

ROLE OF THE SHARE MARKET IN SRI LANKA

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The share market activities cover the dealings of primary and secondary markets. The former market helps the formation of long-term private capital while the latter helps to form short-term capital. In addition, the secondary share market provides liquidity to shares. It also transfers its short-term capital to the primary market to form long-term capital. The ideal behaviour of the two markets with high interdependence will pave way for the private economy to move towards what is called the 'shareholder capitalism'. The market signals produced by the latter encourage or discourage investments in firms (industries) reallocating funds among industries under this alternative 'invisible hand'.

There are some special features in Sri Lanka's share market. Both markets are small in size and trade. The primary market is not active and has so far been able to generate only a limited volume of financial capital to the system. On the supply side, the offers of new shares coming to this market have drastically declined since the mid- 90s. Unusually, the private sector raises its own long-term capital through conventional means. This behaviour of the private sector seems quite irrational in the sense that the cheapest source of capital is the equity capital formation in firms. On the demand side, there was substantial over-subscription. This has turned into an under-subscription in recent times. The secondary share market is a 'thin market' which produces high vicissitudes in share prices. Formerly the foreign investors were the main participants in this market but now they are the net sellers of shares. Domestic investors seem to show little enthusiasm in market activities. This market is constantly being influenced by changes in internal and external political and economic variables.

The two markets are interdependent to the extent that high (low) share prices at the secondary market cause high (low) demand and supply of shares and thereby high (low) premiums for shares at the primary market. Sri Lanka's share market is still under-developed. Therefore it is quite unrealistic to expect the share market to mobilise resources to move the private economy towards 'shareholder capitalism' even in the medium term.