

Contents

<i>Preface</i>	vii
<i>Acknowledgements</i>	ix
<i>Abbreviations</i>	xxi
<i>Abbreviations: Companies</i>	xxiii
<i>List of Figures</i>	xxv
<i>List of Tables</i>	xxvii
<i>Table of Legislation</i>	xxix
<i>Table of Cases</i>	xxxiii
Introduction	1
0.1. Objectives and Importance of Study	1
0.2. Overview of Research Methods	5
0.3. Structure of Study	5
Chapter 1 Corporate Governance and Economic Development: The Nexus	9
1.1. Introduction	9
1.2. Corporate Governance and Economic Development: The Theory and Evidence	11
1.2.1. Economic Development and Corporations	11
1.2.2. Corporate Governance and Economic Development	14
(a) Development of the Financial Sector and Increased Access to Financing	15

	(b) Cost of Capital and Firm Valuation	17
	(c) Improved Operational Performance	19
	(d) Reduced Risk of Financial Crises	21
1.2.3.	The Emerging Consensus	23
1.3.	Corporate Governance for Economic Development: The Way Forward	26
1.3.1.	Corporate Governance	27
1.3.2.	Systems and Practices	28
1.3.3.	Systems of Corporate Governance	29
	(a) Outsider/Arm's Length System (Dispersed Ownership)	30
	(b) Insider/Control-Oriented System (Concentrated Ownership)	31
	(c) The Models	32
1.3.4.	Corporate Governance Framework	34
1.4.	Conclusion	36
Chapter 2	Corporate Ownership, Control and Corporate Governance	39
2.1.	Introduction	39
2.2.	Context of Study: Sri Lanka	40
2.2.1.	Recent Economic History	40
2.2.2.	Motivation for Corporate Governance Reform in Sri Lanka	43
	(a) Financial Stability	44
	(b) Attracting Private Capital	44
	(c) Convergence-Driven Reform	45
	(d) Crisis-Driven Reform	46
	(e) Structural Adjustment Programmes	47
	(f) Pro forma Corporate Governance	47
2.3.	Corporate Ownership, Control and Corporate Governance	48
2.3.1.	Ownership and Control of Companies	48
2.3.2.	Correlation between Ownership, Control and Corporate Governance	50
	(a) The Agency Conflict	50
	(b) Patterns of Financing	53

(c)	Theories of the Firm	56
(d)	Core Elements of the Corporate Form	59
(e)	Corporate Control and Corporate Law	59
(f)	Potential Governance Mechanism	60
(g)	Ownership and Firm Value	60
2.3.3.	Correlation between Ownership, Control and Corporate Governance in Sri Lanka	61
(a)	The Agency Conflict	61
(b)	Patterns of Financing	63
2.4.	Conclusion	63
Chapter 3	The Separation of Ownership and Control in Sri Lanka	65
3.1.	Introduction	65
3.2.	Data, Definition of Terms and Methodology	68
3.2.1.	Corporate Landscape	68
3.2.2.	Data	68
3.2.3.	Definition of Terms	69
(a)	Ownership (Cash Flow Rights)	69
(b)	Control	69
(c)	Blockholders	70
(d)	Controlling Shareholders	70
(e)	Vertical Groups	70
(f)	Horizontal Groups	71
(g)	Subsidiary, Group Companies and Associate Company	72
3.2.4.	Methodology	73
3.3.	Results	74
3.3.1.	Coverage of the Sample	74
3.3.2.	Description of the Sample	74
3.3.3.	Concentration of Ownership	76
3.3.4.	Nature of Corporate Ownership	79
3.3.5.	The Distinction between Corporate Ownership and Control	85
(a)	Control Rights of Blockholders	86
(b)	Mechanisms to Separate Ownership from Control	96

	(c) Nature of Controlling Shareholders	104
	(d) Summary	106
3.4.	Corporate Ownership and Control: The Challenges Facing Corporate Governance in Sri Lanka	107
3.4.1.	Findings	107
	(a) Concentration of Ownership	107
	(b) Nature of Corporate Ownership	107
	(c) Distinction between Corporate Ownership and Control	111
3.4.2.	The Challenges facing Corporate Governance in Sri Lanka	112
	(a) Concentration of Ownership	112
	(b) Nature of Corporate Ownership	113
	(c) Distinction between Corporate Ownership and Control	114
3.5.	Conclusion	116
Chapter 4	Determinants of Ownership and Control Structures in Sri Lanka	119
4.1.	Introduction	119
4.2.	An Outline of Ownership Evolution in Sri Lanka	122
4.2.1.	Introduction	122
4.2.2.	Pre-Independence: Pre-1948	123
4.2.3.	Independence: 1948	124
4.2.4.	Post-Independence	129
4.2.5.	Privatisation	131
4.3.	Determinants for the Persistence of Concentrated Ownership in Sri Lanka	142
4.3.1.	Introduction	142
4.3.2.	Determinants for the Persistence of Concentrated Ownership and Business Groups in Sri Lanka	143
	(a) Entrepreneurship	143
	(b) Market Intermediaries	145
	(c) Budget Deficits	148

	(d) Public Float	153
	(e) Interest Rates on Deposits	156
4.4.	Implications for Corporate Governance in Light of the Causes for the Persistence of Concentrated Corporate Ownership	158
Chapter 5	Controlling Shareholder Systems and Corporate Governance	161
5.1.	Introduction	161
5.1.1.	Ownership and Control	161
5.1.2.	Family Control	163
5.1.3.	Group Affiliation	164
5.1.4.	Impact of Controlling Shareholder Systems	165
5.1.5.	Why are Controlling Shareholders Efficient in One Jurisdiction and Not in Another?	167
5.1.6.	Framework of the Chapter	168
5.2.	Costs of Controlling Shareholder Systems	169
5.2.1.	Private Benefits of Control	170
	(a) Internal Benefits of Control	170
	(b) External Benefits of Control	172
	(c) Measuring Private Benefits of Control	172
5.2.2.	Private Benefits of Control in Sri Lanka	174
5.2.3.	Private Benefits of Control in Group Scenarios: Tunnelling	177
	(a) Measuring Private Benefits of Control in Group Scenarios: Tunnelling	178
5.2.4.	Private Benefits of Control in Group Scenarios: Tunnelling in Sri Lanka	180
5.2.5.	Political Influence	181
5.2.6.	Political Influence in Sri Lanka	184
5.2.7.	Market Power and Anti-Competitive Practices	186
5.2.8.	Market Power and Anti-Competitive Practices in Sri Lanka	187

5.2.9.	Entrenchment	189
5.2.10.	Entrenchment in Sri Lanka	192
5.2.11.	Conclusion	194
5.3.	Benefits of Controlling Shareholder Systems	194
5.3.1.	Limiting the Classic Agency Problem	195
	(a) Monitoring	197
	(b) Long-term Planning	199
5.3.2.	Limiting the 'Classic Agency Problem' in Sri Lanka	200
5.3.3.	Trust and Reputation	201
5.3.4.	Trust and Reputation in Sri Lanka	203
5.3.5.	Controlling Shareholders as Private Investment Vehicles	206
5.3.6.	Controlling Shareholders as Private Investment Vehicles in Sri Lanka	207
5.3.7.	Conclusion	209
5.4.	The Implications of a Cost-Benefit Analysis of Controlling Shareholder Systems for Corporate Governance	210
5.4.1.	The Benefits of Controlling Shareholder Systems are Dependent on the Size of the Economic Stake of the Controlling Shareholders and the Divergence between their Economic Stakes and Control Rights	211
5.4.2.	Application to Sri Lanka	213
5.4.3.	Costs Associated with Controlling Shareholder Systems are Contingent upon the Legal and Regulatory Environment, and Market Forces	216
5.4.4.	Application to Sri Lanka	217
5.5.	The Controlling Shareholder Trade-off	221
5.5.1.	Introduction	221
5.5.2.	Controlling Shareholder Trade-off	223
5.5.3.	Inferences for Corporate Governance Reform in Sri Lanka by Examination of the Controlling Shareholder Trade-off	226

Chapter 6	Controlling Shareholder Systems: The Search for Reform	229
6.1.	Introduction	229
6.1.1.	Corporate Governance Reforms in Sri Lanka	230
6.1.2.	The Literature on Corporate Governance Reform	232
6.1.3.	The Framework of the Chapter	233
6.2.	Controlling the Costs of Controlling Shareholder Systems	236
6.2.1.	A Framework for Controlling the Costs of Controlling Shareholder Systems	236
6.3.	External Governance Mechanisms and Controlling the Costs of Controlling Shareholder Systems	238
6.3.1.	Law as an External Governance Mechanism	239
6.3.2.	Law as an External Governance Mechanism in Sri Lanka	242
6.3.3.	Norms as an External Governance Mechanism	245
6.3.4.	Norms as an External Governance Mechanism in Sri Lanka	247
6.3.5.	Market Forces as an External Governance Mechanism	250
6.3.6.	Market Forces an External Governance Mechanism in Sri Lanka	253
6.4.	The Framework for Reform	254
6.4.1.	Debt as an External Market-based Governance Mechanism in Sri Lanka	255
6.4.2.	The Hybrid Reform Agenda	258
Chapter 7	The Role of Lenders in Controlling Shareholder Systems	259
7.1.	Introduction	259
7.2.	Lenders as a Corporate Governance Mechanism	260
7.2.1.	Definitions	261
7.2.2.	Literature	262

7.2.3.	Conventional Role of Lenders	265
7.2.4.	The Governance Role of Lenders	267
	(a) Debt Covenants	268
	(b) Direct Involvement in the Management of the Borrowers	269
	(c) Asset-based Lending	271
	(d) Threat of Insolvency by Lenders	272
	(e) Reduction of Free Cash Flow	273
7.3.	Lenders as a Corporate Governance Mechanism	274
7.3.1.	Evaluating Lenders as a Corporate Governance Mechanism	274
	(a) Supply of Capital	275
	(b) Access to Information and Ability to Monitor	276
	(c) Incentive	277
	(d) Ability to Secure Compliance	277
	(e) Controlling Shareholders	278
	(f) Limitations on Equity Markets and Equity Finance in Developing Countries	278
	(g) Lenders' Ability to Overcome Weaknesses in Enforcement	279
	(h) Lenders Are Potentially Effective Resource Allocators	280
	(i) Limited Liability	281
	(j) The Lending Bias	281
	(k) Contingent or Conditional Governance	282
7.3.2.	Evaluating Lenders as a Corporate Governance Mechanism in Sri Lanka	283
	(a) The Importance of Bank Lending in Sri Lanka	284
	(b) Availability of Funds for Lending by Banks and other Financial Institutions	285
	(c) Creditor Rights Are Stronger Than Shareholder Rights	286

	(d) Banks as Equity Holders of the Borrowing Companies: Relationship Banking	289
	(e) Lenders Are Strictly Regulated and Less Likely to Suffer from Own Corporate Governance Issues	291
7.4.	Legal and Institutional Preconditions Necessary for Lenders to Be an Effective Corporate Governance Mechanism to Control the Costs of Controlling Shareholders in Sri Lanka	293
7.4.1.	Regulating Conflicts of Interest: Independence of Lenders	294
	(a) Restrictions on Shareholdings in Lenders	295
	(b) Lenders' Ownership in Non- Financial Companies	297
	(c) Single-Borrower Limit (Large Exposure Limit)	299
	(d) Rules on Related-Party Transactions between Lenders and Borrowers	301
	(e) Minimising Government Interference in the Banking Sector	302
7.4.2.	Improving Accountability of Borrowers: Disclosure and Transparency	303
	(a) Financial Disclosure	305
	(b) Disclosures with regard to Corporate Governance Practices	310
	(c) Disclosure of Material Information	315
	(d) Disclosure and Approval of Related-Party Transactions	316
7.4.3.	Improving Rights of Lenders	318
	(a) Lenders' Rights in the Creation of Real and Personal Property	318
	(b) Lenders' Rights in the Enforcement of Real and Personal Property	320
	(c) Rights of Creditors in the Event of Insolvency	323

7.4.4.	Fiduciary Duties Owed to Lenders	325
(a)	The Liability of Directors	326
(b)	The Liability of Controlling Shareholders	328
(c)	The Liability of Professional Advisers	331
7.4.5.	Internal Management Role for Lenders	333
(a)	Lenders' Equity Stakes in Borrower Companies	334
(b)	Leveraged Buyouts	335
(c)	Venture Capital	336
7.4.6.	Enhancing Lenders' Corporate Governance	336
7.4.7.	Credit Ratings and Credit Bureaus	339
7.4.8.	Competition	341
7.5.	Conclusion	342

Conclusion **345**

Bibliography Acts, Statutes and Rules 347

Bibliography Cases 350

Bibliography Journals 352

Bibliography Books 360

Working Papers and Discussion Papers 368

Bibliography Reports 373

Bibliography Electronic Sources 378

Bibliography Conference and other Papers 381

Bibliography Newspapers 383

Author Index 385

Company Index 387

Subject Index 391