

THE PROVISION OF CAPITAL TO STOCK EXCHANGE LISTED COMPANIES

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Many senior personnel in the private and public sectors have advised the author though sole responsibility, for the opinions expressed in this article, is that of the author. The author was the founding Secretary General of the Colombo Stock Exchange. He directs the Wiro Loh Institute, for autochthonous Economics and Policy Research.

This paper utilises material made available elsewhere recently⁽¹⁾ so as to highlight certain problems that exist in the Sri Lanka Stock Exchange Market and our methods of financing enterprises.

Background

The Sri Lanka Stock Exchange was brought under the aegis of public direction only after the passage of the Securities Council Act in 1987. From 1982 upto that point there was a Stock Exchange bringing a wider and public range of interests to bear on the market. In the period from 1981 onwards, there was public promotion, at least in intention, of the Stock Market. Prior to that the market was run as a private club. The traditions and personnel of the market date largely from that early period.

The Share Market began after the creation of companies by law in Sri Lanka about five years after such legislation was introduced in England. By 1977 the local commodity brokers and agents who handled the export commodities were also handling sufficient volume of shares to organise into an informal association called the Colombo Brokers Association. The share ownership comprised largely British colonials and London Stock Exchange investors. From the mid 1950s to 1981, the volume of transactions declined and the ownership of companies concentrated. These matters have been dealt with by the author elsewhere in greater detail.

Stock Market Companies

In the publications noted above,⁽²⁾ detailed material on the 167 companies listed in the Stock Exchange on March 31 1984 were given. The companies whose businesses had been nationalized, such

as the Estates, were excluded from these studies. This paper utilizes this data in the discussion that follows.

This means that our discussion is biased towards recent events; for only 38 (ie. 22.8%) companies of the 167 were incorporated prior to 1948. Indeed, 83 of the companies had been brought into the Stock Market following the new promotional measures in the eighties.

The paid up capital of the listed companies amounted to Rs.6,256.8 million distributed into mainly Manufacturing 37.8 percent; Hotels 32.1 percent; and Property Development 18.2 percent. The concentration in the largely capital intensive hotels and property sectors is clear. It should be realised that under Sri Lankan practice, in contrast to practices elsewhere, especially our commercial neighbour India, capital issue is not the same as the cash payment to the enterprise. Our practices allow initial share issues for items such as promotion or lease that suffer loose quantification. It is also possible to revalue assets, make a book entry into reserves and to issue shares against such reserves to existing shareholders. These amounts also appear as issued capital. Therefore it may be prudent, at this preliminary stage, to improve estimates by reducing the amounts of bonus issues from issued capital. Rs.386.6 million bonus shares had been issued of which Manufacturing accounted for Rs. 262.5 million.

Capital

From the point of view of the provision of capital, 30.9 percent came from foreigners and should be regarded as Trade Investments rather than Portfolio or Share Market Investments as the capital really serves further interests than

1. Dr. Darin C. Gunasekera and D.L.L.P. Jayawardena, Preliminary data analysis of stock exchange listed company ownership and provision of capital SLAAS Annual Sessions, December 1988.

A more complete treatment of the survey data will be available in D.L.L.P. Jayawardena's forthcoming book from Sathosa Printers.

2. vide note 1.

market shareholding. Statutory bodies held 19 percent, and 8.4 percent was held by government and associated bodies. Domestic private investors held 37.2 percent of the issued share capital as stated at the outset. But this is not the actual market amount. The primary market for shares may be defined to be the amounts raised by public offer. Only Rs.1,466.1 million had been raised by primary offer to the public (a much larger amount had been offered) and Rs. 541.6 million by way of rights offers to shareholders.

These sums of money are small and need to be tempered with the fact that the 167 companies accounted for only 47,341 jobs. This incidently amounts to an issued capital, of various vintage Rupee of Rs.128,000 per job. This is a high per job cost both in terms of the national economy and by general domestic company standards. It suggests that the quoted companies are the high capital intensity end of the Sri Lankan commercial sector. This actually confirms Economic Logic. The Stock Market was being promoted by tax measures that made cost of capital low and provided Government enhancements to increase returns to capital. So we diverted national resources into this market where capital intensity - generally speaking imported machines and modern buildings - was much higher.

The loans granted these companies amounted to Rs.4.53 billion, of which 43.4 percent was foreign agencies and foreign banks; while 40.4 percent was from governmental sources. The rest were from in-group companies, directors, local private banks, and finance companies. The debt equity ratio of manufacturing, the largest debtor, was .83. These amounts relate to loan capital as disclosed by the companies. It is not equal to the total bank liability to equity position.

In Sri Lanka, bank short term, loans and advances to these enterprises are of a fairly permanent nature and are given against security of liquid assets or other mortgaged assets. There is therefore a case to include these with loan capital, which would make the Debt Equity ratio very much higher.

Ownership

Nine of the listed companies were closely affiliated in ownership to other lis-

ted companies. The gross number of shareholders was 88,859 with 40.1 percent in manufacturing and 30.4 percent and 8.9 percent in Hotels and Property, respectively. However, on glancing through the lists of shareholders of the companies it appeared that certain companies had fewer than twenty shareholders in total. Therefore the percentage of shares held by the largest twenty shareholders was ascertained.

No distinction was made as to whether the shareholders were distinct entities or close relatives or one owning the other, as may be the case with corporate shareholders. This will be considered at a following stage in so far as shareowners of the same address may be lumped together. In the case of 51 companies the top twenty held 90 - 100 percent of the issued shares and in a further 50 companies the holding was 80 - 89 percent. In 75 percent of the listed companies, the twenty largest individually listed shareholders owned more than 70 percent of the shares. In only 4.7 percent of the cases did the top twenty hold below 50 percent. As the name and address lists in the data suggest the twenty top holders are largely related in business, family or by power of attorney or constitute the existing directorate; and this depiction is consistent with the increasing concentration of shareholding suggested above. The data is also consistent with the model constructed by the author and referred to elsewhere.

It was noted that a modification of this data should be made to take into account certain features of these companies when interpreting the data. These features are those peculiar to new companies as the greater weight of promoters' shares and shares issued in-lieu of initial services. However, even taking these factors into account the concentration depicted above is hardly lessened.

It was interesting to note that several companies did not possess even 20

shareholders. This was without any test of whether the persons were indeed separate persons without relationships or ownership amongst them. It was thus clear that the Stock Market's own Rule on ownership must be in gross violation. The Rule is that 20 percent of shares must be with the general public.⁽³⁾

By all standards abroad - developed and underdeveloped - the above is not a situation that can be called a Stock Market. By way of comparison in an underdeveloped country of our general level of development, India, shareholding of companies is in the millions (even of Bombay only situations) and 40 percent is the minimum general public holding. The term general public is stringently defined and applied.

Change

This situation demands change. The agents of change may inquire why this situation arose. The reason lies in the role of Banks. The Banks have been lending short term but permanent in practice to the quoted companies without demanding Share Capital increase. This is particularly clear when one notes the poor position of paid in share capital at the commercial private banks themselves. As they had been not asking for fresh subscriptions as the balance of ownership on their own Board, for instance Hatton National Bank Ltd., at the date of this survey, would be disturbed as all could not meet such cash demands, they could hardly force borrowers to raise owners' paid-in-capital.

The solution proposed by the Stock Exchange project was to give the Banks an interest in expanding companies' capital base. This meant a financial reward in this business. They brought banks in as broker-dealers in the Stock Exchange. The Finance Ministry and Central Bank's Governor at the time disallowed it⁽⁴⁾ and the Commercial Banks withdrew from the project. However, it should be recorded that all the four Sr

3. A senior Chartered Accountant who has advised many of these companies informed me as follows. "The printed Rule states that 20 percent shares must be offered to the public. It does not state that this must be taken up nor that it must be continued after listing is given. The matter of what constitutes "offer" was much debated following Central Bank Governor Tennekoon's ruling on the transfer of Hatton National Bank shares. Events overlook any final conclusion. Presently (1989) these Rules are required to be considered as Guidelines. The rationale is that the present situation is in a stage of growth and flux. One is reminded of the motorist in Rome 'traffic lights are advisory' he told the policeman.

4. For reasons not concerning the Stock Market listed companies.

Lankan commercial banks at the time did join the project and thus signalled their own acknowledgement of the situation and their desire to make things progressively better.

Foreign

Looking over the above data, it is clear that the major function of the Stock Exchange has been the facilitation of Foreign Investors. It enables foreign investment in share and loan Capital - the dominant amount - to be combined with similar Government contributions in government approved fields and ventures. Domestic private sector collaborators purchase or receive a share as well. The usefulness of the market is to enable a continuous evaluation of the stake in Sri Lanka for the investing organisation and in setting a fair price at point of sale.⁽⁵⁾ Proceeds of Stock Market share sales and dividends are remittable and are of financial "seniority" at a time of applying foreign remittance restrictions.

Individual consideration of the largest companies makes this clear. Shaw Wallace, largely foreign owned, relies on a good dividend (100% in recent years) to reward owners. Such rates would not be a reasonable strategy for a purely domestic broad based company. Ceylon Tobacco and Reckit and Coleman have a well over 80 percent foreign partner ownership. Where Ceylon Tobacco is concerned, there is a ready demand for its shares. The 93 percent British America Tobacco foreign holding must be attributed to a desire for return by way of dividend rather than gain through managerial practice.

In highlighting these features, it is my intention to make the evolution, practices, personnel, attitudes⁽⁶⁾ and so on at the Stock Exchange more understandable. An economic situation may or may not be good depending on the viewpoint and development strategy. To understand an economic situation is not to make such a judgement but to see why aspects that may not be logically obvious are being compelled to be that way.

5. Upon passage of money and shares the deal is valid by law and acceptable for all purposes. Certain companies contain Articles requiring share ownership transfer to be further approved by its Board. But stock exchange market price is accepted. This is the reason for careful scrutiny of this process.

6. Relative degree of new investor search, for instance. Unlike many developing countries we do not have door to door salesmen of shares. Another is dress, speech and business style in which this sector is guided by the senior foreign companies in this country.

GLOSSARY OF TERMS

STOCKS, SHARES

Shares now used interchangeably. The ownership of a registered company is achieved through ownership of its shares. The list of share owners is maintained by the Company's Secretary, who is required to annually file this list with the Registrar of Companies. The Companies Act deals primarily with matters relating to shares and share ownership. Persons acquire shares by way of initial issue of shares; subsequent issues of shares by sale, distribution of shares as a Bonus to shareholders, by way of Rights offered to shareholders or purchase or transfer of shares from an existing owner.

CAPITAL

The term is used in the sense of Finance Capital. It is usually divided into Loan Capital and Equity Capital. Loan Capital is long term Liability on Loan. Equity capital is the sum of issued shares at their value received by the Company and Reserves. The reserves of a company should be shown in two accounts. Earned reserves are actually earned and retained profits where the company received money. Other reserves are gains of an accounting nature as when assets are revalued but not sold.

STOCK EXCHANGE

It is the market place for already issued stocks. Only brokers or dealers registered with the exchange may do sale/purchase at the Exchange. Since 1987, no transfers of ownership in companies listed at the Colombo Exchange can take place outside it. This is a law unique to Sri Lanka. In other countries restrictions on sales/purchases are limited to those imposed by companies at their secretaries' offices and listing requires them to remove these so as to make share sales readily negotiable.

LISTED COMPANIES

Also called quoted companies. These are companies whose shares are available for trading on the exchange. The normal principle is that listed shares must be available for sale to anyone equally. However, we protect our foreign investor groups from hostile tactics customary elsewhere. No issued share may be sold to a foreigner without a 100 percent penalty tax on the value of the transaction. This effectively prevents replacement or substitution of foreign partners. It also prevents the addition of new foreign partners without acceptance by existing foreign investors. It is this rule, also unique to Sri Lanka, that makes our exchange essentially a vehicle for foreign investors. The article shows that the attractions have worked in selling in foreign investment. Our exchange also permits restrictions on share sales to groups wishing to gain control of companies unlike in the US type exchanges where this is encouraged. There exists these two views as to whether changes in control are good or bad. Practically, listed companies in Colombo are very much more difficult to take over than in other reported markets. Share ownership reflects this.

According to current legislation a 100 percent transfer tax applies on the transfer of land and shares to non-nationals. Now the abolition of the transfer tax on shares is being contemplated though the tax on transfer of land to non-nationals will continue.