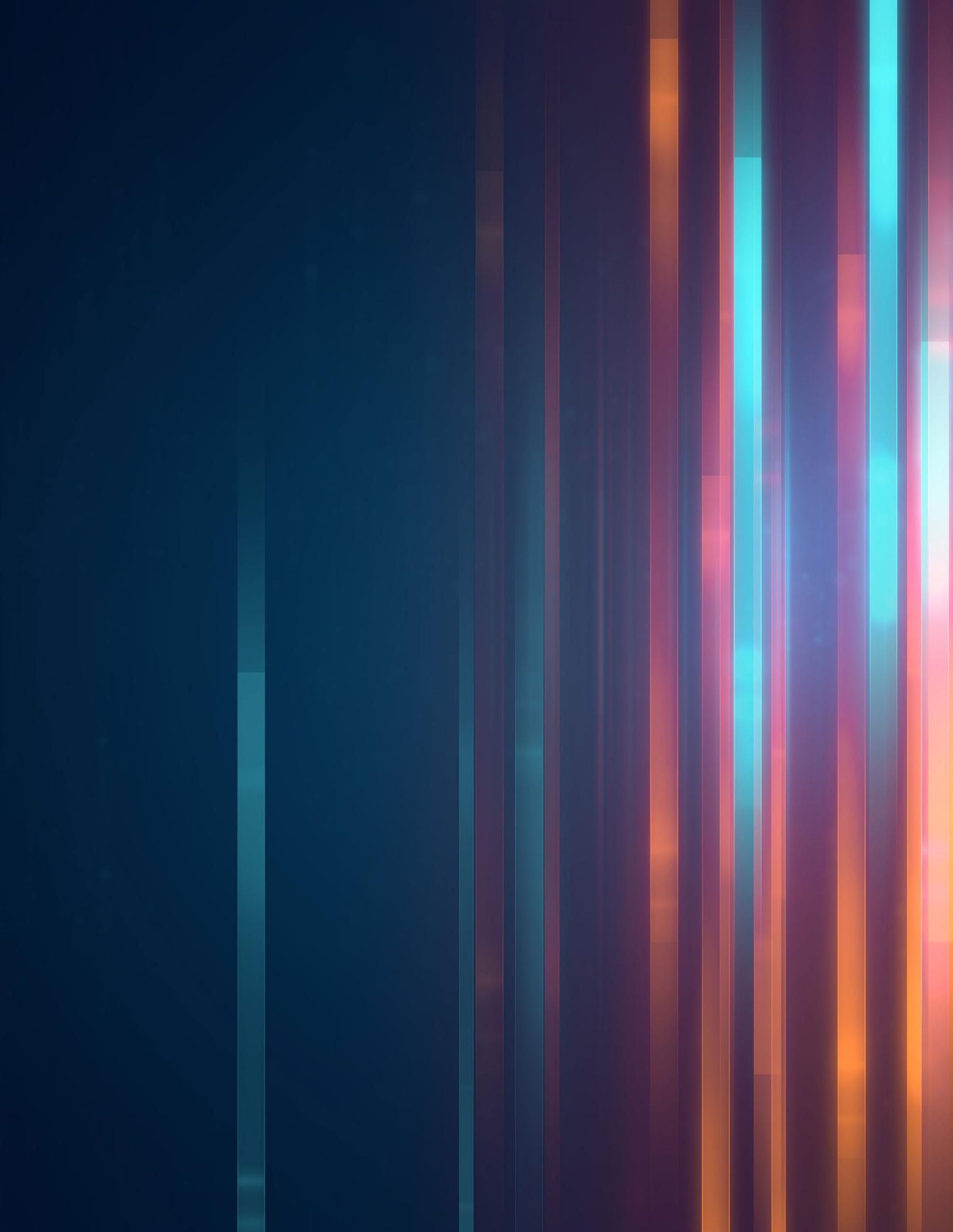


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Priorities for Attracting Public Equity Listings in Nepal: New Survey Evidence

JOHN SCHELLHASE





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ABOUT THE NEPAL STOCK EXCHANGE

The Nepal Stock Exchange (NEPSE) contributes to the creation of wealth in Nepal through providing a platform for the trading of listed securities, as well as clearing and settlement facilities, and supervising and regulating its members. The basic objectives of the NEPSE are to provide liquidity for government bonds and corporate securities by facilitating transactions through intermediaries, such as brokers and market makers, and to protect investors' rights.

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Introduction and Summary of Key Findings

As part of its role hosting the May 2019 meeting of the executive committee of the South Asian Federation of Exchanges, the Nepal Stock Exchange (NEPSE) partnered with the Milken Institute to hold a daylong roundtable in Kathmandu on the topic of modernizing Nepal's public equity market. Topics included prerequisites for capital market development, opportunities to attract new listings and investors, strategies to increase market liquidity, and the potential to reorganize the exchange's ownership and governance structures.¹

Prior to the roundtable, to inform the discussion and contribute to the NEPSE's overall development strategy, NEPSE and the Milken Institute conducted a survey of Nepali businesses, asking them about their ability to access finance and their perceptions of the NEPSE. The first report on this survey, "Access to Finance in Nepal: New Survey Evidence," explores findings related to financial access. This report examines results specific to the development of the stock exchange.

With 216 listed companies and a market capitalization of around US\$13 billion,² the NEPSE is a relatively large market for an economy of Nepal's size. This is due in large part to the fact that the exchange relies on a regulatory mandate to drive new listings. The Security Board of Nepal (SEBON) requires that banks, insurance companies, microfinance institutions, and hydropower companies issue shares on the exchange.³ For the past decade, only firms required to list have listed. As a result, the exchange is dominated by banking and financial stocks, which represent about 80 percent of listed firms and over 60 percent of market capitalization.

To understand how the NEPSE might best attract new listings from other priority sectors, including manufacturing, tourism, agribusiness, health, and IT services, the survey asked unlisted firms about their perceptions of the benefits and downsides of going public and asked listed companies about their experience on the NEPSE. Below, we summarize the key findings for each group. These results are explored in further detail in the following pages.

1. For a summary of the roundtable discussion, see "Framing the Issues: Modernizing the Public Equity Market in Nepal" (Milken Institute, November 2019), <http://milkeninstitute.org/reports/framing-issues-modernizing-public-equity-market-nepal>.
2. "Cumulative Summary Report: Week of 03-Nov-2019 To 08-Nov-2019" (Nepal Stock Exchange Limited, November 2019), <http://nepalstock.com.np/reports-by-category/1>.
3. See SEBON's Securities Listing and Trading Regulation, 2075.



FOR UNLISTED COMPANIES:

1. MOST UNLISTED FIRMS HAD NEVER CONSIDERED ISSUING SHARES; MANY SAID THEY WERE TOO SMALL:

About 80 percent of unlisted respondents said they had never considered going public. Among this group, 49 percent said their firms were too small to list.

2. THE LISTING MANDATE FOR BANKS AND FINANCIAL INSTITUTIONS AFFECTED WHETHER FIRMS FROM OTHER SECTORS VIEWED A PUBLIC LISTING AS APPROPRIATE FOR THEIR COMPANY:

Of the firms that had never considered a listing, 37 percent said the fact that the listing mandate does not apply to their sector affected how they view the possibility of issuing shares.

3. FOR FIRMS THAT HAVE CONSIDERED LISTING, A TOP MOTIVATION IS THE POTENTIAL IMPACT ON BRAND VISIBILITY:

Nearly two-thirds of these firms viewed the impact on brand visibility and prestige as “critical” to their potential to list.

4. TOP DETERRENTS INCLUDED LOSING COMPANY CONTROL AND THE REGULATORY CAP ON IPO PRICING:

The majority of firms that had considered listing (60 percent) viewed loss of company control as a critical negative factor affecting their view of issuing shares; 55 percent said the same of the regulatory caps on IPO pricing.

5. UNLISTED FIRMS REPORTED LOW AWARENESS ABOUT THE BENEFITS AND COSTS OF LISTING, AND VERY FEW HAVE RECEIVED EDUCATIONAL OUTREACH ABOUT GOING PUBLIC:

Only about 40 percent of unlisted respondents said they had adequate information on the IPO process and potential benefits of a NEPSE listing. More than 80 percent said “no one has reached out” to them about the process, benefits, and costs of listing.

6. AND YET, MOST UNLISTED FIRMS SAID THEY WANTED TO LEARN MORE ABOUT A NEPSE LISTING:

Nearly 80 percent of unlisted firms said they “would be interested in participating in seminars or other trainings” to learn more about the listing process.



FOR LISTED COMPANIES:

1. LISTED FIRMS DECIDED TO ISSUE SHARES TO IMPROVE BRAND VISIBILITY AND ACHIEVE OTHER BENEFITS, BEYOND MERELY COMPLYING WITH REGULATORY REQUIREMENTS:

Among participating listed firms, 50 percent cited the impact on brand visibility and prestige as a “critical” factor in their decision to list. Surprisingly, only 44 percent cited the listing requirement as critical to their decision, even though all but one were required to list.

2. THE NEPSE HAS GENERALLY DELIVERED ON KEY BENEFITS:

Over 90 percent of responding firms said that listing improved their firms’ financial reporting standards and overall transparency, and 82 percent said that listing improved their brand visibility and prestige.

3. FIRMS CITED A COSTLY PRE-LISTING PROCESS AND UNDERPRICING OF IPO SHARES AS DRAWBACKS TO GOING PUBLIC:

Over half—56 percent—of respondents said that the process of preparing for the IPO was overly expensive; 41 percent said their shares issued at a lower price than they might have received had the valuation not been capped by regulation.

4. BUT FIRMS DID NOT SUFFER A LOSS OF COMPANY CONTROL OR OTHER POTENTIAL DOWNSIDES:

Despite those financial concerns, over 70 percent said that going public did not result in a loss of company control, which was the main concern cited by unlisted firms. Likewise, listed firms generally did not view listings requirements as overly burdensome.

The next section discusses the survey methodology, describes the sample, and identifies the survey’s potential limitations. It is followed by the findings as they pertain to both unlisted and listed companies, and then the main priorities for NEPSE development as ranked by both groups.

The report concludes with a summary of the implications of the survey results for the NEPSE and offers three recommendations. First, the results point to the need for a proactive NEPSE marketing strategy to inform and attract unlisted firms. Second, both listed and unlisted firms rank improving the NEPSE’s IT systems and data management capacity as a high priority. Third, the results highlight the need to reform the current IPO pricing regulations to allow for market-based pricing of initial NEPSE issuances.

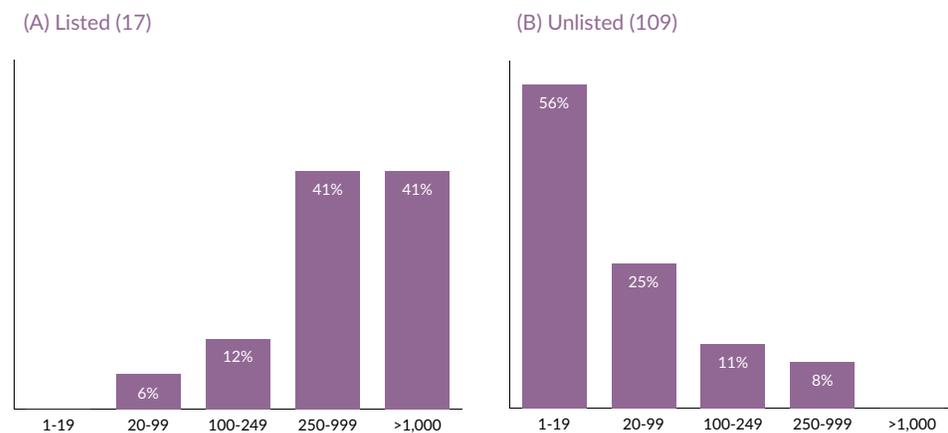


Methodology, Sample, and Limitations

The NEPSE and the Milken Institute collected survey responses from May 2 to May 24, 2019, by means of both an online click-through survey distributed by email to members of various Nepali business associations and by in-person interviews conducted by NEPSE staff. The survey team focused on collecting responses both from firms listed on the NEPSE and from unlisted firms. Respondents were required to be proprietors, senior-level executives, or staff with direct knowledge of the firm's funding sources and ownership structure.

During the collection period, the survey team received 126 valid responses, most of them collected online. Within the sample, 17 firms are listed, and 109 are unlisted. Unsurprisingly, the listed firms tend to be larger than unlisted firms.

Figure 1. Listed and Unlisted Companies, by Number of Employees (percent)

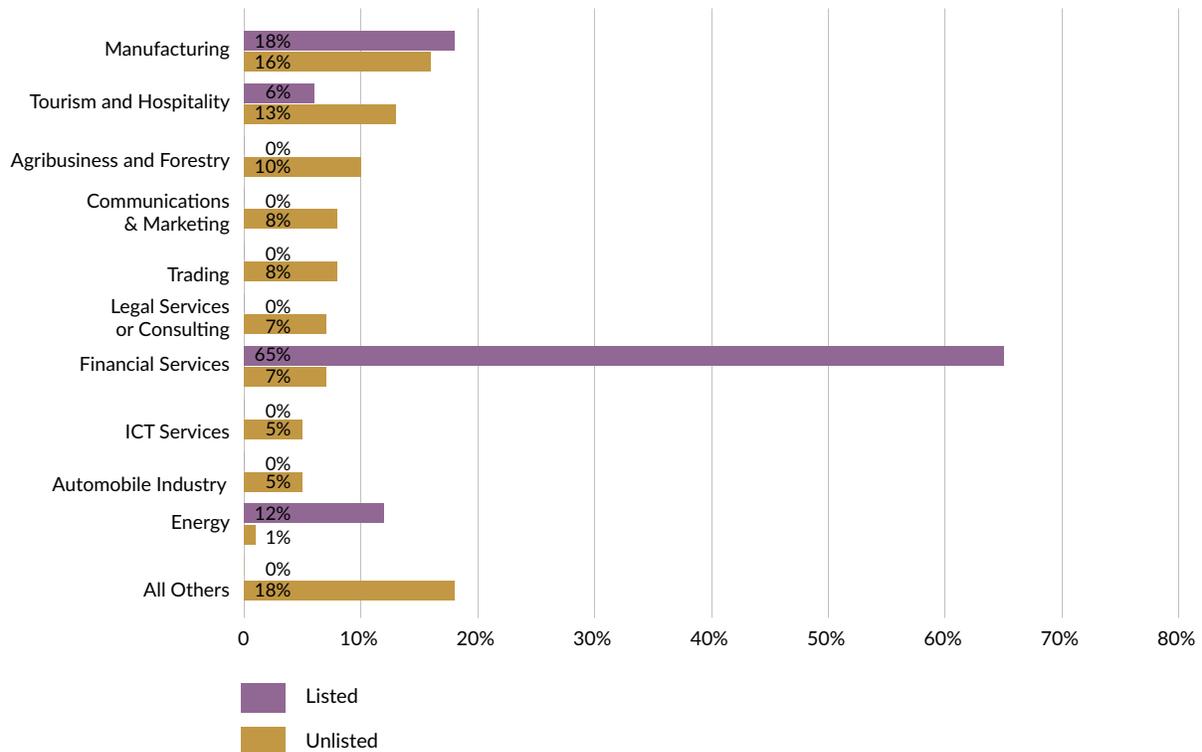


Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019



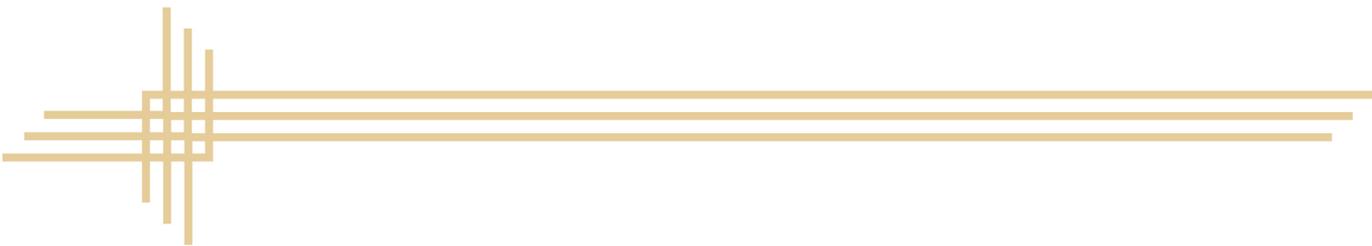
The majority of listed firms (65 percent) are from the financial services industry. This is also unsurprising, given that about 80 percent of companies listed on the NEPSE are from the financial industry. Among unlisted firms, the distribution of sectors within the sample is more representative of the Nepali economy.

Figure 2. Listed and Unlisted Companies, by Sector (percent)



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019
 Note: Here and elsewhere, percentages may not add up to 100 due to rounding.

The survey had several limitations. First, its purpose was to inform a roundtable discussion and not to serve as a comprehensive national study. It is understood that the sample of 109 unlisted and 17 listed firms is not statistically representative of Nepal's business community. Second, the survey was conducted in English and primarily online, excluding potential respondents who do not understand English and limiting responses from firms without internet access. Third, survey results are more representative of conditions in the capital city and its surroundings than the nation as a whole, as 84 percent of the sample was located in the Kathmandu Valley (Province 3), while only 16 percent responded from other parts of the country. Finally, there could have been potential response biases associated with in-person survey interviews conducted by NEPSE staff.



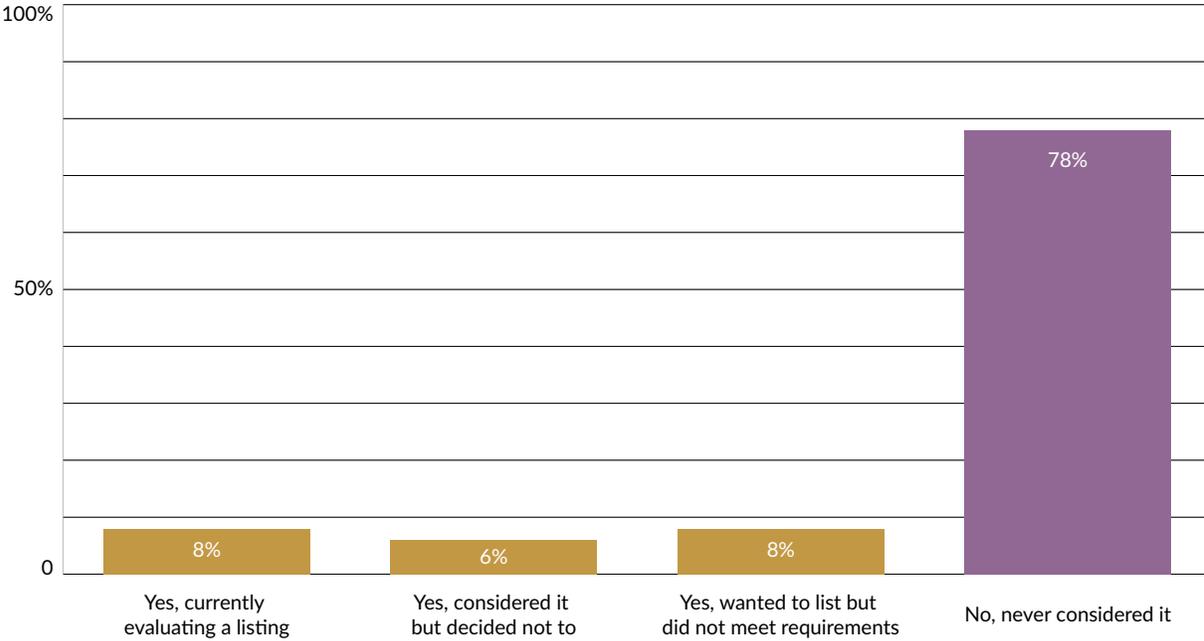
The Views of Unlisted Companies

As the NEPSE leadership contemplates a strategy for attracting new listings from the real economy, it is important to understand how unlisted firms currently view the exchange. The survey asked these companies whether they had ever considered listing on the NEPSE, what affected their views of going public, whether they had received any educational outreach about the NEPSE, and whether they would like to learn more about the exchange in the future. The findings from their responses are detailed here.

FINDING: MOST UNLISTED FIRMS HAD NEVER CONSIDERED ISSUING SHARES; MANY SAID THEY WERE TOO SMALL.

Only 8 percent of responding unlisted firms said they were evaluating a NEPSE listing at the time of the survey, while about 14 percent had done so in the past. Nearly 80 percent, though, had never considered listing on the NEPSE.

Figure 3. Unlisted Firms that Have (and Have Not) Considered a NEPSE Listing (percent)
Q. Have you ever considered, or are you now considering, listing on the NEPSE?



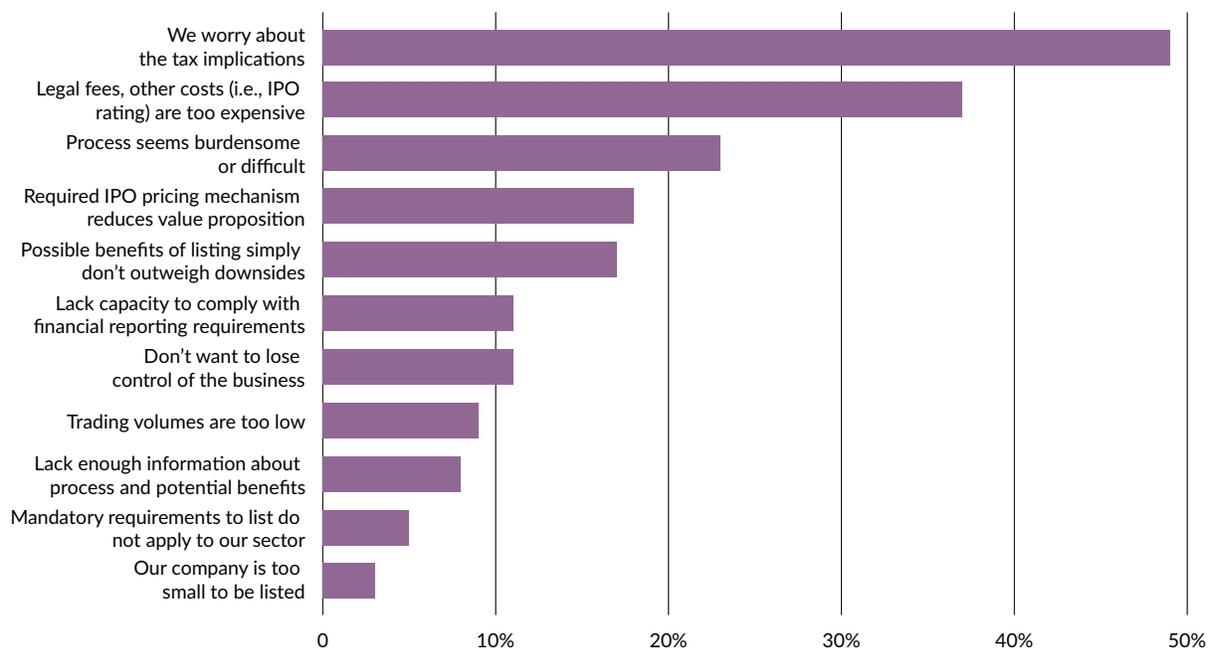
Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019



Those firms that had never considered listing received a follow-up question. Asked what factors affected their views of joining the NEPSE, 49 percent of this segment responded that their companies were too small to be listed. This is probably a reasonable self-assessment, considering the costs involved to prepare a listing and comply with ongoing reporting requirements. In fact, most of the companies who said they were too small are indeed very small companies, with 56 percent of them employing fewer than 20 people.⁴

Figure 4. Factors Shaping Views of a NEPSE Listing, Among Firms that Have Not Considered Going Public

Q. Which of the following factors affect your views of a listing on the NEPSE? Select all that apply.



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

FINDING: THE LISTING MANDATE FOR BANKS AND FINANCIAL INSTITUTIONS AFFECTED WHETHER FIRMS FROM OTHER SECTORS VIEWED A PUBLIC LISTING AS APPROPRIATE FOR THEIR COMPANY.

Over a third (37 percent) of firms that had never considered listing said that the fact that mandatory requirements do not apply to their sector affected their view of going public. This was the second-highest response after “Our company is too small.” The firms selecting this response were mainly from the tourism, trading, manufacturing, agribusiness, and automobile industries—precisely the kinds of firms the NEPSE wants to attract. Their responses may reflect a need for greater outreach campaigns to overcome misperceptions.

4. An additional 28 percent of this segment had 20-99 employees. In terms of fixed assets, which is the official Nepali measure of a firm's size, 93 percent had less than 150 million rupees (about US\$1.3 million) in assets.

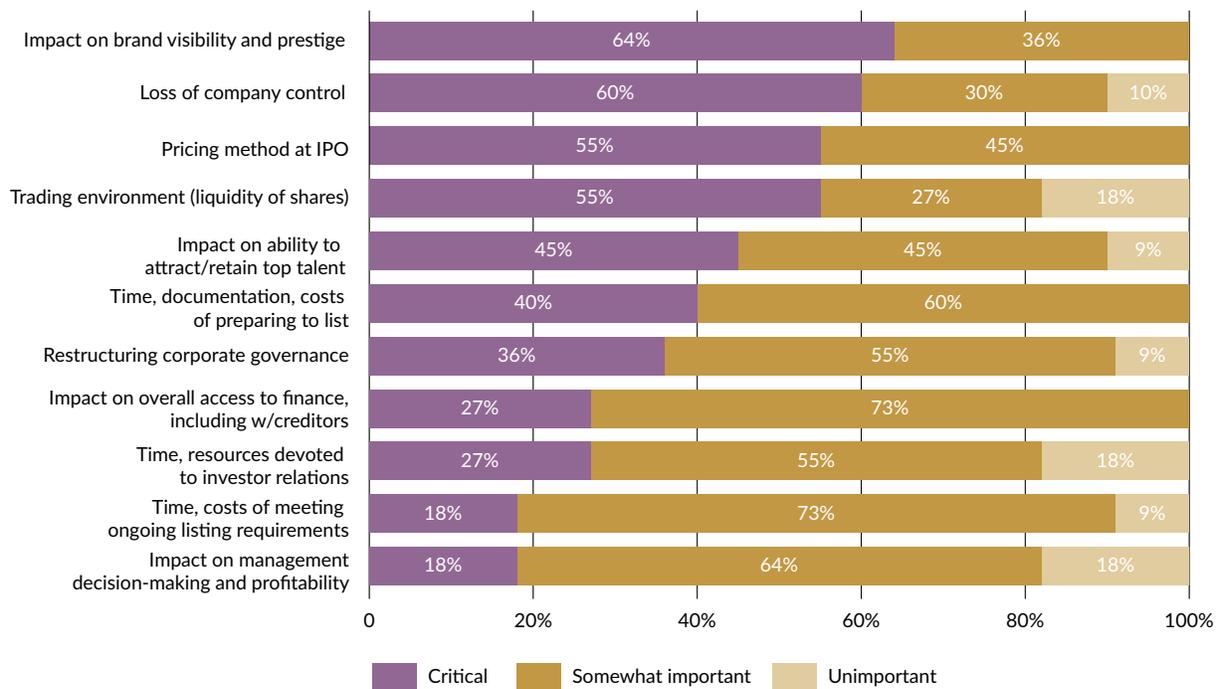


FINDING: FOR FIRMS THAT HAVE CONSIDERED LISTING, A TOP MOTIVATION IS THE POTENTIAL IMPACT ON BRAND VISIBILITY

Unlisted firms that have considered going public were given a list of factors and asked to rank each according to the weight it held in their decision-making (critical, somewhat important, or unimportant). Here, 64 percent cited the impact on brand visibility and prestige as critical; 45 percent identified the impact on attracting top talent as critical.

Of interest, only 27 percent considered the impact of improved overall access to finance to be a critical factor. Likewise, only 18 percent saw the impact on improved managerial decision-making and profitability as a critical factor.

Figure 5. Factors Shaping Views of a NEPSE Listing, Among Firms that Have Considered Going Public
Q. For those companies that considered listing in the past and those that are currently considering a listing, how important were/are the following factors in your decision to list or not?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

FINDING: TOP DETERRENTS TO LISTING INCLUDED LOSING COMPANY CONTROL AND THE REGULATORY CAP ON IPO PRICING.

At the same time, 60 percent of this group saw a loss of company control as a critical factor, and 55 percent viewed the pricing method at IPO (see box) as critical to their assessment of the NEPSE. Likewise, 55 percent viewed the level of NEPSE trading, which is fairly low, as a critical factor in their consideration.



Nepal's IPO Pricing Cap

The Securities Board of Nepal (SEBON) sets a maximum limit for valuations of companies preparing their IPOs. According to the 2016 Securities Issuance and Allocation Directives, share prices at IPO cannot exceed a total valuation of four times the book value of a company's assets.⁵

At the roundtable held by the NEPSE and the Milken Institute, participants identified the IPO pricing cap as a critical disincentive to investment in Nepal—and, ultimately, to attracting new listings to the NEPSE. Without the possibility of strong returns, investors are unlikely to take risks on the kinds of young, innovative small and medium-sized enterprises that tend to catalyze economic growth. And if they do invest in those firms, the pricing cap means they may look for other ways to exit their investments rather than issuing shares on the exchange.

FINDING: UNLISTED FIRMS REPORTED LOW AWARENESS ABOUT THE BENEFITS AND COSTS OF LISTING, AND VERY FEW HAVE RECEIVED EDUCATIONAL OUTREACH ABOUT GOING PUBLIC.

While 46 percent of firms said they had sufficient information about corporate governance practices, only 33 percent said they had sufficient information about the process and costs involved in getting and staying listed.

These results may not be surprising in light of the very limited outreach reported by unlisted respondents. Only 16 percent had received outreach from any organization on the process, benefits, and costs of a NEPSE listing, but 84 percent reported that no one had reached out to them with this information. Of note, none of the unlisted firms surveyed had received any direct outreach from the NEPSE itself.

5. For valuations from one- to four-times book value, SEBON allows companies to use market-based valuation formulas. Historically, though, most companies listing on the NEPSE have done so at par—that is, the share price is valued at the firm's book value of assets—but it is worth noting that almost all of these companies are banks and financial institutions that came to the market because of regulatory mandate.

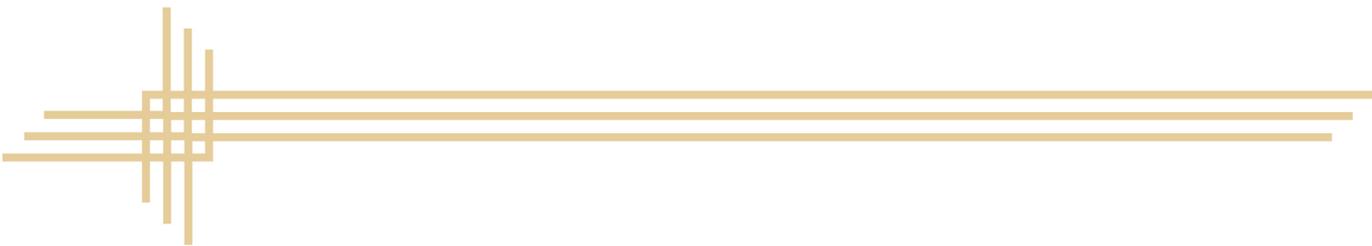
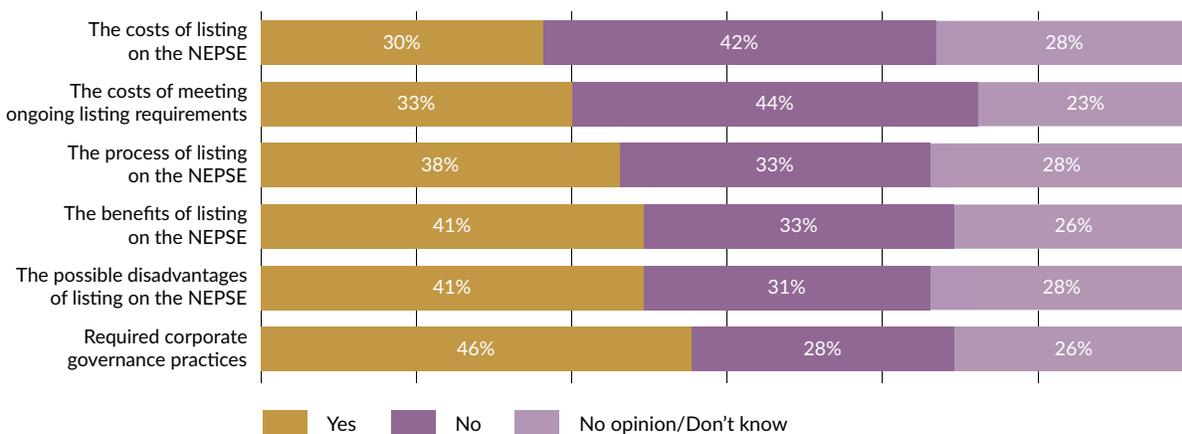


Figure 6. Reported Awareness of Various Aspects of Going Public

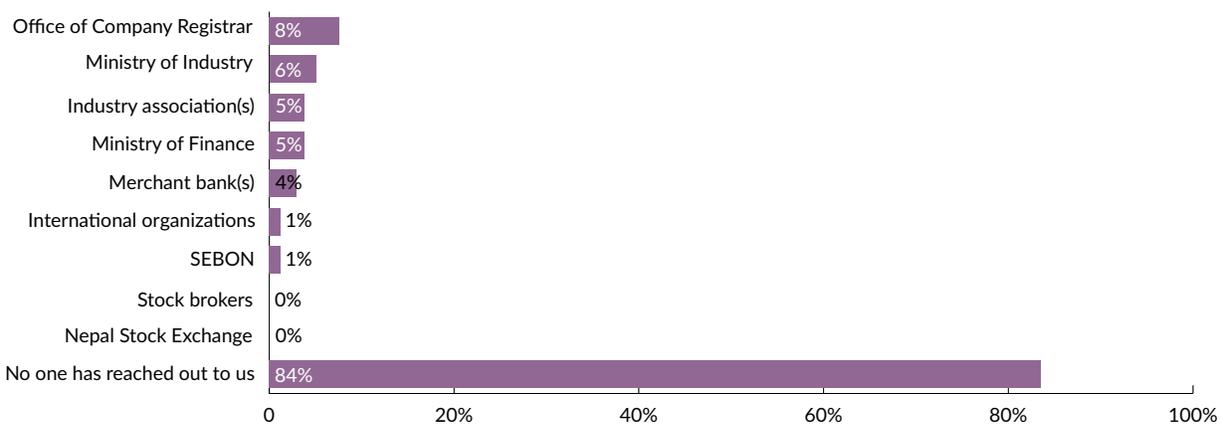
Q. Do you believe your company's management team has adequate information about the following aspects of being a listed company?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

Figure 7. Outreach to Unlisted Companies

Q. Has anyone reached out to your company to provide you with information about the process, benefits, and related costs of listing? Select all that apply.



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019



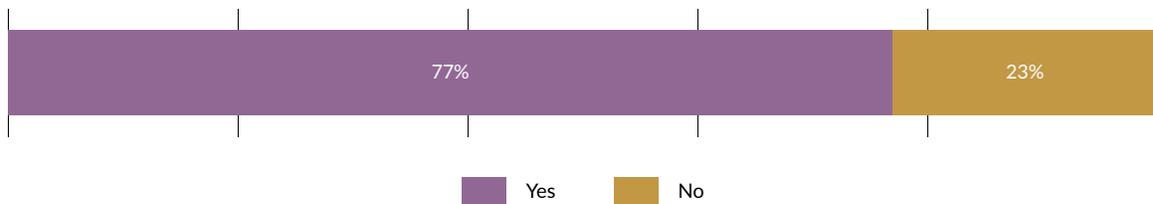
FINDING: MOST UNLISTED FIRMS SAID THEY WANTED TO LEARN MORE ABOUT A NEPSE LISTING.

The good news for NEPSE is that a large majority of responding unlisted firms (77 percent) were interested in participating in seminars and trainings to learn more about going public. This finding suggests there is a strong marketing opportunity for the NEPSE as it seeks to attract new listings.

As discussed in the next section, the NEPSE can potentially craft a compelling case for attracting unlisted firms based on the experiences of currently listed companies. In particular, the experiences of listed firms seem to contradict one of the main worries of those firms considering a listing: loss of company control.

Figure 8. Interest in Learning about the Process of Going Public

Q. Would your company be interested in seminars or trainings to learn more about the process of becoming a listed company?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019



The Experience of Listed Companies

The survey asked listed firms about what motivated their decision to list and whether or not they experienced a variety of potential benefits and downsides. As discussed here, the results allow for interesting comparisons between the perspectives of unlisted companies and the experiences of being listed as reported by firms already on the exchange.

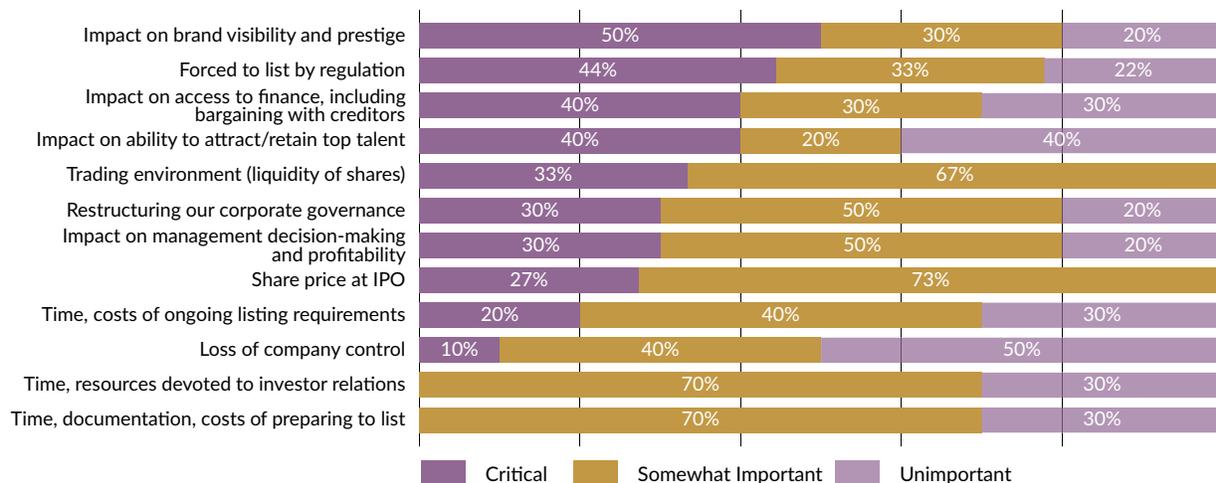
FINDING: LISTED FIRMS DECIDED TO ISSUE SHARES TO IMPROVE BRAND VISIBILITY AND ACHIEVE OTHER BENEFITS, BEYOND MERELY COMPLYING WITH REGULATORY REQUIREMENTS.

Nearly all participating listed companies—94 percent—said that regulatory mandates required them to issue shares. But only 44 percent of listed firms said this requirement was critical to their decision to join the exchange, while 33 percent said it was important. Notably, 22 percent said the mandatory requirement was unimportant to their decision.

Beyond mere compliance, the listing decision for most firms was driven by various factors. Foremost among them, cited as critical by 50 percent of listed firms, was the potential impact on brand visibility and prestige—a view that 64 percent of unlisted firms also singled out as crucial. The impact of listing on talent recruitment and retention was also critical to 40 percent of responding listed firms.

Figure 9. Motivations for Listing on the NEPSE

Q. Thinking back to when your company was considering a listing, how important were the following factors in motivating your decision to list on the stock exchange?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

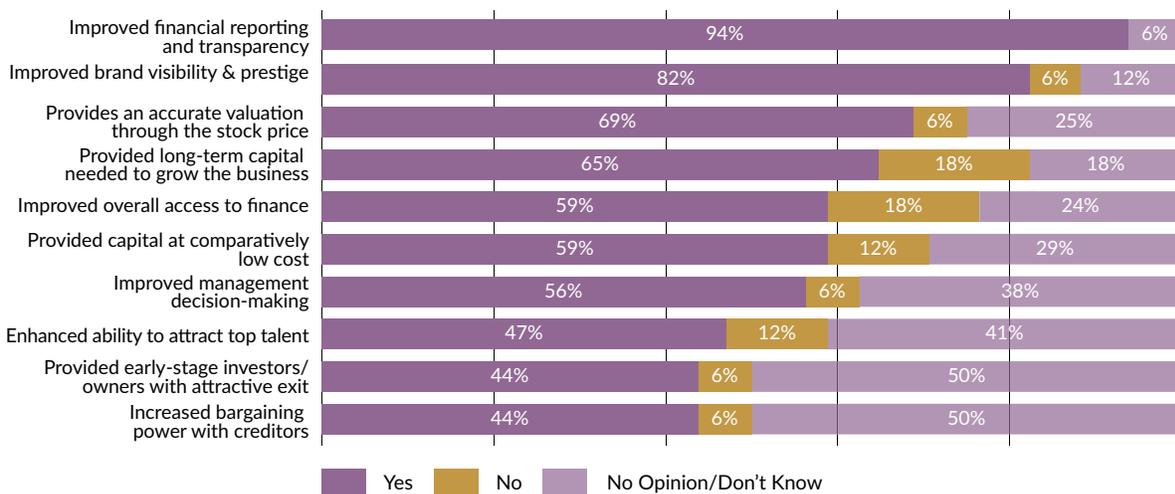


FINDING: THE NEPSE HAS GENERALLY DELIVERED ON KEY BENEFITS.

A large majority—94 percent—of listed respondents said that going public has improved their firm’s financial reporting standards and transparency. Likewise, 82 percent said listing delivered on their top pre-listing incentive of improving brand visibility and prestige. For 69 percent of listed respondents, the NEPSE also provided an accurate and up-to-date valuation of their company through the stock price. Nearly two-thirds (65 percent) reported that their listing helped them raise long-term capital to grow the business, while 59 percent cited improved overall access to finance, and the same number said the listing provided capital at a comparatively low cost.

Figure 10. Benefits of Listing on the NEPSE

Q. Based on your company’s experience, has listing on NEPSE delivered the following benefits or not?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

FINDING: FIRMS CITED A COSTLY PRE-LISTING PROCESS AND UNDERPRICING OF IPO SHARES AS DRAWBACKS TO GOING PUBLIC.

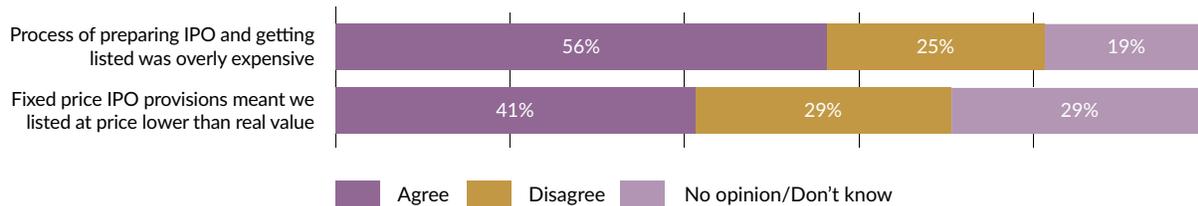
Over half—56 percent—of listed respondents said that the IPO preparation process was overly expensive. This is an issue that the NEPSE and regulators at SEBON may wish to address, as it was also cited by 40 percent of unlisted firms as critical to their considerations of going public.

Another notable downside was the IPO pricing cap. A sizable number of responding firms—41 percent—said they issued shares at a price lower than they might have received had their valuation not been capped by regulation. This finding suggests that out of the 216 companies listed on the NEPSE, nearly 90 may have listed at a value lower than the market would have paid. In other words, a large number of NEPSE-listed firms likely raised less capital for investment and expansion than they would have with market-based pricing.



Figure 11. Actual Downsides of Listing

Q. In the case of your company's listing experience, please indicate whether you agree or disagree with the following statements on the possible downsides of listing.



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

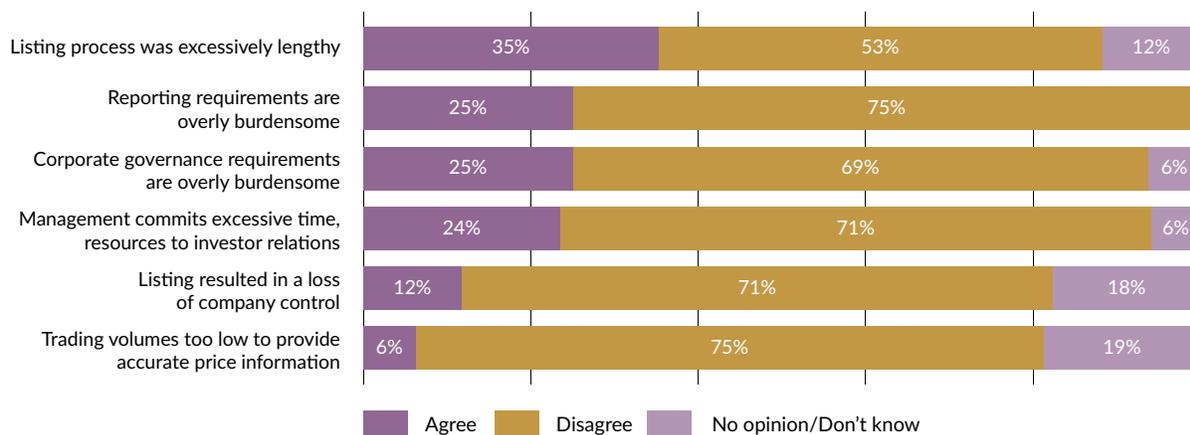
FINDING: FIRMS DID NOT SUFFER A LOSS OF COMPANY CONTROL OR OTHER POTENTIAL DOWNSIDES.

While drawbacks are related to getting listed, once firms issue shares, they are generally satisfied with their experience, according to survey results. In particular, in the important area of company control, 71 percent of surveyed firms said they disagreed with the statement that listing had resulted in a loss of control. The same number, 71 percent, disagreed that their management spends too much time responding to shareholders, an important aspect of controlling the direction of the company. These findings suggest that unlisted firms' concerns about losing control, as cited by 60 percent of unlisted respondents, may be misguided.

In several other areas, surveyed listed firms reported that they did not experience possible downsides of listing. In particular, they disagreed with statements that reporting and corporate governance requirements were too burdensome and that trading volumes were too low to provide an accurate view of their firm's price.

Figure 12: Unrealized Downsides of Listing

Q. In the case of your company's listing experience, please indicate whether you agree or disagree with the following statements on the possible downsides of listing.



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

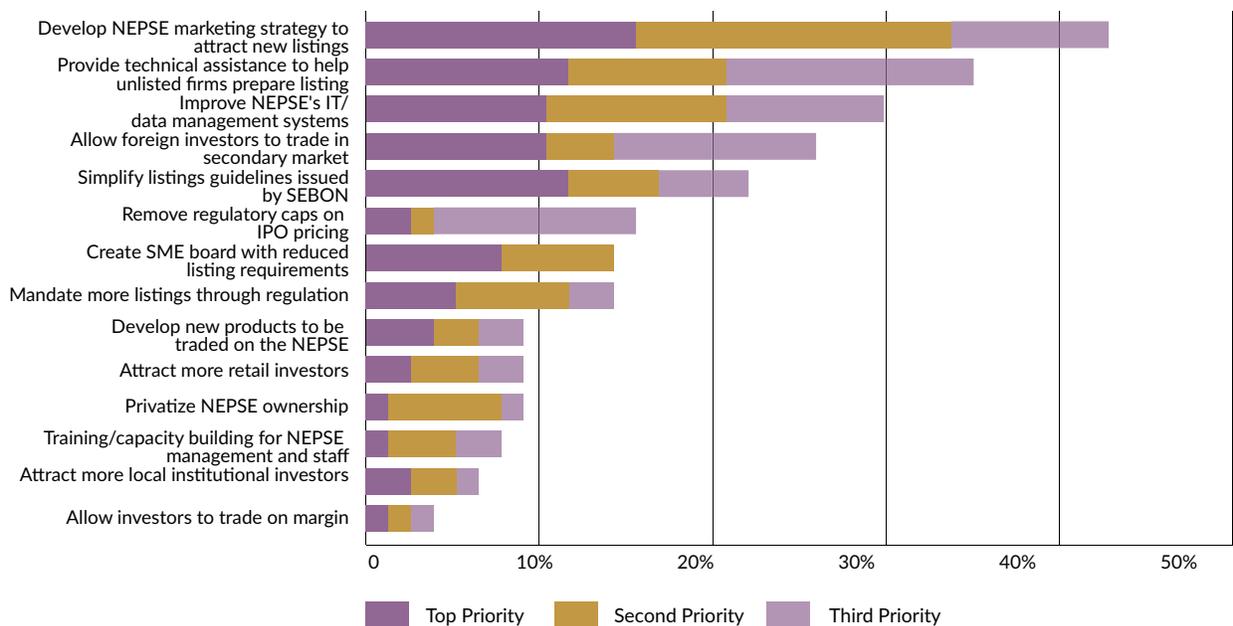


Priorities for NEPSE Development

Finally, recognizing that the institutional development of the exchange will require making strategic choices, we asked respondents to select their top three priorities for the NEPSE from a list of options we developed through consultations with the NEPSE leadership and various market stakeholders. The results, divided here by unlisted and listed firms, affirm several findings discussed in earlier sections and introduce new issues that these companies want the exchange to address.

For unlisted firms, the top two priorities reflect an appetite to learn more about listing on the NEPSE. Over 40 percent of these respondents ranked “develop a NEPSE marketing and outreach strategy to attract new listings” in their top three priorities. Likewise, 35 percent named “provide technical assistance to help prepare for a listing” in their top three. Seeing the exchange invest in improved IT and data management systems also ranked as one of their top three priorities.

Figure 13: Priorities for NEPSE Development, Unlisted Companies
Q. What would your top three priorities be for stock market development in Nepal?



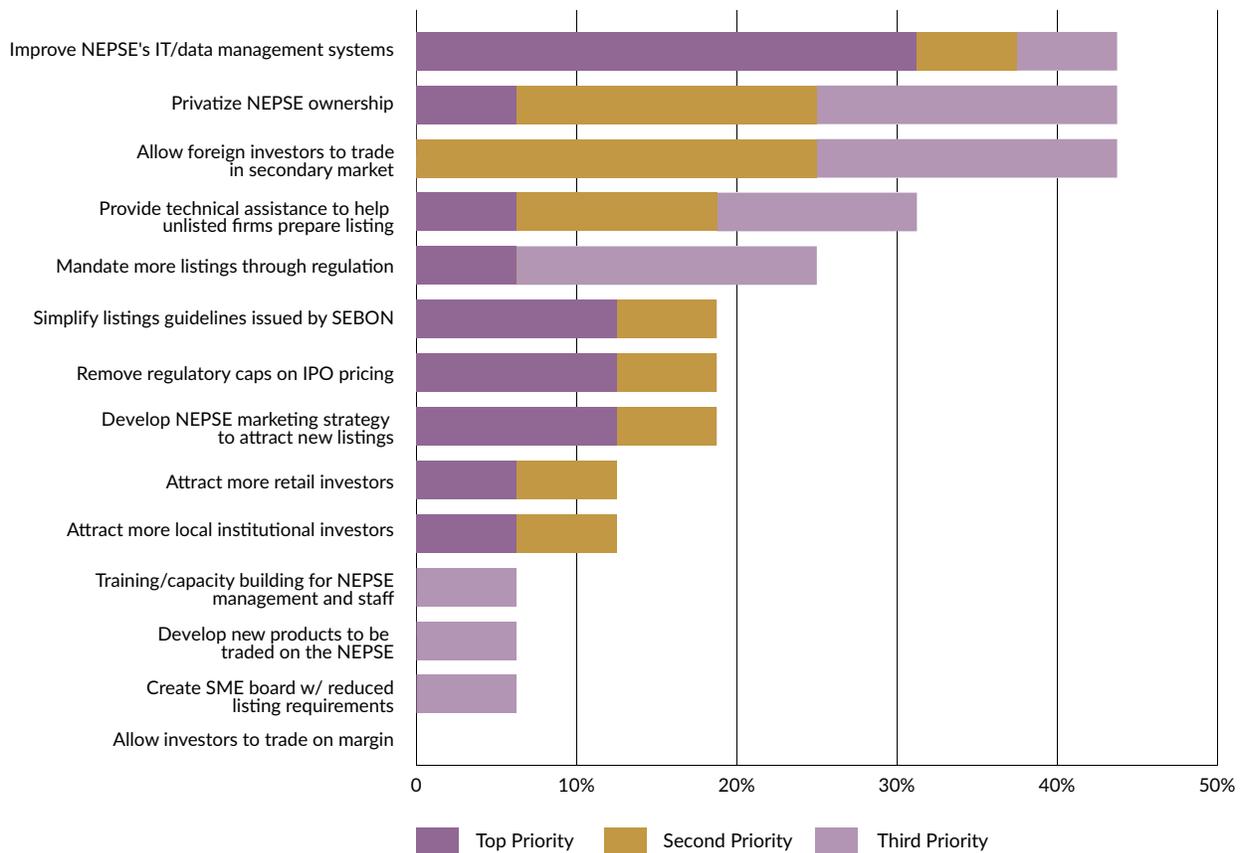
Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019



Listed firms identified a slightly different set of top priorities. Over 40 percent of these firms ranked improving the NEPSE IT and data management systems in their top three priorities, with 31 percent flagging this as the most important priority. Listed firms also ranked privatizing the NEPSE's ownership structure and allowing foreign investors to trade in the secondary market as two additional important development goals for the exchange.

Figure 14: Priorities for NEPSE Development, Listed Companies

Q. What would your top three priorities be for stock market development in Nepal?



Source: NEPSE-Milken Institute Survey of Nepali Businesses, 2019

The NEPSE's current status as a state-owned enterprise and the importance of attracting foreign investors were topics discussed extensively at the NEPSE-Milken Institute roundtable. There was broad consensus that privatization would benefit market development by allowing the exchange to more independently and effectively pursue its mission to connect issuers and investors. There was also consensus that attracting foreign investment to the NEPSE will be an essential complement to efforts to deepen the local investment base.



Conclusion and Recommendations

The NEPSE-Milken Institute survey highlights several key themes for attracting new listings to the exchange. First, few participating unlisted firms had considered going public, believing themselves to be too small or dismissing the possibility because the regulatory mandate to list does not apply to their sector. Second, unlisted firms reported low levels of awareness of the process, benefits, and costs of listing, a result likely tied to the fact that very few firms have received any educational outreach about going public. The good news for the NEPSE is that a large majority (77 percent) of unlisted respondents said they would be interested in learning more about issuing shares on the exchange.

The survey results suggest that public companies are generally satisfied with their NEPSE experience. Most report that going public has resulted in improving firm prestige and branding power—the main motivation for listing cited by both listed firms and those considering issuing shares. At the same time, most listed firms rejected the idea that listing results in a loss of company control, as unlisted firms worry it will.

Taken as a whole, the survey findings point to three key recommendations for making a NEPSE listing more attractive to Nepali firms:

- 1. THE NEPSE SHOULD DESIGN AND EXECUTE A MARKETING AND OUTREACH STRATEGY FOR UNLISTED FIRMS.**

The strategy should emphasize the benefits of improved brand visibility and prestige, address the negligible risk of losing company control, and correct the potential misperception that sectoral mandates to list do not mean that other sectors are excluded from the exchange.

- 2. THE NEPSE SHOULD IMPROVE ITS IT AND DATA MANAGEMENT SYSTEMS.**

This was cited as a top development priority by both listed and unlisted firms.

- 3. SEBON SHOULD REFORM THE IPO PRICING REGULATIONS.**

Though beyond the NEPSE's direct control, this reform would make listing more attractive while ensuring that firms that do list raise as much capital to invest for growth as market conditions allow.



As discussed in the first paper on this survey, the most pressing challenge for the Nepali business community is access to finance. Firms are eager to see new funding sources developed that will make them less reliant on bank lending. For many, a NEPSE listing could be a way to access the capital they need for investment and expansion.

The recommendations here suggest a roadmap for helping the NEPSE increase listings without having to rely on regulatory mandates. When firms issue shares in the capital markets, they open another avenue for accessing the funding they need to grow, create jobs, and contribute to the national economy.

ABOUT THE AUTHOR

John Schellhase is an associate director with the Milken Institute's Global Market Development (GMD) practice. The GMD practice supports policymakers in developing countries and emerging markets in their effort to strengthen and deepen domestic capital markets and catalyze funding for national development priorities. As part of the GMD team, Schellhase has managed financial-sector development projects in Rwanda, Myanmar, Nepal, the Philippines, and Thailand. He is based in Madrid, Spain.

On behalf of the Milken Institute, the author wishes to thank the leadership of the NEPSE for their ongoing partnership on capital market development research in Nepal and for their substantial support throughout the fielding of this survey.



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