

OPPORTUNITIES AND CHALLENGES FACED BY THE SRI LANKAN CONSTRUCTION COMPANIES IN THE STOCK MARKET

S.M.W.L. Siriwardhana^{*}, P.A.P.V.D.S. Disaratna, S.M.N. Anuruddika and N.N. Wimalasena

Department of Building Economics, University of Moratuwa, Sri Lanka

ABSTRACT

In recent years, the social and technological changes originating from globalization, information revolution and knowledge-based economy fundamentally modified the construction industry environment. Local contractors need to originate a strategy to upgrade not only its technological capacity, but also the financial capacity to compete successfully in this landscape. Access to capital is one of the key strategic asset which contributes to the success of construction firms. This research focuses on to determine suitability of financing through the Stock Market for construction companies.

Survey approach was used to collect data. Mainly questionnaire was designed to identify the opportunities and challenges in the Stock Market for a construction company. Semi structured interviews were conducted to identify the strategies to enhance opportunities and face challenges in Stock Market. Preliminary survey was carried to structure the questionnaire.

The data gathered related to the challenges were analysed using SPSS one sample t-test and IPA matrix. Simple graphical analysis methods and manual content analysis technique also were used to analyse data. A total number of 22 opportunities related to the Stock Market for a construction company were identified during the questionnaire survey and semi-structured interviews. Then identified the 17 challenges related to the Stock Market for a construction company. However, just only 4 number of challenges were identified as critical challenges. Mechanisms available to enhance opportunities and to face challenges in the Stock Market were investigated. Finally, identified that financing through Stock Market is a better opportunity for the construction companies in Sri Lanka.

Keywords: Construction Companies; Opportunities and Challenges; Sri Lanka; Stock Market.

1. INTRODUCTION

Donaldson (1961) and Myers and Majluf (1984) discovered that companies use internal financing of funds from their operations. When internal funds are not adequate, companies would use external financing. The Public offering is an important financing method. Normally, shareholders expect a return from new equity issues, and like that the public is interested in contributing for shares (Kiymaz, 2000; Aaij and Brounen 2002). In addition to that Redman, Tanner and Manakyan, (2002) mentioned that Managers tend to look at the tax advantages of debt and availability of cash flows in determining which financing methods to use, more than theoretical corporate finance factors.

The Capital Asset Pricing Model (CAPM) has possessed a central position in financial economics over the twenty years since its origins in the papers by Sharpe (1964) and Lintner (1965). Moreover Bokpin (2010) mentioned that well-developed Stock Markets accommodate information acquisition, liquidity and diversification resource mobilization for corporate finance, growth and investment. Further, they mentioned that an active and liquid Stock Market help firms to finance their operations through equity capital than debt in the relatively cheaper way. Similarly, Olaleye (2011) mentioned that investors could consider the content of listed property stock in their portfolios with the anticipation of a significant return enhancement with marginal risk reduction.

^{*}Corresponding Author: E-mail –waruni163@gmail.com

The political position of a country highly effects on the development of the Stock Market. At the end of a a ruinous 30 years of civil war, Colombo Stock Exchange has initiated to peak and became one of the best performing Stock Markets in Asia (Hettiarachchi, 2009).

The Colombo Stock Exchange (CSE) has 294 companies deputizing 20 business sectors with a market capitalization of Rs. 2,701.6 Bn as at 31st January 2017. Public companies established under the Companies Act No.7 of 2007 or any other statutory corporation, established or incorporated under the laws of Sri Lanka or incorporated under the laws of any other state (subject to Exchange Control approval) are eligible to look for a listing on the Colombo Stock Exchange to obtain debt or equity. Companies asking to be entered into the official list of the Exchange and to protect a listing of their securities will be required to conform to the relevant provisions of the above act and the Securities and Exchange Commission (SEC) Act No.36 of 1987 and the Listing Rules of the Exchange.

Listed companies in different industries have different market structures, profitability and industry life cycle, therefore listed companies performance, share price gains and investment risk differ from industry to industry (Zhao, 2013). Construction firms and commercial bank are two developing sectors of the Polish economy and dominate the Stock Market. This implies that growing companies contribute to its development and dominate the Stock Market (Kominek, 2004).

Under the Colombo stock exchange there are two registered contracting companies. Access Engineering (PLC) was listed on the CSE on 27th March 2012. The shares were listed on the Diri Savi Board and it is classified under the Construction and Engineering Sector (Colombo Stock Exchange, 2016). MTD Walkers PLC had been established as a Public Limited Company (PLC) in 1981 and it was listed on the Main Board of the Colombo Stock Exchange in 1983 (MTD Walkers PLC, 2016). According to the Polish economy, there is more involvement of construction companies in the Stock Market. But still Sri Lankan construction companies not that much involve with the Stock Market.

Very few studies have been conducted internationally and locally regarding to the involvement of construction companies in the Stock Market. Moreover, in other countries' economies like the Polish economy, there are more construction companies in the Stock Market. But still, in Sri Lanka there is no that much involvement of construction companies in the Stock Market. It shows that there is a problem related to this area. Hence, this research focused to identify the opportunities and challenges faced by Sri Lankan Construction companies when involving with the Stock Market.

The aim of the research is to identify the opportunities and challenges faced by the Sri Lankan Construction companies in the Stock Market and give recommendations to overcome the challenges. It is also expected to identify the differenet types of financing methods available for construction companies and to determine the suitability of financing through the Stock Market for construction companies.

2. LITERATURE FINDINGS

Shares of public listed companies are traded on the Stock Market. Companies float shares to the general public in an initial public offering (IPO) to accumulate capital in the primary market (Economic Times, 2016). Stock Market plays a major role in accomplishing capital requirement of the companies. For the long term fund requirements, issuing shares to the public is one of the most cost effective ways. Many researchers find that investment which requires long term funding affect to the economic growth and development of the country. Normally Stock Market is a complex place while the principles of it are straightforward. The Stock Market is the one of the most important place that a company can raise funds for its various needs like for further growth and expansion.

The Colombo Stock Exchange (CSE) has started to peak and became one of the best performing and promising Stock Markets in Asia after the end of a civil war, which has lasted over three decades in Sri Lanka (Hettiarachchi, 2009).

Financing is one of the salient areas in a firm. To maximize company's value and minimize the cost of capital, a manager should establish an optimum capital structure (Bokpin, 2010). Therefore, firms should attempt to determine the optimum capital structure that maximizes the firm's value. But no strict theory has been developed yet to determine the exact optimum capital structure (Sangeetha and Sivathaasan, 2013). Normally,

managers identify factors influencing capital structure decision to make an optimum mix of debt and equity to maximize firm's value (Puwanenthiren, 2011).

Literature review identified that equity and debt financing as major financing methods for companies. Equity, preference shares, debentures and bank loans are financing methods available for companies under equity and debt financing. Equity and preference shares come under the equity capital and debentures and bank loans comes under the debt capital. The most optimum capital structure is the debt-equity mix which maximize the firms' value, so firms' should attempt to optimize their capital structure by a suitable mix of debt-equity capital.

According to the Lawal *et al.* (2014), debt to equity ratio and total debt are negatively related to firm performance. Furthermore, they recommended that when firms financing their business they should use more of equity than debt. When interest rates are low equity is more expensive than debt. Although, if earnings decline, equity does not need to be paid back like debt. Maintaining a low debt-to-equity ratio also puts a company in a better position to get a loan in the future when needed. Debt and equity finance have both advantages and disadvantages as well. Thus, it is better to have a structure comprising of both debt and equity financing for the given project.

There are 295 companies which represent 20 business sectors in the Colombo Stock Exchange (CSE) as at 31st January 2017 (Colombo Stock Exchange, 2017).

Under the construction and engineering sector below companies are listed on the Colombo stock exchange

- MTD Walkers PLC
- Access Engineering PLC
- Colombo Dockyard PLC
- Lankem Developments PLC

MTD Walkers PLC and Access Engineering PLC are the main contracting companies among those four companies which registered under the construction and engineering sector of the Colombo stock Exchange.

Opportunities in the Stock Market for a company:

- Can raise new money anytime from the public
- Encourages employee by rewarding
- Ability to attract better employees
- Enhance the public image of the company
- Provides transparency around the value of the business
- Help to build a global business
- Spread the risk of ownership
- Indirect advertising
- Reduction of the cost of other capital

Challenges in the Stock Market for a company:

- Listing on stock exchange is an expensive and time-consuming process
- Ownership of the company can go to outsider's hand
- Loss of Management Control
- Enhanced Reporting Requirements
- Increased Regulatory Oversight
- Increased Liability
- Perceptions of short-termism
- Dealing with institutional investors
- The Stock Market does not understand entrepreneurs
- Market fluctuations
- Responsibilities to shareholders
- Demands on the management team

3. RESEARCH METHODOLOGY

The survey approach was most suitable to achieve the aim and objectives of this research. Through literature review chapter secondary data for the research were collected. Preliminary survey, questionnaire survey and semi-structured interview survey were used to collect primary data. According to the findings of the literature review and preliminary survey, a questionnaire was developed for the questionnaire survey. Mainly questionnaire was designed to identify the opportunities and challenges in the Stock Market for a construction company. Preliminary survey was conducted with selected three resource person to validate the literature findings, to refine the research process effectively and to design the questionnaire. To achieve the third objective of this research; “to investigate mechanisms available for construction companies to enhance opportunities and to face challenges in the Stock Market”, semi structured interviews were conducted until the data saturation.

The collected data through the initial questions in the questionnaire survey were analysed using graphical presentation tools like bar charts and pie charts. One sample T-test of SPSS statistical software was used to analyse data regarding challenges collected through the Likert scale. One Sample T-test which compares the means of unrelated variables on the same continuous and assumed test value for mean were used to identify the most significant challenges out of the challenges mentioned in the questionnaire. After calculating the mean of each challenge, challenges were mapped into the IPA matrix using SPSS software. The modified IPA matrix was used to present the two dimensions of the challenges which are the level of challenge and level of ability to overcome the challenge. Collected data from semi-structured interviews related to the mechanisms available for construction companies to enhance opportunities and to face challenges in the Stock Market were analysed using content analysis technique manually.

4. RESEARCH FINDINGS

4.1. STATUS OF CONSTRUCTION COMPANIES IN SRI LANKAN STOCK MARKET

According to the literature review, in other countries' economies like the Polish economy, there are more construction companies in the Stock Market. But still, in Sri Lanka there is no that much involvement of construction companies in the Stock Market.

The analysis of the questionnaire survey portrayed a substantial need of involvement of construction companies in the Stock Market. On the other hand, respondents shown that there are ample of opportunities to go public. Having such friendly market, still the establishment of construction companies as Public Limited Liability Company has been significantly hindered. One of the main underlying reasons was figured to be the most of the construction companies are family owned and don't like to give ownership to outside. Due to the fact that majority of the large construction companies are financially stable, it makes less enthusiasm for Sri Lankan construction companies to enter into the Stock Market with more risk and commitment.

On the other hand, the respondents of semi structured interviews mentioned that the current market can be dramatically varied in coming years, if construction companies open into international construction market. Accordingly, construction companies may need more capital, there is a high possibility that they would think about the Stock Market. Hence, this phenomenon portrays a need of identification of opportunities and challenges related to the Sri Lankan Stock Market for Sri Lankan construction companies. The results were figured to be the fact that construction companies would not be capable of seeing the bigger picture of how other countries' construction industry executes and it has to be upgraded with the awareness. After calculating the mean of each challenge, challenges were mapped into the IPA matrix using SPSS software. The modified IPA matrix was used to present the two dimensions of the challenges which are the level of challenge and level of ability to overcome the challenge. Collected data from semi-structured interviews related to the mechanisms available for construction companies to enhance opportunities and to face challenges in the Stock Market were analysed using content analysis technique manually.

4.2. IMPACT OF INVOLVEMENT IN THE STOCK MARKET FOR THE CONSTRUCTION INDUSTRY

The outcomes of the survey analysis revealed a significant impact by the involvement of construction companies in the Stock Market for Country Development. However, the survey revealed another fact that Sri Lankan construction companies are less focused on going public.

The outcomes of the study suggest that the Stock Market growth and economic growth have a long-run relationship. It reveals that the Stock Market liquidity do help to improve the future economy. Nowbutsing and Odit (2011) also found that Stock Market development is an important ingredient for growth in Mauritius since the Stock Market gives a general idea of an economy's health. More precisely, the causality runs from Stock Market proxies to economic growth shows a significant relation between market capitalization, total trade value and turnover ratio on the Gross Domestic Product (GDP) and FDI.

Stock Market performance and economic growth are just like a two sides of a coin. As the Stock Market increases economy is also fast in growth in the other hand downfall in make in market performance means slowdown of economic growth. Both are related to each other so have to create new ways to maintain growth of the market, saving and more investment. There is a need for economic growth in Sri Lanka, that's why the emphasis should be more on the functioning of the Stock Market.

Normally, market capitalization affects positively to the GDP (Badr, 2015). The outcomes of the survey revealed that, Sri Lankan government must understand that it is time to find financial policies, to encourage companies and develop a financial Stock Market culture, and enhance to push companies to initiate IPOs instead of bank loans when money is needed to increase their investment.

4.3. OPPORTUNITIES IN THE STOCK MARKET FOR A CONSTRUCTION COMPANY

A total number of 10 opportunities were identified in the literature review as opportunities for a Public Limited Liability Company. In the preliminary survey, there were not added opportunities related to the Stock Market for a construction company. During the questionnaire survey new four numbers of opportunities related to the Stock Market for a construction company were identified. In addition to that, total number of 09 new opportunities have been identified during the Semi Structured Interviews. Accordingly, the total number of 22 opportunities related to the Stock Market for a construction company were identified during the questionnaire survey and semi-structured interviews.

Those 22 opportunities related to the Stock Market for a construction company are given below:

- Ability of gathering new capital at anytime
- Ability to create larger investor base
- Encourages employees by rewarding
- Ability to Attract Better Employees
- Enhance the public image of the company
- Provides transparency around the value of the business
- Help to build a global business
- Spread the risk of ownership
- Indirect advertising
- Reduction of the Cost of Other Capital
- Ability to attract foreign investors
- Increase the confidence on company financial position
- Improve the credibility on company financial statement
- Ability to gather government tax incentives
- Ability to acquire other companies and ability to grow
- There is a limitation that bank can issue loans, because of that it is better to go to the Stock Market when need of capital in high level
- Can accurately know about value of company by share price
- Strength cooperates governance
- Preference to get a loan
- Ability raises capital through right issue and debenture than a private company
- Exit mechanism to exit from the company when major shareholders want to exit from the company
- Accurate audited financial information help to prevent internal corruptions

4.4. STRATEGIES THAT CAN BE TAKEN TO ENHANCE OPPORTUNITIES IN THE STOCK MARKET

Suggestions for enhancing opportunities in the Stock Market were collected from semi-structured interviews with contractors and experts in the Stock Market. Interviewees were questioned for each of the opportunities regarding actions that can be taken to enhance opportunities. The sense of these experts has provided reliable and practicable strategies to enhance opportunities. According to the findings of the semi-structured interviews, below shows the actions that can be taken to enhance opportunities.

Respondents mentioned that, awareness program which emphasize benefits, will help to attract construction companies into the Stock Market. Moreover, respondents mentioned that, the government can give tax relief to construction companies, who are willing to list on the Stock Market. Other than that respondents mentioned that, the government can offer other financial incentives other than tax incentives.

According to the respondents they mentioned that, increased institutional and foreign client participation in the Stock Market will increase the visibility of the companies which are listed in the stock exchange. This will induce majority of the local large companies to list on the market. Moreover respondents mentioned that, there must be a need to collect capital from the Stock Market and without high need of capital companies do not need to list on the Stock Exchange. In addition to that increasing visibility of the Stock Market can cause to attract construction companies.

Furthermore respondents mentioned that, improving the market capitalization will help to enhance opportunities in the Stock Market. Hence, it is important that the government plays a key role in this regard by listing at least minority stakes of the non-strategic SOE's (State Owned Enterprises) to increase liquidity and the market capitalization. Unless the government stronghold of the economy is reduced, the market participation rate of the private companies cannot be improved.

Moreover respondents mentioned that, government can release regulations that need to list on the Stock Market and after that they can control. In addition to that companies may not have trust about the Stock Market. Because of that Stock Market must create trust about the Stock Market and Stock Market must be an efficient market than manipulated market.

In addition to all those actions respondents mentioned that, the government can get action to enhance business opportunities related to the construction industry and open the Sri Lankan construction industry into international market. These actions may help to expand the construction companies and their need of Capital will increase with it.

Other than that, the government side companies also can get action to get the maximum out of the Stock Market. Respondents mentioned that, adhering to the listing procedures coupled with strict financial reporting procedures and capital adequacy will enhance the listing opportunities in the Stock Market. Furthermore, respondents mentioned that, if a company need to list on the Stock Market they must have a plan to establish financial and non-financial capabilities by ensuring good employer base and by increasing financial capabilities. Moreover, they mentioned that, listed company can use Debenture issue, Right issue and Warrant issue to attract capital by using their reputation. In addition to that respondents mentioned that, CSE is only a facilitator and a company limited by guarantee. The SEC is the government body who controls capital market. Government and companies must get action to enhance the opportunities in the Stock Market.

4.5. CHALLENGES IN THE STOCK MARKET FOR A CONSTRUCTION COMPANY

The total number of 13 challenges were identified in the literature review as challenges related to the Stock Market for a construction company. In the preliminary survey, three more challenges were added by the experts making the total number of challenges to 16. With the use of one sample t-test of SPSS software, 9 numbers of challenges were identified as significant challenges and 3 number of challenges have significant ability to overcome the challenge. Then, the 16 challenges were mapped in an IPA matrix. The challenges placed in the quadrant of high level of challenge and less level of ability to overcome (Quadrant D) were identified as the most critical challenges as per the concept of an IPA matrix by Martilla and James (1977). Accordingly, only the total number of 4 challenges were identified as critical challenges.

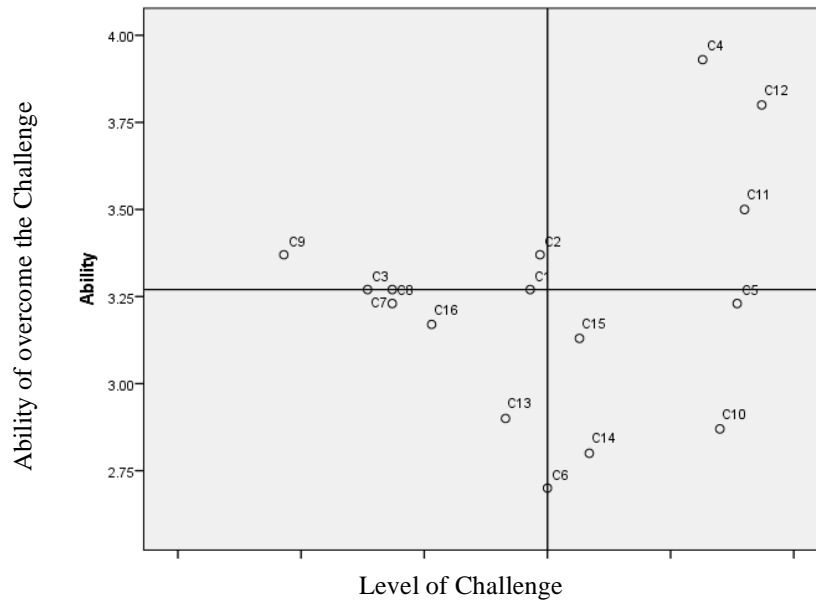


Figure 1: Modified IPA Matrix

Survey results identified the increased regulatory oversight (C5) as one of the most critical challenges. Similarly, the not having enough financial capabilities (C15) was also mapped in the quadrant that needs the high concentration. Further, market fluctuations (C10) were also classified under the above quadrant. Moreover, fluctuations in the construction industry (C14) were identified as a critical challenge even though it has been identified in the preliminary survey.

4.6. ACTIONS THAT CAN BE TAKEN TO MINIMIZE CHALLENGES

Identified mechanisms to overcome the challenges during the semi structured interviews can be summarized as given in Table 1.

Table 1: Strategies to Overcome Challenges

Challenges	Strategies to Overcome Challenges
Listing on stock exchange is an expensive and time-consuming process	Changing legislation Preparing accurate prospector in one time Outsource the listing process Just only consider about the essential requirements
Ownership of the company can go to outsider's hand	Get consultant advice Issue limited Share Percentage
Loss of Management Control	Get consultant advices Enhanced Reporting Requirements Improve information system Just only consider about the essential requirements
Increased Regulatory Oversight	Ensure and maintain information timely and transparent manner
Increased Company Liability	Ensure good staff and good information system Establish profit maximizing activities Perceptions of short-termism Prevent from narrow profit maximizing targets
Bad relationship between financial stakeholders	Been more ethical and transparent Establish an investor relationship unit
Market fluctuations	Forecasting about the market Responsibilities to shareholders Correct disclosures on correct time
More responsibilities of management than private companies	Improve the performance of management Add more employees to the staff

Challenges	Strategies to Overcome Challenges
Fluctuations in construction industry	Diversification
Not having enough financial capabilities	Establish another board for Small and Medium scale companies
Not having trust about the construction industry in general public	Introduce awareness programs Maintaining better information system, talented staff, accurate financial statement and audit committee.

4.7. *SUITABILITY OF FINANCING THROUGH THE STOCK MARKET FOR A CONSTRUCTION COMPANY*

When deciding the suitability of financing through the Stock Market have to consider about the advantages and disadvantages of equity and debt financing. During the literature survey financing methods and their advantages and disadvantages were identified. During the questionnaire survey respondent provided their ideas related to some advantages and disadvantages.

During the questionnaire survey, 72% of respondents said that, limited access to finance through generally and bank loans is a major barrier to innovation and industry development. In addition to that, 72% of respondents mentioned that, lack of affordable capital was a one of the major barriers to business growth.

Furthermore, during the questionnaire survey, 67% of respondent said that, companies listed on a stock exchange are much more popular and visible than privately held companies. 83% of respondents believed that, stock and share options programs can be used to attract top talented employees.

94% of respondents said that, motivation given by sharing ownership with the employees, employees tend to work for the profit maximization. In addition to that, when compared to other construction companies the performance of these companies has been highlighted than other companies' performance. After analysing all above findings, literature review findings and discussions under above sub-topics can suggest that, financing through the Stock Market is the best way to collect funds for a construction company.

5. CONCLUSIONS AND RECOMMENDATIONS

After a ruinous 30 years of civil war, Sri Lanka is concentrating on long-term strategies to overcome challenges as it struggles to shift to an upper middle income country. In this background, the performance of the construction industry is serious, as the economy of the country mostly depends on it. Instead, the construction companies owe a duty to participate into the development of the country. In this phenomenon, involvement of construction companies in the Stock Market has been recognized as a huge reason for the development of the construction industry and the country. In this background, the research is aimed to discover strategic mechanisms to enhance opportunities and to face challenges in the Stock Market for the construction companies.

Literature review identified that equity and debt financing as major financing methods for construction companies. In addition to that equity, preference shares, debentures and bank loans are financing methods available for companies under equity and debt financing. Total number of 22 opportunities related to the Stock Market for a construction company were identified during the questionnaire survey and semi-structured interviews. Then identified the 16 challenges related to the Stock Market for a construction company. But, just only 4 number of challenges were identified as critical challenges. During the Semi Structured interviews the actions that can be taken to enhance the opportunities related to the Stock Market for a construction company were identified. In addition to that, the actions that can be taken to minimize the challenges related to Stock Market for a construction company were identified. After analysing all findings of the literature review, questionnaire survey and semi structured interviews can suggest that, financing through the Stock Market is the best way to collect funds for a construction company.

The construction companies have been grown effectively within last eras, not limiting to the Construction Industry. This expansion is now been unveiled the doors for construction companies which can have a huge contribution to the Construction industry and Sri Lankan the economy. Opportunities and challenges related to the Stock Market can create a significant effect to enter into the Stock Market. But in Sri Lanka less number of construction companies are listed on the Stock Market when compared to the other Countries. Therefore, this research clearly identified the opportunities and challenges related to the Stock Market and investigated

the mechanism available to minimize challenges and enhance opportunities as recommendations to the construction companies.

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