



Arjun Fernando, CEO - DFCC Bank

ON A TRANSFORMATIONAL PATH

DFCC Bank has been the pioneering development bank in Sri Lanka. Having supported industries and entrepreneurs for more than 60 years, the Bank amalgamated with its commercial banking subsidiary Vardhana Bank and now provides the full gamut of financial services to its customers. Today, DFCC is both a development and commercial bank. Arjun Fernando, CEO comes with an overall wealth of experience including international banking exposure.

He is also a national sportsman having excelled at tennis where he is to date the highest ranking Sri Lankan tennis pro, having been ranked at 220 in the world in 1980. At the young age of 15, Arjun Fernando was the youngest Sri Lankan to win a Davis Cup match. He captained the Island's Davis Cup team, where the country's team performed exceptionally well against the Asian giants. A practice match between Jimmy Connors during his college days in the US taught him the important lesson that to achieve what you want you always need to have the competitive instinct and drive. This has stood him well in his banking career where he has been able to lead DFCC Bank on a transformational path.

By Udeshi Amarasinghe | Photography Mahesh Bandara and Menaka Aravinda

Established in 1955, DFCC Bank is one of the oldest development banks not only in Sri Lanka but in Asia. Can you tell us about the journey of the Bank?

DFCC Bank was established following World Bank recommendations on a Private-Public Partnership (PPP) model, which was unique. DFCC Bank was never a 100 percent Government owned entity due to this World Bank model. The success of DFCC is that it has evolved over 60 years adapting to the changing business environment without adhering to the old business model. Over the years, DFCC has evolved into a financial services group. In 1990, the DFCC Bank was a sponsor of National Asset Management Limited, the first Unit Trust Management company in Sri Lanka. In 1992, DFCC entered into a unique PPP model with the Government to set up and operate an Industrial Park in Sapugaskanda. This enterprise - LINDEL remains one of the most successful public-private partnerships in the country. In 2003, DFCC acquired and rebranded MERC Bank as DFCC Vardhana Bank. Vardhana Bank was one of the fastest growing banks in Sri Lanka and was amalgamated with DFCC in 2015. In 2004, in order to harness its project financing skills, DFCC formed DFCC Consulting. The company has undertaken several assignments locally and

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overseas, especially in the field of Renewable Energy and is regarded as a specialist in the field of Renewable Energy. In 2006, it was decided to form Synapsys, an IT subsidiary to get into the growing FinTech industry. The company has both Sri Lankan and international footprint having deployed the core banking solutions in the Solomon Islands and other FinTech solutions in Fiji and Cambodia. In 2008, DFCC and HNB formed Acuity Partners which is a 50:50 joint venture. Acuity Partners is a fully integrated Investment Bank offering the full range of capital market and corporate finance services.

It would be noted DFCC Bank has been more than a development bank and has evolved with changing market conditions and customer requirements over the years. Therefore, I would say that DFCC Bank is now one of the leading financial services conglomerates in Sri Lanka.

The Bank was established to drive development through the private sector participation, how has DFCC fulfilled this role over the years?

If you look at the major industries, such as telecom, tourism, apparel or renewable energy we have been the first to support the pioneers. Today, many of them are successful, large companies in their respective sectors.

This is the case even in the smaller industries. When I travel across the DFCC Bank network it is very gratifying to see businesses that had received their first loans from DFCC Bank during their pioneering stages, now doing well.

What are the key sectors that the Bank focuses today?

Although we have become a commercial bank, we have not given up our focus on project finance and we will continue to support projects especially those in pioneering sectors. This is how we differentiate ourselves from other commercial banks. While we are now a fully-fledged commercial bank we will continue to engage in development project financing. While the mix between project financing and commercial banking is being maintained, it will be a challenge for the bank to continue this combination. Earlier there were funding lines that supported long-term lending. However, as Sri Lanka moves into the Middle Income category those concessionary funding lines are increasingly scarce. Therefore as a commercial bank we are garnering our deposits to fund some of these long-term projects. At the same time, there are funding lines from, for example, organizations such as the European Investment Bank who regard DFCC as a preferred partner for disbursing credit lines in Sri Lanka. We have a similar association with other multi-lateral agencies such as the Asian Development Bank, KfW, DEG, FMO and Proparco. However, unlike in the past, when credit lines were available at concessionary rates, funding lines are now increasingly based on commercial market rates.

Can you tell us about the significance of DFCC Bank becoming a commercial bank as well?

The traditional Development Finance Institution (DFI) model can only be sustained by being 100 percent Government owned and funded as well. Evolution of this model are seen in institutions such as ICICI Bank in India and DBS Bank Singapore, where the original development finance enterprise has merged or expanded into commercial banking while focusing on the long term lending. The DFCC Vardhana Bank, our commercial banking subsidiary was run as a separate legal entity for over ten years. During this period, we ensured that the operational functions of the two banks were merged. Therefore, while we

operated as two Banks, the credit, treasury and HR functions of the two entities were merged. Eventually, in order to gain the full synergy of the separate entities, the two Banks needed to become one. That is the reason we made the transition to a commercial bank.

Can you tell us about the performance of DFCC Bank?

Our 2016 results indicate that we have grown our profits by up to 60 percent since the amalgamation. An important fact is that, as this profit growth is driven by our core banking business, unlike in the past where in certain years profits were also due to the exceptional capital gains from the sale of shares. At the same time, the Non Performing Loans have decreased significantly owing to a renewed focus on credit quality. Looking at the entire Bank, there are more synergies to be harvested. This will improve our cost-to-income ratio, which is the lowest in the banking industry and further drive our profitability. While we have got our operational costs under control, we can do more with our cost of funds.

One challenge for us at the moment is the CASA (Current Account and Savings Account Deposits) component in our funding base, which is around 20 percent, compared to 30-40 percent in the commercial banking industry. The relatively low CASA component is a legacy of our development banking model where the bulk of lending was supported by concessionary credit lines from multi-lateral institutions. Following the amalgamation of DFCC Bank and Vardhana, this ratio will increase and drive down our cost of funds. Overall, in terms of numbers, we are happy with what we have achieved in 2016.

To support the transition of the Bank from a development bank to a commercial bank we are investing greatly on our brand.

In the past, DFCC was looked upon as a project financing bank and our customers were mainly borrowers of long term loans. But now, it is imperative that we to look at increasing our deposits. Accordingly, we have rebranded DFCC to appeal to the investing public and this has materialized in an improved CASA ratio.

Our key resource is our employees. We are investing in several HR initiatives to ensure a greater engagement between the employee and the bank. This has been successful and borne out by the performance achieved by the Bank.

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What can you tell us about the branch network of DFCC?

Currently, the Bank has a network of 138 branches, out of which 43 are post office units. This is a unique strategy as the post office unit provides a low cost entry into that particular location. Generally, the post office units do not provide the full range of banking services, but what we are doing currently is converting these postal service units to fully-fledged DFCC Bank branches. We opened about ten branches in the last few months and are looking to add another 40 branches in the near future. We are also looking at digital banking as a way to increase our customer base as well as to compete with other commercial banks that have much larger networks. Digital banking is the key to compete with the big players and although traditional brick and mortar networks are still required, technology savvy customers are increasingly converting to electronic banking.

How important is it for Sri Lanka to have banks such as DFCC?

The presence of institutions such as DFCC Bank is important, especially from a long term financing perspective and even as a provider of capital to pioneering ventures. This is what DFCC has contributed in terms of developing several industrial sectors of the Sri Lankan economy. Generally at the entrepreneur stage, DFCC has taken the startup risk, which would deter most funding institutions. However, in most instances what we are seeing today are banks funding businesses for which DFCC took the initial risk. This is the rationale for DFCC to transit to a commercial bank whereby it could fund a whole suite of corporate and personal needs.

DFCC Bank has been able to transform itself into a multi-product and robust financial institution according to the changing requirements of the customer. How was this achieved?

There are several factors that supported the transformation of DFCC Bank into a multi-product financial institution. I believe that most important was the fact that the staff in the two Banks were willing to embrace change. For instance, while DFCC Bank staff had the development banking mentality, they realized that transition had to take place to ensure the future of DFCC as a profitable as



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well as robust institution. In fact, they saw that the change of moving to commercial banking would extend the Bank's product range and services while retaining a focus on project financing. Senior management also embraced this change as they realized that the development banking model needed to be adapted to the changing market requirements. As the CEO of DFCC, I needed to manage this transition, and my background in international banking where I handled organizational change, was most advantageous. One example that DFCC is now a multi-product financial institution is Bancassurance, which we offer in partnership with AIA. This is an example where an existing customer base is utilised to sell other financial products which also add fee income to the Bank. It is also an example that the sale of traditional banking products have to be supplemented with ancillary products.

What about DFCC's involvement with the state sector?

DFCC Bank has funded some of the road and water projects undertaken by the Government



agencies such as the RDA and National Water Supply and Drainage Board. In such cases, the lending is supported by a guarantee from the Treasury. Taking into account the magnitude of such funding, most of this lending is in the form of syndicated loans. And a critical aspect for such lending is the project has to have a positive social and economic benefit. However, there are credit limits for certain sectors within which we operate.

What are your thoughts on the banking industry in Sri Lanka, what more can be done?

In my personal view, and not necessarily that of DFCC, there are too many banks in Sri Lanka. Some form of consolidation needs to take place and I understand that the Government is thinking along the same lines. My view applies not only to the banking industry but also to other service sectors such as the country's hospitality trade. The underlying rationale for my belief is that there is always an optimum number where the distribution as well as profitability are balanced. If this number is surpassed and the balance disturbed, it will result in an oversupply situation leading to marginal enterprises folding up due to lack

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of sustainability and other players coming under increased stress.

In the past, interest margins have been good. However, the situation is different today, where margins are coming under increasing pressure for various reasons. The situation is compounded by increasing network, compliance and other costs, which are difficult to keep under control.

Therefore, talking from a forward looking perspective, consolidation in the banking industry is a must. While many think that it is just a cost cutting exercise, the idea is that you generate more business from realizing synergies. In other words, it is a case that the sum of the parts is greater than the whole. This has been our experience with Vardhana Bank where the increased revenue from the amalgamated entities was more than the savings from synergies.

Can you tell us about yourself?

I completed my tertiary studies in the USA where I was fortunate to be awarded a tennis scholarship when I was 16 years old. The reason for looking overseas was the fact that I wanted an opportunity to combine studies with sports. I was ranked as the number one tennis player in Sri Lanka at that time, and I would not have been able to maintain my tennis prowess had I stayed in Sri Lanka. The good thing about the system in the US, is that you can continue your studies while you practice your sport at a serious level. College tennis in the US is the next stage before entering the pros and I gained a lot in terms of Tennis technique in the College circuit.

I completed my Bachelor of Engineering in 1979. I then started playing in the professional circuit and entered the world ranking. Sadly, I injured my knee and had to undergo surgery and had to withdraw from pro tennis. At that time, I decided to do my Masters, and again thanks to tennis, was appointed the assistant coach of my university, which meant that I received funding for my Masters course. When I had completely recovered from my injury I tried to play pro tennis again, but once you lose that edge it is difficult to make a comeback.

In 1984 I joined HSBC as a management trainee. Although I worked at HSBC for 28 years, it seemed like I worked for five different firms. At the time I joined HSBC, the bank was very small compared to what it is today. However, they grew mainly through various acquisitions including that of Midland Bank in the UK. Also, the strategies

implemented over the 28 years by the various Chairmen and CEOs were quite different.

I was also posted overseas, in Hong Kong and Bangladesh. In fact in my 28 year career, eight years was spent overseas. I was also quite fortunate because at that time we were rotated to various positions, which gave me exposure to many different functions and operations. During my last stint in Hong Kong in 2012, I received the offer from DFCC to come back and take over the CEOs position from Mr Nihal Fonseka. I first came in as Deputy CEO and assumed the post of CEO when Mr Fonseka retired in 2013.

You were a national tennis player, and also represented the country in the Davis Cup. What can you tell us about this experience?

Yes, the Davis Cup was in fact a very special event for me; while tennis is an individual's sport the Davis Cup is a team event. I captained the Sri Lanka tennis team and the experience of inculcating a team spirit among the players and competing for the country was very special. Our team had some memorable wins including the contest with Taiwan where I had to play the decider. I also took part in two Asian Games and SAF Games representing Sri Lanka. I was the overall captain of the SL team for the 1986 Asian Games and when you are selected as a team captain whatever the sport, it is very special. These are fond memories.

Tennis has greatly evolved and now you can no longer be a part time player to compete at a serious level. You have to invest in the sport full time spending at least six hours a day starting from a very young age. In fact in many cases, serious players actually forego the school environment and must continue in their studies through home schooling. For Sri Lanka this is a major mindset change for parents to get into an arrangement like that. This is where our players are at a disadvantage because others across the world, devote a lot more time to the sport.

We have great talent at a very junior age; but however to develop this talent requires great sacrifices given the level of dedication required to compete at a serious level. Now we see some emerging players who are going overseas and getting the required exposure. From my personal experience there should be more, unfortunately affordability is also a determining factor in terms of sport.

The message Jimmy Connors gave me that day was "How does a small punk like you dare to ace me when I am number 1 in the world?" Killer instinct cannot be just 'turned on' be it in sports or business and it needs to be developed as part of your DNA.

Message to Sri Lankan tennis players?

I am a firm believer that hard work and perseverance is what is required, not only in tennis but in life as well. One of the areas of concern, which I have observed amongst the youngsters today is the way that they practice. The other day I saw a young girl practicing with headphones on. I went to her and said that when you play in a competition you do not have your headphones. Therefore, you must practice as if you are playing a match. You cannot just think that you will be able to turn your game on only during a match, it should be second nature. You not only need to have the will to win, but you need to prepare to win.

The university in which I studied in the US was located in the home town of Jimmy Connors. He would come and play with the college team when visiting his mother. When he played, all the club members came to watch him. One day I had the fortune of playing with him and I happened to hit two aces down the middle. In annoyance, he pulled down his pants and exposed his bum to me. The message Jimmy Connors gave me that day was "How does a small punk like you dare to ace me when I am number 1 in the world?" That was the day I realized the level of intensity he had even in practice. It is not that easy to convert that into life and as Asians I think we are too nice and at times lack the killer drive. Killer instinct cannot be just 'turned on' be it in sports or business, and needs to be developed as part of your DNA. In fact, I believe that we lost the T20 World Cup because we were too relaxed when we were on top.

I remember the Sri Lankan captain saying that even if the West Indies were to get 130 runs, Sri Lanka could win. The West Indies were 100/8 and Sri Lanka was in good position. However, the last pair scored more than 30 runs and Sri Lanka could not chase that score. The Australians or any other country would have driven hard and limited the West Indies to at least 110 runs. Those are the things you see from the West, where real killer instinct prevails.

How have you drawn from your experiences as a sportsman to your position as CEO?

Sport has been the key differentiator for me when I look at my role. As a CEO you are under pressure, but having played sports you know how to deal with it. Team sports enable you to get the maximum out of people. I feel that when I look at

my career there have been times when I have had to really go that extra mile to clinch something.

Tennis has helped with networking as well. When I am with company, it is much easier to break the ice and also get business since they know that I am a sportsman. In fact, leadership styles and traits are developed when you participate and compete in sports.

I am a firm believer in the team as well as I believe people below me should be recognized when they deliver. My philosophy as a CEO is that my role is equivalent to that of a football coach or a conductor of an orchestra; that is to get the right people as well as motivate them to deliver. Today the banking industry and financial services sector are quite complex, so if you do not have the knowledge or skills in any area or are unable to hone in on the right skills to deliver, it will be a challenge.

How important is it to have an overall experience?

In my view, having an international exposure is an enlightening experience. It forces you to think quite differently and often outside the box. Sometimes in Sri Lanka you are in a comfort zone and you focus only on one market. Yet, the banking environment is changing quickly and I believe consolidation is a must. However, not much has happened in this area, as banks have grown organically. Therefore, the question that is asked mostly in Sri Lanka is why do you need to consolidate when you are showing growth. On the other hand, I have seen large banks such as HSBC and Standard Chartered Bank, retrenching and cutting jobs although they have been growing. Therefore, when you have to deliver on profits, pure growth is not a priority. Sustainable growth needs to be strived for.

Overall experience helps while having knowledge in the industry is key. It is not just bricks and mortar banking today, and the area that we all need to develop in is in terms of digitalization, which is happening across the industry. For instance, if you consider commercial banking, payment was the bread and butter of the industry. However today, telcos are fast eating into the payments market and the banks are losing out. Therefore, you need to strategize as to how you retain a part of it.

The current banking business model is ripe for change. I am a firm believer that what was successful in the past is not always going to be successful going forward.

Future plans?

DFCC's major challenge last year was to go through its amalgamation with Vardhana Bank and ensure that the synergies have been well-garnered. I now believe that the best days of DFCC are ahead as the Bank will build on the amalgamation momentum and ride on a wave of organic growth. At the same time, we will consider other opportunities as well. We have a valuable resource in the form of our 15 per cent stake in Commercial Bank. That capital, if realized, can be utilized into some other type of investment. In fact, the Board is looking at other ways besides organic growth to drive DFCC. In this context, several strategies have been put in place. For instance, Consumer Banking is an area which we will grow. This strategy will be underpinned by our premier banking proposition. We will also continue to look at expanding our SME banking to the microfinance sector. Cost optimization programmes and service level enhancement programmes are ongoing.

Message to the industry?

It has been a successful journey and we have made a huge impact in pioneering several growth sectors. However, I am of the view that one cannot be complacent, but must anticipate headwinds and where the threats are coming from. Institutions must be more proactive rather than reactive. As for DFCC, we are in a strong position. Although banks give priority to profits, I am of the view that we need to look at the capital employed in this industry. In DFCC Bank's case, we have about 40 billion rupees worth in capital. For example if I put that sum in a fixed deposit and just earn ten per cent doing nothing, it will give me an income of four billion rupees. On the other hand, for me to make 3.2 billion rupees I have to employ over 1,500 staff and run a network of over 100 branches. On top of these large numbers, we have operational costs and other expenses. It is therefore a complex picture that will be more complicated with the implementation of the impending regulations in the next few years.

The current banking business model is ripe for change. The local banking industry is not immune to the international trends where the disruptive processes as well as technologies are emerging daily. I am a firm believer that what was successful in the past is not always going to be successful going forward. 