

Right Share Policy Issue: Violating the shareholder's Right in Nepalese Capital Market

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Abstract:- Right share is an issue of securities to the existing shareholders with the right resting on the investor either to accept or reject the offer. The main objective of the study was to analyze the violating shareholder's right through auction, Further Public offering (FPO) instead of the first Privilege or Preemptive right of the existing shareholders. Both primary and secondary data was collected and analyzed. The sample of the companies was selected from the latest three years offering right auction and FPO (Further Public Offering) according to the convenience sampling and purposive judgmental sampling. The Survey is conducted on Kathmandu valley with the duration of six months ranging from 5th march to 10th december, 2019 with the view of 200 respondents is taken including the investors and experts through the judgmental convenience sampling techniques. The result depicted that regulators and other concerned government agencies violated the rules and regulation of the company and also influence the stock market through unwanted right auction and promoting the match fixing business. In the past three years, the right auction and FPO of the listed companies is rising rapidly which leads to become the challenging issue for the corporate governance.

Keywords:- Right Share Issue, Right Auction, Policies and Directives, Further Public Offering, Shareholder's Preemptive Right.

I. INTRODUCTION

Capital market helps to grow country's economic in many ways. Stock market reduces cost of mobilizing saving and facilitates investment through encouraging acquisition and dissemination of information. In the country where share markets of discipline is an effective firm tends to be more productive thereby creating more wealth (Smith, 1997). Stock Market contributes for the short term economic growth and long term economic development as well. The future of Nepalese stock market partly depends on the positive role of the government in supporting the effort of Securities Board of Nepal (SEBON) for regulatory and institutional strengthen to translate the dream into effective plan and policies implementation.

In the changing context federal government structure with encouraging positivism like stable government, favorable international situation, positive political goodwill, relationship with big neighbor countries and various developments provided better feedback in the growth of

capital market. The dynamic role of SEBON in promoting *capital market expo 2075 B.S.* is no doubt providing a better signal of capital market development. However, the weakness like SEBON direct violation of Preemptive right in a situation where INVESTMENT FORUM Nepal (*Share Lagani Karta Sanga*) could not raise the voice on the relevant issue rather than engaging in petty fog interest of personal gain at the cost of shareholder's right. Capital market is organized market through which buyers and sellers of long term capital are met and the function of buying and selling takes place.

Capital market is such a powerful marketing which gives opportunity to invest the savings in ordinary share, debenture and government securities. For fast industrial growth, capital market plays an important role. Historically, the development of capital market dates back to 1936 with the flotation of share by Biratnagar Jute Mill Ltd., introduction of the company Act in 1964, the first issuance of government bond in 1964 and establishment of Securities Marketing Centre Ltd. (SMC) in 1976 were other significant developments relating to stock market. Securities exchange centre was established for facilitating and promoting the growth of capital market (NEPSE, 2002). Recently, right share is one of the key instruments to raise capital in Nepalese capital market.

Right issue is new equity sales to existing shareholders made on a pro-rata basis. In the US, among listed industrial firms, right issue dominated from the 1930s to 1950s but since the 1960s right issue have been on the diminishing trend (Eckbo and Masulis, 1995). Right share is an issue of securities to the existing shareholders with the right resting on the investor either to accept or reject the offer. In Nepalese context, right issue is an extra funds rising of listed companies. The usual practices is giving option to investors to apply more shares without fixing to apply 30% to 40% more shares and after allotment right shares are distributed on a proportional basis without doing right auction. Right auction as found to be a bad practice making companies and the banks to have easy money without doing hard work. This is where; regulatory oversight from SEBON is a missing factor as can be called policy level negligence.

Hansen (1988) mentioned that right issue is the Preemptive right of the existing shareholder in which outsiders can participate only buying shares from the secondary market. So the regulatory authority like SEBON is committing gross regulatory negligence in going above law to invite right offering to outsider's i.e. direct violation of the existing shareholder's right.

➤ *Objective*

The main *objective* of the study is to know why the company calls the right auction, Further Public offering instead of the first Privilege or priority of the existing shareholders.

II. LITERATURE REVIEW

➤ *Right Share Issue*

Right issue can be defined as the right of existing shareholders that entitles to buy new shares at a specific price in order to protect their interest. The rights issues are being offered at a substantial discount (relative to prevailing market prices).

➤ *Effects of Rights Issue on Shareholder's Wealth*

Right offering allows stockholders to maintain their proportionate ownership in the corporation and typically allow the corporation to raise new capital less expensively. Adaoglu (2006) right shares effect the increase in the number of share outstanding and decrease in share price. Thus, right issue involves selling of ordinary shares to the existing shareholders of the company.

➤ *Right Auction*

Auction is the process in which the stock exchange auctions the stock holding of an investor when he or she had sold the stock but cannot deliver the stock within a stipulated time. In Nepalese context, the right auction is increasing gradually due to the less duration of right offering date; lose regulation of regulators, communication gap with investors and companies.

Laws	Descriptions
<p>Sec.81(1), Company Act, 1956</p>	<ul style="list-style-type: none"> • Right shares are those shares which are issued after the original issue of shares but having an inherent right of the existing shareholders to subscribe the shares in proportion to their share holding. Such shares must be offered to the existing equity shareholders on pro-rata basis. • The offer of this type of shares shall be made in the form of notice giving the particulars of shares offered and within a time not less than 15 days from the date of offer for acceptance. These shares can also be issued to the other existing members through renunciation when the existing shareholders do not accept the offer before or within a period of 15 days or more.
<p>In the chapter IV (2007) Securities Regulation and Issue Regulation Act 2008, 1(3) (Renunciation of the Right)</p>	<ul style="list-style-type: none"> • Clearly spell out the right issue. Belonging to the existing outstanding shareholder, it is a sole and hold privilege mandatory provision. • The transfer of right to the existing shareholders. Likewise, this act 9(1) defined right issue of securities to increase capital should be first offered to the existing shareholders. <ul style="list-style-type: none"> • This Act 1(e) memorandum of association and article of association. • Regulators are proving to act as regulatory violation making willful negligence for the right issue. Likewise, they also neglect the corporate managerial policy oversight. • FPO is also the way of violating existing right of shareholder. This sort of corporate practice is the direct violation of investor's right by providing misleading or fraudulent information.
<p>As per the NRB Unified Directive 2067 B.S. (2010)</p>	<p style="text-align: center;">Right Share Selling</p> <ol style="list-style-type: none"> a. If the right share is not subscribed or not permitted for transfer by the concerned shareholder, then the licensed bank has right to cancel such share, except in case of section (c), as per the Banking and Financial Institutions Act 2063. b. If the bank has to cancel the right offering of any shareholder, then the amount of right share could be adjusted to the maximum by bank in next fiscal year. c. If after the cancellation of the right offering, the share ownership structure is going to be adversely influenced, then the bank should sell the share by Public Auction Basis and the value of share should be specified Rs. 100. d. <i>The right share of promoter that could not be subscribed should be sold among the existing promoters.</i> If the bank is going to new person to sell the promoter's right share, then the bank should inform NRB.

10th five year Plan (2002-2007)	<ul style="list-style-type: none"> • Diversifying securities market instrument attracting institutional investors, protecting investor's interest, expanding the securities market service nationwide and improving the compliance and integrity of the market. • The strategy of modernizing the stock exchange and the regulating the securities system more effective. This policy also demonstrates to develop effective and investor friendly role of securities market regulators.
Right Act 2074 B.S.	<p style="text-align: center;">Right share:</p> <ul style="list-style-type: none"> • Before issue of right share, BOD make the decision and approval law 43 with a required fee. Likewise, Sec 3(2) also defined the required documents. Similarly, Sec 4(3) also clarified that the length of right share should be at least 35 days. • Likewise, company must distribute the right share within 10 days after the share application closing date and also refund the unallotted amount. This law also guaranteed the Preemptive right of the existing shareholder and also sells or transfers their Preemptive right.
SEBON Directive (August, 2016)	<ul style="list-style-type: none"> • The value of shares to be issued through FPO must be determined based on capitalized earning, net worth per share, average closing price of 180 days and discounted cash flow. SEBON securities registration and issue regulation says listed companies, generated net profit in the last two to five years and whose net worth per share is higher than paid up value per share can launch FPO. However, regulation says that a listed company needs to justify the reason for adding premium to shares being floated through FPO.

Table 1: Regulatory features in Right issue under different laws and precedents in Nepal

Source: *Right Issue in different Laws and Directives as updated up to 2017*➤ *Empirical Review in Right Issue*

Lambrechts and Mostert (2000)	Rights issues give the existing shareholders the option of purchasing additional shares, normally issued at a discount i.e. par value below the market value to encourage participation.
Gowthorpe (2005)	Rights issue targets existing shareholders and are allocated based on the number of shares they hold.
Rana (2007)	The value of right differs from company to company and announcement of equity rights issue positively effect on share prices. Likewise, company issues rights share for increasing equity capital (as required by NRB) and to invest it in company's diversification and expansion.
Pathak and Giri (2008)	The preemptive right or rights as the privilege offered to existing stockholders for buying specified number of additional shares of the company's stock generally offered at a subscription price somewhat lower than the market price of share.
Khatiwada (2010)	Theoretically share price would increase after the right announcement and decrease after the allotment of share. But, the share prices of major companies don't follow the theory.
Hillier, Ross, Westerfield & Jordan (2013)	In rights offerings, companies grant shareholders a chance to buy new shares at a discount to the current trading price.
Gaurav, Jeteley & Shamim (2015)	A rights issue is an invitation to existing shareholders to purchase additional new shares; a chance to increase their exposure to the stock at a discount price.
Adhikari (2020)	FPO (Further Public Offering) and unwanted right auction are fraudulent way against right offering/issue and challenging for corporate governance in Nepalese capital market.

Table 2:-

Source: *As cited various authors and journals*

➤ *Conceptual Framework*

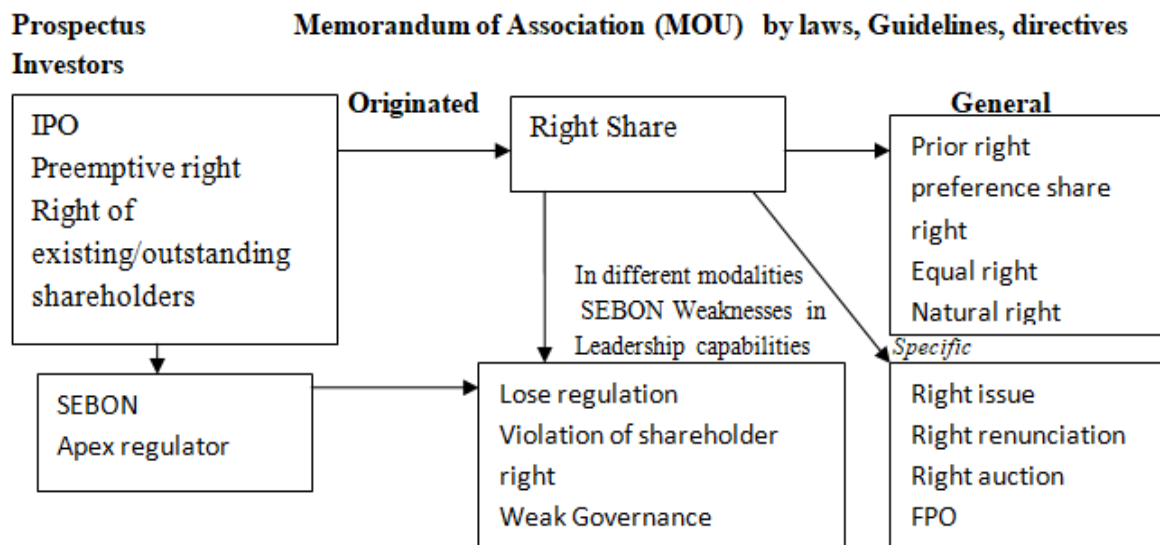


Fig 1

Source: Designed by Researcher 2019

III. RESEARCH METHODOLOGY

This research is designed in descriptive and exploratory manner. Both secondary and primary is used. The secondary sources of data includes the records available with the annual reports of SEBON, respective companies, directories of the stock exchange, NRB reports, issue managers websites and reports, NEPSE trading reports, Scholar research journals and books. The right auction shares were collected from the published national daily newspapers such as Kantipur, Gorkhapatra, Arthik Avians and The Kathmandu Post as well as trading report of NEPSE. The sample of the companies is selected from the latest three years offering right auction and FPO (Further Public Offering) according to the convenience sampling and purposive judgmental sampling. The Survey was conducted on Kathmandu valley with the duration of six months ranging from 5th march to 10th December, 2019. The view of 200 respondents is taken including the investors and experts through the judgmental convenience sampling with questionnaire. The banks, development banks, hydropower and insurance companies are included while taking the secondary data of latest years and current scenario. The collected data is administered through the SPSS version 18.0. Both quantitative and qualitative approach has been used while analyzing the data.

IV. RESULT AND DISCUSSION

A. Primary Survey Analysis:

The questionnaire is drawn while gathering from respondent’s view in regards to right issue. Likewise, informal interview is also taken while collecting the information. The result has been shown in the following manner.

Descriptions	Strongly disagree	Disagree	Fairly agree	Agree	Strongly agree	Total
i. Sufficient information access of the right share issue	76 (38%)	46 (23%)	22(11%)	50 (25%)	6 (3%)	200 (100%)
ii. Entertain Filling right share issue form	2 (1%)	28(14%)	20 (10%)	110(55%)	40(20%)	200 (100%)
iii. Regulator violated right of the existing shareholder	6 (3%)	30 (15%)	20(10%)	120 (60%)	24 (12%)	200 (100%)
iv. Develop guideline that existing shareholder informed to apply 15% to 25% more share in the right prospectus	10 (5%)	50 (25%)	20 (10%)	90 (45%)	30 (15%)	200 (100%)

Table 3:- Respondent’s view on right issue

Source: Field Survey 2019

Under information access, majority respondents respond have not got the sufficient information of right share issue. The reason behind not to give the information about the right issue is that the company is benefited by selling their right shares and also distribute their benefit by sharing with the merchant bankers. By testing chi-square test, the company is not give the information of right share issue since p value is $0.00 < 0.05$ at 5% level of significance. Similarly, 55% respondents agree that investors are needy to entertain of filling right issue form more than one month in order to exercise their right. Most of them also coded that to manage the fund for applying the right share they need to certain months. Likewise, 60% of them agree and 12% strongly agree that the regulator violated the right of the existing shareholders. **The main reason to negligence the right of shareholders in current practices is right auction, FPO and both.** Among them, FPO is the main reason for negligence of the Shareholder's right in current practices (50%). Likewise, the right auction and both of them are the main reason for negligence shareholder's right is 20% and 30% respectively. The regulator and company match fixing the shares; violating the preemptive right of existing shareholders. Moreover, mostly banking and financial institutions directly announces the FPO rather to give the Preemptive right of existing shareholders i.e. dramatically increasing. Similarly, almost agree that the company may develop the guideline for existing shareholder informed to apply 15% to 25% more share in the right prospectus than their right. By testing chi-square test, all these variables (issues) are significant since p value is $0.00 < 0.05$ at 5% level of significance.

B. Informal Interview

Among the selected 50% of total respondents (100) who are curious to respond and know further in regards to

Preemptive right of the existing shareholders through judgmental sampling. Instead of right issue, both right auction and FPO is growing. In the absence of bylaws under right issue and FPO how professional regulator like SEBON can undermine the right of the existing shareholders. Considering the global practice and in accordance with internationally tested practices there should be clear line of demarcation between regulations and the operations. Sharp respondents (80%) depicted that at present, SEBON is crossing its regulatory boundary in doing match fixing price instead of allowing merchant bankers to quote right offering price either in right auction or FPO. Thus, SEBON should monitor the price quotation of merchant bankers to protect investors from excessive right offering not more than three times limits of net worth per share. There is institutionally managed exploitation of the existing shareholders due to the lose regulation. 85% respond FPO is fraudulent way against right offering. Precedent is above the directive generally practice of law. Monetary and evaluation of delisted companies has not performed by SEBON like manufacturing sectors (Chaudhary group, wai-wai noodles). 70% depicted that company may develop the guideline that existing shareholders are informed to apply 15% to 25% more share than their specified application right shares. Majority of them also respond that Investors Forum and Institutions are closing their eyes without any venture and courage to raise voice in focusing the attention of regulators and the government in allowing the violation of existing shareholder's right.

C. Secondary data analysis

The violation of right share issue with FPO and right auction of last three years is growing gradually and depicted as under.

Name	FPO Amount (Rs Million) (a) * (b)	FPO Share (units) (a)	Premium	Total rate (b)	Issue Date (B.S.)
Premier Insurance co. Nepal	5266.99	6,59,565	699	799	2074/9/16
Nepal SBI Bank	65.8	67767 units	871	971	2073/10/9
Nepal Investment bank Ltd.	5450.7	9069388 units	501	601	2072/11/11/-11/14
Standard chartered bank Nepal	3299.82	25.58 lakh units	1190	1290	2073/1/12
Nepal Life Insurance Co. Ltd.	4411.8	30.96 Lakh	1325	1425	2073/09/27-10/02
Butwal Power Co. Ltd.	2044.58	4081000	401	501	2074/10/15-10/19
Shikhar Insurance Co. Ltd.	33.21	510988	550	650	2072/08/17- 08/21

Table 4:- FPO of Listed companies

Source: Issue Manager, NMB, Global IME, ACE, NCM, and Capital market

The table 4. depicts the FPO of listed companies i.e. banks and insurance. The FPO of Nepal investment bank Ltd. is 90,69,388 units and Standard chartered bank Nepal Ltd. is 25.58 lakh units. Likewise, FPO of Nepal Life insurance is 30.96 Lakh units whereas Butwal power co. Ltd. is 40.81 lakhs units. Moreover, FPO of Shikhar insurance co. Ltd. and Nepal SBI bank is 510,988 units and 67767 units. The FPO of Nepal life insurance co. Ltd. is the highest of Rs.1425 with the premium of Rs.1325 whereas Nepal investment bank Ltd. is Rs. 601 with premium. Likewise, FPO of Butwal Power co. Ltd. is Rs. 501 with premium of Rs. 401.

Name	Right Auction (kitta)	Auction date	Issue manager
Nepal grammen bikash bank ltd.	87564	2074/5/14 -5/25	NMB Capital
NB micro-finance bittiya sanstha	Pro: 15800, eq:14974 = 30774		NMB capital
Swarojgar Laghubitta Bikash bank.	Pro: 1584.74, eq: 1396.86 = 2981.6	074/03/01- 074/04/04	NMB capital
Namaste Bittiya sanstha Ltd	7951	073/09/08-073/12/27	NMB Capital
Saptokoshi development bank Ltd.	8,16,677	074/07/22- 074/07/29	NMB capital
ICFC Finance Ltd.	60,903	2074/10/15-25	Global IME Capital
Central Finance Ltd.	1085000	2075/01/20-27	NIBL, ACE capital
Neko Insurance	99949	2075/01/11-26	NMB capital
Kabeli Bikash bank Ltd.	45391	2074/12/27- 75/01/04	Global IME capital
Pokhara Finance Ltd.	180000	1/6/2075	NIBL, ACE capital
Shree investment and finance co. Ltd.	277000	2074/12/28-75/01/05	Siddhartha Capital
Reliance Finance Ltd.	535000	074/12/24- 075/01/03	Sunrise capital
Sangrila development bank Ltd.	392772	075/12/13- 12/20	Prabhu capital
Nepal insurance co. Ltd.	433,043	2074/10/21-10/228	NIBL ,ACE Capital
Himalayan General Insurance	71530	2074/07/27-08/04	NMB Capital

Table 5:- Right Share Auction of companies

NRB directives 2074 sec (15) # pro= promoter share, eq= equity or ordinary share

Nepal Grameen bikash bank has 87,564 kitta right auctions. Similarly, NB micro-finance bittiya sanstha and swarojghar laghubitta bikash has 30,774 and 2981.6 kitta respectively. Likewise, the right auction of saptakoshi development bank Ltd., central finance and Neco insurance are 8,16,677 kitta, 10,85,000 kitta and 99,949 kitta respectively and others companies are as stated in table 3. Regulators and other bodies violated the rules and regulation of the company and promoting the match fixing business through right auction and FPO. In the past three years, the right auction of the listed companies is rising rapidly which becomes the challenging issue for corporate governance.

V. CONCLUSION

By this SEBON/ Regulators violated the Preemptive right of existing shareholders. Likewise, chairman and executives are not qualified professional in capital market. Lastly, Regulators and other bodies (stakeholders) violated the rules and regulation of the company and also influence the stock market through unwanted right auction and promoting the match fixing business. Hence, both primary and secondary analysis clearly prevails the violation of Preemptive right of the existing shareholders through unwanted right auction and FPO.

FUTURE OUTLOOK

➤ The right issue form should extend more than one month (at least 60 days), timely information access through national newspapers, mobile SMS alert individually and other audio-visual (TV/Radio) communication channels networking to shareholders. Likewise, regulator also makes policy to apply 20-30% additional shares so that undersubscribed right share automatically transferred to existing shareholder. **Similarly**, company can focus on earning power of share rather than losing or over capitalization through right issue, dynamic restructuring

and improvement in internal management of SEBON, independent evaluation of SEBON, compliances status and key performance policy level reform.

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