

Investment Decision Behaviour of Nepalese Investors in Initial Public Offerings

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Abstract

The main objective of this study is to explore the investment decision behaviour of Nepalese investors in Initial Public Offerings (IPOs). The study is qualitative in nature where semi-structured interviews are adopted to solicit an understanding of six young Nepalese investors on their investment decision. An understanding of how a specific individual in a specific setting makes meaning of a specific experience has been gained through the application of interpretative phenomenological analysis. The findings indicate investors are not influenced by psychological biases because they do not 'herd' on the information; rather it was found that they are influenced by overconfidence bias as investors overestimate their skills when investing. Moreover, this study has solely focused on IPO only, i.e., primary market, further qualitative research can be conducted on the secondary market to understand the financial setting and gain knowledge on how investors behave when investing in a riskier and more volatile market.

INTRODUCTION AND STUDY OBJECTIVES

Initial Public Offering (IPO) has become the investor's most preferred choice for long-term investing in Nepalese context. The procedure through which a company sells its shares to the general public is referred to as an initial public offering (IPO). An IPO pools the savings of several investors who share

a common financial goal. The stock market gets crowded with numerous applicants whenever an organisation issues an IPO. Almost all the time IPOs are being oversubscribed. [Rijal \(2020\)](#) stated that the IPO of Nepal Reinsurance Company was oversubscribed by 1.57 times within two days of issuance while the NEPSE's index was down by 3.3674 percent at that point of time. Similarly, [Sharesansar \(2022\)](#) revealed that since

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the IPO of Emerging Nepal Limited was oversubscribed on the first day itself, it closed to accept the applicants at the early closing date. Thus, the share market is heavily oversubscribed. Mushrooming demand for initial public offerings is also considered to be extremely sensitive to investor sentiment (Baker & Wurgler, 2007).

Irrationality of the investors has been pointed out repeatedly. The investor is unable to adhere to the "rational" principles of traditional finance theory. Financial markets reflecting human failings is not surprising because investors are also people. Furthermore, contrary to what traditional theory claim, investors are not rational utility-maximising machines. Instead, the investors are escorted by their own thoughts, that's why they are more inclined to make cognitive errors. Additionally, Investors might be overconfident on their capabilities, exaggerate the information, lack self-control, and follow the crowd without realising the consequences (Statman, 2012).

An investment is saving current money and other resources for future benefit but investors while investing their money exhibits inconsistency at their decisions and preferences that leads to bear uncertain losses. Nonetheless, the factors like stock market index, remittance and interest rate have a significant relationship with IPOs returns (Laohakosol et al., 2018). But most of the Nepalese investors do not acquire sufficient information regarding the share market. Although they still show their willingness to invest in shares.

Majority of the studies also focus on how different behavioural biases influence the investment decision and most of them are quantitative studies. Besides, most commonly it is found that studies comprise overconfidence, disposition effect, herding bias, availability bias, representative bias and home bias to examine the investment decision of investors on the stock market (Dahal, 2007; Rana, 2019; Dangol & Manandhar, 2020). Moreover, Jaiyeoba and Haron (2016) stated that the assumptions of traditional finance theory where investors' take decisions by assembling required data and possess the abilities to process collected information in a rational, unemotional way to arrive at an optimal choice is not enough to examine the investor's behaviour these days, and, thus, need to analyse more about behavioural finance in qualitative way.

Further, studies focusing investor's behaviour on IPOs is rarely found in the context of Nepal. So, it is essential to understand how the investors behave before venturing into the business of buying stocks. Thus, this study has used a qualitative method to explore how investors make their investment decisions in an IPO.

Moreover, the conclusion of this research can help to solve many queries that are associated with all the stakeholders in the stock market of Nepal.

LITERATURE REVIEW

This section mainly discusses the behavioural biases and factors that affect investment decisions in both international and Nepali context.

Empirical Reviews: In a study, a multi-period market model was built to explain how traders learn about their skills and how a bias in this learning can lead to overconfidence. In the model, a trader initially is unaware of his skill. This skill is judged from his accomplishments and failures. The trader gives himself too much credit for his/her success while evaluating his/her skill. It makes one overconfident. In the beginning of their careers, traders are more likely to be overconfident. Then, as one gains experience, he better recognises his capacity (Gervais & Odean, 2001). Another study of the presence of herding behaviour in Chinese markets using both individual firm- and sector-level data was done. Perhaps surprisingly, we find no evidence of herd formation. Evidence suggests that market participants in Chinese stock markets make investment choices rationally. So, herding behaviour does not exist in the Chinese Market (Demirer & Kutan, 2006).

Kaustia and Knupfer (2007) found that increase in an investor's profits on prior IPO investments has a positive effect on the investor's inclination to participate in future IPOs. Additionally, it has been discovered that personally experienced returns play a significant role in predicting future IPO subscriptions. The investor emulates behaviour that has led to positive results in the past and avoids behaviour that has led to negative results. It means the individual prioritises own experience. Investors who subscribe to their first initial public offerings (IPOs) demonstrate that the first-hand experience has both short- and long-term effects on their willingness to utilise the same financial product in the future.

Bildik and Yilmaz (2008) believed that a pool of investors may not only indicate the size of the IPO but, more significantly, the level of interest it generated. Due to excess demand for the IPO shares, greater initial returns may be anticipated as more investors engage in the offering. In hot markets, IPOs with more investors may well experience bigger early abnormal returns due to market psychology, which eventually shift into underperformance as investors discover they were overly optimistic about the IPO's worth (overvaluation) during the original offering.

Similarly, research was conducted in Vietnam to examine the behavioural aspects influencing the performance and decision-making of individual investors at the Ho Chi Minh stock exchange. Overconfidence, availability bias, herding, market variables, prospecting, and anchoring were among the factors examined. According to the study's findings, the market factor has the greatest influence on decision-making, with all other elements having mild effects. Herding, prospects, and overconfidence are the only three variables that have an impact on investment performance (Luong & Ha, 2011).

Since more people are becoming aware of the stock market, there is a stronger flow of money, and people are beginning to grasp the value of investing in stocks. Roka (2011) evaluated the public's response to the primary market as extremely positive. The author said that the lack of investment options in other sectors is responsible for the strong public reaction to the stock market. Although Nepal's general

investors are interested in making investments in the primary market, they lack appropriate knowledge about it. It is identified that the public is drawn to stocks because they can raise the value of their investments.

Individuals display behavioural biases in their trading activities. The most significant initial step is to be aware that the decision-making process is not negatively impacted by behavioural biases. When decision-makers have access to enough information and that information is presented and analysed to identify risks, rational decisions are more likely to be made (Abiola & Adetiloye, 2012).

Bashiretal.(2013)examinedtheinfluence of behavioural biases on investors' financial decision-making. According to the study's findings, investors' financial decisions are influenced by confirmation bias, overconfidence bias, excessive optimism, and the locus of control where loss aversion, mental accounting, and the status quo does not impact. A weak negative correlation between overconfidence bias and the other behavioural biases covered in the study was also noted by the authors. The results showed that there is no significant difference between males and females' overconfidence bias in decision-making.

Jagullice (2013) revealed that IPOs offered investors abnormal returns soon. This most likely cause recent IPOs to be oversubscribed, some of which have had poor aftermarket performances. This shows that their erroneous investment decisions, as

explained by behavioural finance theorists, may have been impacted by cognitive and emotional biases. Individual investors made the biggest cognitive mistakes in relation to IPOs. Additionally, rather than being guided by logic, individual investors' investing decisions were frequently affected by their gut feelings.

Dangol and Shrestha (2018) analysed the effects of the Big Five Personality Traits and demographics like age, gender, education levels, and stock market investment experience on three proposed behavioural biases of individual investors in investment decisions: overconfidence bias, disposition effect, and herding behaviour. According to the study's findings, extroverted investors should seek the advice of financial advisers and expert people, as well as confirm market information, to prevent the development of overconfidence bias. Similarly,, investors who exhibit neuroticism should determine whether to sell or hold an investment after carefully weighing its potential benefits and drawbacks to avoid the disposition effect. Corresponding to this, investors with higher levels of conscientiousness should confirm the market information and come to their own conclusion to invest to prevent developing herding and overconfidence biases.

Gurung (2019) opined that university professors' personal self-awareness, followed by the media, publications, friends, and their professional experiences, are the main influences for IPO activities. The findings also indicate that although university teachers have a fair amount of awareness about IPOs.

Even though they do not participate in official training programmes or courses, they have good reading habits and are knowledgeable about the capital market. They mostly find out about IPO activities through friends, the media, publications, and self-awareness. However, word-of-mouth, stock-brokers, bankers, and parents are the least influential elements in learning about IPO.

According to [Gnawali \(2020\)](#), before making an investment decision in an IPO, Nepalese investors are greatly influenced by quality management, company reputation, company performance, and corporate sector and market information. [Paudel \(2021\)](#) also highlighted the fact that firm performance, quality management, company goodwill, and market knowledge have significant relationships with general investors' investment decisions.

[Gurung \(2020\)](#) examined general investors' perspectives on their IPO. According to the survey, the most popular industries for purchasing common stocks on the primary market with the hope of receiving long-term gains are banking and finance, followed by hydropower. Male and female investors generally hold quite different opinions regarding the risk and return of IPO investments. The study comes to the further conclusion that the size of the company issuing the IPOs and the government's policy statements are the main factors of IPO return and risk, while the public subscription rate is the least important factor.

[Dangol and Manandhar \(2020\)](#) found that four heuristic biases have an

impact on Nepalese investors. The research also identified a substantial moderating role for locus of control in the relationship between investment decisions and the three heuristic biases of availability, representativeness, and anchoring. The study, however, shows no moderation impact regarding overconfidence bias. According to the authors, investors in Nepal believe they have access to all the necessary information and are therefore capable of making wise investment decisions. Investors who are feeling confident tend to act quickly and without doing any careful thought first. However, the degree of locus of control the investors have also has an impact on the thoughts and actions of Nepalese investors.

Behavioural Finance Theory: The study of investment behaviours has drawn the attention of behavioural finance scholars in integrating various psychological theories. Among a number of these theories, [Kumar and Goyal \(2015\)](#) outlined four prevalent ones, including overconfidence, disposition effect, herding bias, and home bias/familiarity bias that might influence the decision-making process for investments. Overconfidence, also known as miscalibration, is a prevalent phenomenon that can have adverse effects. Investors that possess overconfidence trait overestimate their analytical abilities and misrepresent the authenticity of their information. In the same way, Investors that are subject to the self-attribution bias tend to praise their abilities for their success in the market and disregard the risks involved in the investment.

The disposition effect is a crucial behavioural bias that demonstrates fear of regret and seeking pride by the investors leads to sell profitable shares too soon and hold onto losers for too long. When rational people begin to imitate the irrational behaviour of others while making financial decisions, it is referred to as herding bias. Individual investors frequently engage in this behaviour by adopting the viewpoint of the majority investors. Home bias/familiarity bias is another psychological bias addressed by [Kumar and Goyal \(2015\)](#). Home bias is the tendency for investors to invest in securities that they are familiar with, which restricts the benefits of portfolio diversification.

To determine the types of investors in the Nepalese primary market and to prevent typical mental errors and errors in investment decisions, it is apparently crucial to understand these investor biases. Additionally, behavioural finance is helpful in providing investors with sound advice on how to understand themselves ([Muradoglu & Harvey, 2012](#)). This suggests that understanding oneself is more crucial than having a strong knowledge of the stocks. Further, it also suggests that it is equally vital to know yourself because even informed investors usually fail because they let their cognitive biases influence their judgement.

The success of the IPO itself can also be evaluated in a variety of ways. Under-pricing is the key performance indicator identified in IPO research ([Carter & Manaster, 1990](#)). Under-pricing is the discrepancy between the initial offering price and the stock's closing price on the first trading day. Since

the 1980s, extensive study has been done on under-pricing in the market for IPOs. The reasons behind initial public offerings' under-pricing remain a major mystery, even though scholars have offered several suggestions to explain the extent of under-pricing. Some of the most well-known ideas were categorised by [Ljungqvist \(2004\)](#) into four primary groups: asymmetric information, institutional explanations, ownership and control explanations, and behavioural approaches. Parts of under-pricing are defined by these theories. However, there isn't a definitive explanation that fully explains under-pricing.

Regarding the number of issuing companies and the proportion of subscriptions, IPOs are expanding in Nepal. This pattern suggests that initial public offerings (IPOs) are frequently under-priced. The performance of IPOs will be better for investors when deeper the under-pricing, higher the early returns will be ([Dahal, 2007](#)).

RESEARCH METHODS

An exploratory research design has been used under qualitative study. Likewise, phenomenological inquiry is employed to understand the lived experience of Nepalese investors in the stock market, i.e., exploring the Nepalese investor's investment decision in IPO. In this study, the interpretive approach is adopted to shed a light to understand beliefs and existing valued knowledge about a phenomenon. Data collection was done through semi-structured interviews to explore in-depth individuals' experiences to analyse the information collected and to offer insights into how a particular

person in a certain situation interprets a specific phenomenon. The interviews were around one hour where three interviews were held through google meet and three were in person. The conversations were recorded with the informant's permission by maintaining secrecy. Recordings were transcribed and contents were analysed through an interpretative phenomenological approach.

The number of participants for this study consisted of six Nepali investors aged between 25-35 and who have invested in IPOs. Malterud et al. (2015) stated that 6 to 12 interviews with informants establishes sufficient and needed information in a qualitative-based study. The selection criteria of the participants are based on convenience and judgement so that participants are known to have experienced the phenomenon of the study interest.

DATA ANALYSIS AND DISCUSSION

This section describes the overall opinions of the participants by generating themes.

Motivating Factor to Invest in IPOs

Today's small amount can earn a high return, this is what the investors believe. A huge amount is not required to invest in an IPO like in real estates, fixed deposits etc. Profit and high return in the short period is the major motivating factor to invest in an IPO. Likewise, it helps in cash shortage and the participants also said that their savings get utilised as well. Investors perceive investing in

an IPO is better than savings and fixed deposits. Informants consider an IPO as a quick way of making money. They believe they can earn a good return in future in comparison to savings and fixed deposits. Interviewee: "With only 1000 rupees, we can invest and be the shareholder of a particular company. But sometimes due to its rigid process to proceed in the secondary market and selling process as well as high transaction trading volume, it takes time to get money back with profit."

Negative Rumours of the Company Issuing IPO

Self-analysis is quite essential while investing in an IPO to mitigate the rumours. There is an easy way to get information about the companies and the share-market through different social mediums. Investors differentiate between market value and actual value of shares by analysing the share market. In addition, share applicants are mushrooming which ultimately decreases the chance of getting allotted. So, to minimise the competition in the market, negative rumours are spread about the companies that issue an IPO. But negative rumours do not impact the investment decision of investors, whether it is right or wrong, they invest in IPOs, as the investment amount is small and if not allotted the invested amount will be returned after some time.

Interviewee: "In many Facebook pages, negative rumours were seen when the IPO of Chandragiri Hills was issued but such news didn't influence in any ways to invest."

Sources of Information

In the past, one could get the information from the broker or had to read the newspapers regarding the issue of IPO. Nowadays, there are various social media sites like sharesansar, merolagani, facebook and even Tiktok from where the information related to IPO can be obtained. Nonetheless, sometimes due to the contrasting information from social media, the investor collects the information from friends and family or does the self-assessment as well.

Interviewee: "With the presence of different social media and electronic devices in today's context, it's easy to be informed about the issue of IPO"

Risk and Safety

There is the presence of risk even though a good return can be earned from an IPO. Share value fluctuates as per the market demand generally in the context of Nepal. So, it might also go below the par value but it's a rare case. So, there is a risk but very minimum and its short term in the primary market as well. Patience is the best remedy to eliminate the risk. Investors hold those shares if they are at loss and sell only after their price rises above baseline or if the market is bullish. Regarding safety, there are regulators to regulate companies in Nepal. So, there is a low chance of insolvency of the company. It is safe to invest the savings since the amount invested will be returned if not allotted and if allotted there is a high chance of getting profit, getting the return.

Interviewee: "Although in an IPO there is negligible risk or very low risk but if

risk arises, patience is the best remedy to eliminate such uncertainties."

Skills and Knowledge

Participants believe that they have enough knowledge to invest in an IPO in today's context. They seem aware of the procedures to invest in an IPO. They believed that some basic knowledge to apply for shares is enough. In the same way, participants do not generally study companies issuing IPO generally and evaluate their financial performance. But later, if some big companies issue an IPO where the par value will be more than 100, then informants said that their skills and knowledge are not enough.

Interviewee: "Only basic skills and knowledge are enough for investing in an IPO. Understanding the procedures is enough. No need for fundamental and technical analysis is required."

Perception of Stock Market

The stock market in Nepal is small and manipulated. Informants said that everyone goes with the crowd assuming they will be rich. The reason behind the growing number of share applicants is due to the crowd and rumours about being wealthy from IPO and share market. They do not do any kind of analysis. They are jumping in the market without knowing anything; this is what participants feel. Most of the investors lack knowledge about the share market. If the investors are well educated and well informed about the stock market, then the stock market of Nepal looks good. Participants perceived that there is herding behaviour in the market, but they have not been put

in the position of "Herd" which means they do not have herding behaviour.

Interviewee: "Without having zero knowledge about IPO, people blindly invest their savings. People run after rumours in Nepalese market. They do not think before they invest."

DISCUSSION

Nepalese Investors make their investment decisions based on certain purposes. The major purpose found in this study is for good returns from small investments in a short time period. Same patterns of investing behaviour are seen among the chosen investors. In addition, participants believe that there is availability of risk to invest in IPO as well since past records exhibit the downfall of share price below par value (Sharesansar, 2012). Despite the presence of risks, they are willing to continue their participation in the market. This shows the evidence about whatever the nature of the companies issuing IPO, they are always ready to invest in it. It might be due to good initial market returns in the past few years. Dahal (2007) stated that IPOs investors make 53.25 percent market adjusted returns which also indicates that Nepalese IPOs are highly under-priced. More the underpricing, the higher will be the initial returns resulting in the profit from IPOs.

Similarly, fundamental or technical analysis is not so much used by investors for forecasting share market trends and therefore making an investment decision. Investors rely more on social media, friends and relatives for the information regarding issuing of IPO. Dangol et al (2020)

argued that Nepalese investors prefer to use shortcuts rather than using their intelligence for investment even though they are literate.

Although investors do not seem herd with the crowd in the market, decisions made by themselves also go wrong sometimes. Investors frequently overestimate their abilities and underestimate the chances of unfavourable outcomes that they may influence (Hede, 2012). Similarly, Skala (2008) discussed that overconfidence results in either an overestimation of the accuracy of their information or an underestimation of risk which leads them to hold riskier portfolios. One of the IPOs in which most participants invested is currently experiencing a loss. It was discovered that there was a dearth of understanding of behavioural finance or financial behaviour on the construct that outlines the reasons why people make poor investing decisions. A good grasp of investment behaviour is essential as this could guide investors on how to proceed carefully when making investment selections.

CONCLUSION AND IMPLICATIONS

To conclude this study, investors believe that they do not need much knowledge to invest in the primary market. Basic knowledge on how to apply in IPO and knowing about some terminology like dematerialised account number, customer registration number, meroshare, issued units, applied units etc. is quite sufficient to invest in IPO. Investors are confident in the organisations issuing IPO as they are guaranteed by the good

returns. Past positive returns from the IPO gained the trust of the investors and boosted the investment. Thus, mainly good return on investment, low investment amount, minimum risk and safe portal influences for investment decision in IPO. It shows that Nepalese market is influenced by overconfidence bias. According to Dangol (2020), Nepalese investors believe they have access to all the necessary information and are therefore capable of making wise investment choices. They think they can make better financial decisions than other people and that all their profitable investments are the consequence of their own competence and expertise. All these emotions and self-assurance cause investors to make snap judgments without conducting thoughtful deliberation.

The researcher believed that a thorough understanding of the industry through fundamental and technical analysis can offer better ways to supplement or address the market's issues with loss and risk. To make wise stock investment decisions, investors must be aware of the market conditions,

the economic and demographic data about the firm, and its operational activities. Understanding the Nepalese financial sector would undoubtedly help investors make better decisions and reap greater financial benefits from their investments. Mohamad and Perry (2015) stated that market experience is the most effective technique to comprehend the economy. Therefore, it is believed that having good experience, as evidenced by the investors in this study, is essential to understanding the Nepalese stock market.

This study only includes six young Nepalese investors between the ages of 25-35. A more detailed investigation of the investors' behaviour with more samples may expand the understanding of this issue. And as this study has focused solely on IPOs, i.e., primary market, further qualitative research can be conducted on the secondary market also known as the stock market. The secondary market is volatile and risky, and it will be essential to understand the financial setting and gain knowledge on how investors behave before investing in such a market.

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Conflict of interest

The author declares having no conflict of interest in the research work.

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