

# The Role of State Banks in the Sri Lankan Economy with Special Reference to the People's Bank

## Abstract

**I**n 2011, the People's Bank, which was established on 1 July 1961, completes 50 years of valuable service to the nation. The setting up of the People's Bank gave an entirely new dimension to banking activities in Sri Lanka. It has been a long journey since then and the Bank has grown in size and stature to encompass every area of present-day banking activity and has carved a distinct identity of being Sri Lanka's Premier Public Sector Bank. The purpose of this paper is to examine the role of state banks in the Sri Lankan economy with special reference to the People's Bank. Throughout the years, the Bank has continued to demonstrate that it is tightly woven into the social fabric of the Sri Lankan people, and in a larger sense, into the economy. To cater to the needs of different types of customers and meet the future challenges, the Bank need to identify new business niches, to implement innovative strategies and to capture new market opportunities. It will be necessary for the Bank to reconcile economic efficiency with social equity to achieve growth which will have a tangible impact on disadvantaged sections of the society.

## Introduction

As reported by the Central Bank of Sri Lanka (CBSL), Sri Lanka's economy grew by an impressive 8 per cent in 2010, reflecting a fast

recovery from the setback suffered in 2009 and moved to a high and sustainable growth path. All key sectors of the economy including financial services sector demonstrated a commendable performance in 2010, underpinned by the peaceful domestic environment, and improved investor confidence, favourable macroeconomic conditions and gradual recovery of the global economy from one of the deepest recessions in history (CBSL, 2010a).

The contribution of the services sector and the financial sector to GDP (Gross Domestic Product) in Sri Lanka, 59% and 9% respectively in 2010 reflects the importance of the two sectors to the economy. Today, one of the faster growing segments in Sri Lanka's economy is the financial sector. This is manifested in developments in money and capital markets, where the volume of transactions has expanded considerably and the degree of sophistication has grown markedly. The financial system in Sri Lanka mainly consists of banks, finance companies, other credit-providing institutions (including microfinance institutions), leasing companies, insurance companies, primary dealers, stock brokers/dealers, investment managers, margin providers, stock underwriters, unit trusts, provident and pension funds. The banking sector accounting for 52 per cent of the financial system's total assets continued to dominate the financial sector in Sri Lanka (CBSL, 2010b).

Today, the role of banks has expanded like never before and has become the most integral part of

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every society. Banks offer a wide range of products and services, customised to cater to specific needs of different categories of customers. These ranged from current accounts, savings products, term deposits, foreign currency deposits, trade, finance, leasing, factoring, personal lending, pawning, housing, credit/debit cards, inward remittances, investments in government securities, fund management, project finance and special lending schemes for areas such as fisheries, agri-business and small and medium enterprises. If the banking system in a country is effective, efficient and disciplined, it brings about a rapid growth in various sectors of the economy. The role of banking in the economy thus can be considered to be very significant and imperative.

The purpose of this paper is to examine the role of State banks in the Sri Lankan economy with special reference to the People's Bank. This paper is organised into four sections. The next section presents a brief historical overview of the domestic banking industry in Sri Lanka with special reference to the State banks. The second section discusses the outcomes of financial reforms in Sri Lanka that have been introduced since the latter part of 1977 to create an efficient and competitive market in brief. The third section analysis the role of People's Bank in the

economy considering its performance, risk management, achievements and innovations. The last section presents conclusions of the analysis.

### **Historical Overview**

During the mid 19th century, the Ceylonese had no access to the foreign Banks (mainly British and Indian Banks), and it was the Nattukottai Chettiar who provided the Ceylonese with all banking facilities, and they were regarded as the official money lenders to the nation (Weerasuriya, 1973). There was no direct communication between the bank officials and the Ceylonese business community. The village farmers who cultivated rice, vegetables, and other subsidiary food crops were entirely dependent on the village money-lenders, indigenous bankers, pawn-brokers, traders and merchants, landlords, friends and relatives who acted as intermediaries in the unorganised credit market. Interest rates that prevailed in the unorganised market were higher than those in the organised market. Therefore, a necessity arose to establish a national bank to cater to the requirements of the local entrepreneurs and to provide financing on a progressive scale to diversify the economy.

Realising the fact that the Nattukottai Chettiers could not continue in their role as money lenders and financiers to the nation, the Banking Commission appointed by the Governor in 1934, headed by Sir Sorabji Pochanawala recommended to the government the establishment of an indigenous Government-sponsored commercial bank to cater to the needs of Ceylonese agricultural and business interests. The State Council of Ceylon approved this recommendation, and the Bank of Ceylon (BOC) was established on 1st of August 1939, under Bank of Ceylon Ordinance (No. 53 of 1938), as Sri Lanka's first State-owned commercial bank.

In 1961, the establishment of the People's Bank, under the People's Bank Act No.29 of 1961 as a public sector bank and the nationalisation of the Bank of Ceylon in 1961 to facilitate the national development efforts of the country, marked a 'turning point in the history of banking' in Sri Lanka. Having been inspired by a larger social responsibility, the two state banks- the Bank of Ceylon and the People's Bank have served national priorities and objectives such as rapid growth of agriculture, small industries and exports, increase of employment levels, encouragement of new entrepreneurs and development of backward areas. For much of the Sri Lanka's history, these two state banks have played a major role in the economy - at times controlling over three-fourths of deposits and assets of the banking system - and they continue to control nearly half the assets and deposits of the banking system today. They have ensured the right to have access to credit on reasonable terms without discrimination to all people of Sri Lanka, irrespective of class, race or religion.

### **Financial Reforms**

After nearly 30 years of inward-looking economic policies and financial repression, the economic policy reforms package which was introduced in 1977 included some structural changes in relation to deregulation of the financial services sector, along with other economic reforms in Sri Lanka. Prior to that policy change, economic stagnation, financial repression, policy distortions and excessive government intervention impeded the development of an efficient and a viable financial system in the country. Financial reforms implemented in Sri Lanka during the past two decades were intended to create an efficient, competitive and developed financial system, while strengthening financial stability (CBSL, 2000).

Among the significant measures that have been taken to deregulate the financial sector since 1977 include interest rate deregulation, introduction of market-oriented credit allocation, relaxation of market entry for foreign and domestic banks, implementation of institutional reforms, and improvement of supervisory framework including appropriate legislative measures to safeguard the financial system (Edirisuriya, 2007). A number of policy changes were introduced since then, and the process has been continuing according to the changing domestic and international environment.

The banking sector, which had been rigidly controlled, was liberalised. Foreign banks were encouraged to enter the Sri Lankan financial market and were permitted to open branches in Sri Lanka. In addition, the domestic private sector was allowed to engage in commercial banking. New types of financial institutions, such as, money brokers, venture capital companies, merchant banks and unit trusts were permitted to commence operations. The removal of barriers to entry broadened the financial market, and increased efficiency through competition.

The two State banks were recapitalised and granted greater autonomy in their commercial operations to restore their financial viability and profitability (CBSL, 2000). Those drastic policy changes were affected to expand the scope of the banking industry as well as to increase the number of firms in the industry. The financial services industry thus supported the continued expansion in economic activity in the country. The expansion of the financial services has shown in the Table - 1.

As at the end of 1979, there were 14 banks - consisting of 4 domestic banks, and 10 foreign banks. The domestic banks consisted of two state banks and two private banks,

namely, the Commercial Bank of Ceylon (established in 1969 as the first private bank) and the Hatton National Bank (established in 1970 as the second

private bank). The number of foreign banks increased to 28 at the end of 1982 while 4 indigenous banks were permitted to open branches in outstations. Thus, the competition became acute as large portion of the financial market share hitherto held by the State banks were acquired by the new-comers to the banking industry.

In 2000, the total number of commercial banks operating in the country was 26 consisting of 2 state banks, 8 domestic private banks and 16 foreign banks. The total number of bank branches stood at 1,084 at the end 2000. The increase in branch network was mainly through opening of new branches by the domestic banks. Accordingly, the total branch network of domestic banks reached 1046 while foreign bank branches increased to 38. In 2009, the total number of branches of commercial banks rose to 2,214, consisting of 2000 domestic bank branches and 214 foreign bank branches. The state banks had the largest number of branches; numbering 1,175, consisted of 679 People's Bank branches and 496 Bank of Ceylon branches. The distribution of commercial banks branch network for the period of 2000-2009 is given in Table 2.

The banking sector, which is the most dominant and systemically important sector in the financial system, has shown a significant expansion during the last two decades, reflecting the increase in

**Table 1: Composition of the Banking Sector as at 30 September 2010**

| Type of Banks                    | Number of Institutions | Number of Main Branches | Total Assets Rs.Bn | Market share of industry (%) |
|----------------------------------|------------------------|-------------------------|--------------------|------------------------------|
| <b>Licensed Commercial Banks</b> | <b>22</b>              | <b>1,408</b>            | <b>2,809</b>       | <b>83.5</b>                  |
| State banks                      | 2                      | 640                     | 1,156              | 34.4                         |
| Private domestic banks           | 9                      | 722                     | 1,248              | 37.1                         |
| Foreign banks                    | 11                     | 46                      | 405                | 12.0                         |
| <b>Licensed Specialised Bank</b> | <b>9</b>               | <b>468</b>              | <b>553</b>         | <b>16.5</b>                  |
| State banks                      | 6                      | 405                     | 470                | 14.0                         |
| Private banks                    | 3                      | 63                      | 83                 | 2.5                          |
| <b>Banking Industry</b>          | <b>31</b>              | <b>1,876</b>            | <b>3,362</b>       | <b>100.0</b>                 |

Source: Central Bank of Sri Lanka, (2011).

financial transactions to facilitate the growing economy. As at end of 2010, the number of banks stood at 31 comprising 22 licensed commercial banks (LCBs) and 9 licensed specialised banks (LSBs). There were 1,932 bank branches, 965 extension offices, 2,977 other banking outlets by the end of 2010. This network was further strengthened by 2,006 Automated Teller Machines (ATMs) indicating an increasing reliance on card-

based payment modes by the banking community (CBSL, 2010a). Sri Lanka now has 9.1 branches for every 100,000 individuals as opposed to the global median of 8.4 branches for every 100,000 individuals (CBSL 2011). Overall, the banking sector experienced solid growth maintaining its soundness and profitability, with increases in the asset base, loans and advances portfolio, investments and deposit

**Table 2: Bank Branch Network of Commercial Banks 2000-2009**

| Item   | 2000       | 2005       | 2008       | 2009       |
|--|------------|------------|------------|------------|
| <b>Licensed Commercial Banks (a)</b>         | 1,084      | 1,627      | 2,071      | 2,214      |
| Domestic Banks                               | 1,046      | 1,585      | 1,857      | 2,000      |
| Bank of Ceylon                               | 341        | 390        | 455        | 496        |
| <b>People's Bank</b>                         | <b>343</b> | <b>602</b> | <b>653</b> | <b>679</b> |
| Commercial Bank of Ceylon                    | 81         | 140        | 177        | 179        |
| Hatton National Bank                         | 120        | 150        | 177        | 182        |
| Sampath Bank                                 | 39         | 84         | 115        | 137        |
| Seylan Bank                                  | 90         | 114        | 114        | 114        |
| Other (b)                                    | 32         | 105        | 166        | 213        |
| Foreign Banks                                | 38         | 42         | 214        | 214        |
| Population per Bank Branch                   | 6,642      | 5,293      | 4,369      | 4,201      |
| Commercial Bank Branches per 100,000 Persons | 5.7        | 8.3        | 10.2       | 10.8       |
| No. of Commercial Banks                      | 26         | 22         | 22         | 22         |
| Domestic Banks                               | 10         | 11         | 11         | 11         |
| Foreign Banks                                | 16         | 11         | 11         | 11         |

(a) Includes main branches and other extension banking offices except Pawning Centres, Student Savings Units and mobile banks

(b) Includes Union Bank of Colombo Ltd., Pan Asia Banking Corporation Ltd., Nations Trust Bank PLC, National Development Bank PLC and DFCC Vardhana Bank Ltd.

Source: Central Bank of Sri Lanka, (2010c).

**Table 3: Number of State Bank Branches by Province by end 2009**

| Item           | Western | Central | Southern | Northern | Eastern | North Western | North Central | Uva | Sabara gamuwa | All Island |
|----------------|---------|---------|----------|----------|---------|---------------|---------------|-----|---------------|------------|
| Bank of Ceylon | 134     | 58      | 55       | 36       | 41      | 47            | 40            | 37  | 45            | 493        |
| People's Bank  | 203     | 90      | 83       | 32       | 53      | 72            | 44            | 45  | 57            | 679        |
| Total          | 337     | 148     | 138      | 68       | 94      | 119           | 84            | 82  | 102           | 1,172      |

Source: Central Bank of Sri Lanka, (2010c).

mobilisation in the face of external shocks and challenging domestic macroeconomic conditions (CBSL, 2010a).

### The Role of the People's Bank

This year, the People's Bank (known as the Pulse of the People), which was established on 1 July 1961, completes 50 years of valuable service to the nation. It is a licensed commercial bank established under the Banking Act No. 30 of 1988. The setting up of the People's Bank gave an entirely new dimension to banking activities in Sri Lanka. By statute, the purposes of the Bank shall be "to develop the co-operative movement of Ceylon, rural banking and agricultural credit, by furnishing financial and other assistance to co-operative societies, approved societies, cultivation committees and other persons" (People's Bank Act No. 29 of 1961, Section. 4).

As stated, the Vision of the Bank is to be the Bank of the aspiring people of Sri Lanka, empowering people to become value creating, competitive and self-reliant. The Mission of the Bank is to take pride in providing an excellent service for customers in the most caring, responsive and professional manner; generate benefits for the national economy whilst being independent and commercially viable; and create opportunities for employees to benefit from their high performance by becoming value-creating, skilled, self-confident and professional individuals who are also team players (People's Bank, 2009).

The People's Bank pursued an aggressive branch expansion

programme from the beginning, bringing the total number of its branches to 100 within a decade in 1971 and expanded to 300 in 1982. In 1993, the total number of bank branches stood at 330. Today, People's Bank has the largest branch network of over 680, covering all provincials of Sri Lanka (Table 3) and over 12 million strong customer base. The total number of employees stood at 8,863 at the end of year 2009 (People's Bank, 2009). In 2010, 266 branches and 283 service centres totalling 549 were online and interconnected to provide fast and easy service to the nation. Bank's ATM network 330 in numbers in 2010, serve the people 365 days 24 hours in all 24 districts of the country. The Bank also has its expansive correspondent banking network numbering 300 in over 105 countries.

Historically, the People's Bank has been one of the domestic banks that have consistently provided its services to people in the most remote areas of the country. The Co-operative Rural Banks (CRBs) scheme, which focused mainly on meeting the specific needs of rural households, was inaugurated in 1964 with the help of the People's Bank. At the initial stages, the accounting and financial systems of CRBs were supervised by the Bank and as a consequence, the People's Bank introduced micro-credit to rural communities.

In 1967, the Bank commenced a new Agriculture Credit Scheme, becoming the pioneer lender to the small farm sector. The Comprehensive Rural Credit Scheme (CRCS) was launched in 1973 to provide both consumption and production credit facilities and

continued to function as the major source of institutional credit to the rural sector. The New Comprehensive Rural Credit Scheme (NCRCS) was introduced in 1986 with several new features and strategies for lending in rural areas for agriculture. One of the objectives at that time was to bring down the transaction cost of credit to small borrowers. The Bank also extended its credit facilities to small-and medium-scale enterprises and industries (such as agriculture, agro based industries, self-employment category industry, trade and services) under the Poverty Alleviation Micro Finance Project (Revolving Fund) refinanced by Central Bank of Sri Lanka and Poverty Alleviation Small Enterprise Development Loan Scheme Refinance by National Development Trust Fund.

The People's Bank Provides credit facilities to entrepreneurs who are being trained and introduced by the 'Vidatha Resource Centers' by the Ministry of Science and Technology under the Vidatha Loan Scheme (Technology to the Village), to uplift the economic level and skills of the rural people. Also, the Bank implements 'Vanitha Navodya' loan scheme - under the sponsorship of the Ministry of Child Development and Women's Empowerment and financial contribution from the United Nations Development Fund for Women (UNIFEM), for women who faced with economic difficulties due to natural disasters (as flood, landslides, typhoons, hurricanes etc.), and due to the war - like situation prevailing in certain areas in Sri Lanka. Table 4 shows the micro-finance and other Government- directed loans and advances of the People's Bank.

**Table 4: Government Directed Loans & Advances of the People's Bank 2008-2010**

|  | 2008<br>(Rs.'000) | 2009<br>(Rs.'000) | 2010<br>(Rs.'000) |
|--|-------------------|-------------------|-------------------|
| Microfinance                                 | 285,583           | 237,694           | 307,725           |
| Agriculture and other development loans      | 1,647,661         | 1,142,836         | 2,356,863         |
| Housing loans granted to government servants | 9,364,049         | 9,521,640         | 14,646,427        |

Source: People's Bank, (2009, 2010).

The People's Bank has introduced various specialised services, such as savings accounts, current accounts, fixed deposits, foreign currency accounts, business, personal and home loan facilities, leasing facilities, and credit card services to exclusively cater to high-net-worth customers. The Bank offers innovative savings schemes for infants (*Nidahase Upatha* and *Isuru Udana*), children (*Sisu Udāna*)<sup>1</sup>, school leavers (Yes Future Stars), young executives (YES), women (*Vanitha Wasana*), senior citizens (*Parinatha*), pensioners (*Visrama Suvaya*), Government sector health personnel (*Suwa Sevana*), internet banking users (AMEX), home dreamers (*Jaya Nivasa*), Self-

employed people (*Surathura*), agriculturists (*Aswenna*), and migrant workers (*Videshika*), teachers (*Guru Setha*) with a host of facilities, which can be customised to suit the individual needs of the account holders. The Bank also provides exclusive financial facilities under various projects such as *Uturu Wasanthaya*, *Nagenahira Nawodaya* and 'Reawakening of the North' to rebuild shattered livelihoods of the People in North and East of the country.

#### Assets and deposits structure

The People's bank holds the second largest asset base in the industry.

As shown in Table -5, the total assets of the Bank recorded a significant growth of 15% in 2010 which ended at Rs. 547 Bn, as compared to the growth of around 14% in the banking industry. This could be attributed to the significant growth of 27.4% in investments, which accounted

**Table 5: Composition of Assets of the People's Bank in 2009 and 2010**

| Item  | 2009<br>(Rs. Mn) | 2010<br>(Rs. Mn) | Change % |
|---|------------------|------------------|----------|
| Cash in Hand                                    | 8,975            | 8,997            | 0.2      |
| Balance with Central Bank                       | 22,717           | 26,739           | 17.7     |
| Due from banks and other financial institutions | 41,356           | 37,359           | 9.7      |
| Investments                                     | 95,729           | 96,653           | 27.4     |
| Loans and Advances (net)                        | 283,760          | 357,336          | 25.9     |
| Other Assets                                    | 23,708           | 20,532           | 23.0     |
| Total Assets                                    | 476,245          | 547,616          | 15.0     |

Peoples Bank, (2010).

**Table 6: Composition of Liabilities of the People's Bank in 2009 and 2010**

| Item                     | 2009           | 2010           | Change %    |
|--------------------------|----------------|----------------|-------------|
| <b>Total Deposits</b>    | <b>396,157</b> | <b>462,140</b> | <b>16.7</b> |
| Demand                   | 37,352         | 40,617         | 8.7         |
| Savings                  | 174,735        | 203,003        | 16.2        |
| Time                     | 181,259        | 215,107        | 18.7        |
| CD & Others              | 2,811          | 3,411          | 18.7        |
| <b>Total Borrowings</b>  | <b>41,884</b>  | <b>44,132</b>  | <b>5.4</b>  |
| Other Liabilities        | 20,403         | 20,505         | 1.0         |
| <b>Total Liabilities</b> | <b>458,445</b> | <b>526,777</b> | <b>14.9</b> |

Source: People's Bank, (2010).

for around 20 percent of the total assets by the end 2010. Meanwhile loans and advances, which represented the major portion of around 65% of the

Bank's assets, also displayed a significant growth of nearly 26% in 2010. At the end of 2010, the Bank had loans and advances (net) exceeding Rs. 357 Bn. as against Rs. 283 Bn. as at end 2009, an increase of 24 percent over 2009.

Deposits continued to be the main source of funding of the Bank accounting for 88% of total liabilities. The value of total deposits of the Bank increased by 17% surpassing Rs. 462 Bn in 2010, which was significant when compared to the 22% increase totalling 396 Bn increase in 2009, (People's Bank, 2010). The total increase in deposits was directly influenced by the growth in rupee Savings Deposit base by 16%, which ended at Rs. 203 Bn, despite intense competition from other commercial banks and term deposit demand driven by high yields. The rupee-Fixed (Time) Deposits which represent a significant portion of the deposit portfolio grew by 19 percent over 2009, ended at 215 Bn in 2010. Demand account balances closed at Rs. 40.6 Bn contributed primarily by the expansion of its branch networks. Current and savings accounts over total deposits averaged at 53% to total deposits in 2010 when compared to the average of 54% in 2009. The structure of deposits has given in the Table 6.

At the end of 2010, the growth of loans was mainly in respect of the pawning, construction, trade, other services sectors, and agriculture and fishing with annual growth of 34%, 19%, 18%, 10% and 8% respectively (Table 7). The Pawning business has grown to become an integral part of the loans and

advances sector of the Bank. Currently, People's Bank is the market leader in pawning and the most preferred and sought-after pawning service provider. According to the Bank 'this business yields good returns and is a major contributor to Bank's bottom line in addition to being very capital efficient,' (People's Bank, 2009).

The growth of credit to the services sector (including trade) and manufacturing sector was in line with the improved performances of these sectors in GDP, where the services sector grew by 59% and the manufacturing sector by 16% in 2010.

It is noteworthy that the share of total loans to the agricultural sector is less than 8%, demonstrating the Bank's lack of enthusiasm for lending to the agriculture sector. It is believed that one of the major reasons for the poverty is a low accessibility for credits by rural poor. Although there are inherent inefficiencies and vulnerabilities that have made the agriculture sector risky and costly, as a State bank, it is a responsibility of the Bank to help and restore the confidence in the minds of rural farmers by providing more accessibility towards credit and other facilities.

#### Capital adequacy

People's Bank has continuously increased its Capital Base (combination of Tier I & Tier II Capital as approved by CBSL under Basel I & II) with maximum ploughed-back earnings, capital from the Government and two

**Table 7: Sector-wise Credit Exposure of the People's Bank in 2009 and 2010**

| Sector                          | 2009<br>Rs. Mn. | Composition<br>% | 2010<br>Rs. Mn. | Composition<br>% |
|---------------------------------|-----------------|------------------|-----------------|------------------|
| Agriculture and Fishing         | 34,442          | 11.5             | 29,204          | 7.9              |
| Manufacturing                   | 21,912          | 7.3              | 20,014          | 6.2              |
| Tourism                         | 4,287           | 1.4              | 3,200           | 0.9              |
| Transport                       | 257             | 0.1              | 356             | 0.1              |
| Construction                    | 55,687          | 18.6             | 71,725          | 19.3             |
| Traders                         | 50,551          | 16.9             | 65,443          | 17.6             |
| Financial and Business Services | 5,344           | 1.8              | 4,375           | 1.2              |
| Infrastructure                  | 605             | 0.2              | 254             | 0.1              |
| Other Services                  | 25,572          | 8.6              | 38,307          | 10.3             |
| Credit Card                     | 875             | 0.3              | 834             | 0.2              |
| Pawning                         | 97,534          | 32.6             | 133,299         | 35.9             |
| Other                           | 2,011           | 0.7              | 1,792           | 0.4              |
| Total                           | 299,077         | 100              | 371,804         | 100              |

Source: People's Bank Annual Report, (2010).

debt issues to the value of Rs. 5 Bn. In keeping with the agreement signed between the Government of Sri Lanka, ADB (Asian Development Bank) and the People's Bank, the Ministry of Finance injected capital to the Bank as four tranches of Equity Capital Investment of LKR. 2 Bn, Rs. 1 Bn, Rs. 1.5 Bn and Rs. 1.5 Bn for the years 2005, 2006, 2007 and 2008 respectively based on the capitalisation plan and on the conditions of People's Bank achieving certain performance targets and key performance indicators. These strategies together with retained

**Table 8: Selected Performance Indicators of the People's Bank, 2009-2010**

| Indicators  | 2009 | 2010 |
|---|------|------|
| Total Capital Adequacy Ratio (Minimum Requirement 10% ) | 13.4 | 12.8 |
| Tier 1 Capital Adequacy Ratio (Minimum Requirement 5% ) | 7.7  | 7.9  |
| Gross NPL Ratio (%)                                     | 6.6  | 5.0  |
| Return on Assets (%) - (Before Tax)                     | 1.4  | 1.7  |
| Return on Equity (%) - (After Tax)                      | 19.7 | 26.9 |
| Capital Adequacy Ratio (%)                              | 13.4 | 12.8 |
| Statutory Liquidity Ratio (DBU)                         | 29.9 | 23.4 |

Source: Peoples Bank, (2010).

earnings for the year 2009 of Rs. 1.9 Bn and the marginal growth in risk-weighted assets during the year, have enabled the Bank to reach a Capital Adequacy Ratio (CAR) of 12.8% by the end 2010 compared to 13.4% in 2009 (Table 8). This ratio was above the

**Table 9: Selected Financial Highlights of the People's Bank 2009 - 2010**

| Item                            | 2009<br>Rs Mn. | 2010<br>Rs Mn. | Change<br>% |
|---------------------------------|----------------|----------------|-------------|
| Gross Income                    | 69,049         | 62,532         | 9.4         |
| Total Interest Income           | 62,341         | 56,534         | 9.3         |
| Total Interest Expenses         | 38,414         | 30,635         | 20.2        |
| Net interest income             | 23,926         | 25,898         | 8.2         |
| Total other income              | 5,331          | 4,939          | 9.4         |
| Non Interest Income             | 5,332          | 4,939          | 8.2         |
| Non Interest Expenses           | 16,879         | 17,670         | 4.7         |
| Profit before Taxation          | 6,076          | 8,771          | 44.4        |
| Profit after Taxation           | 3,320          | 5,206          | 56.8        |
| Operating profit for the period | 3,320          | 5,206          | 56.8        |

Sources: Peoples Bank, (2009, 2010).

statutory requirement of the CBSL. This is a remarkable achievement given that this ratio was negative or below 10% a few years ago.

Compared to the banking industry's Non- Performing Loan (NPL) ratio which stands at just under 9% in 2009, People's Bank's NPL remains below this average at 5.5%, in 2010 compared to 6.7% in 2009. The Bank's NPL coverage ratio is over 70% compared to less than 50% in the industry (People's Bank, 2010). Overall, the Bank achieved the highest recorded profit before tax of Rs. 8.8 Bn 2010 compared to Rs. 6.1 Bn in 2009; a 44.4 % increased, certainly a great achievement given the extreme market conditions. Profit after tax is posted at Rs. 5.2 Bn, an increase of nearly 57% from the 2009 figure of Rs. 3.3 Bn. Net Interest Income was recorded at 8.2 % growth amounting to Rs. 25.9 Bn, despite a reduction in lending rates during the year and the challenging macro environment (Table 9).

### **Achievements**

As one of the most transparent and accountable financial institution in the South Asian region, People's Bank received a SAFA (South Asian Federation of Accountants) award for the 2008 Annual Report for the first time in the Bank's history, competing with several well-known public sector entities from countries including Pakistan, India, Nepal, Bangladesh and Sri Lanka underlining its commitment to upholding highest standards. The Bank also received SAFA award for the first place in the Public Sector Category for the 2009 Annual Report.

The People's Bank won the popular SLIM (Sri Lanka Institute of Marketing) Brand Excellence Awards - 'Services Brand of the Year 2009 (Gold Award)' award for the first time by the Sri Lanka Institute

of Marketing and the People's Award for the fourth consecutive year in the Banking and Financial sector at the People's Awards in 2009, in recognition of its services to accomplish the social responsibility and in uplifting the lives of Sri Lankan people. The Bank also won the People's Service Brand of the Year 2010 Award presented at the SLIM Nielson People's Awards for the fifth consecutive year.

Moreover, the Bank's Core Banking initiative won the Best Core Banking Implementation and Deployment Award for South Asia and the Middle East from Silverlake and IBM at the Banking Technology Summit held in Perth, Australia in 2009.

These achievements enabled the Bank to boost its rating during the year 2010, raising its position to AA- (positive) from A (stable) by Fitch Rating Lanka Ltd, further augmented by AAA rating by RAM Ratings Lanka Ltd, reflecting Bank's strong financial profile in terms of capital base, profitability and assets quality.

### **Innovations**

The array of financial products and services and delivery channels of the Bank broadened with the introduction of new schemes and Information and Communication Technology (ICT)- based products and services, such as internet banking, mobile phone banking (joining with Dialog Axia), Palm Top banking and SMS banking. Core-Banking system was further extended across the branch network, increasing the total number of interlinked branches to 461 in 2010. This was an innovative way of providing quick access to urgently-required banking facilities in a far lesser time than a conventional branch. There was a

significant shift towards card-based payment modes and ATM facilities. With these innovations, Bank can be developed customer relationships and service standards together with improvements in delivery timing.

### **Challenges Ahead**

The financial liberalisation and continuous deregulation has made the financial market in Sri Lanka extremely competitive with greater autonomy, and operational flexibility. At the same time, globalisation of domestic banks has also been facilitated by tremendous advancement in information and communications technology. In the future, banking will be driven more of technology and telecommunication systems. These increased convergences present great opportunities for banking institutions to broaden their activities over potential markets. Therefore, the banks who understand the market dynamics, perceive threats, anticipate volatility, show high degree of professionalism and dynamism in their functioning and respond promptly to the market needs would sustain and prosper.

Given the new environment, the State banks in Sri Lanka can't remain unaffected by the changes round and challenges before them. Therefore, State banks need to restructure themselves by benchmarking of service standards to improve competitiveness and productivity. Moreover, the State banks must improve the capacity and qualifications of officials and experts and renovate working methods and business thinking and expanding its capital scale to improve the quality of services and business efficiency.

Although the People's Bank has shown impressive financial performance over the last several years, it is indeed important to take several steps to improve the competitiveness and efficiency of the Bank to meet the future challenges and continue the market leadership. The enhancement of customer service; introduction of innovative and diversified products, application of advanced technology; implementation of Basel II; improvement of risk management systems; implementation of new accounting standards; enhancement of transparency & disclosures; and compliance with KYC (Know Your Customer) aspects are a few broad challenges faced by the Bank today. These challenges require the Bank that has its own dynamism and agility to respond proactively to the changing requirements of the economy, as it stands on the threshold of completing the golden jubilee. Thus, the vision, mission, innovations, and social commitments of the People's Bank can convert these challenges into opportunities.

In addition, the excluded segments of the population require products which are customized, taking into consideration their varied needs. Their banking requirements being small, the issue of servicing and delivery in a cost-effective manner assumes significance.

At the same time, the State banks in Sri Lanka need to go further to improve their efficiencies to bring them up to the standard of international financial markets. Therefore, both the public and private sector banks should be fully prepared to face the new global standards referred to as Basel III which will be implemented in phased manner over 5 years from 2013.

## Conclusions

The Sri Lankan banking industry has experienced structural changes over the last four decades, as a consequence of deregulation of the financial services sector. The reforms aimed to enhance both the productivity and efficiency and the degree of competition of financial market. The State banks have long been the backbone of the Sri Lanka's banking system. Since their inception, they have served as a driving force behind the growth of small to medium businesses from major cities to rural outposts across the country. During the past fifty years, the People's Bank has evolved and undergone various changes based on the economic and social needs of the people and forces of economic development in Sri Lanka. Today, the People's Bank has emerged as a dynamic and fast-growing bank with a firm financial stability, and a leading market share. Supported by the latest technology, the Bank has made rapid strides in product innovation and delivery, thereby improving quality of customer service. The stronger capital positions, prudent retention of earnings and improved risk management systems supported by an enhanced regulatory and supervisory framework, has placed the Bank on a stronger footing to absorb the impact of the global economic slowdown.

Nevertheless, enhancement of customer service, innovations in technology, improvement of risk management systems, and diversifying products are necessary to maintain the market leadership of the Bank. Since access to finance has been seen as a critical factor in enabling people to transform their production and employment activities and to exit

poverty, the Bank needs to look towards the vulnerable and other excluded sections of the population as bankable, reconciling economic efficiency with social equity. And that is the key challenge.

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## Footnote:

1 *Sisu Udana* is one of the most successful student-oriented products of the Bank conceptualised to reach beyond the conventional banking ethos. The scheme enfolds the lives of over two million children, resulting in a notable mobilisation of Rs. 3 Bn during the year 2009. ■