

**FUTURE PROSPECTS AND STRATEGIES OF  
DEVELOPMENT BANKS IN SRI LANKA**

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**(DPM/96/51)**

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## **Author's Declaration**

This work describe in this thesis was carried out by me under the supervision of Dr. H.M.T.N.R.Herath and a report on this has not being submitted in whole or in part to any university or any institution for another Degree/ Diploma.



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## Certification


I hereby recommended that the dissertation entitled "Future Prospects and Strategies of Development Banks in Sri Lanka" prepared by Mr. J.B.A.S.Jayasinghe under my supervision be accepted in partial fulfilment of the requirements for the Degree of Master of Science in Management.



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Accepted by the examining committee



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## LIST OF ACRONYMS

ADB	Asian Development Bank
MDFIAD Pacific	Association of Development Financing institution of Asia and Pacific
ATM	Automated Teller Machine
CBSL	Central Bank of Sri Lanka
CISIR	Ceylon Institute of Scientific and Industrial Research
DB	Development Bank
DBS	Development Bank of Singapore
DFCC	Development Finance Corporation of Ceylon
DBI	Development Bank of India
DFI	Development Finance Institution
EPF	Employee's Provident Fund
ETF	Employee's Trust Fund
GDP	Gross Domestic Product
HDFC	Housing Development Finance Corporation
HFI	Housing Finance Institutions
ICICI	Industrial Credit Investment Corporation of India
IDA	International Development Association
IT	Information Technology
KDFC	Korea Development Finance Corporation
LSB	Licensed Specialized Bank
MSE	Medium Sector Enterprises
NDB	National Development Bank
NHDB	National Housing Development Bank

NSB	National Savings Bank
PICIC	Pakistan Development Credit and Investment Corporation
PSDB	Pramukha Savings and Development Bank
PWHC	Price Water House Copper
SME	Small Medium Enterprises
SMI	Small Medium Investment
SIDA	Swedish International Development Agency
SMIB	State Mortgage Investment Bank
SMIL	Small and Macro Industries Leader
USAID	United State Agency for International Development

## **ABSTRACT**

Development Banks were established under the patronage of the government to accelerate the economic development of the country. Initial funding at concessionary rates from multilateral agencies and the re-finance schemes were handled by the CBSL. The government's assistance was the guarantees on borrowings and cover against fluctuation in the exchange rate. This study aimed at achieving four objectives namely re-assessing the role of DBs, identifying present challenges of DBs, drawing experiences of selected DBs in the Asian region and investigating strategies and future prospects of DBs in Sri Lanka. Data required were collected through the desk research, questionnaire and interviewing. Interviews were held amongst twelve respondents selected from different sectors targeting an assortment of views. An analysis of the development banking industry revealed that it was in the maturity stage of its life cycle and that the industry was highly competitive offering participants little opportunity for earning super normal profits. The main industry players, NDB and DFCC have to find innovative strategies to ensure future prospects. It further revealed that the most critical issue faced by the DBs was non-availability of low cost funds from the credit lines. Some of the other challenges identified included the rigidity of organization culture, changing customer needs and competition from the commercial banks. These challenges and changes had a prominent impact on the shareholding structure proving that the DBs can no longer operate as Development Banks in a traditional way. Therefore, transformation into profit earning organizations while maintaining their initial objectives was inevitable. They had to diversify their product range and to introduce new organization culture with the objective of becoming a universal bank that offers a complete range of financial products and services.

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# CHAPTER ONE

## INTRODUCTION

### **1.1 Background**

A Development Bank is a financial institution with the scope that can be more precisely delimited with regard to its functions and operations. The field of development banking goes beyond the scope of the Development Bank (DB). In addition to functions and operations of a Development Bank, it also covers the areas of national planning, and has a link with national development programs, industrial, agricultural, infrastructural, social and other development processes. (Bruck, 2001) Furthermore, development banking requires certain knowledge about financial marketing and international finance. However, the term 'Development Bank' is not as precise as the term 'Development Finance Institutions'. Since the term Development Bank is a synonym to development finance institution (DFI) and it is more easily understood, the former is used in this study to stand in general for development finance institutions.

The term "bank" means a privately owned institution licensed by a government financial authority to be engaged in the business of banking with the public. In many developing countries, financing of development projects are carried out by the government owned financial institutions. These institutions have been created by law with the direction of Central Bank and Ministry of Finance. After the Second World War, institutions such as United Nations made a distinction between Development Banks and development corporations. According to United Nations, the former organizations were intended to engage in long term finance whilst the latter were to be

concerned with equity capital and with fostering and managing specific companies as well as providing financial support. This distinction though conceptually valid is usually too blurred to be useful in practice. Hence, both these types of institutions are referred to by the synonym DF1 (Rathnayake 1997). What makes these institutions different from commercial banks, according to the World Bank Development Report (1989) is that these institutions offer small and medium sized enterprises the long-term finance that commercial banks would not provide. Although these definitions capture the essence of development banking, one could also incorporate the view of World Bank official, D.L.Gorden quoting as, “the ultimate purpose of a Development Bank is to identify and assist productive projects” (Skully 2000).

Development Banks were established in developing countries with the objectives of providing long-term funds for economic reconstruction and development following the Second World War. The idea of the Development Bank used as a suitable transfer mechanism for the external financing of development projects emerged under the post-war economic environment (Bruck 2001). At present, every developing country and some of the industrial countries have development banks functioning. There are government owned or public development banks, private development banks and mixed ownership institutions. However, 65 percent of financing comes from public institutions, about 15 per cent from mixed ownership institutions and remaining 20 percent of the financing is provided by private owned development finance companies (Bruck 2001). The role of these banks differs from the services provided by commercial banks and development finance corporations.

In analyzing the nature of a Development Bank one should examine its role comparing it with other banks such as commercial and investment banks. While commercial banks provide short-term credit, which are repayable within a period of less than one year, investment banks specialize in raising long-term funds through the issuing of securities, bonds and other financial instruments. But the basic difference is that investment banks do not provide long term financing for development projects while the Development Banks provide financing for them. Therefore, a Development Bank is set apart from the other financing institutions such as commercial and investment banks due to two important operational policies. These policies establish the two main requirements for the approval of any loan for the financing of a project (a) an economic appraisal of a project and (b) observing the principle of the DB acting as a lender of last resort.

In Sri Lanka, the first DB known as Development Finance Corporation of Ceylon (DFCC) was established in 1955 with a view to accelerating the economic development of the country. This institution was established by an Act of parliament in 1955, introducing the first long term finance corporation. The National Development Bank of Sri Lanka was set up under National Development Bank (NDB) of Sri Lanka Act 2 of 1979. However, with the change of economic conditions today the main purpose of a Development Bank is to identify and assist productive projects in the dynamic economic environment and at the same time earning profits to survive in the market.

## **1.2 Research problem**

From the inception, both Development Finance Corporation of Ceylon and National Development Bank played an integral part in fostering and supporting the economic development in the country. In the past, most of the funding requirements for the