GREATER INCLUSION - THE WAY FORWARD FOR A STABLE AND SUSTAINABLE BANKING INDUSTRY

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Across nations sustainability is a factor that is increasingly highlighted. Recent global financial crises have caused alarm on the detrimental effects of deviation from the fundamental banking principles. Yet, the question remains as to how a stable and sustainable banking industry may be established. Can we encapsulate the different interpretations of a sustainable banking industry in one single word or phrase? Whilst an investor interprets sustainability as consistent creation of economic value addition over time and building of products for consumers to consume, the society at large expects a value chain that neither destroys natural eco systems nor consumes resources. In such a situation how do we achieve a stable and sustainable banking industry?

Current banking industry status

Amidst the global economic meltdown and credit crisis, Sri Lanka and its banking industry stood resilient and performed well to bring down non performing loan levels in the post war era. Banking sector continues to dominate the financial sector by accounting for 52 percent of the total assets of the financial system. The government has intensified its investments on infrastructure development and is working based on the five hub concept i.e. Port, Aviation, Energy, Knowledge and Commerce. Therefore, the banking industry has a vital role to play in this unique post conflict development to aggregate economic growth in providing financial services to those emerging market opportunities.

As per the Central Bank publications, Economic and Social Statistics of Sri Lanka 2011 and the Annual Report for the year 2010

Type of Bank	Number of branches
Licensed Commercial Banks (LCBs)	2,133
● Domestic	1,917
● Foreign	216
Licensed Specialized Banks (LSBs)	569
Registered Finance Companies (RFCs)	376
Specialized Leasing Companies (SLCs)	224

Number of	In use per 100,000 persons
Bank branches	14
ATMs	11
Credit cards	3,770

As mentioned on Lanka Business Online (LBO), the current banking industry is densely concentrated in the Western Province with nearly 40 percent of the branches of LCBs and 31 percent of the branches of RFCs being present in this area. With respect to banks, the banking density (the number of bank branches per 100,000 persons) is 11.9 in the Western Province against a range of 5.3 to 8.4 in the other provinces.

Is the banking industry of Sri Lankan evolving?

Although the island's banking sector was largely unaffected by the global credit crisis as it was not exposed to the risky practices that led to it, it does face structural challenges. The industry is over concentrated, over-banked and saddled with high costs, especially for distribution, and the prevents the optimization of economies of scale. This in turn makes it difficult to attract new investments into the sector.

At present the Sri Lankan banking industry is heavily concentrated in the Western Province. Thus all banks are competing to capture the same customers resulting in having to slash down the rate of interest in order to retain them. This does benefit the few large corporate firms and neglects the Small and Medium Enterprises (SME). This is detrimental to the long run stability and sustainability of the bottom line of banks due to the high competition among banks to cater to the few large corporations, thinning interest margin as a result of price sensitivity and the high cost incurred in managing the portfolios, human capital and overheads.

Another strategic management error the banks continue to ponder on is catering to the 20 percent of the market which used to contribute 80 percent of the revenue in the good old days. Nowadays the operating environment for banks has changed significantly, making the banking industry more competitive and price sensitive. As such the 20/80 rule is no longer valid. In essence, the 20 percent now amounts to more of the cost and time, in terms of recruitment of high skilled personnel, administration, documentation, continuous revision due to environment dynamics and approval process. In order to be sustainable in the future, the banks will have to rework and align their strategy to get the best out of the other 80 percent at a 20 percent cost.

Going by the five pillars of the marketing mix, it is sensible to argue that the products offered by the banks be available, accessible and affordable to those who require them. The present Sri Lankan banking inclusion rate is at 40 percent. Therefore there is clear indication of the potential and the gaps available for further inclusion. Commercial banks have to make financial services available, accessible and affordable to the segments in the market such as the youth, women, migrant population, rural agriculture sector and the SMEs. It is crucial to identify the needs of these segments to bring out the potential long run sustainable banking business. Surviving the fierce competition and demanding customers is not possible by resorting to serving only one segment of the market. The SME sector in particular should be made an integral part of the banking spectrum. A 360 degree outlook is required and all possible avenues should be patronized and opportunities should be exploited in times of downturn.

Changing the paradigm

Jumping at several small opportunities may get us there more quickly than waiting for one big one to come along. - Hugh Allen

The time has come if not too late for banks to move away from traditional thinking of serving only the large corporations and take a more holistic view if the industry is to stably and sustainably move forward. Greater inclusion of the masses is fundamental for the future of the industry. Generally banks take from masses to lend to few. Nevertheless, if banks are to remain stable and sustainable they should break the frame and focus on taking from masses to lend to masses, thereby facilitating enhanced banking inclusion.

By making financial services available for more people at more places banks can create more access and greater inclusion. Banks are continuously slashing the rate of interest quoted to corporate sector to secure business. Yet, this cost leadership in the corporate sector is rarely able to provide a sustainable competitive advantage for the banking industry. In most cases firms end up in price wars. Therefore, one would suggest that by having a widespread network that taps the remote locations with potential would give the banks a higher competitive advantage whilst, the society will benefit from the trickle down effects. However, in today's context, this can be done at a very low cost due to the technological advancement, its availability and accessibility invalidating the concept of brick and mortar as an obstacle in extending financial services.

Savings, thrift concept, financial management and financial literacy should be made a part of the education of every human being from his or her childhood in order to achieve a financially savvy society. Banks should take a long term view with respect to inculcating minor savings without the enormous effort put forward to enticing the children and parents with the extravagant gift schemes.

Commercial banks have a responsibility towards the provision of financial literacy to the youth of the country and engage them in financial services. Youth unemployment rate is estimated to be 6 percent. Yet, the recent rush for Korean job applications and other similar scenarios make one wonder whether the reality is otherwise. The numbers of dropouts from schools and universities are increasing but the creation of jobs and job opportunities remain minimal.

The women of Sri Lanka are a responsible and accountable segment of the society, with high a literacy rate, entrepreneurial skills and great potential for employment. As such, women should be empowered to build their life and the families of those around them to better standards through the engagement in economic activity.

A silent but integral part of economic development is the rural community and farmers. Small holder agriculture related activities are a major contributor towards the Gross Domestic Production (GDP) of the country. The financial security of the farmer is crucial to ensure food security. Commercial banks have a major responsibility in facilitating the small holder famers in terms of access to finance, financial knowhow, capacity building and management of finance.

Reportedly, 10 percent of the Sri Lankan population consists of migrant workers contributing US$ 4.1 Bn that is approximately 8 percent of the GDP. Yet, there is no improvement in their asset creation or lending due to the short term approach by financial institutions catering only for remittances and transfer of money.

The aging population of Sri Lanka is on an upward trend and 10 percent of the population is estimated to be over 60 years of age. This is another segment that needs to be engaged in the productive economic activity. The experience and expertise possessed by retired persons or pensioners should be diverted to contribute to the society by partnering them in economic activity for revenue generation by the financial institutions.

The SME sector requires banks to provide more cash flow based viable project financing instead of the collateral oriented financing. In addition, the technical knowledge sharing and capacity building programmes are vital to establish a strong SME sector in Sri Lanka. Hence, greater engagement by commercial banks in facilitating Micro Enterprises island wide and graduating them to SME, commercial and corporate levels creating access to financial services is imperative to have economic benefits flow across the nation.

Mergers and Acquisitions (M & A) are an aspect of corporate strategy, corporate finance and management dealing with the buying, selling, dividing and combing of different companies and similar entities that can aid, finance or help an enterprise grow rapidly in its sector without creating a subsidiary. Through M & A, banks will be able to deliver several services to customers under the universal banking concept and also bring down the cost of transaction such as overheads, capital expenditure.

Technologies such as ATM networks are common to all banks in facilitating financial transaction. Therefore, it is prudent to share and make use of these platforms to provide better access to financial services to customers. A small country like Sri Lanka having a large number of small banks may not reap the same amount of returns it could otherwise earn if platforms are shared to expand service provision. Geographical inclusion could be better addressed if technology is used to its best potential.

Increasingly, businesses are expected to find ways to be part of the solution to the world's environmental and social problems. The best companies are finding ways to turn this responsibility into an opportunity. It is believed that when business and societal interests overlap, everyone wins. However, it is important that banks not only look at it from a corporate social responsibility point of view but have a corporate commercial responsibility point of view where the organization contribute to the society at large by way of new employment creation, development programmes, career guidance, financial knowledge and linkages. Last but not least they can initiate financial schemes to support the entrepreneurial community.

Micro entrepreneurs are an important segment that was unnoticed by many financial institutions until recent times. Greater inclusion of the segment is essential for a strong, stable and a sustainable economy. Also subcontracting and cottage industries too assist promotion of financial inclusion particularly in countries engaged in agriculture and micro industries. It is a great way to earn additional income during the part of the year when there is no farming and one could engage in a productive activity at home. Companies could outsource or subcontract their production to these cottage industries and collect the produce and sell them to the market.

Development of banking industry and services should be integrated in order to achieve more progressive growth for the benefits of the inclusion to spread through out the economy.

Stability, sustainability and the triple bottom line

Sri Lanka with access to free education and health is blessed with high literacy and low mortality rates. This results in a more economically employable population. Sixty to seventy percent of this population is in the rural Sri Lanka and due to the communication gap and the lack of information flow valuable human resources are wasted. Although more than 70 percent of the population has access to information communication technology, media, mobile communication and the internet, the language barrier and the lack of direction has led to deprivation of opportunities. Therefore, it is of utmost importance that commercial banks take part in capacity building activities.

Sri Lanka was faced with significant challenges in the 1971, the 1989 and the three decade long terrorism. All these were unfortunate outbreaks of the frustrated and excluded youth from the economic activities and their continued marginalization. It is debatable that, over time, this marginalization will develop a gap which eventually could create another unfortunate youth rebellion. Therefore, greater rural economic enrichment is required to withstand the mounting pressures of the youth as witnessed in the past. Those with a long term vision and a prudent strategy will find ways to turn this responsibility into an opportunity. And it is true that when business and societal interests overlap, everyone wins.

For any industry, sustainability is a powerful and defining idea: a sustainable corporation is one that creates profit for its shareholders while protecting the environment and improving the lives of those with whom it interacts. It operates in such a way that its business interests and the interests of the environment and society intersect. A sustainable business stands an excellent chance of being more successful tomorrow than it is today, and remaining successful, not just for months or even years, but for decades or generations.

The triple bottom line approach focuses on the three core elements i.e. profit, people and planet. Yet, the increased passion for corporate social responsibility should not be a mere exercise for the sake of winning awards. It should deliberate on identifying the real need of the society and the country. The organizational hierarchy should focus on the triple bottom line approach. The discussions and the initiatives should be documented based on the impact created by organizations in reducing unemployment, poverty head count, initiatives on wealth creation and distribution to large societal segments infusing significant effects to the economic empowerment and enrichment of people. Moreover, the impact on preserving, sustaining and further replenishing natural resources and the dynamic engagement with all stakeholder groups should be addressed. This automatically paves way for sustainable, responsible and accountable revenue generation.

Commercial banks should rethink on their strategy about making hay while sun shines if they are looking at sustainable banking business. A broader spectrum should be evaluated instead of the short term windfalls that concentrate on Year on Year Key Performance Indicators (KPI's).

With the end of the war, new avenues are opening up and there is need for greater outreach to those who yet remain unbanked. There lay far reaching potential if we only care to open our eyes and see beyond the limitless horizon. The question remains, are we going to eat the same cake or are we going to bake new cakes to eat? Being more proactive to changing market dynamics, scaling down for greater inclusion and catering to all segments of the market exceeding their expectations is the way forward for a stable future for banking industry and ensuring sustainable banking business.