International Journal of Economics, Commerce and Management
United Kingdom Vol. III, Issue 10, October 2015
http://ijecm.co.uk/ ISSN 2348 0386

DISTRIBUTION OF CONTROLLING SHAREHOLDERS IN SRI LANKAN LISTED COMPANIES

Koperunthevy Kalainathan
Senior Lecturer, Dept of Finance and Accountancy, Vavuniya Campus, Sri Lanka
kkoperunthevy@gmail.com

Abstract

Corporate governance system insists on the separation of ownership and control. Even though most of the capital markets all over the world are controlled by a few dominant shareholders and these shareholders control matured and emerging markets. Therefore, the study appraises the current distribution of controlling shareholders in Sri Lankan listed companies. For this evaluation purpose, 135 companies from Colombo Stock Exchange (CSE) were identified as the sample and two-step identification was incorporated. Step one identifies the shareholders who have five per cent or more equity shares in every sector and step two identifies the full controlling shareholders who have more than 50 per cent of equity shares. The study finds that more than 90 per cent of the companies are under the control of full controlling shareholders and these full controlling shareholders are institutions, directors, individuals and the state. The research finds out those major full controlling shareholders are institutions and directors, individual and the state controlling shareholders are very less in this market. Further, single full controlling shareholder controlled companies show an increasing trend in this market and more than 95 per cent of the listed companies are fully controlled by six or less number of controlling shareholders.

Keywords: Controlling Shareholders, distribution, governance, Colombo Stock Exchange

INTRODUCTION

The development of corporate governance and ownership structure is closely connected with the development of capitalism: different governance structures have evolved with different corporate forms which in turn design to pursue new economic opportunities or resolve new economic problems. The first recorded company with a diffused share capital was the Dutch

East India Company established in the early seventeenth century. There were more than 1,000 investors to put their money into it, and were thus rapidly confronted with the key corporate governance issues (Frentrop, 2003).

Unavoidably, technological changes and the expansion of markets in the nineteenth century increased the scale and complexity of enterprises, and rapidly increased the need for additional capital. In this context, the joint-stock companies moved from the margins to the mainstream of economic activity. Unlimited liability was the major threat in these companies and to safeguard personal fortunes of investors, limited liability was granted in the latter part of the nineteenth century.

The limited liability companies required more capital and the capital requirement for the expansion of the business increased. Therefore, a single entrepreneur, family or small group of associates was rarely able to manage enterprises and required professional managers. So, ownership and management were soon separated. Since the objective of managers was creating value for its owners/shareholders, this gave rise to the principal-agent (PA) (agency theory) problem.

Recently, another important problem of principal-principal (PP) problem has been articulated, tested in matured capital markets, and has recently been tested in emerging markets. The principal- principal problem arises in a firm with one large shareholder and a fringe of small shareholders (Villalonga and Amit, 2006). These kinds of large shareholders have the power to control entire organizational activities and enjoy corporate resources with the expenses of other minority holders (Anderson and Reeb, 2004). It is important to note that the PP problem overshadows the PA problem when the large shareholder is an individual or a family or an institution. This is because an individual or family will have incentives for the firm through excessive compensation, related-party transactions, or special dividends (Ibid).

The role of large owners in a firm is one of the important topics in corporate governance. In Sri Lankan context, most of the companies' shares are controlled by large shareholders (Samarakoon, 1999; Senaratne and Gunaratne, 2007; and Kalainathan and Vijayarani, 2014). Hence, identification of large controlling shareholders has become an interesting topic in the country and has given motivation to incorporate necessary amendments in corporate governance practices.

In this context, objectives of the study are to appraise the sector-wise distribution of controlling shareholders, types of full-controlling shareholders and number of full-controlling shareholders in Sri Lankan listed companies.

The remainder of the paper is organized as follows. Section 2 reviews the literature of the study, the section 3 presents method of the study, the section 4 identifies the distribution of controlling and full-controlling shareholders and finally the section 5 concludes with the recommendation for the corporate governance.

LITERATURE REVIEW

The good corporate governance insists on the separation of ownership and control. Even though some investors own a significant/large proportion of voting shares in an entity, they could act together and form a block/large shareholding. These large shareholders do act together; they may be able to influence corporate decisions which provide more benefits to them. Further, minority expropriation is motivated by the private benefit of control enjoyed by the large shareholders (Holderness, 2003).

The minority shareholders' control on majority stock shows the investors' protection problem and low level of shareholders' right. Legal system and corporate governance system should play an important role in shareholder's protection and shareholder's right. The Sri Lankan legal system is built on the English Common Law system widely prevalent among English origin, in which the Sri Lankan shareholders' right index score is three (3). It is the second lowest value of the 18 (La Porta, Silanes, Shleifer and Vishny, 2002). Investors' protection in Sri Lanka ranks as 52 out of 187 countries, which does not provide confidence to investors to invest more and more capital in this stock market. The strength of investor protection index is 6.0 out of 10, which is little lower than OECD countries and comparatively higher than South Asian countries (Doing Business – World Bank/IFC 2014).

This low level of investors' protection motivates the large shareholders in Sri Lankan listed companies. Very high percentage of the shareholders are small shareholders who hold only a very small proportion of the total number of equity shares and more than 50 per cent of the equity shares are controlled by very few number of controlling shareholders (Samarakoon, 1999; Senaratne and Gunaratne, 2007; Manawaduge et al,. 2009; Wellalage and Locke, 2012; and Kalainathan and Vijayarani, 2014). Further, institutional ownership is very high compared to directors and individual ownership (Senaratne and Gunaratne, 2007).

METHODOLOGY

Sample Selection and Data Collection

As at 31st December 2013, the Colombo Stock Exchange (CSE) had 289 listed companies representing 20 business sectors. The sample data cover a representative sample of Sri Lanka's companies listed on the CSE. At the end of 2013, out of 289 companies 66 companies were newly listed and 12 companies were delisted during the sample period. These companies were excluded from the study. Out of 235 companies, 100 companies did not upload their annual reports in the CSE web site during the whole sample period. So, based on data availability, the sample consisted of 135 companies from 2007/08 financial year to 2012/13 financial year.

The related data were collected from the selected listed companies' published audited annual reports. Controlling shareholders' details were gathered from the companies' 20 largest shareholders' schedule which was presented in the audited annual reports.

Variables

Controlling Shareholders: The Code of Best Practice on Corporate Governance-2013, Sri Lanka defines controlling shareholders as significant shareholdings. The significant shareholdings can be defined as "*Shareholding not less than 5% of the voting rights of the company" (Page No, 7).* Shleifer and Vishny (1986) identify as large shareholders and define as "*At least one shareholder owning five per cent of the firm"* Therefore, it is considered that the shareholders who have 5 per cent or more shares as controlling shareholders and more than 50 per cent shares as full-controlling shareholders.

Age of the Firm: Age of the firm is measured by difference between year of establishment and observation year.

Firm Size: Firm size is measured by total sales.

ANALYSIS AND RESULTS

Profile of sample companies

Table 1 provides a brief profile of the sample companies, giving an indication of their size and maturity. This shows a significant dispersion among the sample companies in respect of size, as measured by sales; and maturity, as measured by age.

The sales of the sample companies over 2007/08 reporting period ranges from 0 to 35,225 million rupees and age ranges from 5 years to 116 years. This shows a substantial disparity between the sample companies. The sample companies consist of both young and old enterprises. 42.22 per cent of companies in the sample are under 25 years, while only 20.74 per cent of companies are over 50 years in the beginning time of the sample period. As for the size level of the companies, 49.63 per cent of the companies are below 500 million rupees of sales, while 22.97 per cent of the companies are above 2,500 million of sales. These profile data show the substantial disparity between the sample companies.

Table 1. Profile of Sample Companies

Age			Sales		
Years	**Frequency**	**Per cent**	**Rs. millions**	**Frequency**	**Per cent**
0 -5	1	0.74	0-100	38	28.15
6 - 15	13	9.63	101-500	29	21.48
16-25	43	31.85	501-1000	19	14.07
26 – 50	50	37.04	1001-2500	18	13.33
51-100	24	17.78	2501-10000	22	16.30
>100	4	2.96	>10000	9	6.67
Total	**135**	**100**	**Total**	**135**	**100**
Descriptive Statistics			**Descriptive Statistics (in millions)**		
Mean		36.00	Mean		2,472
Standard deviation		24.88	Standard deviation		5,506
Minimum		5	Minimum		0
Maximum		116	Maximum		35,223

Source: Annual reports of sample companies

Sector - wise distribution

The Table 2 provides details of companies by sector wise which are controlled by controlling shareholders. Based on the control power, two ranges of controlled power such as 5≤50 per cent, low control and 50≤100 per cent, full control are applied to identify the sector-wise control power.

Table 2. Sector-wise Distribution

Sector	Range of Controlling			
	2007/08		2012/13	
	Low Control	Full Control	Low Control	Full Control
Bank Finance and Insurance	2	14	3	13
Beverage Food &Tobacco	1	11	0	12
Chemicals & pharmaceutical	0	6	0	6
Construction & Engineering	1	1	0	2
Diversified Holdings	2	7	1	8
Footwear and Textiles	0	1	0	1
Health care	0	3	0	3
Hotels and Travels	0	19	1	18
Information Technology	0	1	0	1

Investment Trust	0	5	0	5
Land and Property	0	11	2	9
Manufacturing	2	13	1	14
Motors	0	4	0	4
Oil Palms	0	3	0	3
Plantations	0	12	0	12
Power and Energy	0	2	0	2
Services	1	3	2	2
Stores and Supplies	0	3	0	3
Telecommunication	0	1	0	1
Trading	1	5	2	4
Total	**10**	**125**	**12**	**123**

Source: Annual reports of sample companies, twenty largest shareholders schedule

Bank Finance and Insurance sector has two companies with low level controlling shareholders in 2007/08 and these increase as three in 2012/13. This result shows that during the study period the number of widely held companies increase in this sector. Other six sectors such as Beverage Food and Tobacco (1), Construction and Engineering (1), Diversified Holding (2), Manufacturing (2), Services (1), and Trading (1) have seven companies with less than or equal 50 per cent of controlling shareholders in 2007/08. These companies are the widely held companies and increase to 10 companies in 2012/13. Beverage Food and Tobacco and Construction and Engineering do not have low level controlling shareholders and have become closely held companies. Diversified Holding and Manufacturing sectors lose one company each from low level shareholding and Hotels and Travel sector totally lose low level shareholding and have become closely held. Two companies from Land and Property sector have newly become widely held companies. In services and Trading sectors, one more new company became widely held from closely held from 2007/08 to 2012/13. The sector-wise distribution proves that the widely held companies increase by two companies in 2012/13. This is a good sign because a very few companies in the stock market are little open to public shareholders.

Types of Full-Controlling Shareholders

Based on the previous literature (Lee, 2010 as cited by Wellalage and Locke, 2012; Waduge, 2010; Jenson and Meckling, 1976; Lins, 2003; Boone, 2011; Senaratne and Gunaratne, 2007) related to Sri Lanka and other countries, major groups of large shareholders are the institutions, directors, individuals, and the state.

Table 3. Full-Controlling Shareholders

Year	No. of Companies	No. of Full-Controlling Share holders	Types of Full-Controlling Shareholders			
			Institutions	Directors	Individuals	State*
2007/08	125	406	314	53	35	4
2008/09	127	413	317	57	35	4
2009/10	121	380	289	52	35	4
2010/11	120	379	290	53	32	4
2011/12	121	385	304	51	26	4
2012/13	123	383	302	50	27	4

Source: Annual reports of sample companies

*Each company's state shareholding is treated as separate one. Therefore, the number of state controlling shareholders is four.

Table 3 provides information regarding number of companies controlled by full-controlling shareholders, number of full-controlling shareholders and types of full-controlling shareholders. Out of 135 companies, nearly 90 per cent of the companies are under the control of full-controlling shareholders and number of full-controlling shareholders gradually and steadily decreases during this period. Institutions are the major controlling shareholders; directors are the second largest full-controlling shareholders compared to individuals and state. The types of full-controlling shareholders which are more rigid to hold their equity holdings lead to concentrated ownership and PP problem. Further, the decreasing trend of full-controlling shareholders is a signal of some powerful shareholders tightening their shareholdings.

Number of Full-Controlling Shareholders

Less number of controlling shareholders has more power on voting rights than high numbers. The number of full-controlling shareholders in the sample companies is presented in Table 4. A maximum of ten controlling shareholders control majority of the equity shares in CSE. The number of companies, percentage of companies and cumulative values are identified based on number of controlling shareholders.

Table 4. Number of Full-Controlling Shareholders

Number of Full-Controlling Shareholders	2007/08			2008/09			2009/10			2010/11			2011/12			2012/13		
	Companies	Percentage	Cumulative	Companies	Percentage	Cumulative	Companies	Percentage	Cumulative	Companies	Percentage	Cumulative	Companies	Percentage	Cumulative	Companies	Percentage	Cumulative
1	15	12.0	12.0	18	14.17	14.17	22	18.18	18.18	21	17.50	17.5	23	19.01	19.01	22	17.89	17.89
2	35	28.0	40.0	31	24.41	38.58	28	23.14	41.32	28	23.33	40.83	23	19.01	38.02	29	23.58	41.47
3	24	19.2	59.2	28	22.04	60.62	27	22.31	63.63	27	22.50	63.33	29	23.97	61.99	30	24.39	65.86
4	25	20.0	79.2	22	17.32	77.94	17	14.05	77.68	19	15.83	79.17	24	19.83	81.82	20	16.26	82.12
5	15	12.0	91.2	17	13.39	91.33	16	13.22	90.90	13	10.83	90.00	8	6.61	88.43	8	6.50	88.62
6	7	5.6	96.8	5	3.94	95.27	8	6.61	97.51	8	6.67	96.67	9	7.44	95.87	9	7.32	95.94
7	2	1.6	98.4	4	3.15	98.42	1	0.83	98.34	2	1.67	98.33	3	2.48	98.35	3	2.44	98.38
8	1	0.8	99.2	1	0.79	99.21	1	0.83	99.17	1	0.83	99.17	1	0.83	99.18	1	0.81	99.19
9	0	0	99.2	0	0	99.21	0	0.00	99.17	0	0.00	99.17	0	0.00	99.18	0	0.00	99.19
10	1	0.8	100	1	0.79	100	1	0.83	100	1	0.83	100	1	0.83	100	1	0.81	100
Total	**125**	**100**		**127**	**100**		**121**	**100**		**120**	**100**		**121**	**100**		**123**	**100**	

Source: Annual reports of sample companies

Table 4 provides information related to number of full controlling shareholders in CSE. During the period, companies which are controlled by single full-controlling shareholder increase, and it is in fifteen companies in 2007/08 and this number of companies increases as twenty-two in 2012/13. These calculations in Table 4 reveals that more than 95 per cent of the companies have six or less full-controlling shareholders and nearly 59 or more per cent of the companies have three or less full-controlling shareholders.

CSE is a very small emerging market and a small group of investors rigidly control it with deep pockets and they can manipulate prices and this may be the reason for several stock market scandals taken place in CSE from 2008 to 2012. In addition to that, very small number of full-controlling shareholders can fully control entire stock market with their voting rights in the annual general meeting by electing their representative as board of directors or they can be a member of board. This ultimate control power leads to control the entire stock market with the cross holding power and causes market manipulation in this market.

CONCLUSION

The review of controlling shareholders in Sri Lankan listed companies reveals that most of the listed companies in CSE are under the tight control of a small number of controlling shareholders. It proves that the ownership and control is in the hands of controlling shareholders and these circumstances make minority expropriation. Further, private benefit of control is motivated with investors' protection problem. Therefore, the proper corporate governance mechanism should be incorporated to protect small investors with in the political and economical condition of this country. As a legal entity, the shareholders have no power to interfere companies' activities. Even though, several corporate scandals occurred in Sri Lanka resulted in the failure of corporate governance and need further investors' protection Laws. The full-controlling shareholders' power on corporate activities may have barriers on the implementation of corporate governance best practices. Therefore, good corporate governance system should be adapted to control controlling shareholders.

However, since the study is limited to focus on the distribution of controlling shareholders in Sri Lankan listed companies. Generalization of these findings to other countries needs to be done with caution. Further, the measurement of controlling shareholders is limited to an examination of the direct controlling shareholders. It is avoided to include indirect control which could have impact on control power. However, due to the limitation on indirect shareholding data, direct controlling shareholding is only considered in this study.

REFERENCES

Anderson, R. C. & Reeb, D. (2004). Board Composition: Balancing Family Influence in S & P 500 firms. Administrative Science Quarterly, 49, 209 – 237.

Boone, N. (2011). Block Shareholder Identity and Firm Performance in New Zealand. Retrieved December 8, 2013, from www.emeraldinsight.com/journala.htm?articleid=1950858.

Frentrop, P. (2003). A History of corporate governance, 1602 – 2002, Brussels: Deminor.

Holderness, C. G. (2003). A Survey of Blockholders and Corporate Control, FRBNY Economic Policy Review, April, 51 – 64.

Jensen, M., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. Journal of Financial Economics, 3, 305-360.

Kalainathan. K., & Viayarani, K. (2014). Blockholder Ownership Structure of Sri Lankan Listed Companies. International journal of Research in Commerce & Management, 5(8), 24 -30.

Lee, J. (2010). Institutional Change: Asian Corporate governance and Finance.

Lins, K. (2003). Equity Ownership and Firm Value in Emerging Markets. Journal of Financial and Quantitative Analysis, 38(1), 159 – 184.

Manawaduge, A., De Zoysa, A., & Rudkin, K. (2009). Performance Implication of Ownership Structure and Ownership Concentration: Evidence from Sri Lankan Firms. Retrieved February 10, 2010 from, www.pma.otago.ac.nz/pma-cd/papers/1040.pdf

Samarakoon, L. (1999). Ownership Structure of Sri Lankan Companies. Sri Lankan Journal of management, 4 (3,4), 143 – 157.

Senaratne, & Gunaratne P. S. M. (2007) Ownership Structure and Corporate Governance of Sri Lankan Listed Companies, Proceeding from fourth international conference on Business Management, Faculty of Management Studies and Commerce, University of Sri Jayewardenepura, Sri Lanka, pp 82 – 91.

Tricker, B. (2009). Corporate Governance, Principles, Policies and Practices (2nd ed). Oxford University Press, United Kingdom.

Villalonga, B., & Amit, R. C. (2006). How do Family Ownership Control and Management affect Firm Value?. Journal of Financial Economies, 80, 385 – 417.

Waduge, C. S. D. S. L. (2010). Corporate Governance best Practice and Listing Rules in Sri Lanka. Proceedings of the 2nd International Conference on corporate governance, Victoria University, 168 – 186.

Wellalage, N. H., & Locke, S. (2012). Ownership Structure and Firm Financial Performance: Evidence from Panel Data in Sri Lanka. Journal of Business Systems, Governance and Ethics, 52-65.