THE YEAR IN REVIEW – 2017

COUNTRY REPORT – SRI LANKA

Sharang Pant
Managing Director,
Nielsen Sri Lanka

INTRODUCTION – HOPING FOR A REVIVAL

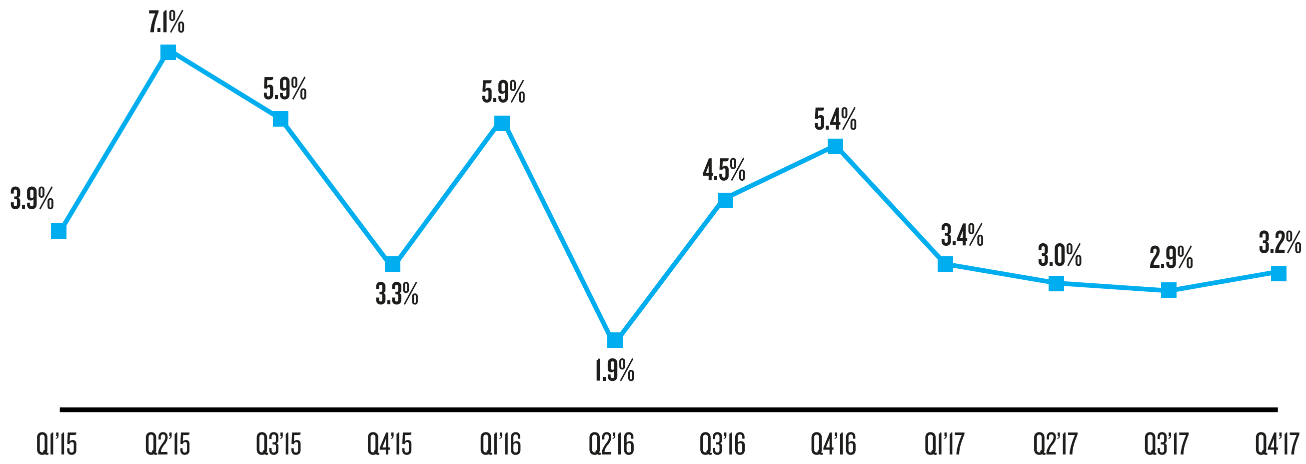
Two years of drought, rising prices and other uncertainties continued to restrain growth in Sri Lanka. While focus of the policy makers was on fiscal consolidation, the business confidence remained muted though fluctuations were lower than in the previous years. Significant slowdown in consumption remains the biggest concern for businesses as they struggle to get consumers to spend. Some green shoots were however seen towards the end of 2017 which should augur well for a potential revival towards later half of 2018.

Nielsen Sri Lanka's 'Year in Review – 2017' document, gives perspective across sectors identifying the key trends of 2017 that will continue to echo through 2018, and the dynamics that will define the way each of these key sectors reshape their fortunes. Our interpretation and the subsequent application by brands will ultimately reshape how the landscape turns out.

REAL SECTOR PERFORMANCE IN 2017 – MUTED GROWTH ACROSS SECTORS

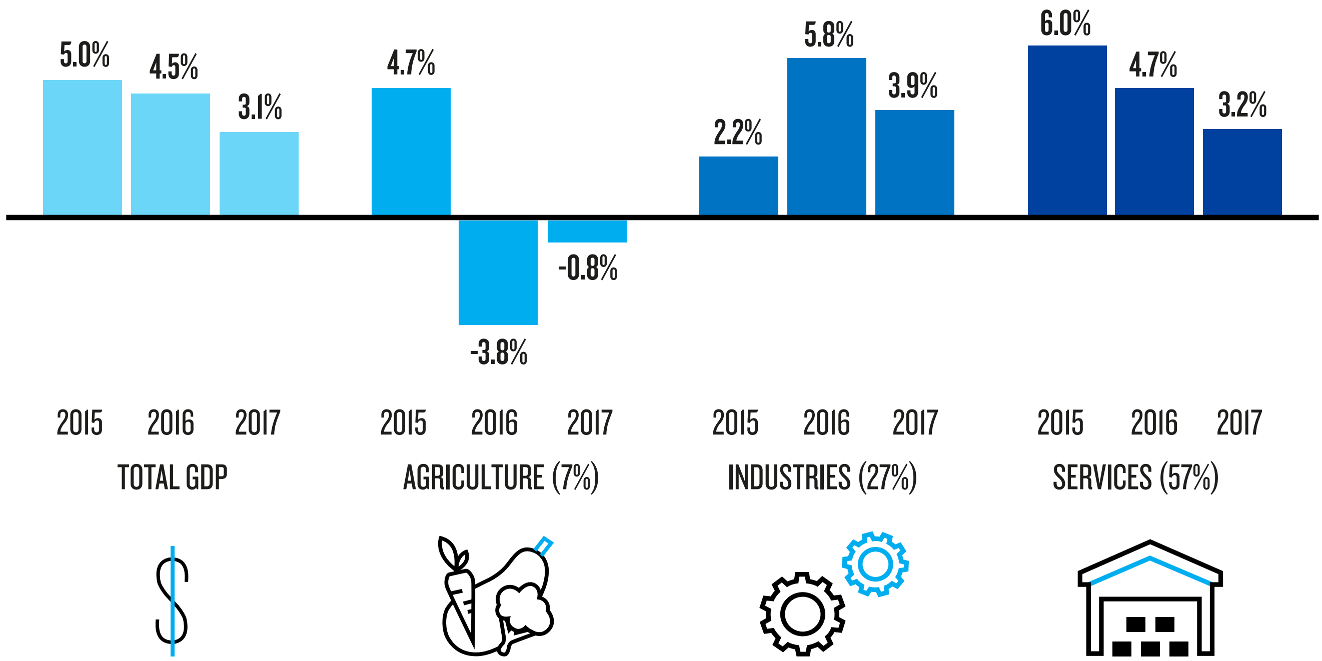
The agriculture sector continued to decelerate for most part of 2016 and 2017. The adverse weather from 2016 that continued in the first half of 2017 had an impact on the output, pushing up prices of Coconut and Rice quarter over quarter. Various infrastructure projects are up and running and there is a revival in manufacturing sector in the last quarter of 2017. However, lower demand due to inflation put pressure on manufacturing and overall industry sector growth closed lower at 3.9% compared to 5.8% in 2016. Services growth also slowed down in 2017 despite healthy growths in the Banking and financial Services and the IT services.

SRI LANKA TOTAL GDP GROWTH RATE %
(VS SAME QUARTER LAST YEAR)



Source: Department of Census and Statistics, Sri Lanka, Last update March 2018
Note: Growth rate at constant Prices - 2010

SRI LANKA GDP GROWTH RATE BY SECTORS %
(VS SAME PERIOD LAST YEAR)

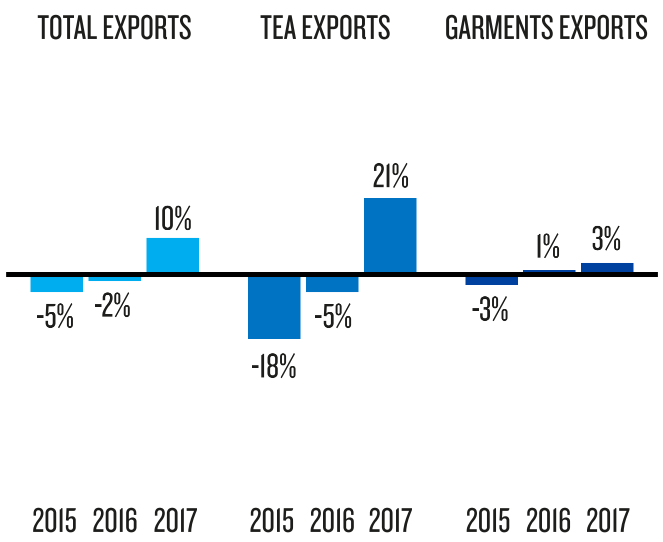


Source: Department of Census and Statistics, Sri Lanka, Last update March 2018
Note: Growth rate at constant prices-2010,
Figures in bracket indicate contribution of sector to GDP in the year 2017. Remainder is 'TAXES LESS SUBSIDIES'

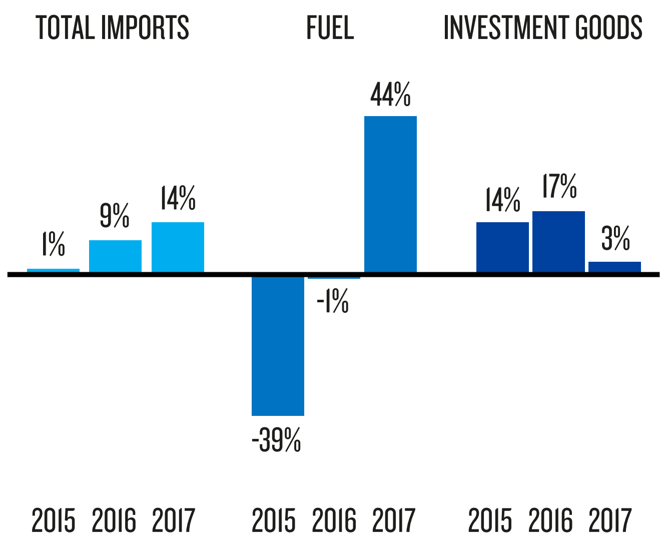
EXTERNAL SECTOR PERFORMANCE IN 2017 – EXPORTS REGISTER IMPRESSIVE GROWTH

Revival of strong demand in the US and Europe and the re-instatement of GSP+ status resulted in a strong exports performance in 2017 for Sri Lanka. Growth was particularly good in tea and garments, which together account for a little over 50% of Sri Lanka's total exports. However, imports too reflected a high growth, especially in fuel to support power generation in lieu of hydro-electricity and capital equipments and building material to support growth in the construction sector. Foreign currency reserves saw an improvement coming from the tranche received from IMF and equity investment in the Hambantota Port. FDI increased in 2017 compared to previous year. Better forex position resulted in a lower depreciation for the Lankan Rupee at 2% compared to 4% in 2016.

SRI LANKA EXPORTS GROWTH %
(VS SAME PERIOD LAST YEAR)



SRI LANKA IMPORTS GROWTH %
(VS SAME PERIOD LAST YEAR)



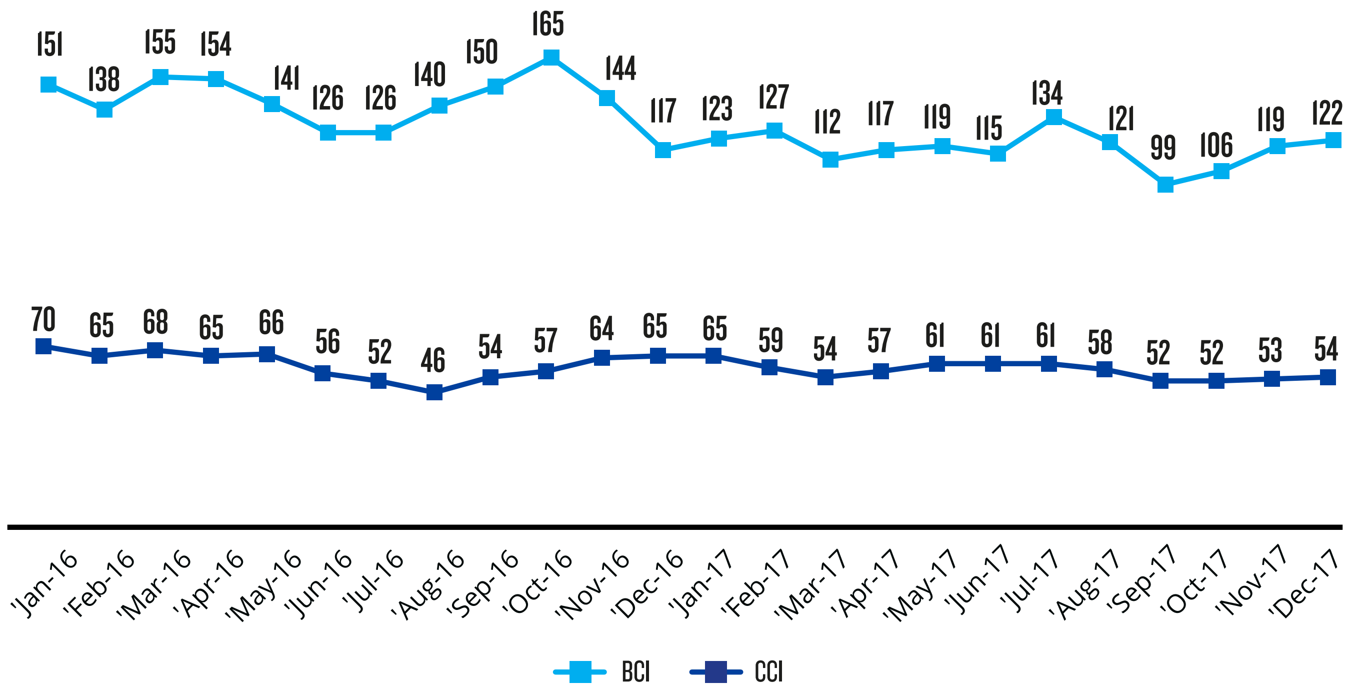
Source: Central Bank of Sri Lanka

BUSINESS AND CONSUMER CONFIDENCE – LOW BUT RELATIVELY STABLE

For more than 15 years now, the LMD Nielsen Business Confidence Index (BCI) has been tracking business and consumer sentiments on a regular basis. The survey done on a monthly basis among business leaders and consumers, reports perceptions on performance of the economy, business performance, investment climate and outlook for the coming year.

The BCI remained relatively stable in 2017 with a high of 134, a low of 99 and an average of 118. Another noticeable difference, compared to 2016, was the fact that the index moved up consecutively for 2 months after the budget was presented in November. There was a reverse or declining trend seen in the index in the last 2 months of 2016. This reposes belief in the long-term benefits of the 'Blue-Green' budget and the Vision 2025 document presented by the Unity Government.

BUSINESS CONFIDENCE INDEX TREND, CONSUMER CONFIDENCE INDEX TREND



Source: Nielsen Lanka CCI and BCI Surveys

*BCI is based on survey of 100 Managers/Senior Executives or above in the city of Colombo carried out by Nielsen and is compiled through series of questions on business conditions and expectations.

*CCI is based on survey of 100 respondents every month. From 2011 onwards Nielsen tracks the consumer confidence index every month among 100 consumers in Western, Central and Southern provinces. Index is developed based on consumers' confidence in the job market, status of their personal finances and readiness to spend.

BUSINESS CONFIDENCE REMAINED RELATIVELY STABLE IN 2017 WITH A HIGH OF 134, A LOW OF 99 AND AN AVERAGE OF 118. ANOTHER NOTICEABLE DIFFERENCE, COMPARED TO 2016, WAS THE FACT THAT THE INDEX MOVED UP CONSECUTIVELY FOR 2 MONTHS AFTER THE BUDGET WAS PRESENTED IN NOVEMBER.

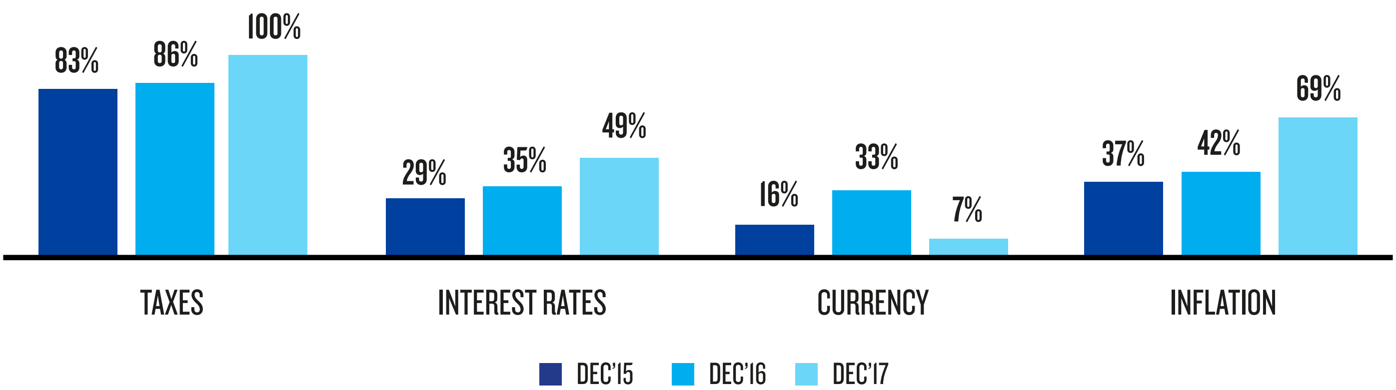
About one in two or 49% of the business leaders said their business had done better in 2015 compared to previous year. This percentage has come down over the last two years with 31% and 27% of the business leaders saying their business did better in 2016 and 2017, respectively, compared to previous year.

While a depreciating currency doesn't seem to worry businesses as much; worries around taxes, interest rates and inflation have continued to grow over the last 3 years. Inflation is seen as an impediment to consumption. Overall inflation (National Consumer Price Index - NCPI) witnessed a 12-month average change of 7.7% in 2017 compared to 4.0% in 2016. This increase was largely led by food that saw a 12-month average change of 11.3% in 2017 compared to 3.1% in 2016. The largest driver of this change included increasing prices of coconuts and vegetables.

A 7% drop in inward remittances had an impact on disposable income and consumption eventually. Remittances account for almost 9% of Sri Lanka's GDP, and it is believed that almost one in every eight households in Sri Lanka receives remittances and supports their monthly consumption budget.

PRESSING ISSUES FOR DOING BUSINESS

(% RESPONDENTS MENTIONING EACH ISSUE)



Source: Nielsen Business Confidence Index Survey, Frequency: Monthly; Base: All respondents n=100 per month

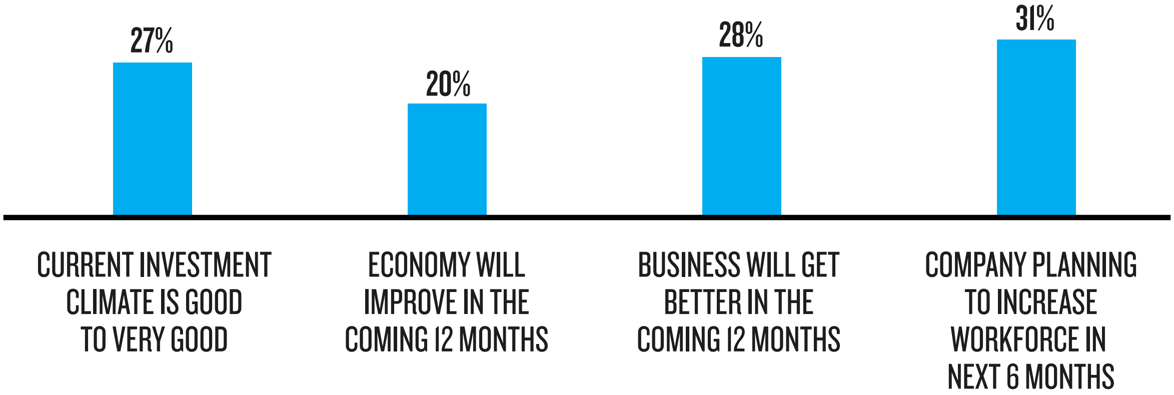
Businesses found it difficult to expand operations as the average weighted lending rate (AWLR) reached a maximum of 13.9% in August 2017. This slowed down aggressive lending in the private sector that was otherwise seen over the past few years.

Some businesses managed a good performance in 2017. Central Bank statistics reveal that the tourism sector witnessed an all time high of tourist arrivals at 2.1 million, a growth of 3.2% over 2016 but short of the 2.2 million mark the industry had set for itself. Apparels exports grew by 3% for the full year 2017. However, if we consider the six months period of July-December 2017, 6 months post reinstatement of GSP+, apparels exports grew by 12% over same period last year. Construction sector disappointed with delay in implementation of some key projects.

The apparel and the construction sector are expected to drive the growth in the coming years provided concerns around labor shortage and cost of raw materials are addressed. The Labor Demand Survey in Sri Lanka, conducted by the Department of Census and Statistics, reveals nearly half a million vacancies in the private sector. Vacancies for sewing machine operators and security guards accounted for almost a fourth of these vacancies. Another recent study on labor shortages in the manufacturing sector, notes that manufacturing jobs – particularly in the apparel sector – are becoming increasingly undesirable. Competing sectors such as tourism and retail offer more competitive wages, better working conditions, and higher social recognition.

OUTLOOK FOR THE COMING YEAR

(% RESPONDENTS MENTIONING)



Source: Nielsen Business Confidence Index Survey, Frequency: Monthly; Base: All respondents n=100 per month

Conclusion:

The Sri Lanka economy has witnessed high fluctuations in the last couple of years. Still reeling under the impact of adverse weather conditions and inflation impacting consumption, business leaders feel outlook to 2018 is still positive provided political stability ensures policy implementation and continuation of fiscal consolidation.

Athula Eriyagama
Director,
Nielsen Sri Lanka

FMCG CONSUMPTION UNDER PRESSURE

The fast-moving consumer goods (FMCG) sector is a major contributor to the Sri Lankan economy. The overall FMCG sector; including food and beverages, alcoholic beverages and tobacco; that operates through the wholesale and retail channel, contributes to above 30.0% of GDP and close to 20% of the overall employment in the country. Like some of the neighboring countries, Sri Lanka is also a consumption heavy economy with consumption as a % of GDP continuing to hover around 75% of GDP. FMCG categories tracked by Nielsen Sri Lanka in the Traditional Trade channels recorded a growth of 7% in 2016 versus 2015. This growth was mainly due to a one off salary increase, budgetary relief allowance and arrears that was paid in 2016 for the public sector employees and inflation that was still in low single digits. Growth, however, started to slow down in the second half of 2016 post increase in taxation, currency depreciation and rise in inflation as well as increasing interest rate.

234 | Billion LKR*
FMCG Value Sales in General Trade for Sri Lanka, Year 2017

263 | Thousand*
FMCG General Trade Universe in Sri Lanka, Dec. 2017

-0.3%* | FMCG Value Sales Growth
in Sri Lanka, Year 2017 over Year 2016

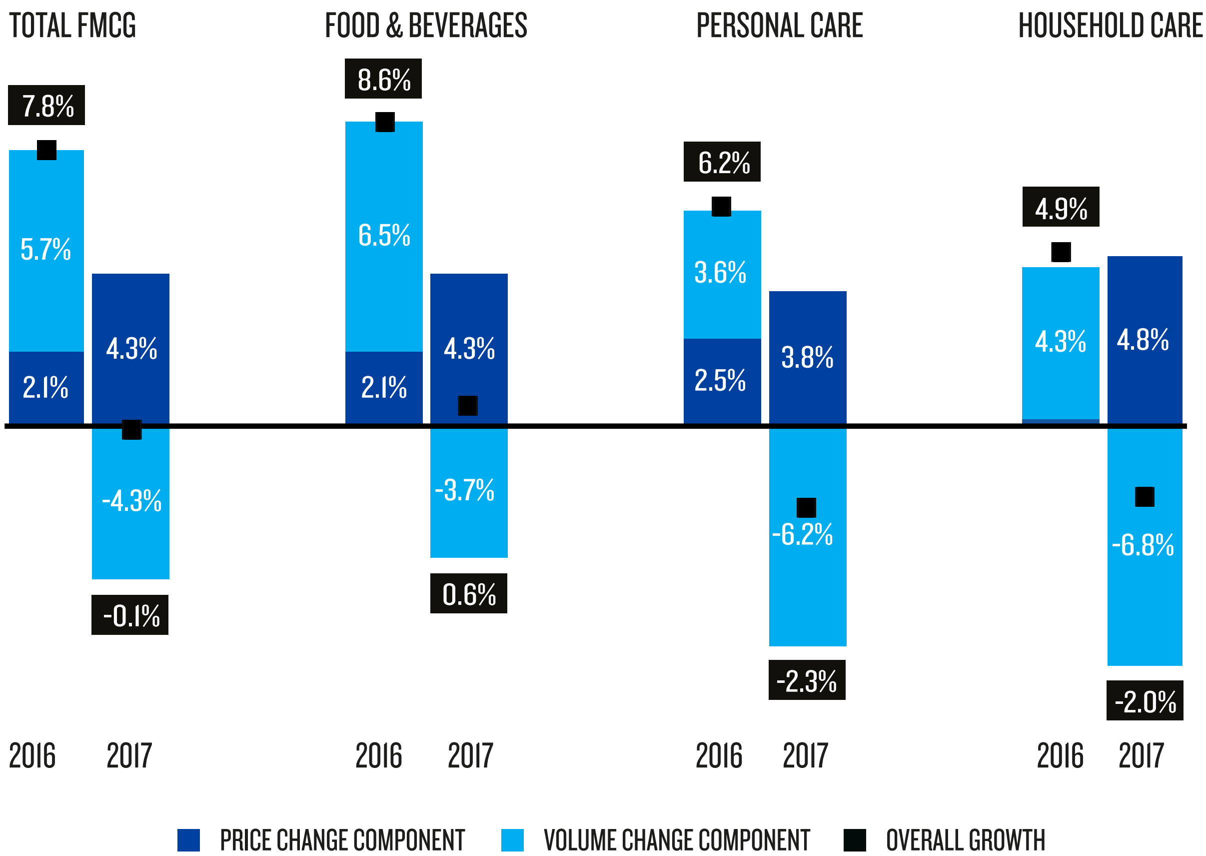
Source: * Nielsen Sri Lanka, RMS Data, for All FMCG (40 Categories including Soft Drinks), from General Trade, including Northern Province, Year 2017

Consumption pressure continued in 2017 and two major factors that influenced the economy of Sri Lanka, particularly during the first three quarters of 2017, had a direct bearing on the FMCG consumption pattern as well. First, the failure of the economy to fuel much needed growth in individual and household income levels due to poor performance of key sectors of the economy. This has a multiplier effect on income levels of low income households having a direct impact on disposable income and capacity to consume. The second key theme was the re-emergence of high inflation, mainly in the food sector during third quarter, pushing the overall inflation level to stand at 8.6% in September 2017. Adverse weather conditions continued during 2017 impacting economic activities around production and consumption that further contributed to the slowdown.

As a result, quarter over quarter, FMCG consumption declined. The LKR 234 billion FMCG market as tracked by Nielsen closed 2017 with a decline of 0.3% compared with 2016.

The overall growth of personal care segment dipped below the line as drop in volume consumption led to a big decline in growth. Household care segment experienced over 6% decline in 2017, being the hardest hit out of the three super segments.

GROWTH OF FMCG SUPER-SEGMENTS
(VS LAST YEAR)



Source: Nielsen Sri Lanka, RMS Data, for All FMCG (including Northern Province, 2016 and 2017)

> A KEY THEME WAS THE RE-EMERGENCE OF HIGH INFLATION, MAINLY IN THE FOOD SECTOR DURING THIRD QUARTER, PUSHING THE OVERALL INFLATION LEVEL TO STAND AT 8.6% IN SEPTEMBER 2017. ADVERSE WEATHER CONDITIONS CONTINUED DURING 2017 IMPACTING ECONOMIC ACTIVITIES AROUND PRODUCTION AND CONSUMPTION THAT FURTHER CONTRIBUTED TO THE SLOWDOWN.

SPENDING FLEXIBILITY DURING INFLATIONARY TIMES (EXTRACTS FROM NIELSEN GLOBAL INFLATION IMPACT REPORT, 2013)

The expanding middle class meets rising food prices. The convergence of these two mega trends is set to dramatically and permanently reshape the consumer landscape. With the global middle class growing by 70 million each year, and food prices expected to more than double within 20 years, the world is entering an unprecedented period of rising demand, economic pressures and aspirationally-driven buying behavior.

But focusing solely on the middle class, which is often defined by income parameters that are either too high or too low for universal acceptance, is unlikely to fulfill economic growth expectations for business. New findings from Nielsen reveal that differences in buying intentions for food products with regard to what we buy, where we shop, and our perceived spending flexibility is driven more by aspirations and cultural norms than by income alone. The Nielsen Global Survey of Inflation Impact, 2013 reported understanding of how respondents around the world of all income ranges were coping with rising food prices. These trends are still relevant in a market like Sri Lanka which is witnessing a growing middle income class and rising food prices.

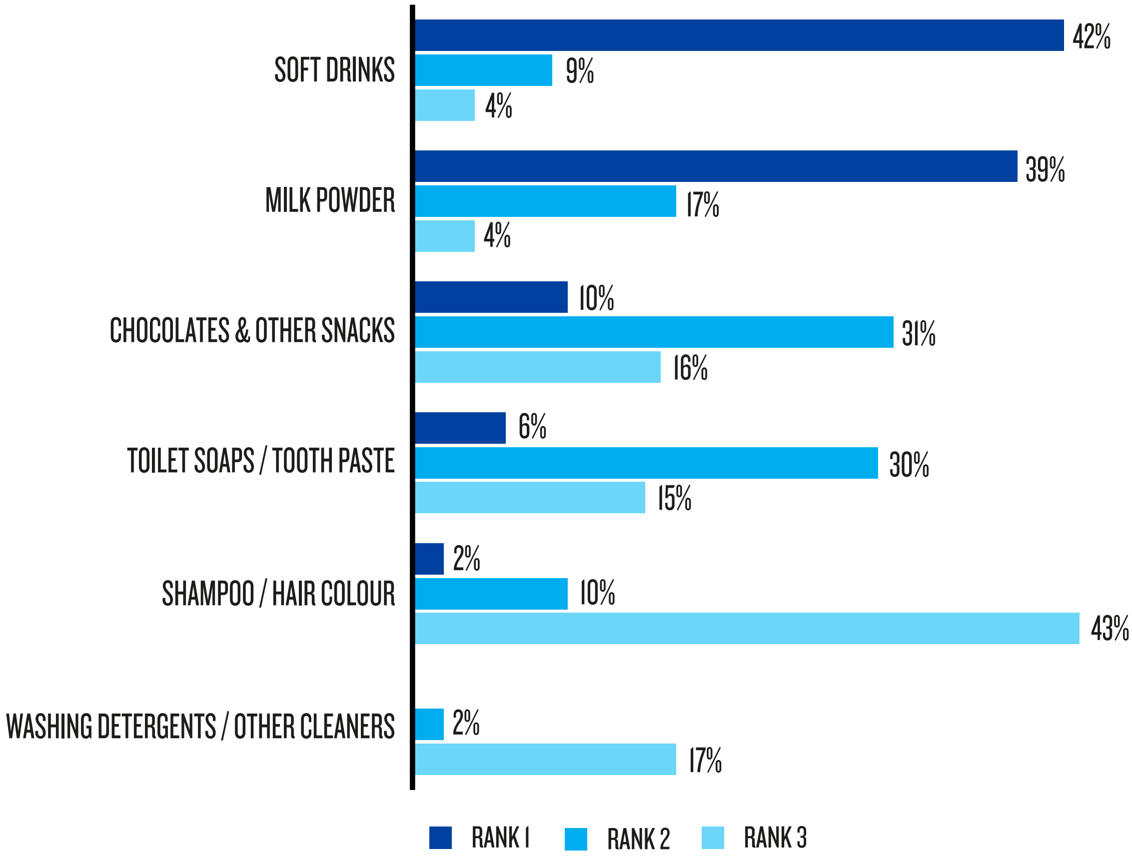
As consumers make trade-offs, determining which categories have staying power and which ones are more vulnerable is critical as tough in-store decisions are made. While buying more of anything is a challenge when wallets are squeezed, there were several categories that showed resilience to inflation. The one category that rose to the top across all regions was loose, unpackaged, unbranded cereal (such as rice, wheat and grains).

Categories most vulnerable during inflationary times included discretionary products such as candies, cookies and other sweets, chips and other snack foods, carbonated beverages, alcoholic beverages, prepared meals and convenience foods.

In Sri Lanka, as expected, the food and beverage segments faced the brunt first where a large majority of the consumers indicated that they have cut back on consumption amidst steep price increases in daily commodities such as milk food drinks and branded tea as well as impulse and snacking products. Consumers either stuck to their usual brands but reduced consumption or traded down to cheaper brands. In daily use categories like milk powder, consumers also preferred to buy larger packs to get pricing benefits.

TOP CATEGORIES THAT WITNESSED CONSUMPTION CUT DOWN

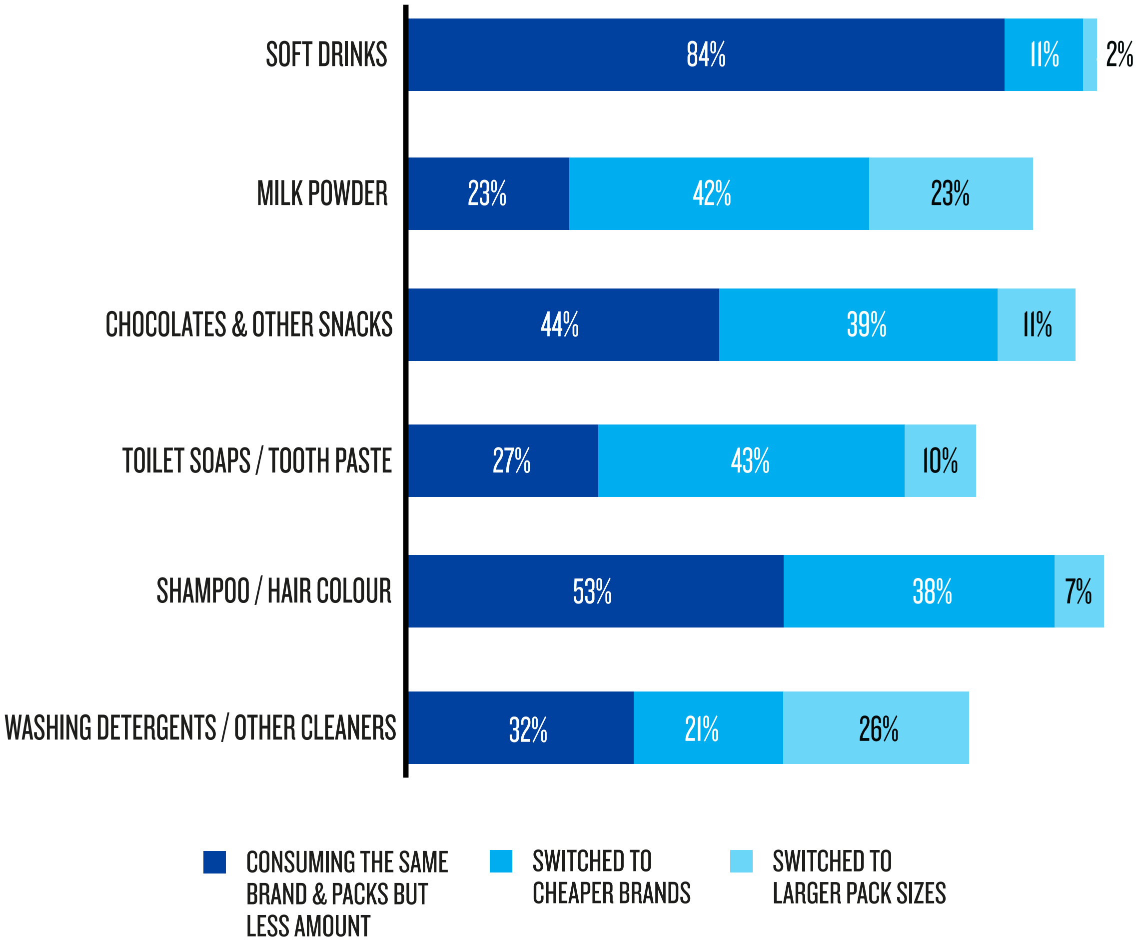
(PERCENTAGE RESPONDENTS GIVING RANKS TO TOP FMCG CATEGORIES WHERE THEY HAVE REDUCED CONSUMPTION/SPEND IN LAST 3 MONTHS)



Source: Nielsen Consumer Confidence Index Survey, January 2018

ACTIONS CONSUMERS TAKE TO REDUCE SPENDS ON VARIOUS CATEGORIES

(PERCENTAGE RESPONDENTS STATING DIFFERENT ACTIONS TAKEN TO REDUCE CONSUMPTION/SPEND IN LAST 3 MONTHS)



Source: Nielsen Consumer Confidence Index Survey, January 2018

With less money to spend and hungry mouths to feed, global consumers continually look for ways to stretch their budgets and find the best value for the money, and would shop more at discount/dollar stores in times of rising prices. As shoppers increasingly look for value, private-label brands, also known as store brands, have a potential advantage as shoppers become more discerning and lower-priced alternatives proliferate.

KEY ACTIONS TAKEN BY CONSUMERS DURING CRISIS MODE

CAUTIOUS CONSUMER

- Quality of life becomes secondary
- Saving Mode
- Not spending more than they earn

CHANNEL SHIFTS

- Diminished Loyalty
- Emerging Formats

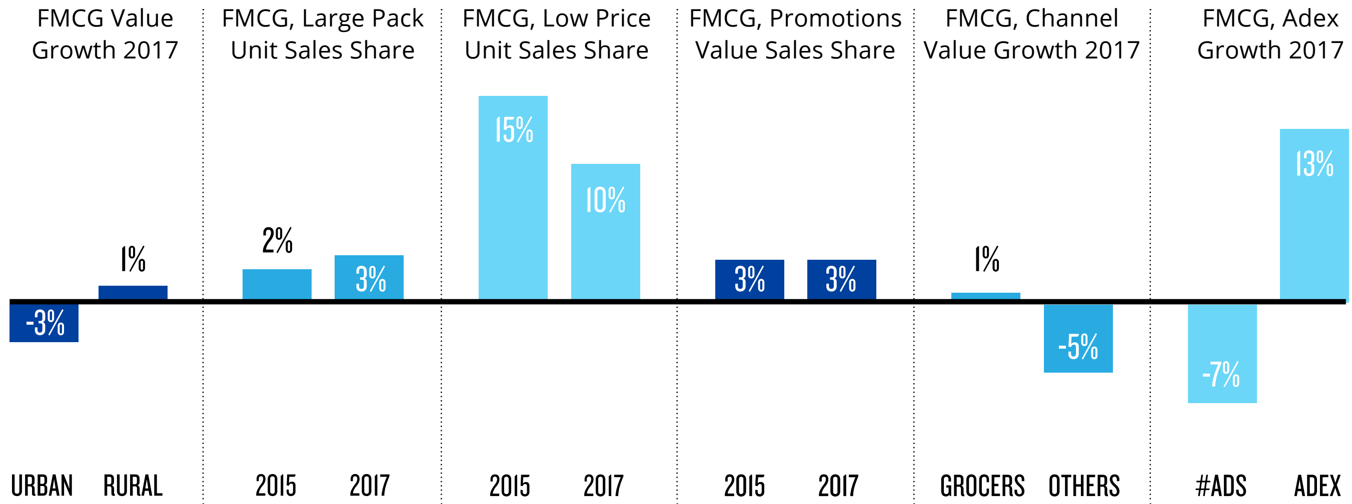
VALUE FOR MONEY

- Large Sizes / Multipacks
- Low Price Brands
- Retail Brands

KEY THEMES EMERGING IN SRI LANKA FMCG LANDSCAPE

Plagued by high inflation, FMCG consumption in Sri Lanka trended downward. However, there are specific themes emerging that can be the opportunities in 2018 and years to come.

KEY THEMES



Source: Nielsen Sri Lanka, RMS Data, for All FMCG (including Northern Province, 2016 and 2017), Nielsen Adex

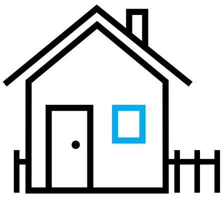
Consumption in rural Sri Lanka is still growing. FMCG consumption recorded a 1% growth in rural Sri Lanka compared to a 3% decline in urban Sri Lanka. Both the food and beverage segment and non-food segment recorded growth in rural Sri Lanka. A possible reason here could be that rural consumers had substitutes and home grown options available for items that saw high price increase like coconut, vegetables and rice. Therefore, the rural consumer could divert the money saved to sustain packaged, branded FMCG consumption. Companies would do well by focusing on rural consumers with specific portfolio.

Consumers moved toward mid and larger pack ranges looking for value for money proposition as a measure of mitigating the impact of inflation. This offers greater opportunity for brands that look for upgrading the consumer towards consuming larger packs at a higher price point. Large pack contribution at an overall level moved up from 2.4% of all units sold in 2015 to 3.3% of all units sold in 2017. In volume terms, large pack contribution moved up from 19% to 25% over three years as per Nielsen audit data. There is still a larger opportunity on the large packs when compared to other similar markets.

In terms of price points, contribution of the low price points to overall units sold dropped from 15% in 2015 to 10% in 2017. This is probably indicating that a section of society that usually buys these mass price points for packaged branded FMCG products has moved to unbranded loose products. Contribution of premium price point has remained stable at 16% over the last three years. Companies need to protect the consumption at the 'bottom of the pyramid' with the right pack and price portfolio.

Consumer promotions have a negligible contribution towards fueling any growth in Sri Lanka as companies do not have a promotion heavy portfolio. Essentially the value contribution from promotions to the overall FMCG market remained around 3% equaling the contribution from previous years. However, this offers a challenging but promising opportunity if one wants to look at ways of fueling growth even in short duration through promotions such as value offers.

In terms of trade channels, the main channel, grocers, registered a growth of just about 1%. However, steep decline was witnessed in fringe stores like cosmetics stores for FMCG. This could be an indication of change in business of these stores or a relook at the portfolio in order to sustain in difficult economic conditions. Organized retail followed the lead from Lanka Sathosa in lowering prices to reduce inflation burden on consumers, thereby driving a shift towards organized trade or modern trade. Nielsen does not measure modern retail in Sri Lanka.



RURAL CONSUMERS HAD SUBSTITUTES AND HOME GROWN OPTIONS AVAILABLE FOR ITEMS THAT SAW HIGH PRICE INCREASE LIKE COCONUT, VEGETABLES AND RICE. THEREFORE, THE RURAL CONSUMER COULD DIVERT THE MONEY SAVED TO SUSTAIN PACKAGED, BRANDED FMCG CONSUMPTION. COMPANIES WOULD DO WELL BY FOCUSING ON RURAL CONSUMERS WITH SPECIFIC PORTFOLIO.

In the meantime, marketers in the FMCG industry exercised caution in managing advertising spends during 2017 by visibly cutting down on the frequency or the occasions of advertising as there is a drop of 7% in the total number of advertisements in 2017 vs. previous year for FMCG categories. Although there was a decline in the frequency of advertising, the overall expenditure on advertising showed an increase of 13% during 2017. This could be influenced by the increases in rate card costs. Brands may be consciously attempting to stay top of mind even during tough period.

Fiona Juriansz Munasinghe
General Manager Marketing,
Hemas Consumer Brand

Farman Nizar
General Manager Marketing,
Watawala Tea Ceylon Ltd.

IN CONVERSATION WITH MARKETING LEADERS

Ms. Fiona Juriansz Munasinghe, General Manager Marketing, Hemas Consumer Brand and Mr. Farman Nizar, General Manager Marketing, Watawala Tea Ceylon Ltd, shared with us perspectives on challenges and opportunities within the FMCG sector.

Q. Later part of 2016 and the whole of 2017 has been a tough time for consumers with pressure on disposable income. How have you seen this impact overall consumption of FMCG products?

Fiona Juriansz Munasinghe (FJM): Consumers have been struggling with increasing cost of living. As a result we see many categories drop on household penetration or consumption volume. This is especially significant in the rural segment for non-essential items.

Farman Nizar (FN): Yes. The rise in F&B inflation together with climatic disruptions (i.e., droughts in 2016 and decline in predicted rains in 2017) resulted in dual impact for our industry. 2017 has been a year of price growth for many consumer products including tea. Though essential products didn't see penetration drop, it certainly had an impact on total consumption levels.

Q. Is the pressure of managing grocery budget getting consumers move to loose, unbranded commodities?

FJM: Consumers are faced with higher living costs and many are forced to reevaluate non essential purchase decisions. In the essential products, consumers are seen moving towards cheaper products and products with consumer promotions. Categories where loose commodity is an option, consumers are opting for it.

FN: Sri Lankan consumers over the years have been continuing to migrate from traditional commodities to branded options; this is the case for many food and beverage categories, including tea, oil, bottled water, etc. During inflationary periods however companies can expect a slowdown on this and may be keen to prevent any reversal in the trend by introducing smaller SKUs or conducting more consumer offers. However in the case of tea the conversion rates have improved due to inconsistency in the supply-quality of loose teas in the last two years and the liberal availability of branded packs across the country.

Q. Are consumers opting for large packs that offer better price per grammage?

FJM: Unlike in the past where we saw a movement towards bigger packs, in the recent past we do see some movement towards mid-sized packs that allow the one time outlay to be lower.

FN: In daily-use categories like Hot Beverages, there is a pronounced move towards larger packs. This could be a result of more frequent consumer offers for the larger packs.

Q. Are consumers moving towards modern retail or private label for the better price offer?

FJM: There is a shift toward the modern trade (self service) and this is due to the expansion of the chains and the offers for consumers. We also see many grocery outlets moving to the self service format as consumers demand more choice and convenience. A movement towards store brands or private Label is seen in some low involvement categories, but less so for now in personal care where trust and brands play an important role in consumer decision making.

FN: Each day more consumers are entering into the organized retail sector with rising access to them and increased scale of value offers by the chains and their partner credit cards companies. Movement to private labels is also evident in some categories like jams and cordials. However, the trend is not yet significant in hot beverages.

Q. Is the slowdown affecting Innovation investment in general?

FJM: Companies focused on catering to consumer needs continue to focus on innovation, even during crisis time. Brands have to innovate to drive up consumer demand and cater to preferences.

FN: There is a need to promote innovation which is somewhat stunted by the present risk averse climate.

Q. Do you see companies reducing investments in ATL activities or BTL in-store spends during the slowdown?

FJM: We do see some reduction in smaller companies in ATL investments but overall we see that the marketplace is still very active. We see an escalation of BTL promotions in terms of promotional packs as companies fight for a share of slower growing volumes.

FN: Companies are likely to maintain similar ad spends to keep their brand consideration strong in consumer minds.

Q. Are consumers becoming more conscious of local vs. foreign brands now?

FJM: There are many foreign brands who have built strong connections with consumers and consumers may often not be able to judge which brands are foreign. At the same time there are many local brands which have significantly upped their game and are delivering more aspiration and high quality offerings to the consumer. In certain categories (e.g., skin care) consumers desire what suits them with international quality. If brands are able to articulate this and deliver on product benefits consumers are likely to be positive to the brand. What the consumer is looking for is superior value and they will lean towards brands that offer this.

FN: Yes, the urban is embracing modern options faster (e.g., beauty to branded sportswear, etc.). However, the mainstream is upgrading to the next best options that are available and promoted in modern trade stores (i.e., supermarkets and retail clothing stores); some of these are local and others are foreign; however in several cases consumers may or may not know that. However, online purchase trends have shot up both from local and overseas stores for several personal and home care products.

Q. Do you see new consumer segments / niche getting created across categories as a result of macro economic situation and specific marketing activations?

FJM: There are emerging consumers segments coming up which will provide opportunities as well as challenges to companies. Marketing activities can very much drive need states by driving up awareness of previously dormant consumer needs/tensions. For example, the rise of the woman as the key decision maker in non-traditional categories, more women have the disposable income as well as the need for more convenience driven products.

FN: Rising exposure of Sri Lankans to global mindset and global lifestyles continues to help overcome local cultural conditionings ()e.g., online purchasing, fashion trends, entertainment TV programs, dining out, modern entrepreneurial initiatives like YAMU, Quickies, Pick Me, Bookings.lk, etc.). The open source media today continues to fuel this transition in both the young and mature generation. Finding niches is one thing but creating niches for a new products and services is another rising opportunity.

Therica Miyanadeniya
Director,
Nielsen Sri Lanka

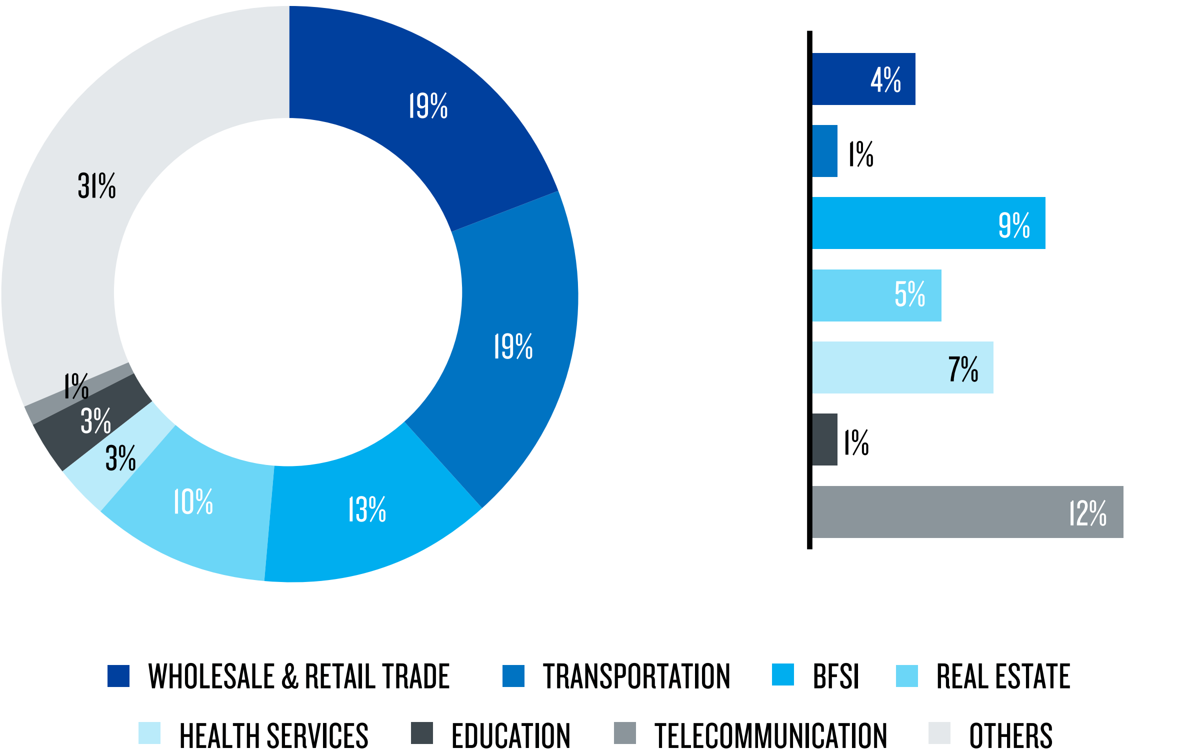
SERVICES SHOW MIXED PERFORMANCE

Services account for 57% of the Sri Lankan gross domestic product (GDP) as of Year 2017, and have grown at marginally higher than the overall GDP at 3.2%. Notably, while telecommunication and Banking Financial Service Insurance (BFSI) account for only about 14% of the total services component, they account for as much as 37% of the incremental value from the Services component of the total GDP. Together, telecommunication and BFSI have grown by 9% over the last year, a growth of about 3X compared to services or total GDP.

PERFORMANCE OF VARIOUS SECTORS WITHIN SERVICES GDP

CONTRIBUTION OF SECTORS TO TOTAL SERVICES GDP YEAR 2017

GROWTH OF SECTORS YEAR 2017 VS. YEAR AGO



Source: Department of Census and Statistics, Sri Lanka, Last update March 2018

High penetration of mobile devices and fixed lines and increasing volume of telecom equipment import means the Telecom Sector continues to be a tax magnet for the government to shore up revenue. Telecom taxes in Sri Lanka are amongst the highest across the globe. The Government removed the 25% telecommunication levy imposed on internet services from September 2017 with the aim of encouraging active online participation of youth to promote the internet economy. However, the 'Tower Tax' introduced in the 2018 budget could make operators close towers in unprofitable areas, discouraging internet penetration expansion which is currently at about 38%.

> **NOTABLY, WHILE TELECOMMUNICATION AND BANKING FINANCIAL SERVICE INSURANCE (BFSI) ACCOUNT FOR ONLY ABOUT 15% OF THE TOTAL SERVICES COMPONENT, THEY ACCOUNT FOR AS MUCH AS 51% OF THE INCREMENTAL VALUE FROM THE SERVICES COMPONENT OF THE TOTAL GDP.**

On the other hand, the banking, financial services and insurance sector (BFSI) is strongly correlated to economic activity in the country. As economic growth slowed down in the last couple of years compared to post war rapid growth, consumption related loans also slowed down in 2016 and 2017. Banks will continue to play a key role in financing the new and expanding corporate and the small and medium-sized enterprises (SMEs) that have got a boost in the 2018 budget. Transparent fee structures and IT enabled infrastructure will facilitate long term growth. Data analytics based customer profiling will help in judicious disbursal of loans and better management of non-performing loans (NPL). We delve deeper into the trends in banking sector in a conversation with Mr. Hasrath Munasinghe, Deputy General Manager Marketing, Commercial Bank of Ceylon PLC.

Hasrath Munasinghe
Deputy General Manager Marketing,
Commercial Bank of Ceylon PLC

IN CONVERSATION WITH MARKETING LEADERS

Mr. Hasrath Munasinghe, Deputy General Manager Marketing - Commercial Bank of Ceylon PLC., shares his outlook on the Banking Sector.

Q. Banking sector was one of the few that did not get impacted by the slowdown in 2016-17 and most banks have reported a healthy performance. What has driven this performance?

Despite experiencing a slight decrease in credit demand the banks have been able to maintain good profits. In 2017 Banks have registered around 20% growth over 2016. The gradual reduction of interest rates throughout the year resulted in Banks being able to re-price liabilities faster than assets which affected the net interest margin of the banks positively.

In addition to net interest margin that contributes a higher percentage to banks' profitability, in 2017, we have witnessed an increase in non-interest income, contributing to the increase the profitability of banks.

Also, banks have been able to maintain their operating expenses at a low level, which has positively affected the bottom line.

Q. The macroeconomic condition has affected the consumer wallet or disposable income significantly. How do see this impacting his/her financial behavior? Are consumers saving more as deposits/savings or are loans on the rise? Do you see NPLs plaguing the sector as a result of this?

We have seen a reduction in private sector credit growth in 2017 compared to 2016. At the same time,we have seen a marginal growth in deposits.

Industry NPL ratio has experienced an increasing trend during the latter part of 2017.

Q. There is a big focus on technology by the BFSI sector and telecom sector is also emerging as a competition with mobile pay and payment banks. Sri Lanka is still largely a traditional banking market. What will drive consumer adoption to these innovations?

The simplicity of the technology applications will be one of the key drivers in influencing the adoption of the digital banking applications. With a plethora of digital innovations being offered, the consumers will also be mindful of the relevance of the technology to their particular need and also the security level offered.

Technology that is secure, and simple to use, addressing a key need of the consumers will drive subscriptions to the technology.

Customer profit maximization through customer relationship management (CRM) and customer lifestyle management (CLM) utilizing technology will continue to play a crucial role in shaping the banking landscape. Business Intelligence based on data mining and big data will keep playing a bigger role in the industry.

All banks will keep adding to its digital product offering and automation will be a key focus area.

Q. The government is working on favorable policies for investments, SMEs and exporters. Are you seeing an uptick in loans through lending rates have not come down?

The export volumes and corporate finance activities have shown a growth though not an exceptional growth. SME loan volumes have recorded a moderate growth due to industry focus and multiple value additions.

The retail loans, utilized for consumption purposes and loans for construction, traders and manufacturing have shown a notable growth. Due to the prevailing somewhat volatile macro economic situation, the corporate sector seems a little cautious in venturing into big investments.

Q. Customers are consolidating accounts and moving to smaller/ local banks. Will this be a threat to larger banks and how can they overcome the threat?

There has been no evidence of a mass withdrawal of accounts from larger banks as a consolidation exercise. Customers tend to consider small/regional banks for savings, primarily due to high interest rates offered by those institutions. However, this has not resulted in terminating the relationship with large banks.

The large banks will continue to add value in terms of offering a broad range of products and services including multi channel banking services.

Q. What is the outlook for the sector in 2018?

A steady outlook for 2018-2020 period is predicted by industry analysts with a moderate credit growth and a steady GDP growth.

CONCLUSION

Growth slowed down in 2017 at the back of inflation and other macro indicators. However, there are green shoots visible and we should see a possible recovery by second half of 2018. With pressure on disposable income, consumers are managing their spends to cut down on discretionary items, buy more of large packs and move to channels that offer a price advantage. At the same time technology continues to drive changes in service sectors with rising increase in internet penetration and convenience being offered.

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