Opportunities and challenges

Dr Nalaka Godahewa (Chairman SEC)
February 2013
Colombo Stock Market (End 2012)

– Market Size
  • Market Capitalization of Rs 2.2 Trillion
  • 287 Listed Companies

– Market Liquidity
  • Turnover to Market Cap 9.8% in 2012

– Number of Investors
  • 702,438 CDS Accounts and 64,792 active investors

– Foreign Participation
  • A net foreign inflow of Rs 37 Bn in 2012
Key Economic Targets for 2016
- Central Bank Road Map

2012

A USD 59 Bn Economy

Per Capita Income of USD 2922

2016

A USD 100 Bn Economy

Per Capita Income of USD 4000

USD

Bn

Economy

USD

Bn

Economy

Per Capita
Income

USD

4000

Per Capita
Income

USD

2922

USD

4000
Capital market is still not a key contributor in our Economy

Market Capitalization to GDP

- Vietnam: 17%
- Bangladesh: 29%
- Sri Lanka: 30%
- Indonesia: 49%
- India: 53%
- Thailand: 77%
- Philippines: 87%
- Malaysia: 160%
- Singapore: 250%
The Task Ahead

- We would like to see market capitalization over 50% when GDP reaches 100 M
- For that we need to double the current market capitalization in 3 years!
Numbers look quite challenging
The Focus Required

Regulation  Development
Need for a strategic approach

May 2009
End of war

3 ½ years

Nov 2012
Unveiling of capital
Mkt development road map
Capital Market Development Road Map

• A joint initiative of SEC, CSE and key industry stakeholders.
• 10 key projects covering a range of initiatives
• Launched in November 2012 with a 3 year time horizon
• Supported by the findings of CSE initiated Mckinsey & Company report of 2012
Index Performance 1985 to 2012

The ASPI gained only 1,400 points for 24 years.

The ASPI gained 4,250 points in 3 ½ years after the war.
1) Attract more funds (foreign and local)

- When local investors shy away one needs strong foreign participation to keep markets active
- 4 international road shows planned for the year
- Mumbai road show just concluded with participation of nearly 150 fund managers
- Hong Kong, Singapore, Middle East next
- Local Pension Funds are now allowed to invest in equity
Attractive PE valuations compared to regional counterparts

- **Sri Lanka**: Current = 14, 1 Yr Fwd = 11, 2 Yr Fwd = 10
- **Vietnam**: Current = 15, 1 Yr Fwd = 12, 2 Yr Fwd = 8
- **India**: Current = 17, 1 Yr Fwd = 13, 2 Yr Fwd = 12
- **Indonesia**: Current = 18, 1 Yr Fwd = 13, 2 Yr Fwd = 11
- **Philippines**: Current = 19, 1 Yr Fwd = 14, 2 Yr Fwd = 12
During 2009-2012 CSEALL outperformed major global & regional indices.
CSE is less levered compared to regional counterparts

CSE’s Debt Equity Ratio is 64.5% compared to world average of 125% and regional average of 104%
We already see encouraging trend in foreign participation.

2011:
- Foreign: 10.90%
- Local: 89.10%

2012:
- Foreign: 24.90%
- Local: 75.10%

2013 (Jan-Feb):
- Foreign: 50.10%
- Local: 49.90%
Foreign contribution became positive by 2012
2) Increase liquidity in the Market

- Less than 5% of operationally active companies are listed. The number to be increased significantly.
- There are many successful private sector companies who are not yet convinced.
- Government is opening up for the recommendation for listing state entities.
- Listing will ensure greater transparency and better governance of state entities.
- Existing listed companies should be encourage to increase the free float. The 2013 budget gave special concessions for those maintaining 20% free float.
Challenging task ahead to increase number of listed companies
3) Develop the Corporate Debt Market

• In many countries debt market is bigger than equity market
• The current Gvt securities market is 1.6 times bigger than equity market
• However the corporate debt market is relatively small in Sri Lanka
• The corporate debt market is less than 5% of the equity market
• There is a strong need to develop the corporate debt market as an effective means of raising funds for business development
• In 2013 budget several concessions were given to encourage debt market
4) Develop new products (derivatives, commodities markets etc)

- The product portfolio is quite limited in Sri Lanka’s capital market
- In a developed market a investors have access to a variety of instruments (Bonds, Debentures, Options, Futures, etc)
- Solutions such as commodity exchanges can actually help the producers as well as buyers through price stability
- Introducing these products involve technology infrastructure as well as regulatory changes
- A group of experts are currently working in a team to identify priorities and to draw up an implementation plan supported by a policy metrix
5) Grow the Unit Trusts market

- Unsophisticated retail investors should ideally enter the market through unit trusts
  - Managed by professionals
  - Hassel free
  - High liquidity
  - Affordable

- Several tax concessions already given to encourage the industry
- Diaspora can directly invest now in unit trusts without going through SIA accounts
- Awareness levels are currently low. Need support on initial marketing
- Unit Trust industry to be supported through a major advertising campaign funded by SEC & CSE
6) Promote Education and Awareness

- Retail Investors
- Education & Awareness
- Industry Participants
- Corporate Entities
- Public & Media
Banks Vs Capital Market

24% Total Market Value of Securities held by CDS (Rs.)
76% Total Deposits of Commercial Banks & Other Licensed Non Commercial Bank Financial Institutions
We need more retail involvement

- 2008: 478,202
- 2009: 496,907
- 2010: 554,192
- 2011: 666,665
- 2012: 702,428
- 2016: 1,400,000

Challenge
Proper information to media

- Some serious damage was caused during 2011, 2012 period due to negative publicity affecting public sentiments.

- Rebuilding public confidence and reactivating mass scale retail participation has been a priority for the last few months.

- Constantly interacting with media and providing accurate information was important.
Education and awareness initiatives

• Constant interaction with media and clarifying doubts
• Series of technical papers released to papers
• Warana TV program on market education
• ITN quiz program for school children
• Launching of ‘how to invest in stock market’ Sinhala booklet
• English TV discussions on technical subjects to start soon
• An advertising campaign promoting Unit trusts to commence in April
• Enhanced quality assurance of SEC run educational programs and plans to obtain University accreditations
• An investor seminar planned for May
## Market Returns

### Equity Risk Premium Estimates for Sri Lanka

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of Years</th>
<th>(1) Average Market Return (%) (with dividends)</th>
<th>(2) Average 12-Month Treasury Bill Yield (%)</th>
<th>(3) = (1) - (2) Equity Risk Premium</th>
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</thead>
<tbody>
<tr>
<td>2002 - 2012</td>
<td>11</td>
<td>32.98</td>
<td>11.56</td>
<td>21.42</td>
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<tr>
<td>2009 - 2012</td>
<td>4</td>
<td>53.53</td>
<td>11.33</td>
<td>42.20</td>
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From the year 2002, the stock market has given 21.42% higher return than TBs.
7) Develop Trading Infrastructure

• In the 80’s we were ahead of most of our regional counterparts in terms of market sophistication and infrastructure
• Sri Lanka at that time had invested in state of the art technology
• But for the next 30 years we have advanced very little in systems and infrastructure
• We intend to bounce back within the next 3 years and be on par with the best in the world
8) Strengthen Risk Management systems (RMS, DVP, CCP)

• With our ambitious targets to grow the market, risk management becomes a high priority
• Industry stakeholders such as brokers need to upgrade their back office systems to be inline with improvements in trading infrastructure
• DVP /CCP solutions are be implemented at the earliest possible
9) Demutualize the stock exchange

- Demutualization of the CSE will give the exchange the opportunity to position itself better to respond to the interests of its stakeholders and become more competitive and customer driven.
- Demutualization requires amendments to the existing SEC Act and even a separate demutualization Act. Drafts acts are now ready.
- Demutualization process will require further technical assistance. We are talking to ADB for assistance.
10) SEC Act amendment

- Facilitate regulation of Demutualized exchanges
- Facilitate the establishment of a Central Counter Party
- Support introduction of new products and enhancing the regulatory framework
- Introducing civil sanctions and administrative sanctions to deal with capital market offenders
It's time for a dynamic capital market

<table>
<thead>
<tr>
<th>Index</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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<tbody>
<tr>
<td>Global Competitiveness Index</td>
<td>69</td>
<td>62</td>
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<tr>
<td>Doing Business Index</td>
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<td>89</td>
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<td>Global Economic Index</td>
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<td>107</td>
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<td>Human Development Index</td>
<td>102</td>
<td>99</td>
<td>91</td>
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</table>
The Future Envisaged (2016)

- GDP of USD 100 Bn
- USD 4000 per capita income
- Market Capitalization to be 50% of GDP
- A fully Demutualised Stock Exchange
- A fully fledged Clearing Corporation
- Enhanced risk management
- Closer to US $ 10 Bn Bond Market
- SEC Act in line with modern day capital market requirements.