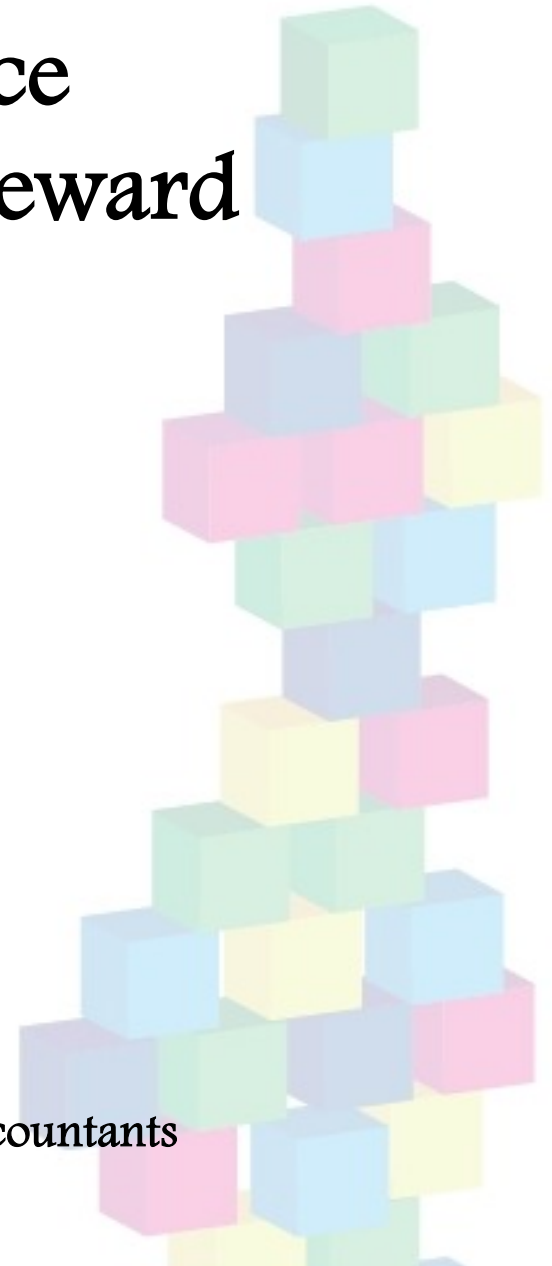


Quest for Balance Shareholder: Risk, Reward & Responsibility

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OUTLINE

1. Expectations of Stakeholders
2. Corporate Governance
3. Guardians - Auditors & Independent directors
4. Issues of Stakeholders
5. Sustainability

RIGHTS AND EXPECTATIONS OF SHAREHOLDERS / STAKEHOLDERS



- Shareholders have no power to interfere with the operation or management of a company other than through the specific procedures. Powers reserved may only be exercised at a shareholders meeting.
- Since a company has a separate legal personality, its shareholders are not liable for any act, default or obligation of the company. Their liability towards the company is limited. Shareholders have no duty of care to the company.
- Companies generally operate on the basis of majority rule and if minority shareholders dissent from the majority view they are free to sell their shares and exit from the company. However this is often not feasible, especially in unquoted companies, because of the lack of liquidity for such shares. There are some specific protections in the form of minority buy-out provisions.

RIGHTS AND EXPECTATIONS OF SHAREHOLDERS / STAKEHOLDERS



- Many Companies make increasing shareholder value a key if not the ultimate goal.
- Shareholders expect a minimum return (eg. Rate paid by Government Securities) plus a risk premium for the level of risk associated eg. IBM or a new Internet company.
- Balancing the stakeholder expectations is important and the companies have to be mindful of them today than ever. Wall Street Protestors.
- More and more businesses attempt to become responsible business citizens to address the expectations of the stakeholders and to be more accountable.
- Earning the respect of the stakeholders and building a reputation is important as it can bring direct benefits to any organization. (Share price, Ability to attract and retain good people and borrowing costs)

SHAREHOLDER EXPECTATIONS



- Companies have to balance the complexed worldwide macro scenarios with the agenda of its stakeholders to strike an optimum balance.
- The different interests of shareholders of both long term and short term interests must be catered for – hence the Company must implement growth strategies that will benefit both kinds of investors even though they may be in conflict with each other.
- This stakeholder model has come under attack as it does not take into account the interests of employees, distributors, suppliers, government, community and environment – this is a dilemma which can slow down the decision making process. Hence all interests need looking after as otherwise either customers or employees will quit, and the business will suffer.

RIGHTS AND EXPECTATIONS OF SHAREHOLDERS / STAKEHOLDERS



Stakeholder expectations are linked to the Corporate Strategy

- Successful global companies address the multiple stakeholders at the corporate strategy level when defining Vision and Mission.



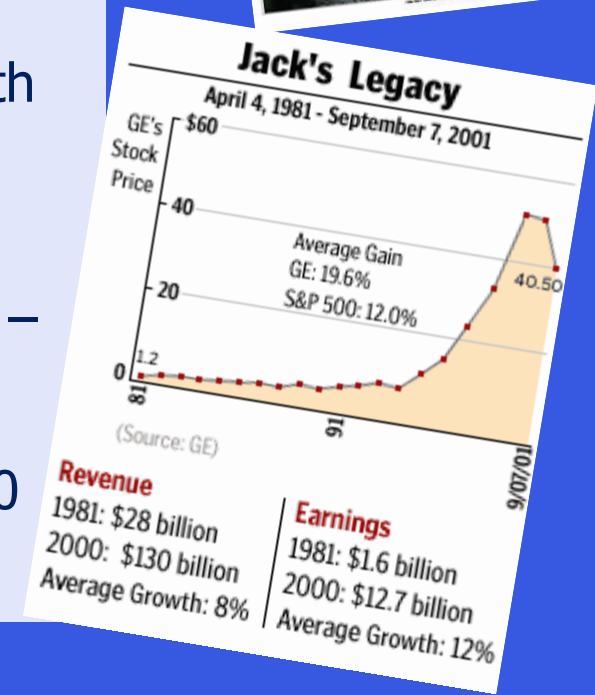
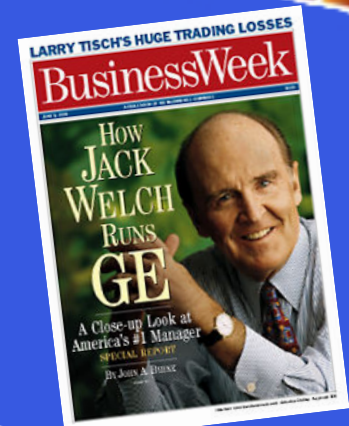
Eg:

- GE Core Values – Excellent Customer Service, Integrity and Social Responsibility
- Starbucks – Understanding the environmental Issues, sharing information with the partners, Selling Environmentally friendly products and encouraging the Partners to Share the Mission.
- Coca Cola – People (Great place to work), Planet (Be a responsible corporate citizen) and Partners (Winning net work of customers and supplier to create value).



SHAREHOLDER EXPECTATIONS

- General Electric cuts tens of thousands of jobs in order to generate earnings growth averaging 15% each year. During Jack Welch's tenure GE's stock price soared as Company slashed employment by nearly 50%.
- IPS study shows rising stock prices and soaring CEO pay packages are commonly associated with layoffs.
- Sri Lanka Experience – philanthropic and social obligations may force us to ensure employment – No social security system.
- By 2020 – 20% of our population will be over 60 years.



BUSINESS TODAY TOP TWENTY 2010-2011



1 John Keells Holdings
Suresh Pathiraja
Chairman/CEO



2 Distilleries Company of Sri Lanka
D.H.S. Jayawardena
Chairman/Managing Director



3 Commercial Bank of Ceylon
A.L. Gooneratne
Managing Director



4 Bukit Darah
Hazil Selvanathan
Chairman



5 Hatton National Bank
Rajendra Theerajajah
Managing Director/CEO



6 Dialog Axiata
Dr Hans Mijayawariya
CEO



7 Sri Lanka Telecom
Nimal Malgama
Chairman



8 Lanka Orix Leasing Company
Dilwan Nanayakkara
Deputy Chairman



9 DFCC Bank
Nihal Fonseka
CEO



10 Sampath Bank
I.M. Senanayake
Chairman



11 Aitken Spence
D.H.S. Jayawardena
Chairman



12 Diesel & Motor Engineering
A.R. Pandithage
Chairman/Managing Director/CEO



13 Richard Pieris & Company
Dr Sena Kodalage
Chairman/Managing Director/CEO



14 Hayleys
A.M. Pandithage
Chairman/CEO



15 Colombo Dockyard
Mangala P.B. Yapa
Managing Director/CEO



16 NDB Bank
Russell de Mel
CEO



17 Cargills (Ceylon)
Ranjit Pege
Deputy Chairman/CEO



18 Hemas Holdings
Hussein Erubally
CEO



19 Chevron Lubricants Lanka
Dr Kishor Goonesinghe
Managing Director/CEO



20 Seylan Bank
Eastman Wasingoda
Chairman

10
Conglomerates

6 Banks

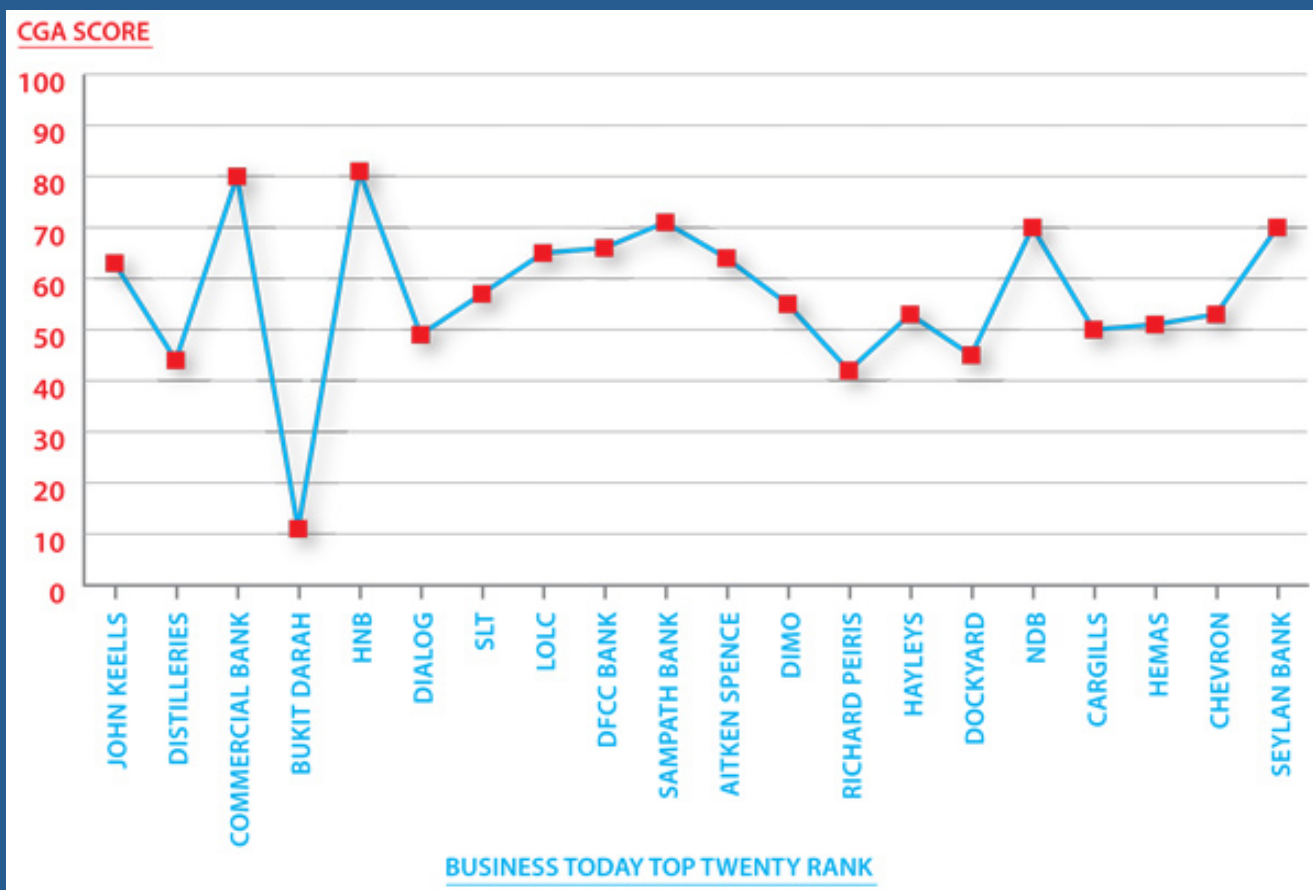
2 Telecom
Companies

Colombo
Dockyard

Chevron
Lubricants

No apparel
manufacturers

BUSINESS
TODAY



This assessment should pave the way for an organisational review or study to understand whether Boards just follow the governance rules for disclosure purposes or do much more than that. This can be done by the Colombo Stock Exchange or the SEC or by independent bodies.

- The Banks come on top because CBSL has mandated several procedures. Hence other regulators can take a cue.
- Higher weights for independence of Board Directors, separation of Chairman and CEO (5 companies do not comply), audit committee terms and composition, steps taken to avoid conflicts of interest, policy on fraud and political donations.

Corporate Governance

- Corporate Governance is now considered as part of a Company's general risk management culture and practice.
- Despite all this great companies collapsed ENRON, LEHMANS, WORLD COM.
- We must get strategic solutions that will create the right incentives to push for sustainable and inclusive growth.
- The need to incorporate the principles of Good Governance, transparency, accountability and legitimacy as an integral part of the policy process.



Corporate Governance

- The lack of transparency and stakeholder consultations was evident in Employees Pension Benefits Fund Bill
- Businesses are represented (through the various Chambers) but not consumers due to lack of influential lobbying power.
- Media attention can motivate politicians and bureaucrats to adopt more effective corporate governance laws.
- Do we need Shareholder Protection Act – which requires prior shareholder approval of corporate political donations. In UK Shareholders can cast a binding vote to stop political donations.
- A major problem in the private sector is the tendency to go in line with every political regime so as to minimize 'political risks'.



Auditors



- The Internal Auditors (reporting to the Audit Committee) should be independent from Management.
- Do Auditors look after the interests of the Company and its shareholders: Are they getting value for money ?
- In theory the Auditors are appointed by the shareholders but effectively management controls the appointment process.
- In most cases, the directors negotiate the audit contract and hence the Auditors will never be able to have complete economic independence – especially when they provide extra services.
- Now Auditors are under intense competition for contracts, to reduce audit fees and the loss of a big client affects the image.

Auditors



- If users of the Audit Report believe that the Auditors are not influenced by the Company's Managers/Directors, then it enhances the credibility of the financial statements.
- Do Auditors have unlimited access to All Board of Directors?
- Maybe shareholders be given more powers rather than more stringent rules to govern the auditing profession. Also possible rotation of Audit Firm.
- Shareholders have only limited remedies as the duty of the Auditor is limited to reporting on the financial statements. Hence other information which they had access to, may not be divulged due to pressure from management.

Auditors



- Measuring the performance of the Auditors is handled by the Audit Committee consisting of the Independent Directors, who in practice are “appointed” by the Management.
- Auditors gave no warning of the Banking crisis. The UK House of Lords investigating the case of the financial crisis accused the Auditors of a ‘dereliction of duty’ and Investors criticized for their apathy.
- ENRON – Arthur Anderson/Ceylinco. Would better financial reporting have prevented the failure?
- In the 1990’s a number of Sri Lankan finance companies went bust but there was no warning by the Auditors.



Independent Directors



- Are they representing the Shareholders and looking after the interests of the Company.
- They do not form part of the Executive team but are generally appointed through contacts of the Management / Major shareholders.
- Their responsibilities are for:
 - Strategy formulation
 - Performance management
 - Risk
 - People
 - Standard of Conduct

Independent Directors



- In practice, most are not really independent – overly sympathetic towards Management, as paid by Company and close interaction with Top Management. They may also not possess the expertise to understand complex businesses.
- There must be a willingness to challenge assumptions and beliefs. Be willing to argue their case and ferret out the truth.
- Attendance at meetings is essential as performance is difficult to judge. They must be paid adequately but not excessively.
- Overall having independent directors has added some balance to the Board Room governance. However they should be more accountable to the shareholders.

Illusion of Wealth Creation



- In the 1990's there was the greatest transfer of wealth for small and big investors to Directors and Executives. Most shareholders and other stakeholders lost out.
- In November 2001 ENRON filed for bankruptcy. Stock which traded at US\$ 90 per share a year ago plummeted to US\$ 1 but ENRON executives and Board members dumped their stocks and options and netted US\$ 1.2 Bn.
- Similarly CEO's of Oracle, Disney Corp and Barclays PLC had huge payouts but all stocks lost value
- Present moves in the UK as moral pressure has failed despite Banks receiving Public Money. Now a Party formed in Scotland merely to ban Banker's bonuses and bonuses may be paid in shares only in the future
- Is Share Options the best incentive for Management? Are some bonuses not just obscene but commercially wholly unmerited?

Banks - Protection of Depositors and Shareholders

- Leveraging on Depositors funds. Depositors only get a fixed nominal return though they provide the bulk of the funds. These funds are at risk in the Bank's operations.

- | <u>As at 31.12.2010</u> | <u>(Rs. M)</u> | <u>HNB</u> | <u>Commercial Bank</u> |
|-------------------------|----------------|------------|------------------------|
| Deposits from Customers | | 234,071 | 259,779 |
| Shareholders Fund | | 27,274 | 33,539 |

- In 1990 Banks started seeking higher profits for shareholders to secure executive performance pay bonuses.
- Northern Rock PLC, became the first UK Bank in 150 years to suffer a Bank run. It was nationalised. Depositors were protected but shareholders lost their investment.
- In Sri Lanka, Banks are presently giving out credit cards without credit references.

Shareholders – “NEW”/”OLD” are they being balanced



- Split/ Bonus - Capitalisation of equity and it does not affect the Company’s capital structure or earnings but new shareholders are paying much more for same shares. This happens only in Sri Lanka. Shares
- IPO - Heavily oversubscribed due to the guarantees provided by Banks. No cash required. High Networth individuals subscribed in full, so giving them a higher allocation than a retailer who had to put up cash. Now restrictions imposed
- Many retailers lost money as prices dropped on opening. Those who owned it by way of Placement previously at a discount sold out. Hence were these overpriced, causing loss to the new shareholders.
- Penny Stocks- They possess a better potential to make quicker capital gains. They are easy to manipulate. However one should not discourage speculation. Herd instinct.
- Liquidity - Lack of liquidity in the shares of most Sri Lankan Companies can distort the price of shares.

Shareholders – “NEW”/”OLD” are they being balanced

Insider Trader is benefiting some shareholders

- A survey of Wall Street professionals found that 7% would break the law if chances of getting caught were 50%. 58% would break the law if chances were NIL.
- Hence regulation by SEC is very important and should not be underfunded.
- The best known case was GALLEON Group run by Raj Rajaratnam. The death blow was RAJAT GUPTA, GOLDMAN SACHS Director re. Warren Buffet’s \$5 Bn investment and Galleon bought 350,000 shares.

- *“Rajaratnam, once a high-flying billionaire and hedge fund manager, is now a convicted felon, 14 times over,” Bharara said in a statement after the verdict. “Rajaratnam was among the best and the brightest -- one of the most educated, successful and privileged professionals in the country. Yet, like so many others recently, he let greed and corruption cause his undoing*

Charge	Count	Verdict	Companies Involved	Max Jail Time
Conspiracy to commit securities fraud	1	GUILTY	Many	5 yrs. each
	2	GUILTY		
	3	GUILTY		
	4	GUILTY		
	5	GUILTY		
	6	GUILTY		
	7	GUILTY		
Securities fraud	8	GUILTY	Clearwire, Intel, AMD, ATI Tech, Ebay, AMD, Akamai	20 yrs. each
	9	GUILTY		
	10	GUILTY		
	11	GUILTY		
	12	GUILTY		
	13	GUILTY		
	14	GUILTY		



Non Voting Shares – Who is loosing out ?

	As at 7.10.2011		
	<u>Voting</u>	<u>Non Voting</u>	<u>% Difference</u>
HATTON NATIONAL BANK PLC	197	90	119
SEYLAN BANK PLC	65	36.8	76
CIC HOLDINGS PLC	128.9	85.8	50
THE FINANCE COMPANY PLC	42.2	14	200
NEWS CORP A	16.3	16.25	0.31
CBS CORP B	21.73	21.51	1.02
CARNIVAL PLC	2072	2027.32	2.20

Non Voting Shares – Who is loosing out ?



- Sri Lanka appears to have the most number of Companies having Non Voting shares – Hence they have no voting rights re. Directors; Takeovers; Mergers; Dealing with connected parties.
- Purpose is to maintain control; to raise capital; and may in certain cases be for the benefit of an employee share scheme. However, apart from the Controlling Shareholder, are other Shareholders benefiting having shares with voting rights?
- If there are no other 'motives', it could be good value for Non Voting shareholders as all other rights are retained and they benefit from a better dividend yield.
- Fund Managers disapprove of Non Voting shares and the dual shareholder structure.

Dividend Payout and Dividend Yield

	Market Value per share as at 17.10.2011	For the Financial Year 2010/11			Dividend Yield (%)
		Dividends (2010/11)	EPS	Dividend payout (%)	
John Keells Holdings PLC	199.70	3.00	13.24	22.65	1.50
Ceylon Tobacco Company PLC	389.50	27.17	27.21	99.85	6.98
Nestle Lanka PLC	850.00	34.50 (F/Y 2010)	35.39	97.84	4.06
Cargills Ceylon PLC	200.10	1.50	4.86	30.86	0.75
LB Finance PLC	144.10	3.50	14.73	23.76	2.42
Commercial Bank of Ceylon PLC	V 110.40 X 74.80	7.00 (F/Y 2010)	14.67	47.71	V 6.34 X 9.35
Hatton National Bank PLC	V 194.00 X 81.90	7.00 (F/Y 2010)	18.84	37.15	V 3.60 X 8.54

Dividends



- Balancing shareholders wish of maximum dividends as opposed to retaining funds for branding, expansion, capital expenditure and to build up the Company's reserves.
- In Sri Lanka the Multi-nationals pay the best dividends to their parent Companies, which boost the share price. Such shares are very attractive to Pension funds.
- A reasonable dividend policy will help the Company in the capital market and establish a good corporate image.
- Dividend payout ratios and Dividend yield in Sri Lanka.
- Deemed Dividends

CEO



- If Board representing the shareholders disagrees with the strategic direction pursued by the CEO – then CEO should be removed. Strategic direction is the responsibility of the Board and the CEO is answerable to the Board.
- No payouts for failure.
- CEO of Hewlett Packard was removed in 2005 due to her inability to deliver the profit promised and her refusal to relinquish some operating controls and to make the changes the Board required.



Fiorina out, HP stock soars

CEO who engineered Compaq merger leaving after fight with board; will walk away with \$21 million.

February 10, 2005: 9:15 AM EST

By [Paul R. La Monica](#), CNN/Money senior writer



Carly Fiorina is leaving Hewlett Packard, effective immediately.

Financial Reports



- There is no independent or fundamental analysis done by Newspapers, magazines or even Brokers.
- Emphasis is on bottom line profits without a proper analysis of the makeup such as capital gains, exceptional or extraordinary profits
- IFS tries to rectify it by focusing on Balance Sheet and Fair Values. No agreement yet with the Inland Revenue
- People will structure transactions to circumvent IFRS rules. However, we must strive for Uniform Accounting.

Balancing Shareholders Interests – on Take Overs of Companies

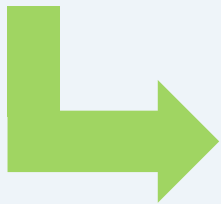
- Shareholders can experience significant financial consequences when the Board activates a defence or signals its intention to do so. The Board must represent the shareholders interest during negotiations.
- Rights - Shareholders can purchase additional stock at an attractive discounted price making it difficult and more expensive to be taken over.
- Other defences - Greenmail; white Knight; increasing debt; making an acquisition
- One of the largest conglomerates in Sri Lanka set up an Employee Share Trust to fight a takeover. Co. set a firewall around it and found it difficult to expand. Ultimately taken over when existing shareholders were disappointed.



Sustainability is a Business Strategy

...a prerequisite for long-term growth

the way a company or organization creates value for its **shareholders and society** by maximizing the positive and minimizing the negative effects on social, environmental and economic issues and stakeholders **to:**



- *Grow revenue*
- *Reduce cost*
- *Manage risk*
- *Build intangible assets*

It's about:



Create Sustainable Value
Drive Reliable Growth

How: holistic management

The holistic management of five different types of capital that reflect an organisation's overall impact and wealth, in order to proactively ensure its long-term viability, profitability and integrity.

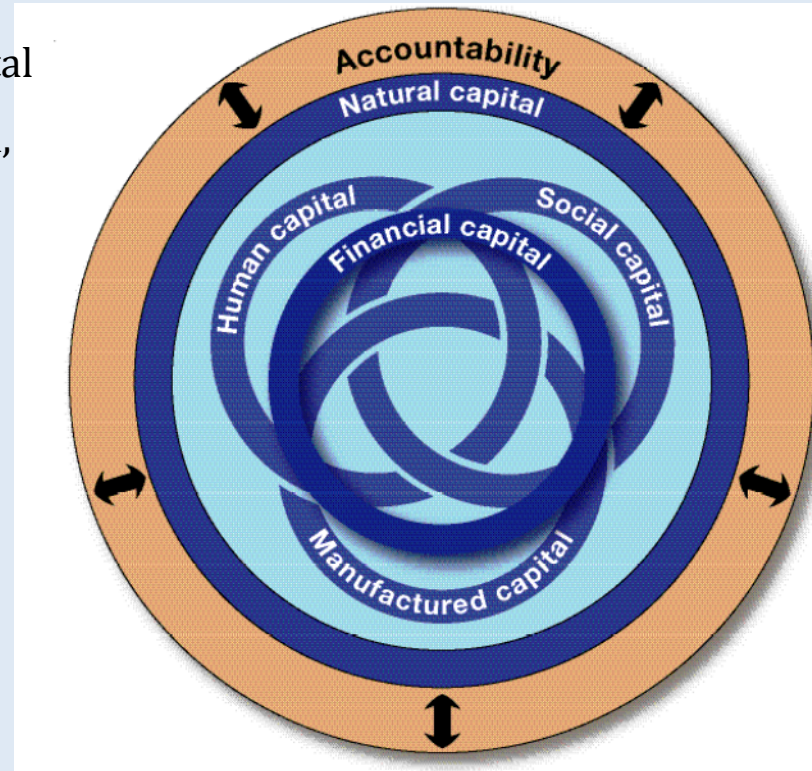
Natural capital: the environment

Social capital: social relationships & structures

Human capital: people

Manufactured capital: fixed assets

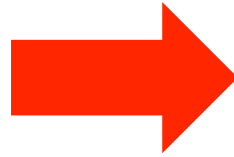
Financial capital: profit & loss, sales, shares, cash etc.



Unsustainable Operations Damage Companies



Deepwater Horizon oil spill

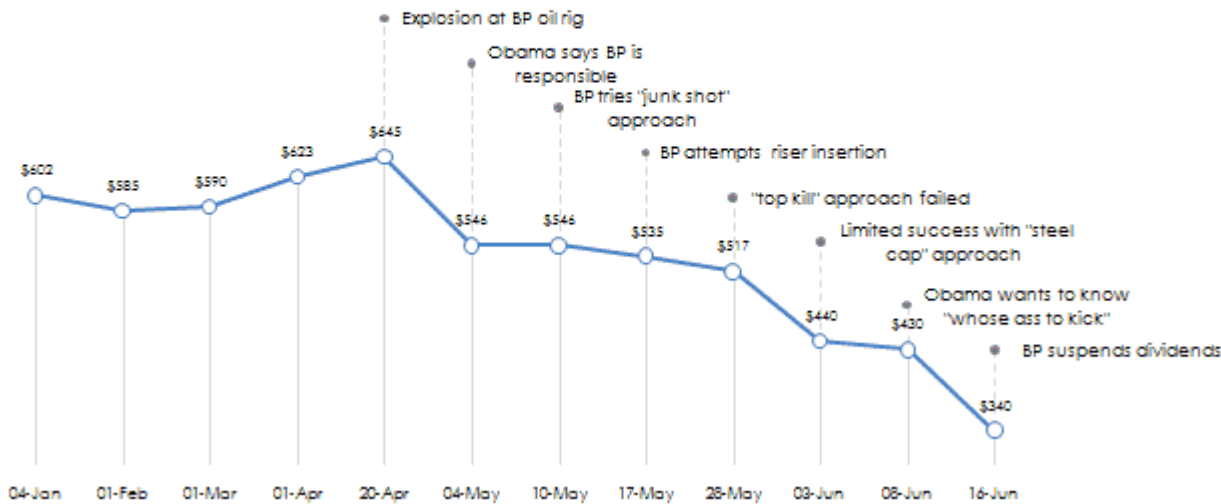


BP's own costs reached \$ 3.1bn; total bill may reach up to \$ 12bn. Stock fell by 52% in 50 days.



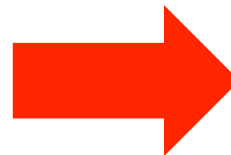
bp's BIG SPILL & it's stock price

The 20 April 2010 explosion of the Deepwater Horizon, in which 11 people died, led to an oil spill that devastated a vast area of the United States marine environment and had a serious impact on the local fishing industry.



ARTHUR ANDERSEN

Shredding documents related to audit client Enron after the SEC launched an inquiry into Enron



Convicted of obstruction of justice. Ceased auditing public firms. Lost hundreds of clients. Massive employee defections.



Sustainability



- Corporate social responsibility should not become a smoke screen for corporate greed and it needs to be built into the strategies and culture of the organisation.
- Consumers and employees want to be associated with companies that are socially and ethically responsible.
- Balancing or managing risks is part of the good governance which always set out a path to build a better corporate image to protect the expectations of the stakeholder. Such Companies are in a better position to manage risks by anticipating compliance risks, taking proactive steps against the competitive action or accessing new markets etc.

Sustainability



- Climatic change can be catastrophic, so business will have to be more responsive about the way its operations impact the environment - Decarbonisation.
- Nation mindedness must also be a focus. We are still reliant on Plantations and agriculture. Hence an enhancement of resources linked to the agrarian economy would be beneficial.
- Honesty is the best policy. It takes a lifetime to build a reputation but a few minutes to ruin it. We can earn stakeholder respect by being ethical, responsible, transparent and accountable.
- Major types of risks that can create a significant impact on the shareholders today are; Governance Risk, data protection (Wiki Leaks) and confidentiality. Companies are even liable for the business practices of the suppliers (Child labour by suppliers).

Concluding Remarks

- Balancing of all stakeholders needs are important.
- Corporate Leaders must decide what emphasis should be made to address the varying and often conflicting stakeholder expectations and then to provide the framework and the systems to address them (e.g. Sustainability (GRI) Reporting, Investor Forums, Employee Focus Groups).
- Provide additional information in the financial statements to address specific industry needs, stakeholder needs even if such disclosures are not mandatory as per the accounting guidelines.
- Corporate Credibility and Gaining the stakeholder trust is important for the survival of business in the current context.



BALANCE

Thank you

