

# Impact of Rights Share Issue of Commercial Banks on Share Price in Nepal

**Binay Shrestha**

*(Ph.D. Scholar) Birganj Public College  
Tribhuvan University  
E-mail: binay273@gmail.com*

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**Abstracts**—*The study is focused on rights share issue by commercial bank and its impact on share price in Nepal. With the help of study, it is able to find out the rights share issued by the commercial banks, the price before issuing rights share and after allotment. In this research, analytical as well descriptive research design is employed. Data is collected from secondary sources but some primary sources are also used i.e. questionnaire, direct interview etc. In this study six Commercial Banks are taken as sample and from the study it is analyzed the impact on share prices due to the rights share issue. It is founded from the sample companies, there are more cases of rights offering which has met theory i.e. the share price has increased significantly after the announcement of rights share and then traded on ex-right price the allotment of rights shares. The Study is based on the five years performance of the bank from FY 2011/2012 to 2015/2016. This study has been done to fulfill some specific objectives. Main objectives of the study are to examine the announcement of rights issue and to analyze the rights issue practice in Nepal.*

**Keywords:** *Right share, share price, NEPSE, commercial bank.*

## 1. INTRODUCTION

The financial system is a set of institutional arrangements through which financial surplus in the economy are mobilized from surplus units and transferred to deficit units. A healthy corporate sector is vitally dependent on transfer of funds from people who are net savers to firms which needs capital. Securities market works as a medium to arrange such transfer of funds. Development and expansion as securities market is essential for the rapid economic growth of the country. Securities market helps economic development by mobilizing long term capital needed for productive sector. The securities markets are vital to the growth, development and strength of market economy. They support corporate initiatives, finance the exploitation of new ideas and facilitate the management of financial risk. They have a greater role in the development of a nation.

Nepalese capital market is in an early stage of development. There are various inconsistencies and hindrances exist on the way to run the market smoothly. The Nepalese capital market was established as Security Market Center (SMC) in 1976. In

1984, the SMC was renamed as Security Exchange Center (SEC). After converting SEC into Nepal Stock Exchange (NEPSE) in 1993, it brought new atmosphere in Nepalese capital market. NEPSE is non-profit making organization. It is one and only secondary market for Nepalese corporate securities, operating under Security Exchange Act 1983. NEPSE opened its trading floor on 13<sup>th</sup> January 1994 and started to calculate the NEPSE Index since 12<sup>th</sup> February 1994. NEPSE plays vital role for developing the efficient capital market. It is clear that when a large-scale firm is to be established it fulfills the financial requirement by the issue of equity share. There are some other sources available to raise fund. These sources are called financial instruments such as preferred stock, bond, debenture, rights share, dividend etc. Among these alternatives this study is mainly focused on the impact of right offering in share price movement and its practice in Nepal. The rights issue is in increasing trend but the companies of all sector does not issue the rights. Among various sectors, Finance companies are ahead in the rights issue practice. The process of issuing the rights is lengthy and complicated in Nepal. To issue the right share, the company should take permission from SEBON and also should register their shares.

## 2. LITERATURE REVIEW

Literature review means taking knowledge from different sources. In this chapter the researcher has reviewed various published and unpublished materials. This chapter is divided into two parts i.e. Conceptual Review and Review of related studies. “Our small investor needs to be educated on the working of the stock exchange. In this task the role of Nepal stock Exchange and the government and probably also that of the centers, which manage shares issues of companies, becomes evidence in addition stock exchange watchers feel that the government should revise its stock market rules to take account of the various aspects of stock market including loopholes in order to prevent share market profilers from fleecing public (The Rising Nepal, January 20<sup>th</sup> 1995).

These days the interest of the investors is gradually fading away. Investors have been discouraged with the shares market running at a snail's pace. There is no room for satisfaction for investors. Although the country has adopted the liberal market policies to revise the economy, it has not been applied into concrete actions in Nepalese context. Brokers have been reporting since long about Nepal's stock market positions; however, no action has been taken from the government. The government has not been able to regulate the companies, and the corporate culture is also not being developed among companies. There are many loopholes in our stock exchange Act. Investors feel insecure here. A few years back there was a company called Nimrod Pharmaceutical Company that floated in shares, but where are they now? Similarly, it has been more than a year that Bansbari Leather has allocated its shares, but why didn't the company list its shares in the market? Government remained silent in all these cases. This is why the general public also well as the institutional buyers is not feeling secure investing in stock market" (Business age, January 2000: 25).

The SEBON further informed that it permitted a total of 16 companies to issue shares during the period of these companies issued shares worth Rs.1.02 billion during the last fiscal year, states the statement. Speaking on the occasion, Deepak Raj Kafle, chairman of the SEBON stressed on the need to enact investors in the capital market." Lack of necessary laws has been stalling the growth of the capital market, he said. He however said that enforcement of the securities Act that is awaiting royal seal will help to ameliorate the capital market along with the secondary market (The Katmandu Post, Friday November 5; 2004:2). In this fiscal year (2004/2005) securities market indicators in general witnessed an uptrend almost the decelerating growth trends in the economy. The capital mobilized by the corporate sector through the issue of securities has increased. Likewise, the value of securities traded in the stock exchange and the market capitalization of listed securities has also increased significantly. During the year, SEBON's policy priority; was on developing legal framework for trading of government securities through the stock exchange, enhancing professionalism of market intermediaries establishing system for the identification of investors, systematizing the grievances handling procedures and building awareness in the corporate sector to encourage good corporate governance practice (Securities Board of Nepal (Annual report 2004/2005).

### 3. RESEARCH METHODOLOGY

This study is mostly based on secondary data. Primary data are also taken to some extent. So, qualitative as well as quantitative data are taken for the study. Primary data are collected to identify the problems and prospects of rights share practice of commercial banks in Nepal. The sources for the primary data include the responses of the questionnaires, personal interviews with concerned person such as experts, brokers, investors, issue managers, issue companies etc.

Secondary sources of data include annual reports of SEBON, various publication of NEPSE, statistical book of Nepal, published and unpublished documents, previous studies, dissertation, articles and foreign related journals as well. Newspaper, magazine, books and other reports such as Kantipur, The Himalayan Times, Gorkhapatra, and New Business Age etc. are taken as useful sources of secondary data in this study. Some other important information has been collected. Co-efficient of Correlation ( $r$ ), Coefficient of Determination ( $r^2$ ) and Probable Error have been used for the analysis of data. Probable Error (P.E.) is used to measure the reliability and test of significance of correlation coefficient. It is calculated by following formula:

$$P.E. = 0.6745 \times \frac{1 - r^2}{\sqrt{n}}$$

Where,  $r$  = Value of correlation coefficient

$n$  = No. of pairs of observation.

#### d) Valuation of Rights

Rights have certain market value because the rights share is generally offered at lower than market price. The value of a stock right may be defined as the value at which the right should be quoted in the market so that people are interested towards that particular share attached with rights. After rights offering, existing shareholders want to exercise those rights to purchase new common stock and some want to sell rights. Though there is no provision to make right transferable in Nepal, but valuation of rights is very important to analyze the share price movement. After the closing date of rights share offering, the share price will drop to the extent of value of rights.

$$\text{Theoretical price of share} = P_o - \frac{S}{\# + 1}$$

Where,  $P_o$  = Current market price of share, rights-on

$S$  = Subscription price.

$\#$  = Number of right required to purchase one new share.

### 4. CHARACTERISTIC OF RIGHTS OFFERING IN NEPAL

Now there are 229 listed companies in NEPSE, out of them 97 companies have issued the rights (SEBON report 2015/16). The history of rights offering is not so long in Nepalese contest. Nepal finance and saving co. ltd was the first company, who issued rights shares in Nepalese market in fiscal year 1998/1999. The company announced on 01/12/1995, the ratio was 4:1, each existing shareholders who had 4 shares they owned were allowed to purchase each additional share issued by the company. Since, from the fiscal

year 1998/1999, Nepalese corporate firm, started to issue rights share. Almost all of them were finance, banking and insurance companies who issued rights share in Nepalese capital market. All companies who had issued their rights share at par value i.e. Rs.100 per share because according to Company Act, company cannot issue their rights share on discount, but premium can be added, due to fear of under subscription no company had issue their rights share on premium. As a result, there is wide difference between subscription price and market price per share, as well as having high share price companies cannot take advantage by premium, which is cost less fund of company. A large number of bank and finance companies announce and issue rights share, to increase the capital base if the corporate management felt such need to comply with the policy directives given by

the concerned authority to increase the capital base from the time to time. Under rights offering, the shareholders are provided a document called “rights” which describes all about the conditions of rights issue. Each stockholder receives right in the proportion of the share currently held.

## 5. RESULT

### Contribution of Rights Share Issues in Total Public Flotation in Nepal

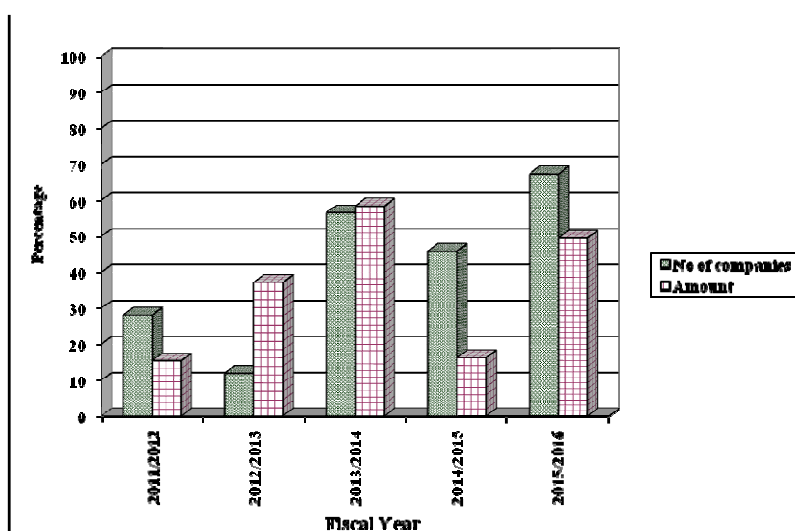
Rights share is an important part of total public issue in Nepal. There are many other alternatives of the public issue. Table no.1 and Figure no.1 show the contribution of rights issue in the total public flotation in each of the fiscal years in which the rights offering has been taken place.

**Table 1: Contribution of Rights Share Issues in the Total Public Flotation.**

	Total issued Approved		Rights Share Approved		Percentage (%)	
	No of companies	Amount (Rs. millions)	No of companies	Amount (Rs. millions)	No of Companies	Amount
2011/2012	25	2950.18	7	451.68	28.00	15.31
2012/2013	42	10602.4	5	3938.9	11.90	37.15
2013/2014	46	7266.69	26	4243.13	56.52	58.39
2014/2015	48	14235.33	22	2307.99	45.83	16.21
2015/2016	55	18998.62	37	9404.38	67.27	49.50

Source: Annual Report of SEBON

Analyzing the table, in FY 2011/2012 it is found 25 total issued approved cases rights issued had been made of 7 issues, which occupied 28.00% of the total public flotation. In the FY 2012/2013 contribution on rights share on total public issue through 5 companies out of 42 total issue approved companies is 11.90%. In the FY 2013/2014 and 2014/2015 the contribution of rights shares on total public issue through 26 and 22 company out of 46 and 48 total issue approved companies was 56.52% and 45.83% respectively. In the FY 2015/2016, contribution on rights share on total public issue through 37 companies out of 55 total issue approved companies' .i.e 67.27%. It is highest contribution till the FY 2015/2016 because 55 issues approved companies issued volume of total public issue amounting 18998.62 million the highest cases of rights offering i.e. 37 cases and 67.27% were made. The figure 1 shows the graphical presentation of contribution of right share issue in the total flotation cost. The figure shows the highest and lowest contribution in the total public flotation. The highest is 67.27% and lowest is 11.9%.



**Figure no. 1: Contribution of Rights Share Issues in the Total Public Flotation**

Source: Annual Report of SEBON

The figure no.1 shows the graphical presentation of contribution of right share issue in the total flotation cost. The figure shows the highest and lowest contribution in the total public flotation. The highest is no. of companies is 67.27% and lowest is 11.9%.

### Correlation Coefficient between Share Price Movement and Movement in General Market

Share price movement, not only affected by rights offering but general market movement also largely affects it. So, the correlation between the share price before and after the announcement of rights share has been calculated to find out, if there is any relation between the share price and price indices of the company. For calculation of correlation, share price of company are considered as the dependent variable, which fluctuate according to the fluctuation on the index of the total equity capital.

The correlation is a statistical tool, which studies the relationship between two variables, and correlation analysis involves various techniques used for studying and measuring at the extent of relationship between the two variables. Correlation is an analysis of the covariance between two or more variables. The effect of correlation is to reduce the range of uncertainty or prediction. Two variables are said to be correlated if the change in one variable results in the corresponding change in the other variable. Correlation coefficient can be either positive or negative. If the values of two variables deviate in the same direction i.e. if the increase in the value of one variable results, on an average, in a corresponding increase in the values of other variables or if a decrease in the values of results, on an average, corresponding decrease on the values of other variables, the correlation is said to be positives and direct.

Nepal Stock Exchange (NEPSE) has just started the practice of calculating and publishing the sector wise indices. For the period under study, sector wise index was not available so that throughout the study period the price index of total equity capital is used. After calculating the correlation between share price movements of sample companies with general market movement following result have been obtained.

### Correlation Coefficient between Share Price Movement and Movement in General Market of Commercial Bank.

Table no.12: Correlation Coefficient between Share Price and NEPSE Indices

S.N .	Sample companies	Correlation coefficient	Coefficient of determination	Probable error (P.E.)	6 P.E.
1	Machhapuchhre Bank Ltd	0.99	0.9801	0.0060	0.0360
2	Century Commercial Bank Ltd	0.99	0.9801	0.0060	0.0360

3	Prabhu Bank Ltd	0.98	0.9604	0.0119	0.0717
4	NIC ASIA Bank Ltd	0.97	0.9409	0.0178	0.1070
5	Sanima Bank Ltd	0.99	0.9801	0.0060	0.0360
6	Citizen Bank International Ltd	0.94	0.8836	0.0351	0.2107

In case of Machhapuchhre Bank Ltd, Century Commercial Bank Ltd and Sanima Bank Ltd there is high degree of positive correlation i.e.  $r = 0.99$  between share price movement and general price movement. This relation is further providing by the coefficient of determination which is 0.9801 i.e. 98.01% and coefficient ( $r$ ) is greater than 6 P.E. Thus correlation is significant and reliable. So, we can conclude that share price behavior of Machhapuchhre Bank Ltd, Century Commercial Bank Ltd and Sanima Bank Ltd is because of general market movement. In case of Prabhu Bank Ltd there is positive correlation (i.e.  $r = 0.98$ ). The coefficient determination i.e.  $r^2 = 0.9604$  means that about 96.04% of variation in the share price is explained by the general market movement. The coefficient of correlation is greater than 6 P.E which proves that correlation is significant. So, we can conclude that share price behavior of Prabhu Bank Ltd is because of general market movement.

In case of NIC ASIA Bank Ltd there is positive correlation (i.e.  $r = 0.97$ ). The coefficient of determination i.e.  $r^2 = 0.9409$  means that about 94.09% of variation in the share price is explained by general market movement. The coefficient of correlation is greater than 6 P.E. (i.e. 6 P.E. = 0.1070) which proves that correlation is significant. So, we can conclude that share price behavior of NIC ASIA Bank Ltd is because of general market movement. In case of Citizen Bank International Ltd there is high degree of positive correlation (i.e.  $r = 0.94$ ). The coefficient determination i.e.  $r^2 = 0.8836$  means that about 88.36% of variation in the share price is explained by the general market movement. The coefficient of correlation is greater than 6 P.E (i.e. 6 P.E. = 0.2107) which proves that correlation is significant. So, we can conclude that share price behavior of Citizen Bank International Ltd because of general market movement.

### c) Action of Shareholders, if Rights are Transferable

Table no.15: Action of Shareholders, if Rights are Transferable

Options	No. of Respondents	Rank
Sell the rights	5	3
Exercise the rights	12	1
Partially exercise & sell the rights	7	2
Neither sell nor exercise	1	4

For the question regarding the action of shareholders if rights are transferable in Nepal, the option, 'exercise the rights' where 12 respondents support it which is least among the four options. Thus, it is ranked as first. Whereas for another option 'Partially exercise & sell the rights', 7 respondents support it which means this option should be ranked in second position. For the option 'sell the rights', 5 respondents support it and it is ranked as third. The option 'neither sell nor exercise the rights' has been ranked in 4<sup>th</sup> position because it is supported by only 1 respondent through out of 25 respondents. So, it can be concluded that shareholder is well aware about their wealth position. They never let the rights to expire and they utilize the rights either by exercising them or by selling them if rights are transferable, in case of Nepal

#### d) Beneficiaries of the Rights Issue

**Table no.16: Beneficiaries of the Rights Issue**

Options	No. of Respondents	Rank
Issuing company	6	2
Shareholders	15	1
Issue managers	3	3
Brokers	1	4

As a response to the question about the beneficiaries of the rights issue, most of the respondents indicated to shareholders as the prime beneficiaries of rights issue. 15 respondents support this option. Issuing companies as beneficiaries got the second rank where 6 respondents support. Likewise, issue managers have been ranked in the third position where 3 respondents support this option. Brokers are the last to gain the benefit of rights issue among the four beneficiaries. This data suggests that there is no any confusion about that the shareholders, issuing companies, issue managers and brokers are the main beneficiaries of the rights offering.

#### e) Cause of Preference Given to Rights Issue by Company

**Table no.17: Cause of Preference Given to Rights Issue by Company**

Causes	No. of Respondents	Rank
Low flotation cost	7	2
Easy process	11	1
Maintain control position in management	5	3
Other	2	4

In another major question about the preference given to issue rights share by companies instead of other instrument, most of the respondents' point towards the option 'easy process of rights issue' as the most important cause. It has been ranked as first where 11 gives support to this option. For another option 'low flotation cost', 7 respondents give their support, which is in the second rank. Another reason of practicing rights share by companies rather than other instruments is to maintain the control position in management, which is in the third position.

Respondents gave fourth rank for the option 'other causes'. In this way, it can be concluded that Nepalese corporate firms issue rights share instead of other instruments due to low flotation cost, easy process to collect fund, to maintain the control position in management and due to some other causes like legal provision etc. as well.

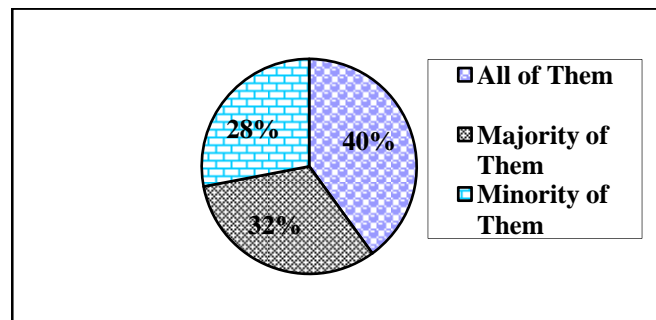
#### f) Causes of under Subscription of Rights Share

**Table no.18: Causes of under Subscription of Rights Share**

Causes	No. of Respondents	Rank
Low performance of company	16	1
Right is not transferable	3	3
Lack of investors awareness	5	2
Other causes	1	4

In response to the question regarding the cause of under subscription of rights share, low performance of company is pointed out for first rank where 16 respondents gives support. Thus, this option is ranked in second important reason of under subscription of rights issue. Rights are not transferable in Nepal, which causes the under subscription of rights share. It becomes third most influencing cause where 3 respondents support this option. Whereas, another option 'other causes' is in the last rank. This helps researcher to conclude that the low performance of the rights issuing companies is the main cause of under subscription of rights share, whereas other causes like lack of rights transferable provision, investors awareness regarding rights share are other causes of under subscription of rights share in Nepal.

#### g) Investors' awareness about rights offering



**Figure 2: Investors Awareness to the Rights Offering**

Question regarding awareness of investors about rights offering, out of total 25 respondents, 10 said that all the investors are well aware to the entire phenomenon of rights share in Nepal. Whereas, 8 respondents said that majority of the investors are well aware and remaining 7 said minority of them are well aware to the entire phenomenon of the rights share in Nepal. So, here researcher can conclude that most of the investors are well aware to entire phenomenon of rights share in Nepal. (Appendix-20)

## 6. CONCLUSION

- Many countries “rights” is a negotiable instrument and therefore transferable and it must logically be transferable and negotiable,
- Some commercial banks, Development banks had issued the large amount of rights share to their existing shareholders therefore these sectors occupied large proportion of rights share,
- Most of the companies which issued rights share have faced the problem of under Subscription.
- All sector has been practiced the rights share, but commercial banks have issued the large volume of rights share and more Development Banks have practiced the rights share.
- Small investors do not want to attend the annual general meeting because they would not get any benefit from it.
- Shareholders who want to sell their rights cannot sell their rights. They must have to exercise their rights or to lose their wealth position.
- Rights share practice is comparatively new phenomena in Nepalese Financial market. There are no easy things to work out make the rights offering as effect instruments of raising capital.
- Shareholders are not getting enough information about the rights share in Nepal. Here, researcher has founded from the sample companies there are more cases of rights offering which has met theory i.e. the share price has increased significantly after the announcement of rights share and then traded on ex-right price the allotment of rights shares.
- Testing the hypothesis researcher has obtained same result. Company's rights share affects share price movement and general market movement. The regulation regarding the calculation of premium is not clear and certain regulation require company to issue rights share in par value that result in wide difference between market price per share and subscription price.
- Finally, rights offering are increasing trend in Nepalese security market. Basically, Banking and Development sectors are more practicing. Rights offering have both positive and negative impact to change on share price. The market price at share is also influenced by general market movement to greater extent in Nepal.

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