

“Stock Market Challenges”

BY GIA SINGH

About two weeks ago we saw the recently appointed General Manager of the Trinidad and Tobago Stock Exchange (TTSE), Mr. Wain Iton, address two major challenges which are inhibiting the growth potential of our local stock market. These are:

- Increasing the number of listed companies
- Getting the public more involved in investing in the stock market

Currently there are 33 listed securities on the market and should the Merger and Acquisition deals carded for this year be realized, there will be even fewer listed companies and a substantial loss in market capitalization.

Increasing the number of listed companies has indeed been a challenge for the TTSE as private companies in T&T are unwilling to take the necessary steps to become public. While there are various reasons why this is so, I agree with Mr. Iton who has pointed out that it is very much a “cultural phenomenon”.

Trinbagonians by nature are very proud and sentimental people. Many businesses are run by families and are passed on from generation to generation much the same as a family heirloom. In some cases, these private companies have been able to grow and expand to large well distinguished corporations. The need to go public is not seen as important as companies are able to achieve goals and objectives through their own means.

Additionally, there are factors which discourage private companies from going public. For instance, one of the requirements to become listed is full disclosure of company financial statements. In Trinidad and Tobago, wealthy individuals and more so entrepreneurs have been the main targets of kidnappings and even in some cases murder. Private owners fear for their safety and that of their families when financials are not even disclosed, far less if this was public information.

Another deterrent from listing is the risk of losing control. This can occur if more than fifty percent of the company is floated on the market and shareholders form an alliance or sell to one large investor. However, this can be prevented by simply floating less than fifty per cent of the issued share capital on the market. Suffice to say, it is only a risk if the initial owners choose to put themselves in that position.

Consideration must also be given to formalities associated with going public, such as having an investor relations department to communicate all relevant information to shareholders. There are also the financial costs involved in listing which include: fees from the exchange, commissioning valuations and prospectus costs. Also public companies have to undergo greater compliance, accounting and reporting procedures than private companies.

While the factors mentioned above may make it less likely for private companies to want to go public, clearly there are benefits to be derived as some companies saw value in making the conversion.

One of the first and main benefits of listing a company is raising new capital. When large sums of capital are required it may be more cost effective for a company to use equity financing as opposed to debt financing. Capital can be used for various reasons including growth and expansion which in turn could lead to larger profits. Also under this point, is the fact that a public company can have additional offerings on the market when further financing is required. Of course, companies should be cautious of diluting Earnings Per Share as more offerings means a larger issued share capital.

Besides the tangible financial benefits there are intangible benefits such as increasing brand awareness and raising the company's profile. Listed companies can also reserve a portion of float capital for their employees which in turn can lead to increased loyalty and motivation towards achieving the goals and objectives of the company.

An Initial Public Offering (IPO) also provides an opportunity for existing private owners who wish to withdraw some or all their capital to do so without diminishing the capital of the company. While existing shareholders would have a market value for their shares which can make it easier for them to secure loans against their capital. Last but not least, lower cost of debt for future financing as the more detailed reporting to shareholders can induce financiers to extend more at lower costs.

Now that we have covered the supply side of the equation, we can now take a look at the challenge of increasing demand! How do we encourage the population to become active in the market? Mr. Iton's view is that the general public does not understand the market and that there is a need for a significant public education drive. Of course this makes sense, after all why would you put money in something you don't understand?

One initiative that has been put in place to educate the public is the Central Bank's National Financial Literacy Program which was launched in January 2007. The program is geared towards educating the public so that they can have the capability and ability to make personal budgets, balance current spending and saving for the future; manage credit and debt; assess the needs for insurance and protection, and evaluate risks and returns involved in different savings and investment options.

Another reason for the lack of demand, is the fact that the confidence in the stock market in the last two years has somewhat diminished. So if current investors are unhappy with returns then why would new ones enter? In addition to lack of confidence, a key contributor to poor demand is the fact that there is a fair degree of uncertainty in the market. Listed companies need to realize the importance of full disclosure to shareholders so that they can make more informed decisions about their investments.

In order to build investor confidence, public companies need to be as transparent as possible and keep investors and shareholders alike up to date with relevant and reliable information. In fact, research has proven that companies who are more transparent about key metrics and performance indicators are more valuable than those companies that keep information to themselves.

Gia Singh
Senior Research Analyst
West Indies Stockbrokers Limited (WISE)
gias@wisett.com