# CHIEF EXECUTIVE OFFICER'S REVIEW

## OUR CONCERNS ARE NATIONAL, BUT THEY ARE BASED IN EVERY CASE ON THE NEEDS AND ASPIRATIONS OF INDIVIDUALS.

Where once we strove to present ourselves as 'a world-class Sri Lankan', we now affirm the belief that every Sri Lankan has the capacity, and the right, to be world-class.

Dear Friends,

The year under review was by no means an easy one for the Bank. The operating environment, events and their implications are discussed by the Chairman in his letter to shareholders. In my review, I will go into a little more detail concerning their consequences for the Bank, as well as discuss some of the other important developments that occurred in the financial year just ended.

### Coping with the Margin Squeeze

The margin squeeze of 2015 affected us more than it did many of our peers. The sharp decline in the Bank's net interest margin from 3.31% to 2.63% during the year more than negated the stellar 19% growth in our loans and receivables portfolio; the overall result being a 6% decline in profit before tax, but which was redeemed through a modest 3% increase in profit after tax.

Let's first look at the underlying factors. With interest rates in the single-digit range and likely to stay there for some time, our interest earnings have come under considerable pressure. The Bank's business model has steadily embraced retail and SME banking over the past decade. By the end of the year, retail and SME accounted for 39% of the total loan book, and provides promising potential to further our involvement in these sectors. In this regard, we have not followed the general trend of the commercial banking industry, which has been to focus increasingly on 'high street' or consumer banking where interest rates are higher. On the deposit side, too, our savings and current account deposit base is relatively small due to a historical concentration on fixed deposits targeted at investors who value security rather than quick returns. What is noteworthy of our deposit base is that, our move to accept public deposits in the capacity of a commercial banking institution is just a decade old, as opposed to many of our mature peers. The encouraging factor about the relatively low current and savings account (CASA) base is that, this too offers us considerable potential for the future, in driving more favourable interest margins.

With net interest income coming under pressure we considered the options. We ruled out getting into a price war with better established competitors. Instead, it was decided to address the margin squeeze using a three-pronged strategy:

- Bring down the cost of funding by increasing the CASA portfolios until they are proportionally on par with those of our peers
- Aggressively pursue growth in fee-based services
- Manage overheads more effectively through better procurement.

Progress was seen on all three fronts during the course of the year. Between January and December, contributions to total operating income from retail and SME banking grew from 36% to 40%. We plan to increase this further up to 45% during 2016, with an

ultimate target of 50% of total operating income sourced from retail and SME banking operations. However, the Bank will move with caution in this area, maintaining the balance between reward and risk.

Fee based income, too, showed a proportionate increase as the year wore on, from around 20% of net interest income to almost 27% in December. Areas of focus were trade finance, inward remittance handling (an important growth area in retail services) and bancassurance, from which income is earned in the form of insurance fees.

Looking at opportunities for reducing overheads, we found that the Bank had little options at hand. Although the year saw a 14% increase in operating expenses, much of this was due to network expansion and also a one-off operational loss. When the cost of this operational loss of LKR 173 million (net of insurance claim) is subtracted, operating expenses for the year grew by 11%. Rather than cut costs further, with possible negative implications for service quality, customer satisfaction and employee morale, we are attempting to manage costs through better procurement processes. Managing costs is one of the core strategic priorities of the Bank.

These initiatives have shown clear results. While our performance in the year's first two quarters was below expectations, Q3 and Q4 showed a greatly improved picture, bringing our medium-term target of 20-25% annual growth within reach and providing a firm foundation for further growth in 2016.

## Supporting Development in Depth

As per-capita income and GDP increase in a growing economy, the rewards of retail or 'consumer' banking become more substantial. People who work harder and make more money have greater need of banking and financial services. As mentioned above, this is an area on which we have traditionally placed less emphasis, although the picture is changing now.

However, our ingrained strengths in corporate and investment banking are sure to serve us well in the new economic and policy environment of today. During the year under review, we further augmented our merchant banking capability by setting up a fully operational private equity fund, value USD 50 million, to offer a third funding option apart from bank loans and equity/debt financing.

Many in the financial sector have decried the loss of business opportunities connected with leasing as a result of some of the provisions of the 2016 National Budget. We, however, see the Budget as offering a number of new opportunities for the Bank. The rush to 'consumerize' financial services in recent years has seen institutions offer easy-to-obtain consumption loans and over-the-counter lease financing for motor cars. Our business model is geared less towards high street finance and increasing consumer indebtedness than towards providing support for productive and sustainable purposes.

While others lament the loss of opportunity in consumer financing, we see a proliferation of opportunities elsewhere. For example, the government plans to develop industrial parks for IT and business process outsourcing firms present opportunities connected with the development of residential complexes adjacent to these parks: developers, on-site service providers and residents themselves will all require financing to meet their various needs. We are already weighing the prospect of realizing such opportunities – and similar ones that exist in areas such as leisure, tourism, housing and commercial agriculture – through multiparty agreements involving developers, employers, workers, etc. Many of these opportunities lie with participants at different points along the industrial value chain – for example, opportunities in commercial agriculture include capital for produce storage and logistics infrastructure, crop insurance and funding through producer co-ops.

With our considerable experience in capital markets, project and realty financing, investment banking and privatization, the Bank and the Group companies are better suited than most to provide support for the development in depth to which the government has committed itself. As such, our strategies will, as always, be guided by what we deem best for the Bank and its stakeholders, in particular its customers.

## Ushering in an IT Revolution

The first quarter of 2016 will see the rollout of the first of a set of integrated IT-based product and service capabilities that, for many customers, will completely change the way they do business with their Bank. More will be introduced during the course of the year. Within a 12-to-15-month window, the transformation will be complete. Following this, customers will enjoy an integrated and unified banking experience at every virtual touch point from ATMs to mobile devices. We call this new approach to banking the Omni Channel Experience.

The Omni Channel Experience will make ordinary banking easy and intuitive for customers. It will also result in the transformation of our cost structure and the relative contribution from different revenue streams. Essentially, we will move banking with NDB Bank into the digital future, with business implications that will only become fully manifest over a decade or so. What is more, we will achieve this in a way that speaks to even greater financial inclusion – relying on the power of technology to leapfrog barriers of time, distance, education and technology. In effect, we will be helping to bring the farmer in his remote village into close contact with the beating heart of the national economy and financial system.

We anticipate, over time, a substantial rise in fee-based income from this 'IT revolution'. But there are social benefits too: by making mainstream finance available to everyone, we help people stay out of the clutches of informal sector operators and help reduce the wealth and opportunity gap.

## Building the Team

As the new leadership of the Bank completes its second full year in office, I am happy to report that the transition has been smooth and the team is now well bonded and integrated. It has happened in a gratifyingly short time. The new members of our Leadership Team are all performing excellently and producing results, bringing to bear their own capabilities and experience to complement our existing skills.

Meanwhile, we continue to build and develop our talent through in-house and external training. Our philosophy is based on a continuous training regime in which staff competency needs are identified on an individual basis and training offered accordingly.

## Everybody Can Be World-Class

Today, the Bank can boast of customers from every walk of life. We finance corporates occupying the commanding heights of the national economy, and we also provide working capital to food vendors on Galle Face Green. Our concerns are national, but they are based in every case on the needs and aspirations of individuals. Where once we strove to present ourselves as 'a world-class Sri Lankan', we now affirm the belief that every Sri Lankan has the capacity, and the right, to be world-class. Our job, for the foreseeable future, will be to help them attain that goal, and sustain it. In short, 'Our Commitment. **Your Success.**'

R Theagarajah
**Chief Executive Officer**

12 February 2016