CHAPTER IV

COLOMBO STOCK EXCHANGE
AND CAPITAL FORMATION

4.1.0 COLOMBO STOCK EXCHANGE

4.1.1 Stock Exchange
4.1.2 Background to the Origin of Company Formation and Colombo Share Market
4.1.3 Share Market Prior to Independence
4.1.4 Development in Company Law: 1938 – 1948
4.1.5 Hindrance to Share Market Development
4.1.6 Requirement for a New Company Act
4.1.7 Significant Setback
4.1.8 Call-over System
4.1.9 Call-over to Open Outcry System
4.1.10 Competitive Share Trading Floor
4.1.11 Amalgamation of Two Share Markets
4.1.12 New Company Act
4.1.13 New Era of the Colombo Stock Exchange
4.1.14 Central Depository System
4.1.15 Companies Listed in the CSE
4.1.16 Rules and Regulations
4.1.17 New Computer System
4.1.18 Three Tiers of Boards
4.1.19 Automated Trading System
4.1.20 Debt Market of CSE
4.1.21 Foreign Investments in the Sri Lanka Share Market
4.1.22 Responsibility and Administration
4.1.23 Certain Identified Characteristics of the CSE

4.2.0 CAPITAL FORMATION OF LISTED COMPANIES

4.2.1 Capital Formation
4.2.2 Issue by Prospectus
4.2.3 Offer for Sale
4.2.4 Stock Exchange Placing
4.2.5 Introduction
4.2.6 Right Issues
4.2.7 Bonus Issues
4.2.8 Secondary Market
4.2.9 Obstacles to be Overcome by CSE

4.3.0 CONCLUSION
COLOMBO STOCK EXCHANGE AND CAPITAL FORMATION OF LISTED COMPANIES

4.1.0 COLOMBO STOCK EXCHANGE

4.1.1 STOCK EXCHANGE

The ultimate objective of disclosure of accounting information by listed companies is to mobilise individual and institutional savings for capital formation of efficiently operated listed companies and it is achieved through the operation of stock exchanges. The stock exchanges in the world contribute to the respective nations by creating value through the securities. The main function of a stock exchange is to operate an efficient market for capital formation of listed companies and to provide a structure for systematic trading of securities. It is the responsibility of the stock exchange to maintain professional quality and standards among its members and listed companies. The Mission Statement of the Colombo Stock Exchange (CSE) is given as follows:

Strategies to commit ourselves to: the Corporate Sector by providing mechanisms through which the capital structure of an organisation could be optimised by having recourse to diverse financial instruments; the Investor with an alternate avenue for investment containing a myriad of risk-return options; the member firms by enabling them to improve profitability and professionalism.¹

The investment potentials of the economy are enhanced in developed stock markets by providing a source of long-term capital to finance investments. The trading mechanism of the stock exchange reconciles the long-

¹ Colombo Stock Exchange (CSE); Annual Report; 1998, p.3.
term investment needs of listed companies and short-term liquidity preference of investors. The historically developed 'flexibility' of the stock exchange is a unique characteristic. Her Excellency the President of Sri Lanka has identified a dynamic stock exchange as a hallmark of an efficient economy. ²

An organised market for certain types of securities such as stocks, shares, debentures, bonds and government stocks is called a stock exchange. This is a major device of long-term capital formation in a market based free enterprise economic system. "[However it] is not an icon of capitalism, but a necessary institution in a modern socialist economy which plays the role of involving the nation at large in the wealth creation process so as to enable all persons to reach higher levels of financial prosperity"³ Even, centrally planned socialist economic systems have recognised the significance of capital formation through issue of shares and stock marked operations. Prior to the political and economic changes in the USSR some co-operatives and state enterprises had issued shares. An international Russian magazine describes the origin of share formation in the Russian economic system as follows.

Real life often overtakes law making. Even before the adoption of the law on co-operatives, the shares for which and other securities are mentioned officially, about a score of co-operatives and state enterprises (here no statistics are available yet) had already issued the first 'shares'. A new phenomenon entered our lives.⁴

Even in the Peoples' Republic of China securities markets have emerged to play a major role in the country's economic development.

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² CSE; Annual Report; 1997, p.8.
⁴ Grigoryev, Leonid; 'Becoming Shareholders'; Moscow News Weekly; No. 34, 1988, p.11.
Bonds and equities began to be issued [in Peoples Republic of China] only in the early 1980s. Secondary trading in a few securities began, on a very restrictive basis, in 1986, and China’s two main securities exchanges in Shanghai and Shenzhen were officially opened in 1990 and 1991, respectively. By the end of 1994, these two equity markets had a combined capitalisation of $43.5 Bn., which was roughly equal to the capitalisation of stock markets in Argentina and Indonesia, and accounted for 2.4 per cent of the capitalisation of all emerging equity markets monitored by the International Finance Corporation.  

In a commodity or produce market the buyers could physically verify the traded goods, and the purchasing decisions are based on the physical examination through senses. In a stock exchange rights to ownership of funds are traded. Rights are transferred from sellers to buyers in the form of certificates or computer based data records. By reference to the certificate or the statement of data record a buyer cannot judge the quality of the right to ownership of the fund of a listed company. As in an ordinary market of goods and services, a stock exchange has many buyers and sellers and they deal in different types of securities. The competition prevailing in the market provides the best price for sellers and buyers through the process of bargaining, according to the available accounting and non-accounting information. In an organised stock market, generally, transactions are carried out through the stockbrokers. They buy and sell securities on behalf of buyers and sellers.

The stock exchange can be identified as an intermediate organisation participating in capital formation or providing of funds for listed

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companies, governments and local administrative bodies. Companies require permanent capital for their projects and long-term operational activities, and this requirement can be satisfied by obtaining loans from financial institutions or through public issue of debentures and/or shares. Loans have to be obtained from banks, finance companies or other financial institutions. Limiting factors such as policies of the institutions, money creating ability, and availability of resources, and the risk involved limit the supply of funds through loans by financial institutions. Therefore, the most appropriate method to obtain long term funds for companies is by issuing shares and debentures to individuals, institutional investors and other organisations possessing excess liquid funds.

Individuals in a country do not spend all of their earnings for consumption purposes. When the consumption is deducted from the income, the remaining balance is the saving. People’s ability to save depends on their marginal propensity to consume (MPC). When the income level is relatively high, the MPC is low and the savings is high, and when the income level is relatively low MPC is high and the savings is low. In developing countries like Sri Lanka the savings proportion is relatively low. If the confidence level of the public on stock market activities could be developed, individual savings could be monitored directly and indirectly for funding efficiently operated companies. Funds available with institutional inverters such as, provident funds, trust funds, unit trusts, insurance companies, savings banks and etc. could be obtained to finance company projects by prompting them to invest in company shares and debentures. The stock market could be instrumented to attract small-scale savers as well as large-scale savers to participate in capital formation of large ventures.
All registered companies of an economy do not possess access to the stock exchange. Private companies can obtain subscriptions for shares and debenture only through private means. They are prohibited from any invitation to the public to subscribe for any shares or debentures of the company and the right to transfer their shares is restricted. A public company can invite the public, through advertisements or by any other accepted means to subscribe for its shares or debentures. However, marketability of these securities is a factor to be considered by the public in investing their money in the securities. If there is no prevailing market for the shares, investors may find it difficult to sell them at a reasonable price, whenever necessary. The solution to the marketing problem of securities of public companies is provided by the stock exchange. If a public company is listed at a stock exchange for security trading purpose, its registered securities could be bought and sold through the competitive open market of the stock exchange. The investors in securities of companies could compare their intrinsic value of shares with market prices available in the stock exchange.

In a stock exchange, basically, there are two types of investors, long-term investors and speculators. Generally, long-term investors do not dispose their shares in the short run. Therefore, their activities are not helpful in order to maintain current market prices of shares. It is, mainly, through the activities of the speculators current market prices are maintained. However, overreaction of their activities could lead the innocent investors into financial difficulties. Keynes in his ‘General Theory’ has observed it as follows:

As the organisation of investment markets improves, the risk of predominance of speculation dose, however, increase ... Speculators may

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6 Companies Act, No. 15 of 1982, Sc. 30(1) (a) and (b), p 16.
do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill done.7

Market value of a share of a listed company depends on the supply and demand for its shares in the stock exchange. When the demand for shares is expanding while the supply is constant or decreasing the market value of shares will be increased. If the demand increases in par with the change in intrinsic value of shares it is justifiable. However, if the increase in demand occurs without any increase in the intrinsic value, it may be a manipulation by some interested parties through misinformation. The activities of Harshad Mehta8 in the Bombay Stock exchange are examples for creation of hypothetical values of shares leading towards loss of innocent investors’ funds. Such situations will damage the confidence of investors on the stock exchange. Generally, stock exchanges and their supervisory committees do have delisting powers to avoid manipulation of share prices in stock exchanges. “The Committee may suspend or cancel the grant of a quotation and the security may be withdrawn from the official list or the recording of bargains may be suspended”.9

Wide distribution of securities of public listed companies has been considered in the past, and even today, as a means to conserve the private ownership of properties and the democratic political system and the following

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8 Aggarwal, S.K.; Stock Markets and Financial Journalism; Shipra Publications; Delhi; 1998; pp 202-211
9 Grigson, J.B.W.; 'Colombo Brokers' Association and Share Dealings in Ceylon'; The Accountancy Journal; 1968 June, p.27.
statement relevant to the share market background of America, in 1933, provides evidence for this.

President Franklin Roosevelt wished to place the Democratic Capitalist System on a firm footing. He understood this to require the participation of the whole populace in the workings of the commercial system and its openness to the public eye. He fully realised this to require not simply reform nor improvement but this assertion of leadership over industry, trade and commerce. The most central element of this was clearly the stock exchanges\textsuperscript{10}

4.1.2 BACKGROUND TO THE ORIGIN OF COMPANY FORMATION AND COLOMBO SHARE MARKET.

As some South Asian countries such as India, Pakistan and Bangladesh, Sri Lanka also has a stock exchange, which has developed through the experience of more than hundred years. The modern educational, judicial, economic, commercial and financial institutions and systems in Sri Lanka have been influenced by the British traditions. The British introduced the concepts such as ‘Incorporated Company’, ‘Capital’, ‘Debenture’, and ‘Share’ during the period of colonial administration. The origin of the modern day limited liability company in Sri Lanka (Ceylon) can be traced back to the British era.

The stock exchange is a by-product of the system of incorporated companies and their capital formation. The Joint Stock Companies Ordinance No. 4 of 1861 was the first statutory enactment on company law introduced in Ceylon (Sri Lanka). The law relating to activities of companies, from 1861 to 1938, was based on this Ordinance. Prior to this Ordinance Royal Charter incorporated a few number of companies in Ceylon. The Bank of Ceylon, established in 1841 and

\textsuperscript{10} Goonesekara, Darin C.; ‘Stock Exchange Development’; \textit{The Accountancy Journal}; 1983, 1\textsuperscript{st} Quarter, p.4.
failed in 1847 was a company incorporated by Royal Charter. Prior to the Joint
Stock Companies Ordinance No. 4 of 1861 companies were governed under the
Civil Law Ordinance of 1853. Penalty on association of more than 20 persons was
introduced under the amendment No. 9 of 1867. To compound for the stamp duties
payable on certain shares issued unstamped, and provision for reduction of capital
were allowed under the Joint stock Companies Ordinance No. 4 of 1888. The Joint
Stock Companies Ordinance No. 3 of 1893 empowered the companies to alter their
objectives subject to confirmation of the court, required the maintaining of a
members register and more detailed disclosure in the prospectus, treated wages and
salaries as having a priority as to settlement in a winding up and provided for
alteration of the company’s name. The Joint Stock Companies Ordinance No 2 of
1897 allowed incorporation of banking companies. Subdivision and consolidation
of shares were allowed under No. 17 of 1907. According to No. 18 of 1909 a
balance sheet was required to be sent to the Registrar of Companies, annually, and
within 12 months of incorporation. Prohibition against the use of misleading
names, inclusion of particulars of directors on the annual list, and carry on of
business in Sri Lanka by overseas companies were incorporated under the Joint
Stock Companies Ordinance No. 7 of 1918.

In England, records of share trading activities go back as far as
1698. The stock exchange evolved in England, from the informal gatherings of
dealers of shares in the coffee-houses around the Royal Exchange. The British
during the latter part of the 19th century introduced the share dealings in Ceylon,
and the British mercantile and investor community was the prime mover of the
economic activities of the country.
The first commercial plantations introduced to Ceylon economy by the British were sugar and indigo, and they had been failures. The coffee, which was introduced subsequently, became the dominant crop during the period from 1820 to 1886. These plantations were organised as sole proprietorships or partnerships. Towards the latter part of the 19th century, a leaf fungus destroyed the coffee plantations. As a result of this, the British plantation community made a strategic and vital decision to switch over to tea and rubber plantations. Due to involvement of heavy expenses and excessive remittances abroad of abundant profits from coffee during the heyday of the coffee boom, the partnership and sole proprietorship business systems could not provide required capital for the new tea and rubber plantations, after the failure of coffee plantations. Conversion of sole-proprietorship and partnership businesses to companies was one of the methods used in company formation. Some companies formed like this did not solicit capital from external sources. However, most of the newly converted companies solicited new capital by issuing shares to friends, relatives, and vendors of the plantations. In order to obtain required funds for tea and rubber plantations, public limited liability companies were floated in both London and Colombo. "The sterling tea companies were beginning to be established in the 1980s and the rubber companies in the 1900s, but they were not subject to any taxes of the Ceylon Government until 1915." 11

When the required capital was considerable, prospectuses were issued to the public calling for subscriptions. This was the mostly used method in large-scale capital formations. "There were 13 public issues made by Ceylon tea

companies by the end of December 1900." The Table 4-1 shows the types of securities and particulars of issues to the public during this period.

The information given in TABLE 4-1 is related to 11 companies and most of them have indicated their intention to obtain official quotation at the London Stock Exchange.

<table>
<thead>
<tr>
<th>TABLE 4-1</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUBLIC ISSUE OF SECURITIES BETWEEN APRIL 1892 AND DECEMBER 1900</td>
</tr>
<tr>
<td>TYPE OF SECURITY</td>
</tr>
<tr>
<td>Ordinary Shares</td>
</tr>
<tr>
<td>6% Cum. Pref. Shares</td>
</tr>
<tr>
<td>5% Cum. Pref. Shares</td>
</tr>
<tr>
<td>6% Debentures</td>
</tr>
<tr>
<td>5% Debentures</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Source: Adopted from (Ramachandran, N, p. 11)

When the applications were called from the public for shares or debentures, prospectuses were issued. The authorised share capital, types of securities for which applications were called, settlement of purchase consideration, names of the directors, bankers, solicitors, auditors, agents and brokers, future of the company and estimated future profits were some of the contents included in prospectuses. The company promoters of this period were optimistic about the future prospects of these companies. The increasing activities in formation of companies and issue of shares to the public during the latter part of the 19th century led to the formalisation of sharebroking activities. The need for a share broker association in Ceylon was felt by the brokers involved in share trading activities.

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12 Ibid., p. 9.
The Colombo Share Brokers’ Association was founded in 1896. H.M. de Soysa, Chairman of the Colombo Brokers Assention, in 1976, describes this situation as follows:

... coffee planters did not set aside adequate funds for development. Most of the profits earned were returned abroad and when the crises came there were insufficient funds to assist the change over from coffee to tea and rubber... Therefore it became necessary to mobilise such resources through the company form of organisation, which led to the birth of Colombo Share Market and the Colombo Share Brokers’ Association.\(^\text{13}\)

In addition to the share broking activities, these brokers were involved in other broking activities. One set of rules were introduced on the model of the London stock exchange, but modified to suit local conditions, to govern the activities of the members and this led to change of the name of the association to Colombo Brokers Association (CBA), in 1904. So, in Ceylon, one official association, was formed to carry out the broking activates of shares and commodities. Combining of commodity trading with share trading was a characteristic of some stock exchanges of this period.

... the way in which each major locus of activity in what may be termed stock or shares developed tended to differ from country to country. In some places on the continent they arose besides the money exchanging bourses. In other areas, as the ports of the New World, they arose besides commodity dealers. [Similar to Ceylon]\(^\text{14}\)

The annual report of Colombo Stock Exchange (CSE) for the year 1988 describes the CBA as follows:

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\(^{13}\) Soysa, H.M.de; 'Colombo Share Market'; \textit{The Ceylon Daily News}; 1976 March, p.5.

\(^{14}\) Gunasekara; \textit{op.cit.}, p.2.
Any firm engaged in the business of broking in Colombo was entitled to the membership of Colombo Brokers' Association. The membership was divided into two classes as 'A' and 'B'. 'A' members were restricted to produce and general brokers exclusively, while class 'B' brokers were engaged in stock and share broking...The founder members of the association, namely, Bartleet & Company, Forbes and Walker, E. John & Company, Keele & Waldock, R. Gordon & Company, and Somerville & Company which originally commenced operations as partnerships and were later converted into Limited Liability Companies were admitted as 'A' and 'B' class members of the CBA...Subsequently, the firms, E. John & Company and Keel and Waldock merged together to form the present firm of John Keells Limited while R. Gordon & Company amalgamated with Forbes & Walker Limited.¹⁵

4.1.3 SHARE MARKET PRIOR TO INDEPENDENCE

During the early period of 20th century, after 1907, there was lot of share trading activities relevant to shares of tea and rubber plantation companies in Ceylon. Shares of these companies were bought and sold in Ceylon as well as in England. With the shoot up of tea and rubber prices in the world market share-trading activities were increased. The advent of the motor car in the U.S.A. and Europe increased the demand for natural rubber and the price of rubber company shares. The number of acreage planted sharply expanded and offering shares to the general public raised the funds required for investments. Grigson describes this share boom as follows:

¹⁵ CSE; Annual Report; 1988, p.12.
... At times stock brokers were being drawn upon in London at 3 days sight for sums ranging between 15 to 20 lakhs, a lot of money in those days. I know of one bank in London that became so worried about one of their broking clients that they asked for the company to curb its business and all it got for its pains was to have the account transferred ... But all that is in the distant past and we are unlikely to experience such conditions again ... 16

The companies registered under the U.K. Company law were called sterling companies, and which were registered under the Ceylon Company law was called rupee companies.

The development of tea and rubber companies required back-up services for the plantation sector, and quite a number of commercial companies were established to provide such services. As a result of this, towards the late 1920’s the Colombo share market had a handful of commercial companies, which had raised their funds from the market by public issues. However, the Colombo share market mainly consisted of plantation companies. Prior to the independence, activities in the Colombo share market were not limited only to locally registered companies. “Shares of companies registered in London, the so called sterling companies, as well as those located in Bombay and Singapore too were freely transacted in the Colombo market. Besides, there were several companies registered locally but owning plantations in Malaysia and South India, whose shares were also traded in the Colombo market.” 17

Share broking business had been the domain of the non-nationals, from the inception. B.E.R. Cooray & Sons and Abeywardene Limited, Sri Lankan

16 Grigson, op. cit., P. 22.
17 CSE; Annual Report; 1988, p.12.
firms, entered into the share broking business in 1946 and 1947 respectively. By the time Sri Lanka received independence from the Great Britain, a considerable number of companies had been listed at the Colombo share market. The companies listed at the Colombo share market (June 1948) were composed as follows:

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>NO OF COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tea Companies</td>
<td>46</td>
</tr>
<tr>
<td>Tea cum Rubber Companies</td>
<td>25</td>
</tr>
<tr>
<td>Rubber Companies</td>
<td>30</td>
</tr>
<tr>
<td>Rubber Companies (Malaya)</td>
<td>10</td>
</tr>
<tr>
<td>Coconut Companies</td>
<td>04</td>
</tr>
<tr>
<td>Coconut Companies (Malaya)</td>
<td>06</td>
</tr>
<tr>
<td>Commercial Companies</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>140</strong></td>
</tr>
</tbody>
</table>

4.1.4 DEVELOPMENT IN COMPANY LAW: 1938-1948

The Companies Ordinance No. 51 of 1938 has brought in considerable changes to the disclosure of accounting information by public companies and this can be considered as a major corner stone in the development of disclosure requirements of public companies in Sri Lanka. This Ordinance was in operation till the end of 1982 in which year the Companies Act No. 17 of 1982 was introduced. In English speaking developed countries there were considerable developments in the company law and disclosure requirement, prior to 1982. A comparative study carried out in 1977 reveals that the statutory disclosure requirement in Sri Lanka was lagging behind that of Australia.¹⁸

Under the Companies Ordinance No. 6 of 1939, appointment of auditors was limited only to registered auditors. Disclosure of information of

directors on business letters, documents and etc., keeping of branch registers, and provisions applicable to banking companies were introduced under Companies Ordinance No. 19 of 1942. Right to examine officers, agents and the books and documents of the company on an inspection were introduced under Companies Ordinance No. 54 of 1946.

4.1.5 HINDRANCE TO SHARE MARKET DEVELOPMENT:

The year of independence for Sri Lanka is 1948, and the government of Sri Lanka commenced introducing exchange control regulations during this year, mainly due to foreign exchange difficulties encountered by the country, after the Second World War. Under these restrictions foreign buyers in the share market of Sri Lanka were adversely affected and foreign participation in the local share market activities was discouraged. The Colombo share market had been very active until 1948 and dealt in securities not only in Sri Lanka, but also in London, Bombay and Singapore. During this period the share market, mainly, catered for the foreign investors and foreign planters. Most of the share brokers were non-nationals who could not understand the needs of the country and the local environment. Only a limited number of Sri Lankans had some idea about the share market and such an environment was not sufficient to maintain an active market, after the independence. As described in a research article “the smooth functioning of the stock market since its inception was hindered to a large extend when exchange control regulations were introduced in 1948, and remained stagnant until very recently”. During this period, most of the companies traded in the market were plantation companies. Since 1958 there has been a market decline

19 Soya, op. cit.
in the turnover of share transactions mainly due to adverse political and economic factors. Share brokers have, generally, offered their important service at a financial loss to their firms. However, services provided by them were maintained as a national venture and as a service to their clients, rather than as a profitable undertaking. From 1956 to 1977, the concepts of “socialism” and “nationalisation” were dominating the political and economic environment of Sri Lanka and there was a general unwillingness to share ownership. The broad-based share ownership was not encouraged either by the government or any other organisation. According to the records maintained at the office of the Registrar of Companies, there were 917 public limited liability companies and 4370 private limited liability companies as at 31st December, 1975.\textsuperscript{21}

During this period, the government of Sri Lanka had a strong nationalisation policy. From late fifties several legislative measures were introduced eroding the private sector business confidence. Bus services were nationalised in 1958. Insurance was nationalised, first life business effective from 1962 and next general business effective from 1964. The Finance Act of 1963 imposed a 100% tax on property including shares acquired by non-nationals. In 1971, Business Acquisition Act was introduced giving power to the Government to acquire any business undertaking. However, private sector participation had also been accepted as a requirement for the development of the economy. The first 5-year plan for the period 1972–76 formulated by the Ministry of Planning and Employment expected a contribution of more than 50% from the private sector investments. Following information included in a document presented to the then prime minister Mrs. Sirimavo Bandaranayake indicates the significance of the

\textsuperscript{21} Soysa, op. cit.
private sector participation in the national economy, even under a government with a strong nationalisation policy.\textsuperscript{22}

<table>
<thead>
<tr>
<th>Private Sector</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage Earners</td>
<td>85%</td>
</tr>
<tr>
<td>Foreign Exchange Earnings</td>
<td>95%</td>
</tr>
<tr>
<td>Gross Domestic Fixed Capital Formation</td>
<td>60%</td>
</tr>
</tbody>
</table>

The government has expected a fair share of contribution from the private sector of the economy. The following statement extracted from a budget speech of a Finance Minister indicates unsatisfactory nature of the private sector contribution.

"The private sector which has to contribute over 50 per cent of the investment targets have not been organised to ensure the fulfilment of their quantitative contribution."\textsuperscript{23}

Nationalisation policies of the government during this period may have discouraged development of the private sector and listed company participation in large-scale investments.

\textbf{4.1.6 REQUIREMENT FOR A NEW COMPANIES ACT:}

There were amendments to the Companies Ordinance, in 1949, 1951 and 1964. The business community and company regulatory bodies of the government felt the requirement for a major improvement. The L.M.D. de Silva Commission prepared a draft bill on company law. This was published as the sessional paper XIII of 1951. Another draft bill was prepared by the Committee Appointed by the Minister of Trade and Commerce, in 1967. However, no significant step had been taken to introduce a new company's act, in order to

\textsuperscript{22} Wijesinghe, Mallory E.; \textit{The Economy of Sri Lanka 1948-75}; Ranco Printers and Publishers Ltd; 1976 p. 22
\textsuperscript{23} Perera, N.M.; \textit{Budget speech 1972-73}; Department of Government Publication; 1972, p.4.
satisfy the business community. Still, the Companies Ordinance of 1938 was in operation with some subsequent amendments.

4.1.7 SIGNIFICANT SETBACK

The year 1975 had a major set back in share market operations of Sri Lanka. From the inception up to the year 1975, the shares of plantation companies dominated the Colombo share market activities. Under the Land Reform Act of 1975 corporate owned lands were nationalised. (Proprietary owned lands were nationalised in 1972) Under this scheme, all the estates in Sri Lanka owned by the public listed companies were transferred to the government ownership and management, and 105 tea, rubber, and coconut plantation companies were effected by this Act. Share market activities were drastically reduced. Even-though, properties were taken over by the government, no action was taken to pay compensation to shareholders of listed companies, until 1978. The policy of the government was to pay compensation in instalments. Public confidence on the share market activities and share ownership had been adversely affected. After take-over of estates, five plantain companies were remained in the Colombo share market, because their estates were located in Malaysia. By the middle of the year 1976 the number of listed companies in the market was 77 excluding the listed companies of which properties were taken over by the government. “The trading in shares of public companies was badly affected by the Land Reform Law, where by a large number of tea, rubber and coconut plantations owned by quoted companies were taken over by the Government.”24 The CBA had to discontinue publication of the Rupee Company Hand Book which contained comprehensive data on all listed companies, after the take over of plantations and

24 CSE; Annual Report; 1988, p.9.
remarkable reduction of the traded shares of listed companies. The issue of the
HandBook was commenced again in 1985 as an annual publication titled
HandBook of Listed Companies.

The share market of Colombo has encountered many obstacles in the past.
However, "... it has been able to keep its head above water and be ready for
the take off to form the nucleus of the Colombo securities Exchange."
25 Although, plantation sectors were withdrawn from the share market a new
sector in tourist and hotel industry was developed subsequently.

4.1.8 CALL-OVER SYSTEM:

This was the share trading system in operation at the secondary
share market from the beginning till July 1984. Grigson describes the call-over
system as follows:

Representatives of these departments [share departments] attend two share
meetings every day, the first at 9.30 a.m. and the second at 2.30 p.m. At the
first meeting we have what is styled a call over when adjustments are made
to the buying and selling quotation in the official list and all business is
recorded that has taken place since the previous day ... each broker will
have on his books buyers and sellers... and the quotations are determined
by the lowest seller and the highest buyer

with business taking place as a general rule somewhere between the two...
A broker is duty bound to report business at the two daily meetings.26

Price mechanism was maintained for the share market through this
system. Activities of the brokers, share transactions of listed companies and buyers
and sellers of securities were controlled by the byelaws of the Colombo Brokers

25 ibid., p. 10.
26 Grigson, op. cit., p.23.
Association. Byelaws introduced at the beginning of the century were revised in 1955 to accord with contemporary development in London. There were criticisms levelled against the call-over system and some of them are given below:

(a) The closed-door meetings held under the call-over system provide opportunities for the brokers to maximise gains at the expense of the buyers,

(b) The buyers may not get the best shares as they want,

(c) There can be collusion between the brokers.

Under this environment it was possible to transact shares without the services of a broker. Even a lawyer could execute share-trading transactions. But the determined price of such transactions may not be the best for the buyers or sellers.

4.1.9 CALL-OVER TO OPEN OUTCRY SYSTEM:

As a result of criticisms, the CBA changed the share trading system from “Call-Over System” to “Open Outcry System”. The Chairman of the CSE has described this process in his annual report of 1988 as follows:

...steps being taken by the Government to re-activate and develop the capital market including the setting up of a stock exchange in Colombo, which would have included those, who are not stockbrokers. I (chairman) did not consider that this was necessary and arranged for the ‘Call Over’ system to be changed to that of a stock market trading floor. Consequently, the last operation of the share market under the ‘Call Over’ system was on the 29th of June 1984. 27

Under the “Open-Outcry” system a share-trading floor was organised and it began operation on 2nd July 1984 in the 2nd floor of Mackinnen

27 CSE; Annual Report; 1988, p.9.

The Merchant Bank of Ceylon, though wanted to play a role with the others, had decided not to participate in the secondary market share trading activities, for the time being. The floor was operated under the supervision of a sub-committee of the CBA, and the share brokers had to be abide by a code of ethics. Each broker company paid an initial sum of Rs. 50,000 and a monthly fee of Rs. 10,000. Annual subscription of a commercial company for listing varied from Rs. 2,500 to Rs. 10,000, depending on its quoted share capital. A quoted company whose assets were taken over by the government, had to pay a sum of Rs. 1,000 to have its name included in the share list.

The trading floor of the share market was open from Monday to Friday (excluding public and mercantile holidays) between 10.00 a.m. and 12.00 noon. Transactions of securities were carried out under the supervision of a floor manager. The Trading Floor had an additional facility of a gallery reserved for the public who could participate in trading while it was taking place. Trading activities were observable from the public gallery, and each broker has a separate intercom terminal fixed in the gallery. Working spaces and facilities were provided in the operation area for brokers. The company name, last transaction prices and dates, transaction prices of the day were displayed over a huge magi board. The floor manager conducts trading transactions of securities. Brokers declare buying

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28 ibid.; p. 13.
29 The public gallery was removed subsequently after connecting the trading floor to brokers' officers through computer terminals.
and selling prices on behalf of their clients, and transactions were carried out openly. New information replaces old information appearing on the board. Trading transactions were carried out on the trading floor and document-processing procedure takes place in brokers’ offices. In September 1982 operations of the trading floor were improved further. For trading purposes, 14 sectors of organisations were divided into three sections on the board.

Once the business is transacted, the selling broker forwards to his client a sold note (share contract) which presents the number and price of the shares sold, and the broker’s commission. Similarly, the buying broker prepares the bought note which indicates the number and price of the shares bought, stamp duty, transfer fees and the broker’s commission. The buyer is expected to make the payment to his broker on or before the settlement date, indicated in the bought note. The seller forwards the share certificate with the signed transfer document, to his broker. He receives the sale proceeds less broker’s commission from the broker. After the payment is received from the buyer, the buyer’s broker forwards to the buyer the transfer form signed by the seller for the buyer’s signature and the amount due to the seller’s broker is settled. The buyer’s broker forwards to the company (registrar) the stamped transfer document for registration in the name of the new buyer. The company (registrar) registers the name of the buyer as a shareholder and a new share certificate is issued.

4.1.10 COMPETITIVE SHARE TRADING FLOOR

In August 1984 a trade hall was opened by the newly formed stockbrokers Association (pvt) Ltd (SBA), a new stock exchange. This was the first registered stockbrokers’ organisation in Sri Lanka. The main objective of the organisation was to safeguard the interest of investors by improving the quality of
the share brokers' profession. There were rules to govern the share trading activities. Forbes Corporate Financial Services (Pvt.) Ltd., Alfred Jones and Associates (Pvt.) Ltd., Jafferjee Brothers Stockbrokers and Financial Services (Pvt.) Ltd. and Mercantile Stock Brokers (Pvt.) Ltd. were the brokers participated in the Trade Hall. Even though the SBA had more members only a few of them participated at the Trade Hall activities. Two trading sessions were held during the day, one from 11.30 a.m. to 12.30 p.m. and the other from 3.15 p.m. to 4.00 p.m. in the afternoon. Brokers met twice at daily sessions to execute orders through the members of the SBA. All orders of buying and selling had to be transacted on the board of the SBA, according to the rules laid down by the SBA. The public was not allowed to observe the activities at the trading hall. They had to communicate with the brokers at their offices or over the telephone. It was expected from the brokers to canvass business among the general public.

While CBA conducted share-trading activities on the trading floor of the Mackinnen building the SBA had its trading on the Trading Hall at Dharmapala Mawatha. Both share markets were located in Colombo. The lack of proper communication between the two markets, provided opportunities for speculators to make profits by buying shares from one market and selling them at the other.30 Most of the businessmen and politicians who anticipated development of share trading activities in Sri Lanka did not appreciate the two market system. On the request of the Finance Minister of Sri Lanka a British Merchant Banking firm, Samuel Montague, on behalf of the Asian Development Bank, submitted a report on the capital market of Sri Lanka. The report recommended not to have two share trading markets in Sri Lanka.

30 Wickramaarachchi, M.W., Share Market in Sri Lanka; Faculty of Management studies and Commerce, University of Sri Jayawardenepura; Paper presented at the Staff Seminar, 1984, p.13.
4.1.11 AMALGAMATION OF TWO SHARE MARKETS:

A number of discussion meetings took place between the decision making bodies of the Trading Floor (CBA) and the Trading Hall (SBA), and by the end of 1985, these discussions came out with successful results. The Colombo Securities Exchange (Gte) Ltd., (CSE) non-profit making corporate body, was incorporated to take over all functions and activities of the share department of CBA, in December 1985. The share members of the CBA and members of the SBA merged together under the new company to operate one security market in Sri Lanka, with effect from 2nd December, 1985. The founder members of the CSE were five members from the share section of the Colombo Brokers' Association, i.e. Bartleet & Co. Ltd. Forbes & Walker Ltd., John Keells Ltd., Serendib Trust Services (Pvt) Ltd., Somerville & Co. Ltd., and two members from the SBA, i.e. Mercantile Stock Brokers Ltd. and J. B. Stock Brokers and Financial Services Ltd.

While these companies participated as members, City Investment Services (Pvt)Ltd and M.H. Investment Trust (Pvt)Ltd. joined subsequently as associate members. The rules and by-laws of the CBA relating to official lists, quotations and dealings, and customs, terms and conditions relating to share transactions in Sri Lanka have been adopted by the CSE. The Trading Floor of the CBA has been accepted as the venue to conduct share-trading business. When the Colombo Securities Exchange (Gte) Ltd was incorporated, there existed another organisation styled 'Colombo Stock Exchange', which though incorporated in 1982 never functioned. In agreement with the founders of that company, action was taken to liquidate it. The name of the company Colombo Securities Exchange (Gte) Ltd. was changed to Colombo Stock Exchange(Gte) Ltd.(CSE), with effect from 20th March 1990.
4.1.12 NEW COMPANIES ACT

Another significant event affecting the companies of the share market, which took place during this period, was enactment of the new company’s act on the basis of the UK Companies Act. On 2nd July 1982, by a Gazette Extraordinary No. 199/14, the Companies Act No. 17 of 1982 became law. This act has introduced more disclosure requirements to the company law in Sri Lanka.

4.1.13 NEW ERA OF COLOMBO STOCK EXCHANGE:

Period after the year 1977 can be considered as a new era for the share market of Sri Lanka. All political parties came to power after this year followed the liberal economic policies, offered a hospitable climate for foreign investments, and encouraged the private sector for the development of the economy. Moldrich and Jeyavarman describe this change as follows:

Sri Lanka embarked on a program of liberalisation of the economy with the introduction of free market and open economy based policies in 1977. Prior to that the state played a prominent role in the day to day commercial and industrial activities with most key industrial and commercial activities being owned and managed by the State. Reform of the financial sector, which encompasses interalia, the equities and money markets, was a major component of the reform process.31

By the end of 1983, the share list had expanded to 176 companies, even though the estates of plantation companies were nationalised in 1975. There were several factors, which helped to improve the share market activities after the year 1977. Liberalisation of economic policies introduced by the government encouraged inflow of foreign investments to the country. Exchange control

regulations were relaxed; foreign banks were allowed to open branches in Sri Lanka; Private sector businessmen were allowed to open up new banks and private sector banks were allowed to open new branches. The permission was granted to open Share Investment External Rupee Accounts (SIERA) for the country funds and regional funds, foreigners and Sri Lankans residing abroad. All dividends and proceeds from sales of securities are banked into these SIERA accounts and outward remittance of funds is allowed without any constraints. In establishing the Multinational Investment Guarantee Agency (MIGA) Sri Lanka Government became a signatory to an international convention. Under this convention, investments made by foreigners of member countries become secured and the trust and confidence for international foreign investments have been brought in. In addition to this the Sri Lankan Government has entered into bilateral investment agreements with a number of major industrial countries. Assurance for the repatriation of proceeds from the investments and the security for the investments have been provided under the agreements. Prior to 1992, in certain sectors of the economy, non-nationals were not allowed to own more than 40% of shares. This restriction was removed enabling foreign investors to hold full ownership of listed companies, if necessary.

The government decided to pay compensation to the shareholders of plantation companies whose estates had been nationalised under the Land Reform Act. This decision had raised the public confidence in the share market. An income tax differential of 10% in favour of listed companies was introduced from 1st April 1980. The Business Acquisition Act was repealed in 1988. The Government commenced privatisation of government owned business undertakings. It is expected that the privatisation programme would stimulate the market activities.
In addition to removal of restrictions on foreign investment in the share market, the Government had introduced a number of tax concessions. In June, 1990, the 100 per cent property tax introduced in 1963 on share purchases of non-nationals was abolished providing opportunities for the foreigners to enter into competition with the local investors. In August 1992 capital gains tax was completely removed. The stamp duty imposed at 1 per cent on share transfers in the secondary market and at half per cent on new issues in the primary market was abolished in 1990. Withholding tax of 15 per cent on dividends paid and the wealth tax on listed company shares were removed in 1991. Listed companies in which no five persons hold more than 60 per cent of the total shares are given income tax reduction of 10 percent on taxable profit. In the case of privatised listed companies this upper limit holding of shares has been increased to 65 per cent. In order to be entitled for this tax concession the number of shareholders of the company should exceed 200 members. In order to attract more foreign funds, country and regional funds have been approved to operate in Sri Lanka and a country fund is required to make an initial investment of US $ 25-30 million. “There are 4 country funds and 575 regional funds registered for investments in the CSE3233 These figures are relevant to the year 1996. In general, it is difficult for small savers to diversify the risk involved in share investment. In 1991, unit trusts, which have been licensed by the Securities and Exchange Commission, were introduced to attract small savers’ funds for the share market funding. Now the small investor is able to invest his savings in a basket of shares which is professionally managed. “Fund management is fast proving to be a new area of business in the rapidly growing financial services market in Sri Lanka.” 33 All the peoplised or privatised government

32 Ibid., p. 35.
corporations are still not listed at the Colombo Stock Exchange. Once they are listed for share trading purposes, the available shares in the market could be increased by a considerable number. There has been a considerable development in the legal framework for the upliftment of the share market activities, during the last 20 years. New companies act was introduced in 1982, and another similar act has been already drafted to be implemented in the near future. In September 1987 the Government established the Securities Council and began to function on the establishment of its Secretariat in August 1988 under the Securities Council Act No. 36 of 1987, as the statutory body responsible for the regulation of the capital market including the stock exchange. The Accounting and Auditing Standards Monitoring Board was established under the Accounting and Auditing Standards Act No. 15 of 1995 to improve the accounting and reporting practice. The Settlement Guarantee and Compensation Fund was established. Stamp duty on IPO's was reduced to =/=50 for every Rs. 1,000. Listed companies, which have provided 25% of the share capital to the public are given a tax bonus of 5 percentage points. Capital gains of listed companies are waived if they seek listing in the CSE within a prescribed period of time. Expenses incurred in listing are treated as deductible expenses for tax purposes. Investments made by individuals in new shares of listed companies are subject to a tax relief up to 1/3 of assessable income. The Employees' Provident Fund, The Employees' Trust Fund, Insurance Corporation, and the National Savings Bank are permitted to invest in the equity of listed companies. Listed companies are permitted to operate their own provident funds. The cess charged by the SEC was reduced from 0.15% to 0.10%. Capital gains on listed debt instruments are exempted from income tax. The Government continued to support the capital market by granting further incentives in the 1999
budget. Stamp duty on the issue of listed debt instruments such as debentures and promissory notes, capital gains tax on share warrants and derivative instruments, and the 10% withholding tax paid on listed debentures were removed. The waiver of the capital gains tax on unquoted companies on conversion to quoted companies and the 5% tax bonus for listed companies were extended.

Incentives are catalysts, which accelerate the development of the share market. However, if the secondary market activities are highly volatile and subdued, offered incentives may not be effective. Share market in Sri Lanka may be an example.

The financial and technical assistance given by the Government of USA to both the SEC and CSE has helped to improve the infrastructure and environment of the Colombo share market. In 1986, the CSE received the associate membership of International Federation of Stock Exchanges (FIBV). The CSE is the only stock exchange in the South Asian Region that has been given membership in the FIBV.\textsuperscript{34}

FIBV is the trade organisation for regulated securities and derivative markets worldwide. The FIBV promotes professional business developments of financial markets both at the national and international levels. Membership of the FIBV is recognition of having world-class business standards, acknowledged as such by regulators, supervisory bodies, and investors and other securities exchanges. The CSE is the 52\textsuperscript{nd} exchange to have been elected to membership of the FIBV.\textsuperscript{35}

A Settlement Guarantee Fund (SGF) was established in May 1998, which operates as a trust, and funded by the Government with Rs. 100 mn. as

\textsuperscript{34} CSE; Annual Report; 1998, p.6.
\textsuperscript{35} ibid; p. 24.
capital. The trustees of the Fund are the Chairmen and Director Generals of the SEC and CSE and a representative from the Ministry of Finance.

The marketing division of the CSE was established in June 1997 with an objective of improving the awareness of the corporate sector on the advantage of listing and the education of the investors on the stock market to consider it as an alternative avenue of investment. A live broadcast of share transactions was introduced from September 1998 over the ETV channel in English and the Swarnawahini channel in Sinhala with the objective of creating awareness and disseminating information to the general public who may not have access to such information.

In keeping with the recommendation of Group 30 the Exchange intends to implement a Delivery vs. Payment (DVP) system of settlement. Stock Borrowing and Lending (SBL) system is going to be introduced in the future and a committee to evaluate the possibilities has been already appointed by the SEC during the year 1988. The Exchange is going to introduce a new ‘trading front-end’ PC based system, which will offer brokers higher performance and is user configurable. Two Investor Service Centres (ISC) in Matara and Kandy will be open in the near future. The purpose of the ISCs is to provide investors in areas outside Colombo with similar facilities as enjoyed by investors in Colombo. Investors will have access to facilities such as on-line trading, real-time information, stock broking services and other connected facilities.

4.1.14 CENTRAL DEPOSITORY SYSTEM

From June 1992, transfer of share ownership through share certificates has been changed to a computer recording system maintained by the Central Depository System (Pvt.) Ltd. (CDS) which is a subsidiary company of the
CSE. The system was first initiated with 5 companies selected in terms of market activity of individual companies in 1990. The number was increased to 22 towards the end of the year with 5 additional companies being introduced to the system every 3 months. Under this system all the shareholders that wish to deal in the secondary share market should register their names and deposit share certificates with the CDS and secondary share dealings outside the CSE is prohibited. Such registration has to be done through a share broker. Accounts for shareholders and share brokers are maintained by the CDS. When a transaction occurs in the trading floor and share ownership is transferred, it will be recorded in the respective accounts maintained in the centralised computer of the CDS. Physical movement of share certificates is not needed. The ownership of shares is transferred through entries. The system provides periodical statements to the shareholders and brokers giving details of the transactions of period and the end of the period balance. It also supplies the companies with updated list of shareholders. Since original share certificates are deposited in the CDS the problem of lost certificate would not arise. The issue of new security printed certificate in place of the old certificate is in operation. The CDS operates on a two tiered settlement cycle with the buyers’ settlement on T+5 and the sellers’ and participants’ settlement on T+7 and the arrangement has been made to reduce the latter to T+6. Prior to the introduction of the CDS, under the manual system, settlements were made on the 2nd and 4th Fridays of each month. The backlog of share documentation and the long delays experienced in obtaining share ownership from listed companies were removed by using the new system. The CDS was introduced with the assistance of the USAID and the Asian Development Bank. With the

36 The CDS was launched in 2nd December 1991 with a selected number of companies.
implementation of the system the Exchange is enable to trade up to 15,000 transactions per day. The CDS meets most of the Group of 30 recommendations.\textsuperscript{37} The Stock Exchange of Mauritius (SEM) purchased and successfully implemented the CDS software developed by the CSE. In October 1998, the CDS obtained the membership of the Asia-Pacific Central Securities Depository Group (ACG).

The TABLE 4–2 presents information about the development of accounts under the CDS. During the first year of its operation around 14,000 accounts were open. The rate of increase in the second year was 321%. By the end of the year 1998, around 298,000 accounts have been open for trading activities.

\textbf{TABLE 4–2}

\textbf{CENTRAL DEPOSITORY SYSTEM ACCOUNTS}

\begin{tabular}{|c|c|c|c|}
\hline
\textbf{YEAR} & \textbf{INCREASE DURING THE YEAR} & \textbf{END OF THE YEAR BALANCE (31\textsuperscript{ST} December)} & \textbf{INCREASE IN PERCENTAGE} \\
\hline
1991 & 14,000 & 14,000 & -  \\
1992 & 45,000 & 59,000 & 321\%  \\
1993 & 42,000 & 101,000 & 61\%  \\
1994 & 73,000 & 174,000 & 30\%  \\
1995 & 12,000 & 186,000 & 43\%  \\
1996 & 6,000 & 192,000 & 1.6\%  \\
1997 & 20,000 & 212,000 & 10.4\%  \\
1998 & 86,000 & 298,000 & 40.5\%  \\
\hline
\end{tabular}

Note: Figures are rounded to thousands.


If the 50\% of these account holders could be persuaded to get involved in the market as frequent buyers and sellers, activities of the secondary market could be improved further.

\textsuperscript{37} CSE; \textit{Annual Report}; 1995, p. 7.
4.1.15 COMPANIES LISTED IN THE CSE:

There was a growth in the number of companies listed in the stock exchange. During the period from 1976 to 1991, in 15 years, the number of listed companies has increased from 77 to 178, by 101, and the average growth is around 6.7 companies per year.

TABLE 4–3
COMPANIES IN THE COLOMBO STOCK EXCHANGE
FROM 1992 TO 1999

<table>
<thead>
<tr>
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<td>15</td>
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<td>NET CHANGE</td>
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<tr>
<td>NO. OF LISTED COMP. (end of the year)</td>
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<td>201</td>
<td>215</td>
<td>226</td>
<td>235</td>
<td>239</td>
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<tr>
<td>NO. OF TRADED COMP.</td>
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<td>187</td>
<td>203</td>
<td>215</td>
<td>214</td>
<td>225</td>
<td>224</td>
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<tr>
<td>NO. OF NON TRADED COMP.</td>
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<td>11</td>
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<td>TRADED COMPANY %</td>
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<td>93</td>
<td>94</td>
<td>95</td>
<td>91</td>
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<td>NON TRADED COMPANY %</td>
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<td>5</td>
<td>9</td>
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</table>

Source: CSE; Annual Reports, 1992 – 1998 and Information from the Marketing Division.

As TABLE 4–3 indicates the number of listed companies has increased from 190 to 240 during the period from 1992 to 1999, 8 years (inclusive of both years). The total net increase is 50 and the average annual increase is 6.2. During this period the number of traded companies has increased from 177 to 224 and the total increase is 47. The years 1992, 1993, 1994, and 1995 show a higher growth in the number of listed companies, which is 12 or more than 12 per annum. This growth has dropped by a considerable number in the subsequent years, and
the year 1999 shows a zero growth. During this period traded percentage of listed companies is more than 90% and in the year 1995, it has been increased to 95% percent.

**TABLE 4-4**

**SECTARIAN CLASSIFICATION OF LISTED COMPANIES (CSE) FROM 1988 TO 1999**

<table>
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<td>BEVERAGE, FOOD &amp;</td>
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<td>17</td>
<td>18</td>
<td>19</td>
<td>19</td>
<td>18</td>
<td>18</td>
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<tr>
<td>CHEMICALS &amp; PHarma.</td>
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<td>7</td>
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<tr>
<td>TOTAL</td>
<td>190</td>
<td>201</td>
<td>215</td>
<td>226</td>
<td>235</td>
<td>239</td>
<td>240</td>
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</tbody>
</table>

Sources: CSE; Annual Reports, 1992–1998 and Information from the Marketing Division

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38 The year 1999 figures are as at 8th September and the other figures are as at the end of the calendar year.
Tables 4 - 4 provides listing information of the companies in the Colombo stock exchange under sectarian classification for the period from 1992 to 1999. The development can be seen only in Bank Finance and Insurance, Beverage Food and Tobacco, Manufacturing, Plantations and Diversified sectors. In majority of the sectors the number of companies registered has not increased.

4.1.16 RULES AND REGULATIONS:

In any stock exchange there are two lobby groups relevant to rules and regulations. The companies and their management, generally, lobby for reducing regulations. Share holders, their advisors and regulatory authorities lobby for more and more stringent regulations. It is the responsibility of the stock exchange to find the optimum level of regulation which enable listed companies to raise capital, and to investors in securities to provide protection from fraud and unethical practice. A sound regulatory framework should facilitate economic development of a country and provides an even playing field to all participants therein. Proper regulations could infuse confidence in investors and lead the market towards development. The CSE introduced a new set of rules with effect from 1st October 1988, replacing the byelaws of the CBA adopted by the CSE at its inception, in December 1985. The newly adopted rules have been modelled on the rules of the Kuala Lumpur Stock Exchange, after taking into consideration, the local environment. Rules were formulated with an objective of expanding the activities of the brokers from agency business to areas such as take up positions for their own account, underwrite or sub-underwrite issues, provide margin trading facilities to clients, and engage in stock lending and borrowing. A wide range of financial services to clients is to be supplied by the brokers. A new format of security printed share certificate was introduced and they are required to be sent
within 7 market days of the lodging of the valid transfer or close of the rights or bonus issue. The ‘crossing of parcels’ with a value exceeding Rs. 10 million on the floor was introduced. Rules for the appointment of ‘Agents’ were passed during the year 1994, so brokers can appoint agents to represent them and provide advice and pass on orders to the brokers for execution. This is a method to link investors through out the country to the share market. During the year 1995, the SEC gazetted the Company Take-overs and Mergers Code. Rules on taking disciplinary action against member firms were introduced in 1998. The rules for listed investment companies were adopted effective from the year-end 1997. The number of dates during which restrictions are imposed on trading by insiders was reduced from 5 to 2 market days after taking into consideration facilities provided by the Automated Trading System.

4.1.17 NEW COMPUTER SYSTEM:

“[Introduction of the new computer system in 1990] ...is a quantum leap in the development of the Securities Industry in Sri Lanka. The post-trade automation would serve as an impetus for the liberalisation of investment in the country.” 39 This is a fully integrated computer system and incorporates a real-time market information service by linking the member firms to the CSE computer system from remote locations, and for others on a ‘dial’ basis.

4.1.18 THREE TIERS OF BOARDS:

Prior to the year 1996, the CSE maintained a single board system to display company information. By the end of 1996, the second and third boards were introduced. The criteria for listing in the Main Board are given below:

“1. A company should have a minimum issued capital of Rs. 75 million or a market capitalisation of Rs. 75 million.

2. A minimum of 25% of the issued capital should be in the hands of the public.
3. A satisfactory operating record of three years. This requirement may be waived depending on the circumstances of each case." 40

The second board of the stock exchange provides a facility for smaller companies and those without track records to seek a listing in the CSE. "The Exchange hopes to target potential companies and appraise them of the advantage of being listed..." 41 Criteria for listing in the CSE for the Second Board are as follows:

"1. A company should have a minimum issued capital of Rs. 5 million or a market capitalisation of Rs. 5 million.
2. A minimum of 10% of issued capital should be in the hands of the public.
3. No operating record is required." 42

The third board provides facilities to display information on over the counter trading.

4.1.19 AUTOMATED TRADING SYSTEM:

Trading of the CSE changed over from the Open Outcry System to the Automated Trading System (ATS) in June 1997. "With the implementation of the ATS the CSE ranks among the best in the world in terms of technology. The challenge facing us today however is to make use of the superior infrastructure for the further development of the market." 43

Supply of information on price and volume of securities being traded, on-line reporting of executed trades and price indices, supply of corporate announcements, providing of information of the status of pending orders are main

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40 CSE; Annual Report; 1997, p. 11.
41 ibid.
42 ibid.
43 ibid.; p.4.
facilities offered. Orders are matched on a price and time priority. Priority on price is based on the highest price in the case of a buy order and the lowest price in the case of a sell order. In terms of priority price precedes time. Trading is done directly from the broker’s office by using computers. This enables the investor to play a more proactive role when trading. The system has increased the execution speed. The investors can keep a better track of the unexecuted orders. “The ATS was designed to handle 20,000 trades per trading day (3 hours trading). Up to date the highest volume of trades recorded was 8,153 in March 1998...”44 The introduction of the ATS has improved the surveillance activities of the CSE. The system enables real-time price and volume alerts to detect abnormal activity with regard to price volatility, unusual activity prior to announcements, and unexplained high volumes. When price exceeds parameterised limits the surveillance system can trip the trading of relevant securities and call a temporary halt in trading. Instances of market manipulations and other unethical practices can be noted and investigated conveniently. During the year 1998, the Surveillance Division conducted 12 investigations on suspected price manipulations and insider trades. The Exchange referred 8 cases investigated to the SEC for further inquiry. 45 The 1997 Annual Report of the CSE describes the trading procedure after introduction of the ATS as follows:

Trading commences at 9.30 a.m. and is open for three hours until 12.30 p.m. each trading day. Trading is preceded by a pre-open period commencing at 8.30 a.m. during which order entry takes place. Orders entered during this period are deemed to have equal time priority. The open auction takes place at 9.30 a.m. during which period an algorithm

45 ibid.
establishes the opening price of securities that will enable the conclusion of
the largest possible number of trades. The system also has a facility for
closing auction. This facility is not used at present considering the limited
volume of shares being traded. 46

4.1.20 DEBT MARKET OF THE CSE:

The CSE debt market is at the initial stage of development. “Only 6
companies with 12 debentures were listed at the CSE by the end of the year 1998,
and the market capitalisation of debts was Rs. 3.1 Bn. In terms of market
capitalisation corporate debts accounted for 2.7% of that of equity”.47 The CSE
does not list Government debts, however in many other FIBV member exchanges,
government debts are listed. If a market is available for government debts,
corporate debts, and equities investors will benefit from the availability of much
investment options. Investors can diversify their investment risk. Even by enabling
investors the free flow of funds among shares, debentures, and government
securities volatility of the share prices may be able to reduce. The development of
the debt market will provide opportunities for the companies to practice more
sophisticated management techniques. “Preliminary studies done by the CSE
indicate a high potential for the development of the debt market provided that a
listing can be granted to companies independent of the listing for equity.” 48

In order to encourage debt market activity the CSE intends to
amend its rules allowing unlisted companies to seek listing for debt securities
under the following conditions:

46 CSE; Annual Report; 1997, p. 15.
47 CSE; Annual Report; 1998, p.16.
48 CSE; Annual Report; 1997, p. 12.
1. Obtain a backup line of credit or a guarantee from a regulated financial institution for the payment of capital and interest of the securities being listed.

2. Enter into an agreement with a regulated financial institution to act as a market maker for the securities being listed.

Establishment of a credit rating agency and a yield curve is required to activate the debt market. Arrangements are being made to establish a credit rating agency in collaboration with Duff and Phelps Credit Rating Company. Trading of treasury bills and government bonds have to be encouraged to establish a yield curve. The interest rates on government debt instruments will act as the benchmark interest rate for the issue of corporate debts.

4.1.21 FOREIGN INVESTMENT IN THE SRI LANKA SHARE MARKET:

In most of security markets foreign investments have led the market development. “Historically, unfettered share trading between nationals and non-national, residents and non-residents, in a regime without the hassles of exchange control, has always contributed to rapid capital market development. This is an ideal to be achieved.” 49

The share market in Sri Lanka was originated with foreign investors, and until the independence in 1948, they were the dominating force. The introducing of exchange controls after the independence has diminished foreigners’ activities in the market. Steady liberalisation of exchange control, after 1977, and removal of discriminating 100% property tax in June 1990 on foreigners’ share purchases have increased the foreign participation in the CSE.

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TABLE 4 - 5
FOREIGN AND DOMESTIC TURNOVER
FROM 1991 TO 1998

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<tbody>
<tr>
<td>DOMESTIC Rs. Mn.</td>
<td>3,381</td>
<td>4,687</td>
<td>14,449</td>
<td>20,699</td>
<td>5,815</td>
<td>3,355</td>
<td>10,455</td>
<td>11,807</td>
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<tr>
<td>FOREIGN Rs. Mn.</td>
<td>2,159</td>
<td>1,472</td>
<td>7,675</td>
<td>13,806</td>
<td>5,434</td>
<td>4,048</td>
<td>7,860</td>
<td>6,425</td>
</tr>
<tr>
<td>TOTAL Rs. Mn.</td>
<td>5,542</td>
<td>6,159</td>
<td>22,124</td>
<td>34,505</td>
<td>11,249</td>
<td>7,403</td>
<td>18,315</td>
<td>18,232</td>
</tr>
<tr>
<td>DOMESTIC %</td>
<td>61</td>
<td>76</td>
<td>65</td>
<td>60</td>
<td>51</td>
<td>46</td>
<td>57</td>
<td>64</td>
</tr>
<tr>
<td>FOREIGN %</td>
<td>39</td>
<td>24</td>
<td>35</td>
<td>40</td>
<td>49</td>
<td>54</td>
<td>43</td>
<td>36</td>
</tr>
</tbody>
</table>


The TABLE 4 – 5 provides information on distribution of total turnover between the domestic and foreign participants. In June 1990, the 100% property tax on share purchases of non-nationals was removed and this step has increased the foreign participation in the share market considerably. In 1991, annual foreign turnover was 39% and this has been increased to 54% in 1996. CSE became a market that was being looked at by foreign brokers and foreign institutional buyers. Linkages and joint ventures between the local broker companies and international broker houses were build up. Foreign activities in the market have increased to average 40% level, and the market is currently dominated by the foreign investments. The market investments and share prices had moved up considerably. However, the market has been seriously affected by the withdrawal of foreign participation due to economic and political factors of other countries and regions. “The Mexican crisis in December 1994 was followed by the East Asian contagion in July 1997 which preceded the South Asian exigency in May 1998. All these events have left an indelible mark on Sri Lanka’s capital market.”\textsuperscript{50} During

\textsuperscript{50} CSE; Annual Report; 1998, p. 9.
these incidences the market was badly affected not due to economic fundamentals or bad corporate performances but due to 'herding instincts'. The nuclear explosion in India and Pakistan has not seriously affected the Indian share market, because of its domestic investor base. The foreign investment accounts for less than 5% of purchases in the Bombay Stock Exchange. The Indian stock markets could weather the South Asian crisis more effectively, due to domestic investor base. The Sri Lankan stock exchange is foreign investor based. The impact of the crises on the CSE was more phenomenal than in other markets in South Asia due to over dependence on foreign investment. Whatever the bad experience it had, Sri Lanka has to rely upon foreign capital flows to bridge the savings and investment gap. The only way of limiting volatility in the share market is to practice good economic management, provide a sound regulatory framework and establish dependable infrastructure, while encouraging increasing domestic participation in the CSE.

4.1.22 RESPONSIBILITY AND ADMINISTRATION:

The CSE as a legally constituted body is responsible to its shareholders that are broker members. "[However,] this technical responsibility is superseded by a duty it owes to the listed companies which truly form its constituency and provide the major source of its income." ⁵¹ The CSE accepting this philosophical view presented its first published Annual Report to the listed companies in addition to the broker members. The 1988 Annual Report is the first annual review of the share market in Sri Lanka. The CBA, which was responsible for organised share trading had not issued an annual review from the inception. The CSE has, so far, published 11 annual report from 1988 to 1998 without any

⁵¹ CSE; Annual Report; 1988, p. 7.
discontinuation. This can be considered as an attempt made by the CSE to apprise its activities among the listed companies, investing and general public, and stock exchanges in different parts of the world.

The executive Committee is the highest administrative and policy making body of the CSE consisting of members appointed by the member brokers. Operational matters devolve on four sub-committees, which consist of members of the Executive Committee. Rules and Byelaws, Capital Issues, Disciplinary, and Finance Research and Development are the four Sub-committees. The principal function of the Rules and Byelaws Sub-committee is the formation of rules relating to listed companies and member firms. The Capital Issues Sub-committee deals with applications for new listings. The Disciplinary Sub-committee is concerned with domestic matters of broker firms relating to administration of the Exchange. The Finance Research and Development Sub-committee is responsible for research on various aspects of the market and funding of the Exchange. The organisation is divided into divisions as Marketing and Public Relations, Clearing and Settlement, Information Technology, Surveillance and Enforcement, and Finance & MIS for administrative purposes. It is the responsibility of the regulatory bodies to see that the broker companies properly implement requirements stipulated by the SEC and CSE. In order to achieve this, in 1994, a compliance officer was required to be appointed by each broker company on full-time or part-time basis.

Handbook of Listed Companies, Listing Rules, Member Regulations, CDS Rules, Conditions of Sale, Rules for the Appointment of Agents, Fact Sheet, Stock Market Daily, Monthly Market Report, Quarterly Facts and Figures, Market Valuation of Shares are the publications made available by the CSE.
4.1.23 CERTAIN IDENTIFIED CHARACTERISTICS OF THE COLOMBO STOCK EXCHANGE:

Generally in emerging markets volatility of the share prices is high, mainly due to imperfect nature of the market and slow transfer of information. An analysis carried out on all share price index (ASPI) and sensitive share price index (SPI) for the period from the beginning of January 1985 to the end of September 1995 has observed high unconditional volatility in the Colombo Stock Exchange.\textsuperscript{52}

In CSE, return on investment seems to be reasonable, according to an analysis\textsuperscript{53} carried out on share price indices for the period from 1985 to 1997, over a period of 13 years. Dividend - adjusted nominal return on ordinary shares was around 27.4 percent per annum; dividend – adjusted risk premium of ordinary shares was 10.6 per cent and the real risk free rate of return on ordinary shares in Sri Lanka was 5.6 percent with a standard deviation of 5.4. Trends of four bull markets and three bear markets have been observed during this period. Another research carried out\textsuperscript{54} for the period from 1985 to 1997 of the Sri Lanka Stock Exchange reveals that long – horizon returns in Sri Lanka are highly negatively correlated implying mean reversion. The predictable variation in 1 – 3 year returns is around 50 per cent. The random walk behaviour of price has been rejected. Liquidity and divisibility of shares, high and steady volume of daily trading, effective information flows, and low transaction costs are basic characteristics of a “thickly” traded capital market. In such a market resources are allocated among the

\textsuperscript{52} Alles, Lakshan; Estimation of Stock Market Volatility in an Emerging Market: The Case of Sri Lanka; Working Paper, School of Economics and Finance, Curtin University of Technology, Perth, Western Australia; 1997.
\textsuperscript{53} Samarakoon, Lalith p.; Lessons from the capital Market History of Sri Lanka: 1985 – 1997; Staff Development Programme, Faculty of Management studies and commerce, university of Sri Jayawardenapura, Nuwara Eliya, Sri Lanka; 1998 (b), March 25
\textsuperscript{54} Samarakoon, Lalith p.; Mean Reversion in stock price in an Emerging Market Sri Lankan Evidence; working paper, Faculty of Management Studies and commerce, university of Sri Jayawardenapura, Nuwara Eliya, Sri Lanka; 1998 (a) February
companies efficiently, and prices will be decided effectively. In a “thinly” traded market above features are diminished. A study carried out\(^{55}\) on the Colombo Stock Exchange reveals that CSE has encountered with ‘thin’ trading problem. In developed capital markets, generally, a causal relationship exists between the macro-economic variables and the share price indices. A study carried out\(^{56}\) on the Colombo Stock Exchange proves a positive relationship between the all share price index of CSE and macroeconomic variables of Treasury Bill Rate and the Inflation Rate. However, the effects of savings rate and the exchange rate on the index is neutral. This may be attributable to the underdeveloped nature of the Colombo Stock Exchange, which has been characterised by high transaction cost, lower liquidity, infrequent trading, non-widespread share ownership and etc. It seems that at present the stock market dose not play an active role in economic activities of Sri Lanka.

Findings of certain characteristics of the Colombo Stock Exchange, discussed so far, are relevant to the field of finance. There are some findings in the area of accounting information prevailing in the market.

Information processed through the accounting system is supplied to the users. Financial statements in annual reports are used as a medium for this purpose. While a company produces financial statements for different years different companies produce financial statements for the same year. For better understanding and vertical and horizontal comparability of these statements consistent rules and procedures have to be applied without anomalies. An analysis


\(^{56}\) Bandara, W.M. Guneratne and Abeyratne, G.; *Causal Nexus between Stock Market Indices and Macroeconomics Variables*, Faculty of Graduate Studies, University Sri Jayawardenapura, Nugegoda, Sri Lanka ; 1998, 27 – 28 March
carried out on a sample of public listed companies discloses that the balance sheets, profit and loss accounts and fund flow statements produced in annual reports of public listed companies contain numerous inconsistencies and anomalies\textsuperscript{57}

A decision on buying or selling of shares can be related to fundamental analysis, or technical analysis or perfect market hypothesis or a combination of any of them. The decision making on the basis of trend of share price, technical analyses, is generally popular among many buyers and sellers. A study has been done, in order to highlight the fluctuation of share prices, for the benefit of the non-expert actors of the share market\textsuperscript{58}. Monthly average share price of each company has been presented through bar charts. A separate bar chart for each company for each year is presented in the form of a bound book. Information for 6 years is summarised. Some companies did not have transactions for all six years; some did not have transactions for a couple of years or couple of months. The change in popularity of companies among actors of the market has been a common occurrence.

Identification of the intrinsic value of shares is significant for buying and selling of shares in a stock exchange. If the identified intrinsic value is higher than the market value, a person may buy such shares and vice versa. In deciding the intrinsic value accounting value or book value of shares is significant. If the book value and market value are close to each other reliability of accounting information may be stronger. A buyer will buy shares if his estimated intrinsic

\textsuperscript{57} Wickramarachchi; M.W.: \textit{An Examination of Selected Financial Reporting Practices of Public Listed companies in Sri Lanka}; Department of Accountancy and Financial Management, University of New England, Australia; 1978.
\textsuperscript{58} Wickramarachchi; M.W.; \textit{A Historical view at Share Market Prices of the Colombo Brokers Association}; Faculty of Management studies and commerce, University Sri Jayawardenapura, Nugegoda, Sri Lanka ; 1986 (a).
value is more than the market value. A seller will sell shares if his estimated intrinsic value is less than the market value. Comparison of accounting book value with the market value is significant and useful in share market decision making. A study has been carried out to present the comparative relationship between these two prices of listed companies for 6 years. A separate bar chart has been prepared for each year of every company. Six years' information has been presented. This study has shown a wide gap between the accounting book value and the market value of shares for most of the listed companies in the Sri Lanka share market.

4.2.0 CAPITAL FORMATION OF LISTED COMPANIES:

4.2.1 CAPITAL FORMATION

Share markets in the world are institutions developed in order to satisfy capital requirement of public listed companies, by mobilising savings for investments. Institutional set up and the origin of the share markets may vary from country to country. However, the ultimate objective is the same. Basically, share market activities could be classified into two main types: primary market and secondary market. Original issue of shares and other securities are carried out in the primary market. Issued securities are retraded in the secondary market. In addition to these activities, brokers are used to find buyers for the sellers of unlisted company shares through the "Over the Counter System". Issue of shares and debentures of public listed companies can be carried out by different means. Following are methods for issue of securities stated in the by-laws of the CBA.

60 Colombo Brokers Association; By-laws of the Colombo Brokers Association for Dealings in Shares and Debentures; CBA; 1975, p.3
1. Issue by prospectus  
2. Offer for sale  
3. Stock exchange placing  

If the issuing company of the securities requires them to be quoted in the stock exchange an application has to be made satisfying the requirements for quotation.

4.2.2 ISSUE BY PROSPECTUS

Issue by prospectus is the most popular method of issuing new shares of a public listed company to the public in Sri Lanka. The Companies Act defines the prospectus as follows:

Prospectus means any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription to or purchase of any shares or debentures of a company and includes any such notice, circular, advertisement, or other invitation notwithstanding that it may contain on the face thereof that it is not a prospectus or offer of shares to the public. \(^{61}\)

The prospectus is a medium of communication from the company to the prospective investors in the company. Accounting information on performance and forecast is incorporated in the prospectus. The types of information usually available in a prospectus issued by a public listed company in Sri Lanka are given below.

- Share capital, Directors and other parties, Purposes and particulars of the issue, Minimum subscription, Brokerage, Cost of the issue, Tax holiday, Reduced rates of company taxation, Dividends exempt from tax, No withholding tax on dividends, Investment relief, Dividends received by companies not subject to tax, Capital gains are free of tax, Sponsors of the

project, History and description of the company, the project, Land and premises, Project cost estimates, Financial plan, Major shareholders, Loans, Management and staff, Prospectus, Accountants' report, Directors interest, Material contracts, Articles of association, Consents, Documents available for inspection, Persons who can apply, How to apply, Acceptance and allotment & etc.  

\[\text{TABLE 4 – 6}\]

\textbf{NEW SHARE ISSUES BY PROSPECTUS: FROM 1988 TO 1998}

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<tbody>
<tr>
<td>NO. OF NEW ISSUES</td>
<td>4</td>
<td>2</td>
<td>1</td>
<td>6</td>
<td>15</td>
<td>12</td>
<td>15</td>
<td>14</td>
<td>9</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>CASH COLLECTED (Rs. Millions)</td>
<td>35</td>
<td>140</td>
<td>7</td>
<td>326</td>
<td>1267</td>
<td>1051</td>
<td>3248</td>
<td>2434</td>
<td>1573</td>
<td>706</td>
<td>349</td>
</tr>
</tbody>
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The \text{TABLE 4 – 6} presents information of the new share issues by prospectus during the period from 1988 to 1998. The years from 1992 to 1995 had relatively higher issues and cash collections than that of the other years and 1990 had been the poorest year in terms of cash collection.

\textbf{4.2.3 OFFER FOR SALE}

Under the offer for sale the original promoters of the company / issuing house / broker / or outside party purchases the shares or debentures of the company and offer them for sale to the public at a price. The offer is not to particular clients but to the general public. The price covers their expenses and the profit margin, which are disclosed. The advertisement published or any document by which the offer for sale is made is for all purposes are deemed to be a

\[\text{Wickramarachchi 1984., op. cit., p.8.}\]
prospectus. "... any document by which the offer for sale to the public is made, shall for all purposes be deemed to be a prospectus issued by the company..."63

Under the system of offer for sale, the company is assured of a definite sum of capital and the public has the opportunity to acquire existing shares or debentures.

4.2.4 STOCK EXCHANGE PLACING:

In stock exchange placing, a broker will arrange for a number of large investors, such as investment trust companies, insurance companies and provident funds to take up shares or debentures of the company to be issued. The company having agreed with the institutions subscribing for shares makes formal application through the brokers for the company’s shares to be quoted at the stock exchange.

4.2.5 INTRODUCTION:

An introduction is an offer of shares of a company to the public through the share market. The shares should be (a) widely held (b) available to start the market and (c) there should be no large “deal” involved as in placing. 64 The company with the assistance of its broker makes a formal application to the CSE for the company’s shares to be quoted. The CSE conducts investigations into company’s affairs. If the result is successful the shares of the company will be granted quotations. The company has to make arrangement to make adequate number of shares available on the market.

4.2.6 RIGHT ISSUES

The issue of shares by a company to its shareholders for a consideration is called the right issue and this is a convenient and inexpensive

63 Companies Act No. 17 of 1982, Sec 47 (1), p. 30
64 Grigson, op. cit., p.28.
method of raising required new capital by a company. If shareholders are satisfied with the affairs of the company, they will not hesitate to acquire new shares under the right issue, if they have sufficient funds. It is possible for the shareholders of a right issue of a public listed company to sell their rights at the trading floor. Since shares under a right issue are allotted to them according to the position of holding at the time, their right to undisclosed value of assets in the balance sheet will not be affected or changed. Usually, shareholders can acquire these additional new shares at a value lower than the market price. However, there were instances, in the Sri Lanka share market, in which some companies having issued shares at par when the market value of shares was below the par value. Tax benefits accruing to the shareholders would have been the reason for this. In a right issue following documents are sent to the shareholders by the company.

1. Circular to shareholders,
2. Provisional letter of allotment,
3. Pink Form.

The circular to shareholders in a right issue is a letter addressed to the shareholders, signed by a director/number of directors on behalf of the company, describing the reasons for requirement of new capital, and its advantages to the company and shareholders.

Provisional letter of allotment is a valuable document which states that a specific number of shares have been provisionally allotted to the shareholder whose name is stated therein. If the shareholder is interested in acquiring the number of shares provisionally allotted, he must complete and sign the Registration Application Form (usually attached to the Provisional Letter of Allotment). He has to send it along with the Provisional Letter of Allotment, and the cheque for the amount payable on the shares provisionally allotted, to the
registrars of the issue. The cheque or bank draft should be drawn in favour of the right issue account of the company in a particular bank named in the Provisional Letter of Allotment. If no payment for the provisionally allotted shares is received before the stated date and time, the provisional allotment is deemed to have been declined and will be treated as cancelled. If the shareholder wants to renounce his right to take up his entitlements in favour of another person, he must complete and sign the Form of Renunciation (usually attached to the Provisional Letter of Allotment). It has to be forwarded to the Registrars to the issue with the Registration Application Form, completed and signed by the person in whose favour the shareholder wants to renounce his right to take up the shares. Generally, the period allowed for renunciation varies from 3 to 7 weeks. A cheque or bank draft for the amount has to be sent along with the relevant documents. Particulars of the right issues of listed companies in Sri Lanka, from 1988 to 1998, are given in the TABLE 4-7.

### TABLE 4-7
RIGHT ISSUES OF SHARES BY PUBLIC LISTED COMPANIES IN SRI LANKA FROM 1988 TO 1998

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</tr>
</thead>
<tbody>
<tr>
<td>NO. OF COMPANIES</td>
<td>12</td>
<td>7</td>
<td>12</td>
<td>17</td>
<td>24</td>
<td>31</td>
<td>29</td>
<td>15</td>
<td>15</td>
<td>12</td>
<td>9</td>
</tr>
<tr>
<td>COLLECTION (Rs mn.)</td>
<td>320</td>
<td>91</td>
<td>495</td>
<td>769</td>
<td>1,799</td>
<td>4,031</td>
<td>7,800</td>
<td>1,166</td>
<td>5,228</td>
<td>1,061</td>
<td>1,815</td>
</tr>
</tbody>
</table>


During the seven years from 1992 to 1998 collection of capital through right issues was relatively high, and during the year 1994 Rs. 7,800 million was collected by 29 companies. Under the pink form shareholders can apply for additional shares. In Sri Lanka share market, some times, shareholders of
issuing company do not subscribe fully for the right issue. On such situations the companies have called up applications from the general public.65

Under the right issue new shares are allotted to the shareholders in proportionate to the holding of share at the time of issue. The ratio is the numerical relationship between the number of old shares and the number of new shares. Different companies have used different ratios for the purpose. The TABLE 4–8 shows the grouping of ratios used by the listed companies of the CSE during the last 11 years. There were 159 right issues during this period and the most popular ratio groups had been between the 41 – 50% and above 90%.

**TABLE 4–8**

**RATIO GROUPS USED BY PUBLIC LISTED COMPANIES.**
**FOR RIGHT ISSUES FROM 1988 TO 1998**

<table>
<thead>
<tr>
<th>Ratio Groups</th>
<th>No. of Issues</th>
<th>Issue %</th>
<th>Ratio Groups</th>
<th>No. of Issues</th>
<th>Issue %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% - 10%</td>
<td>4</td>
<td>3%</td>
<td>51% - 60%</td>
<td>2</td>
<td>1%</td>
</tr>
<tr>
<td>11% - 20%</td>
<td>24</td>
<td>15%</td>
<td>61% - 70%</td>
<td>5</td>
<td>3%</td>
</tr>
<tr>
<td>21% - 30%</td>
<td>20</td>
<td>13%</td>
<td>71% - 80%</td>
<td>4</td>
<td>3%</td>
</tr>
<tr>
<td>31% - 40%</td>
<td>24</td>
<td>15%</td>
<td>81% - 90%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>41% - 50%</td>
<td>38</td>
<td>24%</td>
<td>Above 90%</td>
<td>38</td>
<td>24%</td>
</tr>
</tbody>
</table>


**4.2.7 BONUS ISSUE:**

The issue of shares by a company to its shareholders without making them to pay in money or in any other from is known as a bonus issue. It is a process through which capital and revenue reserves are converted to share capital. There is no inflow of cash from outside of the company. The bonus issue increases the share capital of the company without altering the available capital,

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65 Right issue of Pelawatte Sugar Co.Ltd during the year 1985 is an example.
while share capital is increased reserves are decreased. Generally, shares issued under a bonus issue of a listed company are quoted at the Colombo Stock Exchange. This will increase the available number of shares in the market for trading purposes. By means of a bonus issue a company can transfer the benefits of accumulated profit to its shareholders without reducing the available capital. There is no transfer of cash from the company to shareholders, and no involvement of tax. If a shareholder does not intend to keep the additional shares received by him without paying any money, he could realise money by selling them at the stock exchange. The shareholders can transfer right to bonus shares by completing and signing relevant forms sent to them and filing them with the company registrar before the stated date.

**TABLE 4 - 9**

**BONUS ISSUES BY LISTED COMPANIES OF THE COLOMBO STOCK EXCHANGE FROM 1988 TO 1998**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NO. OF COMPANIES</td>
<td>14</td>
<td>9</td>
<td>17</td>
<td>15</td>
<td>17</td>
<td>19</td>
<td>34</td>
<td>17</td>
<td>21</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>VALUE (Rs. Millions)</td>
<td>155</td>
<td>332</td>
<td>260</td>
<td>199</td>
<td>74</td>
<td>651</td>
<td>1345</td>
<td>555</td>
<td>1107</td>
<td>487</td>
<td>1047</td>
</tr>
</tbody>
</table>


The TABLE 4 - 9 shows information of the bonus issues by the listed companies of the Colombo Stock Exchange for the last 11 years. The highest value of bonus issue was during the year 1994, Rs. 1345 mn. And the lowest value was in the year 1992, Rs. 74 mn.

The number of bonus shares issued to a shareholder varies according to the number of shares owned by him prior to the bonus issue, and the ratio used for the purpose. The ratio is the numerical relationship between the number of old shares and the number of new shares. The ratio to be applied
depends, mainly, on the available reserves, number of old shares and the policy of the company. The groups of the ratios used by the companies during the last 11 years are shown in TABLE 4 – 10.

**TABLE 4 – 10**

<table>
<thead>
<tr>
<th>Ratio Groups</th>
<th>No. of Issues</th>
<th>Issue %</th>
<th>Ratio Groups</th>
<th>No. of Issues</th>
<th>Issue %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1% - 10%</td>
<td>11</td>
<td>5%</td>
<td>51% - 60%</td>
<td>3</td>
<td>1%</td>
</tr>
<tr>
<td>11% - 20%</td>
<td>47</td>
<td>23%</td>
<td>61% - 70%</td>
<td>5</td>
<td>2%</td>
</tr>
<tr>
<td>21% - 30%</td>
<td>20</td>
<td>10%</td>
<td>71% - 80%</td>
<td>2</td>
<td>1%</td>
</tr>
<tr>
<td>31% - 40%</td>
<td>28</td>
<td>13%</td>
<td>81% - 90%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>41% - 50%</td>
<td>36</td>
<td>17%</td>
<td>Above 90%</td>
<td>56</td>
<td>27%</td>
</tr>
</tbody>
</table>


There were 208 bonus issues during this period and the most popular ratios had been above 90% with 27% of issues, and the least popular group had been the 81 – 90% with no issues.

**4.2.8 TOTAL ISSUES**

**TABLE 4 – 11**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NEW ISSUES</th>
<th>RIGHT ISSUES</th>
<th>RIGHT &amp; NEW ISSU.</th>
<th>BONUS ISSUES</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>35</td>
<td>320</td>
<td>355</td>
<td>155</td>
<td>510</td>
</tr>
<tr>
<td>1989</td>
<td>140</td>
<td>91</td>
<td>231</td>
<td>332</td>
<td>563</td>
</tr>
<tr>
<td>1990</td>
<td>7</td>
<td>495</td>
<td>502</td>
<td>260</td>
<td>762</td>
</tr>
<tr>
<td>1991</td>
<td>326</td>
<td>769</td>
<td>1,095</td>
<td>199</td>
<td>1,294</td>
</tr>
<tr>
<td>1992</td>
<td>1,267</td>
<td>1,799</td>
<td>3,066</td>
<td>74</td>
<td>3,140</td>
</tr>
<tr>
<td>1993</td>
<td>1,051</td>
<td>4,031</td>
<td>5,082</td>
<td>651</td>
<td>5,733</td>
</tr>
<tr>
<td>1994</td>
<td>3,248</td>
<td>7,809</td>
<td>11,048</td>
<td>1,345</td>
<td>12,393</td>
</tr>
<tr>
<td>1995</td>
<td>2,434</td>
<td>1,166</td>
<td>3,600</td>
<td>555</td>
<td>4,155</td>
</tr>
<tr>
<td>1996</td>
<td>1,573</td>
<td>5,228</td>
<td>6,801</td>
<td>1,107</td>
<td>7,908</td>
</tr>
<tr>
<td>1997</td>
<td>706</td>
<td>1,061</td>
<td>1,767</td>
<td>487</td>
<td>2,254</td>
</tr>
<tr>
<td>1998</td>
<td>349</td>
<td>1,815</td>
<td>2,164</td>
<td>1,047</td>
<td>3,211</td>
</tr>
<tr>
<td>TOTAL</td>
<td>11,136</td>
<td>24,575</td>
<td>35,711</td>
<td>6,212</td>
<td>41,923</td>
</tr>
</tbody>
</table>
The TABLE 4-11 shows information about issue of shares during the 11-year period from 1988 to 1998. The nominal value of shares issued during this period was Rs. 41,923 million. New issues and right issues were Rs. 35,711 million. Until the year 1994, issue of shares had been gradually increasing. During the year 1994, Rs. 12, 393 million shares were issued. After the year 1994 issue of shares in the market had been decreasing and it has reduced to a very low level of Rs. 3,211 during the year 1998.

4.2.9 SECONDARY MARKET:

Shares already issued by the public listed companies are bought and sold through the secondary market. In Sri Lanka, secondary market activities are organised and executed by the CSE. The trading floor is used for execution of the transactions and the CDS provides recording service of share ownership. In the London Stock Exchange brokers and jobbers assist to carry out the share trading activities.\(^{66}\) In Sri Lanka, share broker companies\(^{67}\) perform share-trading activities with the assistance of the CSE and the CDS. Liquidity of shares is a significant factor effecting the activities of the primary market. Investors in shares prefer to know the realisable value of their share holdings. If the shares are traded in the secondary market the value of shares can be conveniently assessed. Savings of the economy could be diverted to the share market. The traded value indicates the strength of the demand for shares. If the market value of shares is high the company could issue new shares at a higher price with a capital gain. The companies could conveniently obtain funding from the public for the new issue of shares, if the people are aware that a strong secondary market exists for their shares.

\(^{66}\) In Indian stock exchanges many types of service providers are available.

\(^{67}\) There are 15 shares broking companies in Sri Lanka, as at 31\(^{st}\) March 1999.
Information on market capitalisation of the CSE is given in TABLE 4 –12. From 1988 to 1994, in 6 years, market capitalisation has increased from Rs 16 billion to Rs. 144 billion in terms of current values. Market capitalisation as a percentage of GDP has increased from 8% to 27% and turnover as a percentage of market capitalisation has grown from 2% to 24%, during this period. The subsequent 2 years, 1995 and 1996 had a downward trend. It was a development during the year 1997, however it has dropped in the subsequent year. Only from the year 1993, the market capitalisation has increased over 100 billion per annum. During most of the years turnover to market capitalisation has been less than 10%. It has exceeded 10% only in 4 years, and the highest was 24% during the year 1994. This is a clear indication of the lower liquidity level of the CSE.

**TABLE 4 – 12**

**MARKET CAPITALISATION OF CSE**

**FROM 1988 TO 1998**

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MC. AT CURRENT VALUES (Rs. Billions)</td>
<td>16</td>
<td>18</td>
<td>37</td>
<td>82</td>
<td>66</td>
<td>124</td>
<td>144</td>
<td>107</td>
<td>104</td>
<td>129</td>
<td>117</td>
</tr>
<tr>
<td>MC. AS A % OF GDP</td>
<td>8</td>
<td>8</td>
<td>13</td>
<td>24</td>
<td>17</td>
<td>27</td>
<td>27</td>
<td>18</td>
<td>15</td>
<td>16</td>
<td>13</td>
</tr>
<tr>
<td>TURNOVER AS A % OF MC.</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>6</td>
<td>9</td>
<td>17</td>
<td>24</td>
<td>10</td>
<td>7</td>
<td>14</td>
<td>15</td>
</tr>
</tbody>
</table>


The turnover information of the CSE is given in the TABLE 4 –13. The activities during the year 1994 are the peak of the period of 11 years. The increase in the number of transactions is from 13,027 to 404,367; in number of shares traded is from 13 million to 506 million; in annual total turnover is from Rs. 319 million to Rs 34,505 million; in average daily turnover is from Rs. 1.6 million to Rs. 147.5 million; in annual turnover as a percentage of GDP is from 0.15 to
6.59 and in number of shares traded from 13 million to 506 million. This is a remarkable development of the CSE. The activities of the market have diminished during the years 1995 and 1996. The recovery of the market has commenced from 1997. Annual turnover of 1997 and 1998 was more than Rs. 18,000 million per annum and during these two years the annual number of shares traded were 515 million 634 million. These annual figures are higher than the number of shares traded in the best year of performance, 1994. Therefore, the drop in turnover during the years 1997 and 1998 cannot be considered as a reduction of activities.

**TABLE 4 – 13**

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NO. OF TRADED COMPANIES</td>
<td>154</td>
<td>160</td>
<td>164</td>
<td>166</td>
<td>177</td>
<td>187</td>
<td>203</td>
<td>215</td>
<td>214</td>
<td>225</td>
<td>224</td>
</tr>
<tr>
<td>NO. OF TRANSACTIONS IN THOUSANDS</td>
<td>13</td>
<td>16</td>
<td>48</td>
<td>91</td>
<td>109</td>
<td>232</td>
<td>404</td>
<td>186</td>
<td>98</td>
<td>206</td>
<td>329</td>
</tr>
<tr>
<td>ANNUAL TOTAL TURNOVER (Rs. Mn.)</td>
<td>319</td>
<td>226</td>
<td>1563</td>
<td>5542</td>
<td>6159</td>
<td>22124</td>
<td>34505</td>
<td>11249</td>
<td>7403</td>
<td>18315</td>
<td>18232</td>
</tr>
<tr>
<td>AVERAGE DAILY TURNOVER (Rs. Mn.)</td>
<td>1.6</td>
<td>1.1</td>
<td>6.6</td>
<td>22.9</td>
<td>25.5</td>
<td>91.8</td>
<td>147.5</td>
<td>46.9</td>
<td>30.6</td>
<td>76.0</td>
<td>76.0</td>
</tr>
<tr>
<td>ANNUAL TURNOVER AS % OF GDP</td>
<td>0.15</td>
<td>0.09</td>
<td>0.53</td>
<td>1.64</td>
<td>1.59</td>
<td>4.88</td>
<td>6.59</td>
<td>1.88</td>
<td>1.06</td>
<td>2.27</td>
<td>1.99</td>
</tr>
<tr>
<td>NO. OF SHARES TRADED (MILLION)</td>
<td>13</td>
<td>12</td>
<td>42</td>
<td>110</td>
<td>114</td>
<td>424</td>
<td>506</td>
<td>316</td>
<td>227</td>
<td>515</td>
<td>634</td>
</tr>
</tbody>
</table>


The TABLE 4 - 14 shows the movement of share price indices between the years 1988 and 1998. While the highest All Share Price Index (ASPI) was in 1994, the highest Sensitive Price Index (SPI) was in 1993; ASPI has increased from 172 to 987; SPI has moved from 310 to 1442. Share price indices of all the sectors have gone up during the year 1993 or 1994, except for the Oil
Palm sector. The improvement is remarkable almost in all the sectors when compared with the year 1988. This trend of growth was not continued during the year 1992 in which ASPI and SPI have fallen to 605 and 827, respectively. Except in the oil palm in all the other sectors share prices have been decreased. The CSE has been using the ASPI and the SPI for a long period. The ASPI consists of all shares listed in the Exchange. Since considerable number of shares of listed companies are illiquid it lacks the characteristics important to encourage index based financial instruments. The SPI is an index based on blue-chip companies.

**TABLE 4 – 14**

SHARE PRICE INDICES (CSE)
FROM 1988 TO 1998

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ALL SHARE PRICE INDEX</td>
<td>172</td>
<td>180</td>
<td>184</td>
<td>384</td>
<td>605</td>
<td>979</td>
<td>987</td>
<td>664</td>
<td>703</td>
<td>702</td>
<td>597</td>
</tr>
<tr>
<td>SENSITIVE PRICE INDEX</td>
<td>310</td>
<td>342</td>
<td>680</td>
<td>1199</td>
<td>827</td>
<td>1442</td>
<td>1439</td>
<td>991</td>
<td>898</td>
<td>1068</td>
<td>923</td>
</tr>
<tr>
<td>SECTARIAN SHARE PRICE INDICES</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| FINANCE | 157 | 215 | 516 | 1675 | 1100 | 2683 | 2999 | 2003 | 1728 | 1772 | 1356 |
| FOOD | 274 | 261 | 382 | 769 | 534 | 758 | 737 | 528 | 535 | 705 | 764 |
| CHEMICAL | 357 | 483 | 960 | 1374 | 896 | 913 | 944 | 775 | 885 | 830 | 662 |
| CONSTRUCTION | 84 | 31 | 107 | 303 | 184 | 446 | 285 | 215 | 243 | 258 | 254 |
| TEXTILE | 191 | 158 | 342 | 1464 | 689 | 802 | 697 | 360 | 221 | 166 | 108 |
| HOTEL | 93 | 110 | 336 | 531 | 479 | 717 | 571 | 373 | 291 | 307 | 266 |
| INVESTMENT | 217 | 251 | 979 | 2055 | 1847 | 3273 | 3675 | 2547 | 1854 | 1643 | 1260 |
| PROPERTY | 107 | 125 | 158 | 200 | 158 | 206 | 190 | 130 | 126 | 115 | 105 |
| MANUFACTURI | 128 | 111 | 282 | 749 | 489 | 687 | 791 | 483 | 368 | 411 | 348 |
| MOTOR | 71 | 80 | 161 | 536 | 456 | 754 | 627 | 406 | 318 | 373 | 298 |
| OIL PALM | 370 | 498 | 1072 | 1143 | 1209 | 1009 | 1018 | 1062 | 1083 | 1262 | 1441 |
| SERVICES | 165 | 255 | 775 | 1388 | 1111 | 1797 | 1776 | 1176 | 1236 | 1127 | 1687 |
| STORES | 123 | 140 | 273 | 990 | 931 | 1204 | 1232 | 866 | 750 | 560 | 737 |
| TRADING | 239 | 360 | 723 | 1511 | 1120 | 1147 | 1103 | 852 | 714 | 941 | 846 |
| DIVERSIFIED | 107 | 107 | 165 | 144 |
| PLANTATION | 338 | 338 | 543 | 296 |

Base Year = 1985

Some of the companies included in the SPI did not continue to meet the evaluation criteria and the date of its last revision was in August 1994. This is also not suitable for an indexed based financial instruments. Therefore, the Exchange
replaced the SPI with the Milanka Price Index (MPI) with effect from 4th January 1999. The base index was set at 1000 points as at 31st December 1998. The criteria taken into creation of MPI are size and liquidity and it comprised of 25 companies representing 7 sectors. It account for over 50% of the market capitalisation and represents over 10% of the listed companies. "The composition of the companies in the MPI will be revised annually or more frequently in the event of contingencies such as delisting of the security."

4.2.10 OBSTACLES TO BE OVERCOME BY THE CSE:

A stock exchange to be classified as developed must have depth, breath, and liquidity; depth in the number of companies listed for trading and the volume of shares available for trading; breath in the number and distribution of trading participants, both company and location wise; liquidity by access to adequate credit and investment finance to support trading. In order to achieve this status required institutions, appropriate fiscal policies and adequate credit and financial facilities are required. The success of a stock market has to be gauged by measuring the effectiveness in harnessing and channelling savings to the productive sectors of the economy.

Due to financial and technical assistance received from the USAID and the Asian Development Bank the infrastructure and the regulatory framework of the CSE is similar to that of a more developed market. However, supply of and demand for listed securities in the CSE are at a lower level. It is true that the number of listed companies of the CSE during the last five years from 1994 to 1998 has increased marginally by 25, however the number of traded companies has been increased only by 21. The number of transactions and the annual total

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68 CSE; Annual Report; 1998; p. 25.
69 CSE; Annual Report; 1988; p. 7.
turnover have decreased from 404,367 to 329,068, and from Rs. 34,505 mn. to Rs. 18,232 mn. respectively. During the years 1995, 1996, and 1997 the annual turnover figures were Rs. 11,249 mn., Rs. 7,403 mn., and Rs. 18,315 mn., respectively. The trading activities had a downward trend, except for the years 1997 and 1998. According to a survey carried out by the CSE 25% of the listed companies do not maintain the required public float. This is 25% for the companies listed on the main board and 10% for the companies listed on the second board. This reduces the availability of shares in the market. The TABLE 4 - 15 shows comparative figures of market capitalisation and traded value of three countries India, Pakistan, and Sri Lanka. While market capitalisation as a percentage of GDP at Bombay Stock Exchange is 33.7% in CSE it is 14.5%. While trade values, as a percentage of market capitalisation at Karachi Stock Exchange is 104.8 % in CSE it is 14.2%. TABLE 4 - 15 shows the extent to which the share market in Sri Lanka is lagging behind the share markets in Bombay and Karachi.

**TABLE 4-15**

**SIZE AND LIQUIDITY- SRI LANKA IN COMPARISON TO SOUTH ASIA: 1997**

<table>
<thead>
<tr>
<th>STOCK EXCHANGE</th>
<th>MARKET CAPITALISATION AS A % OF GDP</th>
<th>TRADE VALUE AS A % OF MARKET CAPITALISATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bombay</td>
<td>33.7</td>
<td>42.0</td>
</tr>
<tr>
<td>Karachi</td>
<td>18.0</td>
<td>104.8</td>
</tr>
<tr>
<td>Colombo</td>
<td>14.5</td>
<td>14.2</td>
</tr>
</tbody>
</table>

Source: CSE; Annual Report; 1998

The debenture market in Sri Lanka is at the elementary stage of development, and it is important to improve infrastructure to maintain a debt

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70 CSE; Annual Report; 1996; p. 10.
market. In other markets such as Karachi and Bombay, institutions which attract long-term savings of the country are active in the stock market. In Sri Lanka, National Savings Bank, Employees Provident Fund, Employees Trust Fund, Insurance Corporation, and recently established 4 unit trusts attract long-term savings. The unit trusts actively participate in the market. Involvement of the Insurance Corporation is negligible. Other organisations invest only in Government securities. In order to develop CSE these organisations should actively participate in share transactions. In CSE ‘herd instinct’ of investors mainly driven by external crises takes predominance over economic and company fundamentals. “...the structural imbalance in stock market investments has resulted in 75% to 80% of the market being influenced by short term considerations rather than on fundamentals, i.e. foreign investors have been influenced by international factors, while domestic individual investors have been swayed by factors such as short-term market movements and margin facilities.” 71 The stock market in Sri Lanka was over dependent on foreign investment, during the 8 years from 1991 to 1998; the average annual foreign turnover was 40%; and the domestic participation of the investors was around 60%. Sri Lanka needs foreign investment to bridge the gap between required investment for the economic development and the available domestic savings. However, if Sri Lanka is to be an independent investment destination, domestic savings and their involvement in the CSE have to be increased.

At present stock market activities are limited to Colombo area. Outstation investors have shown much interest in stock market activities, in the recent past. Still the CSE and the brokers are not geared to serve investors all over

71 CSE; Annual Report; p. 9.
the country. Rules for the appointment of agents were passed in 1994. If properly organised and appointed, the agents could provide investment advice and pass on orders to the brokers. However, this has not been properly implemented to offer services to investors in small towns throughout the country. It was expected to improve the share market through privatisation programmes. However, new shares issued through these programmes are not making a significant contribution in the market. Another issue, which has surfaced in the market, is the non-availability of a Delivery vs. Payment (DVP) system of settlement. “The Group of 30 (G30) and the International Society of Securities Administrators (ISSA) recommends that a DVP system of settlement be adopted to reduce settlement risk. The absence of a DVP system has been an issue with foreign investors for sometime.” Another matter, which may be considered as a requirement for the development, is the separation of the ownership rights from the trading rights of the Exchange. In some exchanges ownership right is not limited to security brokers, but is open for the public. The Stockholm Stock Exchange (SSE) became indirectly listed through a holding company. The Australian Stock Exchange (ASX) was directly listed in October 1998. Even the CSE may be able to adopt an ownership structure, which separates trading rights from ownership rights in order to introduce wider interest and thinking. Infrastructure facilities of the CSE have been considerably improved. Though, stock market activities have been increased after the 1990 falling in activities and share prices could be seen, without effective changes in company fundamentals. The expected growth has not been achieved. Building up of a general acceptance and a good image, domestically and internationally, could be considered as a strategy to overcome most of the problems. Improvement of communication between the companies and the parties interested in company
affairs, and the disclosure of required company information, which includes accounting information, could be a path in creating a good image. A recent issue of the International Trade Forum magazine, has suggested some recommendations for the share markets of developing countries as follows:

For those countries interested in developing domestic capital markets, including stock exchanges, mandatory financial disclosures must be reliable, timely, verifiable and comparable over times so that investors can identify trends and make informed decision

4.3.0 CONCLUSION

The stock exchange is a main organisation for capital formation of listed companies. Sri Lanka has a long history of company capital formation and share market activities. In order to provide funds for companies involved in economic activities of Sri Lanka, the Colombo share market was formally organised during the latter part of the 19th century. Prior to the independence of the country in 1948, Colombo share market had been strong and active, mainly due to involvement of the foreign buyers and sellers. Foreign exchange difficulties encountered by the government of Sri Lanka, nationalisation policies, and negative attitude of the general public towards the share market have hindered the development of trading activities during the period from 1948 to 1977. The period after 1977 has shown a green light for the development of the Colombo share market. Open economic policies, technical and financial assistance received from the USAID and the Asian Development Bank, and changes of the attitude of the general public and the Government, have improved the share market activities in Sri Lanka. However, there were temporary fluctuations and unavoidable

periodical setbacks experienced by the CSE. It is possible to improve the securities market for the future development of the country. Creation of a good image among the domestic and international investors would be significant for the purpose. The supply of proper accounting and other information of companies would be considerably significant during this process.