

At The Forefront Of The Banking Evolution



In 1920 The Eastern Bank Ltd. opened a branch office at Chatham Street, Colombo. Since then the Commercial Bank of Ceylon has had a distinguished tradition of banking.

Business Today spoke to Amitha Gooneratne, Managing Director of the Bank on the present and the inevitable future of this established financial institution. Gooneratne is a Fellow of The Institute of Chartered Accountants, England & Wales. Former Chairman of the Sri Lanka Banks' Association, Director of the Financial Ombudsman Sri Lanka, Council Member of the Employers' Federation of Ceylon and represents the Bank's interests on the boards of all its associate and subsidiary companies.

By Keith Bernard
Assisted by Harin Fernando

As the Managing Director of Commercial Bank, you have led your bank and ensured its place as an undisputed leader in commercial banking in Sri Lanka. Could you single out any particular reason for your outstanding achievements?
There are several reasons for our success, but one of the main reasons was that the bank was very focused. When we embarked on the journey of improving the banks performance and becoming a national bank, we felt that the only way to achieve that was to provide excellent customer convenience.So we really focused on providing personalised service and providing customer convenience in different forms. For example, we introduced different channels of delivering banking services while strengthening and re-inventing the traditional methods of bricks and mortar banking.

We embarked upon supermarket banking, internet banking, mobile banking. We also introduced holiday banking centres that were open 365 days of the year. So the focus was very much on customer convenience. We expanded our ATM network also thinking of our customers. As you might know we have the largest on-line, real-time network of branches and ATMs in Sri Lanka. All this was done to meet customer requirements and to make banking more accessible.

Another important factor was the building up of the human resource infrastructure. Motivating our staff was also very important so that they shared the same values and that too played a significant role. I think these were the main contributory factors towards maintaining our leadership.

Does the operation of multiple channels imply your movement away from being ‘corporate’ centred to becoming more ‘retail’ centred?
Yes, I would think its fair to say that. Traditionally, the strength of Commercial Bank was in the corporate arena. We had a lot of expertise in that area, but we didn’t have the reach to attract the new MNC’s coming in and some of the large corporates with operations in the outstations. So embarking on a retail expansion also complemented what we were doing in the corporate arena. Expanding the network also helped us to build up the image as a national bank. What we did was a conscious shift in focus where we leveraged our strengths in corporate banking and the strong corporate image to build up a retail base.

In the retail sector to what socio-economic demography do you target your financial services?

Essentially we started with the middle-income earners. We recognised the fact that a lot of people in urban areas and suburban areas still relied on the traditional passbook. That was the main thrust of our expansion, we concentrated on savings products.

To do that, we had to introduce an array of savings products and also be able to offer the convenience to any person with a savings passbook, so that customers can go to any branch with or without their passbooks. We have over two million customers; a lot of them have been issued with ATM cards. With Rs100 you can open a savings account. That really has been our core strength. In that way we attracted the middle class and gradually made our way down to the rural markets. Several new branches were opened targeting these segments.

We Gave Our Staff Targets.Each Department And Branch Were Given Their Individual Targets, And We Constantly Lifted The Bar. If A Target Is Achieved During The Year The Staff Are Specially Rewarded And We Try To Exceed It In The Next.

Through the process you just described you were in a position to observe the transformation of the rural folk from their traditional use of the savings passbook to becoming ATM card users. How did you manage that transition phase?

First of all, there was a learning curve. We went to various factories and we had educational drives demonstrating how ATMs can be used. We also tied up with the owners of factories and placed our ATMs in their work sites. We gave payroll software packages to owners of factories so that they can move away from cash payments with all the attendant risks to a total payments solution. When the workers go back to their villages during their vacations and breaks, they are comfortable knowing that there is a Commercial Bank branch or ATM nearby. With it the convenience and popularity of the ATM cards spread.

You have been judged ‘Best Bank in Sri Lanka’ for eight consecutive years by Global Finance Magazine and ‘Bank of the Year – Sri Lanka’ by Banker Magazine, for five consecutive years. Having secured a front line position, how do you benchmark your performance and push your goals to hold your position as the best year on year?

In the early years, we benchmarked ourselves with local banks, but having done that for several years, we felt that, that itself was not enough. We had to look at the wider financial sector, so we began benchmarking ourselves with the best foreign

banks as well. We also acknowledged the fact that the state banks also have certain strengths, which we believed we had to work towards, if we were to rise to the top.

We gave our staff targets. Each department and branch were given their individual targets, and we constantly lifted the bar. If a target is achieved during the year, the staff are specially rewarded and we try to exceed it in the next.

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How do you ensure that complacency does not set in?
The other banks aren't complacent either, so there's fierce competition. Even though we have achieved what we have, other banks constantly challenge us, so that keeps us on our toes. It's virtually a rolling assessment. We constantly check to see if we're on track and if we're not on track, we get back on and work towards what we have targeted. So it's a continuous assessment of performance based on feedback from our branch and Regional Managers and Departmental Heads.

As one of the preferred employers, how does the Bank align the objectives of at least the senior staff with that of the shareholders?
As employers we are very conscious of the market and the need to keep the interests of staff aligned with that of other shareholders. With that objective we pioneered employee share ownership plans amongst our employees. We also initiated several share option schemes and we currently have an option scheme where staff members are given the right to buy shares based on a price of the previous year. They have about three years to exercise that option so they're constantly working towards enhancing the share price. That way we ensure that employees have a common interest with shareholders

As a financial institution your bank demonstrates sound fundamentals that have earned you an 'AA+ (Sri)' rating by Fitch Rating Lanka. How do you achieve your growth targets and at the same time ensure you stay within strong financial parameters?
We constantly review our performance against pre-agreed indicators. Our primary aim is to gain market share. One of the first goals we set out to do was to become the largest private bank in the country. To do so we needed to increase our assets. We were very conscious of a few things. One was to maintain growth rates in both loans and advances whilst maintaining a healthy 'deposit to advances' ratio. If

deposits were coming down, then we would go to the debt market, issue debentures, preference shares and so on.

But there is also a price to pay for the expansion. Though we have maintained very healthy growth rates in deposits and advances, our ROA, even though we target to reach 2% has come down to 1.4%, which is in line with our peers but we prefer it to be in the region of 2%.

But we are still looking at other ways of driving this through fee based income and other avenues of developing business; we try and get back to the benchmark that we want. There are some ratios that are below target but we are very conscious of this.

Our capital adequacy has also come down very slightly because of our aggressive loan expansion and we are looking at ways of getting back to where we were.

In the third quarter of this year you recorded a net profit of Rs897.3 million. Does interest income feature as a primary contributor towards this profit? And what percentage came from non-interest earnings?

Yes, the net interest income still plays an important part. But in the third quarter, apart from interest income, there were also other factors, which had contributed to that profit. One of the other reasons, was that in terms of the Central Bank regulations we had to mark to market our investments that we were holding for disposal. DFCC shares were one of the investments we were holding, thus we had a contribution from mark to market gains as well as partly from actual sales of DFCC.

In the first quarter we had mark to market gains, in the second quarter we had a small amount of shares again sold, an equivalent amount was also sold in the third quarter. Exchange income was also fairly high in the third quarter.

The Weighted Average Prime Lending Rate (WAPL) rate went up to about 14.7% from around 12.24% a year ago. Was this a significant contributor to your earnings growth?

Well, commensurate with the WAPL, the cost of funds also rose, so when you look at the final net interest margin, it almost remained the same because, the cost of funds rose in line with the increase in lending rates. There is a temporary advantage between the re-pricing of deposits and advances, but it evens out soon. The

margins after a period of time remain about the same.

Do you think commercial banks can maintain the current lending rates with the average inflation rate now over 17%?
There is a lot of pressure to review our lending rates and various other factors are present, so we need to re-price interest rates. Indications in the short-medium terms are, that interest rates will go up, so at that point we will be forced to look into increasing our interest rates.

The Central Bank is contemplating several monetary measures such as credit squeezes, tightening of money supply and perhaps an increase in the interest rates. How would such measures impact on your future earnings targets?
Central Bank has adopted various measures to curtail credit expansion. We saw a 7% depreciation last year and again between 7-8% is forecast for the coming year, and with inflation also running at 18 – 20%, we feel that investors will not really hold back on their investment plans and will be compelled to borrow even at a high rate.

Consumers on the other hand, sensing that inflation is at 19 – 20% will probably accelerate their spending. All this is aimed at bringing consumer credit down, but whether that will materialise is yet to be seen. Because the tendency is for people knowing that price of imported goods are constantly moving up, even if they do not want a particular item or they are planning to replace it in two years time, they will take that decision now and even borrow money and make that purchase in view of the depreciating Rupee and inflation.

So even though these measures are being taken, we feel that the credit expansion will still be there.

Personal loans and housing loans, how will these be affected by the credit squeeze?
In housing, beyond a certain rate of interest, it will not be affordable. If those interest rates go up beyond maybe 1 or 2% then the affordability and the repayment capacity is going to come down, therefore there could be a decline in mortgage lending. However, it may not be the same in personal or consumer lending. But when it comes down to big repayments, the repayment capability might come down with interest rate adjustments.

The Central Bank also recently increased the risk weightage on loans from 100% to 110%, applying a lot of pressure on the capital adequacy ratios, which are now 5% for tier one and 10% for tier one and two. This probably places a lot of strain on commercial banks, more so on banks with lower capitalisations. What have you to say?
With the increase that has been announced, we can manage, as our capital base has been fairly strong and we have had the capability of going out and attracting capital. We have also been putting out debt capital and debenture to top up tier 2, so I think that we can manage given the size we have reached now. But for the smaller and medium sized banks to increase their capital it may be a tough call.

Recently, the Central Bank has increased the provision requirements on loans and advances which would lead to increase the effective tax rate of banks. What have you to say?
There is a Central Bank requirement that has just been announced that banks have to provide up to 1% of performing loans and also 1% on non performing loans that have not been yet classified as ‘non performing’ following a 90-day period. To assist banks in phasing this out, the Central Bank has permitted banks to make this provision over ten quarters, i.e., around 10% over ten quarters, so it is roughly about two years to make the required provision.

This provision is not claimable for tax purposes since this is in the nature of a General Provision.

In reality if you give a loan of Rs100 million to a fairly large customer. One million Rupees will be immediately needed to cover the provision even though it is spaced out.

There Is A Lot Of Pressure To Review Our Lending Rates And Various Other Factors Are Present, So We Need To Re-Price Interest Rates.
You have one of the best cost to income ratios among bank’s in Sri Lanka, and this you have achieved through your investments in technology and economies of scale, including an expansion of your branch network. Will you have the capacity to sustain these growth levels after adhering to the deemed dividend rule?
Yes. Fortunately Commercial Bank has been historically paying out dividends of around 30% from our profits. And since we have been doing it, this will not affect us.

The return to war mood in the country has made it difficult for the smooth operation of banking activities in the north and east. Given the fact that the combined north-east is a significant and important market in terms of size, how adversely affected is Commercial Bank?

There has certainly been disruption and we have been affected in many ways. Firstly the cost of running branches will increase and we have to look into the safety of our staff and this is paramount notwithstanding any other consideration. We are constantly sending out to them dry rations, and extending hardship allowances to meet the rising costs in the north.

Secondly in terms of lending activities, we take a cautionary approach because peoples' lives are disrupted and so their repayment capability is reduced. But on the other hand the flow of remittances to the north and east is stable and growing. Deposits are flowing in as there are a lot of expatriates sending money and this sector continues to grow. That is an area we are focusing on providing conveniences for these people who are based outside Sri Lanka sending remittances to the north and east. There is a large deposit base in the north and east.

When it comes to repayments we may have to look at the facilities given and restructure, reschedule some of those advances. But even in the past we had been cautious on lending activities in view of the unsettled conditions. Therefore,we had not been experiencing a dramatic increase of defaults in the north and east.

How are you trying to break into the lucrative foreign exchange remittance sector? As you say the Rs240 billion remittance market is an attractive segment to banks and the competition for a piece of the pie is fierce. What is your position with regards to this market segment?

We are also very conscious of increasing our market share in this respect and we have tied up with 'Moneygram,' but more than that, we have our own methods of transferring funds that are low cost.

I think it is very important that we have people on the ground in various locations talking to mainly the blue-collar workers, educating them how to send money at a low cost rate. In this regard, throughout the Middle East, we have placed our people in association with local exchange houses; this is the same in Italy. We are now also

looking at setting up our own presence in these areas, but in the Middle East it is not possible, as any entity has to be setup in partnership with a local player.

Toronto, Canada has a very large expatriate population and most of them are from the north totalling around 350,000. We have got approval from the relevant authorities and are now in the process of setting up a presence there in order to cater to the remitters. We also hope to follow suit in Italy.

Tell us about your investment in Credit Agricole Indosuez in Bangladesh?
We are very pleased with our investment of US$20million. The performance has been good and after the third quarter we have made a profit after tax of, Rs285 million, so the rates of return for us have proven to be very attractive.

Another good thing is in a market where NPLs are very high, we have one of the lowest for foreign banks operating in that country. This is due to the culture that we inherited from 'Credit Agricole' that was very conscious of accepting good business consisting of top tier corporates, which we have consistently maintained.

We are also looking at gradually penetrating the second tier corporates and building our retail capability in Bangladesh and to this extent we have already set up seven branches with an eventual target of 15.

The Liberalisation Of Exchange Control Regulations Permitting Sri Lankan Companies To List Their Shares Overseas Would Provide An Impetus To Our Efforts To Set Up In Developed Markets

Does this series of overseas expansions signal your entry into a global arena?

I would not say that our recent expansion would be sufficient to call us a 'global player." But one has to start somewhere and we are trying to get some form of visible international presence. Wherever there is a possibility of serving unexplored markets, we will look at those regions and we will not only be considering developed markets.

The cost of entry to developed markets is also prohibitively high, so before we do that, we need to begin small-scale operations and then get our name known. The liberalisation of exchange control regulations permitting Sri Lankan companies to list their shares overseas, would provide an impetus to our efforts to set up in

developed markets, so that we can raise the required capital to succeed in these markets.

The Bank recently offered up an issue of unsecured, subordinated, redeemable debentures which was also eventually oversubscribed. Was the money raised used to strengthen your Capital Adequacy Ratio?

We took this initiative to develop the debt market. Four or five years ago, the debenture market was not well known and we were the first bank to issue a floating rate debenture and that was for a period of five years and following that we had another debenture issue and these come up for redemption once in five years.

So naturally, if you try to maintain that same rate of growth we would have to issue new debentures to supplement the ones that are being redeemed. And our latest debenture is spread over ten years.

In most developed markets the debt market is more popular than the equity market. Why is that not the case here?

We need to get some of the bigger corporates rated, because the public will have confidence that some independent third party has graded the risk levels associated with the investment. Once that is done, the debt products can be graded and the market will develop.

These debt instruments also need to be listed and there are procedures to do this, and I believe that once these are done, the debt market will flourish like in developed markets, where the instrument itself is rated.