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ADVANCE INFORMATION

Siam IT Solutions (Pvt) Ltd (SITS)

It was 8 October 2004. Dilith Mapatuna had been dreaming of this day for the past 4 years; ever since he graduated from the Faculty of Computer Science and Engineering, University of Moratuwa in 2000. Every month, for several years, he had been setting aside a little money and buying lottery tickets, dreaming that one day he would win big. Even otherwise buying lotteries was not a waste, as Dilith considered, because it was like paying a voluntary tax to the state. However, miraculously he was sitting on the sofa in the living room with his family (father, mother and only sister) holding the winning ticket that meant he would be awarded a “jackpot” of Rs. 50 million by the National Lotteries Board within the next week. What a great feeling! He just wanted to decide how soon he would be going to start his dream IT company. He shared the idea with his family that evening.

Dilith had been a bright student throughout his school career. He was admitted to Richmond College, Galle in 1987 on merit order at the Grade 5 Scholarship Examination. His father was a clerk at the Galle District Secretariat and his mother was a trained teacher at Unawatuna Maha Vidyalaya, Galle, where Dilith also studied until Grade 5. At Richmond Collage, Dilith showed his talents both in studies and extra-curricular activities. He passed the GCE O/L examination in 1992 securing distinctions for all eight subjects, upon which he decided to do his GCE A/L examination in the Maths stream. After two years, he passed the GCE A/L examination with four A grades, securing sufficient marks to enroll in his dream degree programme in Computer Science at the University of Moratuwa, Sri Lanka.

At university, he performed exceptionally well in all four years and secured a First Class Honors Pass. Upon completion of the degree in Computer Science, though he was invited to join the academia, he preferred to gain employment in the IT industry as it was closer to his ambition of setting up his own IT company. On 2 September 2000, he joined Taprobane IT, one of the leading IT companies in Sri Lanka at the time, as a Software Engineer and was promoted to the grade of a Computer Architect within two years. While working, despite his six figure salary, he realised that it was not easy to accumulate sufficient capital to set up his own company within his target time. At times, he thought that luck deserted him when he most needed it. Nevertheless, it had been fun for him to bet his luck on lotteries for some time. Whenever he bought lotteries, he always thought that the concept of a fair game has relevance neither to life in general nor to the statistical inference in science.

Dilith was awarded the cheque for his “jackpot” prize on 15 October 2004 at a ceremony held in the auditorium of the National Lotteries Board. The presenter of the programme interviewed Dilith after awarding the cheque. He wanted to know how Dilith was going to use the prize money. Dilith revealed that his dream was to set up an IT company of his own, ever since his

graduation. He further stated that he could plan it now onwards, thanks to the National Lotteries Board. The presenter nicely wrapped up the programme, saying, “Yes, ladies and gentlemen, like Dilith Mapatuna’s dream, the National Lotteries Board is there to make your dreams come true as well. Congratulations and good luck Dilith!” The entire audience stood up and cheered him. The next day he went to the Borella branch of the National Savings Bank and deposited the entire amount of money in a savings account, so that he could withdraw whenever he needed it. Since then, it took Dilith a couple of months to resign from his first job and step into his own company.

Finding a few talented hands, who would like to take a stake with him was not that easy. Although Dilith approached several of his batch mates who were locally employed at the time, he failed, not only because they were reluctant to take a risk, but also because of Dilith's personality. Dilith was a very reserved person at university who only cared about his studies. However, finally he was able to convince Sameera Ihalakaduwa, one of his subordinates at Taprobane IT, to join him. Dilith was highly impressed with Sameera’s extraordinary computing skills (both in conceptualization and programming). He also found a recently passed out IT graduate (Chamira Jayadewa) of the University of Colombo, School of Computing (UCSC) and two other interns from the Sri Lanka Institute of Information Technology (SLIIT). At the start, there were two other employees; a Secretary cum Administrative Assistant and an Office Assistant. The company was inaugurated in January 2005 with seven staff including Dilith and it was named “Siam IT Solutions (Pvt) Ltd” (SITS). Sameera and Chamira were placed as a Software Engineer and a Computer Programmer respectively, while Dilith functioned as the Chairman cum CEO of the company.

Dilith invested over 75 percent of his “jackpot” prize (Rs. 40 million) to set up the company. Out of this, he spent Rs. 8 million to lease out two floors of a commercial building located in Rajagiriya for five years and about another Rs. 9 million to purchase the required fixed assets. He also made a short term fixed deposit worth Rs. 20 million which earned monthly interest under the company name, to underpin the short term liquidity requirements until operational cash flows were improved to a level of self-sufficiency. Though it was initially difficult for the team to find sufficient assignments/projects to keep the company afloat, gradually they were able to develop work to a level that kept all of them fairly busy with meeting deadlines related to various assignments. The few projects they found initially were through various personal contacts. Within a relatively short period of time, the company became reputed as a reliable web developer and IT service provider. It provided services on long term contracts as well as on casual requests. Towards the end of the first year, SITS slowly moved into conceptualizing and developing computer programmes (software) for various business and industrial applications. They also developed various mobile applications and games. Regular meetings were held to discuss the range of opportunities available and the potential in conceptualizing and developing new

products. One of the first successful products the team was able to develop, was a retail enterprise application specially developed for the automobile part dealers, that helps them to integrate their sales channels, order management, point of sale systems, inventory and other operations to access the right information at the right time. Despite the growth in business volume, the first year concluded with an operating loss of over Rs. 3 million. However, interest income derived from the fixed deposit supported to recover the operating loss to a great extent.

At the beginning of the second year of operations on 15 January 2006, Dilith called a meeting with Sameera and Chamira in order to review the performance of the first year and plan for the year ahead. Dilith started by saying that he could not understand why the company made an operating loss for the year, despite the progress made throughout, in terms of volume of work. He expected the duo's responses when he said, "We all had a busy year. Didn't we?" The meeting helped them to find out a number of reasons for the operating loss made in the first year. *Inter alia*, they listed three main reasons:

- Unequal distribution of work during the year - though everyone had been busy towards the latter half of the year, SITS did not get sufficient work during the initial months.
- Faults in costing and pricing the products and services due to poor project planning and ignorance.
- Absence of a proper marketing strategy - there was absolutely no proper marketing drive within the company.

Sameera and Chamira had a fourth reason which they were reluctant to share with Dilith. All operations were under Dilith. They all had to do what Dilith wanted them to do. In fact, they felt Dilith could have used them more productively. All three knew that the year ahead would surely be busier compared to the prior year. Furthermore, they felt the need to look for offshore projects as growth in all big IT companies is primarily driven by such projects. They also felt the need for expanding the core IT staff with concurrent strengthening of other functions; essentially, marketing and accounting.

It was not difficult to find staff for the company this time around as the name SITS was now known to the industry. The company recruited three programmers, an accountant and a marketing manager. Both the accountant and marketing manager recruited, had previous experience in IT companies. In fact, this was one of the requirements Dilith was looking for. The new recruits helped to reorganise the work arrangements. Dilith was also able to pay more attention to operations. Both the marketing manager and accountant became great sources of inspiration for the growth of the business, especially in terms of identifying and conceptualizing IT solutions for various business applications.

As the company grew, Dilith with the help of his team, planned to develop and expand the software product offerings – most of which were related to streamlining the accounting processes of medium to large-sized entities. Although SITS experienced operational losses during its first year (2005), its profit had increased steadily from 2006. The company’s profit history, including dividend payments and contributions to retained earnings, is summarised in Table 1.

Dilith started SITS investing Rs. 40 million – a lion share of his “jackpot” prize. SITS obtained its first bank loan of Rs. 30 million in 2006 to finance the growth of the company. In the same year, the company leased out two more floors of the same building to facilitate the expansion of the business. The number of employees also increased gradually. In 2008, SITS qualified to obtain its second bank loan amounting to Rs. 50 million. Although Dilith had hoped to maintain 100 percent ownership of the company within his family, after experiencing rapid growth during the first few years, Dilith badly felt the need of external finance to support the growth of the company. Until the end of 2008, SITS continued as a private company registered under the Companies Act No. 7 of 2007 and the only shareholders were Dilith (75 percent), his father Amaranath Mapatuna (15 percent) and his sister Jinadaree Mapatuna (10 percent). Amaranath and Jinadaree were never involved in the affairs of the company. All at home had a high regard for Dilith and they were very proud of him. No one in the family took any serious decision without Dilith’s consent. Sometimes Jinadaree joked with her parents saying, “Who am I? Brother is your whole world.”

At the time Dilith incorporated SITS in 2005, his sister, Jinadaree, was undergoing her internship at a leading accountancy firm to fulfill the training requirements of the Institute of Chartered Accountants of Sri Lanka. After completing her internship at the accountancy firm, she joined a leading company listed in the diversified sector of the Colombo Stock Exchange (CSE) as an accountant, with the aim of obtaining hands on experience in the finance function of a company. When she completed two years at the company, Dilith wanted her to join SITS as the finance manager. Though she enjoyed working with her first employer, especially due to the company’s very open culture and the freedom she was enjoying there, she had no excuse to give Dilith. In the meantime, Dilith was having a continuous dialog with his bank about his plan for expansion. He even inquired about the potential of listing SITS on the CSE. The bank advised that this was too early as the company was not able to meet the listing requirements at that point. However, in 2009, the bank helped Dilith to find two institutional investors (venture capital firms) through its investment banking arm in order to strengthen SITS’s equity base, on the condition that the company would be listed on the CSE within the next 5 to 8 years. Furthermore, the bank agreed to provide a property loan of Rs. 250 million for the acquisition of required land and buildings for its planned expansion. SITS’s statement of financial position prior to the infusion of new capital is summarised in Table 2.

Just prior to the private placement, on the bank's advice, Rs. 82 million of retained earnings were converted to stated capital. Accordingly, 8.2 million shares of common stock were issued by SITS to its original shareholders and two senior employees (Sameera Ihalakaduwa and Chamira Jayadewa). This was allocated as; 8 million shares issued to the original shareholders (Dilith, Amaranath and Jinadaree) in the same ratio of their original holdings, and the balance 0.2 million shares issued equally to Sameera and Chamira. The main objective behind the conversion of retained earnings to stated capital was to avoid any dilution in the original shareholders' ownership interest and to bring down the issue price of the intended private placement.

Considering both the growth potential of SITS and the risk associated with its business model, the bank recommended to keep the issue price in the range of 1.55 to 1.65 times of the current book value of the share. Finally, at the compromised price of Rs. 20, a further 7.8 million shares were issued to the two institutional investors. Soon after these changes, the following new board was appointed to the company:

<i>Chairman and CEO</i>	Dilith Mapatuna
<i>Director Finance</i>	Jinadaree Mapatuna
<i>Director Operations</i>	Sameera Ihalakaduwa
<i>Independent Director</i>	Amaranath Mapatuna
<i>Independent Director</i>	Thevis Saparamadu
<i>Independent Director</i>	John Anthony Sivajilingm

The last two directors were the representatives from the venture capital firms who invested in SITS' shares under the private placement.

When Dilith was able to secure enough funding for the planned investment activities of SITS through its bank in 2009, he had a similar feeling that he had at the time he won the "jackpot" prize in 2004. Nevertheless, he knew that the support of the bank had been outstanding this time. He once mentioned at a SITS board meeting, "having worked with them since the beginning, the relationship team of the bank really understands our business and they are frequently coming up with new ideas to help us grow in the most efficient way possible." Without delay, SITS started its building project in Nawala. As planned, the first phase of the construction of the new building was completed by February 2010. SITS first shifted its operations division in March 2010 to the new building.

Despite being the Chairman and CEO of the company, Dilith never let go of his first love, software development. He directly supervised the operations of the company. Most of the new product development work was planned by Dilith himself, and assigned to the team to carry on. Any new ideas coming from the team could not be launched without his consent. On the other

hand, the company's growing complexity forced Dilith to devote more of his time to administrative duties, thereby interrupting the progress of the smooth functioning of operations. On a number of occasions, Sameera and Chamira pointed out to Dilith, the need for a few skilled business analysts who could act as the link between clients' business objectives and the capabilities of information and communication technology. As traditional methods would no longer lead to reaching business objectives under the ever changing economic and business conditions, they strongly felt that SITS had to employ one or two experienced business analysts without delay. According to them, it was the only way the company could be brought to the next stage of development. Whenever this idea was brought up, Dilith openly threw it away due to his concern about the cost of highly skilled experts in the field. He believed that the company was still able to manage its affairs with the available resources, including him. Paying millions for new experts, he thought, would negatively affect profits and earnings per share (EPS). Moreover, he did not want to lose control over operations. As a result, the operations division of the company had a relatively flat organisational structure. By this time Sameera had been promoted to the Director of Operations and Chamira to the grade of a Senior Software Engineer. Work routines of both of them were more or less similar and they were directly reported to Dilith. There were about 25 others (computer programmers, web developers, graphic designers and analysts) and in addition to this, at any given time, there were about 10 - 15 rolling IT interns from local universities and other degree awarding institutions.

Frustrated, Sameera and Chamira thought they rather approach Jinadaree and brief the story to her. Somewhere in December 2013, they met Jinadaree in her office located in the top floor of the building. Jinadaree had a lot of respect for both of them as they were the key people who helped Dilith to build SITS since its inception. Furthermore, both of them were about 5 years older to her. She never called them by their first name. After exchanging greetings, Sameera started saying, "being the head of finance, Miss Jinadaree, you should have already recognised that we haven't been performing well for some time." "Yes Mr. Ihalakaduwa, I have already pointed out to my brother that we were not doing very well these days. I often find it difficult to manage even our cash flow. Good that you came up here. I was also thinking of meeting you both regarding the same issue", replied Jinadaree. She further questioned them - "What has really been going wrong? We were doing very well until 2011, weren't we?" Sameera replied, "Miss Jinadaree, most of the jobs that were undertaken in the past couple of years were beyond our capacity. We were spending a long time unnecessarily to complete some of these jobs. We were not meeting deadlines. The result was severe; clients delaying payments, work in progress building up. Surely, you must be having cash flow problems. I can understand that well." Jinadaree was puzzled with Sameera's reply. She immediately inquired "Aren't your people working? Is there an issue with their pay?" This time Chamira countered saying, "No it is not that Miss Jinadaree. What Sameera meant was that we need a few more people who can act as liaisons between business people who have business problems and technology people like us

who know how to create automated solutions. We actually don't have a single business analyst here". Sameera added, saying, "We don't have a single capable person who could attend to job defining, scoping and conceptualizing clients' complicated requests. And now, issues with clients are piling up. Payments are getting delayed. Projects are dragging. At the early stage of our development, the scope of the jobs that we handled was narrow. We were able to attend to them reasonably well." Finally, Chamira told, "It is strange that the CEO does not want to understand the real issue confronted by the company." Jinadaree did not want to say anything against her brother. However, she agreed to discuss the matter with him. Sameera and Chamira left Jinadaree's office somewhat happily as they were able to tell her most of the issues that were bottled-up in their minds for some time. While they were leaving Jinadaree's office Sameera told Chamira, "Chamira look here, at least now Jinadaree will understand we are not responsible for the deteriorating operating revenues." "Yes that's true", replied Chamira.

Jinadaree was looking for a good time to talk to Dilith at home. As Dilith used to spend a few hours in the operations division, giving instructions and attending to important work there, he usually went home late. On Saturdays, he spent his entire time at the operations division. Whenever he spent time there, he was fully engrossed in the work in hand at the time. Dilith usually got involved in developing new software with generic applications rather than developing tailor made solutions for specific customer needs. Such projects were handled by others. Initially, he was able to develop a few software applications for different industries. Those applications still bring a lot of good money to the company. However, in recent times, he worked rather independently from others, thinking of developing a more user friendly personal information management software; a software that could manage one's appointment calendar, address book, notepad, and other features to organise what he or she has to do. He started this project purely due to his frustration with some of the existing applications. Furthermore, he thought that he would be able to sell such an application to a company like Microsoft for a higher price. To both Sameera and Chamira, the recent peculiar behavior of Dilith had been very much self-destructive and not in the best interest of the company. According to them, Dilith should have spent more time on ongoing affairs of the company.

It was a Friday morning, the day prior to Jinadaree's 28th birthday. At the breakfast table, Dilith said "Let's go out for lunch tomorrow." Thinking it would be a good time to talk to her brother, Jinadaree asked, "what's special about tomorrow?" Dilith replied, "It's a top secret." The parents, who had been worried about the marriages of their two children, thought that it would be a good time to talk to them too. The next day, Jinadaree, as agreed, took the parents to the restaurant that Dilith wanted them to go to. On the way to the restaurant, until her mother reminded, Jinadaree did not recall that it was her birthday. Once they reached the location, a waiter at the restaurant took them to the table reserved for them. Dilith joined them around 12.30 pm. It was a family day. They talked a lot. The parents recalled a lot of lovely memories about

their life in Galle. Halfway through lunch, when the father changed the topic asking, “How is the company son?”, Jinadaree was happy as that was the topic she was awaiting. After Dilith replied, “Everything is alright father”, Jinadaree intervened, saying “We have to be a bit serious brother. Our operating income has come down after 2011. There are no signs of any improvements as well.” Dilith replied, “You know Jinadaree, IT companies usually have ups and downs. That’s usual. That’s why I have invested fairly a large sum of money in fixed deposits.” Then Jinadaree mentioned, “We are managing our cash flow by drawing from our fixed deposits. I think we have to be more serious about the growing situation.” She also mentioned that she had talked to Sameera and Chamira regarding the issue and that they truly felt SITS had to strengthen its operations by recruiting a few business analysts. Then Dilith’s reply was that good analysts were not cheap and the profit would further deteriorate if any analysts were hired. He felt that the existing team had to manage somehow. Jinadaree did not want to continue beyond that point. Through experience she knew that her parents also did not want her to confront her brother. On the way back home with her parents, Jinadaree thought to herself that there was no point in talking to her brother.

During the first quarter of the year, the employees of the finance division of SITS usually become busy with the preparation of final accounts. Jinadaree was happy that this time she could prepare the unaudited final accounts for the year ended 31 December 2013 by February 2014. She was planning to present them at the next board meeting of the company scheduled to be held on 27 February 2014. At the board meetings, even the executive directors (except Dilith) usually did not discuss the issues of the company. As for independent directors, Amaranath Mapatuna hardly attended the board meetings. The agenda was handled by Dilith. At every meeting, a few questions were raised by the other two independent directors (Thevis and John). Their questions were usually answered by the Chair (Dilith). The other executive directors answered questions, only if they were directed to any such questions by the Chair. Conversely, the Chair rarely obtained the opinion of others in setting the agenda of the meetings.

As usual, the board meeting started at 4.00 pm on 27 February 2014 with greetings from the Chair. The unaudited final accounts for the year ended 31 December 2013 had been circulated with the minutes of the previous meeting. As Jinadaree suspected, both Thevis’ and John’s major concern was the weakening operating performance. They openly questioned what actions had been taken by the management over the last two years to address the situation. Though the Chair made an attempt to justify the situation, saying “This is quite natural for an IT company and we are carrying out a few experiments relating to new developments”, it was appealing to neither Thevis nor John. Thevis stated, “Of course you can do new experiments, but you should not sacrifice your profits. There should be a good return on investment.” John added, “IT is a growing industry. My firm has investments in several other IT companies in the form of equity or debt. They are doing quite well. My suggestion to all executive directors is to have a

brainstorming session with other senior staff immediately and identify the real causes for the worsening operating profits so that you can find a solution. You should open the floodgates.” Finally Thevis reminded, “We contributed to the equity capital of SITS in 2009 with the condition that SITS would list its shares in the CSE within next 5 to 8 years. Almost 5 years have passed by. Under this depressed performance, I don’t think we can harvest any reasonable return from our investment in SITS by listing on the CSE.” He concluded saying, “This is going to be a devastating experience for us if SITS continues in this manner.” The Chair concluded the meeting after agreeing to review the company’s performance in the last two years with the senior staff. He, for the first time, felt that SITS was not only his own.

Table 1

Siam IT Solutions (Pvt) Ltd				
Profit, Dividends and Retained Earnings 2005 – 2012 (Rs ‘000)				
Year	Profit from operations (1)	Net profit after tax (2)	Dividends (3)	Contribution to retained earnings (4)
2005	(3,215)	(195)	-	(195)
2006	21,760	19,475	-	19,475
2007	39,841	29,531	4,000	25,531
2008	78,318	59,789	8,000	51,789
2009	127,566	99,600	30,000	69,600
2010	173,386	135,440	40,000	95,440
2011	202,680	152,750	80,000	72,750
2012	191,730	141,860	80,000	61,860

Table 2

Siam IT Solutions (Pvt) Ltd		
Statement of financial position as at 31 December 2008		
	Rs '000	Rs '000
ASSETS		
Non-current assets		
Fixed assets (net)	96,600	
Leased properties (net)	<u>7,000</u>	103,600
Current assets		
Inventory (software products developed by the company)	36,600	
Short term investments	35,645	
Accounts receivable	28,720	
Cash and cash equivalents	<u>14,120</u>	115,085
Total assets		218,685
EQUITY AND LIABILITIES		
Equity		
Stated capital (4,000,000 ordinary shares)	40,000	
Retained earnings	<u>96,600</u>	
Total equity		136,600
Non-current liabilities		
Interest bearing borrowings		49,500
Current liabilities		
Interest bearing borrowings	9,310	
Accounts payable	2,517	
Tax payable	12,240	
Dividend payable	8,000	
Accruals	<u>518</u>	32,585
Total liabilities		82,085
Total equity and liabilities		218,685