# Political Connections and Firm Performance

## An Analysis of Listed Firms in Sri Lanka

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**2013**

A thesis submitted in partial fulfilment of the requirements for the degree of Master of Commerce in the Department of Accounting and Finance at The University of Auckland, 2013.

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## Acknowledgements

I would like to thank all the people who have helped and inspired me during my Masters study. Without them, I could not have completed this thesis.

I would like to sincerely thank my supervisor Professor Hendrick Berkman for inspiring me to explore this field of research and for his insightful ideas, timely meetings, patience and support. Without his invaluable guidance and help, this thesis would not have been possible.

I would like to thank Professor Vic Naiker and Professor Nick Nguyen from the Accounting and Finance Department of the University of Auckland for assisting me with administrative tasks of this thesis. I would like to also thank Julie Sibthrope, the Accounting and Finance Department's subject librarian at the University of Auckland for her helpful guidance regarding the database research for this thesis.

I would like to thank my parents and brothers, Pinsara and Bimsara, for their invaluable support and love which helped me throughout this thesis. Their insightful advice on Sri Lanka helped immensely with my initial research avenues. I would like to express my gratitude to my uncle, Dr. Palitha Kohona for his insights regarding the political connections in the corporate environment and his knowledge on the Sri Lankan business environment.

I am thankful for my friends for their continued support and numerous helpful discussions. I would like to specially thank Sid Pradhan and Nikitha Kariyawasam for their support and guidance with the editing of this thesis.

# Abstract

This thesis investigates whether political connections affect the value of listed firms in Sri Lanka during positive and negative events for the Sri Lankan government. Using a portfolio time series event study methodology, this thesis compares politically connected firms with non-connected firms using four different types of portfolio hedges. It uses a political connectedness definition to identify firms with political connections within a sample of 103 firms from 2006 to 2011. This thesis aims to answer two questions using the above methodology. Firstly, the event study uses five events to identify if there is a significant difference in cumulative abnormal returns between politically connected and non-connected firms during positive and negative events for the Sri Lankan government. Secondly, this thesis examines if there are significant differences in cumulative abnormal returns between stronger politically connected firms when compared to weaker politically connected firms during positive and negative events for the government. There are several robustness tests carried out to add strength to the findings of this thesis. The hypotheses are further investigated using alternative political connectedness measures such as projects granted to firms by the government, political appointments made by the government after the civil war ended and an analysis of the Tobin's Q value of politically connected and non-connected firms. The overall results for the hypotheses indicate only one event with significant cumulative abnormal returns across all event windows consistently. The results indicate a weak difference between politically connected and non-connected firms. Therefore, the results of this thesis suggest that despite the numerous news articles and public perception detailing the benefits received by politically connected firms, the performance of the politically connected firms does not significantly differ from non-connected firms in Sri Lanka.

# 1 Introduction

"You cannot succeed in business without making the right connections"

The above saying has a distinct importance to many firms in various countries, where politics and firm success goes hand in hand. The interaction between the concepts of "political connections" and "firm performance" has been looked at in several prior studies. There have been differing views on the level of interaction between the political connections of a firm and the effect on its performance. Academics differ on whether the effect of political connections overall has a beneficial or detrimental effect on firm performance (Fisman, 2001).

In this thesis, I will be looking at the impact of political connections on firm performance in a Sri Lankan setting, in the lead up to the conclusion of the civil war in 2009. Sri Lanka is an ideal country to carry out this thesis with its economy focused on growth and a stable and strong ruling government in control for the majority of the post-war period.

In countries where the political decision making process is decentralised, defining political connectedness is difficult (Fisman, 2001). This is because we have to account for multiple hierarchies of personalities and institutions being able to grant political favours and punishments which may affect firm performance. Therefore, a more centralised and stable political structure is helpful to construct a credible measure that indicates the political connectedness of firms (Fisman, 2001). Fortunately, the government of Sri Lanka has remained unchanged for the duration of this thesis's sample period from 2006 to 2011 and the government has a heavy influence from the current President's family, the 'Rajapaksas'. Hence, it is comparatively easy to trace the political connectedness of firms to the ruling party.

There are several reasons for setting the study in Sri Lanka. Firstly, Sri Lanka recently concluded a 30 year civil war and is now focusing on achieving a high level of economic growth in partnership with neighbouring countries like India and regional super economies such as China. Such partnerships breed numerous growth opportunities for firms in Sri Lanka. The Sri Lankan stock market is relatively liquid and sufficiently large to carry out this study. Furthermore, many firms have affiliations to either the ruling government party or one of the opposition parties. Since the government has not been ousted from power since the final stages of the civil war, a comparison can be made as to whether the firms connected to the government party performed better than non-connected firms. Given the ruling government hierarchy is mainly controlled by the Rajapaksa family, connections to this family would provide firms with a significant political connection to the government during the post war period.

The other aspect of this thesis is the effect these political connections might have on firm performance. When estimating the value of political connections to politically connected firms, they may not necessarily earn higher profits (Fisman, 2001). This is due to the fact that even though politically connected firms may earn substantial political rents, they may need to devote resources for non-optimal operations from the firm's point of view. Therefore, it might reduce the total value firms derive from political connections (Fisman, 2001). For example, negative effects may involve a firm having to hire people based on their association with a politician and not necessarily their own merits. In addition to this, politicians may extract rents from the firm by taking cut backs on contracts won by the firm.

I focus on several key studies to develop the hypotheses for this thesis. The first paper is "Politically Connected Firms" by M. Faccio (2003). The second paper is "Political Connections and Minority-Shareholder Protection: Evidence from Securities-

Market Regulation in China" by H. Berkman, R. A. Cole and L. J. Fu (2010). The other important papers used in this thesis include "Estimating the Value of Political Connections" by R. Fisman (2001), "Cronyism and Capital Controls: Evidence from Malaysia" by S. Johnson and T. Mitton (2001) and "Corporate Governance Practices and Firm Performance of Listed Companies in Sri Lanka" by K. Heenetigala (2011). These papers are discussed in more detail in the literature review section of this thesis. Using these prior studies, the research question that this thesis will attempt to answer is as follows,

"How do political connections to the Sri Lankan government affect the performance of listed firms in Sri Lanka?"

The first hypothesis of this thesis is firms which have political connections to the government of Sri Lanka during the period from 2006 to 2011 will perform better than non-connected firms during positive events for the government. I expect to find positive abnormal returns after each event for politically connected firms when compared to non-connected firms. Likewise, I expect to find negative abnormal returns for politically connected firms during negative events for the government. The second hypothesis of this thesis is stronger politically connected firms will have a higher positive abnormal return during positive events for the government when compared to weaker politically connected firms. Likewise, I expect to find larger negative abnormal returns for stronger politically connected firms during negative events for the government

The descriptive statistics indicates that the politically connected firms tend to be larger, have a higher market capitalisation and a slightly higher daily return in comparison to non-connected firms. The return on assets and return on equity is also larger for politically connected firms. The empirical results of this thesis provide no evidence in support of the hypotheses. Four out of the five events have significant results in at least one event window used in the event study. However, two of the events are contrary to the expected direction for the event. Hence, these two events provide no support for the hypotheses. Overall, only one out of the five events (Arrest of General Fonseka) provides consistently significant results in line with the hypotheses. Therefore, the empirical results do not provide consistently significant results in support of the hypotheses.

This thesis contributes to the literature in several ways. Firstly and most importantly, I construct a political connectedness measure to classify the listed firms of Sri Lanka. The definition manages to classify the sample of listed firms into three types of political connections and compare them to non-connected firms. Secondly, this thesis contributes to the literature on the value of these political connections to firm performance by using a robust event study methodology which looks at various measures of firm performance such as the firm's daily returns. It also assesses this through other measures such as projects granted by the government in the post war period, appointments made by the government to the board of governors etc.

The remainder of this thesis is organised as follows. Section 2 provides a background on the economic environment of Sri Lanka. Section 3 summarises the literature in this area of research. Section 4 explains the research method used in this thesis including the variables and statistical methods while sections 5 and 6 identify the data sources, sample selection and hypotheses. Section 7 outlines the results. Finally, section 8 summarises and concludes the thesis and section 9 lists the appendices for this thesis.

# 2 Background on the Economic Environment of Sri Lanka

## 2.1 Early Origins and Summary of Country


Fig. 2.1 - Map of Sri Lanka - Source: (Geology.com, 2008)

Sri Lanka is a small island nation on the southern coast of the Indian sub-continent with a population of around 20 million people (The World Bank Group, 2012). The island, as shown above in fig. 2.1, surrounded by the Indian Ocean, was formally known as Ceylon before becoming a republic in 1972. Due to its location in relation to the Indian Ocean sea routes, it is a strategic link between the Western and Eastern economies (Hillman W. G., 2008). Sri Lanka has been an important part of Buddhism in the world, with it being the only country with a continually Buddhist population over time (Buddha Dharma Education Association and BuddhaNet, 2012). It has a multitude of cultures mixed within this small island. The Sinhalese form the majority of the population, whilst the Tamils are the largest ethnic minority. Other ethnicities include Moors, Dutch, Kaffirs, Malays and the aboriginal Vedda people (The World Bank Group, 2012).

Sri Lanka is a unitary republic with a Semi-Presidential system. The official seat of the government is located in Sri-Jayawardenapura Kotte, the capital of the country. The commercial capital is located in Colombo (see fig. 2.1 above). The Island is famous for its tea, coffee, gemstones, coconuts, rubber and cinnamon. The country has a rich and colourful history of around 3000 years (Asian Development Bank, 2006).

Medieval Sri Lanka was filled with many kingdoms in the central Anuradhapura and Pollonaruwa provinces (see fig. 2.1 above). The country was built around agriculture, monument building and hydro-culture. There were several invasions from India during these times which resulted in the Sinhalese Kingdoms being shifted to the south of the country. Furthermore, this resulted in a Northern Tamil Kingdom of Jaffna being established in the 13th century as a result of these invasions (see fig. 2.1 above). Since then, this new Jaffna kingdom was only part of the unitary Sri Lankan state in 1450 when it was once again conquered by the Southern Kingdom. The Northern Kingdom ceased to exist in 1619 after being conquered by the Portuguese Colonials (Lanka Library, 2009).

Modern Sri Lanka was occupied by colonial invaders who first arrived in 1505. The country's coastal areas were occupied by the Portuguese, Dutch and the British colonials respectively. The country only became fully colonised in 1815 when the British captured the Kandyan Kingdom located in the central province (see fig. 2.1). The country gained independence from the British in 1948 and operated as a dominion of the British Empire till 1972. After gaining independence, there was a feeling of marginalisation amongst the Tamils as they no longer had the preferential positions granted to them by the British under the new Ceylon government. Furthermore, the rise of Sinhala nationalism in the mid-1950s exacerbated the situation. There were several attempts by the leading Tamil and Sinhalese politicians during that time period to find an equitable political solution to the ethnic tensions, which were not successful (Lanka Library, 2009).

## 2.2 Political Situation since 1972 and the Current Government Structure

After becoming a republic in 1972, the Sri Lankan government changed the constitution to create the post of an executive presidency in 1977. The government removed the powers from the post of Prime Minister and modelled the Executive Presidency after that of France (Jayatilaka, 2010). From the early 1980s ethnic tensions between the Sinhalese and Tamils manifested into violence and are detailed in the timeline of the civil war in section 2.3 below.

The current political framework of Sri Lanka is based around a Presidential representative democratic republic, where the President is both the head of state and head of government. The post of Executive President is elected for a term of six years. The multi-party system is dominated by the centre-leftist and progressive "United People's Freedom Alliance" (UPFA) and the comparatively right-wing pro-capitalist "United National Party" (UNP). Generally, the UPFA believes in a more active role of the state, while the UNP believes in a more capitalist role. There are many smaller Buddhist, Socialist, Tamil nationalist political parties. The parliament consists of 225 members and is elected for six years. The parliament makes all laws; however, the President may summon, suspend or dissolve the parliament. The Judicial system of the Sri Lankan political framework is headed by the Supreme Court which has the highest and final court of record (Lanka Library, 2009).

After the conclusion of the Presidential elections of 2005 in which Mahinda Rajapaksa (UPFA) won against Ranil Wickremasinghe (UNP) by the slimmest of margins, the political situation remained tense. The election of Mr Rajapaksa as President resulted in increased violence in the North and East even though the President has continued pursuing peace talks with the separatist terrorist group, the Liberation Tigers of Tamil Eelam (LTTE) (Country Monitor, 2006). The 2002 ceasefire agreement concluded in 2006 with the government forces officially starting military action against the LTTE. International efforts to bring lasting peace appeared to have failed with the peace talks not going beyond the second round (Asia Monitor, 2006). The final details of the war are explained in more detail in section 2.3 below.

The last Presidential election held in 2010 is also won by President Rajapaksa with nearly 60% of the vote. The euphoria of the victory over the LTTE helped the UPFA win the 2010 Parliamentary elections as well (Department of Elections, 2008). The UPFA coalition managed to secure two thirds majority in the parliament which is the first time since 1977, a political party in Sri Lanka has managed this feat. This is a major victory for the government as this allowed them to amend the constitution as they wished. Hence, the government passed the 18$^{th}$ amendment to the constitution which allows a person to become President for any number of times which exceeded the previous limit of two terms (Fernando S. , 2010).

The Sri Lankan government passed a further controversial piece of legislation on 9th November 2011 which allows the government to acquire firms or assets which it deems to be underperforming or underutilised. The legislation, which was opposed by the opposition party, allows the government to acquire 37 assets including two listed firms on grounds of national interest. The President's younger brother Basil Rajapaksa, who is also the Economic Development Minister, told parliament that no private assets have come under the Act, in order to address concerns that this legislation will adversely affect local and foreign investment in the economy. The Minister further stated the owners of these assets will be compensated; however, the basis of compensation is not yet clear. The listed firms that come under this Act include Hotel Developers Lanka PLC, which operates the Hilton Colombo hotel. The second firm is Pelwatte Sugar Industries PLC, which owns 6300 hectares of land. The share prices of these two firms dropped 27.1% and 15.5% respectively since the market first found out about the proposed bill on 1st October 2011. There has been criticism from the opposition party as well as investors and economists that this piece of legislation will amount to nationalisation and damage business confidence (Aneez & Sirilal, 2011).

### 2.2.1 Case Study – Effect of the Expropriation Act on Listed Firms in Sri Lanka

Sevanagala Sugar Industries Ltd, owned by Pelwatte Sugar Industries PLC, was taken over by the Sri Lankan government in 2011, as part of the Act to Acquire Underperforming and Underutilised Assets. At the time of acquisition, the firm was represented by board members who were aligned with the opposition party (United National Party), including the chairman, Daya Gamage. He is publicly associated with the opposition party leadership and has financed the opposition party's activities during the 2010 Presidential elections. He has fallen out of favour with the President after the 2010 elections where previously, his company, Daya Group, received numerous contracts from the President's Highways Ministry (Shauketaly, 2011). Additionally, the other listed firm included in this piece of legislation is Hotel Developers (Lanka) PLC, which owns the Colombo Hilton Hotel (LBO, 2011).

Market speculation over the fear of further government takeovers resulted in the stock market as a whole falling 1% on 17th November 2011, which extended its loss to 4.9% during that week due to the negative sentiment created by the Expropriation Act. Furthermore, John Keells Holdings PLC fell 1.93% due to speculation that its cargo handling unit at the Colombo port may be taken over by the government. The Distilleries Company of Sri Lanka PLC and United Motors PLC also fell 0.6% and 1.37% respectively (Reuters News, 2011).

## 2.3 Timeline of the Sri Lankan Civil War

In order to better understand the environment in which the 30 year old civil war concluded in 2009, the historic events that occurred during the civil war need to be understood. A breakdown of key events, starting from the first incidents that occurred in the early 1980s to the historic conclusion in 2009, is outlined below (Sirilal, Timeline: Sri Lanka's 25-year civil war, 2009).

**Timeline of the Sri Lankan Civil War**

| Year | Event Description |
|---|---|
| 1983 | One of the first incidents that signified the start of the "First Eelam War". The LTTE kills 13 Sri Lankan Soldiers in the North of the country which leads to anti-Tamil riots in the capital Colombo. Hundreds die while thousands flee. |
| 1990 | In 1987 India sent troops to Sri Lanka to enforce a truce it brokered but the LTTE fought the Indian Army which resulted in the Indian Army withdrawing in 1990. The LTTE takes control of the Northern city of Jaffna. This signifies the beginning of the "Second Eelam War". |
| 1991 | The LTTE assassinates the former Indian Prime Minister Rajiv Gandhi in Southern India using a suicide bomber. Two years later, the Sri Lankan President Ranasinghe Premedasa is assassinated in a separate suicide attack. Both these attacks are blamed on the LTTE. |

| | |
|---|---|
| 1995 | President Chandrika Kumaratunga agrees to a truce with the rebels. The “Third Eelam War” begins with the LTTE sinking a naval craft. The LTTE loses the city of Jaffna to the Sri Lankan army |
| 1995-2001 | The war is in full force across the North and East of the country. A suicide bombing at the Central Bank in Colombo kills around 100 people. President Kumaratunga is injured in a separate suicide attack as well. |
| 2002 | A landmark ceasefire agreement is signed between the government and the LTTE, which is brokered by the Norwegians |
| 2004-2005 | The LTTE Eastern Commander, Colonel Karuna Amman, breaks away from the LTTE and takes 6000 rebels with him. Suspected LTTE assassins kill the Foreign Minister of the country. President Rajapaksa wins the closely fought Presidential election of 2005. |
| 2006 | Fighting intensifies again in April and July, which raised the fear of the start of “The Fourth Eelam War”. The peace talk rounds in Geneva fall apart. |
| 2007 | The Sri Lankan forces captures the Eastern province strongholds of the LTTE |
| 2008 | The government annuls the ceasefire agreement in early January and launches a massive offensive against the LTTE. |
| Jan 2, 2009 | The Sri Lankan troops seize the de-facto capital of the LTTE, Killinochchi (See fig. 1) |
| April 17, 2009 | The LTTE calls for a truce after a two-day government fighting pause expires. The government rejects this offer as a ruse. |
| April 20, 2009 | The government gives the LTTE 24 hours to surrender as tens of thousands of civilians flee the battle zone. |
| May 16, 2009 | The Sri Lankan military takes control of the entire coastline for the first time since the war began. President Rajapaksa declares the LTTE has been defeated militarily at a meeting of developing nations in Jordan. However, heavy fighting still continued on the ground. |
| May 17, 2009 | More than 70 LTTE terrorists disguised as civilians are killed while trying to flee on a boat. Many blow themselves apart in multiple suicide attacks as the military finish the final battles. Military declares all civilians freed, which exceeded over 50,000 in four days. The LTTE admits defeat |
| May 18, 2009 | The Sri Lankan Military claim the LTTE leader, V. Prabhakaran, was killed while trying to flee the conflict zone. |
| May 19, 2009 | The President addresses the Parliament and claims the country is liberated from the LTTE and the leader of the LTTE and its senior commanders are all dead. |

Table 2.1 – Timeline of the Sri Lankan Civil War

## 2.4 Economic Composition

The Sri Lankan economy has an estimated GDP of USD 64.9 billion and a GDP per capita of USD 3,139 in 2012 as calculated by the IMF (International Monetary fund, 2012). It is currently classed as a middle income country and has developed from its early agricultural economy in ancient times to the modern service based economy that is seen today.

Since colonial times, Sri Lanka's economy has been based on the plantations industry. The island became famous for its exports of cinnamon, rubber and Ceylon tea. After attaining independence, Socialism played a major part in basing economic policies from 1948 till 1977. The colonial plantations around the country were dismantled and the nationalisation of industries occurred. However, with the change in government and constitution in 1977, the country's economic policy was changed to a free market economy. The government policies encouraged private enterprises, deregulation and privatisation of state entities. This increased the importance of private entities within the economy (Jayatilaka, 2010).

The Colombo Stock Exchange was incorporated in 1985 and has grown to include nearly 250 listed firms in over 20 business sectors. The total market capitalisation is close USD 20 billion which equates to around 40% of Sri Lanka's GDP (Central Bank of Sri Lanka, 2011).

The modern Sri Lankan economy still encompasses the production and export of classic products like tea, rubber, coffee and other agricultural products. Nevertheless, there has been a move towards more modern sectors like food processing, textiles, telecommunication and finance. The main economic sectors include tourism, tea export, clothing, rice production and overseas employment (Jayatilaka, 2010).

**Key Economic Indicators**

| Indicator | 2006 | 2007 | 2008 | 2009 | 2010 (a) |
|---|---|---|---|---|---|
| **Population '000 (Mid-Year)** | **19886** | **20010** | **20217** | **20450** | **20653** |
| Annual Population Growth, % | 1.1 | 1.1 | 1.0 | 1.1 | 1.0 |
| Density of Population, Persons per Sq. km. (b) | 317 | 319 | 322 | 326 | 329 |
| Labour Force, % of Household Population Aged 10 and Above | 51.2 (b) | 49.8 (b) | 49.5 (c) | 48.7 (c) | 48.1 (c) |
| Unemployment, % of Labour Force | 6.5 (b) | 6.0 (b) | 5.4 (c) | 5.8 (c) | 4.9 (c) |
| **National Accounts** | | | | | |
| GNP (Market Prices), Rs. Bn. | 2898 | 3540 | 4306 | 4779 | 5530 |
| Per Capita GNP (Market Prices), Rs. | 145744 | 176893 | 212972 | 233716 | 267780 |
| USD | 1402 | 1599 | 1966 | 2033 | 2368 |
| GDP (Market Prices), Rs. Bn. | 2939 | 3579 | 4411 | 4835 | 5602 |
| Real GDP Growth Rate, % | 7.7 | 6.8 | 6.0 | 3.5 | 8.0 |
| **Investment and Savings, % of GDP** | | | | | |
| Investment | 28.0 | 28.0 | 27.6 | 24.4 | 27.8 |
| Government Investment | 4.1 | 5.4 | 6.5 | 6.6 | 6.2 |
| Domestic Savings | 17.0 | 17.6 | 13.9 | 17.9 | 18.7 |
| National Savings | 22.3 | 23.3 | 17.8 | 23.7 | 24.7 |
| **Price Changes, %** | | | | | |
| Colombo Consumers' Price Index (Annual Avg.) (2002=100) | 10.0 | 15.8 | 22.6 | 3.4 | 5.9 |
| Wholesale Price Index (Annual Avg.) | 11.7 | 24.4 | 24.9 | -4.2 | 11.2 |
| Implicit GNP Deflator | 11.3 | 14.0 | 16.3 | 5.7 | 7.3 |

*(a) Provisional*
*(b) Excluding Northern and Eastern provinces*
(c) *Excluding Northern province*

Table 2.2 – Key Indicators, Source: Central Bank of Sri Lanka (Central Bank of Sri Lanka, 2011)

Despite the global economy being weak in the late 2000s, the Sri Lankan economy had strong real GDP growth fuelled due to Chinese investment and numerous construction projects. Nevertheless, in 2009 as the war came to its climax, there was severe depression in growth in the economy due to massive war expenditure undertaken by the government. The 6-8% growth rate that was maintained since 2006 decreased to 3-4% in 2009 (see fig. 2.2). Moreover, private household spending decreased from a growth rate of 7.5% in 2008 to a mediocre 0.94% growth rate in 2009. After the conclusion of the war, the growth in the economy picked up to 8% in 2010 (see fig. 2.2). This growth can be attributed mainly to the expansion of the service and industrial sectors (see fig. 2.3). Furthermore, private household spending picked up to 10% in 2010 (The World Bank Group, 2012). As of 2010, the service sector makes up 60% of GDP, industrial sector is 28% and agriculture sector is 12% of GDP respectively (see fig. 2.3). Additionally, the private sector accounts for 85% of the economy (Ministry of Finance and Plannning Sri Lanka, 2010).

Since the conclusion of the war, the economy recorded an 8% GDP growth rate combined with an inflation rate of 5.9% and a GDP per capita of USD 2375 (see fig. 2.2). The country has had one of the lowest unemployment rates (7.6%) since the country's independence in 1948. Its workforce is mainly employed in Services (40%) followed by Agriculture (33%) and Industry (25%) (The World Bank Group, 2012). Furthermore, South Asia is emerging as a fast growing economic power-house from which Sri Lanka can benefit by using this opportunity to achieve a higher economic growth through wider economic co-operation. During the past decade, Sri Lanka has had to face a 30 year old civil war, the global financial crisis along with the 2004 Asian Tsunami disaster. Despite these hardships, the country's economy has fared quite well, with GDP and total market capitalisation increasing over time (Heenetigala, 2011).

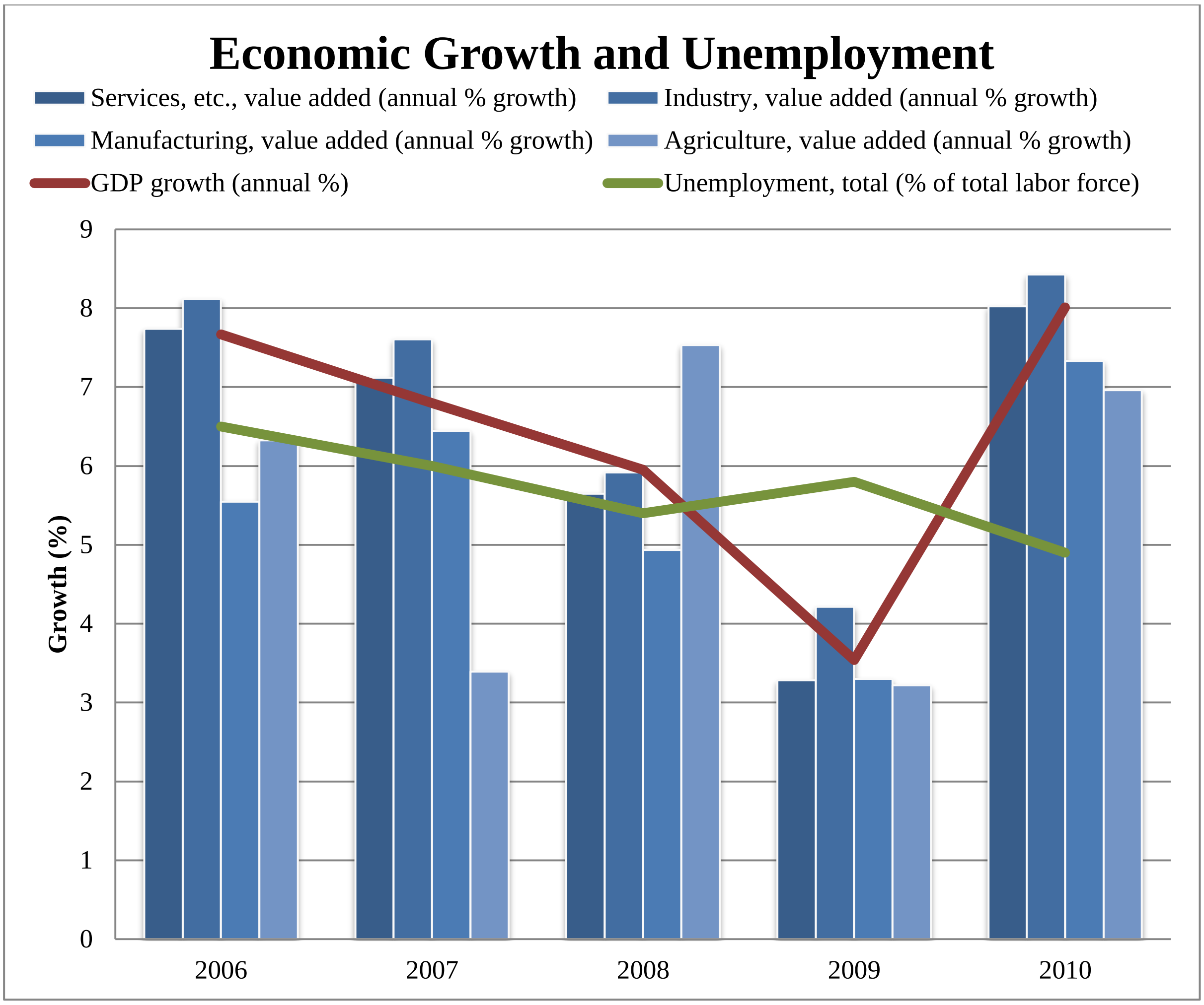
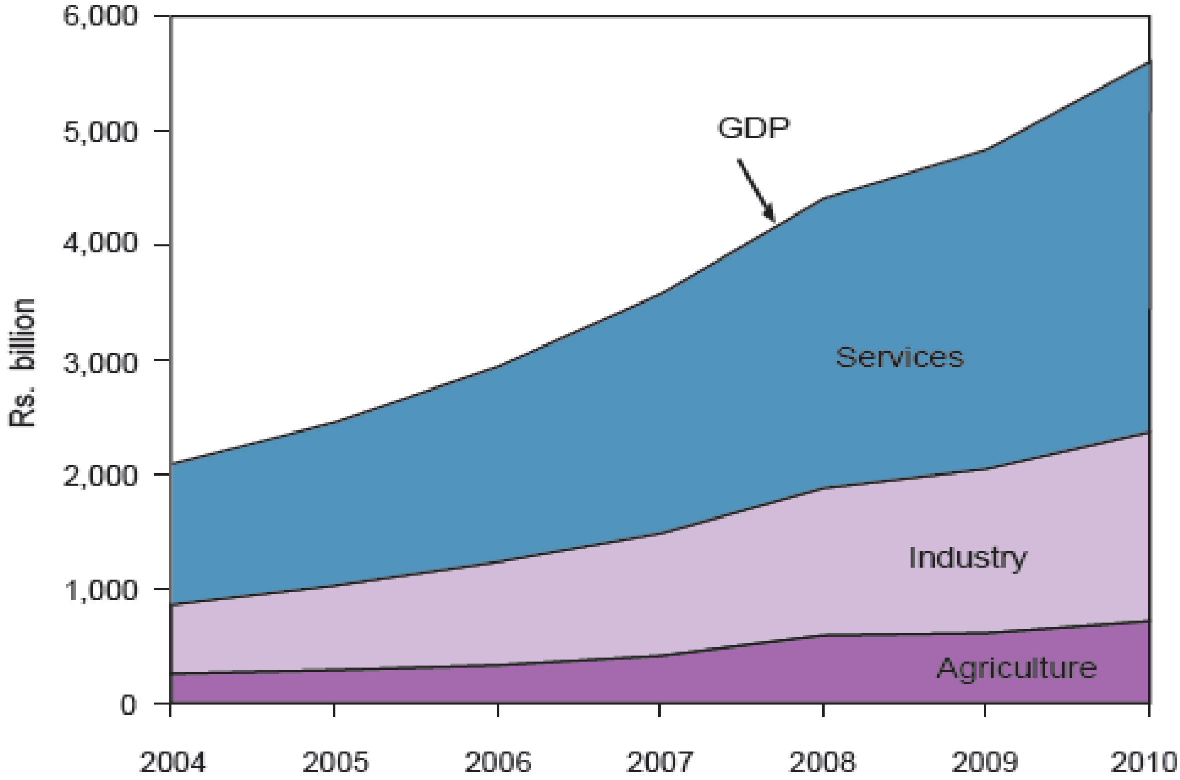



Fig. 2.2 – Growth and Unemployment, Source: World Bank Country profile – Sri Lanka

Sri Lanka's development was severely hampered by the civil war in the north and east of the country. Nevertheless, after the end of the civil war, Sri Lanka was one of the fastest growing economies in the world, and the Colombo Stock Exchange was one of the best performing in the world in 2010 (see fig. 2.4) with a phenomenal 96% increase (Balfour, 2010). This increase is mainly due to the ending of the war in 2009 and the resultant stable economic and political conditions prevalent within the country. Moreover, the increase is attributable to a successful donor campaign, tax amnesty, low interest rates, economic development and strong corporate earnings all of which indicated aggressive investment opportunities available within the securities market of Sri Lanka (Heenetigala, 2011).

GDP (at Current Prices)




**Sectoral Composition of GDP**
**(Rs. bn. at Current Factor Prices)**

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|
| Agriculture | 262 | 290 | 333 | 418 | 590 | 608 | 717 |
| Industry | 598 | 740 | 900 | 1,071 | 1,295 | 1,434 | 1,649 |
| Services | 1,230 | 1,422 | 1,705 | 2,090 | 2,525 | 2,783 | 3,236 |
| **GDP** | **2,091** | **2,453** | **2,939** | **3,579** | **4,410** | **4,825** | **5,602** |

Fig. 2.3 – GDP Composition, Source: Central Bank of Sri Lanka (Central Bank of Sri Lanka, 2011)

The Board of Investment in Sri Lanka has outlined the reasons for investing in the country in the current climate after the war to potential investors. The strong economic performance of the Sri Lankan economy over the past couple of years has helped raise the per capita GDP of the country to a middle income country for the first time in its history. This growth has been supported by several government policies that were implemented over that time period. The liberalisation of the economy that started in the 1970s has been carried on to this day with more conducive government policies for foreign investment within the country. This resulted in the investment laws in the country being more transparent to encourage more direct foreign investment in the economy. Furthermore, Sri Lanka has been named one of the most improved countries in the world for economic freedom according to the 2011 rankings. Moreover, having the most literate population in South Asia with a literacy rate of 91.4%, the country has a productive as well as developed workforce that is ready for further economic growth and expansion. Its strategic location within South Asia has allowed it to use major shipping lines to draw in sea traffic from all over the world. The proximity and relations with sub-continental economic giants like India and Pakistan has resulted in Sri Lanka being the only country to have Free Trade Agreements with both India and Pakistan. Both these Free Trade Agreements have grown in size since their inception, allowing massive growth opportunities to Sri Lanka (Board of Investment of Sri Lanka, 2012).

In order to keep up with the rising economic activity since the end of the war, the Sri Lankan government has been actively engaging in developing infrastructure projects around the country. These include the Colombo South port expansion, new Hambantota port development, expansion of the Bandaranaike international airport, new international airport at Mattala, development of a high mobility road network throughout the country and several power projects which include the Norochcholai coal power plant, upper

Kotmale hydro power plant, and the Trincomalee coal power project. With the conclusion of the war, the government is pushing for investments in several key sectors with the main sector being tourism and leisure. With a massive influx of tourists to the country there have been many national and international companies investing within this sector such as the Shangri-La Group, Sixth Sense Hotels, John Keells Hotels and Aitken Spence Hotels. Other important sectors for investment include infrastructure, knowledge services, utilities, apparels, export manufacturing, export services, agriculture and education. The government has been working in combination with the private sector to grow each of these investment sectors. (Board of Investment of Sri Lanka, 2012).

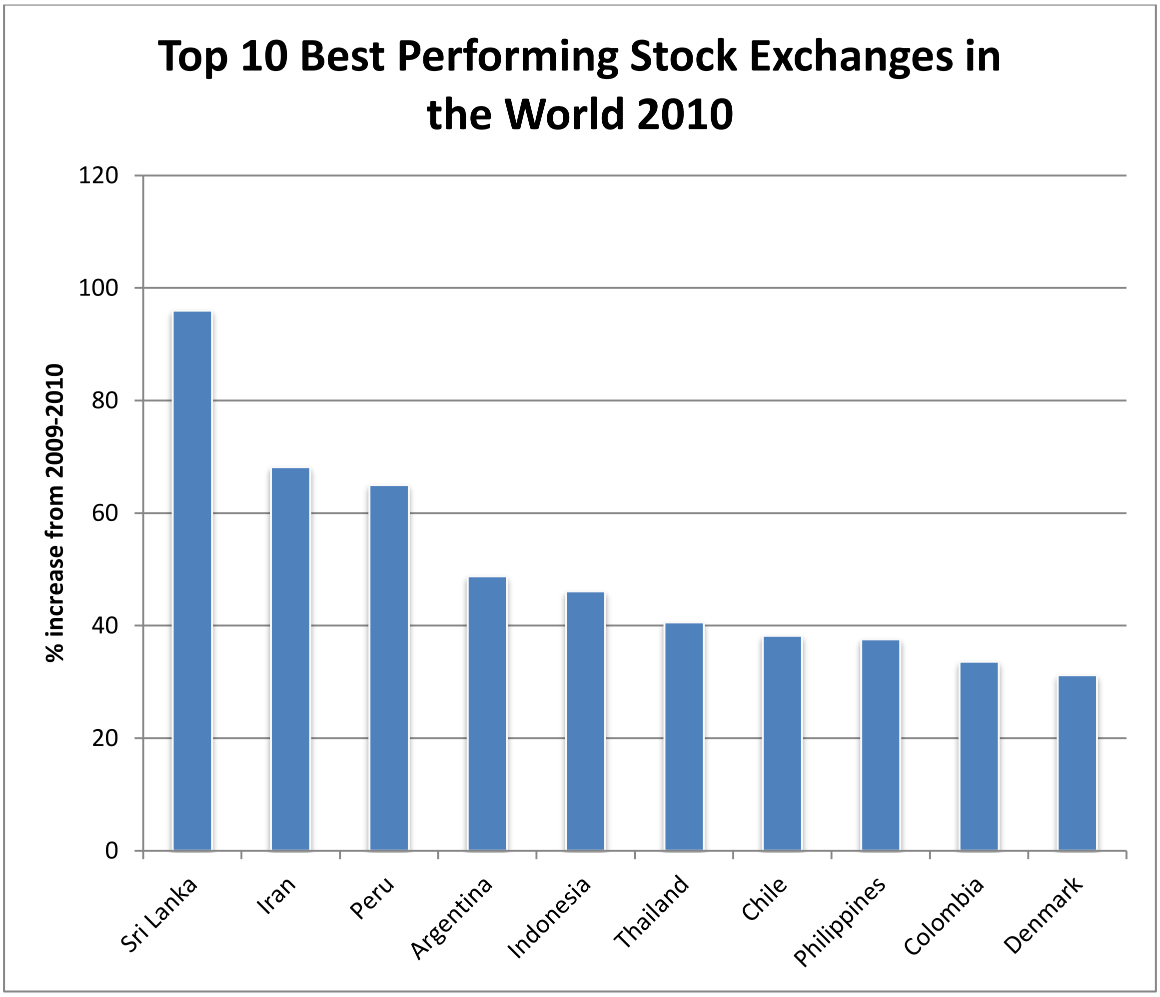



Fig. 2.4 – Top 10 Best Performing Stock Exchanges in the World 2010, Source: World Federation of Exchanges (PinoyMoneyTalk.com , 2011)

The World Economic Forum, which publishes the Global Competitiveness Report, has listed Sri Lanka as a transitive economy, from factor-driven stage to efficiency-driven stage. The report also ranked the country as 52nd in terms of global competitiveness (World Economic Forum, 2012). However, the country has been under fire for its human rights record, which has come under attack for allegations of torture, police violence, and child labour. This resulted in The European Union contemplating suspending the Generalised System of Preferences Plus (GSP+) trade concession for Sri Lanka, which would severely affect the textile manufacturing sector (Asia Monitor, 2009).

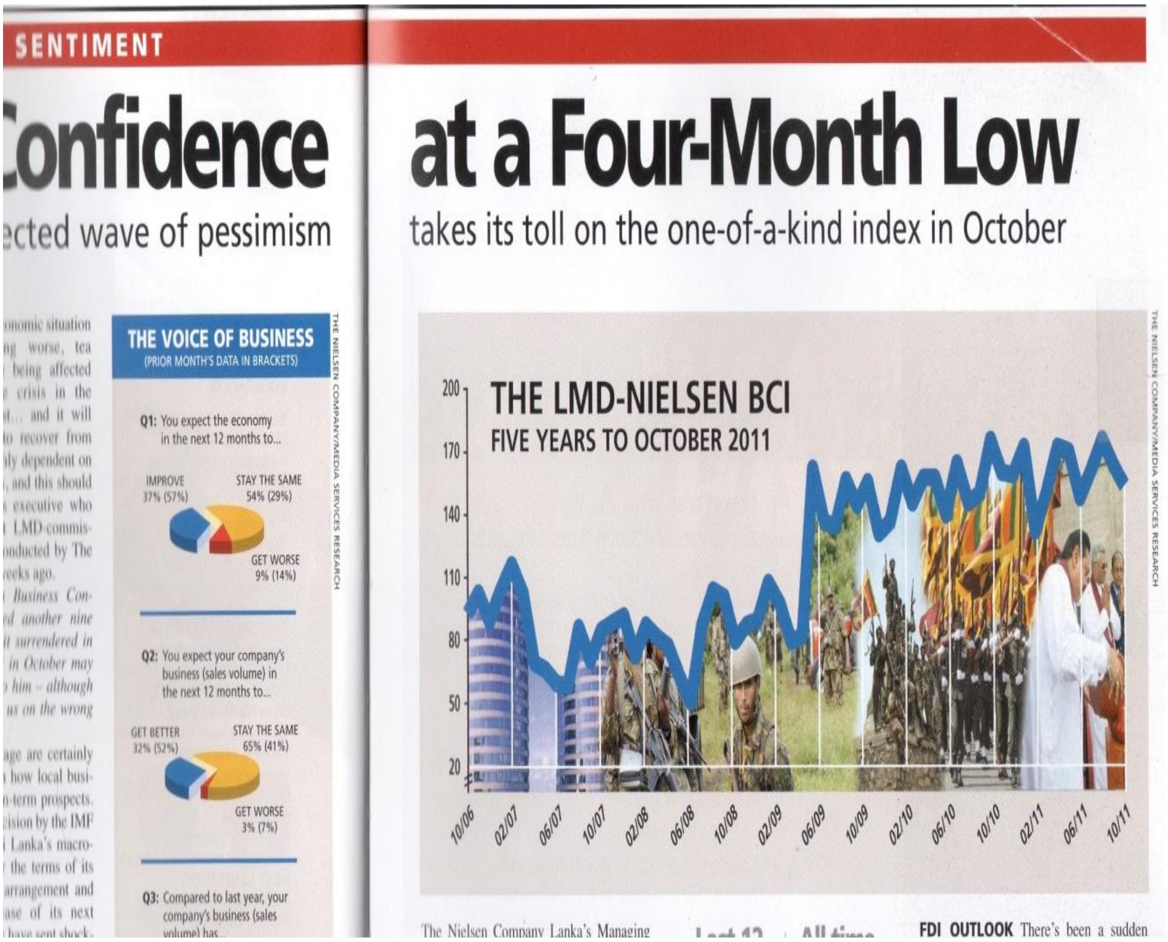



Fig. 2.5 – LMD Nov 2011 Issue, Source: (LMD, 2011)

Since the end of the war, the confidence in the market has been high and has kept steady ever since. The LMD-Nielsen Business Confidence Index (BCI) which is shown in the fig. 2.5 extract above has shown a dramatic improvement after the end of the war in early 2009 and has remained relatively steady since May 2009. The BCI is a survey of 100 senior executives in the city of Colombo and is compiled from a series of questions regarding business conditions and expectations. However, recent surveys have shown business confidence has decreased in the economy, with less than a third of surveyed businesses expecting sales volume to get better in the next 12 months. While most businesses would have experienced growth immediately after the war following the peace dividend, the expectation for continuous growth remains low (LMD, 2011).

# 3 Literature Review

Political connections and firm performance is not a new area of research. There have been articles that have looked into this area and most of them focus on USA, China and several of the other emerging Asian countries. I use this prior research as a basis for my thesis and apply it to a Sri Lankan setting. This section is set out as follows. Firstly, I will go over the main papers that I will be using in this thesis. This will be followed by other studies that expand and support the central themes found within the main papers.

## 3.1 Estimating the Value of Political Connections by R. Fisman (2001)

One of the most cited papers in the political connections and firm performance field of research is "Estimating the Value of Political Connections" by Fisman (2001). The paper focuses on the Indonesian market and researches the claim that in Southeast Asian countries, political connectedness is the primary determinant of profitability of firms, rather than productivity and other fundamentals of doing business. Subsequently, this has led to a distortion of investment decisions in the market. In countries like India, political decision making is decentralised and therefore simply defining political connectedness is an extremely complicated proposition. There would be numerous connections and these connections would have to somehow be aggregated. Furthermore, collecting related data would be difficult due to the taboo nature of the subject in most countries. Even if a political connection measure is defined, estimating the value of a political connection is unclear. Therefore a more centralised and stable political structure is needed to construct a credible index that shows the political connectedness. When estimating the value of connections to politically connected firms, these firms may not necessarily earn higher profits. This is due to the fact that even though well-connected firms may earn tremendous political rents, they may need to devote resources for rent seeking activities. This may involve non-optimal operations from the firm's point of view and therefore reduce the total value firms' derive from political connections (Fisman, 2001).

Fisman's paper concentrates on the valuation of rents for a relatively small subsample of Indonesian companies. However, the 25 groups associated with these firms accounted for a very large percentage of the economic activity in Indonesia, with revenues of more than USD 60 billion in 1995. Fisman considers five key events leading up to the deteriorating health of the former Indonesian President Suharto. The author uses an event study approach with a credible political connectedness index to test these events. In this particular case, a credible political connectedness index is able to be derived because Indonesia had a highly centralised and stable political structure leading up to President Suharto's health deterioration. The study runs a pooled regression using all the events and allows for an interaction between the political connectedness variable and the event severity variable. The paper looks at the reaction of the firms aligned with the government to these specific events (Fisman, 2001).

The accounting and share price data included total assets, total debt, taxes, net income and the international standard industrial classification code. The political index used by Fisman consisted of a numerical rating of the degree to which each of the largest 25 industrial groups in Indonesia is dependent on political connections for its profitability. The rating ranges from 1 to 5 where 5 being the most dependent. All the firms affiliated with the President's children and his long-time allies scored a 5. At the other end of the range; the President's main rivals scored a 1. There were no signs of any systematic differences in size or debt structure across firm types. With regards to most events used in the event study, there is a specific triggering event when the rumours first hit the Jakarta exchange. This is taken as the start of the episode. The end of the episode is taken to be when the event was explicitly put to rest by the revelation of new information or it is reported that analysts had factored new information about Suharto's health into their pricing of securities. In each of the episodes used in the event study, the investors are reacting to a different piece of news.  The results of this paper show that, for a very large part of the Indonesian economy, political connections play a significant role. Around 20-30% of the politically connected firms' value may derive from the political connections the firm had previously established with the government (Fisman, 2001).

However, there are some concerns for using the stock returns as a measure of firm performance and this is highlighted in Fisman (2001). Firstly, if a firm does not trade on a day, it will not register a price change even if the firm did suffer a change in its underlying firm value. Hence, for firms with zero trading volume, no "difference in difference" in returns between different types of firms will be recorded, even though there might be an effect on the underlying values of the securities. A further bias may occur due to the relative thin trading of connected and non-connected firms. Under the assumption that non-connected firms are more likely to have zero-trading volume, then what is being interpreted as the effect of the political connectedness may be simply because of a general market decline. In other words, a smaller decline in non-connected firms is due to the shares of those firms not being traded as frequently as politically connected firms (Fisman, 2001).

A further concern regarding the design of this paper is that politically connected firms may be more sensitive to bad news. Therefore, the observed "difference in differences" effect of connectedness may be due to this higher sensitivity. The paper looked at the returns of unrelated market shocks to President Suharto's regime and found no relationship between share price reaction and dependence (Fisman, 2001).

## 3.2 Cronyism and Capital Controls: Evidence from Malaysia by S. Johnson and T. Mitton (2001)

A similar approach to Fisman (2001) is undertaken by Johnson and Mitton (2001). This paper examines the Malaysian market and is another important paper in the political connections and firm performance research area. Their study looks at how the impact of the Asian financial crisis in 1997-1998, is felt differently among the Malaysian firms that support Prime Minister Mahathir and those that support the "axed" Deputy Prime Minister Anwar. As part of its motivation for the study, the paper explains two types of political favouritism. The first type is the official status awarded to firms that are run by ethnic Malays. Second type is more informal and is between leading politicians and firms that are run by both the Malays and the Chinese. The study explains the population demographic and the history of how ethnic favouritism occurred, due to various parliamentary Acts passed in Malaysia by successive governments (Johnson & Mitton, 2001).

The main process used to analyse the existence of a political connection is the method used by Gomez and Jono (1997). Johnson and Mitton (2001) look at firm's that have officers and/or shareholders with close relationships with key government officials being politically connected to the government. However, Johnson and Mitton (2001) did identify several weaknesses with the use of this definition. One concern is that it is not an exhaustive list. Another concern is that a political connection may have disappeared over the duration of the sample time period (Johnson & Mitton, 2001).

Firm performance is measured using the dividend inclusive monthly stock returns. Johnson and Mitton use stock prices to measure firm performance as done by Fisman (2001). Johnson and Mitton identify several advantages to using stock returns for measuring firm performance rather than looking at a firm's financial statements. The published financial statements appear only with a considerable lag and therefore many other events have taken place between the event date that was looked at and the statement release date. Furthermore, reported earnings do not always reflect the actual firm performance as it depends on the accounting practises used by the management of that firm. Johnson and Mitton expect politically connected firms to take advantage of any manipulation ability that's available to them. The study controls for factors that could affect expected returns by including leverage, size, book to market ratios and industry within the regression calculations (Johnson & Mitton, 2001).

The results show that the firing of the Deputy Prime Minister and the subsequent imposition of capital controls in September 1998 mainly benefit the firms that support the Prime Minister. These capital controls introduced during the Asian financial crisis provide a screen behind which favoured firms could be supported by the Prime Minister led government. They further differentiate the results by looking at firms whether they were foreign listed or not. Furthermore, they find that political connections are most affected by the leverage variable. The study finds that political connections amount to about 17% of total market value after the events of the Asian financial crisis. This falls within the range of 12-23% estimated by Fisman (2001) for Indonesian firms. The robustness tests carried out include truncating the data to the 1$^{st}$ and 99$^{th}$ percentiles, redoing the regression with just financial firms, and using log of net sales as an alternative measure of firm size (Johnson & Mitton, 2001).

## 3.3 Politically Connected Firms by M. Faccio (2003)

"Politically Connected Firms" by Mara Faccio (2003) uses publicly listed firms in 47 countries and looks at some of the common characteristics of countries with widespread political connections. Furthermore, the paper considers whether these connections add value to the firms of those countries. The potential benefits of being a politically connected firm includes preferential treatment by government owned enterprises such as banks and raw material producers, lighter taxation, preferential treatment when competing for government contracts, relaxed regulatory oversight and tighter regulations for competitors. This comes at a cost as the politicians themselves will extract part of the rent derived from the connection to the firm. This may be done by getting preferential employment opportunities for the politician's associates, providing financial support for the politician's party activities etc. (Faccio M. , 2003).

The paper defines a politically connected firm as a firm being connected with a politician, if at least one of its large shareholders (a shareholder who controls at least 10% of the firm shareholdings) or one of its top officers (CEO, President, Vice-President, Chairman, or Secretary) is a member of parliament, a Minister, or is closely related to a top politician or main party. Faccio went on to define "close relationships to top politicians" as when a top executive/ large shareholder of a firm is a friend of the Minister or MP, known to be associated with a political party, and/or a politician of another country. This paper doesn't include any data on political campaign contributions due to political connections as the author claims that the connections mentioned above would be more durable than connections made due to one-off campaign contributions (Faccio M. , 2003).

Faccio uses two political connection variables within her study. The first variable is the percentage of firms connected with a Minister or MP and the second variable is the percentage of firms connected with a Minister or MP, or a close relationship. The first variable relies only on objective connections while the second variable includes the less objective close relationship connections. A regression is done to understand where in the firm, the political connections occur. The value of political connections is examined using an event study around the announcements of officers or large shareholders entering politics and politicians joining boards. This contrasts to the political connections variable that is used in Fisman (2001) which uses an event study approach with a credible political connectedness index to test the events. Faccio (2003) uses the standard Brown and Warner (1985) event study methodology to calculate the market adjusted cumulative abnormal return (CARs) for the five day period around the announcement dates [-2 +2]. If the political connections add value, then the announcement should be associated with positive CARs. However, the lack of data has forced the exclusion of many important connections in Faccio's 2003 study. Furthermore, Faccio must be able to confirm if a particular politician was an officer before the election or appointment to office, as well as whether someone later appointed an officer was already a politician at that time. Finally, stock prices must be available during that time as well (Faccio M. , 2003).

The results show there is a stock price reaction only if the political appointment is a surprise. If the appointment is an easy call to predict within the market, then there will be no reaction. Therefore, the paper uses key phrases such as "surprise, unexpect, and unpredict" when searching the Factiva database for identifying the political appointments (Faccio M. , 2003). The results find that political connections are wide spread within the sample and they are found in 35 out of the 47 countries included in this study. Furthermore, they are more common in countries perceived to be more corrupt (Faccio M. , 2003).

Conducting the event study around the announcement dates when executives announce they will enter politics, Faccio finds firm value will most likely increase near the event date. The paper crosschecks the names of MPs with the executives of the listed firms and finds that connected firms represented only 2.68% or 561 firms of the entire sample. When looking at the largest 50 firms in a country, 6.92% of them have political connections. Hence, larger firms show a greater tendency to have these connections. However, Faccio does note some limitations in her study. The number of connections identified within the sample is far from complete. This may be due to the lack of data and the sensitivity of the subject in some countries. Furthermore, the disclosure regulations can vary from country to country. These limitations are partly addressed by using the following methods. Firstly, Faccio only investigates large shareholders, who would force some level of public disclosure of information in almost every country. Next, the focus of the study is on direct political connections that are observable for all countries. Non-observable connections such as campaign contributions are not considered (Faccio M. , 2003).

## 3.4 Corporate Governance Practices and Firm Performance of Listed Companies in Sri Lanka by K. Heenetigala (2011)

The purpose of Heenetigala's 2011 paper is to look at the relationship between corporate governance practices and firm performance in Sri Lanka. It looks at the adoption of the code of best practice on corporate governance in 2003 and the extent of changes to corporate governance four years after until 2007. Corporate governance is considered to have significant implications for growth prospects of an economy. Furthermore, good governance is needed to reduce risk for investors, attract more capital and improve firm performance. Heenetigala (2011) uses separate leadership, board composition, board committees and corporate social responsibility reporting as corporate governance variables. Firm performance is measured through Return on Equity, Return on Assets, and Tobin's Q. It uses a sample of 37 firms using The Lanka Monthly Digest 50 and analyses these firms using descriptive statistics, Spearman's correlation and Analysis of Variance (Heenetigala, 2011).

The three firm performance measures are considered proxies for accounting returns and market returns. Return on Equity shows the profit generated from the money invested by the shareholders. Return on Assets is used to assess the efficiency of assets employed by the firm. It is an indicator of the short term performance of a firm. Finally, Tobin's Q compares the market value of a firm with the replacement value of the company's assets. The accounting based approach has been criticised as the accounting measures used in its calculations can be easily manipulated by the management of the firm. This may be done through changes to accounting methods or accruals. Furthermore, accounting based methods are historical and are more backward looking. However, market based approaches are based on the value of common stock of a firm and are affected by factors beyond the control of the firm management. These measures are considered forward looking and reflect the current position of a firm (Heenetigala, 2011).

The results show a positive relationship between the corporate governance measures and the return on equity measure. Board composition and board committees have a significant positive relationship with the Tobin's Q performance measure in 2007. The corporate social responsibility reporting practices by firms does not report any significant relationship in 2007. The scope of the study is limited to the top 50 listed firms in the LMD 50 (Heenetigala, 2011).

## 3.5 Political Connections and Minority-Shareholder Protection: Evidence from Securities-Market Regulation in China by H. Berkman, R.A. Cole and L.J. Fu (2011)

Berkman, Cole and Fu (2010) carry out an event study over three regulatory changes intended to improve corporate governance in China by reducing expropriation from minority shareholders by controlling block-holders. The standard event study methodology is used to analyse the link between investor protection and firm value. The potential endogeneity issue inherent in the use of cross-sectional regressions that relate shareholder protection to firm value is reduced with the use of this method. Moreover, the event study methodology doesn't require controls for firm heterogeneity as it analyses the change in value for the same sample of firms before and after each event. Nevertheless, a drawback of this method is that market participants may anticipate the event whereby the results would only partially reflect the estimate of value changes resulting from political connections (Berkman, Cole, & Fu, 2010).

The results indicate a positive 10% market reaction around the introduction of the 1st regulation and further positive reactions are noted with the 2nd and 3rd regulations. The study finds positive abnormal returns with weak governance firms, which are proxied based on the value of related party transactions and other less direct measures. Therefore the three market regulations can be effective in protecting minority shareholders from expropriation in countries with weak judicial enforcement. Furthermore, the study finds that in such countries, like China, investors are unconvinced of the enforcement of regulations against politically connected controlling block-holders. Therefore the effectiveness of regulations is higher for private controlling block-holders and lower for politically connected block-holders. (Berkman, Cole, & Fu, 2010).

## 3.6 Further Studies on Political Connections and Firm Performance

### 3.6.1 Theoretical Background on Political Connectedness

The connections between corporate American firms and politicians have always been scrutinised by the public. Incidents such as the ties between the Bush administration and Enron; and Vice President Dick Cheney's role at Halliburton have brought this matter to the forefront of the American public's attention. The resource dependency theory rationalises why firms create linkages and connections with governments and politicians. Firms are dependent on external entities for their daily activities. This dependency creates risk and uncertainty which then affects the firm performance. However, firms that create relevant and important connections with external entities can reduce this uncertainty by using these connections as a safeguard against the environmental fluctuations. The reduction in uncertainty due to these connections result in lower transaction costs for external exchanges and hence improves the firm performance. Even in modern free trade markets with trends of lower trade barriers and deregulation, the impact of government policy, regulation and enforcement are major external forces which firms have to deal with. Therefore, firms try to absorb politicians with influence over government processes into their board of directors in order to create favourable political connections. The resource dependency theory proposes the need for environmental linkages is a function of the level and type of dependence facing the firm. Therefore, the firm's board of directors should have connections to areas specifically relevant to that firm. Hillman (2005) compares the boards of firms from heavily and less regulated industries. He finds the heavily regulated group has more politician directors compared to the less regulated group. Firms with politicians on the board are associated with better market-based performance across both groups, although the relationship is more pronounced within the heavily regulated industries (Hillman A. , 2005).

Political connections and uncertainty in government policy implementation affects private firms in a similar way to publicly listed firms. In China, private firms engage in a political strategy called the "Red Hat" strategy whereby private firms affiliate themselves with the Communist Party. This strategy is followed to avoid problems with securing property rights and avoiding heavy government regulation. Using a unique firm level data series from China, Du and Girma (2010) analyses the role of political connections in the post-entry performance of private start-up firms. Using a survey, the study finds that Communist Party membership of private entrepreneurs is important for firm profitability. This is especially true in areas with weaker market institutions. However, non-connected start-up firms have enjoyed better productivity improvements; conditional on survival. Furthermore, the benefits of political connections to firms are mainly due to connections at the local or top level governments and are more pronounced in capital intensive industries (Du & Girma, 2010).

In order to identify whether firms actually benefit from political connections, Nee and Opper (2010) looks at which institutional domains political connections might be significantly useful for firm performance. This helps to identify which specific features of the institutional environment contribute to the overall value of political connections. The institutional domains examined in their study range from competitive markets to state regulated and political markets. Moreover, in economic markets, the best advantage from political connections can be drawn within a government-dominated market. However, there is no significant positive return for political connections in competitive product markets. The authors compare the value of political connections in China's market economy. The results indicate the value of political connections is related with institutional domains in which firms can use those political connections to gain advantages. This is more evident in domains where government restrictions and regulations on economic activity are high and the firms compete for rent within the market. Furthermore, the value of political connections in China does not appear to differ fundamentally from other established market economies around the world (Nee & Opper, 2010).

### 3.6.2 Impact of Government Ownership of Firms

In competitive markets with few externalities, government ownership is viewed in a negative sense. The government may choose policies based on social or political outcomes as opposed to profit maximising strategies. Therefore, it may employ staff based on political connections rather than the skills required for the role. Hence, government ownership is viewed as a less efficient option to private ownership. However, there have been studies which have found government ownership may not necessarily be less efficient. It might mean obtaining political backing from the government and other business connections, which can be valuable and in certain situations necessary to be competitive in the market and thereby increase firm performance. Sun, Tong and Tong (2002) looks at the privatisation process of Chinese state owned enterprises (SOEs) and whether this process affected the performance of the SOEs. China has issued shares to the public for these SOEs; however the majority ownership of the entity remains with the government. The results of their study find the government ownership and firm performance are positively related. No matter whether ownership is in the form of government ownership or legal individual ownership, government ownership has a positive effect on partially privatised SOEs. This relationship is non-linear with an inverted U-shape. When a small portion of shares are issued to the public, the firm performance improves. However, after a certain level, the performance of the firm starts to decrease. Hence, too much state ownership can result in a detrimental effect on firm performance. Furthermore, their study indicates that increased firm performance does not necessarily mean increased firm efficiency. This is due to the monopoly power most SOEs have in their respective industry sectors (Sun, Tong, & Tong, 2002).

Government policies have a massive bearing on government-business relationships. However, the control of government resources is most likely done by the government official's mandate. While existing studies usually focus either on the benefit of political connections or on the costs of government influence, a political embeddedness perspective helps us consider both advantages and constraints associated with ties to the government. Okhmatovskiy (2010) looks at the different types of state ownership of public firms. These can be ownership by ministries, state investment funds and state enterprises. These forms of ownership differ in terms of the level of involvement by government officials. Direct government connection firms incur significant costs due to the presence of government officials in the corporate governance process. However, firms with connections to SOEs are indirectly connected to the government. Hence, these firms get access to state-owned resources while avoiding the costs associated with government interventions. State ownership is a particularly important topic in countries with transition economies, where the state influence control over the national economy through corporate governance of firms in strategic industry sectors. Nevertheless, this is not limited to transition economies as seen by the government bailouts of firms in developed economies. Results show that SOEs being linked to firms have a higher profitability, while direct connections to the government have no significant differences to firms (Okhmatovskiy, 2010).

### 3.6.3 Other Political Connection Variables

There are several studies that use different types of political connection variables. Claessens, Feijen and Laeven (2008) looks at how firms that contributed to the winning federal deputies for the 1998 and 2002 elections in Brazil, achieved a higher stock return than the firms which did not support the winners. They use several novel indicators of political connections based on campaign contribution data. The results of the paper indicate that contributions helped shape the policy on a firm specific basis. Furthermore, the paper indicates access to bank finance is an important channel through which political connections influence firms in the market (Claessens, Feijen, & Laeven, 2008).

Goldman, Rocholl and Jongil (2009) use an original hand collected dataset on the political connections the board members of S&P500 firms might have. Their study uses this dataset to sort firms into those connected to the Republican Party and those that are connected to the Democratic Party. The results indicate that there is a positive abnormal stock return following the announcement of the nomination of a politically connected individual to the firm's board. Furthermore, their study analyses the stock price response to the Republican Party's win in the 2000 presidential elections. The results show that the Republican Party firms increased in value, while mainly large firms connected to the Democratic Party decreased in value after the election. Their study is based in the United States and therefore based on a more developed economy which has a well-functioning legal system. Hence, firms are not expected to derive a massive amount of benefits from political connections. This is because any politicians seen to help public firms with a personal motive as opposed to public merit would face severe legal and political costs. Nevertheless, there are instances where firms did benefit from certain political connections. In 2004, an AP newswire reported the Army awarded Vice President Dick Cheney's former firm a contract to rebuild Iraq's oil industry. The contract was worth around USD 1.2 billion over a two year period (Goldman, Rocholl, & Jongil, 2009). Further examples include where an estimated USD 178 million was steered to non-profit groups in his district by West Virginia congressman Alan Mollohan. Similarly, negotiations by former commerce secretary Ron Brown helped McDonnell Douglas Corporation sell 33 airlines worth USD 2 billion to Saudi national airlines (Faccio & Parsley, 2009).

The politically connected variable used by Goldmand et al (2009), is well defined to suit the United States background. The variable is defined to include any board member who has held the following positions in the past: President, Presidential (Vice-Presidential) candidate, senator, member of the House of Representatives, (assistant) secretary, deputy secretary, deputy assistant secretary, undersecretary, associate director, governor, director (CIA, FEMA), deputy director (CIA, OMB), commissioner (IRS, NRC, SSA, CRC, FDA, SEC), representative to the United Nations, Ambassador, mayor, staff (White House, President, Presidential campaign), chairman of the Party Caucus, chairman or staff of the Presidential election campaign, and chairman or member of the President's committee/council (Goldman, Rocholl, & Jongil, 2009).

In one of Faccio's later studies, Faccio and Parsley (2009) try to overcome the anticipation of the event and the contamination of other events in the event window, which affected several earlier studies including Faccio (2006) where the events are not completely unanticipated; and Fisman (2001) where the events relating to President Suharto's health differ in degree or didn't materialise. Hence, Faccio and Parsley (2009) use a different approach which assumes politicians systematically favoured local firms. This may be due to various reasons like need for re-election, concerns for local jobs, and links between friends etc. The key advantage of this approach is that it allows for testing influences on the value of political connections that are not specific to a particular country, politician, or firm. Therefore, it allows the inclusion of several factors that are likely to proxy for different degrees of connectedness. This allows for a cross-sectional analysis of firm, politician and country characteristics which result in a higher value of connections, which is neglected in literature up till this study. Moreover, Faccio and Parsley (2009) looks at sudden deaths of politicians as it gives a clearer result due to there being a lower chance of preannouncement news leakages. Thereby, with the assumption that the market knows the benefits of the connection, the value lost would be reflected in the share price of the firm. The authors find that a connection to an influential politician is worth about 10% of firm value in countries like Pakistan and Zimbabwe, while in USA it is about 4.19%. The findings are more pronounced for family firms, firms with high growth prospects, firms in industries over which the connected politician has jurisdiction, and firms headquartered in highly corrupt countries (Faccio & Parsley, 2009).

### 3.6.4 Performance of Politically Connected Firms

The paper by Faccio, Masulis & McConnell (2006) looks at the likelihood of a government bailout of 450 politically connected firms from 35 countries during the 1997-2002 time period. As expected, politically connected firms are significantly more likely to be bailed out when compared to non-connected firms. This is illustrated when, if the IMF provided financial assistance to the home country government; the politically connected firms are disproportionately more likely to be bailed out in case of failure. Among the bailed out firms, the politically connected firms exhibited significantly worse financial performance than the non-connected firms at the time of the bailout and following the bail out as well. These results indicate that, at least in some countries, political connections influence the allocation of capital, through the mechanism of financial assistance when connected firms confront harsh economic conditions. However, the direction of the results is in contrast to other studies which indicate a positive relationship between firm performance and political connections. The firms did benefit from the political connection by getting bailed out when they were struggling, however, the firm performance did not improve following the bailout by the government. This may be due to the unique nature of firms that require bailouts. They may be underperforming firms that may not improve their performance even if bailed out by the government (Faccio, Masulis, & McConnell, 2006). Their study shows that one channel through which politicians affect firm value, is through corporate bailouts. Applying this to Fisman (2001), the decline in value of the firms connected to President Suharto may be due to the decline in probability of a bailout by the government after the death of the President.

The German parliament introduced a new transparency law in 2007 which published information regarding additional income sources for all parliamentary members. The study by Niessen and Ruenzi (2010) looks at firms with direct connections to politicians as well as parliamentary members engaged in non-parliamentary job activities. It makes a comparison between connected firms and non-connected firms for differences in terms of firm characteristics and performance. The reasons for connected firms being better performers are highlighted as follows. Firstly, the politicians may be involved in non-parliamentary roles and due to reputational reasons they may only choose the best performing firms. Secondly, politicians are usually outsiders to the corporate world and can provide an independent view on the firm. Lastly, the political connection may provide easier access to debt finance, lower taxation, government contracts, and reduced regulatory requirements. Their study finds that members of the conservative party (CDU/CSU) and liberal party (FDP) are more likely to work for firms than members of left-wing parties (SPD and The Left) or the green party (Alliance 90/The Greens). In terms of firm characteristics of connected firms, they are larger than non-connected firms in terms of sales, market capitalisation, and total assets. Furthermore, the Tobin's Q value is lower for connected firms indicating lower growth opportunities when compared to non-connected firms. Further, the PE ratio is smaller for connected firms which indicate politicians usually work for well-established, large firms with few growth opportunities. With regards to the stock market performance, politically connected firms significantly outperformed non-connected firms in 2006, i.e. before the publication of the data on political connections. However, the differences in the stock market performance were much smaller in the following year (Niessen & Ruenzi, 2010).

Gul (2006) focuses on Malaysia and the effect its political environment has on the behaviour and responses of auditors. The auditors are considered an important participant of the market as they are directly connected with the credibility of the financial reports of firms. Their study looks at auditor response in terms of auditor effort and auditor fees of politically connected firms when compared to non-connected firms, during the 1997 Asian financial crisis and the implementation of capital controls which followed, which is similar to Johnson and Mitton (2001). The results show a higher audit risk for connected firms during the financial crisis as there is a greater likelihood of business operation failure and a greater likelihood of misreporting and overstatement of earnings by the firm management in order to avoid defaulting on debt covenants etc. However, with the introduction of capital controls there is less likelihood of firm failure and less incentive for misreporting and overstatement of earnings. Therefore, there is less audit risk involved and thereby lower audit effort and audit fees are required (Gul, 2006).

Chen, Din and Kim (2010) looks at the association between a firm's high level of political connections and earnings forecasts made by financial analysts. After controlling for other determinants of forecast accuracy, their study finds that financial analysts experience greater difficulty in predicting the earnings of firms with political connections, when compared to non-connected firms. However, in countries where corruption level is high, earnings forecast accuracy is influenced more by a firm's political connections. The corruption level increases the impact of the political connection on the analyst forecast by allowing politicians to transfer benefits to the connected firms. Therefore it is important to look at the corruption level of a country and the political connectedness simultaneously in order to understand the relationship between analyst forecasts and firm political connections. The results of their paper indicate political connections increase the information asymmetry between investors and managers and anti-corruption measures can minimise the adverse effect of political connections on the corporate information environment (Chen, Ding, & Kim, 2010).

### 3.6.5 Firm Expropriation by Politicians

As explained by Fisman (2001), the collection of economic resources from firms can take various forms and can be transparent as the collection of taxes or fees from reported income. However, it can take harsher forms like nationalisation of firms as well. Therefore, it is natural for concerned firms to take steps to protect themselves from these expropriation attempts. Therefore firms structure their asset holdings in a difficult and costly manner to make it difficult for politicians and governments to expropriate away from the firm. This sort of firm behaviour is most common in countries where corruption is high and hence firm assets are more susceptible to expropriation. When the threat of expropriation is high in a country, firms will hold most of their assets in less liquid form. The study by Capri, Faccio and McConnell (2008) use data from 109 countries and finds that firm holdings of cash and marketable securities were negatively correlated with political corruption measures. Furthermore, investment in property, plant, inventory and equipment plus dividends is positively correlated with corruption measures. Thus the firms have made a conscious decision to use their funds in ways to shelter them at least partially from any sort of political expropriation. The extent to which this asset configuration reduces efficiency than otherwise if political expropriation was absent, firm sheltering of assets may represent a channel through which corruption reduces economic growth (Caprio, Faccio, & McConnell, 2008).

# 4. Methodology

In this section, I will describe the event study methodology used in this thesis. Firstly, I explain the five events which are used in the event study including when they occurred and their expected effect to the Sri Lankan government. Next, I define the political connection variables followed by the firm performance variables. Finally, I define the event study methodology including the regression used to calculate the CARs for politically connected and non-connected firms during the event study.

## 4.1 Events for Event Study

### 4.1.1 The Ending of the Peace Process – 20th April 2006

Since the conclusion of the 2005 Presidential elections, the political arena in Sri Lanka has remained tense. The election of Mr Rajapaksa as President has resulted in increased violence in the North and East of Sri Lanka even though the country has not reverted to open war again. Furthermore, with the removal of the debt relief which was granted due to the tsunami disaster of 2004, the current account deficit is expected to widen to 3.8% of GDP. The 2006-2007 period performance is to be heavily dependent on the security situation in the country. The President has continued pursuing peace talks with the LTTE even though there had been numerous provocations by the LTTE including a suicide bombing which injured the Army Chief of Staff, General Sarath Fonseka (Country Monitor, 2006). During February 2006, the Sri Lankan market fell slightly on the expectation the disagreement between the government and the LTTE regarding the date of the peace talk round might herald an unravelling of the peace process (Reuters News, 2006). The Geneva peace talks round which took place in 2006 had investors being cautious yet optimistic about the future, with the Colombo Stock Exchange reaching a three month high by March 2006. There have been agreements from both the government and the LTTE to hold further talks in April. This allowed an opportunity to pursue a political solution to end the war (Emerging Markets Monitor, 2006).

Peace-talk negotiations went back and forth for some period with the LTTE pulling out of several peace-talk rounds. After these numerous delays, the LTTE officially pulled out of the Peace talks indefinitely on April 20th 2006 after citing the reason being disapproving the mode of transport to the peace-talks location which they had previously agreed with the government (BBC Sinhala, 2006). Furthermore, in May 2006, the European Union banned the LTTE as a terrorist organisation. The LTTE had warned earlier that the ban would result in increased violence and the resumption of full scale war (Ahamed, 2006). This resulted in even more violence in the Eastern region of the country where the government is pushing the rebels to the North of the country (Reuters, 2006). International efforts to bring lasting peace appeared to have failed with the peace talks not going beyond the second round (Asia Monitor, 2006). Analysts predicted at the time that there is no clear winner in sight and feared the war could grind on for years (Sirilal, Sri Lanka ends ceasefire with Tamil Tigers, 2008).

There are huge financial risks if the government goes to full scale war, with a USD 4.3 billion in financial aid promised by Japan if peace talks would resume. This is on top of the tourism industry which would undoubtedly suffer if full scale war is to resume. Even if open warfare is not resumed, the outlook is expected to be increased violence during the year, with attacks in the North and East as well as the financial hub of the country, Colombo. Moreover, the S&P rating agency downgraded the country from a stable to negative outlook given the increase in violence might lead to war again. Nevertheless, the growth rate for the economy is expected to be around 6% in 2006 (Asia Monitor, 2006).

### 4.1.2 The Capture of the LTTE De-Facto Capital City (Killinochchi) – 2nd January 2009

The Sri Lankan Army managed to capture the de-facto capital city of the LTTE state in the North and East of Sri Lanka. This capture signified a major victory for the Sri Lankan Army and signalled to the public the end is near for the 30 year civil war. This is the first time the Sri Lankan Army entered the city in over a decade. The LTTE used this city as their capital city and had its own tax system, printed its own money and operated in essence as an independent state within Sri Lanka. Therefore, the fall of this city strengthened public opinion that the recent victories by the Army in the East and now in the North of the country might finally end the decades long civil war. Analysts of the war believe this victory will give the Sri Lankan Army momentum and make it harder for the LTTE to tap into their resources around the North of the country. However, they also believe this is not the end of the LTTE as there are still thousands of fighters willing to fight for its cause (Nessman, 2009).

### 4.1.3 Declaration of Victory Over the Civil War – 16th May 2009

On Saturday May 16th 2009, the President declared victory in the war against LTTE and the military claimed the majority of the fighting to be over and only mopping up operations remained. The LTTE conceded defeat in the 25 year old civil war the next day. The formal announcement in parliament by the President is made on Tuesday the 19th of May 2009. The fate of the LTTE leader, V. Prabhakaran remained uncertain as the military did not confirm the identity of the body which is claimed to be of the terrorist leader. The military captured the entire rebel held territory (15,000 Sq Kms) in just three years. The final war effort is marred by accusations of human rights violations from both sides, however, immense pressure from the United Nations to return to peace talks and other western nations threatening to deny an IMF loan of USD 1.9 billion did not stop the

Sri Lankan government finally ending the war. The USD 40 billion Sri Lankan economy which was struggling as the war neared its end is expected to gain a post-war boost and renewed economic growth, which for years have been amongst the highest in South Asia (Bryson Hull & Sirilal, 2009).

#### 4.1.4 General Fonseka Steps Down as CDS in Order to Challenge the President in the 2010 Presidential Elections – 12th November 2009

Sri Lanka's only four star General, General Sarath Fonseka, who led the Sri Lankan Army during the final phases of the war against the LTTE left his position as Chief of Defence Staff on the 12th of November 2009. The position was granted by President Rajapaksa after the war victory and involved a more administrative oversight role of the Army. General Fonseka felt he was being side-lined after the conclusion of the war as he clashed with the President and his brother Gotabhaya Rajapaksa (Defence Secretary) over who should take credit for the war victory (Jayasinghe, 2009). General Fonseka decided to leave his Chief of Defence Staff role given to him in June 2009, in order to pursue a political campaign against President Rajapaksa by uniting all the opposition parties under a new party called the United National Front (UNF). The newly formed party intends to back General Fonseka as the common candidate to challenge President Rajapaksa in the 2010 Presidential elections (Plus News Pakistan, 2009).

#### 4.1.5 General Fonseka is Arrested After the Loss at the 2010 Presidential Elections – 8th February 2010

After the conclusion of the 2010 Presidential elections on 26th of January 2010, the losing candidate, General Sarath Fonseka is arrested on charges of conspiracy by the Sri Lankan government. A military court will try General Fonseka on several charges including conspiracy, attempt to overthrow the government and plotting to assassinate President Rajapaksa. The General accused the government of taking revenge on him for challenging the President at the elections (Colombo Times, 2010). There are heavy criticisms from human rights groups including Amnesty International about the arrest of the opposition candidate. They accused the government of cracking down on political opposition to the government (Agence France Presse, 2010).

## 4.2 Political Connection Variables

The categorisation of firms into politically connected firms or non-connected firms is a critical part of this thesis. There have been many definitions used in prior literature with regards to political connectedness. I will be using a modified definition from prior literature applied to a Sri Lankan setting as well as several alternate political connectedness measures as part of robustness tests in this thesis.

One of the more widely quoted definitions of political connectedness is the definition used by Faccio (2003). I use a modified version of this definition in this thesis. A firm is politically connected to the government in three ways. Firstly, if at least one of its major shareholders (a shareholding of more than 10%) is a government controlled public institution (EPF, ETF, Bank of Ceylon, Sri Lanka Insurance Corporation etc.), a member of parliament (MP), a Minister or a Ministerial Secretary. Secondly, one of its top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary. Finally, a firm is considered politically connected if it is closely related to the government. I define "close relationships to the government" as when a top executive/ large shareholder of a firm is an Ambassador of the country. This last criterion is seen as more ambiguous as it includes less definite political connections. Therefore it is categorised separately from the above two types of political connections. The definitions mentioned above exclude campaign contribution data to identify political connections as per Faccio (2003), one off contributions are viewed as a less durable measure than the ones mentioned above (Faccio M. , Politically Connected Firms, 2003). The political connection types under this definition are categorised with three variables based on where political connection occurs within a firm.

The connections are classified for each event used in the event study as to whether the connection was present when the event occurred. This recognises the fact that political connections may not stay the same or in fact last through all of the events in the same manner. They may appear or disappear during a given time period. Furthermore, the share prices must be available for all event dates for the firm to be included in the above classification (Faccio M. , Politically Connected Firms, 2003).

As a robustness test, I test the political connectedness of firms using further measures. These include the number of projects politically connected firms receive from the government and political appointments made to firms by the government in the post war period. These benefits/appointments may include preferential treatment from government owned enterprises such as banks, insurance providers and raw material producers, lighter taxation, preferential treatment when competing for government contracts, relaxed regulatory oversight and tighter regulation for competitors.

These measures can be contrasted to situations where politicians extract rents from the firm while offering benefits to a firm. This will be much harder to observe as these sorts of rent extractions would not be normally available in the public domain (Faccio M. , Politically Connected Firms, 2003). Therefore, the concentration of this thesis will be on the benefits derived by politically connected firms. The variables focus on preferential treatment in the post-war time period as this was a significant economic expansion period for Sri Lanka with the government spending heavily on public infrastructure and other key areas of the economy. This provides greater opportunity for firms to use political connections to gain financial advantage over their competitors. The political connections are identified using newspaper articles as these articles provide public domain information on which to base political connections of firms. When searching for these articles regarding projects associated with firms in the post-war period on the Factiva database, key words such as "government, politic, minist, connect, and link" are used.

## 4.3 Firm Performance Variables

The political connection variables defined above are used to categorise the firms in to samples. The performance of firms in these samples are analysed using the variables defined in this section. The methodology in Heenetigala (2011) is used as a platform to build the firm performance variables for this thesis. Firm performance is measured using Return on Equity, Return on Assets and share prices of the firms. Moreover, as a robustness test, Tobin's Q is used an indicator of firm value as well.

Return on Equity is an accounting measure which assesses the rate of return on shareholder's equity. It shows the profit generated from the money invested by the shareholders. It is calculated as the net income divided by common equity. Return on Assets is also an accounting measure which is used to assess the efficiency of assets employed by the management of firms. It is an indicator of short term performance of firms. It is used best when comparing firms in the same industry. It is calculated as net income divided by total assets. Tobin's Q is a measure of market performance which shows the financial strength of firms. It is calculated as the market value of a firm divided by the replacement value of the firm's assets. A high Q value of greater than 1 indicates a firm's stock is more expensive than the replacement cost of its assets. In the same manner, a low Q value between zero and one indicates the cost to replace a firm's assets is greater than the value of its stock.

The share prices of the sample of listed firms will be looked at around the event dates to identify cumulative abnormal returns (CARs) around the event window. This variable is described in more detail in the event study methodology section below.

The accounting based measures have been criticised as it can be easily manipulated by the management of the firm. This can be done through changes to accounting methods or accruals used by the firm. Furthermore, accounting based methods are historical and backward looking. However, market based approaches are based on the value of common stock of firms and are affected by factors beyond the control of the management of a firm. Hence, these measures are considered forward looking and reflect the current position of a firm.

## 4.4 Event Study Methodology

I use a Portfolio Time-Series Approach for the event study methodology in this thesis based on Sefcik and Thompson (1986). This method analyses whether politically connected firms are affected differently when compared to non-connected firms. It is similar to the approach used by Berkman, Cole and Fu (2010), which looks at three regulatory changes intended to improve corporate governance in China (Berkman, Cole, & Fu, 2010).

There are several assumptions when using the standard event study methodology. Firstly, the market is efficient when processing information about the event and it is done in an efficient and unbiased manner. Secondly, the event information is unanticipated and any abnormal returns noted are the result of market reactions. This assumption is needed as otherwise market participants may anticipate the event and the results will only partially reflect the change in value of the variables. Finally, there are no confounding effects from other events happening simultaneously. The method brings everything to event time and assumes there are no abnormal returns after the event day as the market adjusts efficiently.

The event study methodology helps reduce any potential endogeneity issues that may arise due to the use of cross-sectional comparisons which examine one point in time for share price reactions to important events mentioned above in relation to political connections. I will be using an identical sample of firms before and after the event date, which allows the event study methodology to control for firm heterogeneity by analysing the change in firm value of the same sample of firms before and after the event (Berkman, Cole, & Fu, 2010).

The events selected for this event study, as detailed earlier, are significant events that took place near the end of the civil war. Starting from the cessation of the peace talks in 2006 till the arrest of General Fonseka after the 2010 Presidential elections, these events have the potential to differentially impact politically connected firms and non-connected firms. The event date is selected to be the date when the news is first distributed to the public which is selected as day 0 in the event window (Fisman, 2001). The event window will comprise of 1 day before the event until 1 day after the event (-1,+1). As a robustness test, I will look at event windows with 5 days (-2,+2) and 7 days (-3,+3).

The definition of the political connection variables, detailed in the previous section, will be used to categorise the firms into samples and the firm daily returns will be used to analyse the performance of firms. The political connections of the sample firms are categorised into four portfolios. I will define these portfolios as $POLCONT_s$, where

S=1 comprises of firms connected with a government controlled public institution, Minister, Ministerial Secretary or MP through its shareholdings; S=2 is made up of the sample firms connected with a government controlled public institution, Minister, Ministerial Secretary or MP through one of its top officials; S=3 is made up of sample firms which are connected to the government through close relationships; and S=4 is made up of sample firms without political connections to the government. Each of these portfolios are ranked according to its level of political connectedness with S=1 being the strongest political connection while S=4 is weakest with firms having no political connection to the government. These samples will be used to constructed for each year in the event period (2006-2011) taking into account when the political connection started during the event period.

I form a hedge portfolio going long in high POLCONT firms and short in low POLCONT firms. The high POLCONT firms are defined as $POLCONT_s$, where S=1,2 and 3. The low POLCONT firms are defined as $POLCONT_s$, where S=4. The first hedge (H1) will long firms in S=1 and short firms in S=4. This hedge is expected to show the strongest difference between politically connected firms and non-connected firms as it uses the strongest and the weakest forms of political connectedness in the sample.

As further robustness tests, I will form three more hedges as follows. The second hedge (H2) will long S=1 and 2 and short S=4. The third hedge (H3) will be long S=3 and short S=4. The final hedge (H4) will long S=1, 2 and 3 and short S=4. Each of these four portfolios is equally weighted using the sample firms included within each portfolio. The return on the hedge portfolio is used as the dependent variable in the event study regression as shown below.

The market return is modelled by the All Share Price Index (ASPI) of the Colombo Stock Exchange. This index is used as it is a good measure of the overall market return of listed firms in Sri Lanka. The market return around each of the event dates is used to analyse the CARs from the event study.

$$R(HIGH - POLCONT_t) - R(LOW - POLCONT_t)$$
$$= \beta_0 + \sum \beta_J \, EVENT_J + \beta_6 MARKET\_RETURN_t + \varepsilon_t$$

Where $R(HIGH - POLCONT_t)$ is the return for day *t* on an equally-weighted portfolio of the strongest politically connected firms based upon POLCONT; $R(LOW - POLCONT_t)$ is the return for day *t* on an equal- weighted portfolio of the weakest politically connected firms based upon POLCONT; $\beta_0$ is the mean portfolio return during the sample period; $\beta_J$, for *J* = 1 to 5, give the estimated differences in the CARs of the high-POLCONT and low-POLCONT hedge portfolios during each event window *J*; $EVENT_J$ for *J* = 1 to 5, are dummy variables that equal $1/n_J$ for the dates within the event window of length $n_J$ days for the *J*th event, and 0 otherwise, where $n_j$=event windows lengths of 3, 5 and 7 days respectively; $MARKET\_RETURN_t$ is the ASPI market return index during each event window J and $\varepsilon_t$ is an independently and identically distributed (i.d.d.) random error term for day *t*.

The event window will be 1 (2, 3) day(s) before the event until 1 (2, 3) day(s) after the event depending on the 3 (5 or 7) day window length. The event day will be when the event information is released to the market first as the market reaction will be greatest around this date.

$\beta_0$, which is the mean portfolio return during the sample period, acts as a robustness test for the portfolio valuation method. $\beta_0$ picks up all the differences between the two groups that are not related to the event and the general market movement. This allows the method to effectively use every non-event date as a robustness test for the method as it will look at the effect on politically connected and non-connected firms during non-event dates.

The firm performance measures including ROE, ROA and Tobin's Q are analysed as part of the descriptive statistics in the results and robustness tests sections. These measures show the accounting and market performance for each event date for politically connected firms and non-connected firms and supplement the daily return results as part of the event study.

## 5 Hypotheses

I expect an increase in CARs for firms in the politically connected hedge portfolio when compared to firms in the non-connected hedge portfolio for events that favour the government. In the same manner, I would expect a decrease in CARs for firms in the politically connected hedge portfolio in comparison to firms in the non-connected hedge portfolio for events that are unfavourable for the government. I hypothesise that the events 2, 3 and 5 will be favourable to the government as it shows the government in good stead to the public (capture of the LTTE HQ signalling the war was coming to an end soon; the declaration of victory over the LTTE after nearly 25 years; the arrest of the main opposition candidate who challenged the President during the election). In the same manner, I hypothesise events 1 and 4 will be unfavourable to the government as it shows a negative outlook for the government (End the of the peace process signalling the resumption of the war; A common opposition candidate uniting all other parties to challenge the President at the 2010 elections).

Furthermore, I expect the events to have a larger CARs effect for firms with stronger political connections when compared to firms with weaker political connections. Hence, I hypothesise that during positive events; the portfolio hedge will have higher positive CARs for stronger politically connected firms and lower positive CARs for weaker politically connected firms. The same notion would apply for negative events and politically connected firms. This hypothesis assumes that market participants can identify and discount firms with varying levels of political connectedness within the market.

# 6 Data

The data used in this thesis include information on accounting values, stock prices and political connections. The political connections data is obtained from the annual reports of firms and news article searches from the Factiva database. The Colombo Stock Exchange website is used to obtain the annual reports for each of the selected sample firms. Any missing annual reports are obtained from the firm's individual website. The annual reports include directors profile descriptions which detail any political connections a director may hold currently or may have held in the past. Furthermore, a list of current MPs and Ministers is compiled from several Sri Lankan government websites. All of these sources are used in conjunction to identify political connections.

The accounting data and stock prices for listed firms are obtained from the Datastream database. From the initial sample of 103 firms, there are 20 firms which did not have firm data available on the Datastream database. The firm data for these firms are supplemented from the annual reports available from the Colombo Stock Exchange website. The stock price used in the calculation of daily return of the sample firms is the official closing price for each day in its local currency (Sri Lankan Rupee). These share prices are adjusted by DataStream for any subsequent capital actions for each firm. The common equity for each firm is taken to be common shareholders' investment in a firm. Net income is defined as net income after preferred dividends that the firm uses to calculate its basic earnings per share. Total Assets is taken as the sum of current assets, long term receivables, investments in unconsolidated subsidiaries, other investments, net property, plant and equipment and other assets. Finally, market capitalisation is defined as market price at year end multiplied by common shares outstanding.

Our initial sample includes 103 listed firms from Sri Lanka. I excluded four firms due to share prices being unavailable during the event period. The above deletions leave a final sample of 99 listed firms.

# 7 Results

## 7.1 Descriptive Statistics

Panel A of Table 7.1 presents the descriptive statistics of the political connections of the sample firms for the period of 2006-2011. The sample looks at the number of political connections at the start of the event period (2006), the end of the period (2011) and any year which has an event that is included as part of the event study (2009,2010). A total of 103 firms are used in the sample and each firm is categorised as politically connected or non-connected according to the political connection variables described earlier in the method section. For each year included in the sample period, the firms are classified into four separate categories including politically connected to the government using "shareholders" (S1), "top officials" (S2), "close relationships" (S3) and "non-connected" (S4) firms. On average, there are 63 politically connected firms and 40 non–connected firms over the sample period. The number of politically connected firms in the sample has gone up over the sample period with the highest number being recorded in 2011. Furthermore, the most common type of political connection for firms is the close relationships connection by having a top official / large shareholder of a firm being an Ambassador of the country.

Table 7.1 panel B provides descriptive statistics for the daily return during the sample period from 2006-2011 for each political connection sample type. The mean daily return for each political connection type is 0.1%, with the exception of top official sample having a higher mean daily return (0.2%) than the rest of the sample. The minimum and maximum daily returns for each sample indicates the highest returns of 12.5% and 12.3% belong to the top official and close relationship samples. The shareholder sample has a lower maximum than the non-connected sample. The lowest minimum also belongs to the shareholder sample of -6.8% which is slightly lower than the non-connected sample of -6.2%.

The firm characteristics for the four connection samples, S1-S4 and (S1+S2+S3)-S4 equally weighted hedge portfolios and the entire sample of 103 firms in 2011 are shown below in table 7.1 panel C. The year 2011 is used to analyse the firm characteristics as the most data available for the firms in the sample was during this year. The mean common shareholder equity (Rs. 4,329 million), net income (Rs. 855 million) and total asset balance (Rs. 11,587 million) is highest for the top official sample. In comparison, the lowest balances for the above three measures is for the shareholder sample which is below the non-connected sample. It is surprising that given the shareholder sample is the strongest political connection sample, it has a negative net income mean balance as the expectation based on previous literature is politically connected firms are more profitable than non-connected firms (Faccio, 2003; Fisman, 2001; Johnson & Mitton, 2001). Nevertheless, the median equity, net income and total asset levels for the shareholder sample is higher than the non-connected sample. This indicates a narrower and condensed equity, net income and total asset balances for the firms in the shareholder sample.

The mean common shareholder equity level is negative for the S1-S4 sample connection portfolio (-Rs 15 million). This indicates the non-connected sample firms on average have a larger equity base than the shareholder sample. Nonetheless, when looking at the (S1+S2+S3)-S4 hedge portfolio, the equity level is positive (Rs. 341 million). This indicates the politically connected firms as a whole on average have a larger equity base than the non-connected firms. Furthermore, the median net income and total asset balances are positive for the S1-S4 as well as the (S1+S2+S3)-S4 hedge portfolios.

The highest mean market capitalisation is Rs. 5,764 million from the top official sample with the lowest being Rs. 493 million for the non-connected sample. The shareholder sample has a higher market capitalisation (Rs. 617 million) than the non-connected sample indicating the market value of the shareholder group is more than the non-connected firms.

The highest mean ROA (9.23%) and ROE (19.76%) is for the top official sample. Likewise, the lowest ROA (6.16%) and ROE (11.57%) is for the shareholder sample. However, the non-connected sample group has a ROA of 8.37% which is higher than the shareholder and close relationship samples and the total sample mean ROA. Nevertheless, the median ROA balances show the non-connected sample (6.04%) is less than top official and close relationship samples and the total sample medians. In addition to this, the ROE of 14.77% for the non-connected sample is lower than top official and close relationship sample groups and the total sample mean ROE.

The descriptive statistics indicate the politically connected firms are generally larger in size and have a higher market value when compared to the non-connected firms. The ROA and ROE are higher for politically connected firms in comparison to non-connected firms. However, the descriptive statistics for firms in the shareholder sample group are in exception to this. Firms which are politically connected through their shareholdings are, on average smaller than the non-connected firms and have a lower net income as well.

**Table 7.1 – Descriptive Statistics**

*Panel A – Sample Connection Portfolio Summary*

| Connection Type | 2006 | 2009 | 2010 | 2011 | Average |
|---|---|---|---|---|---|
| Shareholder connection | 19 | 21 | 22 | 24 | 22 |
| Top Official Connection | 8 | 11 | 15 | 14 | 12 |
| Close relationship connection | 28 | 31 | 28 | 30 | 29 |
| Non-politically connected | 48 | 40 | 38 | 35 | 40 |
| Total Sample | 103 | 103 | 103 | 103 | 103 |

Definitions

| | |
|---|---|
| Average | = Average number of connections over sample event period |
| Shareholder Connection | = At least one of the firm's major shareholders (shareholding of more than 10%) is a government controlled public institution, a member of parliament (MP), a Minister or a Ministerial secretary |
| Top Official Connection | = If one of the firm's top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary |
| Close Relationship Connection | = If the firm has close relationships to the government by having a top executive/ large shareholder of a firm appointed as an Ambassador of the country. |
| Non-Politically Connected | = If a firm has no identifiable political connection to the government |

*Panel B – Sample Connection Portfolio Descriptive Statistics*

| Sample Portfolio | Share Holder (S1) | Top Official (S2) | Close Relationship (S3) | Non-Connected (S4) |
|---|---|---|---|---|
| Mean | 0.001 | 0.002 | 0.001 | 0.001 |
| Median | 0 | 0 | 0 | 0 |
| Mode | 0 | 0 | 0 | 0 |
| Std. Deviation | 0.013 | 0.016 | 0.012 | 0.013 |
| Min | -0.068 | -0.058 | -0.055 | -0.062 |
| Max | 0.087 | 0.125 | 0.123 | 0.093 |
| Count | 1565 | 1565 | 1565 | 1565 |

Definitions

| | |
|---|---|
| Average | = Average number of connections over sample event period |
| Shareholder Connection | = At least one of the firm's major shareholders (shareholding of more than 10%) is a government controlled public institution, a member of parliament (MP), a Minister or a Ministerial secretary |
| Top Official Connection | = If one of the firm's top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary |
| Close Relationship Connection | = If the firm has close relationships to the government by having a top executive/ large shareholder of a firm appointed as an Ambassador of the country. |
| Non-Politically Connected | = If a firm has no identifiable political connection to the government |

*Panel C – Sample Connection Portfolio Company Characteristics*

| Sample Portfolio | Shareholder (S1) (Count = 23) | | Top Official (S2) (Count = 14) | | Close relationship (S3) (Count = 29) | | Non-Connected (S4) (Count = 33) | |
|---|---|---|---|---|---|---|---|---|
| | **Mean** | **Median** | **Mean** | **Median** | **Mean** | **Median** | **Mean** | **Median** |
| Common Shareholder Equity | 186,529,518 | 7,465,332 | 4,329,040,297 | 3,407,104 | 1,357,937,096 | 7,717,180 | 770,108,426 | 3,333,228 |
| Net Income | -10,763,215 | 1,804,004 | 854,699,782 | 396,881 | 229,585,960 | 1,105,271 | 97,920,021 | 460,638 |
| Total Assets | 438,816,458 | 17,984,388 | 11,587,425,489 | 6,577,136 | 3,250,855,729 | 19,724,712 | 1,627,134,338 | 5,483,368 |
| Market Capitalisation | 617,783,511 | 12,740,779 | 5,764,040,870 | 5,346,611 | 1,600,043,252 | 16,000,000 | 493,886,800 | 6,758,399 |
| Return on Assets | 6.16% | 4.94% | 9.23% | 8.70% | 7.83% | 7.00% | 8.37% | 6.04% |
| Return on equity | 11.57% | 15.83% | 19.76% | 14.11% | 15.26% | 14.17% | 14.77% | 13.03% |

The initial sample of 103 firms excludes 4 firms due to no share price information being available on Datastream to leave a final sample of 99 firms in 2011.

Definitions

| | |
|---|---|
| Common Shareholder Equity | = Common shareholders' investment in a company |
| Net Income | = Net income after preferred dividends that the company uses to calculate its basic earnings per share |
| Total Assets | = Sum of current assets, long term receivables, investments in unconsolidated subsidiaries, other investments, net property, plant and equipment and other assets |
| Market Capitalisation | = Market price at year end multiplied by common shares outstanding |
| Return on Assets | = Net income divided by total assets |
| Return on Equity | = Net income divided by common equity |
| Shareholder Connection | = At least one of the firm's major shareholders (shareholding of more than 10%) is government controlled public institution, a member of parliament (MP), a Minister or a Ministerial secretary |
| Top Official Connection | = If one of the firm's top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary |
| Close Relationship Connection | = If the firm has close relationships to the government by having a top executive/ large shareholder of a firm appointed as an Ambassador of the country. |
| Non-Politically Connected | = If a firm has no identifiable political connection to the government |

*Panel C – Sample Connection Portfolio Company Characteristics (Continued)*

| Sample Portfolio | Total Sample (Count = 99) | | S1-S4 (Equally Weighted) | | (S1+S2+S3)-S4 (Equally Weighted) | |
|---|---|---|---|---|---|---|
| | **Mean** | **Median** | **Mean** | **Median** | **Mean** | **Median** |
| Common Shareholder Equity | 1,310,005,020 | 5,242,687 | -15,226,640 | 223,573 | 340,815,941 | 733,047 |
| Net Income | 218,258,551 | 858,414 | - 3,435,239 | 64,476 | 65,531,502 | 130,938 |
| Total Assets | 3,235,222,068 | 11,954,444 | -30,228,125 | 615,767 | 909,543,598 | 1,765,725 |
| Market Capitalisation | 1,591,970,825 | 8,646,900 | 11,893,886 | 349,147 | 478,784,996 | 1,282,772 |
| Return on Assets | 7.82% | 6.81% | 0.01% | 0.03% | 0.94% | 0.89% |
| Return on equity | 14.87% | 14.52% | 0.06% | 0.29% | 1.99% | 1.79% |

The initial sample of 103 firms excludes 4 firms due to no share price information being available on Datastream to leave a final sample of 99 firms in 2011.

<u>Definitions</u>

| | |
|---|---|
| Common Shareholder Equity | = Common shareholders' investment in a company |
| Net Income | = Net income after preferred dividends that the company uses to calculate its basic earnings per share |
| Total Assets | = Sum of current assets, long term receivables, investments in unconsolidated subsidiaries, other investments, net property, plant and equipment and other assets |
| Market Capitalisation | = Market price at year end multiplied by common shares outstanding |
| Return on Assets | = Net income divided by total assets |
| Return on Equity | = Net income divided by common equity |
| Shareholder Connection | = At least one of the firm's major shareholders (shareholding of more than 10%) is government controlled public institution, a member of parliament (MP), a Minister or a Ministerial secretary |
| Top Official Connection | = If one of the firm's top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary |
| Close Relationship Connection | = If the firm has close relationships to the government by having a top executive/ large shareholder of a firm appointed as an Ambassador of the country. |
| Non-Politically Connected | = If a firm has no identifiable political connection to the government |

Table 7.2 panel A presents the descriptive statistics for the daily returns for the hedge portfolios used in the event study regressions. In a portfolio time series regression, the difference between the daily returns for the two hedged positions is expected to be zero. The descriptive statistic indicates the four hedges have a 0.00% or +/-0.01% difference between the daily returns over the whole sample period. This is consistent with the prior literature on political connections (Faccio, 2003; Fisman, 2001; Johnson & Mitton, 2001). Table 7.2 demonstrates the politically connected firms have a slightly higher daily return when compared to non-connected firms with the exception of the S1-S4 hedge portfolio which has a slightly negative mean return of -0.005%. The total sample of 103 firms has a daily return of 0.12% and the overall market has a daily return of 0.08%. This difference between the total sample and the overall market is due to the equally weighted nature of the sample versus the value weighted nature of the overall market. The greatest variance between the hedged positions is between the S3-S4 hedge portfolio with a standard deviation of 1.003%. This is further supported by the hedge portfolio having the largest minimum (-6.5%) and maximum (8.77%) daily returns. The highest return in the entire sample of 180% is from the Guardian Capital Partners PLC on 11/01/2011 and lowest return of -90% is from John Keells Hotels PLC on 28/07/2006. The total sample standard deviation of 1.101% per day is in line with the overall market standard deviation of 1.038% during the same time period. In addition, all four hedges have a lower volatility than the overall market and the total sample used in this study.

Panel B of table 7.2 details the Pearson correlation matrix for the hedge portfolio variables used as part of the event study regression. The matrix indicates all the political connection hedge portfolios are positively correlated with the market variable and with each other with one exception. The S3-S4 hedge portfolio is negatively correlated with the market variable. The positive association between the hedge portfolio return and the market return establishes an increase in the hedge portfolio return will correlate with an increase in the market return. Furthermore, the weak relationships with the market variable (Rm) as shown by the near zero values for the Rm variable indicates the hedge portfolios used within the event study is effective as it takes out any market variances from the portfolio hedges.

**Table 7.2 – Descriptive Statistics (Daily Returns)**
*Panel A – Hedge Portfolio Descriptive Statistics*

| | **Total** | **S1-S4** | **(S1+S2)-S4** | **S3-S4** | **(S1+S2+S3)-S4** | **Rm** |
|---|---|---|---|---|---|---|
| Mean | 0.124% | -0.005% | 0.011% | 0.004% | 0.004% | 0.079% |
| Median | 0.000% | 0.000% | 0.000% | 0.000% | 0.000% | 0.000% |
| Std. Deviation | 1.101% | 0.935% | 0.884% | 1.003% | 0.807% | 1.038% |
| Min | -90.000% | -5.663% | -6.045% | -6.504% | -6.250% | -4.979% |
| Max | 180.036% | 5.859% | 5.156% | 8.770% | 4.997% | 7.572% |
| Count | 103 | 1565 | 1565 | 1565 | 1565 | 1565 |

Definitions
TOTAL = Share returns for total sample of 103 firms for entire sample period of 1565 days
S1-S4 = Share return for Hedge portfolio which is long S1 and short S4.
(S1+S2)-S4 = Share return for Hedge portfolio which is long S1,S2 and short S4.
S3-S4 = Share return for Hedge portfolio which is long S3 and short S4.
(S1+S2+S3)-S4 = Share return for Hedge portfolio which is long S1,S2,S3 and short S4.
Rm = Share return of the market for the sample period of 1565 days

*Panel B – Hedge Portfolio Pearson's Correlation Matrix*

| Hedge Portfolios | S1-S4 | (S1+S2)-S4 | S3-S4 | (S1+S2+S3)-S4 | Rm |
|---|---|---|---|---|---|
| S1-S4 | 1.000 | | | | |
| (S1+S2)-S4 | 0.857 | 1.000 | | | |
| S3-S4 | 0.384 | 0.472 | 1.000 | | |
| (S1+S2+S3)-S4 | 0.710 | 0.843 | 0.870 | 1.000 | |
| Rm | 0.067 | 0.075 | -0.054 | 0.010 | 1.000 |

Definitions
S1-S4 = Share return for Hedge portfolio which is long S1 and short S4.
(S1+S2)-S4 = Share return for Hedge portfolio which is long S1,S2 and short S4.
S3-S4 = Share return for Hedge portfolio which is long S3 and short S4.
(S1+S2+S3)-S4 = Share return for Hedge portfolio which is long S1,S2,S3 and short S4.
Rm = Share return of the market for the sample period of 1565 days

## 7.2 Political Connection Portfolio Hedges and Cross-Sectional Differences in CARs

### 7.2.1 Graphical Analysis of Cumulative Abnormal Returns

As part of the event study regression analysis, the CARs for each of the four hedge portfolios are calculated for the duration of the event period from 2006 till 2011. A further CARs graph is calculated for the overall market. The CARs for each hedge portfolio and the overall market are portrayed in graphs to identify if there are significant movements in the CARs for each event day used in the study. Each graph has the five event dates marked on them to identify any CAR movements around the event dates.

The first CAR graph shows the S1-S4 hedge portfolio during the sample period. In terms of the five event dates, there seems to be a significant movement around events 2 and 4. Events 2 (Capture Killinochchi) and 3 (Victory over war) are expected to be positive events for the government. Therefore, the CARs for the firms in the shareholder sample should be larger than the non-connected sample. This in turn would lead to an increase in CARs during those events. However, event 2 seems to have downward moving CARs and event 3 does not have a clear direction of CARs around the event date. Additionally, event 4 (Resign as CDS) seem to be contrary to the expected negative direction for the event as the CARs appear to be move upwards indicating positive CARs around the event date. With events 1 (End of peace process) and 5 (Fonseka arrested), there seems to be less clear indications of the movement of the CARs. Therefore, a more in-depth regression analysis is required to determine the significance of these events.

Further to these event days, there seems to be significant movements during January 2007, March 2011 and August 2011. Given this graph outline the CARs for the political hedge of S1-S4, these may be other political events which occurred during the event time period. A search was done on the Factiva database for newspaper articles detailing events around the above time periods to identify significant political events. However, no clear events could be found around these dates from the search of the Factiva newspaper articles database.

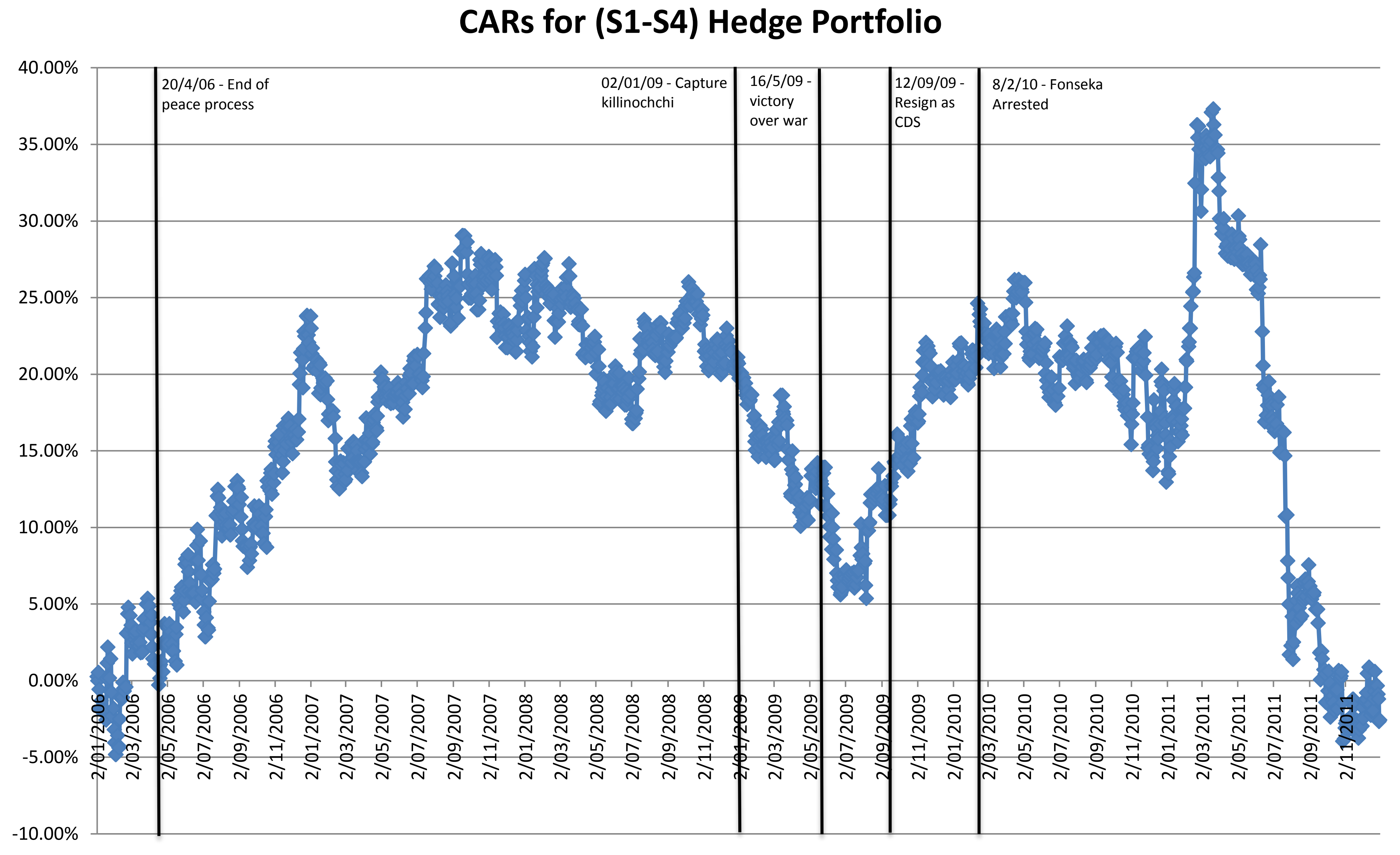
The second CAR graph which corresponds to the (S1+S2)-S4 hedge portfolio, follows a similar pattern to table 7.3. However, there seems to be fewer fluctuations during the event period, especially in 2009. The events in this graph appear to be less significant as there is a lack of movement around event dates when compared to table 7.3 with event 5 having the largest movement around the event date. Furthermore, the lack of movement around the event dates for event 1, 3 and 4 makes the direction of CARs less clear. However, event 2 has a negative direction for CARs as noted earlier in table 7.3 while event 5 has an expected positive direction for the CARs during the event date.

The third CAR graph which relates to the S3-S4 hedge portfolio behaves slightly differently to the rest of the graphs. There seem to be more fluctuation during the event period with more time periods where the non-connected firms have a higher CAR than the politically connected firms. Event 2 appears to be opposite to the expected positive CARs direction and event 5 is in line with the expected positive CARs as earlier. However, events 1, 3 and 4 seem to be less clear as to the direction of the CARs during the event dates.

The fourth and final hedge portfolio graph relates to (S1+S2+S3)-S4. This is very similar to the table 7.4 hedge portfolio with events 2 and 5 having significant movements and events 1, 3 and 4 being less clear as to the direction of the CARs around the event dates.

The final CAR graph relates to the entire market's CAR during the event period. The graph indicates an overall positive CARs direction during the period with the exception of the start of 2009 which suffers a decrease in the CARs. Furthermore, from September 2010, the CARs for the market plateaued off instead of continuing the increasing trend. In terms of the event dates, events 2, 3 and 4 appear to have positive CARs during the event dates. This is in line with the expected directions for the events with the exception of event 4 which is expected to be a negative event for the government. In addition to this, events 1 and 5 seem to be less clear in terms of the directions of the CARs during the event dates.

## Table 7.3



CARs for (S1-S4) Hedge Portfolio
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
20/4/06 - End of peace process
02/01/09 - Capture killinochchi
16/5/09 - victory over war
12/09/09 - Resign as CDS
8/2/10 - Fonseka Arrested
2/01/2006
2/03/2006
2/05/2006
2/07/2006
2/09/2006
2/11/2006
2/01/2007
2/03/2007
2/05/2007
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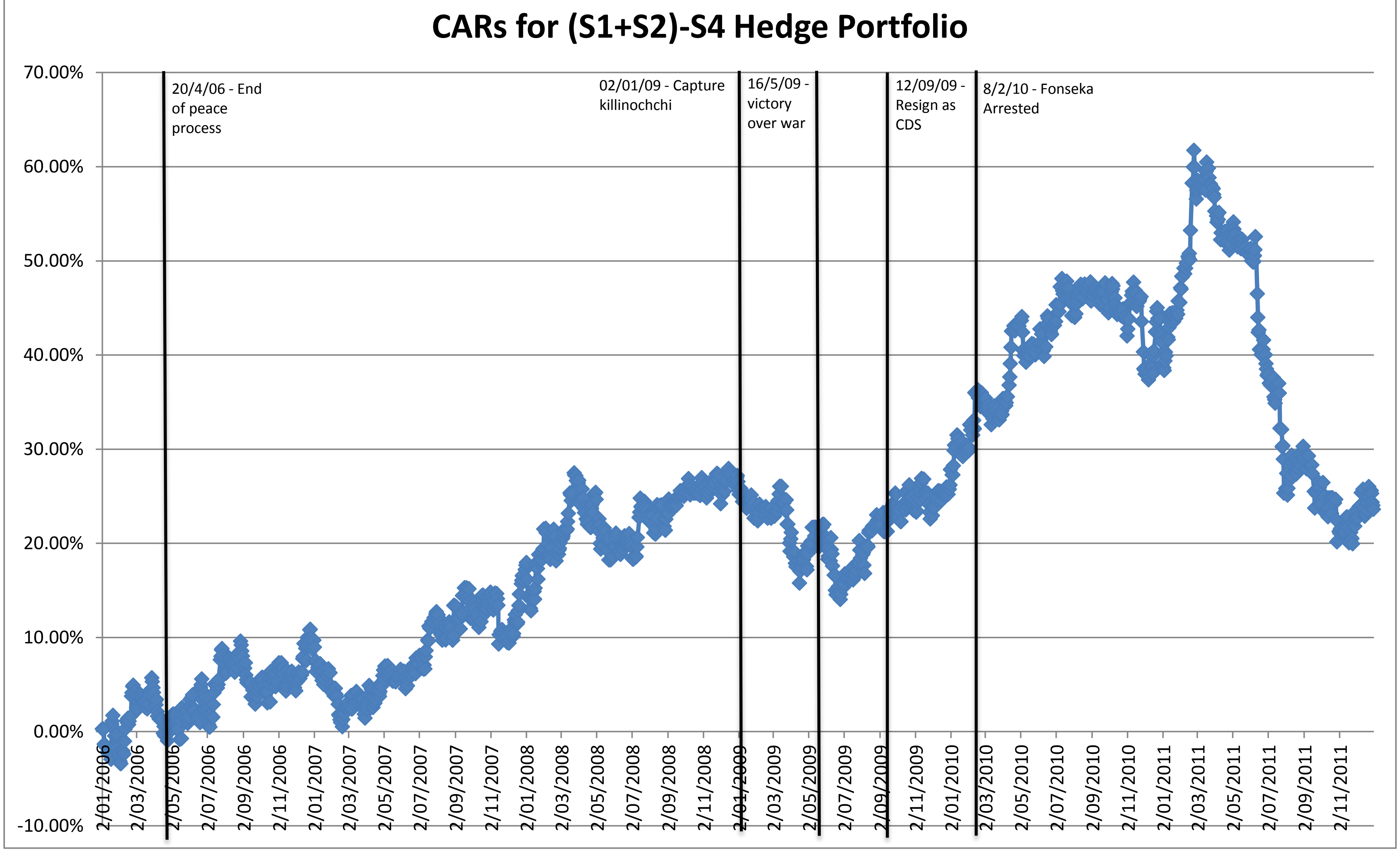
2/07/2010
2/09/2010
2/11/2010
2/01/2011
2/03/2011
2/05/2011
2/07/2011
2/09/2011
2/11/2011

Table 7.4


CARs for (S1+S2)-S4 Hedge Portfolio
70.00%
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
-10.00%
20/4/06 - End of peace process
02/01/09 - Capture killinochchi
16/5/09 - victory over war
12/09/09 - Resign as CDS
8/2/10 - Fonseka Arrested
2/01/2006
2/03/2006
2/05/2006
2/07/2006
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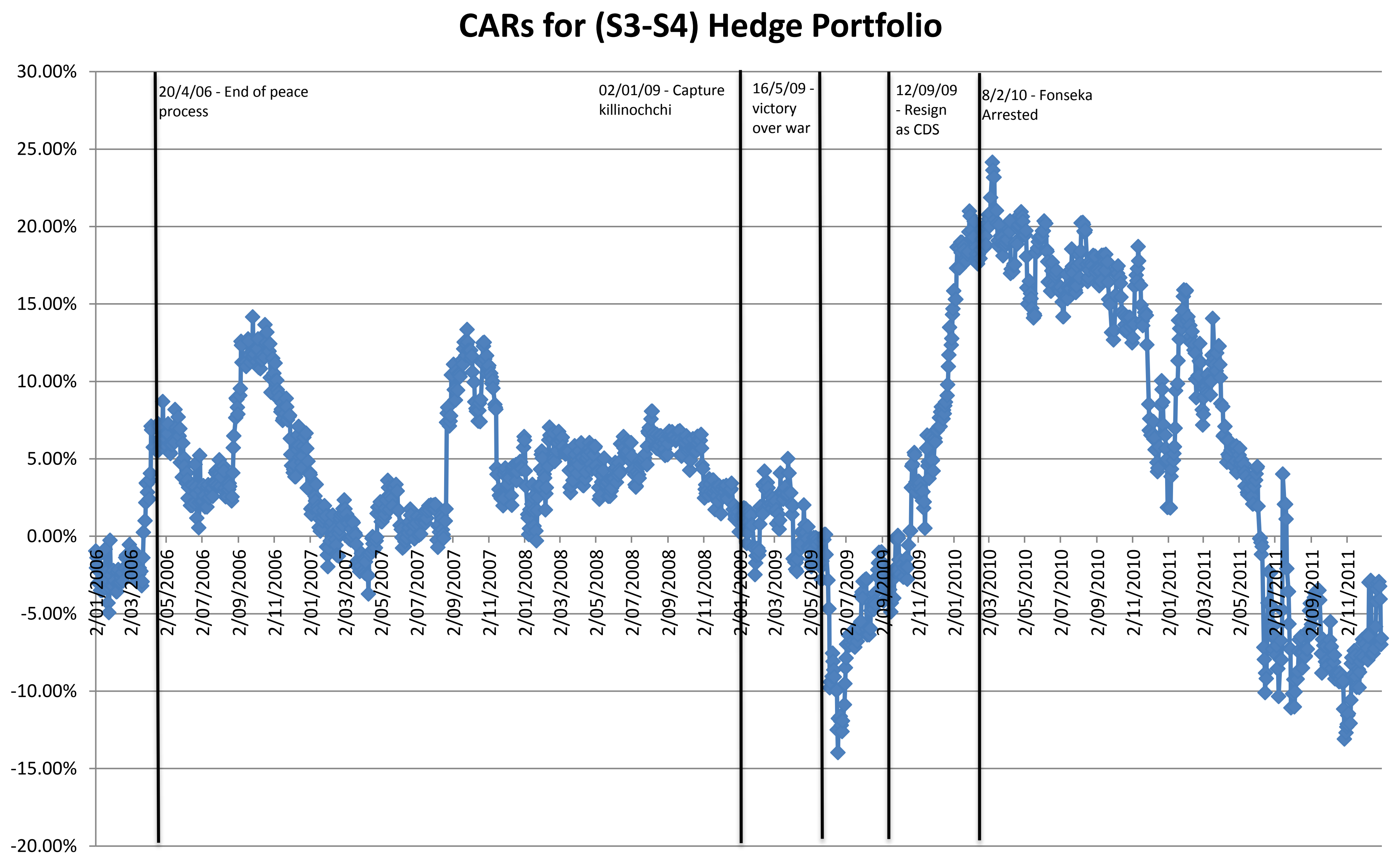
2/05/2010
2/07/2010
2/09/2010
2/11/2010
2/01/2011
2/03/2011
2/05/2011
2/07/2011
2/09/2011
2/11/2011

Table 7.5


CARs for (S3-S4) Hedge Portfolio
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
-15.00%
-20.00%
20/4/06 - End of peace process
02/01/09 - Capture killinochchi
16/5/09 - victory over war
12/09/09 - Resign as CDS
8/2/10 - Fonseka Arrested
2/01/2006
2/03/2006
2/05/2006
2/07/2006
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2/07/2010
2/09/2010
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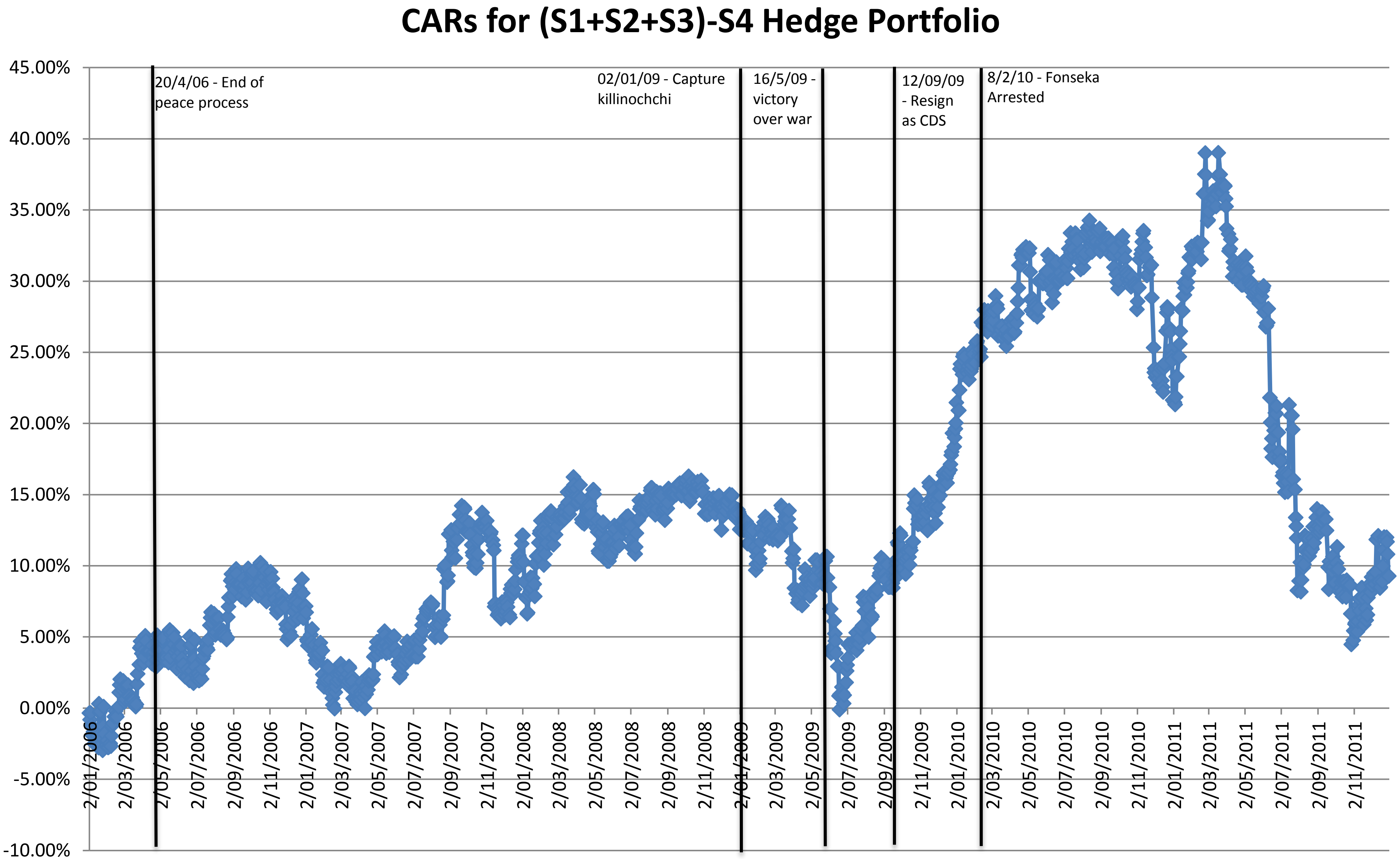
2/01/2011
2/03/2011
2/05/2011
2/07/2011
2/09/2011
2/11/2011

Table 7.6



CARs for (S1+S2+S3)-S4 Hedge Portfolio
45.00%
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
20/4/06 - End of peace process
02/01/09 - Capture killinochchi
16/5/09 - victory over war
12/09/09 - Resign as CDS
8/2/10 - Fonseka Arrested
2/01/2006
2/03/2006
2/05/2006
2/07/2006
2/09/2006
2/11/2006
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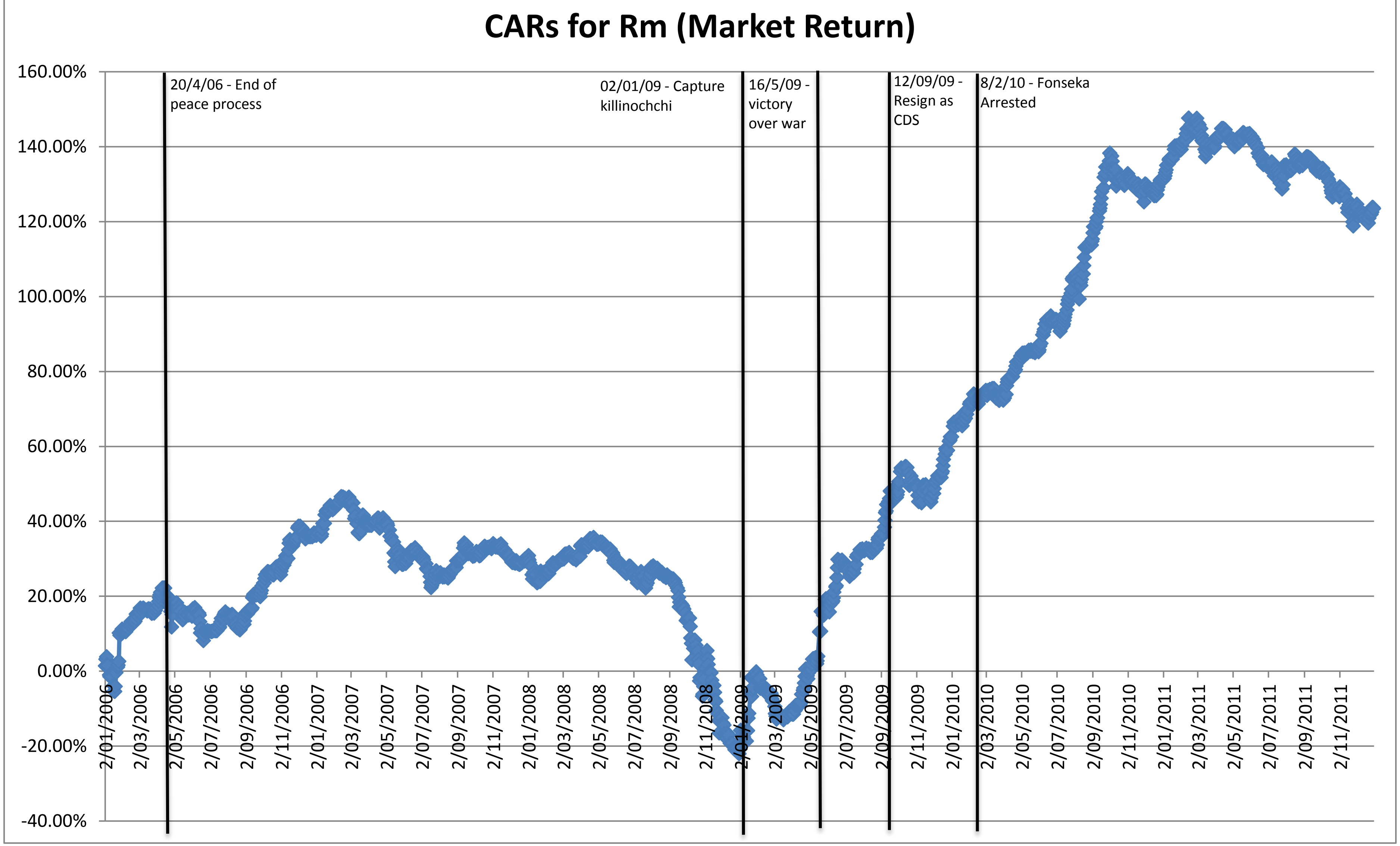
2/07/2010
2/09/2010
2/11/2010
2/01/2011
2/03/2011
2/05/2011
2/07/2011
2/09/2011
2/11/2011

Table 7.7


CARs for Rm (Market Return)
160.00%
140.00%
120.00%
100.00%
80.00%
60.00%
40.00%
20.00%
0.00%
-20.00%
-40.00%
20/4/06 - End of peace process
02/01/09 - Capture killinochchi
16/5/09 - victory over war
12/09/09 - Resign as CDS
8/2/10 - Fonseka Arrested
2/01/2006
2/03/2006
2/05/2006
2/07/2006
2/09/2006
2/11/2006
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2/09/2010
2/11/2010
2/01/2011
2/03/2011
2/05/2011
2/07/2011
2/09/2011
2/11/2011

### 7.2.2 Event Study Regression Results Analysis

As mentioned previously in the method section, I use the standard event study methodology to obtain the CARs around each of the five event dates. In table 7.8, the results for the market return and each event window lengths are presented. Panel A shows the results for the overall market at each window. Panels B to E show the CARs for each of the four hedge portfolios respectively. With each panel, the regressions are done at varying event windows (3 day, 5 day, and 7 day) in order to test the robustness of the regression results. The main results window that is used is the 3 day window while the 5 and 7 day windows are used as additional support. A final summary of the regression results in shown in panel F.

Panel A indicates the quality of the events used in the event study by showing the significance of each event in the market. The 3 day event window indicates 3 out of the 5 events are significant at the 5% level or higher. The declaration of victory over the LTTE is the most significant event with it being significant at the 1% level for all three event windows tested. Furthermore, the capture of Killinochchi is significant at the 10% level in the 5 day event window length. All the events have the expected direction for CARs during the 3 day event window with the exception of event 4 which has the opposite direction. The expectation for this event is that it will negatively affect the firms connected to the government. However, the market seemed to have positive CARs during this event.

Panel B shows the event study regression results for the S1-S4 hedge portfolio. All of the events used in the 3 day event window are insignificant for this hedge portfolio. However, the capture of Killinochchi has a significant (at the 10% level) negative return for the 5 day event window. The CARs for this event is contrary to the expected positive direction for the event. Furthermore, the declaration of victory and the resignation of General Fonseka as the CDS events are both insignificant and contrary to the expected direction for the CARs during the events.

Panel C details the (S1+S2)-S4 hedge portfolio results. The resignation of General Fonseka as the CDS and the subsequent arrest of the General are both significant events at the 5% level during the 3 day event window for this hedge portfolio. The resignation of General Fonseka as the CDS is significant at the 1% level and 10% level during the 5 day and 7 day event windows respectively. However, the end of the peace process, the capture of Killinochchi and the declaration of victory are not significant during the 3 day event window length. Events 2 and 3 are yet again contrary to the expected positive direction during the event windows.

The hedge portfolio CARs for S3-S4 is shown in panel D. During the 3 day event window, the capture of Killinochchi (at the 1% level), declaration of victory (at the 5% level) and the arrest of General Fonseka (at the 10% level) are all significant. The capture of Killinochchi is also significant at the 1% level and 5% level during the 5 day and 7 day event windows respectively. Additionally, the declaration of victory is significant at the 5% level during the 7 day event window. Only two of the events (the end of the peace process and the resignation of General Fonseka as the CDS) remained insignificant during the 3 day event window.  As seen in the earlier panels, the capture of Killinochchi and the resignation of General Fonseka as the CDS are contrary to the anticipated direction for the CARs.

Panel E shows the results for the (S1+S2+S3)-S4 hedge portfolio. The capture of Killinochchi (at the 5% level) and the arrest of General Fonseka (at the 5% level) are both significant in the 3 day event window. Likewise, the capture of Killinochchi is significant at the 5% level during the 5 day event window length. Additionally, the resignation of General Fonseka as the CDS is significant at the 5% and 10% levels respectively during the 5 day and 7 day event windows. The expected direction of CARs for the capture of Killinochchi and the resignation of General Fonseka as CDS events are contrary to the expected direction.

Overall, the results of the event study provides no support for the alternate hypotheses and is more in line with the null hypotheses; politically connected firms in Sri Lanka do not have higher CARs when compared to non-connected firms during positive events to the government and vice versa for negative events. Similarly, stronger politically connected firms in Sri Lanka do not have larger CARs than weaker connected firms. As shown in panel F, there are four events with significant results during the event dates used in the event study. However, there is only one out of the 5 events (Arrest of General Fonseka) used in the event study which provides clear evidence in majority of the hedge portfolios and event windows.

Some of the events have CARs contrary to the expected direction for the event. The resignation of General Fonseka as the CDS event has results contrary to the initial negative event expectation. The stepping down of General Fonseka as the Chief of Defence staff on 12$^{th}$ November 2009 to challenge President Rajapaksa at the 2010 Presidential elections is seen as a major victory for the opposition parties who all united to defeat the President at the 2010 elections. However, the results indicate significant positive CARs for two out of the four hedge portfolios in panels C and E. These hedges indicate the politically connected firms have higher CARs than non-connected firms. The S1-S4 and S3-S4 hedges also have positive CARs but insignificant. Hence, this event does not provide support for the hypothesis; politically connected firms will have lower CARs than non-connected firms during negative events for the government.

Furthermore, the positive event expectation for the capture of Killinochchi event is set based on the similar positive notions expressed by the business community of Sri Lanka. Ajit Gunewardena, the deputy chairman of John Keells Holdings, states the ending of the war as one of the momentous occasions for the country both economically and socially. The focus of the firm will turn again towards investing within Sri Lanka which was previously focused on a regional level. Furthermore, he feels tourism will be the most prominent revenue driver in the near future for Sri Lanka's economy (Wright, 2009). Therefore, the event study expectation is that the war coming to an end would positively affect the politically connected firms in comparison to the non-connected firms. This hypothesis is supported by the overall market reaction to the event being positive as per panel A above. However, it is not supported by the results from panels B, D and E as they have negative CARs for politically connected firms when compared to non-connected firms. Therefore, this event's results do not provide evidence in support of the hypotheses of the thesis.

**Table 7.8 – Event Study Regression Results**

*Panel A – Market Return*

| Event Window (*Expectation*) | Intercept | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) |
|---|---|---|---|---|---|---|
| **3 Day** | **-0.000** | **-0.020** | **0.037** | **0.077** | **0.045** | **0.022** |
| | **(0.009)*** | **(0.260)** | **(0.038)** | **(0.000)*** | **(0.012)** | **(0.227)** |
| 5 Day | 0.001 | 0.001 | 0.041 | 0.083 | 0.035 | 0.017 |
| | (0.010)* | (0.980) | (0.078)* | (0.000)*** | (0.127) | (0.454) |
| 7 Day | 0.001 | -0.031 | 0.032 | 0.125 | 0.020 | -0.000 |
| | (0.008)*** | (0.255) | (0.246) | (0.000)*** | (0.464) | (0.991) |

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels respectively

*Panel B – S1 – S4 Portfolio Hedge Return*

| Event Window (*Expectation*) | Intercept | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) | Rm |
|---|---|---|---|---|---|---|---|
| **3 Day** | **-0.000** | **-0.010** | **-0.016** | **-0.006** | **0.019** | **0.015** | **0.060** |
| | **(0.674)** | **(0.519)** | **(0.339)** | **(0.697)** | **(0.242)** | **(0.359)** | **(0.009)*** |
| 5 Day | -0.000 | 0.021 | -0.039 | -0.008 | 0.025 | 0.001 | 0.062 |
| | (0.672) | (0.321) | (0.066)* | (0.699) | (0.232) | (0.960) | (0.007)*** |
| 7 Day | -0.000 | 0.033 | -0.006 | 0.008 | 0.014 | 0.001 | 0.061 |
| | (0.584) | (0.180) | (0.817) | (0.752) | (0.585) | (0.979) | (0.008)*** |

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels respectively

*Panel C – (S1+S2) – S4 Portfolio Hedge Return*

| Event Window (*Expectation*) | Intercept | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) | Rm |
|---|---|---|---|---|---|---|---|
| **3 Day** | **0.000** | **-0.008** | **-0.010** | **-0.004** | **0.035** | **0.034** | **0.061** |
| | **(0.877)** | **(0.592)** | **(0.494)** | **(0.803)** | **(0.023)**** | **(0.028)**** | **(0.005)***** |
| 5 Day | 0.000 | 0.011 | -0.028 | -0.008 | 0.061 | 0.021 | 0.063 |
| | (0.909) | (0.573) | (0.157) | (0.699) | (0.002)*** | (0.296) | (0.003)*** |
| 7 Day | 0.000 | 0.016 | 0.001 | 0.007 | 0.061 | 0.013 | 0.063 |
| | (0.999) | (0.497) | (0.982) | (0.767) | (0.010)* | (0.577) | (0.004)*** |

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels respectively

*Panel D – S3 – S4 Portfolio Hedge Return*

| Event Window (*Expectation*) | Intercept | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) | Rm |
|---|---|---|---|---|---|---|---|
| **3 Day** | **-0.000** | **0.008** | **-0.045** | **0.036** | **0.007** | **0.029** | **-0.056** |
| | **(0.956)** | **(0.631)** | **(0.009)***** | **0.041**** | **(0.681)** | **(0.096)*** | **(0.024)**** |
| 5 Day | 0.000 | 0.003 | -0.060 | 0.028 | 0.019 | 0.014 | -0.053 |
| | (0.990) | (0.887) | (0.008)*** | (0.218) | (0.393) | (0.526) | (0.031)** |
| 7 Day | -0.000 | 0.000 | -0.062 | 0.053 | 0.020 | 0.002 | -0.056 |
| | (0.999) | (0.999) | (0.020)** | (0.048)** | (0.441) | (0.928) | (0.022)** |

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels respectively

*Panel E – (S1+S2+S3) – S4 Portfolio Hedge Return*

| Event Window (*Expectation*) | Intercept | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) | Rm |
|---|---|---|---|---|---|---|---|
| **3 Day** | **0.000** | **0.000** | **-0.028** | **0.016** | **0.021** | **0.032** | **0.004** |
| | **(0.978)** | **(0.973)** | **(0.046)**** | **(0.260)** | **(0.136)** | **(0.023)**** | **(0.838)** |
| 5 Day | 0.000 | 0.007 | -0.044 | 0.010 | 0.040 | 0.018 | 0.007 |
| | (0.960) | (0.698) | (0.015)** | (0.584) | (0.027)** | (0.319) | (0.733) |
| 7 Day | -0.000 | 0.008 | -0.032 | 0.030 | 0.040 | 0.008 | 0.005 |
| | (0.985) | (0.717) | (0.141) | (0.167) | (0.058)* | (0.692) | (0.806) |

*Panel F – Regression Results Summary (3, 5 and 7 day windows combined)*

| Hedge Portfolio (*Expectation*) | E 1 (End of Peace Process) (-) | E 2 (Capture Killinochchi) (+) | E 3 (Declare Victory) (+) | E 4 (Resign as CDS) (-) | E 5 (Fonseka Arrested) (+) |
|---|---|---|---|---|---|
| S1 –S4 | × | -5 | × | × | × |
| (S1+S2)-S4 | × | × | × | +3,+5,+7 | +3 |
| S3-S4 | × | -3,-5,-7 | +3,+7 | × | +3 |
| (S1+S2+S3)-S4 | × | -3,-5 | × | +5,+7 | +3 |

Definitions

| | |
|---|---|
| Event 1 | = The ending of the peace process on 20/04/2006 |
| Event 2 | = Capture of the LTTE de-facto capital city, Killinochchi on 02/01/2009 |
| Event 3 | = Declaration of victory over the civil war on 16/05/2009 |
| Event 4 | = General Fonseka steps down as CDS to challenge the President at the 2010 presidential elections on 12/09/2009 |
| Event 5 | = General Fonseka arrested after the 2010 presidential elections on 08/02/2010 |
| Rm | = CARs of the market for the event window |
| Market return | = CARS for the market for the entire sample period of 1565 days |
| S1-S4 | = CARs for Hedge portfolio which is long S1 and short S4. |
| (S1+S2)-S4 | = CARs for Hedge portfolio which is long S1,S2 and short S4. |
| S3-S4 | = CARs for Hedge portfolio which is long S3 and short S4. |
| (S1+S2+S3)-S4 | = CARs for Hedge portfolio which is long S1,S2,S3 and short S4. |
| × | = No significant events during 3, 5 and 7 day event windows |

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels respectively

## 7.3 Advantages, Possible Drawbacks and Future Research Opportunities

There are several advantages and drawbacks with the method used in this thesis. Firstly, the prerequisites for an efficient market are that information is available freely to participants; there is investor competition and effective communication among market participants. Heenetigala (2011) states "several previous studies by Abeysekera (2001) and Wickremasinghe (2007) have indicated the trading of stocks within the Colombo Stock Exchange do not behave in a manner consistent with the weak form efficient market hypothesis". This is due emerging stock market exchanges not being as information efficient as developed stock markets such as NYSE, ASX and NZX. However, this thesis uses a sample of the largest listed firms and their subsidiaries from the Colombo Stock Exchange. These firms have the largest market capitalisation and trades frequently as seen by the movement of the daily share price of the sample firms. Hence, it is reasonable to expect the sample firms to have information efficiency. However, it is worth noting that the Colombo Stock Exchange as a whole may have a lower level of information efficiency than well-developed markets due to the Colombo Stock Exchange being a relatively young stock exchange of about only 25 years. There have been tremendous changes in culture and operations as a result of organisational and technological changes during this time period. Therefore, the Colombo stock exchange is still in its primary stages in terms of perfecting its information efficiency when compared to stock exchange giants such as Dow Jones, NYSE and Nasdaq.

Next, in order to correctly assess the political connectedness of a firm, a stable and strong political structure within a country is required. Otherwise, credibility of the political connections may not be able to be verified (Fisman, 2001). The issue of credibility of political connections is partially mitigated in this thesis by using a political connectedness definition which is narrow enough to capture the main political figures in firms while at the same time wide enough to capture other political connections such as the close relationships category.

In addition, with regards to the daily returns used within the event study methodology, if there has not been trading of shares on a day, there would be no price change even if the firm did suffer from an underlying change in firm value (Fisman, 2001). Therefore, the returns might not fully reflect the actual value of the firm's performance. Furthermore, if the shares are not being traded frequently, this may mean a smaller decrease in the non-connected firms in comparison to politically connected firms may be due to the non-connected firms not being traded as often (Fisman, 2001). In terms of overcoming the lack of liquidity of some of the Sri Lankan listed firms, the sample comprised of the largest listed firms and their subsidiaries. Therefore, these largest firms are more likely to be traded than other firms on the Colombo Stock Exchange, thereby mitigating the issue of liquidity in the market.

A possible limitation to this study is the definition of the politically connected firms (Faccio, 2003; Johnson & Mitton, 2001). This definition is not exhaustive and there may be other politically connected firms not taken into account within this event study. Additionally, due to the lack of data and the sensitive nature of the subject, many political connections may not have been included. An expanded definition which includes further political appointments to firms may be used in future studies to capture other politically connected firms within the market. Other appointments may include Presidential appointments to government institutions, former Presidential candidates, campaign managers as such.

A limitation with using a politically connectedness definition, which is noted in Johnson and Mitton (2001), and is overcome within this study, is the disappearance of political connections during the sample period. The classification of political connections in this event study is revised at every event date used. Therefore, the political connection is confirmed as being present and valid at each event date. Likewise, the lack of disclosure of political connections is overcome to an extent with the use of only large shareholders which require at least some level of disclosure by firms.

Finally, the portfolio time series event study methodology controls for any firm heterogeneity issues as the analysis is based on the change in value for the same sample of firms before and after the event days used in the event study. Thereby any firm characteristics will be cancelled out when the hedge portfolio is formed for the event study regression. However, a possible limitation to this method is that the market participants may anticipate the events and therefore the CARs around the event date may only partially reflect the estimated change in value for the hedge portfolios. This thesis mitigates this issue by using event dates which are less anticipated by the market. This is seen in table 7.8 panel A where 3 out of the 5 events have significant market returns.

## 7.4 Robustness tests

### 7.4.1 Projects Granted During Post-War Period

As part of the robustness tests for the results obtained from the event study methodology above, the following additional tests are carried out. As an alternate political connectedness measure for the event study results using the POLCONT measure, I use the number of projects granted by the government to listed firms in the post war period. I use the Factiva database to search for articles detailing any projects granted to the sample firms after the end of the war. The firms are ranked according to the number of projects granted by the government during the period. The full details of the projects in the post war period are given in Appendix A, attached at the end of the thesis.

**Table 7.9 – Projects Granted in the Post-War Period**

| Company | Market Cap. (as a % of Total Market Cap. in CSE) | Number of projects | Politically connected ? | Political connection sample |
|---|---|---|---|---|
| Aitken Spence PLC | 2.05% | 3 | Yes | 1 (till ’10) and 3 (from ’11) |
| Hemas Power PLC | 0.76% | 2 | No | 4 (from ’09) |
| Laugfs Gas PLC | 0.55% | 2 | Yes | 1 (from ’11) |
| Hayleys PLC | 1.24% | 1 | Yes | 1 (from ’09) |
| Commercial Bank of Ceylon PLC | 3.44% | 1 | No | 4 (from ’09) |
| Diesel and Motor Engineering PLC | 0.52% | 1 | Yes | 1 (from ’11) |
| Hemas Holdings Group | 0.76% | 1 | Yes | 3 (from ’09) |
| John Keells Holdings PLC | 6.63% | 1 | Yes | 3 (from ’09) |
| Lanka Ashok Leyland PLC | 0.54% | 1 | Yes | 2 (from ’09) |
| Lanka Orix Leasing Company PLC | 1.63% | 1 | Yes | 2 (from ’09) |
| Nestle PLC | 2.12% | 1 | No | 4 (from ’09) |
| Overseas Realty (Ceylon) PLC | 0.53% | 1 | Yes | 3 (from ’09) |
| Softlogic Holdings PLC | 0.57% | 1 | No | 4 (from ’09) |
| Sri Lanka Telecom PLC | 3.69% | 1 | Yes | 1 (from ’09) |
| Ceylon Tobacco Company PLC | 3.94% | 1 | Yes | 2 (from ’09) |
| | | 19 | Yes=11<br>No=4 | 1=3(till 10);4(from 11)<br>2=3(from 09-12)<br>3=3(till 10);4(from 11)<br>4=4(from 09-12) |

<u>Definitions</u>
1 = Shareholder Political connection sample
2 = Top Official political connection sample
3 = Close Relationship political connection sample
4 = Non-Connected sample

There are 15 firms in the sample with newspaper articles about projects granted in the post-war period with 19 different projects. These 15 firms represent almost 29% of the total market capitalisation of the Colombo Stock Exchange. The firms deemed politically connected under the POLCONT variable defined earlier include 11 out of the 15 firms. OF these 11 politically connected firms, there are two firms that developed a political connection later on during the sampled period in 2011. The projects are granted to these firms after the political connection is established. These projects include the two projects for Laugfs Gas PLC in 2011/2 and the project for Diesel and Motor Engineering PLC in August 2011. Only 4 firms with projects granted in the post-war period are non-connected firms.

In terms of the number of projects granted to the sample firms, more than 73% is granted to politically connected firms. The non-connected firms received 26% of the projects granted during the post war period. Additionally, these politically connected firms with projects granted to them represent 22% of the total market capitalisation while the non-connected firms with projects represent fewer than 7% of the total market capitalisation of the Colombo Stock Exchange. Hence, it is reasonable to expect politically connected firms to have a larger number of projects granted to them. A further observation from this robustness test indicates that the majority of the projects granted to firms are construction projects around the country. This is logical as there is a massive rebuilding phase within the country immediately after the civil war concluded in May 2009. When looking only at firms which are granted construction projects in the above sample, it is only 68% of the sample market capitalisation while the non-connected firms' sample market capitalisation increases to 32%. However, in terms of the above sample, the politically connected firms market capitalisation represent over 76% of the sample market capitalisation. This suggests even though the majority of the projects granted by the government in the post-war period that has been reported in the media have been to politically connected firms, it is in line with the percentage of politically connected firms included within the sample (73%). Therefore, it is not unexpected that the majority of the projects (15 out of 19 projects) being granted to politically connected firms during the post-war period.

### 7.4.2 Political Appointments Made During Post-War Period

A further search was done on newspaper articles for any political appointments made during the post-war period by the government to the sample of listed firms used in this study. A full list of instances of political appointments and arrangements are detailed in Appendix A. These appointments and arrangements of listed firms range from directorial appointments, insurance provider selection and share purchases. These appointments may be used as part of political connections being used to control the actions of the listed firms according to the government’s liking. These actions may not necessarily be the most efficient or profitable action for the listed firm in these types of situations.

A comparison between the actual return less the market return over a 3 day window is carried out for each of the 9 events identified. The regression results for these listed firms with political appointments are shown in table 7.10. Based on the political connectedness definition described earlier, there are two non-connected firms (Diesel and Motor Engineering PLC and Commercial Bank of Ceylon PLC) with political appointments made to them while the other 7 firms are categorised as politically connected firms.

From the results in table 7.10, the highest CARs during the events are for Sri Lanka Telecom. The takeover by Maxis Malaysia of Sri Lanka Telecom has an 11.42%

CARs which indicates the firm return is higher than the market return during that 3 day window on 1/4/2008. The mean CARs for all events are 0.43% with a t-stat of 0.4974. The t-stat is not high and therefore does not indicate any significant impact in the results. Furthermore, the mean CARs for the 7 connected firms are 0.60% and for the 2 non-connected firms are -0.17%. Thus, while based on a small sample, the results of this test do not suggest that political connections add to the value of listed firms in Sri Lanka.

**Table 7.10 – Political Appointments Event Study Regression Results**

| Appointment | Listed Firm | Date of Announcement | CAR (-1,+1) |
|---|---|---|---|
| Nimal Welgama | Sri Lanka Telecom PLC | 23/05/2010 | -0.83% |
| Employee Provident Fund | Diesel and Motor Engineering PLC | 15/6/2011 | -0.58% |
| Employee Provident Fund | Richard Pieris & Company PLC | 15/6/2011 | 0.03% |
| Gotabhaya Rajapaksa | Lanka Hospital Corporation PLC | 4/05/2011 | 1.55% |
| Maxis Malaysia | Sri Lanka Telecom | 1/4/2008 | 11.42% |
| Sri Lanka Insurance Corp | Colombo Dockyard PLC | 26/4/2011 | -2.90% |
| Dr. Ranee Jayamaha | Hatton National Bank PLC | 17/3/2011 | -2.59% |
| Lakshman Hulugalle | Commercial Bank PLC | 30/3/2011 | 0.24% |
| Dhammika Perera | Sampath Bank PLC | 29/12/2011 | -2.49% |

Definitions

Note: The event study regression uses a 3 day event window around each political appointment

CAR (-1,+1) = The cumulative abnormal return during a 3 day event window calculated by the actual return of the firm less the market return on the of the event

### 7.4.3 Tobin's Q Descriptive Statistics

A final robustness test is carried out by looking at Tobin's Q values for each of the political connected samples used in section 5.2.2. The Tobin's Q value gives an indication of the relative asset value of the firm to its market value. In other words, the Q value indicates whether the cost of replacing the total assets of a firm is greater or less than the total value of its shares. To measure the impact of political connections on Tobin's Q, a regression analysis is performed, where politically connected firms are compared to non-connected firms while controlling for size (market capitalisation), leverage (Return on Assets), industry class and the political connection type. The P value for each variable is shown in brackets to indicate the significance of the variables. The results are shown in table 7.11 below.

The results from table 7.11 indicate the difference between the politically connected firms and non-connected firms' Tobin's Q value. Out of the control variables used in the regression below, leverage is a significant control (at the 1% level) when looking at the Tobin's Q value for listed firms in Sri Lanka. The controls for each industry indicate the market value is higher than the total assets of the sample firms for the Investments Trusts industry which is significant at the 10% level. The Other and Hotel & Travels industry categories also have a market value higher than the total asset value. However, these results are not significant. The overall results from the regression indicate there is no significant difference in the Tobin's Q values for politically connected and non-connected firms in Sri Lanka. Therefore, the result of this robustness test suggests political connections do not add value to listed firms in Sri Lanka.

**Table 7.11 – Tobin's Q Analysis**

| Variables | Tobin's Q |
|---|---|
| Intercept | -0.097 |
| | (0.935) |
| Size | 0.000 |
| | (0.978) |
| Leverage | 7.149 |
| | (0.000)*** |
| Shareholder (S1) | -0.387 |
| | (0.235) |
| Top Official (S2) | -0.406 |
| | (0.341) |
| Close Relationship (S3) | -0.022 |
| | (0.943) |
| I 1 – Diversified Holdings | 0.509 |
| | (0.675) |
| I 2 – Bank, Finance and Insurance | 0.458 |
| | (0.698) |
| I 3 – Beverage, Food, Tobacco & | 0.959 |
| Plantations | (0.421) |
| I 4 – Hotel and Travels | 1.369 |
| | (0.267) |
| I 5 – Investment trusts | 2.406 |
| | (0.071)* |
| I 6 – Land and Property | 0.214 |
| | (0.864) |
| I 7 - Manufacturing | 0.735 |
| | (0.540) |
| I 10 - Other | 1.239 |
| | (0.294) |

The initial sample of 103 firms excludes 4 firms due to no company data being available on Datastream to leave a final sample of 99 firms in 2011.

Definitions

| | |
|---|---|
| Tobin's Q | = The market value divided by the total assets figure |
| Size | = Size of the sample firms have been controlled for using the market capitalisation of firms as at the end of 2011 |
| Leverage | = Leverage has been controlled for using the Return on Assets for the sample firms as at the end of 2011 |
| Shareholder Connection | = At least one of the firm's major shareholders (shareholding of more than 10%) is a government controlled public institution, a member of parliament (MP), a Minister or a Ministerial secretary |
| Top Official Connection | = If one of the firm's top officials (CEO, Chairman, Deputy Chairman, President, Vice President, Secretary or Director) is a MP, a Minister or Ministerial secretary |
| Close Relationship Connection | = If the firm has close relationships to the government by having a top executive/ large shareholder of a firm appointed as an Ambassador of the country. |
| Non-Politically Connected | = If a firm has no identifiable political connection to the government |

# 8 Conclusion

Several studies over the years have looked at the relationship between political connectedness and firm performance. Initial studies done by Johnson & Mitton (2001) and Fisman (2001) to subsequent studies by Faccio (2003) have all shed light on this relationship. The primary issue raised within these studies, is defining what is considered to be politically connected and how it should be measured.

In this thesis, using a portfolio time series event study methodology, I look into the relationship between politically connected firms and non-connected firms in Sri Lanka and compare the share price performance of these two types of firms. I use a definition of political connectedness which is a combination from past literature definitions. I look at the daily returns for a sample of listed firms on the Colombo Stock Exchange and compare the difference between the daily returns to test if politically connected firms have a higher firm performance when compared to non-connected firms during events that are positive for the government of Sri Lanka. Likewise, I expect lower firm performance for connected firms during negative events for the government.

Sri Lanka is an ideal country to carry out this thesis with its economy focused on growth and a stable and strong ruling government in control for the majority of the post-war period. It has a relatively centralised and stable political structure with the government of Sri Lanka remaining unchanged for the duration of this thesis's sample period from 2006 to 2011. The current political framework of Sri Lanka is based around a Presidential representative democratic republic, where the President is both the head of state and head of government. The multi-party system is currently dominated by the centre-leftist and progressive "United People's Freedom Alliance" (UPFA) and the main opposition party being the comparatively right-wing pro-capitalist "United National

Party" (UNP). The parliament makes all laws; however, the President may summon, suspend or dissolve the parliament. The Judicial system of the Sri Lankan political framework is headed by the Supreme Court which has the highest and final court of record (Lanka Library, 2009). The government has a heavy influence from the current President's family, the 'Rajapaksas'. Many listed firms have affiliations to either the ruling government party or one of the opposition parties. Hence, a comparison can be made as to whether the firms connected to the government party performed better than non-connected firms.

The descriptive statistics of the thesis indicate politically connected firms tend to be larger in size, have a higher market capitalisation and have a slightly higher daily return in comparison to non-connected firms. The ROA and ROE is also larger for the politically connected firms. However, there is an exception to this with the "shareholder-connected" sample which is smaller in size, has a lower net income and a slightly negative daily return when compared to non-connected firms. This is in line with Okhmatovskiy (2010), who finds firms with direct political connections have a lower firm performance compared to firms with indirect connections through SOEs.

The empirical results of the thesis provide no evidence for the thesis hypotheses. Four out of the five events have at least one significant result in an event window used in the event study. However, two of the events are contrary to the expected direction for the event and therefore does not lend support for the hypotheses. Overall, only one out of the five events (Arrest of General Fonseka) is significant and consistent with the hypotheses.

The results from this thesis add to our understanding of the relationship between political connections and firm performance. The most important implication of the results is that in Sri Lanka political connections do not provide a significant advantage for politically connected firms in terms of their performance in comparison to non-connected firms. The results of the thesis indicate that daily returns of politically connected firms are not significantly higher than non-connected firms during the sample period. Furthermore, the results do not provide evidence to support the hypothesis that stronger political connections have a higher positive effect on firm performance in comparison to weaker political connections during positive events for the government and vice versa during negative events. This is contrary to the initial expectation of this thesis and past literature Fisman, (2001); Johnson and Mitton, (2001); Faccio (2005); Hillman (2005) and Faccio and Parley (2009) where political connections are hypothesised to provide a significant advantage for politically connected firms in comparison to non-connected firms.

There are several strengths and limitations in this thesis. Firstly, the Sri Lankan stock exchange is relatively new with around 25 years of operation and small in size compared to other better established stock exchanges such as Dow Jones, Nasdaq and Nikkei. Hence, the stocks listed on the Colombo Stock Exchange as a whole may not be entirely liquid and not fully information efficient. Therefore, information may not be freely available for market participants, investor competition may be restricted and communication between market participants may not be efficient. In addition, not all information regarding political connections may be available in the public domain. The issues of information inefficiency and illiquidity of the stock market are mitigated in this thesis by using larger listed firms which are traded more frequently and have better information disclosures.

A further strength of this thesis is it overcomes issues about the credibility and completeness of political connections definition, by using a political connectedness identifiable from the public information domain such as annual reports of firms and newspaper articles. Furthermore, the political connectedness definition is broad enough to cover both direct political connections such as shareholdings and top officials and indirect political connections such as ones established through close-relationships with political figures.

The political connectedness definition used in this thesis similarly overcomes the issue of political connections of firms disappearing over time by revising the classification of political connections for each sample firm in this event study at every event date used. Therefore, the political connection is confirmed as being present and valid at each event date.

Next, the portfolio time series event study methodology used in this thesis controls for firm heterogeneity as the analysis is based on the change in value for the same sample of firms before and after the event days used in the event study.

A weakness of the definition of political connectedness used in this thesis is that it is not exhaustive and therefore it might not capture all political connections, listed firms in Sri Lanka may possess. An expanded definition which includes directors of Presidential commissions, former Presidential candidates and heads of SOEs as such may be used in future studies to capture a more inclusive political connectedness definition for listed firms in Sri Lanka.

This thesis contributes to the literature in several ways. Firstly and most importantly, I construct a political connectedness measure to classify the listed firms of Sri Lanka into three types of political connections and compare them to non-connected firms. Secondly, this thesis contributes to the literature on the value of these political connections to firm performance by using a robust event study methodology which looks at various measures of firm performance such as the firm’s daily returns. It also assesses this through other measures such as projects granted by the government in the post war period, appointments made by the government to the board of governors etc. Moreover, there are several future research opportunities with this thesis including the use of an expanded political connectedness definition as described above and looking at reasons for the public perception of political favouritism for listed firms not having a statistically significant effect on the share prices of these firms.

To summarise the findings of this thesis, a statement from the eldest son of the President, Namal Rajapaksa, and a current MP of the Parliament seems fitting. Namal Rajapaksa has stated that private businesses do not need to feel they must be connected to the first family or the government to invest around Sri Lanka. He further stated it is natural for the entrepreneurs and business leaders who supported the government and President to take the first initiatives to venture out into the war torn areas as this is out of their own self-belief and as a duty to the nation (Daily FT, 2012).

# 9 Appendices

## 9.1 Appendix A: Newspaper Articles on Political Connections

### 9.1.1 Projects in the Post-War Period (2009 onwards)

| Firm Name | Politically Connected ? | Description | Value of Contract |
|---|---|---|---|
| Aitken Spence PLC | Yes | The firm received from the Ministry of Ports and Aviation and the Ports Authority of Sri Lanka, the letter of intent to design, build and operate a new deep-water container terminal in Colombo Port following cabinet approval (Aitken Spence Blog, 2010). The Built Own Transfer agreement was signed on the 17th of November 2011. It is one of the largest public-private partnership projects undertaken in Sri Lanka and is a flagship development project of the government in the post-war period. It was signed by China Merchants Holdings (International) Ltd (55%), Aitken Spence PLC (30%) and the Sri Lanka Ports Authority (15%). The first phase is expected to be completed by December 2013 (Daily News - Sri Lanka, 2011). However, Aitken Spence PLC pulled out of the project, two and a half years after the initial signing sighting issues with funding and cost escalations. The difference of opinion between the Chinese partners was also partly responsible for the pull out (Daily FT, 2011). Nonetheless, by January 2012 the company had re-entered negotiations for the contract (LBO, 2012). | USD 500 million |
| Aitken Spence PLC | Yes | The firm has decided to invest USD 78 million into the leisure sector in the post-war period | USD 78 million |

| | | | |
|---|---|---|---|
| | | where tourist arrivals were seen increasing up 40% during 2010. The firm will refurbish and expand its hotels in Kalutara and Beruwala. Furthermore, they are planning to develop a 10 acre land in Ahungalle and a 100 acre land in Nilaweli located in the North Eastern region of the country. The firm is scouting for more locations in the north of the country. The government has been allocating land for developers in Pasikuda and a further tourism zone was opened in Kuchchaveli (Asia Pulse, 2010). These refurbishments included a project granted in April 2010 as part of the USD 20 million eight new investment ventures under the Board of Investment (Targeted News Service, 2010). Furthermore, the firm plans to build a luxury inner city hotel within Colombo using state owned land. The Minister in charge is in negotiations to make the project a seven-star class hotel (LBO, 2010). In September 2010, the firm signed with the international hotel group, Six Senses Group, to establish the first Six Senses property in Sri Lanka as a 50:50 joint venture worth USD 40 million (Aitken Spence Blog, 2010). | |
| Aitken Spence PLC,<br>Hemas Power PLC and<br>Hayleys PLC | Yes<br><br>No<br><br>Yes | The power segment of Aitken Spence PLC plans to commence two renewable energy projects towards the middle of 2011. The new power projects will be in Matale and Ambewela with a 2.5 megawatt hydro power plant and a 3 megawatt wind power plant respectively. Hemas PLC already has under construction a mini hydro project named Magal | $- |

| | | | |
|---|---|---|---|
| | | Ganga which is expected to commence production in September 2011. Moreover, Hayleys PLC has invested in a subsidiary company Nirmalapura Wind Power which is a promising wind power project. These firms are aligning their investments in line with the government's target of generating 15% of national energy supplies through non-conventional renewable sources by 2015 (Daily News - Sri Lanka, 2011). | |
| Commercial Bank of Ceylon PLC | No | The firm became the first bank to support national development initiatives with concessionary long term lending from its Investment Fund Account (IFA) which was set up in accordance with a proposal by President Rajapaksa in August 2011. The first disbursement of the IFA was an USD 15 million to the Road Development Authority over 14.5 years. In return the government promised lower VAT taxes and tax on profits for financial institutions that formulated IFA accounts (The Sunday Times, 2011). The bank has a stake of 14.19% owned by government controlled state owned entities, which increases the likelihood of support in times of need (Asia Pulse, 2011). | USD 15 million |
| Diesel and Motor Engineering PLC | Yes | The firm acquired an order for over 900 TATA commercial vehicles for the Defence Ministry. The first batch of vehicles was delivered to the Navy in August 2011 and the rest will be distributed among the rest of the armed forces. Furthermore, DIMO is the sole distributor of spare parts for TAT vehicles in the country | $- |

| | | | |
|---|---|---|---|
| | | (Daily News - Sri Lanka, 2011). | |
| Hemas Holdings Group | Yes | The group announced in 2010, it plans to invest USD 75 million over the next five years in the hotel industry. It will expand several of its existing hotels and is also planning to build new ones in the next five years. It expects its revenue from the hotel sector to be the largest contributor for the firm's total revenue in the coming years (Lanka Business Online, 2010). | USD 75 million |
| Hemas Power PLC | No | The firm is planning on building another hydro power plant in June 2010 and raising its total capacity 24 Giga watts. The firm believes power generation is a key catalyst to unlocking the country's potential in the post-war period (Lanka Business Online, 2010). | USD 2+ million |
| John Keells Holdings PLC | Yes | The firm intends to invest around USD 100 million building new resorts to benefit from the economic resurgence in the post-war period. In 2009, the firm stated they plan to build at least five new hotels over the next 3 years (Colombo Times, 2009). The firm is planning a USD 65 million condominium project in Colombo's Union Place. The market response has been good and the firm is awaiting government approval to start marketing the project (Asia Pulse, 2011). Moreover, the firm has opened a four star resort on the east coast named "Chaaya Blu". It is one of the first developments undertaken by the firm after the conclusion of the war (Daily News - Sri Lanka, 2010). Moreover, the firm's Trans Asia Hotel (later renamed Cinnamon Lakeside Colombo) suffered damage in an aircraft strike by the | USD 100 million |

| | | | |
|---|---|---|---|
| | | LTTE on February 20, 2009. It was later refurbished and opened in September 2009 and the firm expects to recover its investment of USD 5 million within two years (Asia Pulse, 2009). | |
| Lanka Ashok Leyland PLC | Yes | Ashok Leyland has been granted a contract valued at USD 26 million to supply 1000 buses to Sri Lanka's People's Leasing Company. The firm is in a joint venture with Lanka Ashok Leyland PLC. The contract is expected to be completed by March 2011 (Dow Jones International News, 2010). | USD 26 million |
| Lanka Orix Leasing Company PLC | Yes | The Board of Investment (BOI) granted two new projects in May 2010. The BOI granted the firm an agreement to develop software for the local market. The contract was valued at USD 150,000 and is expected to create 50 new jobs (Hindustan Timres, 2010). | USD 150,000 |
| Laugfs Gas PLC | Yes | The firm has been granted 50% of the entire LP gas output in Sri Lanka by Ceylon Petroleum Corporation (CPC), under the directive of the President Rajapaksa. Previously, the firm had an agreement with the CPC to acquire the entire LPG production which was later reduced to 30% (Sunday Observer - Sri Lanka, 2011). Moreover, the firm entered into a joint venture with the Sri Lanka Institute of Nanotechnology to setup the country's first ever titanium dioxide production plant (Daily Mirror - Sri Lanka, 2012). | $- |
| Nestle PLC | No | The firm opened a new state of the art noodles manufacturing facility in Kurunegala at a cost of USD 11 million in January 2012. This forms | USD 36 million |

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| | | the second part of the firm's USD 100 million investment commitment to the country. The inauguration ceremony was attended by several government Ministers as well as the deputy head of the Switzerland embassy (Daily FT, 2012). Furthermore, the firm has invested USD 25 million in 2011 for expanding its dairy manufacturing capabilities. The firm, being the biggest private sector dairy collector in Sri Lanka, stated the government's strong focus on developing the local dairy industry is commendable and lifting taxes on dairy machinery is a welcome move (Daily News - Sri Lanka, 2011). | |
| Overseas Realty (Ceylon) PLC | Yes | The firm is one of the largest listed property developers in Sri Lanka which owns the World Trade Centre Twin Towers in Colombo. After the ending of the war, the firm resumed its joint venture with the Bank of Ceylon on 13th December 2010 to develop a 17 acre mixed development project (Havelock City) in Colombo, which is the largest of its kind in Sri Lankan history (Paha, 2010). The project is backed by Singapore based Shing Kwan group (Lanka Business Online, 2010). | USD 350 million |
| Softlogic Holdings PLC | No | The company firm in June 2011 to build a five star hotel in the heart of Colombo at a value of USD 33 million to capitalise on the booming tourism market in the post-war period (Sunday Observer - Sri Lanka, 2011).The firm is planning to build another luxury resort in Pasikudah at a value of USD 2 million. This was announced in January 2012 and it is | USD 35 million |

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| | | expected to be completed in 2013. The government has already put in measures to develop several places as key tourism areas including Pasikudah with the expected boom in the country's tourism sector (Daily News - Sri Lanka, 2012). | |
| Sri Lanka Telecom PLC | Yes | The firm has commissioned a fibre optic cable linking the former warzones with the rest of the country. The project began in May 2009 as soon as the war ended and is expected to cost USD 60 million over two years. This will offer high speed communications to the whole Jaffna peninsula (Bloomberg, 2011). | USD 60 million |
| Ceylon Tobacco Company PLC | Yes | Sri Lanka's sole licenced cigarette maker has been a key source of government revenue in 2009 with a contribution of USD 520 million. This accounted for 7.6% of the total tax revenue and approximately 2.2% of the GDP (Business Today, 2010). | USD 520 million |

### 9.1.2 Instances of Political Appointments/Arrangements

| Connected Person (Affiliated Company) | Description |
|---|---|
| **Janaki Kurrupu** (Colombo Dockyard PLC and Commercial Bank PLC)<br>**Susantha Ratnayake** (John Keells Holdings PLC, Asian Hotels and Properties PLC, Ceylon Cold Stores PLC, Ceylon Tobacco PLC, Tea Small Holder Factories PLC and Trans Asia Hotels PLC) | Janaki Kurrupu was appointed the Chairman of the Sri Lankan Tea Board in December 2011 replacing Susantha Ratnayake. His voluntary stepping down after one and a half years comes amidst much speculation of a reshuffle in the public sector institutions (Daily FT, 2011). |
| **Dhammika Perera** (Hayleys PLC, Haycarb PLC, Dipped Products PLC, National Development Bank of Sri Lanka PLC, Royal Ceramics Lanka PLC and Asia Capital PLC) | He was to be appointed Chairman of Sampath Bank PLC on December 29 2011, after being on the board since 2007. Dhammika is the largest shareholder of the firm with a holding of 15% via his company Vallibel One PLC. This appointment adds to his already growing portfolio of positions including the Secretary of the Ministry of Transport which was given to him by President Rajapaksa (Daily FT, 2011). |
| **Sri Lanka Insurance Corporation** (Hatton National Bank PLC, National Development Bank PLC, Commercial Bank PLC, Sampath Bank PLC, DFCC Bank PLC and Colombo Dockyard PLC) | A government issued circular which grants Sri Lanka Insurance Corporation a monopoly in general insurance business has negatively impacted on private insurance providers. Furthermore, listed firms such as Hatton National Bank, National Development Bank, Commercial Bank, Sampath Bank, DFCC Bank and Colombo Dockyard PLC which are indirectly owned by the government will now have to place their insurance risks with Sri Lanka Insurance Corporation. This has resulted in these firms losing the opportunity to obtain competitive rates for their insurance |

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| | risks (Daily Mirror - Sri Lanka, 2011). |
| **Sri Lanka Insurance Corporation, Employee Provident Fund (EPF) and Employee Trust Fund (ETF)**<br><br>**Dr. Ranee Jayamaha** (Hatton National Bank PLC)<br><br>**Ranjit M. S. Fernando** (Commercial Bank PLC)<br>**Lakshman Hulugalle** (Commercial Bank PLC) | There has been much speculation regarding the governance of banks, ever since state institutions and state funds such as Sri Lanka Insurance Corporation, EPF, ETF began investing in private commercial banks. Recently Hatton National Bank appointed Dr. Ranee Jayamaha, who is currently an influential advisor to the President and a former deputy governor of the Central Bank, as a nominee director on the board. Moreover, the chairman of the board of Commercial Bank, Ranjit Fernando, was replaced by Lakshman Hulugalle, who is an influential government official. This was done at the request of the government who exercised its shareholding rights to oppose the re-election of Mr Fernando to the post. The reason for the removal of Ranjit Fernando has been speculated to be because of his links to the opposition party, United National Party (The Sunday Times, 2011). |
| **Sri Lanka Insurance Corporation** (Colombo Dockyard PLC) | Colombo Dockyard PLC informed the Colombo Stock Exchange that state owned Sri Lanka Insurance Corporation have requested the nomination of a director to the board of the company after acquiring 10% stake in the company. It is not clear as to why such a nomination has been requested however, there has been speculation by certain analysts that the government is making inroads to controlling the decision process of certain companies (Daily Mirror - Sri Lanka, 2011). |

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| **Raj Rajaratnam** (John Keells Holdings PLC and via Galleon Fund - Asian Hotels and Holdings PLC, DFCC Bank PLC, National Development Bank PLC and Environmental Resources Investments PLC) | Raj Rajaratnam, the founder of the Galleon hedge fund founder, was sentenced to 11 years in prison on October 13th 2011 on all counts of insider trading. Galleon fund is one of the largest foreign investment funds in Sri Lanka and has large stakes in firms like John Keells Holdings. He was recently accused of funding Sri Lanka's decade long civil war against the Tamil tiger terrorist organisation, LTTE (Hindustan Times, 2011). |
| **The LTTE** (via Maxis Malaysia - Sri Lanka Telecom PLC) | It was revealed by former LTTE commander, KP, that the LTTE obtained 42% of Sri Lanka Telecom via Maxis Malaysia. The intention was to take over the national communication network under the LTTE. 52% of the firm was owned by the government and in 2008 April, Maxis spent USD 3.2 million to obtain 42% of the firm (Colombo Times, 2009). |
| **Basil Rajapaksa** (Micro Cars Ltd (not listed)) | President's brother, Basil Rajapaksa acquired a 25% stake in Micro cars Ltd in 2005 once the firm went public. The firm granted exemption from the 300% cess levy on imported cars into the country. Furthermore, all government authorities were ordered to buy Micro cars as directed by Basil Rajapaksa (Lanka News Web, 2010). |
| **Lanka Hospital Corporation PLC** | Sri Lankan Government remains passionate about the firm after the acquisition of this listed firm. The chairman is the President's brother Gotabhaya Rajapaksa. The state now runs the entire fee paying hospital system funded by taxes as well as one-off fee levying hospitals (Asia Pulse, 2011). |

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| **Employee Provident Fund (EPF)** (Diesel and Motor Engineering PLC, Richard Pieris and Company PLC, Ceylon Grain Elevators PLC, John Keells Holdings PLC, Royal Ceramics PLC, Aitken Spence PLC, Seylan Bank PLC, DFCC Bank PLC, Sampath Bank PLC, HNB Bank PLC and Commercial Bank of Ceylon PLC) | The Central Bank operated EPF has acquired a large stake in Diesel and Motor Engineering PLC and Richard Pieris and Company PLC in two separate deals carried out recently. The fund, under the guidance of the Central Bank, has been acquiring stakes in numerous listed firms. Other firms the fund has recently stepped up buying shares include, Ceylon Grain Elevators PLC, John Keells Holdings PLC, Royal Ceramics PLC, Aitken Spence PLC, Seylan Bank PLC, DFCC Bank PLC, Sampath Bank PLC, HNB Bank PLC and Commercial Bank of Ceylon PLC (Fernando J. A., 2011). |
| **D. Harry S. Jayawardena** (Aitken Spence PLC, Hatton National Bank PLC, Distilleries Company of Sri Lanka PLC, Pelwatte Sugar Industries PLC and Lanka Milk Foods PLC);<br><br>**Nimal Welgama** (Sri Lanka Telecom PLC) | The government has appointed several new faces to state run entities which were incurring massive losses. Harry Jayawardena was appointed the chairman of the Ceylon Petroleum Corporation PLC. Moreover, Nimal Welgama, the CEO of the Upali group has been appointed the chairman of Sri Lanka Telecom PLC. The move to appoint private sector business leaders to loss making state run entities has been commended by several analysts. Furthermore, since these appointments were made by the President there would be minimal interference from other politicians (Sunday Observer - Sri Lanka, 2010). |

## 9.2 Appendix B: List of Political Connections Identified from Annual Reports

| Firm Name | Connected Person | Description |
|---|---|---|
| **Aitken Spence & Co Ltd** | D. H. S. Jayawardena | Consul-General for Denmark in Sri Lanka. Awarded Knight Cross of Dannebrog by Her Majesty the Queen of Denmark in 2010 |
| | Niranjan De Silva Deva Aditya | MP of EU from Southern England, Honorary Ambassador for SL |
| | Sri Lanka Insurance Corporation | SLIC is a major shareholder till 2010 |
| **Ceylon Tobacco Company Ltd** | Ariyaratne Hewage | Former Secretary to the Ministry of Education; Secretary to Ministry of Ports and Aviation, Ministry of Rehabilitation, Resettlement and Refugees and Ministry of Development of the East, Rehabilitation and Resettlement, Rural Housing and Women's Affairs. |
| **Hatton National Bank PLC** | D. H. S. Jayawardena | Consul-General for Denmark in Sri Lanka. Awarded Knight Cross of Dannebrog by Her Majesty the Queen of Denmark in 2010 |
| | W.W. Gamage | Secretary to Ministry of State Resources and Enterprises Development, Co-ordinating Director to President |
| | Pratapkumar De Silva | Honorary Consul of the Republic of Peru in Sri Lanka |
| | Sri Lanka Insurance Corporation | Government owned via SLIC 11.95% (plus EPF 7.69%) from 2010 onwards |
| **Asian Hotels and Properties PLC** | Ivan Samarawickrama | Director Rural Development; Controller of Prices; Director of Commerce; Additional Secretary of the Ministry of Lands and Land Development; Secretary of the Ministry of Mahaweli Development (irrigation ministry); Secretary of two |

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| | | Cabinet Sub Committees viz. Economic Affairs and Economic Overheads and Infrastructure. Operated as Counsellor - Economic & Commercial Affairs and at times functioned as Charge'd' affairs of the Sri Lanka Embassy in Bonn. Furthermore, was the Inspector of Training (deputy commandant) of the SL army volunteer force - the highest position available to a volunteer officer |
| **John Keells Holdings Ltd** | Ashroff Omar | Hon. Consul General of the Republic of Finland since March 2007 |
| | Deshabandu Tilak De Zoysa | Honorary Consul for Croatia in Sri Lanka since 1999, past chair of chamber of commerce |
| **Distilleries Co. of Sri Lanka Ltd** | D. H. S. Jayawardene | Consul-General for Denmark in Sri Lanka. Awarded Knight Cross of Dannebrog by Her Majesty the Queen of Denmark in 2010 |
| | Niranjan De Silva Deva Aditya | MP of EU from Southern England, Honorary Ambassador for SL |
| | A. Shakthevale | Additional Secretary (Livestock) from the Ministry of Agriculture and Livestock in 2002. He served as the Secretary, Ministry of Rehabilitation and Social Service in the Northeast Provincial Council |
| **Pelwatte Sugar Industries Ltd.** | D. H. S. Jayawardene | Consul-General for Denmark in Sri Lanka. Awarded Knight Cross of Dannebrog by Her Majesty the Queen of Denmark in 2010 |
| | Bank of Ceylon | Government owned via BOC (27.4%) |
| **Cargills (Ceylon) Ltd** | Jayantha Danapala | Former United Nations Under-Secretary General for Disarmament Affairs (1998-2003) and a former Ambassador of Sri Lanka to the USA (1995-1997) and to the UN Office in Geneva (1984-1987). He was Director of the UN Institute for Disarmament Research (UNIDIR) from 1987-1992. As a Sri Lankan diplomat Mr. Dhanapala served in London, |

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| | | Beijing, Washington D.C., New Delhi and Geneva |
| **Lanka Orix Leasing Co., Ltd** | Deshamanya M. D. Dharmasiri Pieris | Former Secretary to PM, Ministry of Public Administration, Provincial Councils and Home Affairs, Ministry of Agriculture, Food and Cooperatives, Ministry of Education and Higher Education, Director General of Broadcasting. Helped as Secretary of Ministry of Defence and External Affairs, Ministry of Trade and Shipping. Member of Presidential Commission on Finance and Banking. |
| **Sampath Bank Ltd.** | K. D. Dhammika Perera | Secretary to the Ministry of Transport, chairman of BOI from 2007-2010. Also owned by K. D. Dhammika Perera via Vallibel Investments (14.99%) |
| | Dharani S. Wijethilaka | Secretary to Ministry of Technology and Research, Former Secretary to Ministry of Justice, Ministry of Plan Implementation |
| | Sri Lanka Insurance Corporation, EPF | Government owned via SLIC and EPF 13.25% |
| **DFCC Bank (Sri Lanka)** | Damitha de Zoysa | Secretary to Ministry of Fisheries and Aquatic Resource Development |
| | Bank of Ceylon, Sri Lanka Insurance Corporation, EPF, ETF | Owned by government via BOC, EPF, ETF and SLIC (30% in total) |
| **Lanka Ventures PLC** | Acuity Partners Pvt Ltd | Acuity Partners Pvt Ltd which is a joint venture by HNB and DFCC owns 79.58%. Therefore the government is a major shareholder indirectly via DFCC. |
| **Hayleys Ltd** | K. D. Dhammika Perera | Secretary to the Ministry of Transport, chairman of BOI from 2007-2010. Also owned 25% from 2009 |

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| | N. J. De S. Deva Aditya | MP of EU from Southern England, Honorary Ambassador for SL |
| **Haycarb Ltd.** | K. D. Dhammika Perera | Secretary to the Ministry of Transport, chairman of BOI from 2007-2010 |
| **Dipped Products Ltd** | K. D. Dhammika Perera | Secretary to the Ministry of Transport, chairman of BOI from 2007-2010 |
| | Employee Provident Fund | Government owned from 2011 via EPF (10.52%) |
| **Central Finance Co. Ltd** | Sarath De Costa | Former Consul General for SL in Japan |
| | Sri Lanka Insurance Corporation | SLIC life fund Investment till 2010 (12%) |
| **National Development Bank of Sri Lanka** | Anura Siriwardena | Former Secretary to Ministry of Cooperatives and Internal Trade; Current Secretary to Ministry of Coconut Development and Janatha Estate Development |
| | Chandra Ekanayake | Nominee Director of the Ministry of Finance and Planning; Director General of Dept. of National Budget of the Ministry of Finance and Planning |
| | Bank of Ceylon; Sri Lanka Insurance Corporation, EPF | Government controlled via BOC, SLIC, EPF (30% in total) |
| **Namunukula Planatations PLC** | Government Shareholder; Secretary to Treasury | Listed as government owned via the Golden Shareholder clause. Also has the Secretary of Treasury owing 15% of the Shares. Majority shares are however owned by Richard Pieris PLC |
| **Kegalle Plantations PLC** | Government Shareholder | Listed as government owned via the Golden Shareholder clause. Majority shares are however owned by Richard Pieris PLC |
| **Maskeliya Plantations PLC** | Government Shareholder | Listed as government owned via the Golden Shareholder clause. Majority shares are however owned by Richard Pieris PLC |

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| **Colombo Dockyard Ltd.** | Sarath De Costa | Former consul general for SL in Japan |
| | Employee Provident Fund | Listed as government owned via EPF (15%) |
| **Royal Ceramics Lanka Ltd** | K. D. Dhammika Perera | Secretary to the Ministry of Transport, chairman of BOI from 2007-2010. Also owned by K. D. Dhammika Perera via Vallibel Investments (51%) |
| **Lion Brewery Ceylon Ltd** | Mano Selvanathan | Chair of the Ceylon Chamber of Commerce, Awarded Desamanya title by SL president, Awarded Pravasi Bharatiya Samman by President of India, Consul for Chile in SL |
| **Ceylon Beverage Holdings PLC** | Mano Selvanathan | Chair of the Ceylon Chamber of Commerce, Awarded Desamanya title by SL president, Awarded Pravasi Bharatiya Samman by President of India, Consul for Chile in SL |
| **CT Land Development Ltd.** | Bank of Ceylon | BOC (10%) from 2011 |
| **Singer (Sri Lanka) Ltd** | Ajit Jayaratne | Former chair of Colombo Stock Exchange, Chamber of Commerce; Former high commissioner for Singapore |
| **Diesel & Motor Engineering Co., Ltd** | Employee Provident Fund | Government ownership from 2011 onwards via EPF (10.33%), reduction in taxes and rationalising tariffs on vehicles by the govt has helped the firm increase profit by 10 times in 2011 |
| **Seylan Bank Ltd.** | Sri Lanka Insurance Corporation; Bank of Ceylon | Government owned from 2009 via SLIC, BOC (25% in total) |
| **The Bukit Darah PLC** | Mano Selvanathan | Chair of the Ceylon Chamber of Commerce, Awarded Desamanya title by SL president, Awarded Pravasi Bharatiya Samman by President of India, Consul for Chile in SL |
| | Tilak De Zoysa | Awarded title of Deshabandu by SL president, |

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| | | recipient of order of rising sun by emperor of Japan, Consul for Croatia, Past chair of Chamber of Commerce |
| | Asoka Gunasekera | Past chair of National Chamber of Commerce, legal advisor and Secretary to Ministry of Posts and Telecommunication, Co-ordinating Secretary for Ministry Power and Energy and Ministry of Highways, Acting Secretary for Ministry Policy Planning |
| **Sri Lanka Telecom PLC** | Nimal Welgama | Appointed as an overhaul of the leadership of company by the President of Sri Lanka |
| | Shameendra Rajapaksa | Private Secretary to Ministry of Finance and Planning, Former Private Secretary to Ministry of Ports and Aviation |
| | Sumith Wijesinghe | Co-ordinating Secretary from 1999-2004 to Ministry of Fisheries and Aquatic Resources Development, Ministry of Ports, Shipping, Fisheries and Aquatic Resources Development, and to the leader of the opposition. From 2004-5 he was Co-ordinating Secretary to the PM and from 2005 he was the Co-ordinating Secretary to the President |
| | U. R. Seneviratne | Current Deputy Secretary to Treasury at the Ministry of Finance and Planning |
| | Secretary to Treasury; EPF | Listed as government owned via Secretary to Treasury and EPF (52%) |
| **Dialog Axiata PLC** | Jayantha Dhanapala | Ambassador of SL and permanent representative to the UN in Geneva (1984-7), Ambassador to USA (95-7), UN under-secretary general (98-03) |
| **Lanka Walltile Ltd.** | T. De zoysa | Awarded Deshabandu title as well as an honorary title from the emperor of Japan, Honorary Consul for Croatia in Sri Lanka since 1999, past chair of chamber of commerce |
| **Vallibel One** | K. D. Dhammika | Secretary to the Ministry of Transport, chairman of |

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| **PLC** | Perera | BOI from 2007-2010. Also owned by K. D. Dhammika Perera 64.34% |
| **Hemas Holdings PLC** | Abbas Esufally | Honorary Consul General of Bhutan in SL |
| **Ceylinco Insurance PLC** | Deshamanya Lalith Kothalawala | Honorary Consul General of Singapore in SL |
| **Asiri Hospital Holdings PLC** | Sri Lanka Insurance Corporation | Government controlled till 2010 via SLIC Funds (26%) |
| **Asiri Surgical Hospital PLC** | Sri Lanka Insurance Corporation | Government controlled till 2010 via SLIC Funds (11.37%) |
| **Asiri Central Hospitals PLC** | Sri Lanka Insurance Corporation | Government indirectly controlled till 2010 via Asiri Hospital Holdings and Asiri Surgical Hospitals through SLIC Funds (26%) |
| **Environmental Resources Investments PLC** | Lalith Heengama | Secretary to Ministry of Trade and Commerce, Member of Presidential Tariff commission |
| | Gamini Sarath Munasinghe | Deputy High Commissioner in London from 91-7, High Commissioner in South Africa from 98-02, High Commissioner in Bangladesh from 03-06, Director of Economic Affairs at the Ministry of Foreign Affairs, |
| **Laugfs Gas PLC** | Employee Provident Fund | Government controlled 17.28% via EPF from 2011 onwards |
| **Lanka Ashok Leyland PLC** | B M Riyaj | Coordinating Secretary to Ministry of Industries Commerce |
| **Overseas Realty (Ceylon)** | Ajit Mahendra De Silva Jayaratne | Chairman of Colombo Stock Exchange, Chair of Finance Commission, Chair of Chamber of Commerce, High Commissioner of Singapore |

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| **PLC** | | |
| **The Lanka Hospital Corporation PLC** | Gotabaya Rajapaksa | Secretary to Ministry of Defence, brother to the president |
| | H A P Kahandaliyanage | Former Secretary Ministry of Healthcare and Nutrition |
| | T R C Reberu | Secretary to Ministry of Health |
| | Sri Lanka Insurance Corporation | Govt owned via SLIC (55%) |

## 9.3 Appendix C: List of Politicians in Sri Lanka

**Key**

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| **President** | **Deputy Ministers** |
| **Prime Minister** | **Secretary** |
| **Senior Ministers** | **Other Parliament members – Government** |
| **Other Cabinet Ministers** | **Other Parliament members – Opposition** |

| Ministry | Minister | Deputy | Secretary |
|---|---|---|---|
| **Defence & Urban Development** | Mahinda Rajapaksa | | Mr. Gotabhaya Rajapaksa |
| **Finance & Planning** | Mahinda Rajapaksa | Hon. Geethanjana Gunawardena | Dr. P.B. Jayasundara |
| **Ports & Aviation** | Mahinda Rajapaksa | Hon. Rohitha Abeygunawardena, Hon. Nirmala Kothalawala | Mrs. Sujatha Cooray |
| **Highways** | Mahinda Rajapaksa | | |
| **Buddha Sasana & Religious Affairs** | D. M. Jayaratne | Hon. A.D.S. Gunawardena | Mr. S. Amarasena |
| **Good Governance & Infrastructure Facilities** | Ratnasiri Wickramanayake | | |
| **Human Resources** | D. E. W. Gunasekera | | |
| **Rural Affairs** | Athauda Seneviratne | | |
| **Food & Nutrition** | P. Dayaratne | | |
| **Urban Affairs** | A. H. M. Fowzie | | |
| **Consumer Welfare** | S. B. Navinne | | |
| **National Assets** | Piyasena Gamage | | |
| **Scientific Affairs** | (Prof) Tissa Vitharana | | |
| **International Monetary Cooperation** | (Dr) Sarath Amunugama | | |

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| **Irrigation & Water Resources Management** | Hon. Nimal Siripala | Hon. W. B. Ekanayake | Mr. Aiwan De Silva |
| **Health** | Hon. Maithreepala Sirisena | Hon. Lalith Dissanayake | Dr. T. R. C. Ruberu |
| **Petroleum Industries** | Hon. Susil Premajayantha | Hon. Sarana Gunawardena | Mr. H. T. M. Jayawardena |
| **Livestock and Rural Community Development** | Hon. Arumugam Thondaman | Hon. H. R. Mithrapala | Mr. A. H. Gamage |
| **Water Supply & Drainage** | Hon. Dinesh Gunawardena | Hon. Nirupama Rajapaksa | Mr. A. Abeygunasekara |
| **Traditional Industries & Small Enterprise Development** | Hon. Douglas Devananda | Hon. Weerakumara Dissanayake | Mr. V. Sivagnanasothi |
| **Local Government & Provincial Councils** | Hon. A. L. M. Athaullah | Hon. Indika Bandaranayake | Dr. Nihal Jayathilake |
| **Industry & Commerce** | Hon. Rishad Bathiyutheen | Hon. Jayaratna Herath | Mr. Thilak Kollure |
| **Power & Energy** | Hon. Champika Ranawaka | Hon. Premalal Jayasekera | Mr. M. C. Ferdinando |
| **Construction, Engineering Services, Housing & Common Amenities** | Hon. Wimal Weerawansa | Hon. Lasantha Alagiyawanne | Mr. S. M. P. Jayarathna |
| **Justice** | Hon. Rauff Hakeem | | Mr. Suhada Gamlath |
| **Economic Development (finance & planning)** | Hon. Basil Rajapaksa | Hon. Lakshman Yapa Abeywardena, Hon. Muthu Sivalingam | |

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| **National Languages and Social Integration** | Hon. Vasudeva Nanayakkara | | Mrs. M. S. Wikramasinghe |
| **Higher Education** | Hon. S. B. Dissanayake | Hon. Nandimithra Ekanayake | Dr. Sunil Jayantha Nawarathna |
| **External Affairs** | Hon. (Prof) G.L. Peiris | | Mr. C. R. Jayasinghe |
| **Public Administration & Home Affairs** | Hon. W. D. J. Seneviratne | | Mr. P B Abeykoon |
| **Parliamentary Affairs** | Hon. Sumeda G Jayasena | | Mrs. H. P. Jayathunga |
| **Postal Services** | Hon. Jeevan Kumaranatunga | | Mr. Hemasiri Fernando |
| **Technology and Research** | Hon. Pavithra Wanniarachchi | Hon. Faizer Mustapha | Mrs. Dharani S Wijethilaka |
| **Environment** | Hon. Anura Priyadarshana Yapa | Hon. Abdul Cardar | Dr. R. H. S. Samarathunga |
| **Child Development and Women's Affairs** | Hon. Tissa Karaliyadde | Hon. N. L. A. M. Hisbullah | Mrs. Sumithra Rahubadda |
| **Labour and Labour Relations** | Hon. Gamini Lokuge | | Mr. W. J. L. U. Wijeweera |
| **Education** | Hon. Bandula Gunawardena | Hon. Vijayamuni Zoysa | Mr. H. M. Gunasekara |
| **Plantations** | Hon. Mahinda Samarasinghe | Hon. Earl Gunasekara | Mrs. R. A. D. R. M. Peiris |
| **Fisheries and Aquatic Resource Development** | Hon. Rajitha Senaratne | Hon. Susantha Punchinilame | Dr. P. Damitha N. De Soyza |
| **Land and Land Development** | Hon. Janaka Bandara Tennakoon | Hon. Siripala Gamlath | Mr. T. A. Peiris |

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| **Social Services** | Hon. Felix Perera | Hon. Chandrasiri Suriyarachchi | Ms. W.Yamuna Chithrangani |
| **Private Transport Services** | Hon. C B Rathnayake | | Mr. Victor Samaraweera |
| **Agriculture** | Hon. Mahinda Yapa Abeywardena | | Mr. K. E. Karunathilaka |
| **Mass Media and Information** | Hon. Keheliya Rambukwella | | Mr. W. B. Ganegala |
| **Transport** | Hon. Kumara Welgama | Hon. Rohana Dissanayake | Mr. Dhammika Perera |
| **Youth Affairs and Skills Development** | Hon. Dullas Alahapperuma | Hon. Duminda Dissanayaka | Mr. S. S. Hewapathirana |
| **Cooperatives and Internal Trade** | Hon. Johnston Fernando | Hon. Segue Dawood | Mr. Sunil S. Sirisena |
| **Rehabilitation and Prison Reforms** | Hon. Chandrasiri Gajadeera | | Mr. A. Dissanayake |
| **Indigenous Medicine** | Hon. Salinda Dissanayake | Hon. Pandu Bandaranayake | Mr. B. D. Dahanayake |
| **Minor Export Crops Promotion** | Hon. Reginald Cooray | | Mr. W. M. V. Narampanawa |
| **Foreign Employment Promotion and Welfare** | Hon. Dilan Perera | | Mr. Nissanka M. Wijerathna |
| **Coconut Development and State Plantations Development** | Hon. Jagath Pushpakumara | | Mr. Anura Siriwardena |
| **Culture and Aesthetic Affairs** | Hon. T B Ekanayake | | Mr. Wimal Rubasinghe |
| **Disaster Management** | Hon. Mahinda Amaraweera | Hon. Dulip Wijesekera | Mrs. S. M. M. Mohamed |

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| **Agrarian Services and Wildlife** | Hon. S M Chandrasena | | Mr. B.K.U.A. Wickramasinghe |
| **Resettlement** | Hon. Gunaratne Weerakoon | Hon. Vinayagamoorthy Muralitharan | Mr. B.M.U.D. Basnayake |
| **Public Coordination and Public Affairs** | Hon. Mervin Silva | | Mr. W. M. Wijesuriya |
| **Sports** | Hon. Mahindananada Aluthgamage | | Mr. U. R. Seneviratna |
| **State Assets and Enterprise Development** | Hon. Dayasritha Tissera | | Mr. W. W. Gamage |
| **Telecommunication and Information Technology** | Hon. Ranjith Siyambalapitiya | | Mr. M. A. Athukorala |
| **National Heritage** | Hon. Jagath Balasuriya | | Mrs. M.D.K.H. Wijethunga |
| **Productivity Promotion** | Hon. Lakshman Seneviratne | | Mr. W. M. Bandusena |
| **State Management Reforms** | Hon. Navin Dissanayake | | Mr. P. K. D. Amarawardena |
| **Civil Aviation** | Hon. Priyankara Jayaratna | | Mr. K. V. R. de Silva |
| **Secretary to the Prime Minister** | | | Mr. S. Amarasekara |
| **Cabinet Secretary** | | | Mr. Sumith Abeysinghe |
| **Secretary to the President** | | | Mr. Lalith Weeratunga |

| Other Parliament Ministers – Opposition | | Other Parliament Ministers – Government | |
|---|---|---|---|
| Mohamed Aslam | John Amaratunga | Victor Antony | Murugesu Chandrakumar |
| Tiran Alles | A.H.M. Azwer | Silvastrie Alantin | T. Ranjith De Soysa |
| Palitha Range Bandara | Sivasakthy Ananthan | Dilum Amunugama | Mohan Priyadarshana De Silva |
| Faizal Cassim | Tissa Attanayake | Vijitha Berugoda | Sajin De Vass Gunawardena |
| Harsha De Silva | Selvam Adaikkalanathan, | A. M. Chamika Buddhadasa | Wijaya Dahanayake, |
| Harin Fernando | Thalatha Atukorale | Tharanath Basnayaka | Malani Fonseka |
| Hunais Farook | M.T. Hasen Ali | Shantha Bandara | Arundika Fernando |
| Dunesh Gankanda | P.Ariyanethran | Sarath Kumara Gunaratne | Sudarshini Fernandopulle |
| Mohan Lal Grero | Ashok Abeysinghe | Hemal Gunasekera | Milroy Fernando |
| Praba Ganesan | Wasantha Aluwihare | Kanaka Herath | Sarath Weerasekara |
| Anoma Gamage | Jayalath Jayawardana | V.K. Indika | Sriyani Wijewickrama |
| Abdul Haleem | Chandrani Bandara Jayasinghe | Achala Jagodage | Eric Prasanna Weerawardhana |
| Sunil Handunnetti | Karu Jayasuriya | Sanath Jayasuriya | Rajiva Wijesinha |
| P. Harrison | Gayantha Karunatileka | Ellawala Medhananda Thero | Sanee Rohana Kodithuvakku |
| Vijitha Herath | Ravi Karunanayake | S.C. Mutukumarana | Udith Lokubandara |
| Kabir Hashim | Jayantha Ketagoda | Nishantha Muthuhettigamage | Neomal Perera |
| H.M.M. Harees | Lakshman Kiriella | Chamal Rajapaksa | Rohana Pushpa Kumara |
| Dayasiri Jayasekara | Ajith Kumara | Athuraliye Rathana Thero | Ramesh Pathirana |

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|---|---|---|---|
| Ranjith Madduma Bandara | Akila Wiraj Kariyawasam | Ruwan Ranatunga | Y.G. Padmasiri |
| Vijayakala Maheswaran | M. Joseph Michael Perera | V.S. Radhakrishnan | Namal Rajapaksa |
| M.B. Farook | | Roshan Ranasinghe | Lohan Ratwatte |
| Manusha Nanayakkara | A.D. Champika Premadasa | Perumal Rajathurai | Kamala Ranathunga |
| Gamini Jayawickrama Perera | Sajith Premadasa | R. Dumindha Silva | Shehan Semasinghe |
| P. Piyasena | Suresh K. Premachandran | Thilanga Sumathipala | Vasantha Senanayake |
| Ranjan Ramanayake | Ajith P. Perera | Vidura Wickramanayaka | Thenuka Vidanagamage |
| Arjuna Ranatunga | Lakshman Wasantha Perera | Chandima Weerakkody | Neranjan Wickremasinghe |
| Pon. Selvarasa | Niroshan Perera | | |
| Wijeyadasa Rajapakshe | Buddhika Pathirana | | |
| Mangala Samaraweera | Rosy Senanayake | | |
| Mavai S. Senathirajah | Sujeewa Senasinghe | | |
| Rajavarothiam Sampanthan | J. Sri Ranga | | |
| Upeksha Swarnamali | S. Shritharan | | |
| A. Vinayagamoorthy | E. Saravanapavan | | |
| S. Vino | M.S. Thowfeek | | |
| R. Yogarajan | Palitha Thewarapperuma | | |
| Seeniththamby Yoheswaran | Palany Thigambaram | | |
| Dilip Wedaarachchi | Janaka Wakkumbura | | |

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|---|---|---|---|
| Ranil Wickremasinghe | Nimal Wijesinghe | | |
| Eran Wickramaratne | Ruwan Wijewardene | | |

Source: (Policy Research & Information Unit of the Presidential Secretariat of Sri Lanka , 2011) and (Parliament of Sri Lanka, 2011)

## 9.4 Appendix D: Sample of Sri Lankan Listed Firms

The initial sample includes 103 listed firms which captures 79% of the total market capitalisation of the Sri Lankan stock market (Colombo Stock Exchange, 2012).

| Company Name | Symbol | Market Cap. (as a % of Total Market Cap.) |
|---|---|---|
| John Keells Holdings Plc | JKH.N0000 | 6.63(%) |
| The Bukit Darah Plc | BUKI.N0000 | 4.98(%) |
| Carsons Cumberbatch Plc | CARS.N0000 | 4.85(%) |
| Ceylon Tobacco Company Plc | CTC.N0000 | 3.94(%) |
| Sri Lanka Telecom Plc | SLTL.N0000 | 3.69(%) |
| Commercial Bank Of Ceylon Plc | COMB.N0000 | 3.44(%) |
| Dialog Axiata Plc | DIAL.N0000 | 2.92(%) |
| Nestle Lanka Plc | NEST.N0000 | 2.12(%) |
| Hatton National Bank Plc | HNB.N0000 | 2.06(%) |
| Aitken Spence Plc | SPEN.N0000 | 2.05(%) |
| Distilleries Company Of Sri Lanka Plc | DIST.N0000 | 2.02(%) |
| Cargills (Ceylon) Plc | CARG.N0000 | 2.00(%) |
| Lanka Orix Leasing Company Plc | LOLC.N0000 | 1.63(%) |
| Asian Hotels & Properties Plc | AHPL.N0000 | 1.61(%) |
| Sampath Bank Plc | SAMP.N0000 | 1.41(%) |
| C T Holdings Plc | CTHR.N0000 | 1.38(%) |
| Dfcc Bank | DFCC.N0000 | 1.31(%) |
| Hayleys Plc | HAYL.N0000 | 1.24(%) |
| People's Leasing Company Plc | PLC.N0000 | 1.07(%) |
| Vallibel One Plc | VONE.N0000 | 1.04(%) |
| Lanka Orix Finance Plc | LOFC.N0000 | 1.02(%) |
| Aitken Spence Hotel Holdings Plc | AHUN.N0000 | 1.00(%) |
| Ceylon Guardian Investment Trust Plc | GUAR.N0000 | .97(%) |
| Central Finance Company Plc | CFIN.N0000 | .95(%) |
| Chevron Lubricants Lanka Plc | LLUB.N0000 | .92(%) |
| National Development Bank Plc | NDB.N0000 | .91(%) |

| | | |
|---|---|---|
| John Keells Hotels Plc | KHL.N0000 | .85(%) |
| Hemas Holdings Plc | HHL.N0000 | .76(%) |
| Expolanka Holdings Plc | EXPO.N0000 | .76(%) |
| Richard Pieris And Company Plc | RICH.N0000 | .75(%) |
| Brown & Company Plc | BRWN.N0000 | .74(%) |
| Colombo Dockyard Plc | DOCK.N0000 | .72(%) |
| Royal Ceramics Lanka Plc | RCL.N0000 | .70(%) |
| Ceylinco Insurance Plc | CINS.N0000 | .68(%) |
| The Lion Brewery Ceylon Plc | LION.N0000 | .68(%) |
| Singer Sri Lanka Plc | SINS.N0000 | .67(%) |
| Trans Asia Hotels Plc | TRAN.N0000 | .66(%) |
| Ceylon Tea Services Plc | CTEA.N0000 | .62(%) |
| Capital Development And Investment Company Plc | CDIC.N0000 | .59(%) |
| Nations Trust Bank Plc | NTB.N0000 | .58(%) |
| Softlogic Holdings Plc | SHL.N0000 | .57(%) |
| Environmental Resources Investments Plc | GREG.N0000 | .56(%) |
| Laugfs Gas Plc | LGL.N0000 | .55(%) |
| Lanka Ashok Leyland Plc | ASHO.N0000 | .54(%) |
| Overseas Realty (Ceylon) Plc | OSEA.N0000 | .53(%) |
| Diesel & Motor Engineering Plc | DIMO.N0000 | .52(%) |
| Seylan Bank Plc | SEYB.N0000 | .51(%) |
| Ceylon Investment Plc | CINV.N0000 | .49(%) |
| The Lanka Hospital Corporation Plc | LHCL.N0000 | .47(%) |
| The Indo Malay Plc | INDO.N0000 | .44(%) |
| Lb Finance Plc | LFIN.N0000 | .43(%) |
| Ceylon Cold Stores Plc | CCS.N0000 | .41(%) |
| Ceylon Beverage Holdings Plc | BREW.N0000 | .38(%) |
| The Good Hope Plc | GOOD.N0000 | .37(%) |
| Asiri Hospital Holdings Plc | ASIR.N0000 | .35(%) |
| Selinsing Plc | SELI.N0000 | .35(%) |
| Dipped Products Plc | DIPD.N0000 | .29(%) |
| Shalimar (Malay) Plc | SHAL.N0000 | .28(%) |
| Lanka Walltiles Plc | LWL.N0000 | .22(%) |

| | | |
|---|---|---|
| Haycarb Plc | HAYC.N0000 | .21(%) |
| John Keells Plc | JKL.N0000 | .20(%) |
| Lanka Floortiles Plc | TILE.N0000 | .19(%) |
| Asiri Central Hospitals  Plc | ASHA.N0000 | .19(%) |
| Asiri  Surgical Hospital Plc | AMSL.N0000 | .18(%) |
| Ceylon Leather Products Plc | CLPL.N0000 | .15(%) |
| Guardian Capital Partners Plc | WAPO.N0000 | .15(%) |
| Hemas Power Plc | HPWR.N0000 | .14(%) |
| Hotel Services (Ceylon) Plc | SERV.N0000 | .14(%) |
| Kelani Valley Plantations Plc | KVAL.N0000 | .13(%) |
| Singer Finance (Lanka) Plc | SFIN.N0000 | .12(%) |
| Lanka Ceramic Plc | CERA.N0000 | .12(%) |
| Kegalle Plantations Plc | KGAL.N0000 | .11(%) |
| Hnb Assurance Plc | HASU.N0000 | .11(%) |
| Dankotuwa Porcelain Plc | DPL.N0000 | .10(%) |
| People's Finance Plc | SMLL.N0000 | .10(%) |
| Serendib Hotels Plc | SHOT.N0000 | .09(%) |
| Browns Beach Hotels Plc | BBH.N0000 | .09(%) |
| Tea Smallholder Factories Plc | TSML.N0000 | .08(%) |
| Lanka Ventures Plc | LVEN.N0000 | .08(%) |
| Equity One Plc | EQIT.N0000 | .08(%) |
| Seylan Developments Plc | CSD.N0000 | .07(%) |
| Pegasus Hotels Of Ceylon Plc | PEG.N0000 | .07(%) |
| Pelwatte Sugar Industries Plc | SUGA.N0000 | .07(%) |
| Softlogic Finance Plc | CRL.N0000 | .07(%) |
| Namunukula Plantations Plc | NAMU.N0000 | .07(%) |
| Colombo Pharmacy  Company Plc | PHAR.N0000 | .06(%) |
| Kotmale Holdings Plc | LAMB.N0000 | .06(%) |
| Hayleys Mgt Knitting Mills Plc | MGT.N0000 | .06(%) |
| C T Land Development Plc | CTLD.N0000 | .06(%) |
| Dolphin Hotels Plc | STAF.N0000 | .06(%) |
| Commercial Development Company Plc | COMD.N0000 | .05(%) |
| Keells Food Products Plc | KFP.N0000 | .05(%) |

| | | |
|---|---|---|
| Softlogic Capital Limited | SCAP.N0000 | .04(%) |
| Equity Two Plc | ETWO.N0000 | .04(%) |
| Singer Industries (Ceylon) Plc | SINI.N0000 | .04(%) |
| Horana Plantations Plc | HOPL.N0000 | .04(%) |
| Central Industries Plc | CIND.N0000 | .04(%) |
| Balangoda Plantations Plc | BALA.N0000 | .03(%) |
| Maskeliya Plantations Plc | MASK.N0000 | .02(%) |
| Hotel Sigiriya Plc | HSIG.N0000 | .02(%) |
| Hunas Falls Hotels Plc | HUNA.N0000 | .02(%) |
| Richard Pieris Exports Plc | REXP.N0000 | .01(%) |
| Hayleys Exports Plc | HEXP.N0000 | .01(%) |

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