is defined as follows:

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

Where,

R_M = Market Return

I_1 = NEPSE Index on the 1st day of trading

I_0 = NEPSE Index on the day of offering

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

$$UP_{MA} = UP - R_M$$

Where,

UP_{MA} = market adjusted return

Financial and Statistical Tools

Suitable statistical methods are utilized to interpret comparative results effectively.

Bar Diagrams and Line Charts

Bar diagrams and line charts serve as visual aids that provide an overview of numerical data, facilitating comparisons between multiple datasets. There are various types of diagrams available for different visualization needs.

Pie-diagram

A pie chart is frequently used to visually display data when values differ significantly in magnitude. This method involves dividing all the data points into segments of a circle that add up to 360 degrees, representing the entire dataset. Each segment corresponds proportionally to its angle within the circle, reflecting its relative contribution to the dataset.

Percentage

Percentage is a valuable tool for comparing quantities or variables. Essentially, the term "percentage" denotes per hundred. It refers to a fraction where 100 serves as the denominator, and the numerator represents the rate or proportion in terms of percent.

Mean

The mean, denoted by μ or \bar{X} , is calculated as the total sum of observations divided by the number of observations. It serves as a measure of central tendency in data analysis. In this context, the terms mean and average are used interchangeably to refer to the equal weighted mean.

Symbolically,

$$\mu = \Sigma X/N$$

Where,

μ = the population mean of variable X

ΣX = sum of all the observed value of variable X

N = the total number of observations

Standard Deviation

Standard deviation, denoted by σ , is a primary measure of dispersion that quantifies the extent of variations among observation values. A higher standard deviation typically indicates greater fluctuation and risk. In this study, standard deviation is employed to assess the variability in initial returns across different companies throughout the study period. Symbolically,

$$\sigma = \frac{\sqrt{\sum(X-\mu)^2}}{N}$$

Where,

σ = standard deviation

X = observation

μ = population mean for observed value of X

Σ = sum of all values of $(X-\mu)^2$

Coefficient of Variation

The Coefficient of Variation (CV) is a statistical measure of dispersion, typically expressed as a percentage. It facilitates comparisons of variability between populations that have different mean values. A CV greater than 1 indicates significant variation in the distribution, whereas a CV less than 1 suggests lower variability. In this study, CV is utilized to illustrate the relative degree of fluctuation in the level of underpricing across various companies.

The calculation of CV is as follows:

$$CV = \sigma/\mu$$

Where,

CV = Coefficient of Variation

σ = standard deviation of the population

μ = population mean

3.6 Research Framework & Definition of Variables

| Variable Description | Variable | Definition |
|-----------------------------|-------------------------------|---|
| Dependent | Underpricing (Initial Return) | The initial return denotes the difference between a stock's price on its first day of trading and its IPO price. It |

| | | |
|-------------|--------------------------|---|
| | | can be either positive or negative. |
| Independent | Firm Size | The size of the firm may influence outcomes, as larger firms typically possess more capital, potentially reducing investor uncertainty. |
| | Earnings Per Share | EPS offers insights into a company's revenue generation capability. |
| | Profitability | Profitability assesses a company's ability to generate profit, often measured by various financial ratios. |
| | Financial Leverage | Financial leverage indicates a firm's capacity to meet obligations using its total assets. |
| | Underwriter's Reputation | Underwriter's reputation serves as a measure of the quality or reliability of underwriters involved in a company's stock offering. |

Source: Abbas et al, (2022)

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

This chapter focuses on presenting and analyzing data in order to draw conclusions. Primary data is utilized to analyze aspects such as public awareness, responses, expectations, and investment preferences. Secondary data is used to examine public responses to initial public offerings annually and by sector, including oversubscription, undersubscription, growth trends in public offerings, and general investor behavior.

4.1 Presentation and Analysis of Secondary Data

4.1.1 Year wise Analysis of Different Securities with their Number and Amount

Table 2 displays the year-wise analysis of various securities issued over the past decade, from fiscal year 2013/014 to 2022/023.

Table 2

Year Wise Analysis of Different Securities with Their Number and Amount in Arba.

| SN | Year | Primary Share | | Right share | | Further share | | Debenture | |
|--------------|----------|---------------|--------------|---------------|---------------|---------------|--------------|--------------|---------------|
| | | Number | Amount | Number | Amount | Number | Amount | Number | Amount |
| 1 | 2013/014 | 16.00 | 1.57 | 26.00 | 4.24 | - | - | 3.00 | 1.45 |
| 2 | 2014/015 | 18.00 | 6.98 | 22.00 | 2.31 | - | - | 5.00 | 2.90 |
| 3 | 2015/016 | 14.00 | 2.76 | 37.00 | 9.40 | 3.00 | 5.83 | - | - |
| 4 | 2016/017 | 17.00 | 1.50 | 76.00 | 45.64 | 4.00 | 7.99 | - | - |
| 5 | 2017/018 | 21.00 | 8.30 | 55.00 | 25.70 | 6.00 | 11.50 | 1.00 | 3.00 |
| 6 | 2018/019 | 28.00 | 7.35 | 19.00 | 5.88 | - | - | 12.00 | 29.98 |
| 7 | 2019/020 | 9.00 | 3.99 | 11.00 | 4.41 | - | - | 12.00 | 23.45 |
| 8 | 2020/021 | 22.00 | 15.19 | 7.00 | 14.05 | - | - | 23.00 | 69.60 |
| 9 | 2021/022 | 28.00 | 7.20 | 11.00 | 4.79 | - | - | 10.00 | 31.20 |
| 10 | 2022/023 | 42.00 | 22.37 | 7.00 | 15.98 | 1.00 | 0.04 | 12.00 | 31.00 |
| Total | | 215.00 | 77.21 | 271.00 | 132.40 | 14.00 | 25.36 | 78.00 | 192.58 |

(Source – Annual Report of SEBON on respective year)

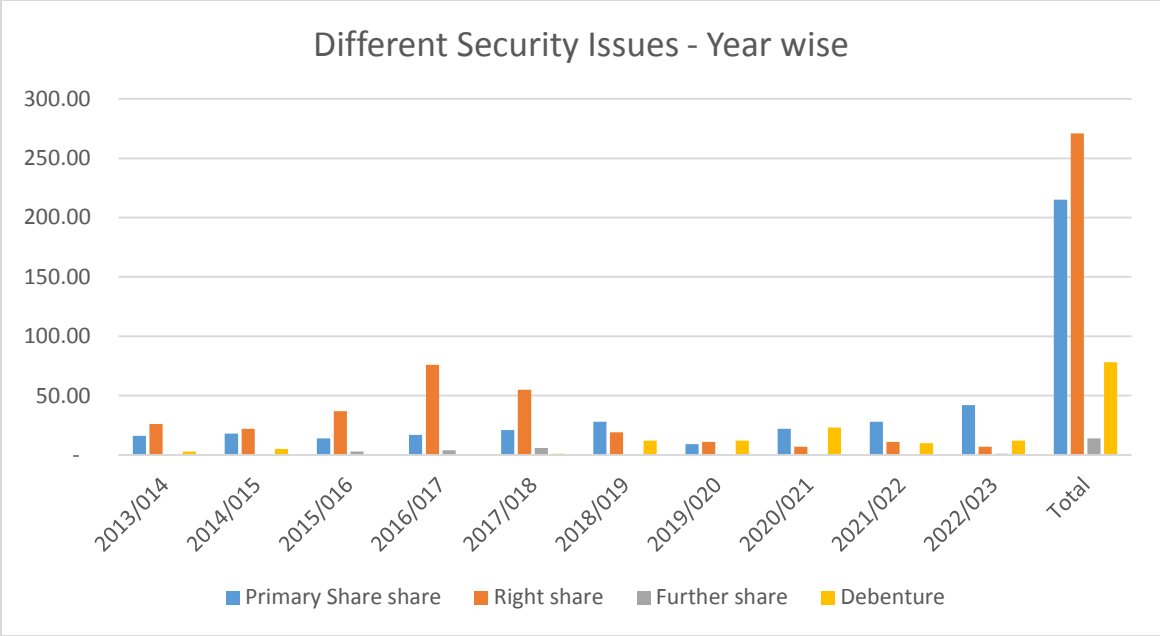


Fig. 1 – Different securities Issues- Year wise (Source - Analysis of different securities in the last 10 fiscal year of respective year)

Table 2 and Figure 1 indicate that additional share issuances occurred only four times and debenture issuances only six times over the ten fiscal years covered in the study period. This underscores the Nepalese Stock Market's heavy reliance on a limited number of instruments such as primary shares, ordinary shares, and rights shares. This heavy dependence restricts investment opportunities for the public and curtails the overall growth potential of the Nepalese Stock Market.

Table 3

The Analysis of NEPSE Index

| Year | | Yearly NEPSE index |
|--------------|--------------------|--------------------|
| English Year | Nepali Fiscal Year | |
| 2013/014 | 2070/071 | 1,036.11 |
| 2014/015 | 2071/072 | 961.23 |
| 2015/016 | 2072/073 | 1,718.15 |
| 2016/017 | 2073/074 | 1,582.67 |
| 2017/018 | 2074/075 | 1,212.36 |
| 2018/019 | 2075/076 | 1,259.02 |
| 2019/020 | 2076/077 | 1,362.65 |
| 2020/021 | 2077/078 | 2,883.41 |
| 2021/022 | 2078/079 | 2,009.47 |
| 2022/023 | 2079/080 | 2,097.10 |

(Source –SEBON annual report of respective year)

4.1.2 The Analysis of NEPSE Index with Turnover and Capitalization

The table below presents the annual NEPSE index, along with details on the number of companies and yearly turnover values.

Table 4

The Analysis of NEPSE Index with Turnover and Capitalization

| SN | Year | No. of Companies | Market Capitalization | Yearly Turnover Values in Rs. | Yearly NEPSE index |
|----|----------|------------------|-----------------------|-------------------------------|--------------------|
| 1 | 2013/014 | 233 | 1,050.17 | 77.3 | 1,036.11 |
| 2 | 2014/015 | 232 | 989.40 | 65.33 | 961.23 |
| 3 | 2015/016 | 230 | 1,890.13 | 163.95 | 1,718.15 |
| 4 | 2016/017 | 208 | 1,856.82 | 205.2 | 1,582.67 |
| 5 | 2017/018 | 196 | 1,435.10 | 121.4 | 1,212.36 |

| | | | | | |
|----|----------|-----|----------|---------|----------|
| 6 | 2018/019 | 215 | 1,567.50 | 110.07 | 1,259.02 |
| 7 | 2019/020 | 212 | 1,792.76 | 150.03 | 1,362.65 |
| 8 | 2020/021 | 219 | 4,010.96 | 1454.44 | 2,883.41 |
| 9 | 2021/022 | 234 | 2,869.34 | 1202.1 | 2,009.47 |
| 10 | 2022/023 | 254 | 3,082.52 | 467.12 | 2,097.10 |

(Source: Annual Report of SEBON 2013/014 to 2022/023)

Figure 2 depicts the NEPSE index over the past eleven fiscal years, spanning from 2013/014 to 2022/023. During this period, the NEPSE index exhibited a modest increase from FY 2015/016 to 2016/017 by approximately 500 points, followed by significant growth in FY 2020/021 by around 1500 points, and further growth in FY 2021/022 by 2200 points. However, beginning in FY 2021/022, the trend reversed, with a decline observed up to FY 2022/023 by approximately 1200 points. This illustrates the high volatility of the Nepalese Stock Market. The NEPSE index ranged from a minimum of 1000 in fiscal year 2014/015 to a maximum of 3200 in fiscal year 2021/022.

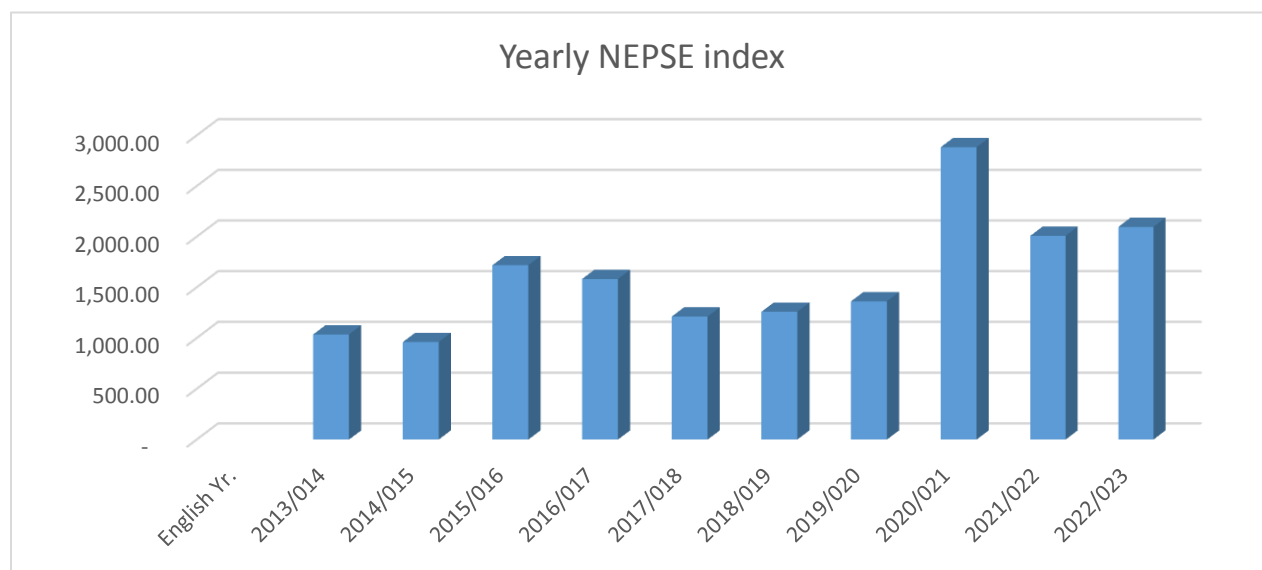


Fig. 2 – Yearly NEPSE Index (Source: Annual Report of SEBON 2013/014 to 2022/023)

4.1.3 Total Paid-up Capital & Listed Companies Ratio

As of the end of fiscal year 2022/023, the paid-up value of listed securities amounted to Rs.126,486 million.

Table 5

Listed Company Occupied Ratio on Total Market

| SN | Sector | No. of listed company | Total Occupied (%) |
|----|------------------------------------|-----------------------|--------------------|
| A | <u>Financial Sector</u> | | |
| 1 | Commercial Bank | 20 | 10.26% |
| 2 | Development Bank | 16 | 8.21% |
| 3 | Finance Companies | 20 | 10.26% |
| 4 | Micro-Finance | 59 | 30.26% |
| 5 | Life Insurance Companies | 8 | 4.10% |
| 6 | Non-Life Insurance Companies | 13 | 6.67% |
| B | <u>Non-Financial Sector</u> | | |
| 7 | Mfg. and Pro. Co | 19 | 9.74% |
| 8 | Trading Co. | 4 | 2.05% |
| 9 | Hotels & Tourism | 7 | 3.59% |
| 10 | Hydro power | 79 | 40.51% |
| 11 | Investment Company | 6 | 3.08% |
| 12 | Other | 3 | 1.54% |

(Source: Report scbonp.com 2022/023)

Commercial banks account for 10.26% of the total value, while development banks hold 8.21%. Finance companies, with 10.26%, represent a slightly lower proportion compared to development banks. The paid-up value of securities at the end of the fiscal year is illustrated in the figure:

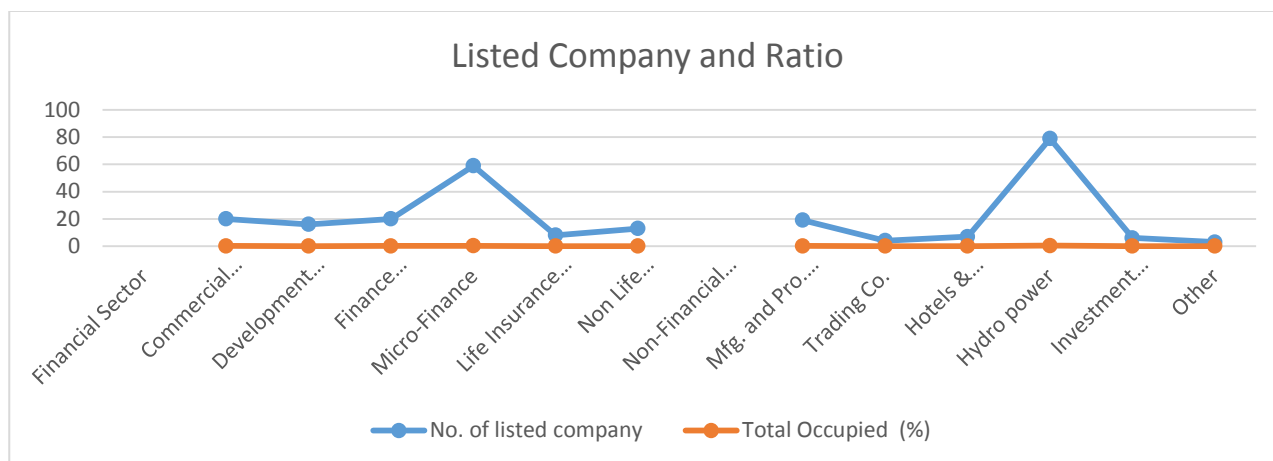


Fig: 3 –Listed Company and Ratio (Source: Report scbonp.com 2022/023)

Table 6

Yearly Volume of Traded Stocks and NEPSE Index

| Yearly Volume of Traded Stocks and NEPSE Index | | | | | | |
|--|--------------|--------------------|------------------|---------------------------------|----------------------------------|--------------------|
| SN | Year | | No. of Companies | Market Capitalization (in Arba) | Turnover Values in Rs. (in Arba) | Yearly NEPSE index |
| | English year | Nepali Fiscal year | | | | |
| 1 | 2013/014 | 2070/071 | 233 | 1,050.17 | 77.3 | 1,036.11 |
| 2 | 2014/015 | 2071/072 | 232 | 989.40 | 65.33 | 961.23 |
| 3 | 2015/016 | 2072/073 | 230 | 1,890.13 | 163.95 | 1,718.15 |
| 4 | 2016/017 | 2073/074 | 208 | 1,856.82 | 205.2 | 1,582.67 |
| 5 | 2017/018 | 2074/075 | 196 | 1,435.10 | 121.4 | 1,212.36 |
| 6 | 2018/019 | 2075/076 | 215 | 1,567.50 | 110.07 | 1,259.02 |
| 7 | 2019/020 | 2076/077 | 212 | 1,792.76 | 150.03 | 1,362.65 |
| 8 | 2020/021 | 2077/078 | 219 | 4,010.96 | 1454.44 | 2,883.41 |
| 9 | 2021/022 | 2078/079 | 234 | 2,869.34 | 1202.1 | 2,009.47 |
| 10 | 2022/023 | 2079/080 | 254 | 3,082.52 | 467.12 | 2,097.10 |

(Source: Trading Report of NPESE & Annual Report SEBON of respective years)

Table 6 depicts the trend of the capital market over the past decade. Based on the table, it is evident that market indicators for securities have shown a significant upward trend compared to transactions over the last seven years. Specifically, in Fiscal year 2077/078, there was a dramatic

increase in the number of shares traded, turnover, transaction value, and market index.

4.1.4 Number of IPO Approved and Amount Volume

The Securities Act of 2063 mandates that any company planning an Initial Public Offering (IPO) must obtain approval from the Securities Board of Nepal (SEBON) before making their offer to the public. Since the inception of SEBON, 262 issues totaling Rs.25,565 million have received issue approval to date (SEBON, 2008). According to securities regulations, companies approved for issuing securities must conduct their offering within two months from the approval date (Security Registration and Issue Approval Guidelines, 2002). This timeframe may lead to discrepancies between the approved amount and the actual amount issued in a fiscal year. Therefore, for precise analysis, this study concentrates on the actual amount of securities issued during the fiscal year rather than the amount approved by SEBON. The table displays the quantity of public issues offered throughout the study period alongside their respective growth rates.

Table 7

Number of IPO Approved and Amount Volume

Rs. In Million

| SN | Year | No. of Public Issue | Amount of Public Issue |
|--------------------------------|----------|---------------------|------------------------|
| 1 | 2013/014 | 45 | 7,270.00 |
| 2 | 2014/015 | 48 | 14,430.00 |
| 3 | 2015/016 | 55 | 18,990.00 |
| 4 | 2016/017 | 101 | 59,390.00 |
| 5 | 2017/018 | 87 | 53,300.00 |
| 6 | 2018/019 | 65 | 49,760.00 |
| 7 | 2019/020 | 34 | 33,650.00 |
| 8 | 2020/021 | 61 | 108,740.00 |
| 9 | 2021/022 | 56 | 50,630.00 |
| 10 | 2022/023 | 82 | 96,040.00 |
| Total in last Ten Years | | | 492,200.00 |

(Source – SEBON annual report of respective year till 2022/023)

Table 7 illustrates the fluctuating nature of public issues since SEBON's inception. In the fiscal year 2013/014, the issues amounted to Rs.7,270 million, doubling to Rs.14,430 million in 2014/015. Subsequent years showed upward trends until 2016/017, with issues reaching Rs.18,990 million in 2015/016 and Rs.59,390 million in 2016/017. Thereafter, the amount declined to Rs.53,300 million in 2017/018, continued decreasing until 2019/020, and surged again to Rs.108,740 million in 2020/021. It dropped in 2021/022 to Rs.50,630 million but rose again in 2022/023 to Rs.96,040 million. Over the ten-year study period, the total issued amount was Rs.492,200 million.

From Figure 4, the substantial coefficient of the trend line indicates that the amount of public issues offered has generally followed an upward or stable trend throughout the study period. The highest amount of public issue occurred in the year 2020/021, totaling Rs.108,740 million, while the lowest amount was recorded in 2013/014 at Rs.7,270 million. Over the entire study duration, the cumulative amount of public issues reached Rs.492,200 million. According to the log-linear model, the instantaneous growth rate of the issued amount is estimated at 10% per year, with a compounded growth rate of 15.80% over the study period, demonstrating sustained growth in issued amounts during this timeframe.

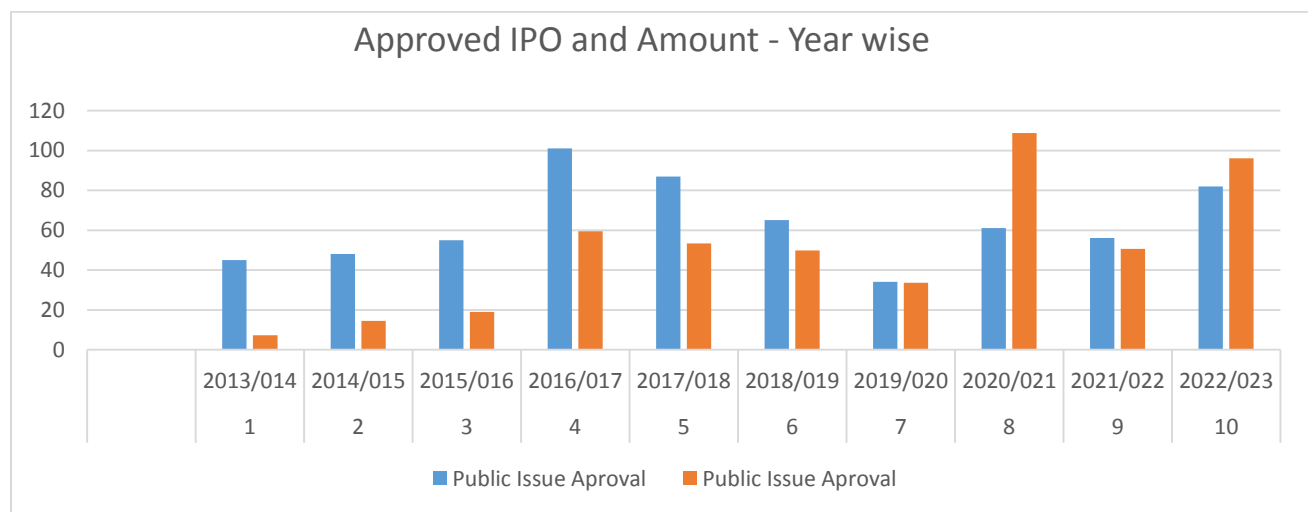


Fig: 4 – Approved IPO and Amount – Year Wise (Source – SEBON annual report of respective year)

4.1.5 Analysis of Subscription Pattern of Issues

When a company introduces its shares to the public, the demand level can vary. If the number of shares demanded exceeds those offered, it is termed as oversubscription. Conversely, if the number of shares demanded is less than those offered, it is referred to as undersubscription. When the offered and demanded shares are equal, it constitutes full subscription.

Table 8

Analysis of Subscription Pattern of Issues

| SN | Sector | Issuing Company | Issued Amount | Subscription Times | Result |
|----|------------------|----------------------------|---------------|--------------------|-----------------|
| 1 | Commercial Bank | Bank of Kathmandu Ltd. | 45 | 5.36 | Oversubscribed |
| | | Lumbini Bank Ltd. | 150 | 7.21 | Oversubscribed |
| | | Nepal Credit & Commerce | 210 | 1.22 | Oversubscribed |
| | | Nirdhan Uthan Bank Ltd. | 3.3 | 3.88 | Oversubscribed |
| 2 | Development Bank | Gandaki Development Bank | 15 | 3.98 | Oversubscribed |
| | | Excel Development Bank | 6 | 18.97 | Oversubscribed |
| | | Infrastructure Development | 24 | 9.36 | Oversubscribed |
| 3 | Finance Company | Annapurna Finance Co. | 2 | 28.04 | Oversubscribed |
| | | Nepal Abas Bikash Bitta | 20 | 0.94 | Undersubscribed |
| | | Narayani Finance Ltd. | 4 | 1.72 | Oversubscribed |
| | | Yeti Finance Co. Ltd. | 8 | 2.20 | Oversubscribed |

| | | | | | |
|---|----------------------|------------------------------|------|-------|----------------|
| | | Universal Finance Ltd. | 3.3 | 4.52 | Oversubscribed |
| | | Lalitpur Finance Co. Ltd. | 9.5 | 1.06 | Oversubscribed |
| | | Pashchimanchal Finance | 8 | 1.47 | Oversubscribed |
| | | Alpic Everest Finance Ltd | 5 | 42.17 | Oversubscribed |
| | | International Leasing & | 30 | 21.70 | Oversubscribed |
| | | United Finance Ltd. | 24 | 10.55 | Oversubscribed |
| | | Standard Finance Ltd. | 24 | 3.63 | Oversubscribed |
| | | Fewa Finance Co. Ltd. | 8 | 23.55 | Oversubscribed |
| | | Birjung Finance Ltd. | 24 | 7.05 | Oversubscribed |
| | | ICFC Bittiya Sanstha Ltd | 24.4 | 35.06 | Oversubscribed |
| | | Kuber Merchant Bittiya | 22.5 | 4.45 | Oversubscribed |
| | | Neco Insurance Co. Ltd. | 20 | 1.21 | Oversubscribed |
| | | Nepal Life Insurance Co. | 50 | 7.56 | Oversubscribed |
| 4 | Insurance Company | Prudential Insurance Co. | 20 | 9.57 | Oversubscribed |
| | | Shikhar Insurance Co. | 25 | 43.76 | Oversubscribed |
| | | Nepal Reinsurance Company | 1600 | 1.57 | Oversubscribed |
| 5 | Manufacturing | Unilever Nepal Ltd. | 13.8 | 6.54 | Oversubscribed |

| | | | | |
|----------------|---------------------------|------|-------|-----------------|
| and Processing | Himgiri Textile Industry | 19.2 | 1.57 | Oversubscribed |
| Company | Sri Ram Sugar Mills Ltd. | 46.5 | 0.53 | Undersubscribed |
| | Sarbottam Cement Limited | 4650 | 19.32 | Oversubscribed |
| | Nepal Infrastructure Bank | 8000 | 1.80 | Oversubscribed |

(Source – NRB Website, SEBON annual report of respective year till 2022/023, Annual report of NEPSE, Sharesansar website, CDSC website and investopaper.com)

SEBON classifies all listed companies into ten sectors: commercial banks, development banks, finance companies, insurance companies, manufacturing and processing companies, trading companies, investor groups, hydropower, hotels & tourism, and others. Table 8 illustrates the subscription status of issues from institutions within commercial banks, development banks, finance companies, insurance companies, and manufacturing and processing companies. Sectors with fewer companies like trading companies, hotels, and others are excluded due to their limited representation within the study period.

From Table 8, it is evident that among the sampled commercial banks, Lumbini Bank Ltd. had the highest subscription demand with a subscription ratio of 7.21, while Nepal Credit and Commerce Bank Ltd. experienced the lowest demand at 1.22 times. However, all selected firms exhibited subscription ratios exceeding one, indicating oversubscription across all offerings.

Similarly, among the sampled development banks, four companies had subscription ratios around 9, indicating oversubscription in this sector as well.

In the finance companies sector, only one out of fifteen sampled companies had a subscription ratio below 1 (0.94), indicating undersubscription. The remaining fourteen companies had subscription ratios above 1, with Alpic Everest Finance Ltd. reaching as high as 42.17 times and Lalitpur Finance Co. Ltd. at 1.06 times.

Among the sampled insurance companies, Shikhar Insurance Co. Ltd. had the highest subscription ratio of 43.76 times. All sampled issues in this sector had subscription ratios greater than 1, indicating oversubscription.

In the manufacturing and processing sector, all sampled issues had subscription ratios above 1. Subscription ratios ranged from a high of 19.32 times for Sarbottam Cement Limited to a low of 0.53 times for Sri Ram Sugar Mills Ltd.

Overall, IPOs from commercial banks, development banks, and insurance companies were oversubscribed, indicating strong demand from the general public. Similarly, most IPOs from finance companies received positive responses, with only one issue experiencing undersubscription. This trend suggests that IPOs from the financial sector generally attracted significant interest during the study period.

In contrast, the manufacturing and processing sector received a less enthusiastic response from the public, with one-third of sampled companies experiencing undersubscription.

While the number of sampled issues across sectors may be limited, these findings provide insights into why IPOs are increasing in the financial sector while facing challenges in non-financial sectors like manufacturing and processing.

4.2 Analyzing Underpricing of IPOs in Nepal

Numerous studies conducted worldwide over varying time periods have consistently shown the presence of underpricing in IPO markets. This study investigates whether underpricing exists in the Nepalese IPO market. To evaluate the degree of underpricing or initial return of the offerings, J.R. Ritter's model has been utilized.

According to this model, the initial return or underpricing is determined by subtracting the offer price from the closing price on the first trading day of the issue, and then dividing this difference by the offer price.

As depicted in Table 9, all sampled companies issued their shares at a face value of Rs. 100 each. Although existing security guidelines allow for issuance of common shares at a discount or premium, none of the companies exercised this option. The data clearly shows that most issues had a closing price on the first trading day that was higher than the offered price, indicating they were underpriced at the time of their issuance.

Table 9

Underpricing of IPOs in Nepal

| SN | Listing Date | Company | Offer Price | 1 st Day Closing Price | Initial Return (%) |
|----|--------------|----------------------------------|-------------|-----------------------------------|--------------------|
| 1 | 02.09.1994 | Annapurna Finance Co. Ltd. | 100 | 366 | 266 |
| 2 | 22.09.1994 | Unilever Nepal Ltd. | 100 | 485 | 385 |
| 3 | 28.05.1995 | Himgiri Textile Industries Ltd. | 100 | 53 | -47 |
| 4 | 01.05.1996 | Nepal Abas Bikash Bitta Co. Ltd. | 100 | 50 | -50 |
| 5 | 25.06.1996 | Narayani Finance Ltd. | 100 | 110 | 10 |
| 6 | 23.01.1997 | Yeti Finance Co. Ltd. | 100 | 96 | -4 |
| 7 | 10.04.1997 | Universal Finance Ltd. | 100 | 50 | -50 |
| 8 | 17.07.1997 | Bank of Kathmandu Ltd. | 100 | 171 | 71 |
| 9 | 30.03.1998 | Neco Insurance Co. Ltd. | 100 | 99 | -1 |
| 10 | 08.10.1998 | Lalitpur Finance Co. Ltd. | 100 | 75 | -25 |
| 11 | 18.04.1999 | Sri Ram Sugar Mills Ltd. | 100 | 50 | -50 |
| 12 | 20.05.1999 | Pashchimanchal Finance Co. Ltd. | 100 | 112 | 12 |
| 13 | 12.10.2001 | Alpic Everest Finance Ltd. | 100 | 264 | 164 |
| 14 | 26.11.2002 | International Leasing & Finance | 100 | 126 | 26 |
| 15 | 26.11.2002 | United Finance Ltd. | 100 | 123 | 23 |
| 16 | 22.01.2003 | Nepal Life Insurance Co. Ltd. | 100 | 145 | 45 |
| 17 | 24.04.2003 | Nirdhan Uthan Bank Ltd. | 100 | 100 | 0 |
| 18 | 17.09.2004 | Fewa Finance Co. Ltd. | 100 | 165 | 65 |
| 19 | 10.11.2004 | Lumbini Bank Ltd. | 100 | 134 | 34 |
| 20 | 10.11.2004 | Prudential Insurance Co. Ltd. | 100 | 150 | 50 |
| 21 | 02.03.2005 | Standard Finance Ltd. | 100 | 122 | 22 |

| | | | | | |
|----|------------|---|-----|-----|-----|
| 22 | 31.03.2005 | Nepal Credit & Commerce Bank | 100 | 110 | 10 |
| 23 | 20.03.2005 | Birjung Finance Ltd. | 100 | 103 | 3 |
| 24 | 21.01.2005 | Butwal Power Company Limited (BPCL) | 100 | 280 | 180 |
| 25 | 29.06.2006 | Gandaki Development Financial | 100 | 115 | 15 |
| 26 | 13.02.2007 | Shikhar Insurance Co. Ltd. | 100 | 270 | 170 |
| 27 | 11.10.2007 | ICFC Bittiya Sanstha Ltd. | 100 | 350 | 250 |
| 28 | 06.11.2007 | Excel Development Bank Ltd. | 100 | 570 | 470 |
| 29 | 24.04.2008 | Infrastructure Development Bank | 100 | 550 | 450 |
| 30 | 13.05.2008 | Kuber Merchant Bittiya Sanstha | 100 | 309 | 209 |
| 31 | 20.03.2011 | NMB Bank Limited (NMB) | 100 | 250 | 150 |
| 32 | 20.03.2011 | Siddhartha Bank Limited (SBL) | 100 | 263 | 163 |
| 33 | 17.12.2012 | Nepal Bank Limited (NBL) | 100 | 394 | 294 |
| 34 | 14.07.2013 | NIC Asia Bank Limited (NICA) | 100 | 489 | 389 |
| 35 | 04.10.2016 | Prabhu Bank Limited (PRVU) | 100 | 437 | 337 |
| 36 | 29.09.2016 | Kumari Bank Limited (KBL) | 100 | 380 | 280 |
| 37 | 14.02.2021 | Nepal Infrastructure Bank Limited | 100 | 372 | 272 |
| 38 | 30.06.2020 | Himal Dolakha Hydropower Company Limited (HDHPC) | 100 | 88 | -12 |
| 39 | 29.06.2020 | Nepal Reinsurance Company Limited | 100 | 382 | 282 |
| 40 | 26.08.2020 | NRN Infrastructure and Development Limited (NRN) | 100 | 335 | 235 |
| 41 | 06.08.2020 | Sadhana Laghubitta Bittiya Sanstha Limited (SDLBSL) | 100 | 396 | 296 |
| 42 | 16.12.2020 | Mountain Energy Nepal Limited (MEN) | 100 | 378 | 278 |
| 43 | 12.12.2020 | United Idi-Mardi and R.B. Hydropower Limited (UMRH) | 100 | 325 | 225 |

| | | | | | |
|----------------|------------|--|-----|-----|-------------|
| 44 | 07.02.2021 | Chandragiri Hills Limited (CGH) | 100 | 164 | 64 |
| 45 | 16.03.2021 | Greenlife Hydropower Limited (GLH) | 100 | 327 | 227 |
| 46 | 16.03.2021 | Mahila Laghubitta Bittiya Sanstha Limited (MLBSL) | 100 | 445 | 345 |
| 47 | 11.08.2022 | Upper Hewakhola Hydropower Company Limited (UHEWA) | 100 | 143 | 43 |
| 48 | 07.12.2023 | Trishuli Jal Vidhyut Company Limited (TVCL) | 100 | 294 | 194 |
| 49 | 17.07.2023 | Samaj Laghubitta Bittiya Sanstha Limited (SAMAJ) | 100 | 72 | -28 |
| 50 | 17.07.2023 | United Ajod Insurance Limited (UAIL) | 100 | 538 | 438 |
| Average | | | | | 7175 |

(Source – SEBON annual report of respective year till 2022/023, Annual report of NEPSE, and Sharesansar website)

Among the 50 sampled IPOs, only 9 had their first trading day's closing price lower than their offer price, indicating instances of overpricing in the Nepalese market. Furthermore, two issues closed at the same price as their offer price, while the remaining 32 issues had a first trading day's closing price higher than their offer price, indicating underpricing. Among these underpriced issues, Excel Development Bank Ltd. recorded the highest initial return of 470%, whereas Birgunj Finance Ltd. had the lowest initial return of 3%. Therefore, the average initial return for Nepalese IPOs is approximately 87%.

Comparing underpricing in IPOs across various emerging markets, Gasbarro (2003) noted an average first-day underpricing of 10.6% in Mauritius, while Paudyel (1998) reported 62% initial underpricing in Malaysia. Similarly, J.R. Ritter (1998) revealed average initial returns of 31.4% for Singapore, 35.3% for India, 45% for Taiwan, and 58.1% for Thailand. These findings suggest that the average first-day return of IPOs in Nepal is comparable to those observed in other emerging markets worldwide.

The average standard deviation for the initial return on stock prices of Nepalese IPOs is reported as 30.24%. In contrast, Gasbarro (2003) reported a standard deviation of 11.47% in Mauritius.

This suggests that the fluctuation in the first-day stock price return of Nepalese IPOs is relatively high, indicating that the initial day returns of Nepalese company issues are more variable compared to those reported in Mauritius and other studies.

4.2.1 Sector Wise Analysis of Underpricing of IPOs in Nepal

Table 10 provides data that explains different aspects of IPO underpricing across five distinct sectors: commercial banks, development banks, finance companies, microfinance companies, insurance companies, hydropower, and manufacturing and processing companies.

Table 10

Sector-wise Analysis of Underpricing of IPOs in Nepal

| SN | Sector | Issuing Company | Initial Returns | Average Initial Return | Standard Deviation (o) | CV |
|-------------------------|-----------------|-------------------------------|-----------------|------------------------|------------------------|-------|
| 1 | Commercial Bank | Nepal Investment Mega Bank | 71 | 192 | 120.52 | 67.98 |
| | | Lumbini Bank Ltd. | 34 | | | |
| | | NMB Bank Limited (NMB) | 150 | | | |
| | | Siddhartha Bank Limited (SBL) | 163 | | | |
| | | Nepal Bank Limited (NBL) | 294 | | | |
| | | NIC Asia Bank Limited (NICA) | 389 | | | |
| | | Prabhu Bank Limited (PRVU) | 337 | | | |
| | | Kumari Bank Limited (KBL) | 280 | | | |
| Nepal Credit & Commerce | 10 | | | | | |

| | | | | | | |
|---|-------------------|---|-----|--------|--------|-------|
| | | Nirdhan Uthan Bank Ltd. | - | | | |
| | | Gandaki Development Bank | 15 | | | |
| | | Excel Development Bank | 470 | | | |
| 2 | Development Banks | Nepal Infrastructure Bank Limited (NIFRA) | 272 | 240.33 | 191.61 | 79.73 |
| | | NRN Infrastructure and Development Limited (NRN) | 235 | | | |
| | | Infrastructure Development | 450 | | | |
| | | Mahila Laghubitta Bittiya Sanstha Limited (MLBSL) | 345 | | | |
| 3 | Micro Finance | Samaj Laghubitta Bittiya Sanstha Limited (SAMAJ) | -28 | 204.33 | 165 | 81.22 |
| | | Sadhana Laghubitta Bittiya Sanstha Limited (SDLBSL) | 296 | | | |
| | | Annapurna Finance Co. | 266 | | | |
| | | Nepal Abas Bikash Bitta | -50 | | | |
| | | Narayani Finance Ltd. | 10 | | | |
| | | Yeti Finance Co. Ltd. | -4 | | | |
| 4 | Finance Companies | Universal Finance Ltd. | -50 | 61.4 | 102.99 | 167.7 |
| | | Lalitpur Finance Co. Ltd. | -25 | | | |
| | | Pashchimanchal Finance | 12 | | | |
| | | Alpic Everest Finance Ltd. | 164 | | | |
| | | International Leasing & | 26 | | | |

| | | | | | | |
|---|--------------------------------------|---|-----|--------|--------|-------|
| | | Finance | | | | |
| | | United Finance Ltd. | 23 | | | |
| | | Standard Finance Ltd. | 22 | | | |
| | | Fewa Finance Co. Ltd. | 65 | | | |
| | | Birjung Finance Ltd. | 3 | | | |
| | | ICFC Bittiya Sanstha Ltd. | 250 | | | |
| | | Kuber Merchant Bittiya | 209 | | | |
| | | Neco Insurance Co. Ltd. | -1 | | | |
| | | Nepal Life Insurance Co. | 45 | | | |
| 5 | Insurance Companies | Prudential Insurance Co. | 50 | 140.4 | 177.72 | 126.6 |
| | | United Ajod Insurance Limited (UAIL) | 438 | | | |
| | | Shikhar Insurance Co. Ltd. | 170 | | | |
| | | Unilever Nepal Ltd. | 385 | | | |
| 6 | Manufacturing & Processing Companies | Himgiri Textile Industries | -47 | | | |
| | | Sri Ram Sugar Mills Ltd. | -50 | 88 | 179.5 | 204 |
| | | Chandragiri Hills Limited (CGH) | 64 | | | |
| | | Mountain Energy Nepal Limited (MEN) | 278 | | | |
| 7 | Hydro Power | United Idi-Mardi and R.B. Hydropower Limited (UMRH) | 225 | 162.14 | 98.15 | 60.53 |

| | |
|--|-----|
| Greenlife Hydropower Limited (GLH) | 227 |
| Upper Hewakhola Hydropower Company Limited (UHEWA) | 43 |
| Trishuli Jal Vidhyut Company Limited (TVCL) | 194 |
| Himal Dolakha Hydropower Company Limited (HDHPC) | -12 |
| Butwal Power Company Limited (BPCL) | 180 |

(Source – SEBON annual report of respective year till 2022/023, Annual report of NEPSE, and Sharesansar website)

Table 10 provides insights into IPO underpricing across different sectors. Among the 9 sampled commercial banks, NIC Asia Bank Limited (NICA) had the highest initial return of 389%, while Nepal Credit and Commerce Bank Ltd. had the lowest at 10%. The sector's average initial return was 192%, with a standard deviation of 120.52%, marginally lower than NEPSE's average initial return.

In the development bank sector, out of 6 sampled issues, one did not provide an initial return. The sector's average initial return was 240.33%, with a standard deviation of 191.61%.

Finance companies showed variability, with 4 issues experiencing negative initial returns. Initial returns ranged from 3% to 266%, averaging at 61.40%, with a standard deviation of 102.99%. Both the average initial return and standard deviation were higher than NEPSE's overall figures, indicating greater variability among the sector's issues.

Among insurance companies, one IPO had a negative initial return, while others ranged from 45% to 438%, resulting in an average initial return of 140.4% and a standard deviation of 177.72%. These figures also surpassed NEPSE's averages, suggesting higher variability in the sector's IPO performance.

For the manufacturing and processing sector, initial returns varied widely from -47% to 385%. The sector averaged an initial return of 88% with a high standard deviation of 204%. This sector exhibited the highest variability compared to NEPSE and other sectors studied.

From the coefficient of variation (CV) perspective, the hydro power sector had the lowest CV at 60.53%, indicating lower risk in average initial returns. Commercial banks followed with a CV of 67.98%, while development banks, microfinance companies, and insurance companies had CVs of 79.13%, 81.22%, and 126.6% respectively, indicating higher variability and risk. Finance companies and manufacturing and processing sectors showed the highest CVs at 204%, indicating the highest variability and risk in their average initial returns among all sectors studied.

In summary, commercial banks had the lowest risk in average initial returns based on CV, while manufacturing and processing companies exhibited the highest risk. This analysis suggests significant variability in IPO performance across different sectors in Nepal.

4.3 IPO Underpricing and Subscription Pattern

In Nepalese IPO market, all sampled companies issued their IPOs at the face value of Rs.100, despite regulations allowing for premiums. The role of merchant bankers in pricing issues appears limited in this context. Given these observations, it is pertinent to examine whether a relationship exists between IPO underpricing and subscription patterns in Nepal.

Table 11

Subscription Pattern of the Issue from Different Sector

Rs. Million

| SN | Sector | Issuing Company | Issued Amount | Subscription Times | Result |
|----|-----------------|-------------------------|---------------|--------------------|----------------|
| 1 | Commercial Bank | Bank of Kathmandu Ltd. | 45 | 5.36 | Oversubscribed |
| | | Lumbini Bank Ltd. | 150 | 7.21 | Oversubscribed |
| | | Nepal Credit & Commerce | 210 | 1.22 | Oversubscribed |
| 2 | Development | Nirdhan Uthan Bank Ltd. | 3.3 | 3.88 | Oversubscribed |

| | | | | | |
|--------------------------|-----------------|----------------------------|-------------------|--------------------------|-----------------|
| 3 | Bank | Gandaki Development Bank | 15 | 3.98 | Oversubscribed |
| | | Excel Development Bank | 6 | 18.97 | Oversubscribed |
| | | Infrastructure Development | 24 | 9.36 | Oversubscribed |
| | | Annapurna Finance Co. | 2 | 28.04 | Oversubscribed |
| | | Nepal Abas Bikash Bitta | 20 | 0.94 | Undersubscribed |
| | | Narayani Finance Ltd. | 4 | 1.72 | Oversubscribed |
| | | Yeti Finance Co. Ltd. | 8 | 2.20 | Oversubscribed |
| | | Universal Finance Ltd. | 3.3 | 4.52 | Oversubscribed |
| | | Lalitpur Finance Co. Ltd. | 9.5 | 1.06 | Oversubscribed |
| | | Pashchimanchal Finance | 8 | 1.47 | Oversubscribed |
| 3 | Finance Company | Alpic Everest Finance Ltd. | 5 | 42.17 | Oversubscribed |
| | | International Leasing & | 30 | 21.70 | Oversubscribed |
| | | United Finance Ltd. | 24 | 10.55 | Oversubscribed |
| | | Standard Finance Ltd. | 24 | 3.63 | Oversubscribed |
| | | Fewa Finance Co. Ltd. | 8 | 23.55 | Oversubscribed |
| | | Birjung Finance Ltd. | 24 | 7.05 | Oversubscribed |
| | | ICFC Bittiya Sanstha Ltd | 24.4 | 35.06 | Oversubscribed |
| | | Kuber Merchant Bittiya | 22.5 | 4.45 | Oversubscribed |
| | | Neco Insurance Co. Ltd. | 20 | 1.21 | Oversubscribed |
| | | 4 | Insurance Company | Nepal Life Insurance Co. | 50 |
| Prudential Insurance Co. | 20 | | | 9.57 | Oversubscribed |

| | | | | | |
|---|--------------------------------------|---------------------------|-------|----------------|-----------------|
| | Shikhar Insurance Co. | 25 | 43.76 | Oversubscribed | |
| | Nepal Reinsurance Company | 1600 | 1.57 | Oversubscribed | |
| | Unilever Nepal Ltd. | 13.8 | 6.54 | Oversubscribed | |
| 5 | Manufacturing and Processing Company | Himgiri Textile Industri | 19.2 | 1.57 | Oversubscribed |
| | | Sri Ram Sugar Mills Ltd. | 46.5 | 0.53 | Undersubscribed |
| | | Sarbottam Cement Limited | 4650 | 19.32 | Oversubscribed |
| | | Nepal Infrastructure Bank | 8000 | 1.80 | Oversubscribed |

(Source – SEBON annual report of respective year till 2022/023, Annual report of NEPSE, and Sharesansar website)

Table 11 illustrates the subscription patterns and initial returns of IPOs across different sectors. In the commercial banks sector, all three sampled issues were oversubscribed with subscription times ranging from 5.36 to 7.21. The initial returns varied with the highest at 71% and the lowest at 10% for Nepal Credit and Commerce Bank Ltd., which received the lowest subscription.

Similarly, in the development banks sector, all four sampled issues were oversubscribed with subscription times nearly reaching 9. Initial returns varied significantly, with one issue yielding no initial return, while others yielded 470% and 450%.

Finance companies such as Annapurna Finance Co. Ltd., Alpic Everest Finance Ltd., International Leasing and Finance Co., and Fewa Finance Co. Ltd. received remarkable responses to their IPOs, with subscription times of 28.04, 42.17, 21.7, and 23.55 respectively. These issues also saw high first-day returns ranging from 26% to 266%. However, Nepal Abas Bikash Bitta Co. Ltd. undersubscribed and yielded a negative initial return, with three oversubscribed issues also yielding negative initial returns.

In the insurance sector, all four sampled companies were oversubscribed, with subscription times ranging from 7.56 to 43.76. Initial returns varied from negative for one issue to high returns of 45%, 50%, and 170% for others.

Finally, in the manufacturing and processing sector, one out of five sampled companies had a highly oversubscribed IPO with a very high initial return of 385%. The remaining companies saw mixed results, with three oversubscribed and one undersubscribed issue, and varied initial returns, including negative returns.

Overall, the data suggests that oversubscribed IPOs tend to have positive initial returns, though there are exceptions. Issues with high oversubscription generally result in very high initial returns, while undersubscribed IPOs tend to yield negative or no initial returns.

4.4 Major Findings of the Study

The primary aim of this study was to comprehensively analyze various sides of IPOs in Nepal. Using data obtained from secondary sources, various statistical tools and models were applied, resulting in the following key findings:

- i. The total amount of issued capital has significantly increased from Rs.7.8 billion in fiscal year 2013/014 to Rs.96.04 billion in fiscal year 2022/023, marking nearly a twelve-fold rise. The trend line coefficient for issued amounts shows a strongly positive relationship. Additionally, the average size of issues offered has increased by Rs.8.87 billion.
- ii. Among the ten sectors analyzed, the commercial banking sector accounted for 30.93% of the total paid-up capital, whereas finance companies represented only 2.01%. The financial sector, encompassing commercial banks, development banks, finance companies, and insurance companies, dominated with 136 offers out of 189, contrasting with 112 offers from the non-financial sector, including manufacturing and processing, trading companies, hotels, and others. Moreover, the financial sector consistently offered around 10 issues per fiscal year compared to approximately 2 issues from the non-financial sector.
- iii. Regarding the types of instruments offered, out of 578 offers, 271 (46.89%) were right shares, followed by primary shares at 215 (37.20%), debentures at 78 (13.49%), and further shares at only 14 (2.42%). In terms of the issued amount, debentures accounted for 45.04% of the total, followed by right shares (30.97%), primary shares (18.06%), and further shares (5.93%).

- iv. Over the study period, 138 companies conducted IPOs for common shares, with 124 companies (87.66%) experiencing oversubscription, 11 companies facing undersubscription, and only 3 companies achieving full subscription.
- v. Sector-wise analysis of subscription patterns indicated full subscription for issues from commercial banks, development banks, and insurance companies. Most issues from finance companies were oversubscribed, while those from the manufacturing and processing sector tended to be undersubscribed.
- vi. According to J.R. Ritter's (1984) model, the study determined that the average level of underpricing (first day's return) was 155.51%, with a standard deviation of 147.92% and a coefficient of variation (CV) of 112.54%.
- vii. From a sectoral perspective, the average initial return and standard deviation were as follows: commercial banks (18%, 17%), development banks (22%, 19%), finance companies (6%, 10%), micro-finance companies (19%, 16%), insurance companies (13%, 17%), manufacturing and processing companies (8%, 17%), and hydro power companies (15%, 9%). Corresponding CVs were commercial banks (9%), development banks (10%), micro-finance companies (10%), finance companies (21%), insurance companies (16%), manufacturing and processing companies (26%), and hydro power companies (8%).
- viii. Among the sampled issues, 32 were oversubscribed, with 21 of those resulting in positive initial returns. Conversely, 2 issues were undersubscribed.

These findings provide a comprehensive overview of the IPO landscape in Nepal, highlighting trends, sectoral variations, and performance metrics related to subscription patterns and initial returns.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter comprises three sections: Summary, Conclusion, and Recommendations. The first part provides an overview of the entire study, the second part outlines the conclusions drawn from the findings, and the final part offers recommendations based on these conclusions.

5.1 Summary

Money or capital is a crucial requirement for any business entity, essential at various stages of its operations. Some enterprises need capital for establishment, while others require it for expansion and achieving growth goals. Typically, businesses acquire capital from two distinct markets: the money market and the capital market. The money market typically supplies short-term financial resources, generally for durations of up to one year, while the capital market provides long-term funding specifically designed to fulfill the requirements of businesses.

The primary market is crucial in raising capital through Initial Public Offerings (IPOs). An IPO marks the initial sale of securities to the public, encompassing both debt and equity offerings. Different facets of the capital market are essential in enabling and overseeing IPO procedures. Notably, investment bankers or underwriters play pivotal roles in these processes. They provide essential functions to ensure that issuing companies adhere to regulatory guidelines and achieve their objectives during IPOs.

In Nepal, the Securities Board of Nepal (SEBON) and the Nepal Stock Exchange (NEPSE) are the principal institutions guiding and overseeing IPO processes. SEBON acts as the regulatory authority overseeing all securities market transactions, including IPOs, while NEPSE serves as Nepal's sole stock exchange, providing liquidity and marketability to the securities offered. By the end of the fiscal year 2022/2023, NEPSE had included 189 companies in its listings.

Despite the establishment of the Security Exchange Centre (SEC) in 1976 AD, marking the foundation of systematic capital market development, Nepal's capital market remains in its early stages even after decades. The securities offered and their practices still largely adhere to traditional norms with limited innovation. Moreover, there is a notable gap in research covering

various aspects of Nepal's capital market. Hence, this study aims to explore and unravel the dynamics of IPOs and their practices within Nepal.

The conceptual review within this study enquires into IPOs, outlining their concepts, advantages, and disadvantages. It positions IPOs as fundamental mechanisms within the primary market and provides a historical perspective on IPOs specific to Nepal. Furthermore, the study analyzes the process of IPOs, detailing their execution within Nepal's context. Additionally, the review of related studies encompasses international research and dissertations focusing on IPOs and IPO underpricing. These studies, primarily sourced from online platforms such as nepalstock.com, sebon.gov.np, nrb.org.np, investopaper.com, sharesansar.com, merolagani.com, and dissertations from St. Xavier's College and T.U libraries, shed light on various patterns associated with IPOs and broader capital market issues.

To achieve its objectives, the study employs a descriptive research design, employing stratified random sampling from a sample frame of 25%. It chooses 50 companies from nine sectors listed on NEPSE: commercial banks, development banks, finance companies, microfinance companies, insurance companies, hydropower companies, hospitality and tourism, and manufacturing and processing companies. The study relies on secondary sources for data, drawn from annual reports of SEBON, trading reports of NEPSE, relevant acts and regulations, and newspapers such as The Kathmandu Post and The Rising Nepal.

Additionally, basic statistical methods such as mean (μ), standard deviation (σ), correlation coefficient (r), and coefficient of variation (CV) are utilized, along with sophisticated tools like J.R. Ritter's (1984) model and log-linear models. Data analysis is conducted manually and aided by sophisticated computer programs such as SPSS, Microsoft Excel, and Word as needed.

The analysis reveals significant findings: the growth of the Nepalese IPO sector over the study period, dominance of the financial sector in the IPO market, preference for ordinary shares as the most offered instrument, and confirmation of underpricing in Nepalese IPOs with an average initial return of 87%. This finding aligns with trends observed in other emerging markets. The study also identifies oversubscription as a prevalent phenomenon during the study period, with a noticeable relationship found between subscription patterns and underpricing. Most oversubscribed issues exhibit positive initial returns, whereas undersubscribed issues do not yield positive returns.

Finally, the analysis segment concludes that the initial return decreases over subsequent days of trading post-IPO, suggesting that investors tend to achieve better returns by selling IPO shares on the first day of trading rather than later days.

5.2 Conclusions

During the study period from 2013/014 to 2022/023, the number of issues offered in the Nepalese IPO market has been increasing annually by 55.20%. This growth trend is featured by a very high positive coefficient of the trend line, indicating a consistent rise in the amount of issues offered throughout the study period. The importance of the financial sector, which includes commercial banks, development banks, finance companies, microfinance companies, and insurance companies, alongside the non-financial sector comprising hydropower, hospitality and tourism, manufacturing and processing, trading, investment groups, and others, is underscored by the significant number of offerings available.

Regarding the type of instruments used during the study period, the most preferred instrument was rights shares, followed by ordinary shares, debentures, and preference shares, respectively, both in terms of the number of issues offered and the amount of capital raised.

Public demand for IPOs has been robust, leading to oversubscription of most companies' issues. Specifically, all sampled companies from commercial banks, development banks, finance companies, hydro power, manufacturing and processing, and insurance sectors experienced oversubscription. Similarly, most issues from finance companies were oversubscribed, while issues from the non-financial sector, particularly the manufacturing and processing sector, were mostly undersubscribed. This illustrates strong public confidence in IPOs offered by financial sector companies, contrasting with less enthusiastic reception for non-financial sector issues.

Underpricing is prevalent in the Nepalese IPO market, with an average underpricing (equally weighted mean) of 144%. The standard deviation, which measures the variability in underpricing levels, indicates significant fluctuation in the underpricing of IPO issues. The manufacturing and processing sector presents the highest risk, while the insurance sector exhibits the lowest risk according to the Coefficient of Variation (CV).

Oversubscribed issues generally yielded initial returns, whereas undersubscribed issues did not yield any initial return. This underscores that companies whose IPOs are heavily demanded by the public tend to justify this support with higher returns on the first day of trading.

Examining the percentage change in offer price during the first, second, and third days of trading shows a decrease in initial returns following the first day. This implies that investors generally fare better by selling IPO shares on the first day rather than holding onto them for subsequent days.

5.3 Recommendations

The Nepalese capital market exhibits a significant dependence on the financial sector, presenting challenges for the comprehensive development of the IPO market and the capital market in its entirety. To foster diversification and broader market participation, regulatory bodies and the government should take proactive steps. Encouraging public issues from sectors like manufacturing and processing through incentives such as tax reductions could help balance the market and stimulate growth.

Ordinary shares and rights shares are predominantly used financial instruments, while preference shares and debentures are rarely issued. It's crucial to recognize that ordinary shares not only entail significant risk for investors but also lead to ownership dilution for issuing companies. Addressing the root causes behind these dynamics is essential. Regulatory frameworks should be revisited to ensure they enable fair pricing mechanisms for IPOs, possibly allowing market forces to determine offer prices. This approach could foster competition among issuers, potentially leading to lower prices that attract more investors, thereby benefiting the capital market in the long term.

The preference for IPOs from the financial sector over those from non-financial sectors reflects public sentiment, likely influenced by the financial sector's better performance compared to non-financial sectors in recent years. Non-financial companies are urged to introduce initiatives that enhance attractiveness for IPOs, thus encouraging quality companies from these sectors to go public.

While most IPOs were found to be underpriced in the study, cases of overpricing were also noted. This imbalance could stem from historical and current regulations that restrict investment

bankers' authority to determine IPO prices. Granting more autonomy to the IPO market to set prices based on market conditions could mitigate such issues and promote investor confidence.

Investors are recommended to sell IPO shares on the first day of trading rather than holding onto them for later days, as research indicates a decrease in initial returns over time. This approach is aligned with maximizing returns in the IPO market.

The study's identification of underpricing in Nepalese IPOs opens avenues for future research. Researchers are encouraged to explore deeper into underpricing with larger sample sizes and include sectors excluded from this study. Additionally, exploring underpricing trends over different years and investigating long-run IPO performance in the Nepalese context are recommended. Researchers should be prepared to invest significant effort in obtaining reliable data to support such studies effectively.

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Appendix

Table 2

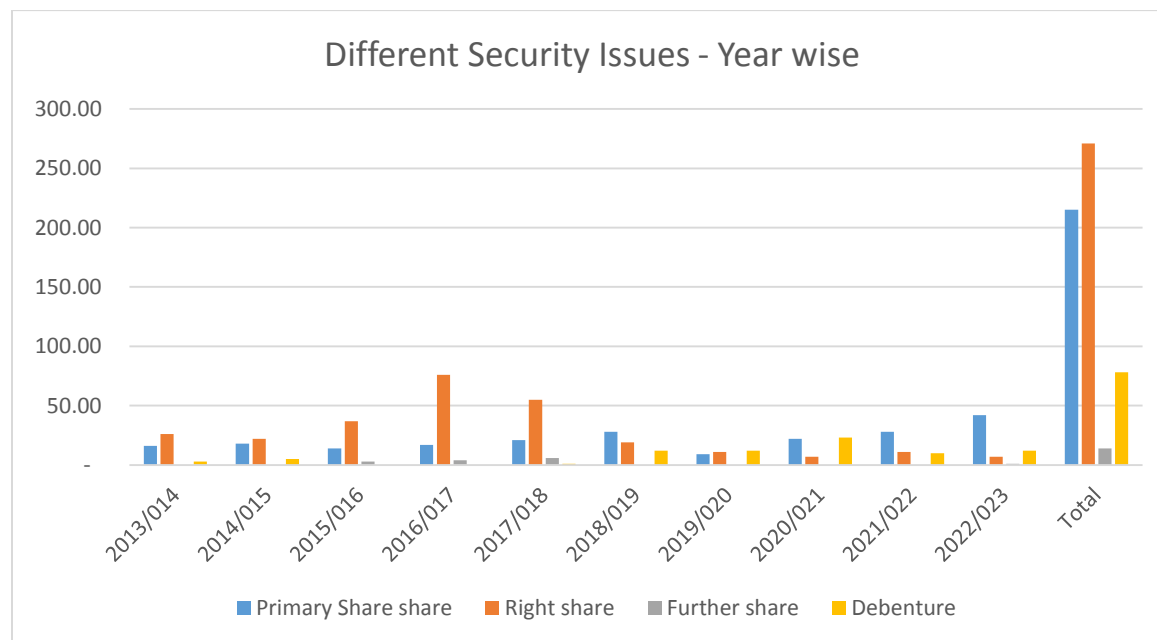
Year Wise Analysis of Different Securities with Their Number and Amount

Amount in Arba

| SN | Year | Primary Share | | Right share | | Further share | | Debenture | | |
|----|----------|---------------|--------|-------------|--------|---------------|--------|-----------|--------|--------|
| | | English | Number | Amount | Number | Amount | Number | Amount | Number | Amount |
| 1 | 2013/014 | | 16.00 | 1.57 | 26.00 | 4.24 | - | - | 3.00 | 1.45 |
| 2 | 2014/015 | | 18.00 | 6.98 | 22.00 | 2.31 | - | - | 5.00 | 2.90 |
| 3 | 2015/016 | | 14.00 | 2.76 | 37.00 | 9.40 | 3.00 | 5.83 | - | - |
| 4 | 2016/017 | | 17.00 | 1.50 | 76.00 | 45.64 | 4.00 | 7.99 | - | - |
| 5 | 2017/018 | | 21.00 | 8.30 | 55.00 | 25.70 | 6.00 | 11.50 | 1.00 | 3.00 |
| 6 | 2018/019 | | 28.00 | 7.35 | 19.00 | 5.88 | - | - | 12.00 | 29.98 |
| 7 | 2019/020 | | 9.00 | 3.99 | 11.00 | 4.41 | - | - | 12.00 | 23.45 |
| 8 | 2020/021 | | 22.00 | 15.19 | 7.00 | 14.05 | - | - | 23.00 | 69.60 |
| 9 | 2021/022 | | 28.00 | 7.20 | 11.00 | 4.79 | - | - | 10.00 | 31.20 |
| 10 | 2022/023 | | 42.00 | 22.37 | 7.00 | 15.98 | 1.00 | 0.04 | 12.00 | 31.00 |

(Source – Annual Report of SEBON on respective year)

Fig. 1 – Different Security Issues – Year wise



(Source - Analysis of different securities in the last 10 fiscal year of respective year)

Table 3

Analysis of NEPSE Index

| Year | | Yearly NEPSE index |
|--------------|--------------------|--------------------|
| English Year | Nepali Fiscal Year | |
| 2013/014 | 2070/071 | 1,036.11 |
| 2014/015 | 2071/072 | 961.23 |
| 2015/016 | 2072/073 | 1,718.15 |
| 2016/017 | 2073/074 | 1,582.67 |
| 2017/018 | 2074/075 | 1,212.36 |
| 2018/019 | 2075/076 | 1,259.02 |
| 2019/020 | 2076/077 | 1,362.65 |
| 2020/021 | 2077/078 | 2,883.41 |
| 2021/022 | 2078/079 | 2,009.47 |
| 2022/023 | 2079/080 | 2,097.10 |

(Source –SEBON annual report of respective year)

Table 4

Analysis of NEPSE Index with Turnover and Capitalization

| SN | Year | No. of Companies | Market Capitalization | Yearly Turnover Values in Rs. | Yearly NEPSE index |
|----|----------|------------------|-----------------------|-------------------------------|--------------------|
| 1 | 2013/014 | 233 | 1,050.17 | 77.3 | 1,036.11 |
| 2 | 2014/015 | 232 | 989.40 | 65.33 | 961.23 |
| 3 | 2015/016 | 230 | 1,890.13 | 163.95 | 1,718.15 |
| 4 | 2016/017 | 208 | 1,856.82 | 205.2 | 1,582.67 |
| 5 | 2017/018 | 196 | 1,435.10 | 121.4 | 1,212.36 |
| 6 | 2018/019 | 215 | 1,567.50 | 110.07 | 1,259.02 |
| 7 | 2019/020 | 212 | 1,792.76 | 150.03 | 1,362.65 |
| 8 | 2020/021 | 219 | 4,010.96 | 1454.44 | 2,883.41 |
| 9 | 2021/022 | 234 | 2,869.34 | 1202.1 | 2,009.47 |
| 10 | 2022/023 | 254 | 3,082.52 | 467.12 | 2,097.10 |

(Source: Annual Report of SEBON 2013/014 to 2022/023)

Table 5

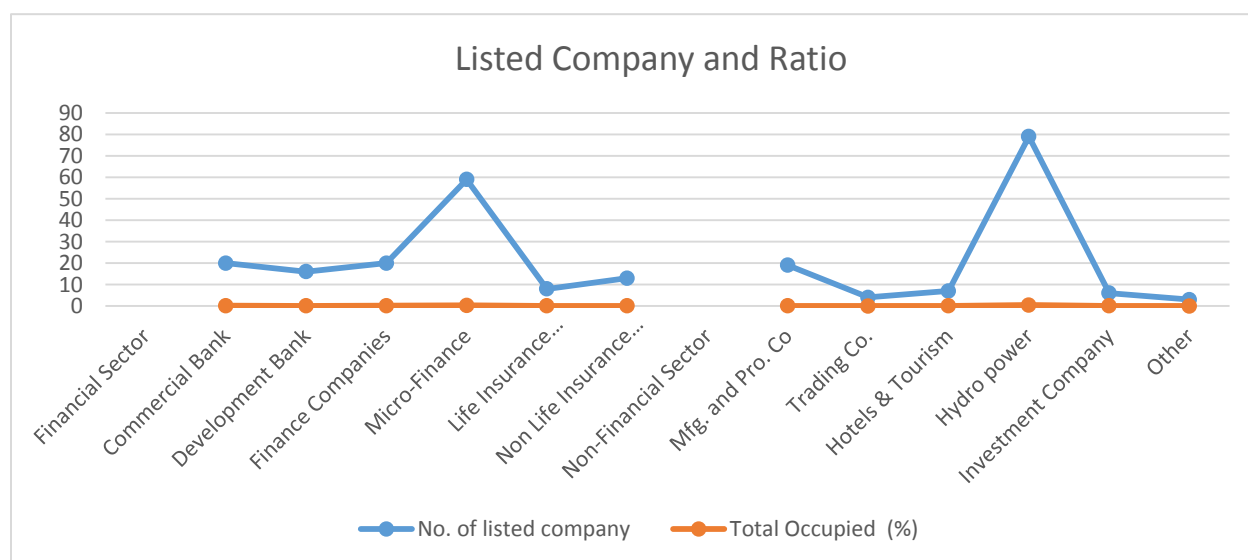
Listed company occupied ratio on total market

| SN | Sector | No. of listed company | Total Occupied (%) |
|----|------------------------------------|-----------------------|--------------------|
| A | <u>Financial Sector</u> | | |
| 1 | Commercial Bank | 20 | 10.26% |
| 2 | Development Bank | 16 | 8.21% |
| 3 | Finance Companies | 20 | 10.26% |
| 4 | Micro-Finance | 59 | 30.26% |
| 5 | Life Insurance Companies | 8 | 4.10% |
| 6 | Non-Life Insurance Companies | 13 | 6.67% |
| B | <u>Non-Financial Sector</u> | | |
| 7 | Mfg. and Pro. Co | 19 | 9.74% |
| 8 | Trading Co. | 4 | 2.05% |

| | | | |
|----|--------------------|----|--------|
| 9 | Hotels & Tourism | 7 | 3.59% |
| 10 | Hydro power | 79 | 40.51% |
| 11 | Investment Company | 6 | 3.08% |
| 12 | Other | 3 | 1.54% |

(Source: Annual report of Sebon 2022/023)

Fig: 3 – Listed Company and Ratio



(Source: Report scbonp.com 2022/023)

Table 6

Yearly Volume of Traded Stocks and NEPSE Index

| SN | Year | | No. of Companies | Market Capitalization (in Arba) | Turnover Values in Rs. (in Arba) | Yearly NEPSE index |
|----|--------------|--------------------|------------------|---------------------------------|----------------------------------|--------------------|
| | English year | Nepali Fiscal year | | | | |
| 1 | 2013/014 | 2070/071 | 233 | 1,050.17 | 77.3 | 1,036.11 |
| 2 | 2014/015 | 2071/072 | 232 | 989.40 | 65.33 | 961.23 |
| 3 | 2015/016 | 2072/073 | 230 | 1,890.13 | 163.95 | 1,718.15 |
| 4 | 2016/017 | 2073/074 | 208 | 1,856.82 | 205.2 | 1,582.67 |
| 5 | 2017/018 | 2074/075 | 196 | 1,435.10 | 121.4 | 1,212.36 |
| 6 | 2018/019 | 2075/076 | 215 | 1,567.50 | 110.07 | 1,259.02 |
| 7 | 2019/020 | 2076/077 | 212 | 1,792.76 | 150.03 | 1,362.65 |
| 8 | 2020/021 | 2077/078 | 219 | 4,010.96 | 1454.44 | 2,883.41 |
| 9 | 2021/022 | 2078/079 | 234 | 2,869.34 | 1202.1 | 2,009.47 |
| 10 | 2022/023 | 2079/080 | 254 | 3,082.52 | 467.12 | 2,097.10 |

(Source: Trading Report of NPESE & Annual Report SEBON of respective years)

Table 7

IPO Approved details with Amount (Year wise)

| SN | Year | No. of Public Issue | Amount of Public Issue |
|----|----------|---------------------|------------------------|
| 1 | 2013/014 | 45 | 7,270.00 |
| 2 | 2014/015 | 48 | 14,430.00 |
| 3 | 2015/016 | 55 | 18,990.00 |
| 4 | 2016/017 | 101 | 59,390.00 |
| 5 | 2017/018 | 87 | 53,300.00 |
| 6 | 2018/019 | 65 | 49,760.00 |
| 7 | 2019/020 | 34 | 33,650.00 |
| 8 | 2020/021 | 61 | 108,740.00 |
| 9 | 2021/022 | 56 | 50,630.00 |

| | | | |
|----|----------|----|-----------|
| 10 | 2022/023 | 82 | 96,040.00 |
|----|----------|----|-----------|

(Source – SEBON annual report of respective year till 2022/023)

Table 8

Subscription Pattern of Issues

| SN | Sector | Issuing Company | Issued Amount | Subscription Times | Result |
|----|------------------|---------------------------|---------------|--------------------|-----------------|
| 1 | Commercial Bank | Bank of Kathmandu Ltd. | 45 | 5.36 | Oversubscribed |
| | | Lumbini Bank Ltd. | 150 | 7.21 | Oversubscribed |
| | | Nepal Credit & Comme | 210 | 1.22 | Oversubscribed |
| | | Nirdhan Uthan Bank Ltd. | 3.3 | 3.88 | Oversubscribed |
| 2 | Development Bank | Gandaki Development F | 15 | 3.98 | Oversubscribed |
| | | Excel Development Bank | 6 | 18.97 | Oversubscribed |
| | | Infrastructure Developm | 24 | 9.36 | Oversubscribed |
| | | Annapurna Finance Co. | 2 | 28.04 | Oversubscribed |
| 3 | Finance Company | Nepal Abas Bikash Bitta | 20 | 0.94 | Undersubscribed |
| | | Narayani Finance Ltd. | 4 | 1.72 | Oversubscribed |
| | | Yeti Finance Co. Ltd. | 8 | 2.20 | Oversubscribed |
| | | Universal Finance Ltd. | 3.3 | 4.52 | Oversubscribed |
| | | Lalitpur Finance Co. Ltd. | 9.5 | 1.06 | Oversubscribed |
| | | Pashchimanchal Finance | 8 | 1.47 | Oversubscribed |

| | | | | | |
|---|--|---------------------------|------|-------|-----------------|
| | | Alpic Everest Finance L | 5 | 42.17 | Oversubscribed |
| | | International Leasing & | 30 | 21.70 | Oversubscribed |
| | | United Finance Ltd. | 24 | 10.55 | Oversubscribed |
| | | Standard Finance Ltd. | 24 | 3.63 | Oversubscribed |
| | | Fewa Finance Co. Ltd. | 8 | 23.55 | Oversubscribed |
| | | Birjung Finance Ltd. | 24 | 7.05 | Oversubscribed |
| | | ICFC Bittiya Sanstha Ltd | 24.4 | 35.06 | Oversubscribed |
| | | Kuber Merchant Bittiya | 22.5 | 4.45 | Oversubscribed |
| | | Neco Insurance Co. Ltd. | 20 | 1.21 | Oversubscribed |
| | | Nepal Life Insurance Co. | 50 | 7.56 | Oversubscribed |
| 4 | Insurance Company | Prudential Insurance Co. | 20 | 9.57 | Oversubscribed |
| | | Shikhar Insurance Co. | 25 | 43.76 | Oversubscribed |
| | | Nepal Reinsurance Company | 1600 | 1.57 | Oversubscribed |
| | | Unilever Nepal Ltd. | 13.8 | 6.54 | Oversubscribed |
| | | Himgiri Textile Industri | 19.2 | 1.57 | Oversubscribed |
| 5 | Manufacturing and Processing Company | Sri Ram Sugar Mills Ltd. | 46.5 | 0.53 | Undersubscribed |
| | | Sarbottam Cement Limited | 4650 | 19.32 | Oversubscribed |
| | | Nepal Infrastructure Bank | 8000 | 1.80 | Oversubscribed |

(Source – NRB Website, SEBON annual report of respective year till 2022/023, Annual report of NEPSE, Sharesansar website, CDSC website and investopaper.com)

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Chapter-I Introduction 1.1 Background of the study An Initial Public Offering (IPO) is a primary market mechanism where a private company sells its shares to the public for the first time, becoming a public entity. This process, also known as a public offering, allows the company to raise capital for expansion, reduce debt, and enhance its value. The types of securities available for offering may consist of common shares, debentures, preferred shares, and units of mutual funds. IPOs are essential for obtaining significant long-term funds and have been utilized by companies in various industries in Nepal, such as banking, trading, manufacturing, and hydropower, to raise capital. The decision to go public is a critical milestone, involving significant changes and opportunities for the company's future. For

a company to go public, it needs to form an **IPO team**