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THE BOURSE OF BEIRUT

By

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ABSTRACT

Though this study is especially devoted to the Bourse of Beirut, we shall consider nevertheless the position of the stock exchange in the general economic picture and the corresponding link between its stage and the overall level of economic development attained.

The emphasis we shall give throughout this study to the Bourse of Beirut is mainly to illustrate this structural relationship. The description of the operations of the Bourse together with the major securities listed (Chapters Three and Four), will be made to help us in analyzing its trends. This analysis will make it clear that the primitive stage of the Bourse and deficiencies in its operations are the outcome of structural drawbacks in the whole economic picture (Chapter Five). Special organizational reforms regarding the acceptance and maintenance of securities on the list and the provision of credit for trading on margin could help in the growth of the Bourse (Chapter Six). But the proper development of the stock exchange would necessitate an abundant flow of eligible securities for admission to the list. The

provision of this requirement is dependent, however, upon the setup of the whole capital market.

Immediate help could be provided to the Bourse through the introduction of first-class foreign securities. This step would widen the range of securities offered and work for the stabilization of the market. But the proper growth of a stock exchange would depend, in the last analysis, upon the long-run solutions to the vital problem of capital formation in general (Chapter Seven). Only reforms along general lines will enable the Bourse to assume effectively the different functions assigned to it in Chapter Two.

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CHAPTER I

INTRODUCTION

A. Aim and Scope of the Study

A stock exchange is a market mechanism for dealing in securities. Its degree of sophistication depends essentially on the number and nature of the securities offered. As a part of the total capital market, the exchange reflects in turn the degree of sophistication of this larger market in allocating long-term capital.

In economies where the capital market has developed, the stock exchanges show a corresponding growth and maturity. On the other hand, the less-developed countries have an embryonic stock market (if they have any at all), with regard both to kinds of transactions and to procedures followed. The low level of supply and demand of long-term capital, interacting with the backwardness of less-developed economies, is pointed up by the relatively small reliance on the corporate form of business. This explains the fact that there is a small flow of securities in such countries, and the stock market is only a reflection of this primitive stage.

It could be deduced, therefore, that the stock exchange is a dependent variable in the overall problem of capital

formation. The major aim of this thesis is to show that the growth of an exchange should be basically sought in those structural reforms which would help the country in the process of its economic development. And we might add that the special attention given to the Bourse de Beyrouth can be regarded as an illustration of this dependence.

With reference to the Bourse de Beyrouth, two of its aspects are excluded from this study. First, we do not consider the foreign exchange market in Beirut, though it is officially included in the activities of the Bourse. This exclusion is made because such a market rightfully belongs in the field of commercial banking. We therefore confine our analysis to the stock market proper. Second, we do not include the activities of the over-the-counter market. This omission is justified for the following reasons:

1. This market is, in a sense, a prelude to the introduction of a particular security to the official stock exchange. Issues are not generally admitted to developed stock markets before their reputations are solidly established. In the meantime, these securities have to be "tested". This pre-listing stage is generally carried on in the over-the-counter market.

We disregard this special market because the reforms suggested for the development of the stock exchange proper

would undoubtedly improve the over-the-counter market as well. This is so because the stock exchange is but the official continuation of the latter.

2. Over-the-counter markets in developed economies are generally the principal dealing places for leverage capital, and consequently, the domain of institutional investors.

With regard to the Lebanese situation, we can say that the bond market is still in its earliest stage. The primitive aspect of the Lebanese capital market is closely inter-related with the absence of institutional investors and investing institutions. The ~~general-bond~~ market then, does not concern us in this study; the problem of equity capital does.

However, the different structural and institutional reforms suggested to induce a more adequate provision of long-term capital would work for the concurrent development of the over-the-counter market. To this extent, the stock exchange would be indirectly assisted in its development, since the over-the-counter market would be better able to perform its function as testing ground of candidates for future listing.

B. Description of the Study

We begin our work with a description of the different functions performed by a stock exchange. The diversity and

efficiency in the fulfilment of such functions are shown to depend upon the stage of the exchange attained and upon the development of the whole capital market. This analysis is found in Chapter Two.

To illustrate the interdependence between the stock exchange and the level of economic development attained by the country, we analyze at length the transactions and the nature of securities offered on the Bourse de Beyrouth. Chapter Three will be devoted to the present organization, the listing requirements, the operations and the growth of the Lebanese exchange. In chapter Four, the major securities listed will be separately analyzed, to help us in studying the predominant trends of the exchange, Chapter Five will be reserved to show that the Bourse reflects the setup of the money and capital markets. It is revealed in this Chapter that the institutional drawbacks of the Lebanese economy and the consequent small flow of securities are creating a precarious state on the Bourse, making it vulnerable to unhealthy and speculative trends. We show further that, through their adverse effects on the whole economy, the major political events which have occurred since 1956, have added to the obstacles facing the Bourse in its development. As a conclusion to this Chapter, we will suggest that two sets of measures be taken to help in the growth of the Lebanese stock exchange.

We shall describe in chapter Six the proper organizational reforms which should be instituted with regard to the admission and maintenance of securities. We shall also propose in this Chapter, the introduction of first-class foreign issues, to widen the range of offered securities and decrease, in this way, the existence of "unhealthy" fluctuations.

Other sets of measures are discussed in the last and most important chapter. In accordance with the aim of the thesis, we shall point out the institutional provisions which should be effected to develop the capital market. It is believed that only such long-term measures would open for the Bourse the best channels of growth. Being a part of the whole economic chain, the stock exchange would grow concomitantly with the pervasive trend of the economy.

We believe that, though we direct our main attention to the development of the Bourse de Beyrouth, we have nevertheless laid down a general outline for the growth of stock exchanges in backward areas. This is effected by linking the special position of the stock market to the fundamental problems facing the country in its capital formation.

CHAPTER II

THE ROLE OF A BOURSE AND ITS POSITION IN THE ECONOMIC STRUCTURE

I. FUNCTIONS OF A BOURSE

A. Information Center

1. Present company performance - The company represented on a Bourse is required, as we shall see in greater detail in Chapter Six, to supply all managerial and financial information related to its condition, information which it would not be compelled to disclose if its securities were not listed. In fact, this is one of the primary purposes of listing, since "it makes available to the public such information as may reasonably be presumed to be necessary to form an intelligent judgment as to the merit of the security."¹

Since the stock exchange is closely related to the capital and money markets, it reflects through this relationship the various trends of the economy as a whole. Aside from fluctuations translating "real" economic events, there are also felt, in the stock market, all events which are thought to possess an incidence on overall economic life.

1. Charles Dice and Wilford Eiteman, The Stock Market (New York: McGraw Hill Book Co., 1952), p. 111.

The public gets then through the stock market not only the necessary information about a corporation to reach an adequate judgment of the worthiness of its securities, but it gets also the reaction of the general economic picture to major world events. The Bourse becomes then a barometer of world politics as well as of the whole economic life.

In addition to the general tenor provided by this barometer, i.e. the level of stock prices, definite appraisals of each listing are given through quotations. The latter are the outcome of the interacting judgements of a multitude of individuals dealing in an auction market. Because of the requirement of wide distribution of securities before being admitted to trading on a Bourse, any artificial manipulation of prices by big shareholders is largely precluded. As a consequence, the evaluations reflected by quotations are more comprehensive and trustworthy than the judgment of one individual, however "sound" it might be. The public gets then through a stock exchange a good appraisal of particular businesses, because the stocks have undergone the test of a free market.¹

In addition to the multitude of individuals/^{trading} in the market, there are many institutional investors (insurance

1. But these definite appraisals would follow the general level of securities prices, which might be "out of line" with present and prospective corporate earnings. In this case, investors

companies for example) and investing institutions, such as the investment trust. The latter is under legal obligation and financial responsibility to invest in securities whose yields are good after the safety factor is considered. Its specialized technical staff follows market trends and analyzes regularly the worthiness of listed securities in order to maintain the best proportions in its portfolio. These analyses are made not only for local securities but for foreign ones too, as the investment trust looks to geographical as well as business diversification in order to minimize risks. Similar analyses are also made by insurance companies, but in their case with a greater concentration on bonds. Investment banks, when approached by a company for further financing, make the same investigations about the current performance and prospects of the firm. Investment departments of commercial banks, brokers, and members of a stock exchange would make a similar scrutiny so as to provide their clientele with all the information and advice needed for the proper management of their portfolios. The existence of an organized stock market encourages the various institutions mentioned above to effect market research which helps tremendously the investing public in formulating a sound judgment about the listed securities.

will be influenced more by general economic considerations, e.g. the threat of inflation which leads to a drive to protect values, rather than a good return on a stable equity.

The absence of a stock exchange would make meaningful analysis unnecessary and even impossible.

The existence of a well-organized stock exchange also provides definite advantages to the corporations, the seekers of capital. The market trend shows which issues can be marketed successfully within the prevailing attitudes of the investment market, e.g. debt or equity capital. More precisely, the market would show which features are more attractive than others (participation or conversion rights for preferred, conversion for bonds, warrant features for common...). "Stocks may at a given time be high in popular favor, so much so that conversion features may prove necessary to make bonds sell at reasonable prices."¹ On the other hand, the over-the-counter market, through which most bond issues are traded, would indicate the trend and structure of interest rates. The investment banker would consider these factors, aside from the capital structure, previous achievements and future prospects of the applying company, to determine its commission on the new issue.

By showing the prevailing rates, trends and attitudes of the investment market, the stock exchange can help corporations to decide about the proper time and the form to

1. Harry Guthman and Herbert Dougall, Corporate Financial Policy (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1956), p. 166.

choose to carry on their further financing. "Debt financing may be chosen sometimes in spite of the risk that it may lead to insolvency because of its cheapness and availability... the choice of the form of financing is determined by a comparison of the costs of the various alternatives and a consideration of the risk which would accrue to the corporation under any of these."¹ Such costs could be easily determined from the market appraisals for the different forms of securities issues.

•2. Future prospects - The stock exchange does not reflect only the current performance of listed companies. Events which would affect, or are thought to affect, the future course of business, are generally discounted by dealers in the stock market. The further development of the business cycle, the changing conditions and prospects in world politics, the future impact of an internal political matter (as the success of Republicans in the election of the United States whose attitude toward business is known to be favorable) are all accounted for in making an appraisal of prevailing market prices.

The effect of psychological factors is more apparent in the stock market than in other sectors of the economy. Giving effect to these psychological attitudes is facilitated

1. Loc.cit.

by the relative ease with which an investor in stocks can change the content and proportions of his portfolio over another investor who has committed himself to fixed and specialized assets. A new trend of the economy is more quickly accounted for, and generally with more intensity by the stock market than by other sectors of the economy. As an illustration of this important point, we could note that the upturn in stock prices which is preceding the recovery from the recent American recession is "over-discounted" by the New York stock exchange. Securities prices are moving up not in accordance with present achievements, "but in anticipation of the continued improvement in general business."¹

The quick response and discount by the stock exchange of future prospects would help to explain the fact that the New York stock exchange got the first and deepest incidence of the depression in the Thirties. "Between the 5th of September and the 13th of November, 1929, the vast bear movement had carried stocks down by about 42 percent of their former value on the New York stock exchange, and had reduced absolutely the value of stocks listed on the exchange by an estimated \$26,000,000,000."²

1. Alexander Hamilton Institute, Business Conditions Weekly (Vol. XXXV, No. 22), p. 1.

2. Irving Fisher, The Stock Market Crash and After (New York: The ~~Mc~~Millan Co., 1930), p. 74.

The anticipation and big discount by the stock market of future events is useful to the monetary authorities in that it notifies them about the growing trends which might become unhealthy to the economy. As a result, necessary precautions can be taken against the ill before its occurrence.

B. Financing Facilities

1. Marketability - By providing an auction market for dealings in securities, the stock exchange enhances the marketability of these securities. Because of the wide distribution of the shares among the investing public, as is required to minimize the possibility of artificial manipulation of prices, the stockholder can dispose of his holdings at the best price corresponding to the prevailing market conditions.

The marketability feature has definite advantages to both the investor and the listed corporation. The investor is in a position to get the income deriving from security holding, while at the same time enjoying the potential right to sell it at a premium or at a loss inferior to the one which would be incurred if the security were not listed on a stock exchange. The stock exchange would become attractive for investors, since aside from the relative safety provided by marketability, it offers a source of steady income and capital gain. By admitting the securities of healthy and

growing enterprises, exchange authorities give the public the opportunity to share in their future prospects. Even by giving way to speculation, the exchange performs an important function, since "the rapid capital gain and profits acquired by speculators are either attracted to new ventures or channelled towards consumption."¹

The listed company benefits from the marketability feature too. Since the securities can be disposed of with minimum relative loss, the public would be more responsive to the solicitation of the company for further financing. In terms of the corporation's problem "this tendency means that both the cost of selling securities and the return which must be offered as an inducement to obtain funds are lowered."²

But in order that marketability provides such facilities to both the public and the corporation, certain prerequisites related to the security issue should be fulfilled, prerequisites with regard to its size, distribution and character of holders.³ These three features should be connected in such a way as to permit active trading on the floor. None alone could assure the marketability of

1. Ibid., p. 60. From a social welfare standpoint, however, it can be argued that there are better ways of allocating resources.

2. Guthman and Dougall, op.cit., p. 330.

3. Ibid., p. 327.

the issue. The size is meaningless if the securities are not adequately distributed to provide a wide market. Even if the latter feature is fulfilled, marketability would not follow if "the stock becoming settled in its good character, tends to drift into the hands of permanent investors."¹

The proper combination of these features would induce marketability for the issue in the sense of active trading. They would not affect directly the value of a security, such value being greatly dependent upon the worthiness and position of the issuing company. The introduction of the securities of the Ford Motor Company to the New York stock exchange and the corresponding increase which followed in their marketability did not add to the intrinsic value of these securities. This value, however, would be relatively preserved through marketability from sudden capital shrinkage, in cases where the security is to be disposed of.

2. Collateral value - By providing the marketability features to listed securities, the exchange helps them to be used as collateral for loans. Such a device provides a great deal of convenience to both the pledger and pledgee, since it is much easier and less costly to use as collateral a claim which is evaluated daily and one which can be dis-

1. Ibid., p. 328.

posed of at sight, rather than to use other forms of mortgage. These characteristics of ready valuation and disposability have led to trading on margin, by which the stockholder provides his broker with a stipulated partial payment on the value of the security to be acquired, the balance being supplied by the broker himself, through the use of his commercial bank credit. Should the stockholder fail to meet his obligation, the broker would be in a safe and legal position to dispose of the security to get back the funds he provided, and use the money initially supplied by the stockholder to offset any loss he might have incurred, a loss resulting from a difference between the amount of money he supplied and the selling price of the pledged security.

3. Further financing - The exchange provides a well-prepared and established market to listed companies for further financing. In order not to dilute their share of the equity, the stockholders have the priority, through the exercise of the pre-emptive right, to acquire the new stock issue. If they want to forfeit their right, they can dispose of it to others, for a sum theoretically determined, by the equation:

$$\text{Value of one right} = \frac{\text{Market value of stock} - \text{subscription price}}{\text{Number of rights to purchase one share} + 1}$$

But when the new issue is small in relation to the

amount already outstanding and the company has good prospects, it is likely that stockholders would subscribe to the whole issue. This would depend, however, upon their income bracket and the prospective tax effect, whether they are interested in capital appreciation or dividend income, their attitude towards present management, etc.

The market which the stock exchange could provide for the ultimate disposal of securities to be acquired through the exercise of the pre-emptive right would help the listed companies in effecting their further financing. This facility is generally carried over by an investment bank which might stand ready to market the remaining unsubscribed balance through its own channels.

But to benefit from the indirect help provided by the stock exchange for further financing, companies should be already admitted to the floor. This advantage, however, is generally reserved to well-established and prosperous concerns and is not available to small and growing enterprises.

C. Economic stabilizer

1. Shock absorber - The liquidity-preference of traders on the stock exchange rises in times of distress and impaired confidence. The marketability facility pro-

vided by the exchange helps in the disposal of many stockholdings. It is true that under such conditions, sellers would have to incur heavy capital losses, especially since the exchange is inclined to exaggerate declines in general business conditions. Nevertheless, the sale of securities, though effected at a loss, is much easier than the liquidation of other forms of assets, and "the liquid capital attained often alleviates the results of the calamity elsewhere in the business structure."¹ Small investors might liquidate their holdings to maintain their consumption level and this would help partly in maintaining the 'effective demand' in the economy.

But the stabilizing function of the stock market does not always come into operation. The slump or boom experienced by the stock market can have in their turn a great effect on the whole economy. For example, /aside from their inflationary impact on the different sectors of the economy, funds attracted more and more to speculation on the exchange would not be available to productive business. For example in February 1929, the Federal Reserve Board sent a letter to member banks which included the following sentence:

1. Parker Willis and Jules Bogen, Investment Banking (New York: Harper & Brothers, 1929), p.72.

"The resources of the Federal Reserve System are ample for meeting the growth of the country's commercial needs for credit, provided they are protected against seepage into uses not contemplated by the Federal Reserve Act."¹

This possibility of diversion of funds from productive investment to speculation requires from the central bank not to stand idle vis-à-vis the trends of the exchange under either circumstance. Proper credit measures, inspired primarily by the severe lessons of the Thirties, are taken to alleviate their incidence, mainly through the changing of margin requirements. But such measures face a major hindrance in checking the trends of the stock exchange, since the latter is greatly influenced by psychological causes, which can at least in part nullify the effects of changes in margin requirements. Basic adjustments are sometimes needed, not only in the stock exchange, but in all other sectors of the economy, if a monetary policy is to be effective.

2. Adequate price determination - Because of the adequate distribution of listed securities and the cooperation of numerous individuals, through auction dealing, to formulate a common judgment on the worthiness of these securities, the stock exchange helps tremendously

L. Dice and Eiteman, op.cit., p. 376.

in the proper evaluation of the related business. This process would become troublesome, difficult, and very subjective in the absence of an organized stock market. Though a security could be highly regarded, it would be difficult for the dealing parties to agree on a final price if it were not listed on a stock exchange.

By determining adequately the prices of securities, the stock market would reflect the community appraisals for businesses with different rates of return earned upon their investments, and this would be of great help for entrepreneurs in formulating their policies.

3. Allocation of savings - A company whose securities are listed and which has made decent earnings records, is better introduced by the stock market to the investing public, and thus more helped in its further financing than another concern with low and deteriorating earnings achievements. The good performance of the corporation would be translated into a promising and steady position of its securities on the exchange, and a further new issue would meet a receptive market. On the other hand, a company whose products and services become less needed by the community or are outrun by competitors, would score poor quotations on the exchange, reflecting in this way its poor performance and gloomy prospects.

Any further financing, even if accepted by the exchange authorities, would not find a responsive market. Under such conditions, the investment banker might not be ready to undertake a stand-by agreement with the company.

Through its reactions to past achievements and future prospects, the stock market helps then in determining which enterprise is to have the use of society's scarce savings for expansion purposes. It helps, in this way, "to divert the flow of individual savings into the lines of production most needed by society."¹

D. Effect on capital formation

Through the marketability feature it provides, the stock exchange facilitates and encourages the supply of capital, as was shown above. "By providing a market for securities after their original distribution, exchanges enhance the liquidity of securities in the eyes of the public and create a willingness to invest in new issues."²

The same facility has made it easier for the investment bank to carry on its merchandising of new securities. Some writers have even gone so far as to attribute the growth of investment houses to the existence of organized

1. Ibid., p. 2. This function has been less important in recent years, as corporations have come to rely increasingly on reinvested earnings to finance expansion.

2. Ibid., p. 57.

securities markets.¹ Investors buy freely mainly, because the bulk of the securities offered are readily marketable.

Can we conclude from this that the stock exchange has a causal effect on capital formation?

In the first place, it should be noted, as was pointed out earlier, that the exchange would not help in providing capital for small and growing enterprises. "The stock market is not the means by which new capital is secured for new enterprises."² Beginning firms must resort to other sources for financing (mainly internal), and will benefit from the exchange facilities mentioned above only when they are well-established and can meet the exchange regulations for admission.

With regard to the facilitating function of shifting ownership provided by the exchange, it has an effect on the supply of capital to the extent that the latter is permitted by the whole capital market. And the position of this market is but a reflection of the stage of economic development attained.

The exchange then, would depend upon the whole economic

1. Willis and Bogen, op.cit., p. 46.

2. Bradley D. Nash, Investment Banking in England (London: A.W. Shawle, 1929), p. 32.

structures for reaching such a level that it can provide all the facilities enumerated above. Its indirect role in facilitating the supply of capital, together with its whole structure, are closely subordinated to the position of the community vis-à-vis the basic problems of capital formation.

This stage of our discussion leads us to a more elaborate analysis of the position of the stock market in the economy and its relationship to all its sectors. The following section is devoted to this purpose.

II. POSITION OF THE STOCK EXCHANGE

1. Characteristic of capitalism - The existence of a real stock exchange presupposes the attainment by the country of a certain level of economic development with a corresponding maturity in its financial and economic institutions. The growth of an exchange is closely related to the economic advance of the community.

Transactions on the stock market presuppose the existence of stocks to be dealt with. Stocks are made available for trading through the resort by the business community to the corporate form. This form requires an appropriate level of supply and demand for investment funds.

The intensity of demand for long-term capital would depend primarily upon the level of entrepreneurial activity in the community. This level would change as new opportunities are revealed to entrepreneurs. The access to "new combinations", to use Schumpeter's term, is interrelated with the mobility and dynamism of the economy, i.e., the level of economic development attained. Demand for capital is then interdependent with this level, and with the attainable level as well.

The level of economic achievement is also connected with the supply side of capital. The higher it is, the more the community would be able and willing to respond to the solicitation for funds to realize new and self-generating opportunities. And the supply and demand for capital would have, in their turn, a causal effect on the driving force of economic change.

Under such changing conditions, the whole investment mechanism would tend to adapt itself to the prevailing circumstances. With the growing demand and response for funds, the money and capital markets would develop in accordance with the growing requirements and diversities. The development of such institutions would have in its turn a causal effect on the demand and supply side of capital, and, through them, on the whole momentum of economic development. As an illustration of the latter point, we could say that the

flow of funds into American rural investment has been stimulated by mortgage banking facilities.¹

From the above discussion, it follows that the structure of the stock exchange is closely dependent upon the level of economic development attained by the community. To show the correlation between the development of a stock exchange and the general growth of the economy, reference could be made to the evolution of the New York stock market:²

"The New York stock exchange had its origin in meetings of brokers, which were first formally organized in 1792. Tradings were chiefly in the national debt of 80 million of dollars, which were created by Congress in 1790, and the stocks of three incorporated banking institutions. Not until 1817 did this organization move indoors into its own quarters and function under a constitution. Just as the building of railroads was the outstanding factor in the economic development of the country, so the trading in their securities was most important in expanding the operations and significance of the exchange. Later the need for gas, then electricity, and finally the telephone created public utility listing for this market. In the latter part of the nineteenth century, the growth of large-scale manufacturing units was marked by huge mergers, and the result was a great increase in the volume of publicly held industrial stocks to be traded there."

It is thus apparent that the stock market is a feature

1. Willis and Bogen, op.cit., p. 203.

2. Guthman and Dougall, op.cit., p. 324.

and characteristic of capitalism. Its developed structure is found only in advanced capitalistic countries and its primitive setup in less developed ones is but a reflection of their embryonic financial institutions and low level of economic achievement.

2. The place of the exchange in the economic structure - The exchange is but one part of the capital market. Its broadness and activity would depend upon the stage of industrial development and the corresponding growth of the corporate form of business.

While a capital market represents the interaction of supply and demand of long-term capital, the definition does not refer to the whole activities of the exchange. The demand for capital is satisfied through the exchange only for well-established firms, as was shown above. The stock market does not help in the realization of new ventures or the financing of small enterprises. The supply side of capital on the exchange could not be considered too as an integral part of the total supply on the capital market, as it is much more subordinated to the speculative fluctuations experienced on the exchange. As such, the stock market should be considered as a specialized aspect of the whole capital market where certain modifications and limits to the characteristics of the latter are in force.

The exchange is a part of the money-market too. Aside from investment transactions carried on to get a source of steady income and assure the safety of capital, speculation is effected to secure a quick capital gain. The exchange would become in this respect a repository for short-term funds, supplemented by a resort to commercial bank credit through trading on the margin.

As such, the exchange would help the central bank in carrying out its monetary and financial policies. The more the economy is developed, the larger is the number of its money sub-markets and the higher is the integration of their structures.¹ This would mean that a manipulation in one part would be felt overall and a particular policy would be more effective in execution than in the absence of such integration. The high sensitivity of the stock exchange, due mainly to the fact that it is greatly influenced by psychological factors, would make it sometimes suitable for such manipulation. On the other hand, the central bank might enter the exchange to increase liquidity or stabilize the values of securities in order to prevent or moderate sharp fluctuations in the quotations of such securities.² But this device would be subordinate to the

1. S.N. Sen, Central Banking in Underdeveloped Money Markets (Calcutta: Bookland Ltd., 1952), pp. 19-21.

2. Ibid., p. 71.

main activities of the central bank activities.

The exchange would help the central bank in carrying on its main policy, primarily through providing for the exercise of open-market operations with their repercussions on the aggregate supply of money and short-term interest rates. On the other hand, a purchase or sale of securities by the central bank affects to some extent the prices of government securities, and therefore influences the long-term rates of interest as well.¹ These changes are likely to affect all other sectors of economic life.

The exchange then is a continuation of the capital market with special modifications in the nature of supply and demand for funds. It is at the same time an inherent part of the money-market and, as such, it would help, however unwillingly, the central bank to carry on its politics. However, the effectiveness of these policies would depend upon the stage of development of the capital and money-markets.

3. Exchanges in undeveloped markets - Less-developed countries are characterized by a low level of economic achievement interacting with a small level of income "in the vicious circle of poverty." The supply of funds would be low resulting from the corresponding small size of dis-

1. Ibid., p. 55.

posable income. Demand too suffers because of the narrowness of the market and the weak incentives to carry on new ventures. The capital market would show these drawbacks and its embryonic structure would reflect the low stage of economic development attained. The money-market too would appear deficient when we compare it to the width and integration of other markets facing more diversities and experiencing a better flow of funds due to a higher level of economic development.

It would be natural that the corporate form of business would not prosper in such economies. The primitive structures of the different markets, the uncertain reward from long-term commitments due to major institutional drawbacks and instability would lead capital to look for short-term opportunities and preferably self-liquidating transactions.

The unfamiliarity with the corporate form of business would be the major hindrance to the existence of an active stock market. The small number of stocks listed on the exchange would make the latter vulnerable to large fluctuations and, consequently, to unhealthy speculation. As a matter of fact, speculation would result not only from the narrow range of listings, but also from the conditions of the market and the nature of funds attracted. People are accustomed, (mainly because of the whole economic environment),

to self-liquidating ventures with a quick yield. They would trade on the exchange, not with a long-term investment purpose assuring an optimum combination of safety of capital and yield, but mainly with the intention of getting a quick capital gain.

Under such conditions, the exchange would not help the central bank to carry on a financial policy, if it had one. This is due first to the narrowness of the market; any manipulation would translate itself more in unhealthy variations in security prices than variations in the supply of money and interest rate structures. Secondly, the special structures of the money and capital markets would make these different sectors of the economy badly integrated. An action on one side would not produce the desired effect on the whole.

Being a part of the capital and money-markets, the position of the exchange would depend upon the stage of development of the community. Devices to promote the stock market in less-developed economies would be of small significance if not preceded by the proper measures which would help the country in its capital formation.

CHAPTER III

"THE BOURSE OF BEIRUT": HISTORICAL SURVEY, PRESENT ORGANIZATION AND OPERATIONS

I. HISTORICAL SURVEY

The Bourse was officially established in 1920. Prior to that date, financial transactions on the Lebanese market were mainly centered on gold and foreign currencies. This was the first to the fact that gold was considered as a safe investment in the face of political instability in the Ottoman Empire. Secondly, the instability of the Turkish pound and the consequent disparities which occurred between rates in Constantinople and Beirut vis-à-vis gold favored arbitrage between the two centers. Thirdly, the economic backwardness of the Ottoman provinces had meant the non-existence of securities, and so, the absence of exchanges. The small trading in stocks was directly effected through the Constantinople market.

In 1920, the French authorities established the Bourse by decree No. 1509.¹ The Bourse, as explained by Art. 2 of the decree, was available to businessmen, bankers, commission agents, changers, ship-owners, insurance companies,

1. Majmuat Al-Kawaneen (Y. Sader, Editor, Vol. VI), pp. 342-43.

travel agencies, and agents and brokers in securities. The members elected a committee which drafted the by-laws and internal regulations of the organization, and these were accepted under decree No. 315.¹ The actual administration was assigned to an elected group of twelve persons. The functions of brokers were defined, and they had to provide a specified money guarantee for acceptance on the floor. Any divergence from the established regulations were to be considered by a disciplinary committee.

However, the establishment of a legal framework was not enough for a smooth functioning of the Bourse. Very few stocks were dealt with and these, representing French companies working in Lebanon, were very responsive to the instability of the French franc prior to its stabilization under the Poincaré regime in 1926. Though after that date a certain activity was noted, the Bourse still did not show much growth, owing to major disturbances in the world economy prior to the second world war, and especially during the Thirties.

In 1941, a new gathering place was provided for dealings in securities. But again due to the instability of the French franc, the French securities listed on the Bourse were liable to great fluctuations and their trading was essentially

1. Ibid., pp. 348-54.

speculative. To check the unhealthy trend of the stock market, the Authorities had to suspend its operations twice, in 1943 and 1945. Up to 1948, the Bourse had to carry out its function with a deficit. The latter was filled by an annual subsidy from the government of around LL 3,000.

Since that time and up to 1954, several favourable events entered the picture and helped in the rapid, if unjustified growth of the Bourse:

1. The establishment of the free exchange system in Lebanon minimized the margin of profits accruing to changers from dealings in foreign exchange. This was accentuated by the fact that banks increased their share in financial settlements of foreign trade and offered more and more suitable exchange facilities to the public. Changers thus turned to the Bourse as a more lucrative form of speculative activity.

2. The change in Russian politics in 1954 created some relaxation in world tension and increased the hope for peace. The supply of gold increased to the extent that the ounce attained the low level of 35 dollars.¹ This minimized the extent of a second major source of revenue to changers as a result of the lower volume of trade in

1. Le Commerce du Levant, Organe économique, Financier et maritime, Beyrouth. No. 272, p. 3.

gold. This development provided a further incentive for changers to gravitate to the Bourse and to bring their speculative frame of mind with them.

3. The Bourse of Paris experienced a strong upturn of activity in 1954, which was directly reflected on the Lebanese market, due to the close interdependence of the two. (We shall examine this interdependence in chapter Five).

4. With an unnecessarily high level of liquidity and the absence of investment opportunities for commercial banks to hold a portfolio, the commercial banking system in Lebanon became more lenient in providing credit for operations on the Bourse. This development helped to increase further dealings in the stock market.

5. A more general factor which had a favourable effect on the growth of the Bourse was the surplus in the Lebanese balance of payments from 1950 onward. This surplus took the form of reserves in gold and foreign currencies to back the Lebanese pound and give it the utmost of stability. This increased the confidence of the public in the financial structure of Lebanon, and consequently, in its stock exchange.

These different factors resulted in a clearly higher level of activity on the Bourse. By 1953-54, the daily volume of transactions increased from an average of

LL 150,000 in 1950 to LL 500,000; at one point it even reached a ceiling of LL 650,000.¹

Due to the growing importance of the Bourse in the Lebanese economy and the increasing level of its activity, it was found necessary to reorganize it. This was carried on in two steps: by the law of June 18, 1954,² and by a more comprehensive law voted by Parliament on February 2, 1957.³ The provisions of the latter, together with the by-laws and Internal Regulations, are briefly described later in this Chapter. This description will help us in carrying forward the analysis of the Bourse.

II. PRESENT ORGANIZATION

A. Administration and framework

1. Dealers in the Bourse - Dealers are of three types:

a) Members

b) Brokers

c) Subscribers (Abbonnés): active or adherent.

a) Members - A member of the Bourse is any person, physical or moral, who deals in Beirut with foreign currencies, gold or movables (Art. 2 of law of February 2, 1957).

1. Ibid.

2. The Official Gazette, 1954, No. 25.

3. Ibid., 1957, No. 6.

Under such title, the following are included:

1. Banks S.A.
2. Bankers
3. Changers

Changers are the moral or physical persons who, although not performing a complete banking business, effect any of the functions described under members (Art. 21 of the Internal Regulations).¹ Changers are subdivided into two classes:

1. Type A, includes all those who have premises to carry on their profession.

2. Type B refers to all those who do not have such places at their disposal.

b) Brokers - To be accepted as a broker on the Bourse, the applicant should fulfil the following conditions (Art. 30):²

1. To be Lebanese of not less than 25 years of age, with full and entire capacity.
2. Not to have been declared bankrupt, except if rehabilitated.
3. Not to have been condemned for a crime or

1. Réglement intérieur de la Bourse et du marché des valeurs. (Le Commerce du Levant, publishers, 1957), p. 4.

2. Ibid., p. 5.

infamous delinquency.

4. To abide by the Internal Regulations and by-laws of the Bourse.

In addition, the applicant should submit to the Bourse a bank guarantee of LL 15,000 as a safeguard to the interests of clients in case of fraud (Art. 31).

c) Subscribers (Abonnés) - All Lebanese corporations with their head office in Lebanon and all concessionary companies working in Lebanon are considered as adherent subscribers to the Bourse (Art. 34). However, it is open to any businessman or industrialist working in Lebanon, irrespective of nationality, to become an active or adherent subscriber (Art. 34).

Active subscribers are allowed to effect transactions for their own account. Adherents can only be present at the operations of the Bourse (Art. 6 of law of February 2, 1957).

2. Committees - The Bourse is administered by a board of twelve persons elected by members, brokers and subscribers. This board is composed of the following, in accordance with Art. 9, as lately amended:¹

(a) Four representatives of banks. (b) Four brokers and Type A changers. (c) Two industrialists. (d) One

1. Commerce du Levant, No. 342, p. 3.

businessman and one representative of corporations whose securities are listed. The government is represented by a Commissioner, designated by decree upon the recommendation of the Minister of Finance (Art. 14 of law of February 2, 1957). The latter has the power to dissolve the board upon the proposal of the Commissioner and to proceed to new elections.

As stipulated in Art. 15 of the same law, the board would elect in its first meeting:

- A directing bureau composed of president, vice-president, a treasurer and a secretary.

- A listing committee.

- A disciplinary committee.

- Any sub-committee deemed necessary.

- The board nominates the members who assist the Administrative General Secretary in the publication of the daily bulletin of quotations.

The general functions of the board are the following (Art. 10):

- To approve the budget of the Bourse.

- To approve its financial statements.

- To prepare the Internal Regulations, to be submitted to the Ministry of Finance for approval.

- To establish the by-laws and job specifications of employees.

- To nominate the Administrative General Secretary upon the proposal of the directing bureau.

- To approve all commitments the value of which exceeds LL 5,000.

The board decides about anything pertaining to the functioning of the Bourse. It has to defend the professional interests of brokers, members and subscribers to the Bourse and remove misunderstandings and conflicts among these and with third parties.

The performance of the above-mentioned function is facilitated through the cooperation of the directing bureau. The latter can be considered as an executive body charged with carrying out the policies adopted by the board. Any infraction of the regulations of the Bourse is considered by the disciplinary committee which is empowered to give any of the following sanctions: 1) warning; 2) blame; 3) suspension for a period not exceeding three months; 4) suspension for one year; 5) expulsion. However, either of the last two penalties must be taken against any member, broker or subscriber, liable for any of the following acts (Art. 133):

a) Having published fictitious prices or reported fictitious transactions.

b) Having spread rumors which tend to divert the

normal trend of prices.

The above-described board and committees are established, in a sense, to help in the smooth functioning of the Bourse and to check any tendency which would trouble its course. However, a listing committee is also provided to decide about the eligibility of companies applying for listing on the Bourse (Art. 52), in accordance with the proper regulations to be discussed later in this Chapter.

This committee is composed of:

- a) The president of the Bourse, acting as chairman.
- b) A banker, a changer, a broker, an industrialist and a businessman, all chosen from the board of the Bourse.

The listing committee must decide about the applying company within one month after the presentation of the petition. In case of delay or refusal, the applying company can resort to the Minister of Finance, who then makes the final decision (Art. 54).

The committee is in a legal position to refuse the admission to the Bourse of any security, even if it fulfils the listing requirements, in case there is a justifiable reason for rejection (Art. 56).

The committee is under legal obligation to remove a security from the list, upon the advice of the Government Commissioner and the Disputed Claims Office (Art. 57), for the following reasons:

- a) If it no longer fulfills the conditions for admission.
- b) If the corresponding company is declared bankrupt.
- c) If its trading on the floor becomes harmful to the public interest (Art. 58).

In case the decision is not in accordance with the advice of the Government Commissioner, the final judge is the Minister of Finance. The company too could find in the latter a last resort for complaint.

3. Fees and commissions charged - The different dealers in the Bourse pay the following annual fees (Art.81):

Members

Banks, S.A.	LL 500
Bankers	350
Changers (Type A)	300
Changers (Type B)	200
Brokers	300
Subscribers (<u>Abonnés</u>)	
Corporations	150
Active	200
Adherents	50

On December 15, 1957, there were registered on the Bourse the following:

37 banks, 36 bankers, 50 brokers, 110 adherent subscribers, 120 sociétés anonymes, 17 changers (type A), 30 changers (type B). Annual fees paid to the Bourse by these registrants amounted to approximately LL 80,000.

With regard to the commission collected on transactions, the rate was one-quarter percent on every party prior to the last reorganization of the Bourse. The charge was increased to one percent beginning March 1st, 1957 (Art. 86).¹

With a total volume of LL 55 million in 1957, the Bourse received as commission the amount of LL 110,000. The gross revenue for that year totalled LL 190,000. Net revenue would be a large percentage of that amount because of the very low level of operating expenses. (The first balance sheet developed by the Bourse on December 31, 1957 was not made public and we were unable to get it. So the above mentioned figures are estimates made by well-informed sources).

It should be added also that seats are rented for the annual sum of LL 150.²

On the other hand, the Bourse gets the following lump sums from companies whose securities are listed (Art.63):

- For corporations whose capital does not exceed LL 500,000 LL 250
- With capital exceeding LL 500,000, the additional fraction would be

1. To finance an old-age pension scheme, the French authorities increased in 1955 the commission charged on transactions effected on the Bourse of Paris from one to three percent on every party. Commerce du Levant, No. 173, p. 3.
2. On the New York stock exchange, seats are owned and can be freely disposed of at market prices.

charged at the rate of¹ One-fourth percent

B. Listing requirements

1. Lebanese securities - The securities of the Lebanese corporations meeting the following requirements are admitted for trading on the floor (Art. 42):

- Whose capital is not less than LL 500,000.
- Which published financial statements for the preceding two fiscal years and which were duly approved by the general assembly of stockholders.
- Whose securities are to bearer and totally paid up. However, nominative securities can be accepted if the by-laws of the respective corporations do not restrict their transferability.

To be admitted to the list, the corporation should apply to the listing committee, and submit to it the following statements (Art. 43):

- a) All documents pertaining to the organization of the company, a description of the features of its floated securities, its by-laws and all amendments brought forward.

1. For the privilege of having its stock listed on the New York stock exchange, a corporation pays a small initial fee of one-fourth to one-half a cent per share, depending upon the number of shares listed, and a continuing fee over 15 years of one-fourth to one-half percent per share. Investment Bankers Association of America, Fundamentals of Investment Banking (New York: Prentice-Hall Inc., 1952), p. 554.

- b) The last two published balance sheets, duly certified and approved, and all information which throw light on the financial situation of the company.
- c) A specimen of the securities to be traded on the floor.
- d) A written agreement to carry on in Beirut the whole financial service of the company (the exercise of the pre-emptive right by stockholders, payment of dividends and interest and the like).

In case the company is admitted to the list, it should submit to the Bourse at the end of every year the following documents (Art. 45): the financial statements and the annual report of the board of directors. Any amendment brought to the by-laws or statutes should be submitted as soon as approved by the general assembly.

Though bonds are not yet dealt with on the floor, a legal provision has been made for their acceptance (Art. 44): only corporations whose stocks are already listed can apply for the admission of their bonds, on condition that the latter are in conformity with Art. 126 of the Lebanese commercial code which stipulates:¹

1. Code de Commerce (Georges Naggear, tr.; Librairie Antoine, Editor; Beirut, 1955), p. 59.

"Prior to any floatation of bonds, the administration of the company should publish, in the Official Gazette, a duly-signed notice showing: the date of the decision taken by the general assembly authorising the issue; the par-value and number of bonds to be issued; the interest to be paid, maturity period, conditions and guarantees of settlement; the outstanding debt and its features; the authorised capital and the amount paid-up; the existence of a clause binding the company to pay a fixed interest rate; the latest certified balance sheet."

2. Foreign securities - The introduction of a foreign security to the Bourse must be expressly authorized by the Ministry of Finance, upon a recommendation of the board. This procedure is needed to introduce to the Bourse the foreign securities which are already listed on the stock exchanges of the originating countries (Art. 47).

However, in the absence of a stock market in the mother country, admission to the Bourse would depend upon the fulfillment of the following conditions:

a) The company should have a minimum countervalue capital of LL one million.

b) The statutes and policy of the company should be in accordance with the regulations of its mother country and not in conflict with the Lebanese commercial code.

c) The company must carry through a bank in Beirut its whole financial service, without any restriction or expense to the stockholder.

Any application for admission should be accompanied by the following documents (Art. 48):

1. The number of the Official Gazette in the mother country in which the statutes of the company were published.
2. Its certified by-laws.
3. A specimen of the securities to be introduced.
4. A written acceptance by a bank in Beirut to carry on gratuitously the financial service of the company.
5. The last three balance sheets duly signed and, in addition, certified by the representative bank in Beirut.
6. An engagement to submit to the Bourse a detailed report about the general meetings, within a fortnight after their occurrence, and any amendment brought to the statutes and by-laws.
7. An engagement to advise the Bourse on any dividend declaration and the exercise of the lottery feature for redemption, if any exists.

In addition to these conditions, the Bourse reserves to itself the right to require from the company any document deemed necessary to its decision about the acceptance of its securities and for their maintenance on the list.

In the light of the above-mentioned requirements to be fulfilled by an applying company, the listing committee decides about its acceptability on the floor. But the decision of the committee is not based on definite quantitative standards and the admission, in the last analysis, is

subject to the complete discretion of its members.

It was also stated that the admitted company should submit specific and regular information to the Bourse. In case the company does not continue to fulfill the previous conditions which have been required for its admission, or the trading of its securities becomes harmful to the public interest, the listing committee has to remove the corresponding security from the floor.

Here again we could see that though the listing committee had provided for future surveillance over the financial position of companies whose securities are listed, such supervision has no scientific basis for adequate appraisal. The acceptance of a security to the list, as well as its removal, is not stipulated in accordance with definite regulations and standards. This drawback will be discussed at length in Chapter Six.

C. Operations of the Bourse

1. Description of transactions - Transactions are effected in the Corbeille (dealing place in the Bourse) through public auction and are settled at sight.

Dealings are made on quantities not below levels determined by the directing bureau (for instance, a minimum of 10 shares for the Port). These are recorded by both the effecting broker and a Bourse representative

(the record of the latter serves as reference in case of dispute and as a basis for the computation of the commission).

The margin of fluctuation in prices between consecutive transactions is limited, in accordance with the par-value of the stock, to the following amounts (Art.66):

LL 10 to 150 of par-value	Margin of LL0.25 to 1.-
150 to 250 " " "	" " 0.50 to 1.50
250 and above	" " 0.50 to 2.-

The Bourse should open at the closing prices of the last session. However, the last quotations of the Bourse of Paris could also be taken as a basis for pricing (due to the close relationship between the two stock exchanges).

The different dealings are recorded in a daily bulletin published by the Bourse and which shows for every company:

- The number of shares transacted.
- The closing prices of the last session.
- The highest and lowest levels attained since the beginning of the year.
- The amount of the last dividend payment.
- The number of the attached coupon.

The bulletin publishes , also daily, the prices of gold, in ingots and coins, as well as the rates for all currencies dealt with on the official and free market of Beirut.

2. Arbitrage - Since the major stocks dealt with on the Lebanese market are also listed on the Bourse of Paris, it is quite natural to think that arbitrage could be effected between the two centers. However, arbitrage is not carried out for the following reasons:

- Beirut generally opens at the closing prices in Paris of the day before. This has been even provided for in the Internal Regulations of the Bourse (Art. 65). This would mean that the trends of both markets are daily adjusted to each other not through the interplay of supply and demand between the two (i.e. arbitrage), but through the formal leadership given to Paris in price determination.

- Since 1955, prices in Beirut have had a tendency to move higher than in Paris. This was due first to the fact that demand was more intensive and the range of supply narrower in the former than in the latter (this trend has however decreased because the securities listed on both markets have largely passed into Lebanese hands). Secondly, the nationalization projects which have been under study for the last three years with regard to the major French companies working in Lebanon, have had a more favourable incidence on their quotations in Beirut than in Paris, as will be detailed in the following chapter. French securities were cheaper in Paris than in Beirut and arbitrage could have been effected through acquiring stocks in the former

and disposing of them in the latter. But such opportunity was not liable to trading activity because:

a) The constantly arising disparity was daily removed through the formal adjustment of Beirut to Paris, as described earlier. Prices in the former were in a sense 'pegged' by the limits of the latter.

b) Even if such daily adjustment were not carried out and arbitrage could have been effected between Paris and Beirut, the French exchange authorities would have strictly prevented the acquisition of stocks in Paris and their selling abroad. This procedure would have been considered as a subterfuge for taking capital out of the country.

D. Volume of operations and its growth

The Bourse does not show a regular trend of growth. This is due not only to the influence of the major events in the Middle East during the last three years, but also, as we shall see later, to the structure of the Bourse and the nature of capital attracted to it.

A comparison of the figures in the following table shows the fluctuations of the volume of transactions between different months of the years 1955-57, and the same months of these three years:

TABLE I

VOLUME OF TRANSACTIONS AND NUMBER OF SHARES
TRADED ON THE BOURSE OF BEIRUT DURING THE YEARS 1955-57

(In LL 000)

	1955	1956	1957
January	2,358	3,280	3,876
February	4,302	4,700	4,831
March	1,944	3,221	4,949
April	4,300	3,578	6,083
May	4,500	4,595	7,035
June	2,566	8,277	6,864
July	1,535	7,745	4,661
August	3,800	6,503	3,751
September	2,375	3,789	2,964
October	2,166	5,533	3,458
November	3,805	5,116	2,941
December	2,900	6,085	3,695
Total volume of transactions	36,551	62,422	55,108
Total number of shares traded	197,006	441,466	324,694

Source: Le Commerce du Levant, No. 165, p. 6;
No. 269, p. 8; No. 369, p. 8.

In June 1956, the volume was 2.5 times that of March of the same year; in July 1956, it was 5 times that of July 1955, but dropped to 1.7 times in July of 1957.

If we consider now the total volume of transactions and number of shares traded for each of the three years, we find out that in 1956, both levels were respectively 2.24 and 1.7 times those attained in 1955.

It is quite natural to wonder what lies behind these big changes. Do such fluctuations correspond to causes noticed in developed stock exchanges, or are they the results of an unhealthy and speculative growth of the Bourse? This leads us to an analysis of the structure of the Bourse which will be carried out in the following chapters.

CHAPTER IV

MAJOR SECURITIES LISTED ON THE BOURSE

All securities dealt with on the Bourse are of the common stock type, with the exception of the "Actions de jouissance," issued by the Régie des Tabacs et Tombacs. The latter are issued in replacement of redeemed stocks by the company and confer on their holders the right to get dividends, without however any right to take back the par-value and share in the proceeds in case of liquidation.¹

By any measure, the majority of the transactions effected on the Bourse are centered around four securities. For example, in 1956, stocks of the Port de Beyrouth, D.H.P., Foncière de Syrie and Compagnie Libanaise des Pétroles amounted to 53 percent of the total number of shares traded. Their share increased to 70 percent in 1957.

In the following part of this chapter, we shall try to point out the important characteristics of these companies. Our examination will not be so detailed as to describe at length all the controversies related to some

1. Code de Commerce, p. 55, Art. 115.

of them. However, the analysis will be carried forward to the extent that it helps us to understand the major trends governing the operations of the Bourse.

A. Port de Beyrouth

This company is French with its head office in Paris. It was established in November 1888, with an initial capital of five million French francs to construct, exploit and manage the port of Beirut. The act of incorporation provided the company with a concession which is to expire in 1990. However, it was stipulated that on or after September 1955, the government would be in a legal position to take back the concession, against an annual payment until 1990 of 50 percent of the average gross revenues which accrued to the company throughout the last five years prior to such settlement.

By 1955, the company was in an excellent financial position. After the second world war, the movement of goods through the port experienced an especially large upward growth. In 1955, it was 25 percent above the level attained in 1954 and the latter was 20 percent above the level of 1953.¹ The construction of a third basin and the extension of facilities already in place

1. Commerce du Levant, No. 150, p. 1.

have been seriously considered in order to keep up with the growing importance of the port not only for Lebanon, but also as a transit center for the entire Middle East.¹

The financial position and capital structure of the company are clearly shown below in the simplified balance sheet of December 31, 1956:

<u>Assets</u>		<u>Liabilities and net worth</u>	
	FF		FF
Cash in banks	256,327,238	Short-term debts	612,725,487
Short-term rec.	103,804,656	Long-term debts	403,703,589
Miscel. debits	497,012,365		
		paid-in capital (95,349 common shares of a par- value of FF 10,000)	953,490,000
Private Properties:			
Lands	807,188,003	Capital surplus	1,243,306,704
Buildings(net)	180,866,734	Approp. surplus	1,779,031,251
Equipment(net)	158,148,109	Free surplus	129,332
Stores	88,033,681		
Public Domain	<u>2,784,688,608</u>		
	FF <u>4,992,386,363</u>		FF <u>4,992,386,363</u>

Source: Le Commerce du Levant, No. 303, p. 3.

1. Of course, the long-range impact of the recent events on port activity cannot be accurately foreseen at present. If Beirut turns out to be a port for Lebanon alone, there may be excess capacity, even in the present facilities.

From this balance sheet, we can see that the book value of a share amounts to FF 41,698 or LL 303 as compared with FF 10,000 of par-value.

In 1955, the government opened negotiations with the company to withdraw the concession. The amount to be paid, as we have seen, was to be based on the average gross revenues of the company for the last five years. The government proposed the years 1950-1954 as a basis. The company, on the other hand, considered that the basis should be the years 1951-1955. Under the former proposal, the average worth at six percent of 50 percent of this amount to be settled yearly over thirty five years represented LL 56 million. For the second alternative (i.e., the company's), the average gross revenue reached LL8,932,400, and the present worth amounted to LL 64 million.

The course of negotiations which produced the different proposals for settlement were reflected in fluctuations on the Bourse. This was to be expected since the adoption of either alternative for the final settlement of the whole issue would have had a special incidence on the liquidation value of the company. Such fluctuations were due to the different expectancies of dealers on the Bourse about the ultimate solutions of the following three issues:

1. Compensation for the concession - The government proposed the amount of LL 56 million to take back the con-

cession, the basis being the gross revenue for the years 1950-1954. The company asked the amount of LL 64 million, on the basis of the years 1951-1955. Under the former alternative, the liquidation value of a share would have been LL 587; whereas under the latter, the value would go up to LL 671. The favourable incidence of the nationalization prospects on the position of the securities of the company in the Bourse could be explained when we compare the liquidation value, under any of the above-mentioned alternatives, to the book value of the share which amounts to LL 303. When the capital stock of the company was split two for one in 1956, the prospective liquidation values came down to LL 335.50 and LL 293.50 respectively, as compared to the new book value of LL 151.50.

What made the evaluation of the securities more difficult, thus strengthening the speculative trend in the Bourse, were two pending questions related to tax arrears and allocation of some plots of land. The suggested solutions for these two issues were widely divergent and gave way to misinterpretations by the public and rumors by dealers in the Bourse.

2. The problem of tax arrears - Between 1945-1952, the company was in dispute with the fiscal authorities about exemptions as well as the basis for taxation. The government proposed the deduction of LL 16 million from the buying price of the concession to settle the issues.¹

1. Commerce du Levant, No. 190, p. 1.

British experts who were consulted, concluded that the amount in dispute was only LL 8 million.¹ The quotations of the stock on the Bourse were very sensitive to such arguments, as any decision taken in this respect would have varying adverse effects on the liquidation value of the company.

3. Allocation of land - Rumors were spread that a conflict might arise between the negotiating parties concerning the true ownership of some plots of land on which the company had built installations. Dealers were divided in discounting the final settlement of this issue. Some argued that the value of these plots should be included in the repurchase agreement, while others contended that they formed a part of the concession which should be recovered by the state without payment. Their value, which amounted to nearly LL 35 million, should therefore be deducted from the buying price of concession. This rumor had a depressive effect on the Bourse because, if it proved correct, it would reduce by more than half the liquidation value of the share.

The manner in which negotiations were carried on helped speculators to manipulate the market. The different issues were tackled individually and at different times.

1. Ibid., No. 234, p. 3.

This procedure helped in the spread of rumors, because an adequate settlement of any issue depended on the solution brought for others. The confusion and uncertainties in negotiations were well exploited by the professional dealers in the Bourse.

Because of the major conflicts outlined above, negotiations did not lead to a final agreement. It was finally concluded that private capital would be in a better position than the government to run such an enterprise. That is why the government became more and more inclined to maintain the private character of the company while working for its "Lebanization". Negotiations on this basis lasted two years. In August 1957, an agreement was entered between the parties and was accepted by the general assembly of shareholders. Until now, however, the agreement has not been ratified by the Lebanese parliament. The major points of the agreement are the following:¹

1. The company would assume Lebanese identity. This step would require certain measures to safeguard the interests of the shareholders. Since these would have to exchange their old stock certificates for those of the new Lebanese company, the transaction would be regarded by the French fiscal authorities as a direct sale of securities. As a result of this

1. Ibid., No. 333, pp. 3-8.

interpretation, they would consider the difference between the actual market value of the share and its nominal value as a taxable capital gain. To remove this burden (especially since the Lebanese shareholder is not liable to the capital gains tax), the agreement, which required the ratification of the French Parliament, stipulated that the above-described procedure would be exempt from the French capital gains tax (Art. 23).

2. Lebanese legislation should provide for the complete transferability of the new issue. This step is deemed necessary to maintain the marketability of stocks and facilitate in this way their trading in the Bourse. The legislation would represent an exception to an existing law which requires that one-third of the shares in any public utility be held by Lebanese nationals.

3. The improvement of port facilities and the construction of the third basin are to be wholly financed by the company (Art. 2). As remuneration, the company would benefit from the exploitation of the extension.

4. The net profits (obtained after deductions from gross revenues of certain percentages), are to be divided in the following way:

- Thirty-five percent to the state and sixty-five percent to the company before the termination of the

third basin, the construction of which would require three years.

- On a fifty-fifty basis after its completion.

5. Revenues accruing from the exploitation of the public domain by the company would be exempt from the income tax. However, profits accruing from the private domain would be liable to the income tax, beginning January 1, 1957 (Art. 11). The pending tax dispute with the fiscal authorities up to December 31, 1956 would be settled by the company with a total payment of LL 2 million payable in three instalments (Art. 17).

6. The new lands to be reclaimed from the sea would be divided in the following way:

The company	151,000 M ₂
The state	60,000 M ₂

All lands acquired prior to the agreement belong to the company. This would settle the issue of LL 35 million in the company's favor.

7. The state would be legally entitled to take back the concession from January, 1976. In addition to the basis for compensation stipulated by the convention of 1888, account would be taken of the remaining unamortized cost of the third basin (which is scheduled to be written off over thirty years).

The new convention gave the company the following advantages over the first alternative, namely, the selling

of the concession;

- A final advantageous settlement of tax arrears and future exemptions of major revenues from taxation.

- The company would get a good share of the lands reclaimed from the sea and confirmation of its ownership of lands acquired prior to the agreement.

- While it is true that the company would assume the burden of financing the whole scheme of construction, the costs to be incurred would be written off from the gross revenues; this would result in a decrease in the share of government in net profits.

- The company has assured itself the possibility of sharing in the rapid growth of the port between 1961, date of termination of the extension, and 1976, the date on which the government could take back the concession.

These advantages were clearly reflected on the Bourse, as will be plainly seen in the next Chapter.

B. Damas, Hama et Prolongements (DHP)

This is another French company which used to hold a concession for providing and exploiting railway facilities in Syria, and still holds one for Lebanon. The enterprise has been in financial difficulty as a result of acute competition by trucks and the rupture of the Syro-Lebanese Customs Union. For the years 1954 and 1955 the deficits

were the following:¹

	<u>Gross revenue</u>	<u>Total expenses</u>	<u>Deficit</u>
1954	FF 6,509,235,27	FF 8,946,543,34	FF 2,437,308,07
1955	7,058,995,87	10,204,820,72	3,145,824,85

The deficits were filled by government subsidy. In 1955, for example, a subsidy of LL 2.5 million was voted by the Lebanese Parliament. In 1956 a credit of LL 1.5 million was also provided the company to compensate the discharged personnel.

In 1955 the Syrian government entered into agreement with the company to buy that portion of the concession and equipment located in Syrian territory. The transaction was effected at SL 5.5 million. The company has received up till now SL 4,100,000 thus far from the government. In April 1956, January and May 1957, capital disbursements of FF 1,000, 4,000 and 1,600 per share were made to stockholders, or a total countervalue amount of SL 3,100,000. Aside from the balance of SL 1,400,000 due from Syria, the company still owns there some movable assets which are valued at SL 500,000.

Beginning in 1955, the Lebanese government was in a legal position to take back the concession and buy the equipment of the company for an agreed upon sum. The

1. Ibid., No. 247, p. 3.

government decided to exercise its option, and an agreement was reached in May, 1957.¹ The convention, however, was not submitted to Parliament in time for it to be ratified prior to the deadline mentioned in one of its provisions. Nonetheless, the clauses of the convention had a clear incidence on the position of the company shares on the Bourse. Some of these clauses follow:

It was agreed that the government would pay a lump sum of LL 2.5 million for the concession. All equipment would be bought for an additional LL 3.5 million. The company would still own in Lebanon certain movable assets worth LL 816,000, which it could dispose of freely.

- Total payments would be effected in two instalments,
- LL 3 million upon the ratification of the agreement by Parliament,
 - The balance to be paid after the promulgation of the 1958 budget, but not later than March 31, 1958.

The contemplated residual value of the 60,000 common shares forming the total capital of the company would be:

- Settlement price by the Lebanese government	LL6,000,000
- Value of movables in Lebanon	816,000
- Arrears in Syria (in LL)	1,260,000
- Movables in Syria	450,000
- Funds received from Syria and not yet disbursed	<u>900,000</u>
	LL9,426,000

1. The text of the agreement was published in the Commerce du Levant, No. 319, pp. 3-8.

The liquidation value of one share would thus be LL 157.

Negotiations between the parties and the final settlement had a very favourable effect on the quotation of the company share in the Bourse. In fact, the actual deficit in earning records and gloomy prospects of the company, coupled with the specialized and obsolescent nature of its equipment, would have provided only a nominal value to its securities in case of liquidation. The possibility of selling the concession and equipment to the government put the value of the share in an entirely different light.

C. Compagnie Libanaise des pétroles

This company was established in 1947, with an initial capital of LL 500,000, divided into 5,000 common shares of LL 100 each. The capital was increased in 1948, 1952, and 1953 to LL one million, one million and a half, and two million respectively.

The concession, which is to last seventy-five years (as amended on August 10, 1955),¹ stipulated that the company should make 9,000 meters of drilling by August 10, 1958, and 3,000 meters per year after that date. In case oil is found, the government would get up to 50 percent

1. Ibid., No. 231, p. 1.

of net profits, depending upon the amount of output. Because of such participation, the company would be exempt from the income tax.

By 1955, the whole capital had been spent on oil prospection, but without positive result. In addition, a credit of LL 400,000 was provided by the Esso Company to follow up the search. By September 30, 1957, LL 292,034,18 of the credit had been spent on prospecting. On that date, the balance sheet of the company was the following:

<u>Assets</u>		<u>Liabilities and net worth</u>	
Cash in banks	LL 346.45	Notes payable	LL292,034.19
Acts. Rec. (Miscel).	17,793.25	Accrued Exp.	44,000.- 336,034.19
Equipment (Net)	8,795.80	Provision (Personnel)	600.-
License	117,693.07	Indemnities (Land)	3,686.25
Research	2,160,791.86	Capital (20,000 com. stock, of LL 100 par value)	2,000,000.-
Miscel.	34,900.- 2,313,384.93		
	<hr/>		<hr/>
	LL 2,340,320.43		LL 2,340,320.43
	<hr/> <hr/>		<hr/> <hr/>

Source: Commerce du Levant, No. 370, p. 3.

It is clearly seen from these figures that the company had no justification for existence, at least from a financial point of view. The amendment of the concession act gave the company another three years to look for oil. As the work to be done necessitated large amounts of additional funds (which might not be provided by the public), negotiations were conducted with different foreign firms, under different conditions, to join in the venture. These negotiations, which did not lead to any positive action, however did result in great fluctuations on the Bourse and cost an unsuspecting public millions of Lebanese pounds. A few examples will illustrate how this happened.

In July 1956, an agreement was studied with Mr. Onassis.¹ The latter was to subscribe to a new issue of 45,000 shares of LL 100 par value and effect payment in two instalments:

- A first payment of LL 1,125,⁰⁰⁰ upon the issuance of the stocks.
- The balance of LL 3,375,000 to be settled as need arose during the course of the work.

Upon the further request of Onassis, the increase in capital was raised to LL 5.5 million, a sum to be completely subscribed by him in order to assure an overwhelming majority

1. Ibid., No. 213, p. 1.

control of 73 percent. It was agreed between the two parties that a period of sixty days would be given to Mr. Onassis to decide about the issue. Since he did not respond before the expiration of the period, the option was thereby dropped.

The second phase of negotiations was carried out between September, 1956 and July, 1957. The company sent a representative to the States to negotiate with American firms for exploration in Lebanon. This trip gave rise to wild rumors which had a tremendous incidence on the Bourse. The whole period was spent on negotiations with a certain R. Henderson who was presumed to represent an important trust of oil companies, but who was revealed later on as a broker of secondary importance.¹

The third phase was carried with another American group, represented by a certain H. Ralph Johnston. An option (for further agreement) was entered between this group and the chairman of the board on August 13, 1957.² Two months later, the option was rejected by the general assembly of stockholders,³ after having given place, in the meantime, to excessive speculation and disorder in the Bourse. The option was refused on the ground, that,

-
1. Discussions of the general meeting held on September 4, 1957.
 2. Commerce du Levant, No. 316, p. 1.
 3. In its general meeting held on October 31, 1957.

though the American group did not provide any guarantee to execute the work in due time and though its position was questionable as to the provision of a farm-out agreement with a capable exploration firm, the group would get definite advantages over the Lebanese stockholder and would be in a position to manipulate at will quotations on the Bourse. In fact, the negotiating firm would freely possess, according to the option, not less than 25,000 shares (the balance to be blocked) which it could turn to the market, according to well-planned rumors. The latter possibility could be easily attained as the group would have the voting majority power in the board since its 45,000 newly-issued shares would have full voting rights, even though they were not fully paid up.

After the option was rejected, a former chairman of the board, who happened to be on a private business trip in Europe, was asked to contact any interested European firm with regard to oil exploration in Lebanon. This request was excessively exploited by speculators in the Bourse.

At the present time, the situation of the company is quite chaotic and mysterious. The concession act (as amended), which had required that 9,000 m. of drilling should be made by August, 1958, was amended further to extend the date to August 1959. But nothing has been done since 1955 and even if work were resumed immediately, the

obligation could not be met by the required date. In spite of all this, the securities of the company, which are in fact worthless, are still traded on the Bourse.

D. Fonci`ere de Syrie

The performance of this company reflects a major characteristic of the Lebanese economy, namely, the boom affecting the real estate sector during the last four years.

The company is French with a capital of FF 207,000,000 divided into 69,000 shares of common stock, of FF 3,000 each. Aside from its real estate activities, the company has a business branch in Sudan for export of raw materials to France. Profits accruing from this branch have made it possible for the company to go on paying regular dividends in years of slow activity in real estate, especially during those prior to 1953.

The company owns around 76,000 M₂ of land in Beirut which has experienced, and still has, excellent prospects of a rapid capital gain. This land was bought at nominal prices when compared with the prevailing ones.

The securities of the company were introduced to the Bourse in October 1955. In less than two years 28,500 shares of a total of 69,000 had passed into Lebanese hands. The excessive and greatly speculative demand for the securities of the company on the Bourse was reflected by

the price of the share which jumped from LL 170 on November 1, 1955, to LL 236 only sixteen days later. The Bourse of Paris adjusted to this boom, and the value of the share increased in less than one year from FF 9,000 to 25,000.¹

On December 31, 1956, the combined balance sheet of the company (for both real estate and trading activities) was the following:

<u>Assets</u>		<u>Liabilities and net worth</u>	
	FF		FF
Cash in banks	64,688,378	Short-term debt	83,768,808
Short-term rec.	137,926,667		
Goods (Inventory)	117,363,982	Capital & net worth:	
Portfolio (Invest.)	4,272,477	capital	
Lands (Leb.)	37,727,410	69,000 shares of	
Bldgs.-Paris-(Net)	145,300,000	FF 3000 par-value	
Bldgs.-Sudan-(Net)	182,490		
		207,000,000	
Furniture-Paris-(Net)	2,064,765	cap. Surplus	127,055,762
Furniture-Sudan-(Net)	1,380,333	Approp. "	12,454,003
		Unapprop."	<u>80,627,929</u>
			427,137,694
	<u>FF 510,906,412</u>		<u>FF 510,906,412</u>

Source: Commerce du Levant, No. 325, p. 3.

1. Le Commerce du Levant, No. 158, p.3.

These figures show that the share, which has a par-value of FF 3,000, has a book value of approximately FF 6,000, or nearly LL 43,50. In 1956, the price of the share on the Bourse fluctuated between a minimum of LL 170 and a maximum of 267. In 1957, the margin was between LL 163 and 216.

The divergence between book and market values was primarily due to a market discount of the capital gain affecting the properties of the company in Lebanon. Prices of plots owned in Ras-Beirut and on the beach have risen tremendously. Furthermore, it was decided by the Lebanese government to build a new court-house in Furn-El-Chebbak in the vicinity of lands owned by the company; this would mean high capital gain on these lands. Finally, the company has seriously considered a project of erecting some buildings on its lands in order to earn a steady income from rents and, at the same time, increase the value of the neighbouring plots. The discount by shareholders of such potential gain was not shown in the balance sheet by re-valuation of lands held and by provision for appreciation. Thus, the book value is much inferior to the market value.

Some of these discounted capital gains are being realized by the sale of plots in Beirut (especially in Ras-Beirut where the company sold one in 1955 at LL 346 per square meter). The realization of such big capital gains from 1952 onward can be shown by the company's earnings

record from 1947 to 1956:

<u>Year</u>	<u>Net Profits (In FF 000)</u>
1947	10,000
1950	20,000
1952	23,000
1953	47,000
1954	67,000
1955	117,000
1956	80,000

Source: Commerce du Levant, No. 190, p. 3.

The high value given to the shares of the company on the Bourse and even the unhealthy speculation experienced could be partly justified on the ground that a strong boom has characterized the real-estate market in Lebanon. This has made the company more attractive to the investor than the Compagnie Libanaise des Pétroles whose prospects are far less clear.

CHAPTER V

THE BOURSE OF BEIRUT: ANALYSIS AND CONCLUSIONS

I. ANALYSIS

A. The interdependence between the Lebanese and French Stock Exchanges

Stock exchanges are closely related to each other.¹ They reflect the interdependence among the different parts of the world economy; however, this relationship becomes more accentuated and clear when we consider one security traded in two different centers. This could be illustrated by the interaction between the stock exchanges of Paris and Beirut with regard to securities listed on both.

French securities dealt with in Beirut represent a large proportion of the total turnover of the Bourse.

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1. "Foreign stock exchanges reacted sympathetically with the American market in 1929. The index of French stock price showed a comparatively moderate rise from early January (167.2) to early September (179.6) and then relative to the American crash, a moderate fall to the end of November (134.1). My index for Germany showed relatively less fluctuations than the American stock price level, being 117.6, 108.9 and 83.5 respectively at the dates named. English stock prices, however, had fallen pretty consistently since the first of 1929, going from 198.9 in the week ended January 11, to 167.3 at the end of August and 91.4 at the end of December, a decline of more than one-half in a year. No doubt the London decline, setting in much earlier than the American, helped give to the crash in stock prices of the latter its initial impulse."

Irving Fisher, The Stock Market Crash and After (New York: The McMillan Co., 1930), p. 20.

The proportion attained 59, 66 and 48 percent for 1955, 1956 and 1957 respectively. (The ratio decreased in 1957 as a result to the high speculative trading of the 'Pétroles', as we shall see later).

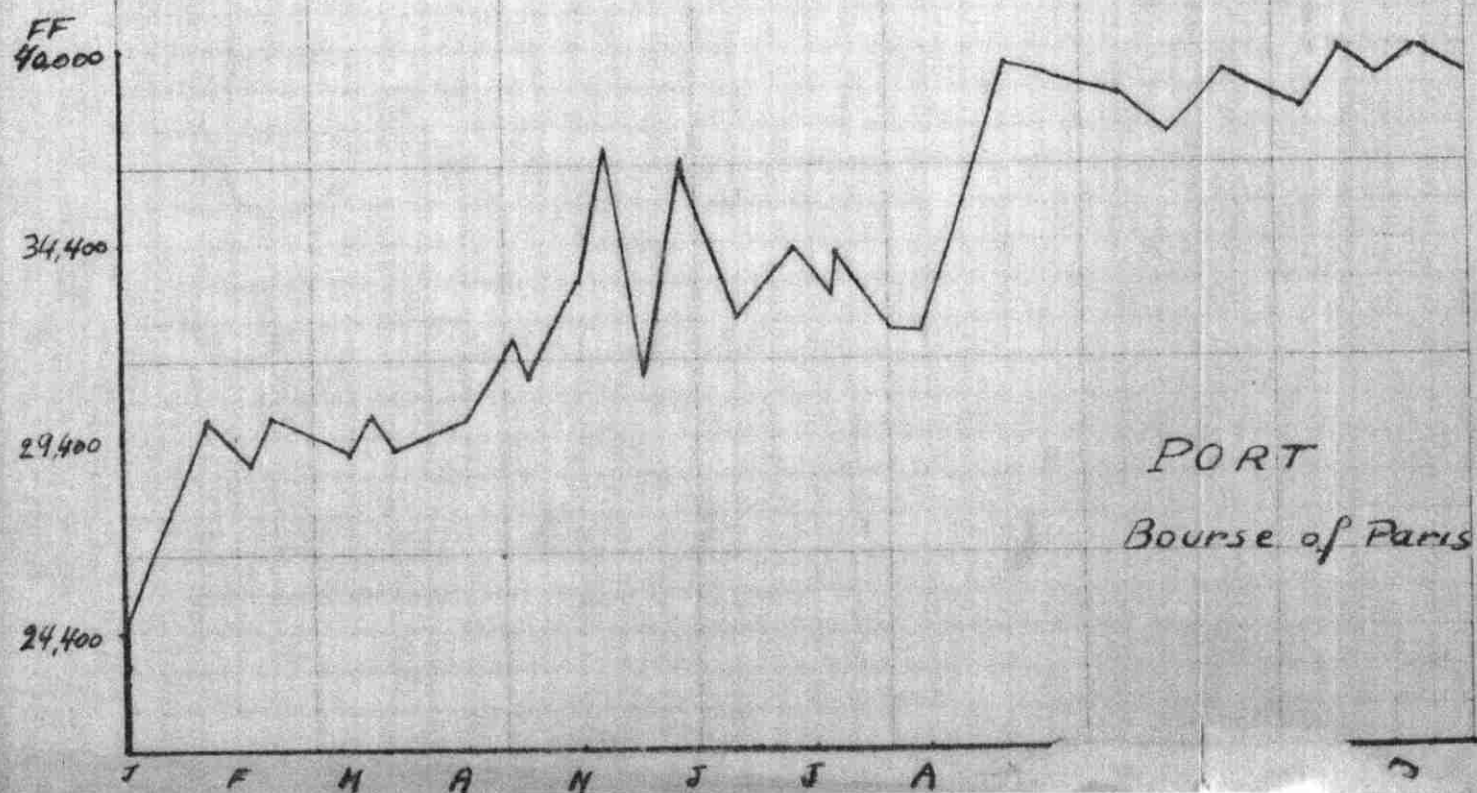
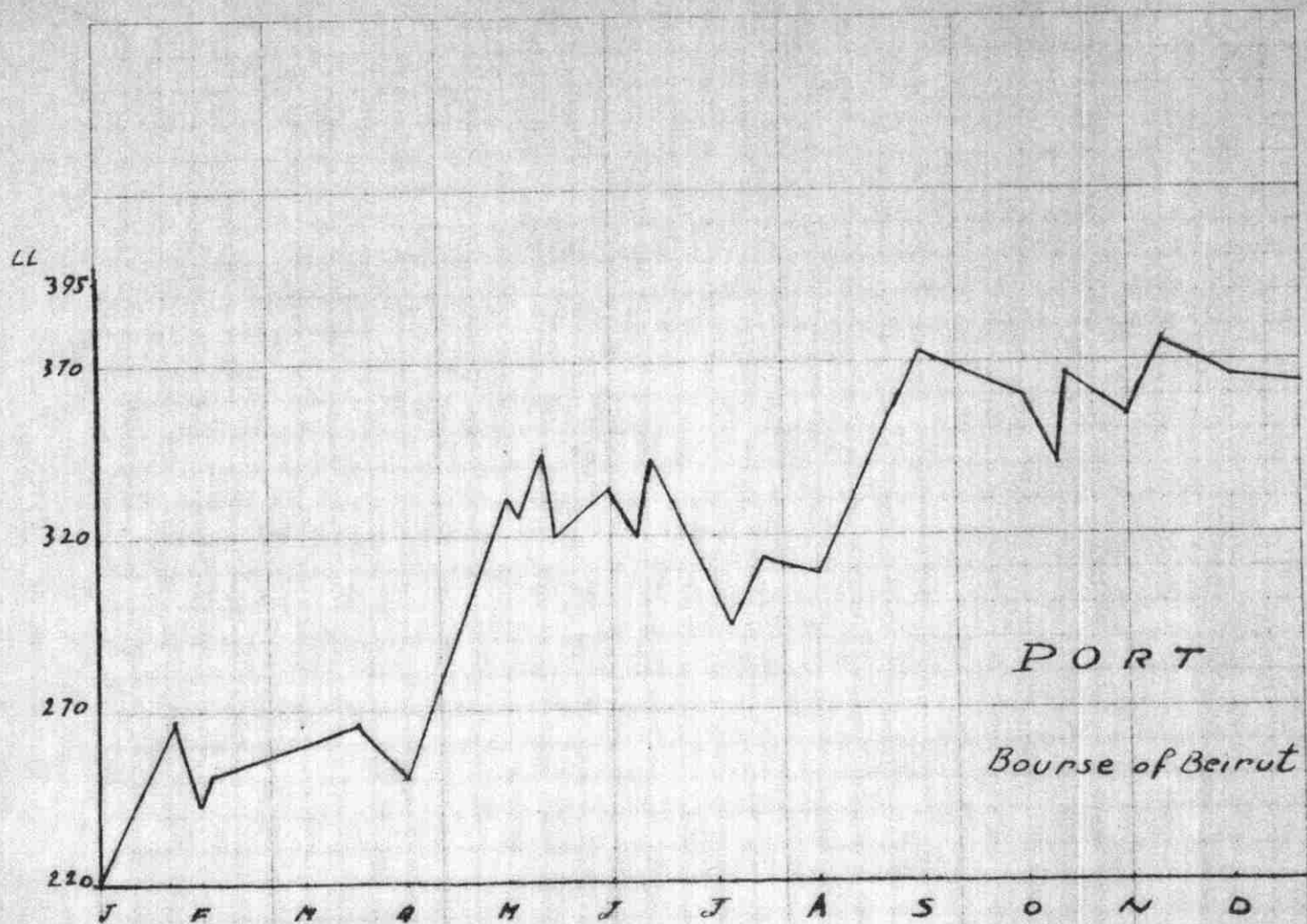
Now, how do these common securities behave on each market?

1. Correlation and standard deviation - The accompanying graphs, which show the movement of prices of the 'Port de Beyrouth' and 'Radio-Orient' on both exchanges in 1955, give an idea about the relationship between the two. We confined the graphs to these listings because information about them was easier to secure. There is no reason to believe that other stocks traded in the two centers would behave differently.

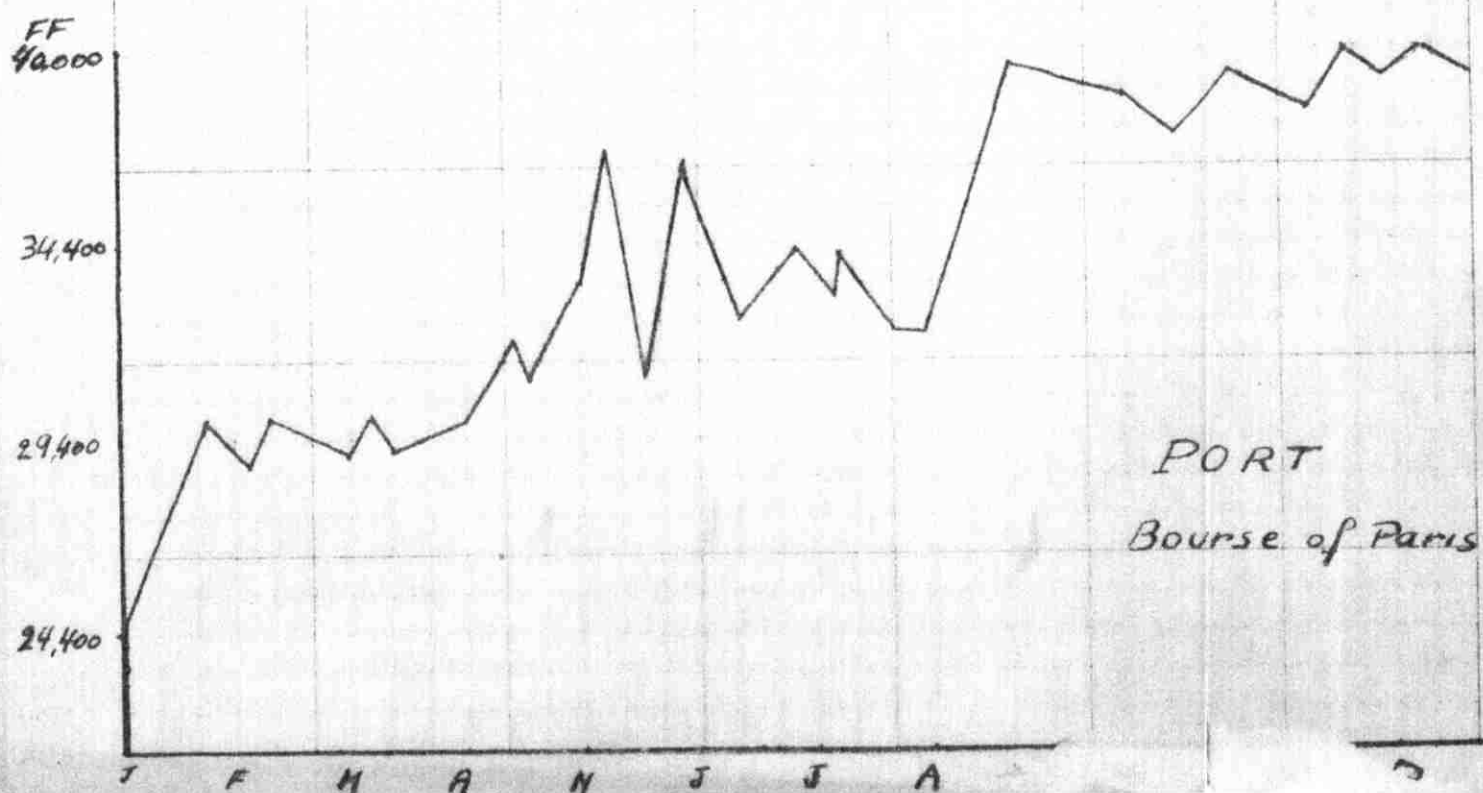
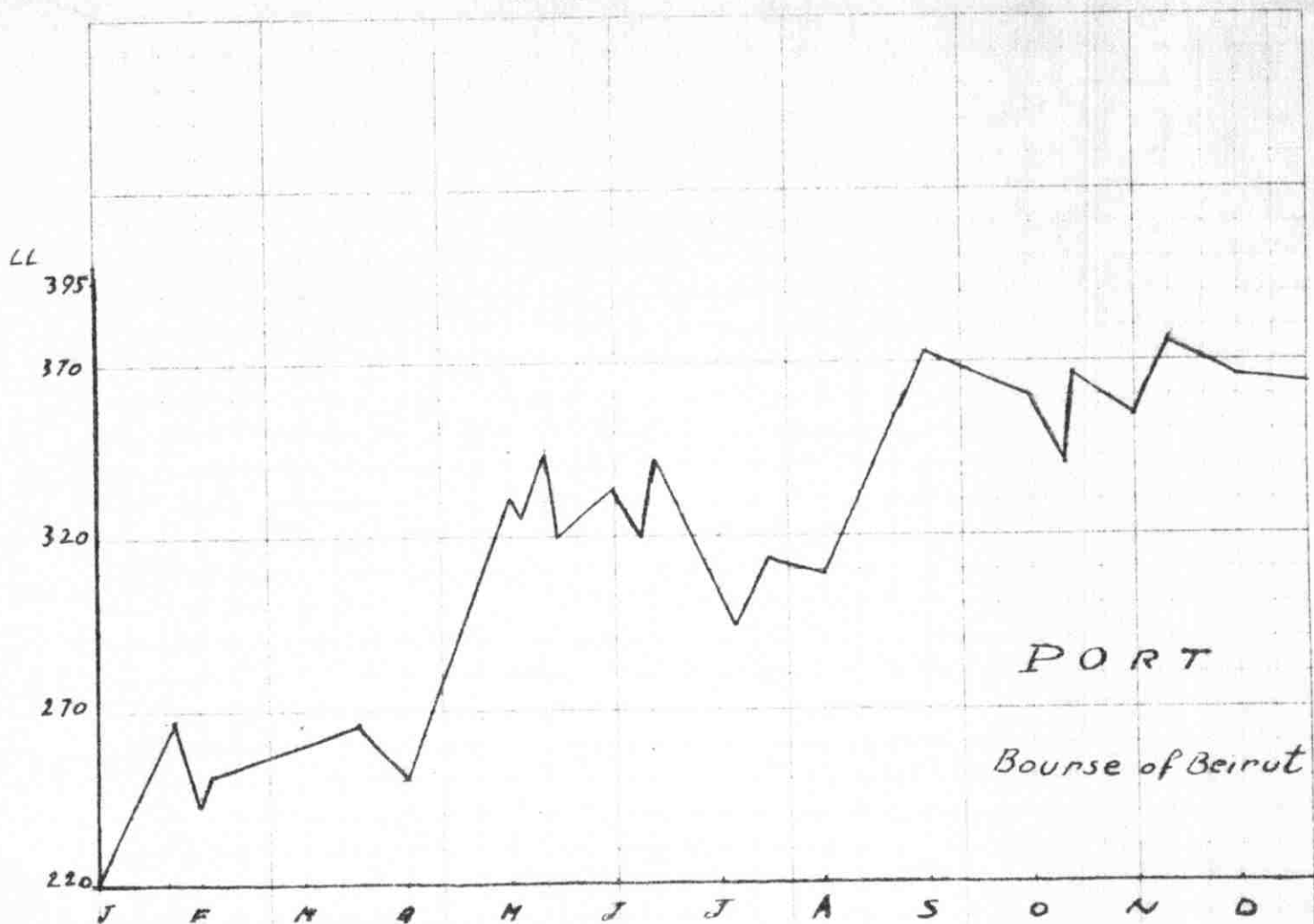
If we want now to show quantitatively the relationship between the two centers, we can point out the correlation between the quotations of both markets. We selected for the purpose of our analysis the prices of May and June 1957, as disturbances from major world events were at their minimum at that time. Correlations between the prices of the major commonly listed securities for that period were the following:

Port de Beyrouth	+ 0.271
Radio-Orient	+ 0.108
DHP	- 0.484
Fonci`ere de Syrie	+ 1

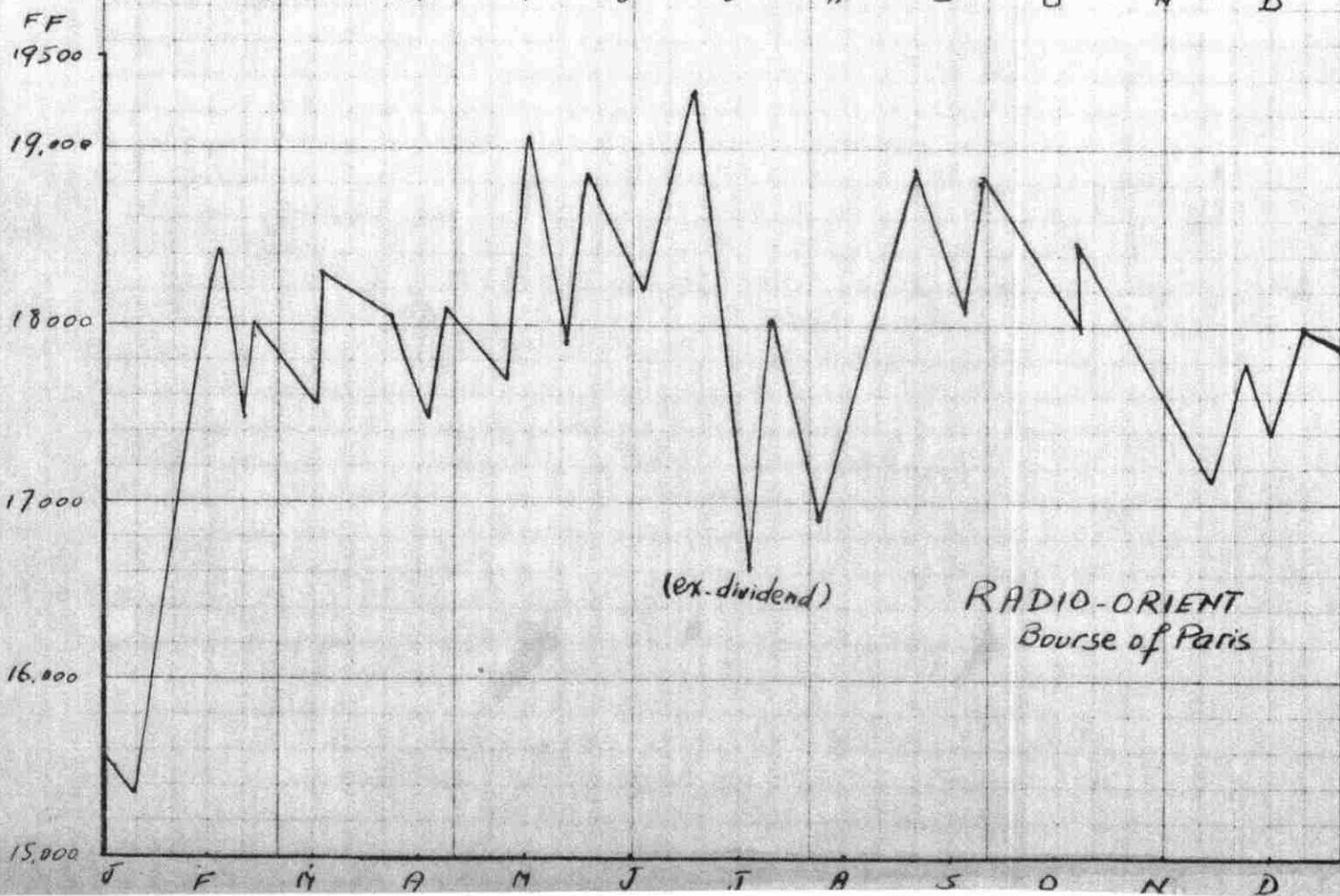
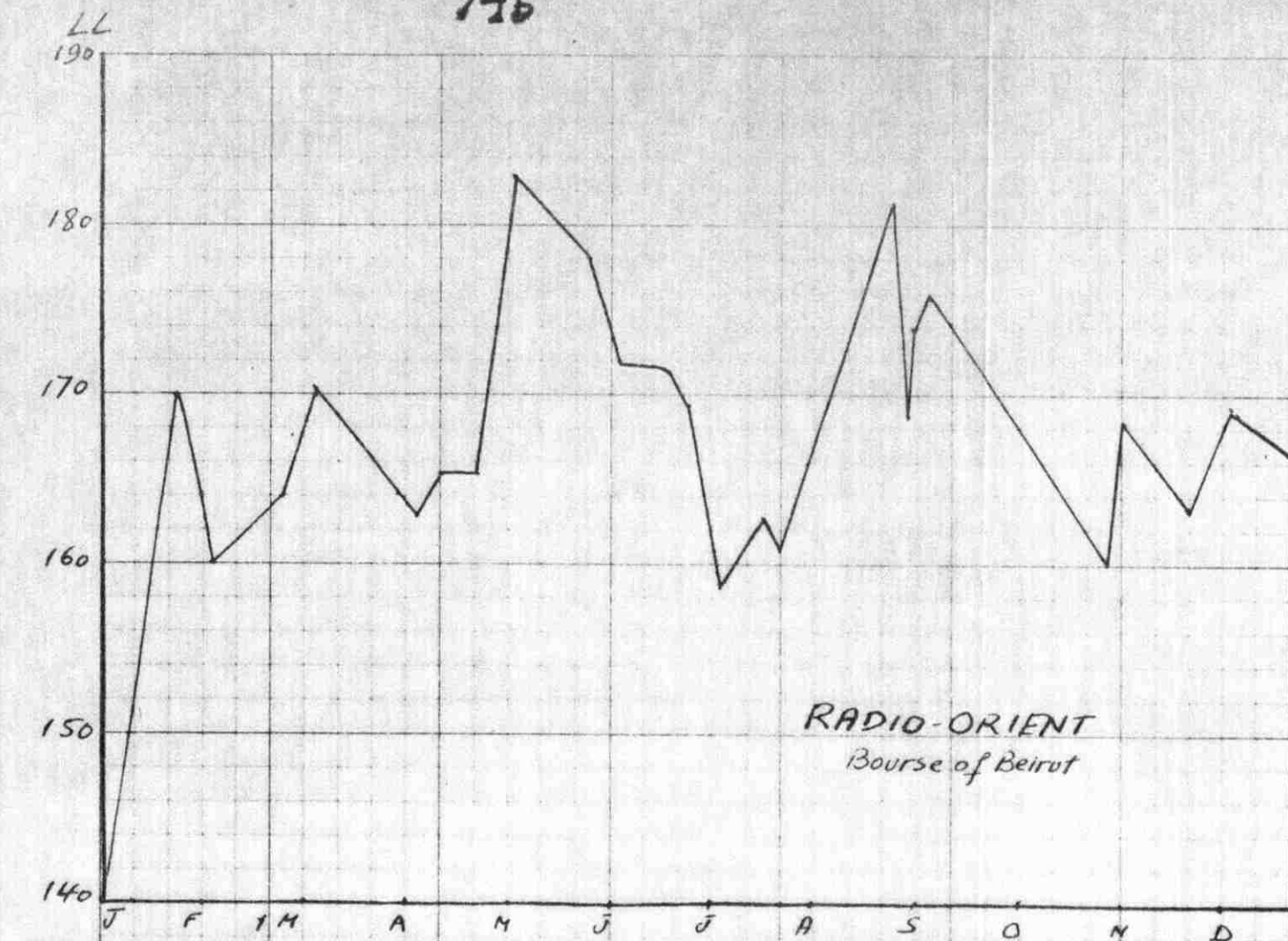
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It is clear that such ratios do not give the same impression shown by the accompanying graphs. This is due primarily to the fact that a certain anachronism occurs in the adjustment between the common quotations. As we have seen earlier, Beirut opens at the closing prices of Paris for the preceding day. This would result in a difference in common quotations for a specific day, and correlation would suffer from this drawback.

With regard to the D.H.P., correlation between both quotations is negative. This resulted from the different reactions of each market to the negotiations of the company with the local government in view of selling the concession to the latter. Paris reacted unfavourably as a result of the anticipated heavy tax burden on capital disbursements (before the amendment of the 'Loi Ringeaud', to be described later).

But the drawback of the correlation ratio to show the interdependence between both markets could be offset if we compare the standard deviation of both quotations. The former method was shown to be inadequate as a result to the discrepancy between the two markets. The latter would enable a better comparison of the total average movement of prices over a larger period of time (May and June 1957). The standard deviation for the major common securities was the following:

	<u>Beirut</u>	<u>Paris</u>
Port de Beyrouth	3.1	2.9
Radio-Orient	1.38	1.40
DHP	2.64	2.55
Foncière de Syrie	11.90	11.39

It could be seen that though there is a daily discrepancy between the quotations, adjustments would quickly occur to make both trends move roughly in unison.

2. "Affaire 20%" - The interdependence between both markets could be more easily noticed when we compare their reactions to the fluctuations in the parity of the French franc vis-à-vis the Lebanese pound. The best illustration was provided on August 10, 1957, when a de facto devaluation of 20 percent was effected on the French franc. The parity of the FF 1,000 (Lebanese account) decreased then from LL 8.75 to 7.50. Prices of the common securities increased in Paris and decreased in Beirut to wipe out the exchange disparity. Quotations on both markets were affected by the devaluation in the following way:

	<u>Bourse of Paris</u> (In FF)		<u>Bourse of Beirut</u> (In LL)	
	<u>9.8.57</u>	<u>30.8.57</u>	<u>9.8.57</u>	<u>30.8.57</u>
Port de Beyrouth	24,020	26,500	217	203 1/2
Radio-Orient	16,600	17,820	140 1/2	137 1/2
Foncière de Syrie	22,160	24,400	197	187
DHP	17,300	18,500	153 1/4	144 1/2

Before the devaluation, the 'port de Beyrouth' was quoted at FF 24,020 in Paris or an equivalent of LL 216 (the parity being LL 9.00 for FF 1,000, including the different commissions and expenses of transfer). After the event, the price in Paris increased to FF 26,500 or an equivalent of LL 198.75 (the parity having come down to LL 7.50). In both cases, it could be seen that prices in Beirut were slightly higher than those of Paris (but not enough to provide an opportunity for arbitrage). This results, as will be plainly seen later, from the more favourable incidence of nationalization prospects on Beirut than on Paris.

B. Trends Governing the Operations of the Bourse

1. Incidence of world disturbances - Before attempting to analyze the inherent trends of the Bourse, we should describe its reactions to the major events which have occurred in the Middle East since 1956. The Bourse received severe shocks while in the primary stages of its development. The nationalization of the Suez Canal, the Sinai conflict, the Syrian crisis in the summer of 1957 and finally, the serious Lebanese crisis in 1958, all burdened the adolescent Bourse with heavy and almost fatal effects.

a) Suez - With an average daily turnover of LL 600,000 prior to July '26, 1956, the date of nationaliza-

tion of the Canal, trading decreased to LL 150,000 (average of July-November). Confidence was fundamentally impaired. Transactions were mainly centered around two stocks, the Port and Pétroles. The former maintained a certain position, while incurring heavy capital losses, as being the soundest security on the market; while the latter, worthless in essence, was heavily liquidated by speculators. The percentage of decrease in quotations and the total capital depreciation in all listed securities, resulting from the nationalization, are shown in the attached table:

The total capital depreciation resulting from the Suez event amounted to LL 50 million, or around 20 percent of the total value of listed securities as before the nationalization. To an embryonic Bourse, this event was no less than a financial catastrophe.

The Suez crisis left a heavy imprint on other markets too. The Dow-Jones average decreased from 515.85 on July 26, to 466.10 on November 28, 1956.¹ The index of the London stock exchange decreased from 185.6 to 163 for the same period. The hardest hit were the 'Suez' securities listed on the Bourse of Paris. These securities underwent

1. Of course, this average was also affected by the Sinai campaign.

TABLE II

INCIDENCE OF NATIONALIZATION OF THE SUEZ CANAL
ON THE LEBANESE STOCK EXCHANGE

Listed Securities	Total No. of shares	Before Suez		After Suez		
		Prices on 26.7.56 (LL) value (in LL)	Total Capital value (in LL)	Prices on 23.11.56(LL) decrease	% of total Capital value LL	
Port	95,349	516	49,200,084	394	23.5	37,567,506
DHP	60,000	145	8,700,000	134	7.5	8,040,000
Radio-Orient	56,433	157	8,859,981	129	12.-	7,279,857
Nahr-Ibrahim	180,000	61 1/2	11,070,000	50	18.5	9,000,000
Nahr-Bared	80,000	149 1/2	11,960,000	118	21.-	9,440,000
Electr. d'Alep	108,000	55 1/2	5,994,000	50	10.-	5,400,000
Kadisha	57,500	331	19,032,500	247	25.-	14,202,500
Pétroles	20,000	232	4,640,000	115	50.-	2,300,000
Foncière	69,000	261 1/2	18,043,500	185	29.25	12,765,000
Eternit	60,000	261	15,660,000	192	26.5	11,520,000
Ciments	240,000	380	91,200,000	320	15.75	76,800,000
Total Capitalization			244,360,065			194,314,863

Source: Le Commerce du Levant, No. 243, p. 1.

a capital depreciation of FF 11 billion. Relative quotations were the following:¹

	<u>July 26</u>	<u>July 27</u>	<u>Difference</u>	<u>Percent of decrease</u>
	FF	FF	FF	
Suez Common stock	92,000	73,000	19,000	21 percent
" 'jouissance'	69,500	51,200	18,300	27 "
" Founders' shares	74,600	54,000	20,600	27 "

After the Sinai conflict, a certain activity was again revealed in the Bourse. But the heavy impairment in confidence and the tightening of credit by banks were clearly felt throughout the whole of 1957.

b) The Syrian crisis - While recovering very slowly from the Suez events, the Bourse received a second shock from the Syrian crisis of August 1957. The important securities lost ground, although at a slower pace than after the other events cited. The 'port' decreased by 7 1/2 percent, the D.H.P. and Foncière by 5 percent, the Eternit and Kadisha by 8 1/2 percent. The decrease in valuation of listed securities amounted to LL 30 million.²

In the meantime, the index of American bonds decreased from 82 to 80.43 and industrials went down from 203.5 to

1. Le Commerce du Levant, No. 208, p. 1.

2. Ibid., No. 321, p. 3.

197.6. It is true that the latter should be explained in the light of the American economic trend which was, by that time, on the brink of recession; but nevertheless, the turmoil in the Middle East was strongly represented (concentration of troops on the Syro-Turkish borders, arrival of Egyptian troops at Latakia, the refusal by Syria of Saudi mediation, and debates in the United Nations).

c) The Lebanese crisis - The tragic and international aspect of the Lebanese crisis had serious effects on the Bourse. At the outset, public opinion considered the crisis to be purely internal, thus foreign markets did not react to its development. After the landing of American troops, the prospect of greater stability in the Middle East was discounted by Western centers. This discount, of course, was reflected in higher prices.

The Lebanese stock exchange, on the other hand, was adversely affected from the beginning. The difficult position of the banks reduced greatly the flow of credit, and the fear of a regional conflict (especially after the Baghdad coup d'état) bore heavily on the state of business confidence. The higher liquidity preference of the investing public and of banks can largely explain the slow activity of the Bourse under the impact of the Lebanese crisis. This could be seen by comparing the turnover of shares and the volume of transactions for the period under

the crisis and a previous normal month:¹

	<u>No. of shares transacted</u>	<u>Volume of trans- actions (in LL)</u>
June 1957	39,240	6,864,325
May 58	8,605	1,512,000
June 58	5,175	740,700
July 58	5,455	801,050

However, 50 percent of the turnover in the crisis period was centered around the 'pétroles'. This was partly due to rumors concerning "alleged" negotiations with^a German group for exploration in Lebanon, but mostly as a result of the higher liquidity-preference of the public, coupled with the firm belief that in case a conflict occurred, all the 'dreams' and rumors built around the company would vanish. Despite the prospect of German participation, the net effect of the opposing tendencies on the price of shares of the pétroles was adverse.

Under these conditions, the higher liquidity-preference was bought at a high capital loss. This could be shown by comparing the closing prices of the most active stocks on April 30, 1958 (just before the troubles began) and July 30 (date of election of the new president):

1. Ibid., No. 413, p. 3.

		<u>30.4.58</u>	<u>30.7.58</u>	<u>% of decrease</u>
Port	LL	188	LL 167	10.8%
Pétroles		174	147	15 %
Radio-Orient		145	130	10 %
Foncière		164	128	21.9%

Even though the events described above have had a blurring effect, definite trends can nevertheless be discerned. These trends result first from the reaction of the market to the uncertain position of concessionary companies and, second, from the structural setup of the Bourse which provides a wide latitude for speculation. Both factors are analyzed in the following sections.

2. Incidence of nationalization prospects -

The securities of companies whose concessions were negotiated with the Lebanese government in view of sale or participation represented respectively 50, 46, and 39 percent of the total turnover of the Bourse for the years 1955, 1956 and 1957. If we exclude the stocks of the pétroles, these ratios would go up to 53, 52 and 60 percent. Of the companies, the Port and D.H.P. accounted for the overwhelming majority of transactions.

As was pointed out earlier in Chapter Four, negotiations with the government about the future status of these companies were favourably met by the market. The liquidation

value of a share, if a final settlement were concluded, would be clearly higher than the book value. The market responded then to the evolution in negotiations with an upward trend.

Throughout 1955, negotiations about the concession of the Port and the construction of the third basin greatly influenced the position of its securities. The price of the latter increased from LL 370 on May 1, 1956, to LL 488 on May 28, when official declarations about the sale of the concession were made. The alternative of sale was then abandoned in June and the price took a downward turn. The conflict with the Lebanese fiscal authorities, ~~at the~~ Suez crisis and the resulting credit difficulties affected adversely the value of the stock which was quoted at LL 387 on August 22, 1956. By that date, the capital stock of the company was split two for one and the share was valued at LL 226 by the end of August. The impact was clearly felt in 1957, as negotiations entered their decisive stage. These talks were concerned with the "Lebanisation" of the company, a process described earlier in Chapter Four. The first discussions were conducted in February and March 1957, and quotations varied at that time between LL 212-220. Some favourable rumors were then spread and the price reached LL 227 1/2 on March 11. The arrival of the company representatives from Paris and progress in negotiations pushed the

price up to LL 247 1/2. Finally, the signing of the agreement on May 27, 1958 brought up the stock to a peak of LL 248 1/2.

The same reactions were found in the case of the D.H.P. Negotiations carried with the Syrian government throughout 1955 and the final decision of sale brought up on November 11, 1955 were closely followed by the market trend. By January 1955, the security was quoted at LL 101.85; it went up to 120 by May, reached 144 in June, 156 1/2 in August, and culminated at LL 157 upon the signature of the agreement.

In the first quarter of 1956, quotations were influenced by the liquidation dividends resulting from the sale of the concession in Syria. The value of the security increased then from LL 118 1/2 to LL 150 in June, a reaction to negotiations with the Lebanese side. By the beginning of 1957, the stock was quoted at LL 131 (as a result to the payment of dividends, the gloomy events of the Middle East, and delay in negotiations). With the resumption of talks, the market took over and reached LL 150 (ex-dividend) on May 18, 1957, date of signature of the new convention.

The boom resulting from nationalization prospects was closely followed by the Bourse of Paris. Some tax amendments were made in France, which exempted from the French income tax all indemnities paid to French stock-

holders against their nationalized interests in foreign territories. The law, known as Loi Ringeaud, was promulgated in 1954 and amended on February 21, 1956,¹ after the hard stroke brought to foreign interests in Egypt. Under the law and its amendment, liquidation dividends would be exempt not only from the French progressive capital-gains tax (applied on the difference between the liquidation and nominal values), but also from the flat personal income tax (19.81 percent).

With regard to the Lebanese stockholder, he would have to pay a progressive personal income tax (varying between 2 and 10 percent) on any liquidation dividend. From this angle, he is at a disadvantage with the French stockholder. But even with this tax burden, the upturn trend in Beirut was slightly more pronounced than in Paris. The cause was more psychological than real. Though the French stockholder would benefit from tax exemption in case of nationalization, the mere use of the word would make him feel anxious, especially after the Suez events.

3. Trends of Lebanese stocks (other than the Pétroles)
Lebanese stocks listed in the Bourse are mainly the following:

- a) Société Phénicienne de Nahr-Ibrahim
- b) Kadisha

1. Ibid., No. 252.

c) Société des Ciments Libanais

d) Eternit

The first two are concerned with hydro-electric production. The remaining produce cement and its derivatives.

Dealings in these stocks represented respectively 20.8, 16.5, and 11.3 percent of the total turnover of 1955, 1956 and 1957. The low activity of these stocks is attributed to the following:

Though these securities revealed a clear upward trend in 1955 and 1956, they were not liable to speculative trading. Stock of the cement company was greatly favoured in 1956 due to the tremendous increase in demand resulting from the earthquake. The increase in demand for hydro-electric power affected favourably the position of the corresponding stocks in the market. But these stocks are largely held by a few investors for a steady income and a share in the good growth prospects of these enterprises. Marketability, in the sense of active trading, suffers as a result. Prospects for a quick capital gain on the Bourse lie elsewhere.

4. The speculative trend - The speculative trend is revealed first with regard to the "Foncière de Syrie". As was shown in Chapter Four, the security of this company fluctuated between LL 170 and 267 in 1956, and 163 and 216

in 1957, whereas the book value of that security is around LL 43.50. This discrepancy between market and book value is attributed mainly to the speculative boom affecting the real estate properties of the company. The construction project of the court-house in Furn-El-Chebbak and the tremendous capital gain prospects accruing to the plots of the company (in Ras Beirut and on the beach) were accounted for by the market.

The high jump in quotations could be partly justified on the ground that such a boom affected the whole Lebanese economy. In addition, the discounted capital gains were getting realized. But what could never be justified are the fluctuations of the 'pétroles' on the market and, more fundamentally, the admission and maintenance on the latter of such fictitious securities.

It was shown in Chapter Four that the securities of this company are, for the time being, worthless. But the excessive rumors and mysteries surrounding the whole issue of negotiations affected profoundly the "atmosphere" of the Bourse which became, for a certain time, a mere "Bourse de Pétroles". The reactions of the market to well-planned rumors resulted in fortunes and failures to many. Negotiations carried with Onassis (July 1956-January 1957) and resumed with the American groups (February 1957-July 1957) resulted in fluctuations in the

value of the security between LL 90 and 405. The accompanying graph gives a clear picture about such tremendous and unhealthy variations.

These abrupt variations and their causing rumors were humorously described in the following way:¹

"Depuis un an, nous assistons au même phénomène sans cesse renouvelé. M. Andraos prend l'avion: le titre monte. M. Andraos va à Vichy: le titre baisse. M. Onassis part en croisière: le titre dégringole. M. Onassis part en croisière: le titre fait un bond. L'avocat de M. Onassis attrape un rhume: le titre agonise. M. Boucherot télégraphie: le titre ressucite. M. Boucherot écrit: le titre recule. Un Américain remplace M. Onassis: le titre monte. L'Américain devient deux Américains. Les deux Américains rencontrent un troisième Américain. Le premier Américain arrive à Beyrouth. Le second Américain rejoint sans le rejoindre le premier Américain. Le troisième Américain envoie un télégramme au premier, qui le transmet au second. Me. Tabet va en Amérique. Me. Tabet reste en Amérique. Me. Tabet tombe malade en Amérique. Me. Alfred Tabet guérit en Amérique.

Et le titre de la C.L.P. monte et descend, remonte et redescend, grimpe et dégringole, regrimpe et redégringole.

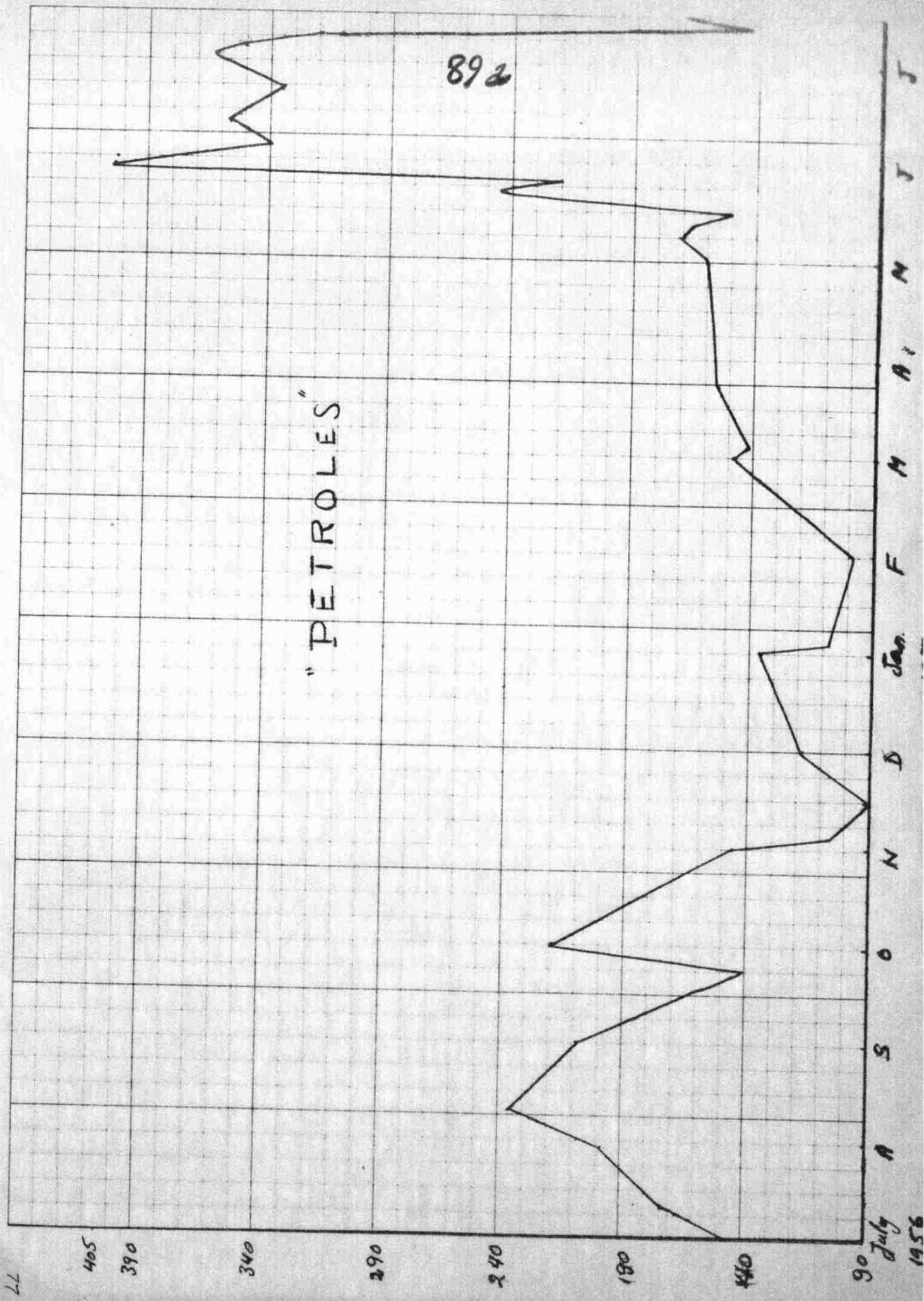
Et des fortunes se font et se défont, se refont et se redéfont. Sans pétroles, sans forages, sans capitaux."

II. CONCLUSIONS

A. The Attraction of Venture and Speculative Capital

In a study performed by the "Exchange", it was revealed that the evolution of market prices has little relationship to profits realized by corresponding companies.

1. Ibid., No. 309, p. 1.



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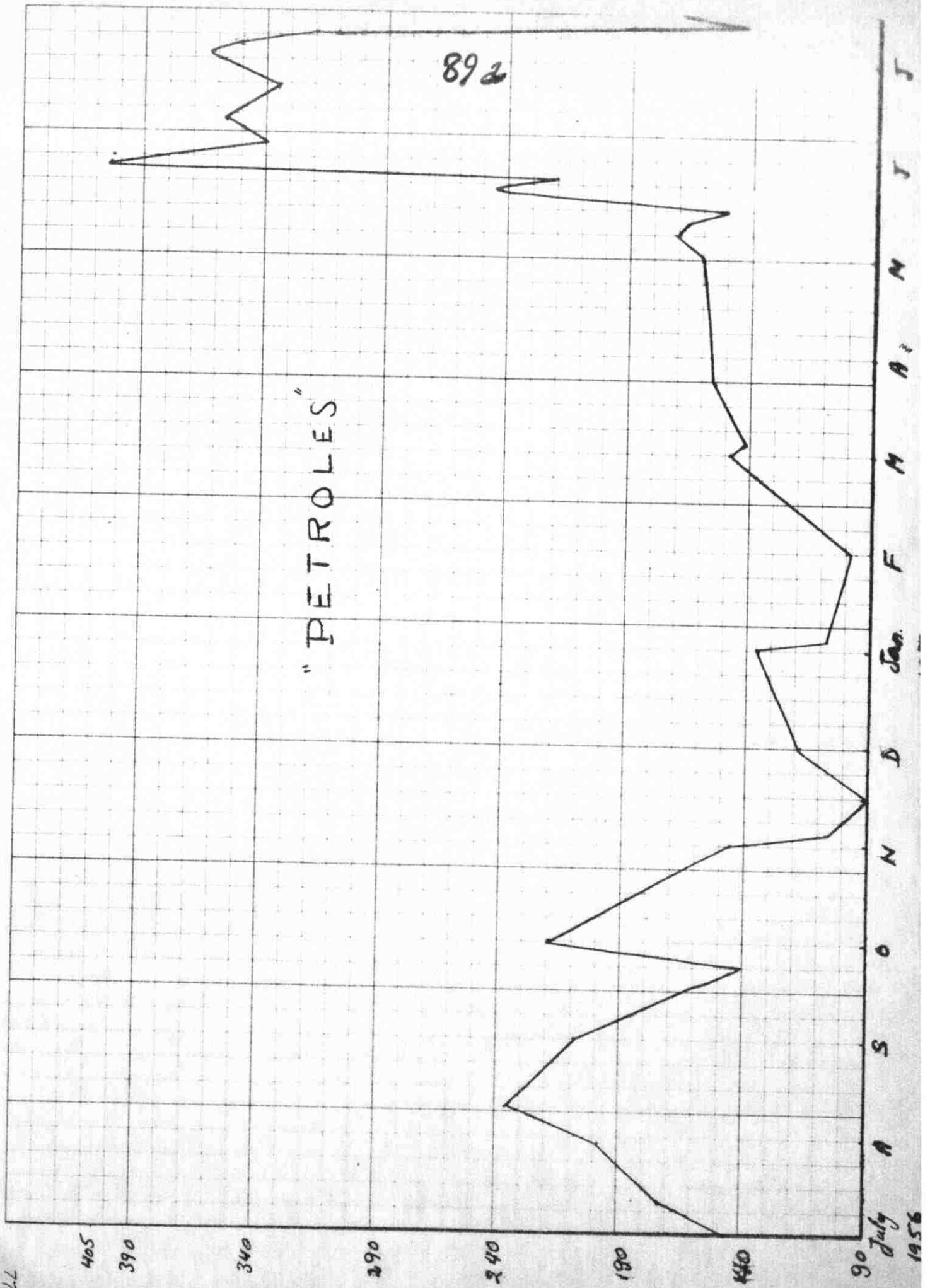
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on the New York stock exchange, profits of the Republic Steel and International Business Machines were respectively capitalized at the rate of 8.5 and 32.2 in 1955.¹

But this discrepancy could not waive the general rule that there is a correlation between the behaviour of the market and the actual conditions and future prospects of the whole economic structure. Every developed exchange reflects, at any time, the general tune of the economy. Prices of the exchange often even precede, and not follow, the direction of the latter. But the anticipatory trend of the market would depend upon the behaviour of economic conditions and, in the long-term, would become adjusted to its course.

The higher volatility of the market quotations would allow healthy speculation by anticipating the ups and downs of the market. But anticipation is not to be confused with the manipulation of the market. "When a professional speculator merely attempts to take advantage of an impending rise or fall of prices, he is usually a public benefactor; but when he attempts to create the rise or fall, of which he is to take advantage, by false reports, by 'covering', or by sudden and great short-selling, especially in conspiracy with others to cause a panic, he becomes a mischief

1. As reported in Le Commerce du Levant, No. 183, p. 3.

maker."¹

The majority of transactions in the 'pétroles' result from mischievous manipulation. Quotations of these issues are always the outcome of well-planned rumors spread by specialized agents. Many a time we have seen brokers, who work for the account of well-known Lebanese capitalists, spreading gloomy reports in order to buy at low prices, and later to sell at higher prices (in the same session) upon the diffusion by a "colleague" of more promising ones.

This game would surely be played on any exchange if an issue similar to the 'pétroles' were admitted. But what is of significance to our study is the great proportion such transactions took in the floor trading. Whereas in the session of June 29, 1956, the 'pétroles' accounted for 2 percent of the total turnover, the ratio increased to 75 percent one year later, on June 28, 1957. The share for 1955, 1956 and 1957 increased from 4.3 to 9.2 and then to 35.8 percent, respectively.'

Such a quick speculative jump can be explained on the following ground:

a) The majority of dealers in the Bourse reverted to this activity when their share in the foreign exchange

1. Fisher, op.cit., p. 220.

transactions and trade in gold greatly decreased after 1950. They entered the Bourse with the speculative bent of mind, so familiar in the foreign exchange field. The securities of the 'pétroles' provided the best opportunity for speculative trading and quick turnover, an opportunity which deteriorated into mere gambling.

b) The greater interest revealed by the public in stock trading was not met by a corresponding supply of new securities. The majority of promising Lebanese stocks listed on the Bourse are closely held by real investors and would not give an opportunity for active trading (especially since they are not speculative by nature). Whereas the volume of turnover of the Bourse increased from LL 36 million in 1955 to 62 million in 1956, no new security, foreign or local, was admitted to the Bourse (other than the quasi-speculative Foncière) to meet the growing interest as evidenced by an increasing supply of funds.

This characteristic is general to underdeveloped exchanges. The stage of economic development (and all the institutional drawbacks of backward countries) would not allow enough securities to be provided to meet the growing interest and fund supply to the Bourse.¹ Speculative

1. "There is a proper ratio of the national income which should be available for new securities issues and increased savings deposits. For the U.S., such a ratio is 9 1/2 percent." Ibid., p. 48.

money must chase a few securities, and an inflationary trend is likely to occur, especially if there are issues similar to the speculative 'Petroles'.

B. Lack of a real stock exchange

1. Small flow of Lebanese securities - To possess the different functions enumerated in Chapter Two, a stock exchange would require an institutional maturity of the whole economy corresponding to a high level of economic development. Such a development would result in an adequate flow of securities, very necessary to the maintenance and growth of a stock market.

With regard to the Bourse of Beirut, it was revealed that the majority of transactions are centered around very few stocks. And these are popular not for the investment opportunity they provide as for the quick capital gain they promise. Trading increased in French securities because of the prospect of nationalization. Stocks of the 'pétroles' got the majority of turnover in 1957 because of their gambling nature. On the other hand, foreign securities are absent from the Bourse and the latter is not developing in accordance with the position claimed by Beirut, namely, the financial center of the Middle East.

The discrepancy between the greater interest and flow of funds into the Bourse on one side, and the rigidity

in the supply of securities on the other could not be attributed solely to the structural setup of the Bourse. It is true that the latter provides some hindrances to the adequate acceptance of securities, but the actual state of the Bourse results mainly from the low development of the corporate form of business in Lebanon and the consequent few securities listed. Although the institutional and financial setup of Lebanon correspond mainly to the family-type of business, other major hindrances, organizational and fiscal, hamper the demand side of corporate capital.

a) Family-type of business. Most of the relatively big enterprises in Lebanon began as private small concerns and financed their expansion mainly through retained earnings. Industrial organizations are, in many cases, local handicrafts which grew up slowly and not without difficulties. This history affects structurally the management and financing. Furthermore, industrial credit in Lebanon suffers from many drawbacks, as we shall plainly see in Chapter Seven, and most industrial loans are short-term, supplied by commercial banks.

Under the type of organization described above, resort to outside capital is eschewed. Managers, who are generally the owners or closely-related to the latter, would not like to share their power with outsiders and thus lose, in this way, the private character of their concerns.

b) Organizational hindrances - The formation of corporations in Lebanon is a long and laborious process. It requires the approval of the statutes by the Government and formation should be authorized by a special decree of the Council of Ministers.¹ This authorization should be provided in three months time from the date of the application. And the decision taken by the Council is final and not liable to any appeal.

Such an intricate organizational process is often influenced by unhealthy considerations which might result in political unfairness and other abuses. It is ^{at} a clear disadvantage with the formalities required in the formation of the more familiar type of business, namely, partnership. The latter is easily organized by a registration in the Commercial Register and formal notification of the Notary Public.²

It is true that the different entity of a corporation would necessitate a more careful analysis and legal provisions to decide about its formation than those required for a partnership. But analysis and decision should be assumed by a specialized agency, at best a department of the Ministry of National Economy, which would provide more expediency in formation and encouragement to this form of business,

1. Code de Commerce (Librairies Antoine, Beyrouth: editors, 1955), Art. 80, p. 44.

2. Ibid., Art. 49, p. 36.

then the unspecialized and ever-changing Council of Ministers. The decision of the latter should be confined to specific types of business, those for instance which apply for a concession or are planning to exploit certain definite channels which have a social national aspect.

These organizational facilities are provided by developed countries. After the establishment of the U.S. Republic, "the number of incorporations was increasing so rapidly that it was fast becoming a physical impossibility to pass a special bill for each company. Therefore, one after another, the various states passed enabling acts. Such acts usually took the form of a general incorporation law, under which groups of qualified persons would form a corporation by making and filing a certificate of incorporation in proper form and paying the required fees. Practically all corporations are now formed in this manner, although it is still possible to organize under a special act when, in the judgment of the legislature, the objects desired by the incorporators cannot be obtained under the provisions of the general law."¹

c) Fiscal incidence - The progressive income tax (on both corporations and partnerships) is a great hindrance to the formation of the corporate form of business. Its rates are the following:²

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1. Joseph Bonneville and Lloyd Dervey, Organizing and Financing Business (New York: Prentice-Hall Inc., 1953), p. 65.
 2. Code de L'impôt Libanais sur le Revenu, 1955, Art. 28, p. 13.

On net profits not exceeding LL 5,000	5 percent
On the fraction varying between LL 5,001 and 15,000	7
Between 15,001 and 25,000 LL	9
25,001 and 35,000	13
35,001 and 50,000	17
50,000 and 75,000	22
75,000 and 100,000	27
100,001 and 250,000	32
250,001 and 500,000	37
500,001 and above	42

It is thought by many that such rates are so high as to hinder the development of corporations. In a note submitted to the fiscal authorities by the Association of Merchants¹ (from whom most of our industrialists have emerged), the following milder progressive rates were suggested:

<u>Net Profits</u>	<u>Proposed rates</u>
Below 10,000 LL	4 percent
Between 10 and 25,000	6
25 and 50,000	10
50 and 100,000	14
100 and 250,000	20
250 and 500,000	25
500 and above	30

1. Le Commerce du Levant, No. 280, p. 1.

But we believe that the serious deterrent to the corporate form of business is not so much the progressive income tax rates imposed on corporations as the milder incidence of the same rates on partnership profits. Whereas total corporate profits are liable to the above-mentioned rates, every partner in a partnership is taxed for his share of net profits.¹ The progressive taxation system will lean more heavily on corporate profits than on the same level of partnership profits. A corporation which scores for instance a net profit of LL 100,000 will have to pay an income tax of LL 17,800. If the same profit were realized by a partnership of four persons with equal shares, each partner would pay as income tax the amount of LL 1,700; thus the four would pay LL 6,800. The partnership would secure over the corporate form a tax saving of LL 11,000 for the first LL 100,000 profits, and the savings would increase with profits due to the progressive tax system.

The clear advantage to partnerships, however, has not prevented the corporate form from achieving a certain growth. Out of LL 213 million invested in Lebanese industry in 1955, 80 million were represented by corporate capital.²

1. Code de L'Impôt Libanais sur le Revenu, Art. 31, pp. 15.

2. Ministry of National Economy, Industrial Census (Beirut, 1957), p. 75.

It would be mistaken to think that this corporate capital is embodied in widely-distributed stocks. As we have previously seen, most of the present Lebanese industrial firms began as closely-owned handicraft businesses and developed mainly through retained earnings. Their owners choose sometimes the corporate form in order to avoid disputes and confusion among future heirs. The capital would be represented by fully-paid stocks endorsed to bearer which would directly transfer to their holders the immediate ownership of the enterprise, without the intervention of the fiscal authorities.

But this form of business, chosen mainly to evade inheritance troubles and inheritance taxes, could provide some tax savings over a publicly-owned corporation. Managers of the corporation (generally its owners) would attribute to themselves highly remunerative salaries which would be exempt from the progressive corporate tax and liable only to the mild personal income tax attaining the maximum rate of 10 percent on the net personal income exceeding LL 48,000.¹

It is not only the demand side for corporate capital which suffers from the above-mentioned drawbacks. The supply side too is hampered by many institutional hindrances,

1. Code de l'impôt Libanais sur le Revenu, Art. 52,
p. 22.

a) Investment considerations - The Lebanese investing public is not yet accustomed to long-term investment. Being traders by background, the Lebanese businessmen are more attracted to short-term, self-liquidating transactions. The latter need less control, and promise a quicker, and often higher yield, than 'long-term' ventures.

The short-term attitude is interrelated with the structure of the Lebanese money and capital markets. The latter have not yet grown up (being correlated to the level of economic development achieved) to cope with the intricacies of long-term credit. Industrial credit is provided to lucky capitalists, mostly by commercial banks on a short-term basis, and is generally renewed yearly to correspond in time to the long-term credit requirements.

The 'disdain' of long-term ventures was best illustrated by the position of private capital with regard to the newly established Industrial, Agricultural, and Real Estate Bank. To induce capitalists to provide LL 3 million, the government had to guarantee to that bank a loan of 25 million from the Banque de Syrie et du Liban, at the low interest rate of 2.5 percent to be later provided to applicants at 5 and 6 percent. On the other hand, the voting majority in the board of directors was assigned to private capital in a clear disproportion to the sum contributed by it. These inducements were naturally taken to get the

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private capital interested in long-term commitments. As a result of the investment market deficiencies, the unproductive investment channels were followed by our capitalists. This would explain the unhealthy boom strongly affecting our real-estate sector.

b) The family-type business mentality - The deficiencies of our capital market and the closely-held business type, mostly familiar to our economy, are reflected by individualistic reasoning on capital commitments. The investor would generally prefer to assure to himself the utmost of control and the quickest return on his capital. This would help to explain the flourishing of the partnership form of business.

The embryonic Bourse of Beirut is not yet settled and prosperous enough to induce the public to undertake long-term commitments. By providing the marketability facilities, the stock exchange would help indirectly, as we have seen, in the process of capital formation. The investor would be willing to launch on long-term ventures when he would assure to himself a decent yield compatible with safety of capital. The primitive stage of the Bourse is not yet ready to provide such facilities.

But as we have previously seen, the stock market does not help directly in the creation and growth of new ventures. The latter would benefit from the Bourse only when getting settled. This stage would have presupposed an institutional environment which fostered the corporate form of business

through a proper channelling of private savings. Deficiencies in the framework are affecting adversely (and in an interrelated manner) the growth of corporations and, ultimately, the development of the stock exchange.

2. Absence of well-known securities from the Bourse -

Foreign securities are not yet represented on the Bourse. This, in our opinion, is a shortcoming which affects the economy from two sides. In the first place, the maladjustment between the increasing interest in the Bourse and the provision of securities is affecting heavily the nature of transactions carried on. Most of the turnover is centered around very few securities, principally the Port and the 'petroles'. The small basis for trading gives a precarious state to the market since its narrowness makes it susceptible to manipulation.

The Bourse needs, in the last analysis, a more abundant supply of securities to provide a wider basis to the interested public. As the development of the corporate form of business is gradual, since it depends upon the overall development of the country, the introduction of first-class foreign securities could widen, in the meantime, the scope of the Bourse. Indirectly, this step would acquaint the public with the stock exchange, and the development of the latter with local issues would become easier. A well-established security would attract the investor; whereas speculative issues, like the 'petroles', would lead away the investing public from the Bourse and

create an unhealthy atmosphere for the adolescent market.

Second, the admission of foreign securities is also necessitated by the structure of the Lebanese economy. Lebanon is becoming more and more the banking center of the Middle East. It is a transit country too, not only for goods but also for the liquid funds of oil-producing countries. It is claiming more and more to become the financial center of the whole region. Its liberal economic system has been deemed necessary for this end. The establishment of the secret banking characteristic has attracted much capital from neighbouring countries. By offering the major securities listed on world markets, the Bourse would help Lebanon to attain its financial place in the Middle East. Meanwhile, the opportunity has been grasped by private foreign institutions. Two years ago, an important brokerage firm, affiliated to the New York stock exchange (Fahnestock and Co.) established a branch in Beirut to cope with the growing local demand for American securities.

The above discussion leads us to the formulation of two sets of measures to be taken with regard to the Bourse.

Immediate reforms should be carried to create a healthy atmosphere and to introduce foreign securities. Admission and maintenance regulations should be revised, or at least enforced. Such steps, together with credit facilities to be provided on stock transactions, are dis-

cussed in the following chapter.

However, the development of the Bourse would basically depend upon the development of the whole economy. Reforms in regulations would be of limited help, if not coupled, and perhaps even preceded, by structural reforms in the whole institutional framework of the economy. Suggestions along this line will be made in the last Chapter of this study.

CHAPTER VI

ORGANIZATIONAL REFORM: LISTING REQUIREMENTS AND CREDIT FACILITIES

I. PURPOSE OF LISTING

To provide the various information and facilities enumerated in Chapter Two, stock exchanges are governed by different regulations and standards which would help in the fulfilment of these ends. While rules differ among markets, the basic goal sought by all is to provide the investing public with the data necessary to make a sound judgment about the worthiness of listed securities, thus minimizing vulnerability to rumors and artificial manipulation of the markets.

In England, the stock exchange committee deals chiefly with points of order and procedure. "It regulates methods of dealing and sees that debts are promptly paid. It makes practically no attempt to assure itself of the soundness of the companies whose securities it admits. It is felt that, if the general public should get the impression that if the stock exchange takes out all worthless securities and all those entered are sound and guaranteed, the result would be the placing of funds thoughtlessly into all entered securities without examination or inspection as to the real

merit of the companies."¹

The passive role of the exchange in England with regard to the worthiness of the securities is extended to the point that any security is admitted to the floor. Admission is not regulated, even for new flotations legally issued under the corporate law. "Many new issues are not publicly offered and sold before listing, as is the case in the United States, but are listed first and then gradually disposed of through the exchange."²

This passivity on the part of the authorities does not mean that the stock exchange would not affect the behaviour of the investing public. Though the English stock market does not regulate the admission of securities, the maintenance of the latter on the list would depend however on their behaviour. And the fact would remain that the stock exchange greatly affects the decisions of the investing public and, at the same time, protect its interests through its regulations.

"The fact that the security is listed gives an investor reasonable ground to believe that the issue of securities was legal, that the concern was legally organized and, at the time of listing, was a solvent going concern with a relatively large issue of securities well distributed so that no single large interest had dominant control of its market. Besides, he knows that he is reasonably protected against

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1. B. Nash, Investment Banking in England (London: A. W. Shawle, 1929), p. 36.
 2. Parker Willis and Jules Bogen, Investment Banking (New York: Harper and Brothers, 1929), p. 501.

counterfeiting the stock certificates and their overissue. Second, the investor knows that he can get at any time reasonably full and recent information with regard to the securities from any member of the exchange. Third, his securities have a much higher collateral value than if they had no open, continuous market. Fourth, the investor has constant quotations as to the value of his securities and can convert them into cash at any time. Fifth, the investor is protected against unreasonable commission and low standards of business practice. Sixth, the fact that his securities are traded on a highly organized market will protect him against the violent fluctuations to which he would be otherwise subject."¹

To assume this diversified responsibility, especially with regard to the prevention of undue fluctuations and the consequential prejudice which could be brought to the interest of the public, stock exchanges have generally set definite standards and regulations for the admission and maintenance of securities, and for the disclosure of precise information by listed companies, deemed necessary for the guidance of the public. These conditions generally are met only by well-established and trustworthy concerns. "Only 1,150 companies have their securities on the exchange in contrast with 400,000 incorporated businesses in the United States."²

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1. Dice and Eiteman, The Stock Market (New York: McGraw Hill Book Co., 1952), p. 123.
 2. Investment Bankers Association of America, Fundamentals of Investment Banking (New York: Prentice-Hall Inc., 1950), p. 551.

II. LISTING REQUIREMENTS ON DEVELOPED STOCK EXCHANGES

A. Conditions for admission

To safeguard the interests of the investing public, stock exchange authorities generally work out their policy for admitting any security to the floor along the following lines:

1. Stage of the industry - While the industry is still in its primary stage of development, its prospects could not be easily discounted and its securities properly evaluated. If the latter were to be formally admitted to the market, their irregular position and uncertain worthiness would affect adversely the normal trend of the exchange. That is why the New York stock exchange "has avoided the listing of most radio stocks and other similar enterprises in their development stage in order to avoid securities, the outlook for which was unusually uncertain. For such issues, a period of reasoning on the over-the-counter or sub-markets is, as a rule, preferred by the exchange authorities."¹

Even if the outlook of the developing industry is not unreasonably uncertain, the securities of concerns in the field could not be properly evaluated, especially in times of rapidly changing business conditions. The best

1. Ibid., p. 71.

example of improper and premature discounting of future earnings is that related to A.M. Byers Company. "Since listing, common stocks of this company had a range from \$23 to 25 prior to the middle of 1927. By September, 1928, it was over 200 and by the end of 1930, back to its former level below 40."¹

The difficulty in evaluation is primarily due to the fact that a new business needs a proper time to demonstrate an earning capacity. Prior to that time, its securities would be more liable to unreasonable variations than those of a more established concern.

2. Position of the concern - By position, we mean the previous success and the future prospects of the applying company in the already-accepted industry. Though the latter could be established and known to be fairly estimated by the public, the different enterprises pertaining to its field would not correspond by the same degree to the different conditions for admission. There would only be accepted to the floor the securities of such concerns which have demonstrated an earning capacity and promise good prospects of growth and achievements. Considerations regarding the future of the applying company would depend

1. Lawrence Chamberlain and William Hay, Investment and Speculation (New York: Henry Holt and Co., 1931), p. 201.

upon the position of that company in its particular field and the standing of the latter in the whole economy.

These conditions for admission are qualitatively described by the New York stock exchange regulations in the following terms:

"To be eligible for listing, an applicant must be a going concern, or be the successor of a going concern. It must have substantial assets or demonstrated earning power, or both. While the amount of assets and earnings are of consideration, the committee places greater emphasis on such questions as the degree of national interest in the company, its standing in its particular field, the character of the market for its products, its relative stability and position in industry, and whether or not it is engaged in an expanding activity and has prospects of maintaining its position."¹

The exchange authorities would evaluate the worthiness of the applying company on these grounds and decide about its admission on the following quantitative data required from any applicant:²

a) A brief description of the company's business, products, earnings and prices of its securities.

b) A financial report for the past ten years.

With regard to mining and oil producing companies, they should file reports by qualified engineers on their properties, reserves, equipment, etc. necessary to enable a proper evaluation of their future prospects.

1. Dice and Eiteman, op.cit., p. 112.

2. Ibid., p. 118.

On the other hand, any company seeking admission to the stock exchange should agree to notify the exchange authorities of any change in the scope of its activities or financial structure so that the authorities could reevaluate its position, and decide about its continued acceptability to the floor.

3) Distribution of securities - If the securities of an applying company are closely held, they would not be admitted to the floor for the following two reasons:

a) The management of the concern would be influenced by the few persons maintaining the majority of power, and small investors would have no voice in its policies. If its securities were admitted for formal trading, quotations would reflect the will of few persons.

b) The concentration of holding would adversely affect the marketability of the issue in the sense of active trading, as was discussed in Chapter Two.

To assure a normal and active market for securities trading, exchange authorities require a proper distribution of holdings, depending upon the capacity of the market and the volume of the issue. On the New York stock exchange for instance, "a broad distribution of over 200,000 shares among 1,500 stockholders is the minimum expected for listing!"¹

1. Investment Bankers Association of America, op.cit., p. 556.

B. Conditions for maintenance

While a security might fulfil the above-described conditions for admission to the stock exchange, it should abide to other sets of rules to be maintained on the floor. When a security is listed, it benefits from the different advantages provided by the stock market and, on the other hand, would get a certain confidence and respect of the public, which would not directly occur if the security were not listed. Many investors would assume that certain conditions pertaining to the company have been fulfilled by the mere fact that its securities are formally traded on the floor, and would not bother to assure themselves of the fulfilment of such conditions. In order to safeguard the interests of the public and maintain its confidence, exchange authorities keep a constant watch on the behaviour of listed companies and stand ready to remove from the list any security which falls short of the several standards necessary for the maintenance of a smooth and normal market.

1. Business achievements - Listed companies should maintain the business level which has helped for their introduction to the market. This is because a declining concern would be adversely evaluated on the market and many portfolios, especially those of small and private investors, would depreciate as a consequence. Companies facing serious financial disturbances are taken off the list. The removal

of many railroad securities from the New York stock exchange in the 1930's and early 1940's came about because the corresponding companies had to be reorganized, owing to financial difficulties.

Not only earnings records are of importance to the maintenance of the security on the list, but any change in the structure, policies or security distribution of the company is liable to alter the previous decision of the exchange authorities. The latter will have always to revise their acceptance of listed securities to safeguard at best the interest of the public, especially of those investors who do not possess a sound business analysis and judgment and who buy securities to assure to themselves a steady income.

2. Publication of information - Listed companies are under legal obligation to divulge to the stock exchange authorities and to the public as a whole "all information about their management, property, business and financial setup."¹

The exchange, as we have seen, keeps a constant watch on the behaviour of the company and its fulfilment of the different standards for maintenance on the list. Any

1. Dice and Eiteman, op.cit., p. 111.

security is liable to removal from the floor if it falls short of the norms and becomes harmful for public dealing. To follow up its supervision, the New York stock exchange requires from every listed corporation to present at least one full report every year about its achievement and policies.

To provide the required information, listed companies on the New York stock exchange "publish quarterly", semi-annual or annual reports consisting of a financial statement, income account, and a general statement of the conditions of the company. The railroads make monthly reports of earnings to the Interstate Commerce Commission and an annual report to the stockholders."¹

3. Margin of fluctuations (Bourse of Paris) - First-class listed securities might be sometimes liable to unhealthy and wide fluctuations on the exchange, due to a gap, rising accidentally between supply and demand. To safeguard the interest of the public, exchange authorities would interfere, while keeping the security on the list. This practice has been generally followed on the Bourse of Paris. Under these circumstances, the "Chambre Syndicale" would formally impose a dealing price for the security, the demand and supply prices being compelled to abide to it. " If this device does not succeed in normalizing the market,

1. Ibid., p. 43.

dealings in the specific security would be suspended for one session. However, the suspension in trading could not last for more than three sessions.

Following this practice, seventeen securities were suspended in the Bourse of Paris on May 12, 1955. On the other hand, the great declines which affected the different securities of Suez on July 26, 1956 (date of nationalization of the Suez Canal Company) did not work for their removal, as the supply and demand of such securities were corresponding to each other.¹

However, if the above-mentioned device does not improve the market situation, the Bourse of Paris could legally remove completely the security from the list. This right is reserved by major stock exchanges to safeguard the ultimate interest of the public.

III. CONDITIONS FOR LISTING ON THE BOURSE OF BEIRUT

After having reviewed the different general requirements for acceptance and maintenance of securities on stock exchanges, we should compare these procedures with what is followed on the Lebanese Bourse, and outline the current defects to be removed.

It should be noted that a stock exchange has an important role to play in underdeveloped countries. In

1. Le Commerce du Levant, No. 310, p. 1.

developed markets, the harm which an unsound security could create is not as drastic as in backward ones. First, if an unworthy or speculative issue is admitted, on a developed exchange, its effect would be limited, due to the fact that there is an adequate range of well-established securities to provide a wide choice and alternatives for dealers. This market, in a sense, would be less vulnerable to unhealthy trends than when the supply of securities is more limited and especially if the latter reflect low business standards. Second, the majority of security dealings in developed countries are effected by institutional investors, whose commitments are legally confined to first-class securities. These have their technical staffs to analyse the worthiness of securities offered and to follow the market trend. If a security is wrongly admitted to the market or if the achievements of the corresponding firm fall short of the stock exchange standards, the market share of such security would greatly decrease, even if the exchange authorities stand idle in its regard. On the other hand, private dealers in stock exchanges are better trained in developed markets than in backward ones and an unsound issue would have lesser chance to be accepted in the former than in the latter.

The Bourse of Beirut, like any undeveloped one, is more vulnerable to unhealthy trends than a more established stock exchange. This vulnerability has an indirect imprint

on the capital market and through it, on the whole process of capital formation. In fact, the excess speculation which was carried over the securities of the "Compagnie Libanaise des pétroles" for the last three years has provided the Bourse with a special meaning to the investing public. To a great fraction of the latter, the Bourse is but a gambling place. A flotation of any new issue would be regarded with care and suspicion due to such association. These conditions would not encourage the formation of corporations, necessary for the speeding up of the development drive.

The Bourse, as we conceive it, and taking into consideration its indirect role in capital formation, should inspire the maximum of confidence and provide the best channels for business education of the saving public. Though the exchanges and the investing public of developed countries are less accessible to harmful trends than in backward ones, strict and specific regulations for admission of securities have been elaborated by the former. These regulations are of a greater necessity to the Lebanese market and should be followed a fortiori to help it in growing from its embryonic stage. While the London stock exchange admits any new issue and leaves it to the investing public to decide upon its worthiness, this practice would be harmful in the case of the Lebanese Bourse. The unacquaintance of the public with securities evaluation and trading and the limited scope of

the Bourse would give space for an unsound issue to lead the market easily into speculation. That is why we would say that only established companies should be admitted to the list.

A. Admission of Securities

Deficiencies in this respect are made clear when we consider the case of the "Compagnie Libanaise des Pétroles."

As has been shown earlier, the securities of the company are worthless if we consider its present situation. They have got a mere speculative value arising from the idea that should the company agree with foreign firms for further research, oil might be brought up and a fortune would accrue to the shareholders. This big discount of the future was easily exploited by planned rumors and resulted, as we have seen in the previous Chapter, in tremendous speculation for the benefit of few shareholders.

These securities should have never been admitted to the Bourse. Aside from the tremendous harm their trading brought to small investors, they gave the Bourse a gambling reputation which affects the whole process of capital formation. The issue should have been denied admission to the list for two major reasons:

1. The company has no financial justification for existence. What is more important is the fact that no achievements whatsoever have been effected and, consequently,

no earnings have been scored to justify its admission to the list.

2. The securities of the company are closely held. In its general meeting held on September 21, 1957, it was revealed that six shareholders own 7,728 shares out of 20,000 shares total. In that same meeting, 62 shareholders were holding the overwhelming majority and so could direct at will the company policy. The narrow distribution of holdings allowed the powerful few shareholders to manipulate the market through false rumors and to exact huge speculative gains.

What is conflicting and even mysterious in this respect is the fact that the regulations for admission to the Bourse were not enforced with regard to this company. It is clearly stipulated (Art. 43 of the Internal Regulations) that an applying company should submit to the listing committee the last two balance sheets and all data pertaining to its activities, before deciding on its acceptance. On the other hand, the committee reserves to itself the right to refuse the admission of a company to the list for a justifiable reason, even if it fulfills the stipulated requirements. (Art. 56)

Considering these two articles, we do not see any justification for accepting the securities of 'pétroles' on the floor. A mere look on the balance sheet of the

company reveals its financial deficiency and the worthlessness of its securities. The company could have never been admitted to the Bourse if the present regulations had been enforced.

Though definite disciplinary sanctions are brought against any person who spreads false rumors or tries to manipulate artificially the market (Art. 133), basic regulations with regard to an adequate distribution of securities of an applying company are not devised. Art. 43 pertaining to admission should be amended to include definite stipulations with respect to maximum holding by an individual shareholder and the minimum number of shareholders, for every company. This would ensure a fair distribution and help in the functioning of a smooth and active market.

B. Maintenance on the list

Regulations for the maintenance of securities on the list are not enforced or, at best, incompletely so. Thus, the interests of the investing public are not safeguarded.

1. Margin of fluctuation - It has been stipulated in Art. 66 of the Internal Regulations that variations in prices between consecutive transactions should be limited to definite amounts, depending upon the par-value of the stock. Though the enforcement of this stipulation might not be practical, the degree of its infringement could reveal the market position of the security. Between February and May 1957, quotations of the pétroles fluctuated

between LL 95 and 400, and variations in prices between consecutive transactions used to exceed, and generally by far, the stipulated limit. On the other hand, the Bourse rarely opened at the closing prices of the previous session, as required by the same article of Regulations.

Under such circumstances, two measures could be taken:

a) Follow the device practiced on the Bourse of Paris with regard to securities whose unhealthy fluctuations become harmful to the public interest. A definite price could be imposed for dealings in such securities and, under the worst conditions, their trading could be temporarily stopped so as to safeguard the confidence in the Bourse, together with its reputation.

b) The Bourse could work for the stabilization of the market through mild intervention and provide, in this way, a relative safe channel for investment. We are of the idea that "a safety fund should be used in emergencies, accumulated over a series of years from small payments subscribed by stock exchange members. Over a number of years, this safety fund could amount to a considerable sum, to be employed in a manner similar to a bankers' consortium fund, to stabilize the market."¹

1. Irving Fisher, The Stock Market Crash and After (New York: The McMillan Co., 1930), p. 247.

As was shown earlier in Chapter Three, the Bourse has an annual net revenue of around LL 170,000. If LL 100,000 are reserved every year for a special safety fund, the latter would amount to LL one million in ten years to be used, on a non-profit basis, in offsetting temporary and erratic movements.

But these devices would not be of great help if the securities are of the kind which should have not been admitted to the list, or, if admitted, should be now removed.

2. Achievements of listed companies - Listed companies should maintain their economic justification, and this with regard to present achievement and future prospects. A chronic deficiency in this respect would adversely affect the market position of the corresponding securities and bring harm to the investing public and the stock exchange taken as a whole. That is why organized stock markets reserve generally to themselves the right to remove from the floor trading any security which falls short of the different standards necessary for the maintenance of a smooth and normal market.

This right, explicitly provided for in the Regulations, was not exercised in the case of the Pétroles. By maintaining this speculative issue whose trading increased to 35.8 percent of the total turnover of the Bourse in 1957, a direct stroke

has been brought to the confidence of the public, which is of first importance in promoting the process of economic growth.

In addition to the necessity for a quick enforcement of the Regulations, certain amendments should be made in order to clarify the conditions for maintenance and make them more effective.

In the first place, quantitative standards should be set with regard to achievements. Listed companies should maintain a certain yield on capital (adequate enough to encourage the making of portfolios). Securities which do not fulfil such conditions (and taking the long-term prospects into consideration) should not be accepted on the floor.

Provision should be also made with respect to the wider distribution of securities. Those securities, which become so closely held that their marketability suffers, should be removed from the list, thus eliminating the possibility of market manipulation.

3. Publication of information - It is stipulated in Art. 45 of the Internal Regulations that listed companies should submit to the Bourse by the end of every business year the financial statements together with the annual report of their boards of directors. Any amendment to their constitutory act should be promptly reported to the

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Bourse.

These steps were provided in order to supply the listing committee with all information pertaining to the listed companies and this to justify their further acceptability on the floor.

What is equally important is that the information should be properly and officially diffused to the public to enable it to formulate a sound and comprehensive business judgment with respect to offered securities.

For this purpose, we believe that the Bourse should publish a monthly review, pertaining to the meetings, policies, present achievements and future prospects of the different listed companies.

Under present circumstances, corporations have to publish their financial statements in the Official Gazette in the two months period following their approbation by the general meeting of shareholders.¹ This device is not sufficient for the guidance of the investing public. First, the public needs immediate information about the listed companies and a period of two months for the publication of the information is too long for proper and adequate guidance. Second, the Official Gazette is read by very few; it is not a business magazine sought after by businessmen.

1. Code de Commerce, Art. 101, p. 51.

At the present time, information about listed companies is much more diffused through talks and personal contacts than through official publications. Aside from the proper way of informing and educating the public, the suggested review would cut short any rumor or wrong interpretations. The best way to stand against false news is not only to provide disciplinary sanctions against those who spread them but to make available to the public the sufficient and objective data necessary for the formation of sound judgments.

IV. LISTING OF FOREIGN SECURITIES

It has been shown in the previous Chapter that the discrepancy between the increasing demand and interest in the Bourse and the rigidity of supply of securities could be removed through the introduction of first-class foreign securities. This step would tend to decrease the speculative nature of the Bourse by providing a wider range of well-established securities. //

On the other hand, this step would correspond to a structural necessity of the Lebanese economy. Lebanon is becoming more and more a custodian of the liquid capital of the neighbouring countries. This function necessitates the development of financial institutions and, among them, a stock exchange. The importance of the development of the latter is made clear in this respect when we consider

that world-known brokerage firms are setting up offices in Beirut to deal with the growing local demand for foreign securities.

It is apparent, then, that it is of crucial importance to the Bourse and the whole Lebanese economy to let first-class foreign securities figure in the list. It follows that the Bourse should solicit foreign companies to be represented on the Lebanese floor.

However, this need is not properly accounted for by the Regulations of the Bourse. It would seem to a person who reviews them that a foreign firm must take the initiative and apply for admission, after fulfilling definite conditions which are exacting. In fact, Art. 47 stipulates:

"Applying companies should assure their whole financial service in Beirut, without any restriction or expense. Such service should be carried on gratuitously to investors by a banking institution in Beirut, and this upon the approval of the foreign exchange authorities or the Ministry of Finance of the mother country of the applying firm."

The different conditions for admission of foreign securities which were described in the Second Chapter of this study could be justified if applying companies were in a position to get a direct benefit through their formal listing. But in fact, the benefits would accrue to the Bourse only, and the stipulated conditions would thus not attract to the list the first-class foreign securities we

need. We do not really think that major American companies, for instance, whose securities are known worldwide, would bother themselves about entering the Lebanese stock exchange and "assure gratuitously their whole financial service through a banking institution in Beirut" in order to be admitted.

As it is of primary importance to the Bourse to get foreign securities to the list, another approach should be used. Aside from the legal formalities and formal procedures which should be respected, we believe that conditions for admission should be greatly simplified. This suggestion could be more easily accepted when we state that only important and world-known companies should be looked for (as the De Beers, Royal Dutch, Du Pont, General Motors...). The securities of these companies figure already on the most developed stock exchanges and their introduction to the Lebanese Bourse would greatly enhance its reputation.

To assure this end, we believe that Art. 47 should be basically amended. While quoting the foreign securities to be introduced to the Bourse, dealings in these securities could be directly effected by Lebanese brokers through offices of the Bourse, to be opened in the major financial centers of the world. If a Lebanese businessman would like to acquire or dispose of so many shares of Alcoa, all he has to do would be to notify his Lebanese broker and the

latter would settle the transaction through the proper office abroad. This office would work as a custodian for the investing public in Beirut of the appropriate foreign securities. The brokerage office should become a member of the stock exchange in the country where it is dealing, and this to get the proper credit facilities from commercial banks to be provided to the ultimate dealer for trading on margin.

In order to encourage local investors in foreign securities to deal through Beirut and not directly through a foreign stock exchange, dividends and interest on their foreign commitments which are transferred to Beirut should be exempt from the Lebanese income tax. Otherwise, it would be more advantageous for them to deal through the foreign exchange and keep in the country of the latter the income derived from security holdings, because under such alternative, the foreign tax would be borne anyhow, but the Lebanese one would be evaded.

The exemption by the Lebanese fiscal authorities would not amount to any appropriate fiscal loss. This is so because the income from securities accruing from free exchange countries (U.S.A., Canada and Switzerland) to shareholders residing in Lebanon is generally received in the form of unspecified account transfer, and this to evade the incidence of Lebanese taxation. The remedy

which might be suggested against this evasion might bring harm to the whole liberal system of the Lebanese economy.

V. TRADING ON MARGIN

It has been shown in Chapter Two that the marketability provided by stock exchanges to listed securities would make it possible to use the latter as collateral for loans. The collateral value would depend upon the actual value of the security and its prospective position on the market.

The use of securities as collateral has developed into trading on margin. The broker would provide his customer a specified credit on his stockholdings, generally to effect further purchases. In his turn, the broker would get a bank credit, generally at a lesser interest rate than would be required from the customer if he applies directly to a bank for credit facilities.

It has also been shown in Chapter Two that the manipulation of the margin requirements is a strong device used by the central bank to implement its monetary policy. In fact, a higher margin requirement would decrease the available volume of credit. The Federal Reserve System, for instance, has decreased the margin (January 1958) as an anti-recession measure; it then increased it (August 1958), to combat the inflationary movement on the New York

stock exchange.

But trading on margin would be of little use in less-developed markets, and might be even harmful if the security offered has an unsound character, because a further credit provided might encourage the speculation in the issue.

A. Actual procedure on the Bourse - Trading on margin is not much practiced on the Lebanese stock exchange. Credit is generally provided by commercial banks to a few customers, and it is not so much secured by the collateral value of the security as by the other C's (capital and capacity). The trading of securities has not yet developed to the point where it attracts the special attention of banks. A credit needed to effect some transactions on the Bourse has to be personally negotiated, between the banker and his customer, as for the general mercantile credit. The terms of credit and the margin provided would vary then between customers, depending upon their three C's.

The small interest of banks in such kind of credit could be partly attributed to drawbacks in legislation. In fact, the bank cannot dispose of a pledged security to recover its money, in case the customer fails to meet his obligations, or to maintain an adequate margin requirement through partial sale of the holding, if the latter declines

in value, without a special recourse to the commercial court. That is why the personal contact of the customer with the bank and his business integrity are much more looked for in the provision of the above-mentioned credit than is the worthiness of the security to be purchased. Whereas in developed money markets, the customer is left free to choose the securities with the credit provided, such a choice has to be approved by the financing bank in Lebanon.

The deficiencies in credit supply and procedures have a structural justification. First, the small number of securities listed on the Bourse and the embryonic character of the latter have not induced commercial banks to have special departments for security analysis and investment as in developed countries. They are not yet accustomed to the special market research necessary for an adequate provision of this specialized type of credit. Second, the speculative trend of the Bourse, and the gambling nature of the most popular issue (Pétroles) have made it difficult, if not impossible, to assess properly the actual worthiness and the future prospects of listed securities. The solicited credit could not be based then on the ever-changing value of the security, but on the more personal elements affecting the level of credit. Third, and mainly for the above two reasons, the B.S.L. does not provide credit to commercial banks on the basis of loans extended to security dealers.

But the introduction to the Bourse of major foreign securities as suggested earlier in this Chapter and the structural reforms to be discussed in next Chapter should be coupled with proper devices for an adequate provision of credit to stock exchange transactions.

B. Reforms -

1. Standardization of credit - Credit to be provided for security dealings should be extended through the care of the broker. The latter would become the intermediary between the customer and the bank, as is generally the case in developed countries. In this way, the bank would avoid the need of informing itself about every customer, and its credit supply would be more centralized and more easily managed. The broker on the other hand would be in a better position than the bank in controlling credit, since aside from his financial obligation towards the bank, he has a moral responsibility towards both parties.

To encourage commercial banks in providing this type of credit and keeping portfolios, the position of the B.S.L. should be also standardized with regard to the supply of credit to private banks. Mortgage loans, secured by stocks, should be properly discounted by the B.S.L., and at a standard rate corresponding to a specific financial

policy. Along the same line too, commercial banks should exact a uniform margin requirement from brokers, and consequently from the ultimate customer, at a rate to be stipulated by the Bank.

2. Position of brokers - To be able to meet his financial responsibility towards the bank, the broker should be in a position to safeguard at best his interest with regard to his customers. In case the latter fail to meet their obligations, or if a further margin is deemed necessary, the formalities for liquidation should be simplified. The broker does not need to sue the customer in court to get his rights. He should be allowed legally to dispose of the pledged security, in case of default, without special recourse to justice. In fact, this is the ordinary procedure followed in developed markets. For instance, the customer has to provide to his broker for dealings on the New York exchange, in the agreement to be entered between both, the following power:

"All monies, securities, commodities or other property which you may at any time be carrying for the undersigned or which may at any time be in your possession for any purpose, including safekeeping, shall be subject to a general lien for the discharge of all obligations of the undersigned to you, irrespective of whether or not you have made advances in connection with such securities, commodities or other property, and irrespective of the number of accounts the undersigned may have with you."

"... You are hereby authorized, in your discretion, should the undersigned die or should you for any reason whatsoever deem it necessary for your protection, to sell any or all of the securities and commodities or other property, which may be in your possession, or which you may be carrying for the undersigned (either individually or jointly with others), or to buy in any securities, commodities or other property of which the account or accounts of the undersigned may be short, or cancel any outstanding orders to close out the account or accounts of the undersigned in whole or in part or in order to close out any commitment made in behalf of the undersigned. Such sale, purchase or cancellation may be made according to your judgment and may be made at your discretion, on the exchange or other market where such business is then usually transacted, or at public auction or at private sale, without advertising the same and without notice to the undersigned or to the personal representatives of the undersigned, and without prior tender, demand or call of any kind upon the undersigned or upon the personal representatives of the undersigned, and you may purchase the whole or any part thereof free from any right of redemption, and the undersigned shall be liable for any deficiency; it being understood that a prior tender, demand or call of any kind from you, or prior notice from you, of the time and place of such sale or purchase, shall not be considered a waiver of your right to sell or buy any securities and/or commodities and/or other property held by you, or owed you by the undersigned, at any time as hereinbefore provided."

CHAPTER VII

INSTITUTIONAL REFORM - SUPPLY AND DEMAND OF LONG-TERM CREDIT

It has been shown in the previous Chapter that the enforcement of adequate regulations with regard to the admission and maintenance of securities on the Bourse, and the introduction of first-class foreign securities to the latter, are necessary steps for a smooth functioning of the Lebanese stock exchange.

But as has been pointed out many times before, the development of the Bourse is dependent upon the overall economic development of the country. A more abundant flow of Lebanese securities to the market depends upon the resort of the community to the corporate form of business and, consequently, is linked to the stage of supply and demand of long-term capital. It is the development of the latter which would assure, in the long run, the promotion of the stock exchange.

I. PRESENT LONG-TERM CREDIT SITUATION IN LEBANON

A. La Société de Crédit Agricole et Industriel du Liban (SCAIL) - This institution was the first to deal with

long-term credit in Lebanon.¹ It was established in 1939 with an initial capital of LL 1,000,000. By 1942, the capital had reached LL 5,000,000. In the same year, the government guaranteed a five percent loan of LL 5,000,000 by the Banque de Syrie et du Liban to SCAIL, to be offered by the latter at 8.5 percent. This credit was increased twice and attained in 1950 the limit of LL 21,000,000.

This institution suffered from many drawbacks. In the first place, almost half of the credit facilities were mainly provided to agriculture. In fact, the funds of the bank were distributed in 1950 in the following proportions:

Agriculture	46 percent
Industry	40.5 "
Real estate (hotels)	13.5 "

This distribution could be partly justified by the relative importance of agriculture in the Lebanese economy. But the credit earmarked to agriculture was not properly channelled. Due to the absence of agricultural cooperatives, loans were made to private individuals, and mainly on the basis of political considerations.

In the second place, the bank was not properly organized to deal separately with the special problems of industry and

1. Talhat Yafi, "Industrial Credit in Lebanon," The Economy of Lebanon and the Arab World, No. 47, pp. 14-30.

agriculture. It is a well-established fact that the problems faced by a credit institution differ basically when dealing with these two sectors. Banks, in extending long-term credit, should have specialized staffs to cope with the different procedures and analyses inherent to each type of activity. A common consideration of the inherent problems of industry and agriculture would not give the best results (as has happened with the SCAIL) to either the bank or its customer. Thirdly, and most important for our analysis, the credit provided to industry did not correspond to the real needs of the latter. This was due, first, to the fact that only medium-term loans (not exceeding five years) were made to industry. Proper growth would necessitate long-term credit and this need was not satisfied by SCAIL. In the second place, medium-term credit was generally provided for the acquisition of machinery. To get a loan, the industrialist had to mortgage property of a minimum market value equal to four times the requested amount. By this requirement, the small industrialist was deprived of the credit facilities of SCAIL. This was so because if the few assets he possessed were mortgaged, his credit standing with commercial banks would be impaired. Thus would the borrower be denied the short-term credit necessary to meet working capital requirements.

To deal with these drawbacks and cope with the growing needs of the different sectors of the Lebanese economy, another long-term institution was established.

B. Banque de Crédit Agricole, Industriel et Foncier (BCAIF) - This Bank was formed in 1954 with a capital of LL 5,000,000, in which the government participated in the amount of 40 percent. The government also guaranteed a forty year loan of LL 25,000,000 provided to the Bank by the B.S.L., at the rate of two percent. In the following section, we shall limit our discussion to the industrial activity of the Bank, as it is directly related to the scope of our study.

The Bank deals with short, medium and long-term types of credit. Short-term is used to finance working capital requirements. The other two are used for expansion purposes.

But again, the newly established Bank suffered from many deficiencies, with respect to both its organization and scope:

1. Many considerations, but mainly political ones, influence the provision of loans. Financial help is not provided for small farmers (since this would necessitate the formation of cooperatives) or to small industrial* firms. Those who get the credit facilities are not always those

who give them the best use, and many defaults might be expected. This has previously happened with the SCAIL which recovered, up to 1955, only 18 percent of the due amount of loans it provided under the guarantee of the government.

2. The amount of long-term credit supplied is limited to 35 percent of the market value of the first-class mortgage. To increase the amount of such credit, the Bank should consider the earning capacity of the enterprise. In the long-run, it is the earning power of the firm and not the value of its specialized assets which assures its solvency and therefore its ability to repay the loan.

To facilitate the access to long-term credit, and especially for small enterprises, the "after-acquired clause" should be used. Under present regulations, only large and well-established concerns can resort to the Bank by effecting a first mortgage on some of their properties. But with the introduction of the after-acquired clause and the primary consideration of the earning potentialities of the applying firm, small concerns could also benefit from long-term credit facilities.

3. Lebanese industrial firms suffer as much from a lack of long-term credit as from the inadequate provisions for financing working capital requirements. Many concerns have overinvested in fixed assets without providing properly

for their working capital. This handicap has been considered by the Bank; but the assessment followed for the provision of short-term credit is not properly made. In fact, the Bank limits the amount of its credit to half the profits scored by the business. But the level of profits realized in the past might be low, and not in accordance with the earning capacity of the firm, due to a previous shortage in liquid capital. In providing a short-term loan, the Bank should consider then not only the past achievements of the concern, but also the impact of the requested loan on the earning capacity of the business.

4. What is of the utmost importance to our further analysis is the fact that the two above-described institutions come mainly to the help of big and well-established enterprises which can rely for the most part on internal sources to finance expansion. These firms are almost the only ones to benefit from the long-term credit of the Bank, since only they have assets large enough to mortgage a part and keep the remaining free, thus maintaining their short-term credit for short-term rating.

What about the small enterprises which have good prospects of growth but which can neither rely on internal sources, nor resort to outside capital to finance their expansion? Aside also from the need of small concerns,

there are many opportunities which should be exploited, but which the private capital is not yet accustomed nor encouraged to try. The entrepreneurial drive, generally deficient in underdeveloped areas along certain lines of basic activities, should be stimulated, helped, and assisted by a public body which has a stronger capacity and better foresight than private capital. This necessity was partly accounted for by a newly-established bank (Beirut-Ryadh Bank) which stipulates, in Art. 2 of its by-laws:

"... The bank is authorized to establish companies and participate in the establishment of companies, through providing either equity or debt capital."

Such a step is not sufficient to meet all the needs of the economy. Being a private commercial concern, the Beirut-Ryadh Bank might not stand ready to participate in those industries which are yet in their primary stage and need, from a national point of view, to get promoted. On the other hand, the newly-established and prospering companies would be reserved by the bank to add to its profits. The public then, would not be given the chance to share in such prosperity, or else he would have to pay the necessary premium for the acquisition of securities.

We believe that proper measures should be taken to come to the help of small and growing enterprises and to direct private incentives to the lines of activity deemed

necessary, while reserving to these incentives the best reward on their commitments. This belief would be substantiated in the proposed institution, to be discussed later in this Chapter.

II. DEVELOPMENT OF LONG-TERM CREDIT

The reluctance of private capital to engage in long-term ventures could be offset a good deal by institutional provisions. The latter in their turn would encourage the growth in supply and demand of long-term capital, to the extent allowed by the level of economic development attained. The following section of this Chapter will be reserved to describe the special role which should be played by certain financial institutions in providing the institutional framework for investment.

A. Supply of long-term capital - This function is mainly provided in developed countries by institutional investors and investing institutions.¹ These channel the savings of the public to entrepreneurs who carry further the economic growth. The institutional link is needed by undeveloped countries first, to meet the growing need for long-term capital and second, to help or even educate the public in the best use of its funds.

1. Commercial banks - These perform an important investment function in developed countries. After keeping

1. This is explained by the fact that most of public savings in these countries is institutionalized.

legal reserves, commercial banks invest part of their deposits in securities "that combine the least credit risk with the greatest liquidity and the least risk of price fluctuation."¹ In the United States, the following securities are exempt from all restrictions for investment by commercial banks:²

- a) Obligations of the U.S. government.
- b) General obligations of any state in any political subdivision thereof.
- c) Obligations issued under the Federal Farm Loan Act, as amended.
- d) Obligations issued by the Federal Home Loan Banks.
- e) Obligations of the Home Owners Loan Corporation.

As an outgrowth of the tremendous expansion of the American national debt since 1930, "commercial banks in the U.S. now hold some 90 percent of their investments in the form of U.S. government securities. The remainder is largely in tax-free state and municipal issues and in 'high-rated' corporate bonds."³

With regard to the investment function of commercial

1. Investment Bankers Association of American, Fundamentals of Investment Banking (New York: Prentice-Hall Inc., 1950), p. 751.

2. Ibid., p. 748.

3. Ibid., p. 48.

banks in Lebanon, ^{free}resources are primarily 'invested' in foreign exchange. The portfolios kept by some are mostly used for speculation in the Bourse. One bank went so far as to use the deposits for speculation in real estate and special gambling ventures, activities which are incompatible with sound banking.

It can be said that commercial banks do not keep a proper investment portfolio for the following two main reasons:

a) The range of securities offered on the market, as was pointed out earlier, is too narrow. Aside from this drawback, the existing securities are very speculative and cannot be used by commercial banks for investment purposes.

b) The savings deposits of commercial banks are too small in comparison to demand deposits. The proportion of the two is shown in the following table:

TABLE III

DEMAND AND TIME DEPOSITS OF COMMERCIAL BANKS
IN LEBANON FOR THE YEARS 1947-1957*

<u>Year</u>	<u>Time deposit (In LL000,000)</u>	<u>Percentage of total deposits</u>	<u>Demand deposits (In LL000,000)</u>
1947.	1.5	.7	205.4
1948	4.5	2.2	194.3
1949	4.8	2.7	175.8
1950	5.3	2.5	209.7
1951	6.2	2.3	253.1
1952	11.8	3.8	301.5
1953	19.1	5.6	324.4
1954	26.7	6.1	362.1
1955	39.3	8.1	442.9
1956	42.4	8.8	440.3
1957	50.4	8.3	551.1

* Source: Ministry of National Economy, Bulletin
Statistique Trimestriel, 1958.

The low proportion of time deposits might be thought as preventing the commercial banks from pursuing a true investment policy. This is made clear when we consider that in 1946, the deposit liabilities of American commercial banks were divided as follows:¹

Demand deposits	77 percent
Time deposits	23 "

1. Ibid., p. 737.

But the small proportion of savings deposits did not prevent some of the Lebanese commercial banks, in order to insure a rapid gain, from resorting to channels which are not open to commercial banks in developed countries. Aside from the absence of proper banking legislation to regulate the investment activity of commercial banks, these resorted to unsafe and risky channels, partly because of the absence of proper investment alternatives corresponding better to their field of activity.

Proper legislative steps should be taken to require the commercial banks to invest part of their deposits in government and guaranteed securities. The provision of the latter will be discussed at length later in this Chapter.

However, two important structural changes should be made in the commercial banking system in order to help it follow an adequate investment policy:

a) Higher interest rates should be paid by commercial banks on time than on demand deposits. This would encourage the public in using the former channel and in this way, investment could be more easily carried by commercial banks. The decrease in profits accruing to the latter (resulting from a higher interest rate paid on time deposits), will be compensated, in the long run, by the income derived from a proper portfolio management.

b) The B.S.L. (whose central banking functions ought to be revised), should stand ready to provide its credit to commercial banks, on the basis of their long-term commitments. Aside from the first-class marketable securities to be used by commercial banks for their portfolio, these banks should be encouraged by the B.S.L., through proper facilities re-discounting/ to promote medium and ~~even~~ long-term credit. "The central bank should adopt no rigid law against medium-term and long-term lending by commercial banks. Even the smallest banks must lend for longer terms than would match their assets, and the central bank must be prepared to supply additional liquidity in case of emergency."¹

2. Insurance companies - These institutions constitute large pools of public savings. Of the ten largest business enterprises in the United States, as measured by their assets, four are life insurance companies.² However, the volume of insurance deposits depends on the level of development and the structural setup of the economy.

The tremendous volume of savings accruing to life insurance companies is invested in a way which provides the maximum of safety and stability. The investment channels

1. R. S. Sayers, Central Banking after Bagehot (Oxford: At the Clarendon Press, 1957), p. 122.

2. Investment Bankers Association of America, op.cit., p. 769.

opened to these institutions are strictly regulated by legislation. In the United States, for instance,

"the capital and surplus, usually up to the minimum required by law, are subject to specially stringent regulations. For foreign companies doing business within a state, the law usually provides for special deposits of securities, which are subject to stringent requirements, that must be left with the superintendent of insurance. The remaining funds of the company, including the reserve and any part of the capital and surplus not covered by the above laws, are generally regulated by a third and less stringent series of regulations. The latter direct the investment of the great bulk of insurance funds along the following lines:

1. U.S. government and municipal bonds.
2. First mortgages on improved real estate up to $66 \frac{2}{3}$ percent of the value of the property.
3. Bonds of corporations which have earned at least four percent on their capital stock for at least five years.
4. Secured bonds of solvent corporations of which not more than one third of the security is capital stock.
5. Preferred stocks of corporations which have earned at least four percent on their capital stock for at least five years."¹

With regard to Lebanon, insurance companies are not provided with investment opportunities to use their funds in a way which helps more in the process of capital formation than the actual practice. The American Life Insurance Company in Lebanon, for instance, keeps most of its funds as time deposits in banks which are mainly lent by the latter for self-liquidating transactions. The biggest Lebanese insurance company, (Al-Ittihad Al-Watani-L'Union Nationale) has used part of its funds for the erection of a building which cost

1. Willis and Bogen, op.cit., pp. 115-116.

LL 4,390,757, or four times the value of the portfolio kept by the same company, as shown in its balance sheet on December 31, 1957.¹

Special provisions should be devised to make such big pools of funds help in the economic development of the country. Insurance companies should be empowered to use an appropriate proportion of their funds for the maintenance of a portfolio through the provision of government and government-guaranteed securities.

3. Savings banks - These collect the savings of the public and invest them in securities. Depositors receive interest on their money which can be withdrawn upon simple notice. Such institutions have grown up in developed countries where (1) the level of savings is high, due to a high disposable income, and (2) the supply of securities for investment is adequate.

Though the savings banks would not have the same opportunity to prosper in backward countries as in developed ones, they represent a necessary link for economic development. The public of such areas is not accustomed, due mainly to a lack in opportunities, to invest in securities and to finance long-term ventures. Savings are mainly used then in a way which does not help in the process of

1. Le Commerce du Levant, No. 408, p. 3.

capital formation. An intermediary institution (savings bank for instance) between the financially uneducated public and the relatively few entrepreneurs would be of primary importance to the economy.

Special devices should be provided for the growth of these institutions in Lebanon. The small range of securities offered for adequate investment should be compensated for by a direct participation of the institution in the creation and development of new enterprises. That is why we reserve the last section of this Chapter to discuss the special role to be played by the BCAIF which, in our opinion, should assume the role of pooling liquid resources from the public and channel them to entrepreneurs.

The different above-mentioned reforms regulating the investment activities of the major institutional investors and investing institutions should be coupled with adequate changes in the other side of the picture. Appropriate channels should be provided to such institutions for a better and more fruitful use of their funds. Aside from the basic structural reforms to be brought to the demand side for long-term capital, which would be discussed in the following section, there should be encouraged such institutions whose securities correspond to the investment standards of the above-mentioned ones. First-class bonds of a real estate mortgage bank for instance, could be highly recommended for acquisition by commercial banks by the use

of an appropriate proportion of their time deposits.

With regard to real estate credit, we have in mind the project submitted by Messrs. Talhat Yafi and Nabil Saadeh for the creation of a specialized bank in Lebanon.¹ The proposed bank, with a capital of LL10,000,000, would get from the B.S.L. a loan of LL 20,000,000, to be guaranteed by the government. To increase the investment opportunities for institutional investors, such funds should be differently procured. The bank should issue its own obligations, to be guaranteed by the Treasury, and the institutional investors would then be enabled to subscribe to part of this issue. The unsubscribed portion would be offered for public investment.

The guarantee feature should be adopted to provide more attraction to investors. Under present circumstances, this provision might be necessary, due to the reluctance of the public from such types of investment and the more relative safety looked for in short-term ventures.

The cooperation of the Treasury in this respect would be of great help in introducing the public to the field of long-term financing. The private capital should be initiated and properly remunerated to help efficiently in the process of capital growth. While discussing the financing of the

1. The Economy of Lebanon and the Arab World, No.47, pp. 31-38.

Litani project, we stated the following:¹

"We should say that the reluctance of private capital from long-term developmental schemes is not based on economic analysis (otherwise it would be more fruitfully used), but on fear, lack of incentives and ignorance. Dealings in the capital market depend upon the economic and social stability and the existence of sound and well-respected financial institutions. More than that, they are the outcome of education and training in this field. The refrain from the supply of LL 3 million to the BCAIF in 1955 was not due to a shortage in private savings, but to the existence of such conditions towards which the private capital prefers short-term self-liquidity. The Litani scheme, whose high yield is known to everyone, could have been the best national mean for capital market training and education. The project could have attracted for sure most of the misused or hoarded personal savings."

The missing institutional link between the private capital and its ultimate use in long-term financing should be filled by the intervention of the Treasury. While the latter guarantees the long-term loans offered by the B.S.L. to other institutions, it does not introduce private capital to the long-term investment field. We believe that such capital needs to be given importance and confidence to contribute to the process of capital formation. To provide more safety and attraction to private capital, the Treasury should guarantee the first-class issue of certain institutions. Such issues would help the major institutional investors in keeping an appropriate portfolio.

1. Nadeem Shwayri, The Litani Project (American University of Beirut: B.B.A. Thesis, 1956), pp. 49-50.

B. Demand of long-term capital

1. Importance of demand - The shortage in the supply of long-term credit is not the only hindrance to the process of economic development. Though the level of savings is low as a result of the relatively low level of the national income, the fact still remains that the main volume of such savings is channelled into passive uses. This can be explained on the ground that the opportunities for long-term investment are limited and the demand for long-term capital is consequently low.

The 'snag' on the demand side for such capital plays an important role in affecting adversely the process of capital formation. "In under-developed economies, the supply of savings is a less significant limitation on the rate of productive investment than the demand for capital."¹ The promotion of the latter, through a greater provision of opportunities and adequate institutional reforms, would inevitably attract misused and hoarded savings into the lines mostly needed by society.

Aside from the institutional background needed to raise the level of demand, proper orientation of the public would be necessary to promote the latter. "The individual's habit of applying his demand along specified

1. Charles Wolf and Sidney Suffin, Capital Formation and Foreign Investment in Under-developed Areas (Syracuse: Syracuse University Press, 1955), p.11.

lines of investment may be largely the result of prejudice or ignorance. An explanation to him of the actual factors involved in investment, and a recognition on his part of the underlying fact that it is not the legal forms of investment but their essential characteristics that fit them for a place in an investment list, will then result in broadening his demand or changing its direction from narrowly specialized channels into much larger fields."¹

The increase in demand would be reflected by an increase in entrepreneurial activity. And the latter will express itself by an aggregate increase in the demand for corporate capital.

2. Promotion of the corporate form of business - It has been shown in Chapter Five that the formation and growth of corporations in Lebanon is hampered by organizational and fiscal obstacles. These hindrances are made clearer when we contrast them to the facilities provided for the formation and growth of partnerships.

It has been suggested earlier that the formalities required in the formation, and later in the amendment of the constitutionary act of corporations, should be greatly simplified and controlled by a special department in the

1. Willis and Bogen, op.cit., p. 442.

Ministry of National Economy. The intervention of the Council of Ministers should be restricted to very special situations, as is the case in developed countries.

But we believe that the incidence of the corporate income tax should be considered again with regard both to the formation of new enterprises and their continuing development. New lines of activity which take the form of widely-held corporations and help the country in its economic development should be exempt from the corporate tax, at least during the initial stage, or if a tax is levied, it should be imposed in a way that does not discourage the investing public from choosing the corporate form of business. At the same time, the corporate tax should be amended so as not to affect adversely the further growth of corporations, and especially through retained earnings. We think that the corporate form is best suited to carry further the process of capital formation. To help in the attainment of this purpose, corporations should be promoted and made more attractive to the investing public than the partnership form.

a) Tax exemptions - A law to this end was promulgated on February 5, 1954, which stipulates in its first article:¹

"Are exempted from the income tax for a period of six years all enterprises which fulfil the following conditions:

1. Official Gazette (1954, No. 6), p. 59.

- If the line of activity chosen is new to the economy and its promotion contributes to the development of the latter.
- If the capital invested in Lebanon attains the minimum of LL one million.
- If the wages and salaries paid by the company to its Lebanese personnel exceed LL one hundred thousand per year."

Though these provisions are necessary to help in the capital formation of the country, they are inadequate in many respects. First, very few enterprises can meet the provisions of the above-mentioned clauses. Tax exemptions should be extended to small and modest ventures too. It is because the latter, which might correspond better to the structural setup of the economy, are not less important for further capital formation than big enterprises. Second, the provisions of the law would make it available to the few capitalists who have the financial capacity to create the new and relatively big enterprises. But we believe that people in the lower income brackets should be encouraged to convert their savings into corporate shares. That is why we suggest that the tax exemptions, provided to enterprises exploiting a new and useful line of activity, should be also extended to new corporations whose capital is contributed by a stipulated minimum of Lebanese people.

The taxation system should be considered more as a device to help in the capital formation through the creation of corporations than as a source of revenue. And in the long run, the former aim will provide a greater taxable

income and consequently, a higher fiscal revenue.

b) Deductions from taxable income - Aside from the above-described provisions of tax exemptions which should be extended to encourage the formation of new enterprises and the resort to the corporate form of business, the corporate tax system should be amended so as to help at the same time in the further growth of already-established concerns.

i) Taxation of reserved earnings - Under present circumstances, the Lebanese fiscal system provides a fiscal advantage to the stockholders of corporations which distribute yearly their profits. "Profits are not liable to the personal income tax if they are distributed in the same year of realization."¹

Since the majority of Lebanese corporations are closely held and managers often are the proprietors of their enterprises, the above-mentioned provision induces the yearly distribution of the bulk of disposable income. We believe that this exemption should be reversed in order to encourage reinvested earnings. This is recommended because small and growing enterprises have to rely mainly on this source for further expansion.

1. Code de l'impôt Libanais sur le revenu, Art. 60, p. 40.

To induce the growing enterprises along this line, the earnings retained for the purpose of growth should be deducted from the corporate income for tax purposes. However, undistributed earnings should be exempt only if they correspond to the 'reasonably anticipated needs' of the business. On the other hand, 'unreasonable accumulations' of earnings carried on to benefit from the proposed exemption should be highly taxed, and at a rate far superior to the personal income tax, in order to promote their distribution.

Aside from the great incentive it provides to corporations to retain their earnings, the corporate tax exemption would have a cumulative advantageous effect on the growth of the enterprise. In fact, the tax savings accruing to the benefiting company in one year, if re-invested, would be added cumulatively to the future earning records of the enterprise.

ii) Deduction of expenses for betterments - Under present circumstances, payments incurred in the betterment and modernization of equipment are not deductible from taxable income.¹ This provision should be removed so as to encourage corporations to make technological changes. The other equipment, should be depreciated not on the

1. Ibid., Art. 7, p. 3.

basis of initial cost, as is presently done, but in accordance with ~~an accelerated rate of depreciation~~ during the initial years.

iii) Capital gains - Capital gains realized by corporations should be liable to the corporate income tax. In some cases, the capital gains tax should be more than the progressive corporate one, and this to check on the unhealthy trends of economy (mainly in the real estate sector).

But individuals are evading the actual capital gains tax by registering the properties in their personal name. In this case, no accounting records are required to be kept, as in the case of corporations, and the capital gain realized upon the sale will not be noticed by the fiscal authority.

To encourage corporations to deal in real estate, either the corporate tax should exempt the realized capital gain accruing from property transactions or the personal income tax should be properly increased and fall on the gain realized by private individuals.

The above-mentioned amendments with regard to the corporate income tax would be of small significance if the partnership form of business remains at a clear advantage over corporations with respect to fiscal incidence. This point was discussed and illustrated in Chapter

Five. Here again we propose that either the corporate income tax should be reconsidered or the partnership profits should be liable to higher fiscal rates. The proper equalization of tax incidence on both forms would greatly make the public choose the corporate form due to its clear advantages.

But from the scope of our study, we should again stress the fact that widely held corporations should be encouraged from both the organizational and fiscal points of view. It is partly because this special form of corporations would work for the imminent development of the stock exchange. The fiscal system should be more lenient towards such a form than with regard to closely held corporations which have been organized by few capitalists mainly to evade the inheritance tax and to take advantage of the above-mentioned proposals of tax exemptions.

C. Need of Government Assistance

The previous section has been devoted to a description of the procedures necessary to encourage corporations, both as to formation and further growth. These were recommended because the stimulation of demand for long-term capital is essential to carry forward the process of capital formation.

But the entrepreneurial activity in backward countries is weakened by many institutional obstacles, especially to

come over the first stages of development. Due to the low purchasing power of the masses and the narrowness of the market, profits are not easily scored in industrial ventures as in the current self-liquidating transactions. And the private capital would be gradually attracted by industry only when the various fields of long-term investment become remunerative.

To attain such level which provides the adequate institutional framework and possibilities to encourage the private incentives, the government would have to assume a transitory role. The latter would be the temporary assistance to private entrepreneurship to reach the stage by which it could carry and generate by itself the drive of capital formation.

III. Role of Government

The necessary assistance to be provided by government with respect to the promotion of long-term capital is outlined in the proposed amendments to be brought to the BCAIF. These were inspired from the recommendations given by the International Bank Mission for the development of Iraq and Syria.

A. Source of funds

The Bank, as was described earlier in this Chapter, relies mainly on the loan provided by the B.S.L. and guaranteed

by the government. To increase its financial resources and channel the savings of the public into useful uses, three major sources of funds should be tapped:

1. Public deposits - In this sense, the institution should assume the functions of a savings bank. The public should be encouraged to deposit its savings, by receiving an adequate interest and the power to draw at sight the money, as is done with demand deposits. However, a higher interest rate should be provided to persons who keep a stipulated amount for a minimum period of time.

Such a function is deemed necessary to compensate for the absence of proper savings institutions. And it will provide a competition with commercial banks for deposits, looked for because these banks do not use for the time being their deposits to help effectively in the process of capital formation.

2. Issue of guaranteed bonds - Under the former advice, the Bank has to keep a constant watch on its liquidity position to meet the demand of depositors. However, a higher liquidity latitude could be provided if the Bank issues its own long-term obligations to finance enterprises, rather than rely exclusively on its deposits. The latter alternative would have two important advantages. First, it will offer to the institutional investors a good opportunity for keeping a portfolio, as was recommended earlier. Second, the negotiable obligations issued by the

Bank would add to the flow of securities to the market and help effectively in the development of the stock exchange.

To attract the public for the acquisition of such obligations, the latter should be guaranteed by the government, with regard to both the principal and interest. To provide more safety and encourage further the investing public, the government might stand ready to redeem the long-term issue at stated prices and at stated intervals of time. This provision would create a one-sided pegging of the market price of the issue and, on the other hand, its marketability would be assured.

3. Funds of municipalities - Presently, these are deposited with the B.S.L. Being primarily a commercial institution, it uses such funds through the further credit of the commercial banking system to finance remunerative short-term ventures.

We believe that the BCAIF could make a better use of this big resource for the provision of long-term credit. Being in essence a non-profit seeking business, the Bank would assist the lines of the economy which, though not highly remunerative at present, would have a good effect in the long-run upon the whole economy.

B. Use of funds

1. Assistance to existing concerns - As has been shown earlier while discussing the functioning of the BCAIF, the credit provided to finance working capital requirements is inadequate. This drawback affects adversely the running of needy businesses especially those whose provisions are inadequate in comparison with the level of fixed assets to which they unnecessarily committed themselves.

We believe that the short-term credit needed to finance working capital should be adequately provided for by the commercial banking system. The BCAIF should be more specialized in long-term financing. This specialization would help it to deal more properly with the technical intricacies of long-term credit.

With regard to this credit, the BCAIF should amend the actual basis for its supply. Under present circumstances, it is provided, as we have seen, to big enterprises which have enough assets to procure a first-class mortgage without impairing their credit standing with commercial banks. But as the primary aim of the Bank is to assist small and growing enterprises which cannot rely on their internal sources, credit should be provided not only on the basis of the actual situation of the enterprise, but also by taking into consideration the incidence of the loan on the earning capacity of the applying firm. From the point

of view of the Bank, it is the earning capacity and not the value of the specialized mortgaged asset which is the best guarantee for the repayment of the loan.

2. Establishment of new enterprises - The primary function of the Bank should be to help in the promotion of new ventures, necessary for the development of the economy, but not carried forward^{alone}/by private capital. This help could be ensured either by cooperating with private capital along new lines of activity, or by launching alone and initiating later the private incentive.

The Bank could participate with the private capital in the creation of new enterprises either by acquiring the unsubscribed balance of the new issue, offered previously for public subscription, or by guaranteeing such issues and providing, in this way, more attraction to the private capital.

The Bank should be also enabled for the creation and organization of new concerns. As was pointed out earlier, private capital might be reluctant from certain lines of industrial investment and would be gradually interested only when an adequate yield becomes noticed. The assistance of the Bank is mostly needed in the neglected industries which have good prospects of growth but are not yet established to attract the private capital. And when the latter begins to get interested along these lines, the

Bank should give way and come to the help of more needy industries.

C. Aim of the Institution

The funds of the Bank should be used in a revolving manner. This would help the Bank to meet the growing needs of new industries. When the private capital becomes attracted to an assisted line, the Bank should give way and turn to the help of more needy industries.

By acquiring the ownership by the Bank of shares in new and prospering enterprises, private capital would share effectively in their future prospects. And we believe that in the long-run, it is the private initiative which could lay down the solid foundations of economic development. The special aim of the Bank would be then the temporary assistance and guidance of such initiative to mature and speed up the drive of capital formation.

The use of the Bank funds should be then similar to that recommended by the International Bank Mission for the proposed industrial bank in Iraq:¹

"The bank's capital should be used primarily as a revolving fund. The bank should generally dispose of its industrial share whenever an enterprise becomes profitable and, therefore, capable of attracting more private capital. Profit-making assets should be kept only to the extent necessary to create a reserve against possible losses. While

1. International Bank for Reconstruction and Development, The Economic Development of Iraq (Baltimore: The Johns Hopkins Press, 1952), p. 295.

the bank should presumably show a small profit to inspire confidence in its operations, it should not retain its participation in profit-making enterprises for the sake of maximizing its profits, particularly when this limits its ability to assist other industries."

Since the Bank has to pay interest to its depositors and bondholders, it should revolve its funds in a way which does not prevent it from meeting its obligations. But the possibility of maximizing its profits by keeping the profit-making assets should be transferred to private capital.

The transfer of ownership of newly-established and prospering enterprises could give a good chance to those in the small and fixed income brackets to share in this prosperity. And in the long-run, the development of the stock exchange would be greatly favoured by the investment education provided to such people. The latter point is illustrated by the declaration of an important brokerage firm affiliated to the New York stock exchange:¹ "In our one hundred offices, we are proud to do business with people who talk in hundreds of dollars, as well as with people who deal in four or five figures. In a recent check, we found that forty one percent of our customers had incomes of less than five thousand dollars."

1. As quoted by Dice and Eiteman, The Stock Market (New York: McGraw Hill Book Co., 1952), p. 66.

If we have described at length the institutional links needed for the growth of the economy, it is mainly because such devices would inevitably lead, in the long-run, to the development of the stock exchange.

Throughout this Chapter, we confined our discussion to the financial institutions needed for an adequate provision of long-term capital. We limited our study to this field because it is directly related to the supply of securities. However, the promotion of the capital market is inter-related with the development of all aspects of the national life. The proposed devices should be properly incorporated into a whole plan which coordinates the different actions to be harmoniously taken on all the fronts. In the long-run, the development of the stock exchange is but a reflection of the overall development of the economy.

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