



IS SRI LANKA POISED TO BE A FINANCIAL HUB?

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Introduction

“America is a nation with no truly national city, no Paris, no Rome, no London, no city which is at once the social center, the political capital, and the financial hub”, wrote the American sociologist C. Wright Mills in his book ‘The Power Elite’ in 1956 in the aftermath of the World War II. Not long after, America used World War II as a launching pad to catch up with the world to make New York a financial hub more powerful than Paris, Rome and even London. Sri Lanka, which ranks 79th in the Global Competitiveness Index¹ too is voicing similar concerns as Mills and time has never been ripe for the country to capitalize on the post war era to become a financial hub to challenge the regional financial hubs like Hong Kong and Singapore and even to rub shoulders with the global financial centres.

Even though ‘financial hub’ has become a buzzword for Sri Lanka in the aftermath of war, the country is no stranger to the concept. Due to its strategic geographical location in the Silk Road, Sri Lanka or Ceylon or Serendib or Taprobane, as the country was called variously by various sea-faring nations, has served as an economic centre which facilitated business among nations and organizations from all over the world. Long before London or New York or Singapore emerged as global financial centres, this tiny island served as a ‘driver of economies’ where people came to trade and lived to trade; a hub that connected the East and the West; a metropolitan centre that combined residential, industrial, business and administrative activity; a cosmopolitan place which was characterized by the existence of multi ethnicities with multi skills and knowledge, quality of people, cultural richness, geographical location, and proper legal structures. It is not surprising however, that these are exactly the criteria that rank modern day global financial hubs like London and New York high on the charts.

Financial Hub has become a panacea for the liberated Sri Lanka, which is for the first time after independence in 1948, evaluating peacefully and efficiently her strengths and weaknesses against the opportunities and challenges in the turbulent world environs. End of war not only resulted in reduced military expenditure but also in a host of other opportunities like increased and effective concentration of efforts on development of the country, saving human capital that could otherwise be employed for the developmental ventures, prevention of brain drain, enhanced relations with the world, enhanced remittances and enhanced capital inflow and economic stability

¹ The Global Competitiveness Report 2009-2010, World Economic Forum (2009)



and growth, conditions that are conducive for transforming Sri Lanka into South Asia's financial services hub. However, there are other factors that make a country a financial hub such as rational and predictable legal-regulatory framework, attractive and sustainable local economy, developed infrastructure and quality of life of the people and for Sri Lanka, a country subjected to a long and devastating civil war followed by low-performing economy, the challenges encountered may be as numerous as the opportunities plundered.

Top 10 Global Financial Centres

Rank	Financial Centre	Country
1	London	England
2	New York	USA
3	Hong Kong	China
4	Singapore	Singapore
5	Tokyo	Japan
6	Chicago	USA
7	Zurich	Switzerland
8	Geneva	Switzerland
9	Shenzhen	China
10	Sydney	Australia

Source: Global Financial Centres Report- 2010

Opportunities

The post-war Sri Lanka has been the investors' haven with its political stability and investor friendly Government policies. In a bid to promote the country more as an investors' paradise, the Government is geared to provide more benefits to foreign investors such as relaxation of foreign exchange controls and introduction of regulatory reforms in the areas of banking and finance laws and Securities and Exchange Commission laws.

Sri Lanka's economy has been resilient throughout the internal civil strife and the world-wide economic crisis and the post-war economy sends very positive signals out to the investors. Sri Lanka Rupee has been steadily appreciating against almost all currencies in the world and thereby the country is experiencing an unprecedented influx of foreign investments in Government securities. The IMF recognizes Sri Lanka as a 'middle income emerging market' and increased facilities by IMF and World Bank will improve the country's credit rating which will invariably lead to more investor confidence and more capital inflows.



Colombo Stock Exchange (CSE) has been the fastest growing Asian stock market since end of war and it records a market capitalization of US\$ 15bn. CSE became only second to Russia among world stock markets with the ASPI reaching all time high of 5,214 during the first week of August 2010. With the stock indices demonstrating exceptional performance, industries like manufacturing, hotel, banking and consumer goods are expected to perform exceptionally and attract foreign investments.

Market Capitalization of Selected Exchanges

Exchange	Market Capitalization USD bn
Bombay SE	1,402.7
Bursa Malaysia	339.1
Colombo SE (CSE)	15.0
Hong Kong Exchanges	2,338.8
Indonesia SE	283.8
Korea Exchange	894.0
Philippine SE	106.0
Shanghai SE	2,381.8
Shenzhen SE	952.8
Singapore Exchange	552.3
Taiwan SE Corp.	626.4
The Stock Exchange of Thailand	215.3

Source: www.world-exchanges.org

In view of developing our capital markets, strengthening the regulatory framework and developing investor confidence by introducing a disclosure-based regulatory system, strengthening antifraud provisions of the securities laws, amending the SEC Act and amending the rules governing the activities of the investment bankers and stock brokers are indispensable. It is also essential to enhance the knowledge and practical skills of the upper-middle to senior-level government officials on development capital markets since they play a main role in developing and introducing regulatory framework. In addition, attention needs to be paid to introduce modern regulation practices for CSE with the objective of improving transparency and accountability and the development of market trading infrastructure, improvement of clearance and settlement system and also to avoid price manipulations that have extensive ramifications for investor confidence.



It is also essential to introduce, instruments such as common trust funds, mutual funds, and pre-need plans and guidelines on portfolio management, full disclosure of information by companies, declaration of unlawful activities, and prohibition of activities that lead to conflict of interests.

Although there is a well-growing, organized and conventional primary public debt (Government Securities) market, the same can not be said about the private sector (Corporate) debt market. There was, and continues to be, little progress in the secondary trading of either debt market. Developing private sector debt market is crucial for the development of the local capital market as it creates more opportunities for corporations to raise capital. As economy expands, we need to introduce derivative instruments such as options, futures and forward contracts to facilitate accelerated economic growth. Corporate

Yet another area that can create investment opportunities for the country is taxation. Sri Lanka's tax structures have changed in almost every year for the past few decades, the result of which is irrational and complicated multiple taxes which have served to ward off rather than attracting potential investors into the country. Having identified this as an impediment, the Government has proposed in its Budget 2010 to introduce tax reforms in the form of a simple, broad based and low tax regime with a view to tallying the globally competitive tax structures of other financial hubs. Board of Investment (BOI) can play a catalytic role in encouraging investors by creating a hassle-free atmosphere. Most of the projects received by BOI cannot take off due to bottlenecks in the approval-granting and land-securing procedures. Even though the promotions carried out by BOI in Europe, USA and East Asian countries render very positive responses from investors, the country stands to lose these opportunities if it does not align its procedures with the requirements and expectations of the investors. To begin with, BOI can grant potential investors the facility to track their applications online and have a definite sense of time as to when they can implement their projects.

Yet another opportunity that Sri Lanka has in realizing its journey towards becoming South Asia's financial hub is its unique geographical location that serves as gateway for transiting goods in the supply chain pipeline from the two cost effective production giants India and China. If Sri Lanka can develop itself into a logistics hub, the benefits would be colossal as the country will be able to capitalize on the growth of the two tiger economies in the way of operating and developing most modern logistics infrastructure with state of the art warehousing facilities combined with integrated information and supply chain solutions, like Singapore is for the ASEAN region. Sri Lanka will then be a complete stock-house covering vast numbers of inventories, allowing buyers and sellers prompt sourcing and to have the shortest delivery circles for their goods and raw-materials within Asia and even Europe, cutting down on the lead-times in bringing their products to the global market.

Sri Lanka has the potential to become a global city with its well developed ports such as Colombo - the region's No.1 port and world's 26th port² in terms of the volume and Trincomalee

² Lloyds Register



port - the world's best natural port. Hambantota Port, which is under construction and which will be Sri Lanka's second largest port after the Port of Colombo, has the minimum deviation from the East West shipping lines and will service an estimated 36,000 ships, including 4,500 oil tankers annually. This Port will be of critical importance to India and China in transiting their goods at the lowest cost within the minimum lead time.

At present, about 70% of total transshipment cargo from India is handled by the Colombo Port and the relative efficiency of the port has made transshipment via Colombo cost- and time-effective for the India. Further, Sri Lankan Airlines remains the largest foreign carrier into India. Being already a full-fledged logistics hub for the regional Giant India, it is not difficult to develop Sri Lanka as South Asia's financial services hub given the strong historical, political, economic and geographical relations the country enjoys with India. Further, Sri Lanka can look forward to the Comprehensive Economic Partnership Agreement (CEPA) with India which opens yet another avenue for Sri Lanka to grow with its powerful neighbour in service, trade and investment.

Sri Lanka is richer in natural resources compared to financial centres like Singapore and Dubai. Therefore, proper management of those resources is essential to gain competitive advantage over the regional players. Table below shows ranking of financial centres according to areas of competitiveness.

Ranking on Areas of Competitiveness

Rank	People	Business Environment	Market Access	Infrastructure	General Competitiveness
1	New York	New York	London	New York	London
2	London	London	New York	London	New York
3	Singapore	Hong Kong	Hong Kong	Hong Kong	Hong Kong
4	Hong Kong	Singapore	Singapore	Singapore	Singapore
5	Tokyo	Chicago	Tokyo	Chicago	Tokyo
6	Toronto	Tokyo	Zurich	Tokyo	Zurich
7	Chicago	Zurich	Shanghai	Zurich	Chicago
8	Sydney	Sydney	Chicago	Sydney	Shanghai
9	Zurich	Geneva	Geneva	Toronto	Geneva
10	Shanghai	Toronto	Frankfurt	Shanghai	Shenzhen

Source: *Global Financial Centres Report - 2010*

The ranking of global financial centres clearly shows level of competition among players and the amount of effort that we need to put in and the areas we need to focus on to become a financial hub.



Challenges

The biggest challenge faced by Sri Lanka, a country slowly emerging from the massive devastation caused by a 30 year long civil war in becoming a financial hub, is the lack or absence of developed infrastructure. Financial hubs such as London, New York and Singapore are characterized by highly developed infrastructure in terms of transportation, human capital, telecommunication, legal and regulatory framework and power and water management.

Transportation

An advanced transportation system that includes several freeways and/or a large mass transit network offering multiple modes of transportation is critical for a financial hub. Sri Lanka has its only international airport in Katunayake, the run way of which does not comply with the international standards either in its length or width and therefore which is too narrow to land double-deck passenger aircrafts like A380, which could be a major dent in promoting Sri Lanka as a financial hub. However, the Government has now started construction of the country's 2nd International airport in Mattala, Hambantota in compliance with the international standards. Sri Lanka needs to develop its internal transportation too.

Human Capital

A financial hub is characterized by the availability of skilled labour with high Literacy and English-speaking talent. The country is rich with high quality human capital with a literacy rate as high as 92% and a life expectancy of 74 years and the quality of life of people is unparalleled in the region. However, due to lack of employment opportunities, Sri Lanka faces the challenge of retaining its skilled labour in the country. Yet a bigger challenge is flexibility of labour market. Sri Lanka's labour laws are in favour of employees and a case in point is that the law does not recognize under performance as fair grounds for dismissal of an employee. In order to make Sri Lanka's workforce globally competitive, the education system needs to be upgraded to international standards, English language skills be improved, finance-related studies be promoted and flexible labour market and cooperative trade unions be encouraged.

Legal and Regulatory Framework

A well developed legal system and existence of predictable, consistent and logical regulatory procedures are quite essential in attracting more foreign investors and global companies to the country. Our legal system and regulations need to treat both domestic and international companies equally and our tax structure needs to be globally competitive. Laws and regulations should also promote corporate governance, compliance and risk management and ensure adoption and application of best practices. Further, free movement of capital and credible currency and liberal policy on visas and work permits are the other factors we need to look at in view of making Sri Lanka a financial hub.

Telecommunication

With the liberalization of the industry and introduction of new technology in Sri Lanka, telecommunication has been growing fast during the last decade. Recently introduced regulations like minimum floor rate has served to increase the competitiveness among the telecom players and create a level playing field, which would attract more investments into the country. However, even if there are global players operating in the country, our telecommunication industry needs to be developed further to provide the communication infrastructure required for a financial hub. Both fixed line operator and mobile operators will have to change and develop their strategies in providing future communication requirements such as reliable and fast data transferring facilities etc.

The Government has allocated a substantial amount of funds towards physical infrastructure development in its recent budget. It has focused its capital expenditure on development of road network, port and aviation and irrigation and water management for which the budget allocates Rs.83.4b, Rs.30b and Rs.37b respectively. It shall be noted that out of the capital expenditure allocated for road development, 23% will be for development of expressways from and to internal economic hubs.

However, most of these developments are still in the planning stage and action should be taken to fast-forward implementation of same to reap the full benefit of the prevailing opportunities.

Financial System Stability & Role of Banks

A stable financial system is a key ingredient for a healthy and successful economy. People need to have confidence that the system is safe and stable, and functions properly to provide critical services to the wider economy. It is important that problems in particular areas do not lead to disruption across the financial system.

Financial system stability is evidenced by and reflected through, an effective regulatory infrastructure, effective and well developed financial markets, and effective and sound financial institutions. A stable financial system encourages efficient financial intermediation which eventually promotes investment and growth. Also it encourages effective and efficient operation of markets and improves distribution of resources in the economy. Accordingly independency of Central Bank needs to be assured and Central Bank has to operate autonomously in view of keeping financial system stability.

As Sri Lanka is geared up to becoming South Asia's financial hub, banks will have to play an important role in facilitating capital and money market transactions on a global scale. This will both be an opportunity and challenge for Sri Lankan banks. Banks need to be aligned on a par with foreign financial instruments and their technology. International banking best practices will have to be adopted and complied with. Local financial institutions must be in a position to provide adequate corporate infrastructure for a potential large customer base. To reach global standards in banking, the industry as a whole needs to benchmark world leading banks in improving areas such



as efficiency, customer care, corporate banking, corporate governance and risk management to global standards. Further, we need to be more proactive, creative and innovative in segregating our services from the regional competitors.

Table below depicts ranking of leading global financial centres according to level of development of different industries.

Ranking of Global Financial Centres According to Different Industries

Rank	Asset Management	Banking	Insurance	Professional Services	Government & Regulatory
1.	London	New York	Hong Kong	London	New York
2.	New York	London	New York	New York	London
3.	Hong Kong	Hong Kong	London	Singapore	Singapore
4.	Singapore	Singapore	Shenzhen	Hong Kong	Hong Kong
5.	Tokyo	Tokyo	Singapore	Zurich	Tokyo
6.	Chicago	Zurich	Shanghai	Geneva	Chicago
7.	Shanghai	Shenzhen	Beijing	Jersey	Frankfurt
8.	San Francisco	Shanghai	Tokyo	Chicago	Toronto
9.	Toronto	Chicago	Chicago	Toronto	Geneva
10.	Zurich	Beijing	Taipei	Tokyo	Zurich

Source: *Global Financial Centres Report- 2010*

Strike while the Iron is Hot...

Be it global like London or New York or regional like Singapore or Hong Kong, be it existing or emerging, attaining the status of a financial hub is a challenge for any country. Sri Lanka being blessed with unmatched natural resources, strategic geographical positioning and competitive human capital can easily become a financial hub, except that the country is short of perseverance. Building Sri Lanka on the war-ravaged rubble to be a global financial centre is a dream that can be achieved only through strategic planning, target setting, hard working and commitment. Fast-growing countries like China and India cannot and will not wait for us. We need to act fast and develop our infrastructure and other logistics to meet their requirements. Opportunity has knocked on our door once; it won't knock twice.