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Capital Structure for a Diversified Conglomerate:

A Case Study for

John Keells Holdings PLC

By

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CANDIDATE'S DECLARATION

The work described in this thesis was carried out by me under the supervision of Dr. Y. K. Weerakoon Banda, Senior Lecturer, Department of Finance of the University of Sri Jayewardenepura, and a report on this has not been submitted in whole or in part to any university or any other institution for another Degree/Diploma.

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SUPERVISOR'S DECLARATION

I certify that the above statement made by the candidate is true and that this thesis is suitable for submission to the University for the purpose of evaluation.

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Capital Structure for a Diversified Conglomerate: A Case Study for John Keells Holdings PLC (JKH)

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Abstract

This thesis devotes to discuss the decision of capital structure for a diversified conglomerate. The research is focused for inconsistent with normative theory of finance and financial performance of the company. The research follows the case study approach. The sample data collected using a structured questionnaire and with the detailed discussions had with the top management, annual reports of the company, quarterly reports of the company and other company articles. The sample data covers during the period from 1998 to 2009.

The research found most of the long term investments are initially financed with short term financing methods. This financing practice is inconsistent with the normative theory of finance. JKH has a mixed strategy towards the decision about the selection of financing sources for long term strategic investment. Further, the result showed that the company performed strongly in the last decade with their investment philosophy.

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Introduction

1.1 Background of the study

Capital structure of a company is an important decision in the corporate finance, because it effectively leads to enhance the value of the firm. Level of equity and debt management capacity is one ingredient of a policy framework that ensures the sustainability of the organization. A group company has the ability to finance the investment with debt and equity as well as part of the dividend income and inter company loans and fund transfers.

1.2 Research problem

Normative theory of finance shows, long term investments need to be financed by long term financing methods as well, short term investments need to be financed by short term financing methods.[1]

[1] Please refer section 3.5 in page number 24.

As a research area, the author identified an area which could show a gap between theory and practice. The identified area is the financing of long term investments by a parent company. As a parent company of a group, it extends the number of financing sources for its long term investments. As the parent company researcher examined the inconsistent in theory of finance for the decision of long term financing for strategic investments of the John Keells Holdings PLC- JKH.

JKH group is a diversified conglomerate with more than 80 subsidiaries and associates. From that, JKH invested with more than 42 companies in the group. Author focused to identify whether there is a gap between normative theory of finance and the current investment strategy of the JKH.

1.3 Objective of the study

The main objective to examine the company's financing strategy for long term investments are inconsistent with normative theory of finance. This research is focused to find the in-consistent with the theory of finance regarding the strategic investments[2] of the JKH.

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[2] An investment that a corporation or affiliated firm makes in a company that offers to bring something of value to the corporation itself.

Normative theory of finance says "Long term investments should be financed with long term financing methods".

This thesis would show the company has the ability to finance the investments with debt and equity as well as part of the dividend income and inter company loans and fund transfer. This expands the issues involved with above financing methods. Author discusses the gap between the normative theories for finance with the current practice of the JKH, whilst the research examines the effect of capital structure decision for the financial performances of the company with the current investment practice.

1.4 Significance of the study

The capital structure decision is a significant managerial decision which influences the risk and return of the investors. It is essential to plan the capital structure at the time of inception and subsequently when in need to raise additional funds for various new projects. In the event of company needs to raise finance, the capital structure decision involves since the assessments like amount to be raised and source of finance for same are the fundamental decisions sorted through the capital structure. This is very important for a diversified conglomerate.