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## Chapter 10

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# Operations Of Commercial Banks

The banking sector in Sri Lanka consists of the Central Bank of Sri Lanka, the governing institution of the monetary system, commercial banks, rural banks, savings banks, development banks and merchant banks. The main feature that distinguishes commercial banks from the other financial institutions is the formers' engagement in the primary function of the acceptance of deposits through current accounts and collection of cheques or other instruments on behalf of their customers<sup>1</sup>. As the term "commercial bank" indicates, they are commercial enterprises motivated to maximize profits. To continue as viable institutions, commercial banks maintain a suitable mix between "profit" and "liquidity" objectives.

At present, there are 24 commercial banks operating in Sri Lanka, of which six are locally incorporated banks and the rest branches of foreign banks. Of the six local banks, two are state owned commercial banks. The

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1 "Commercial banking business" is often referred to as the business of receiving funds from the public through the acceptance of money deposits payable upon demand by cheque, draft, order or otherwise and the use of such funds either in whole or in part for advances, investments, or any other operation either authorized by law or by customary commercial banking practices" (Part XII Section 86, Banking Act No. 30 of 1988).

Regional Rural Development Banks (RRDBs) and the Co-operative Rural Banks are semi-commercial banks as they engage only in primary banking services and not in foreign exchange business.

In analyzing how commercial banks adapted themselves to both domestic and international challenges, this article focuses on major policy, structural and operational changes in the period after 1950. The article proceeds with a brief analysis of banking prior to 1950. The period 1950 -1989 is divided into three phases, i.e. traditional banking - 1951 to 1960; development and social banking - 1961 to 1976; and sophisticated and innovative banking - 1977 to date.

### **Banking Prior to 1950**

Until the setting up of the first joint stock commercial bank in 1841, the "Chettiars" provided financial services to the business community. For the majority of the people, banks represented something strange and alien. The British occupation of Sri Lanka (Ceylon) in the nineteenth and the early twentieth centuries mainly promoted the plantations and the export/import trade.

During the coffee boom, the plantation sector demanded more finances for the export trade. The flourishing mercantile and plantation community together established "Exchange Banks" during this period. The first exchange bank, the Bank of Ceylon<sup>2</sup> was established in 1841 and this was merged with the Oriental Bank to form the Oriental Banking Corporation. The crisis in the coffee industry and mismanagement resulted in the collapse of the Oriental Banking Corporation in 1884 and several other exchange banks, which gave rise to a turning point in the country's banking industry. In 1844, commercial banks were permitted to issue notes subject to the payment of a fee. Later this function was given to the Currency Board System. The Currency Board System directed commercial banks to provide necessary finances to the plantation sector and expedite the inflow of export proceeds.

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2 The Bank of Ceylon referred to was an exchange bank and is not the Bank of Ceylon established in 1939.

The coffee blight, which came in the mid-19th century, destroyed a major source of income of the plantation sector and the trade turned towards tea. This led the mercantile and exchange banks to a point of crisis, forcing banks to operate on a more sound and viable basis. During this time, the British banks dominated the scene but they were prudent and continued to operate within the traditional British banking framework. In addition to their interest in the plantation sector, they assisted local entrepreneurs dealing in real estate development. However, the newly born entrepreneurs in areas other than the export/import trade demanded the establishment of an indigenous bank. Apart from this, no significant changes were observed in the policies or the structure of commercial banks in the early part of the 20th Century.

From the point of view of policy and structural changes, a significant change took place in 1934 when the Ceylon Banking Commission recommended the establishment of a state aided indigenous bank and a few more local banks to finance agriculture and other domestic activities. The Bank of Ceylon (BOC) was established by Ordinance No. 53 of 1938 and the Bank commenced operations in 1939 as the first indigenous private bank in Sri Lanka. The Bank of Ceylon was also based on traditional banking practices, but catered to the indigenous business sector. The Bank of Ceylon's performance during the first few years was impressive and it enjoyed public confidence within a short time. This gave rise to a major break-through in the diversification of commercial bank operations and policies in Sri Lanka.

Table 10.1 shows the composition of the assets portfolios of banks which operated prior to 1950. A large portion of deposits was invested outside the country, the bulk in India and the UK. About 40 per cent financed general commerce and international trade. Approximately 90 per cent of total advances were in the form of overdrafts. The British banks and the other exchange banks were known as "overdraft banks" as they provided only working capital and short term credit, while a major part of investment capital was arranged in the UK. The British banks gave the business community easier access to foreign exchange and they attracted more deposits than the other exchange banks.

Table 10.2 shows the distribution of bank offices since 1939. During the period 1939-1950, there were 15 commercial banks, of which five were

**Table 10.1**  
**Structure of Bank Assets**

(Rs.Mn)

	Cash & Balances with Local Banks		External Assets		Loans & Advances		Bills Discounted		Ceylon Govt. Securities & Treasury Bills		Total Deposit Liabilities	
	Amount Total	% of Total	Amount Total	% of Total	Amount Total	% of Total	Amount Total	% of Total	Amount Total	% of Total	Amount Total	% of Total
1940	20	9.3	148	68.5	28	13.0	3	1.3	17	7.8	216	100
1942	59	17.4	211	62.2	15	4.4	1	0.3	53	15.6	339	100
1944	64	12.8	282	56.5	18	3.6	4	0.8	123	24.6	499	100
1946	176	27.6	217	34.1	49	7.7	19	2.9	177	27.7	622	100
1948	307	40.4	149	19.7	82	10.8	47	6.1	184	23.0	762	100
1950	202	23.5	174	20.2	129	15.0	83	9.6	271	31.5	859	100

Source: Statistical Abstract of Ceylon

**Table 10.2**  
**Distribution of Bank Offices and Deposits**  
**1939 - 1989**

Year	Banks													
	Local		Foreign		Total		Local Banks			Foreign Banks		RRDBs		
	No. of Offices	Amount Rs. Mn.	No. of Offices	Amount Rs. Mn.	No. of Offices	Amount Rs. Mn.	No. of Offices	Amount Rs. Mn.	%	No. of Offices	Amount Rs. Mn.	%	No. of Offices	Amount Rs. Mn.
1939	11	5	6	19	-	-	7	-	-	12	-	-	-	-
1950	15	5	10	40	811	100	23	249	31	17	562	69	-	-
1955	15	5	10	43	911	100	26	324	36	17	587	64	-	-
1960	14	3	11	45	1,057	100	28	472	45	17	585	55	-	-
1965	12	3	9	97	1,546	100	81	1,023	66	16	523	34	-	-
1970	12	4	8	165	2,394	100	152	1,831	76	13	563	24	-	-
1975	11	4	7	562	3,611	100	554	3,076	85	8	539	15	-	-
1977	11	4	7	715	6,793	100	707	5,998	88	8	795	12	-	-
1980	21	4	17	877	17,291	100	859	14,910	86	18	2,381	14	-	-
1985	25	4	21	653	45,459	100	628*	35,683	78	25	9,776	22	4	16
1989	24	6	18	672	69,986	100	651*	55,995	80	21	13,991	20	11	89

Source: Central Bank of Sri Lanka

\* Excludes ASC branches, extension offices, Pay Offices, Kachcheri Branches and Overseas Branches which were relocated during the year.

local and the rest were branches of British, Indian and Pakistani banks. During this period local banks expanded their branch network from 7 to 23. The banking density at that time was low, a bank branch covering approximately 274,000 people.

Prior to 1950, commercial banks concentrated only on the plantations and neglected the other sectors. With the establishment of the Bank of Ceylon in 1939 there was a gradual shift of loans from export/import trade to other domestic activities. In 1946, the Bank of Ceylon established a foreign department in Colombo and opened a branch in London in 1949. In 1948, the Co-operative Federal Bank was established with government financial assistance. The world of commercial banking prior to 1950 was one that only a few shared.

### **Traditional Banking 1951 - 1960**

The banking and financial community made increasing calls for a Central Bank, which resulted in the establishment of the Central Bank of Ceylon<sup>3</sup> by the Monetary Law Act No. 58 of 1949. The Central Bank commenced operations in August 1950. However, the Central Bank was in its infancy and was unable to set development priorities within the macro economic policy framework. Both the Central Bank's and commercial banks' involvement in development activities therefore, were ad hoc in nature. The aftermath of the trade cycles and balance of payment problems highlighted the importance of the diversification of bank lending and the mobilization of domestic resources. The Central Bank's interest in national economic development brought pressure on commercial banks to diversify lending so as to achieve a reasonable balance between export/import trade and the rest of the economy. The Central Bank was also assigned the functions of the banker to commercial banks and the lender of last resort.

The Bank of Ceylon Ordinance of No. 53 of 1938 was amended by the Bank of Ceylon Act No. 19 of 1952, by which restrictions placed on the operations of the Bank of Ceylon with regard to its engagement in development lending were removed. These changes allowed advances

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3 The name of the Central Bank of Ceylon was changed to Central Bank of Sri Lanka in August 1985.

to be granted against the primary security of fixed or immovable property other than plant and machinery and to construct buildings or improve, alter, develop or deal with any property or rights to land taken on lease by the bank. The provisions which limited the maximum period of loans for seasonal credit to 24 months and other loans to 6 months, and those which required the retention of cash reserves of not less than 10 per cent of the total credit of depositors in current accounts or other accounts were also deleted.

The experience and confidence gained by the Bank of Ceylon, together with the amendments of 1952, enabled it to formulate policies to engage in development banking. In 1953, the Bank of Ceylon launched a medium term loan scheme for residential housing and development of industrial property. To mobilize resources, a Special Medium Term Deposits Scheme of 1 to 2 years was designed at interest rates between 2.75 and 4.25 per cent per annum. However, the low deposit inflow due to non-attractive interest rates and the ceilings placed on housing loans made this scheme unsuccessful. In a similar vein, in 1955 the Bank of Ceylon introduced the Safety Cheque and Security Cheque Schemes and these too were not attractive due to low rates. Similarly, loan facilities offered to purchase public company shares upto Rs.7,500 in 1957 and the personal loan scheme launched in 1958 were unsuccessful. Yet, being the only indigenous bank, the Bank of Ceylon was able to build up a reasonable deposit base and by the end of 1957, the Bank of Ceylon's total deposits accounted for nearly 37 per cent of total commercial banks' deposits. Notable changes in the asset/liability structure of commercial banks during the 1950 - 1960 period are shown in Table 10.3

The table reveals a significant reduction in most liquid cash items of commercial banks compared to that of the previous period. The cash on hand and balances due from domestic banks, which stood at Rs.228 million and Rs. 173 million at the end of 1949, decreased to Rs 36 million and Rs. 2.6 million respectively, by 1950 and remained low thereafter. The liquid assets/demand deposits ratio<sup>4</sup> declined from 67 per cent in 1950 to 57 per cent in 1960, reflecting the gradual deviation from holding

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4 Liquid assets are defined to include cash on hand, money in the call money market and Treasury bills.

**TABLE 10.3**  
**Assets/Liabilities Structure of Commercial Banks**  
**1950 - 1960**

	1950	1952	1954	1956	1958	1960
No. of Reporting Banks	12	14	14	15	14	14
Cash on hand	36.0	27.4	26.9	33.9	30.8	39.3
Due from Central bank	163.2	128.0	104.9	149.9	95.5	136.8
Foreign Balances	180.4	50.3	73.0	97.6	48.8	56.3
Investments: Treasury Bills	54.4	61.9	88.0	52.5	14.0	47.9
Bills Discounted	52.7	64.3	82.6	102.8	137.0	111.1
Total Liquid Assets	486.7	331.9	375.4	436.7	326.1	391.4
Total Investments	216.5	240.5	221.8	293.8	285.2	287.5
Total Loans & Advances	182	240.9	306.8	407.1	502.2	543.9
Demand Deposits*	730.3	620	647.7	790.1	661.3	684
Time & Savings Deposits	77.1	103.4	146.6	228.1	284.6	372.2
Total Deposits	807.4	723.4	794.3	1,018.2	945.9	1,056.2
Ratio of	%	%	%	%	%	%
Cash to Demand Deposits	27.2	25.1	20.3	23.3	19.1	25.7
Cash to Total Deposits	24.7	21.5	16.6	18.1	13.3	16.7
Liquid Assets to Demand Deposits	66.6	53.5	58.0	55.3	49.3	57.2
Investments to Total Deposits	26.8	33.2	27.9	28.9	30.2	27.2
Loans & Advances to Total Deposits	22.5	33.3	38.6	40.0	53.1	51.5

Source: Central Bank of Sri Lanka

\* Excludes domestic inter-bank deposits.

a higher share of liquid assets. During this decade, the total assets of commercial banks increased from Rs 858 million to Rs 1,199 million (an increase of 40%). On the liabilities side the major share of deposits took the form of demand deposits.



## **Development and Social Banking 1961 - 1976**

The inward looking economic policy package implemented during the 1961-1976 period was characterised by administrative controls, regulations and restrictions on economic activities. Within this regulated framework, the state sector dominated the scene and banks were expected to engage in development and social banking (by facilitating government payments schemes, salaries, pensions and collecting payments on behalf of the government). Selective credit controls were used to direct credit to priority sectors and promote the supply side with no regard to viability criteria. Due to unrealistically low interest rates, the rate of deposit mobilisation was slow, which resulted in a shortage of loanable funds. Such shortages were met by the Central Bank via accommodation under Bank Rate and through refinance facilities. Government pressure on banks was high and the Central Bank monitored banks' behaviour through selective credit controls which became a popular instrument of monetary policy. The outcome of financial policies pursued during this period resulted in a high rate of expansion in money and credit, causing greater financial instability.

The Peoples' Bank was established by Act No. 29 of 1961 as a state bank to provide adequate finance to the rural sector, develop the co-operative movement and engage in rural banking. The People's Bank absorbed the Co-operative Federal Bank of Ceylon Ltd and was empowered to engage in pawn broking. The Bank of Ceylon was nationalised in the same year and the two state banks were called upon to promote development banking, in particular, the provision of adequate finances to priority sectors, such as agriculture and industry. Commercial banks were required to take risks on small scale business entrepreneurs and help to promote entrepreneurship and economic growth. To enable state banks to engage in development lending, certain legislative and administrative restrictions were removed during the 1961- 1970 period. By the end of 1970, the two state banks accounted for 71 per cent of total deposits and 72 per cent of total advances. Within the regulatory framework, foreign banks functioned at a low key.

## **The Emergence of Private Commercial Banks**

The leading role played by the two state banks provided great strength to other domestic private banks to establish business. The emergence of locally incorporated private commercial banks marked another important event in the development of commercial banking. As a policy, the Central Bank promoted the formation of collaborative banking ventures owned by foreign and local business concerns. In 1969, the Commercial Bank of Ceylon Ltd was incorporated by taking over the business of the Eastern Bank Ltd. Later this bank took over three provincial branches of the Mercantile Bank. The Hatton National Bank Ltd was incorporated in 1970 by amalgamation of the Hatton National Bank Ltd and the Kandy and Nuwara Eliya branches of the Grindlays Bank Ltd. The Hatton National Bank acquired the business of the Mercantile Bank Ltd in 1974.

Government economic policies set up state sector corporations as agents of development and expected the banking sector to assist state corporations, giving less emphasis to viability of projects and recoverability of loans. The state sector later became a financial burden to the state banks. A good part of loanable funds was given to the state corporations and the balance was rationed among the private sector constituents. This also resulted in the denial of credit to the private sector to a damaging extent and suppressed their participation in economic activities.

## **Extensive Branch Banking**

The decade of the 1970's called for extensive branch banking due to emphasis on the mobilisation of domestic resources through time and savings deposits. With the establishment of the National Savings Bank in 1972, commercial banks became more aggressive in the mobilisation of domestic savings. Prior to this, commercial banks held more demand deposits (due to low interest rates) which were matched by short term lendings. On the assets side, commercial banks engaged in medium and long term lending to small scale entrepreneurs, following the government policy of supporting import substitution. Medium scale industries required commercial banks to adjust to risky lending, provide equity, and promote entrepreneurship and proprietorship. Asset

portfolios of banks indicated increased investments and equity participation. In pursuance of the policy of reducing high dependency on imported food and promoting self sufficiency in food production within the economy, the commercial banks, in particular the state banks, allocated a considerable proportion of lending to domestic agriculture. Branch expansion became inevitable and the two state banks expanded their branch network to rural areas. Both the People's Bank and the Bank of Ceylon thus moved away from "unit banking" to "branch banking" during this period, with a view to mobilising deposits and uplifting the living standards of the rural poor. Following the promotional policies of the government, rural sector activities flourished during this period and the two banks were able to mobilize a considerable part of rural deposits through their branch network.

During 1974-1976, the Bank of Ceylon established 390 Agrarian Service Centre (ASC) branches in remote areas to promote cultivation loans. Meanwhile, the People's Bank extended its own branches and also promoted the Co-operative Rural Banking network. Both the Agrarian Service Centre branches of the Bank of Ceylon and the Co-operative Rural Banks are semi-commercial banks. The latter function under the Commissioner of Co-operatives and are agents of the People's Bank. The banks were supported by the Central Bank through subsidized interest rates, refinance facilities and credit guarantees. The asset structure of the two state banks showed increases in credit to agriculture, cultivation and marketing. Refinance loans granted through the co-operative network and directly to farmers by the People's Bank and marketing refinance to the Paddy Marketing Board helped the implementation of the Guaranteed Price Scheme. This brought in diversification and structural changes in the lending portfolios of the two banks.

The outcome of government supported credit programmes, bank finance to meet budget deficits, extension of financial assistance to non-viable institutions and the creation of a "state sector" within the banking sector was a state dominated banking system, leading to misallocation of resources. Monetary policy was conducted through administratively controlled procedures and credit rationing. Selective credit controls were used to introduce structural and operational changes in domestic commercial banks. The objective of the financial sector development

was ignored and due to controls and lack of competition, commercial banks were not innovative.

The security situation in outstation areas, political interference and hence the increased number of wilful defaulters and lack of enthusiasm to recover loans by banks, resulted in the deterioration of the financial viability of outstation branches. The increased amount of non-performing advances of the two state banks emerged as a significant disturbing feature, which in fact discouraged the two banks from adopting more dynamic attitudes towards development banking. The local private commercial banks followed a more cautious policy with regard to branch banking, while the existing foreign banks confined their activities to Colombo and continued to operate in a non-committal manner during this period. Table 10.4 indicates the number of offices of local and foreign banks and the share of deposits held by them during 1961-1976.

The table indicates the gradual decrease in the importance of foreign banks during this period. The deposit share of foreign banks came down from 52 per cent in 1961, to 13 per cent by 1976, while the share of deposits of the local banks increased to 87 per cent, indicating the popularity of locally incorporated commercial banks. The number of branch offices of local banks rose from 37 to 631<sup>5</sup> while the number of foreign bank offices decreased from 17 to 8 during the same period.

Commercial banks, in particular the two state banks, although departing from traditional banking with a view to accommodating urgent credit demands, continued to engage in collateral oriented lending. Despite the emphasis on development banking, project lending undertaken by the two banks was not significant. The policy of nationalising profitable business concerns demoralised the promotion of business entrepreneurship in the economy. Following this, the banks gradually withdrew their investments in private business concerns and became more cautious in lending to this sector.

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5 The number of banks includes ASC branches of the Bank of Ceylon.

**Table 10.4**  
**(1) Distribution of Bank Offices and Deposits**  
**1961-1976**

Year	Banks		Branches (Offices)									
	Total	Local	Foreign	No. of Offices	Total Deposits Amount Rs.Mn.	%	No. of Offices	Local Banks Deposits Amount Rs.Mn.	%	No. of Offices	Foreign Banks Deposits Amount Rs.Mn.	%
1961	13	3	10	54	1,041	100	37	503	48	17	538	52
1963	12	3	9	83	1,301	100	67	801	61	16	500	39
1965	12	3	9	97	1,546	100	81	1,023	66	16	523	34
1967	12	3	9	133	1,637	100	117	1,157	71	16	480	30
1969	12	3	9	155	1,917	100	140	1,405	73	15	511	27
1971	12	3	9	189	2,516	100	176	1,951	77	13	565	23
1973	12	3	9	303	3,169	100	293	2,584	82	10	585	18
1975	11	4	7	562	3,611	100	554	3,076	85	8	539	15
1976	11	4	7	639	4,943	100	631	4,323	87	8	620	13

Source: Central Bank of Sri Lanka

Towards the end of the 1970s, the government was more concerned about the upliftment of the nation's welfare activities and this compelled the two state banks to participate more actively in "social banking". As state corporations were restricted from doing banking business with other private or foreign banks, they became major customers of state banks and enjoyed preferential treatment. The creation of a state dominated banking sector resulted in the two state banks carrying the financial burden of some loss-making corporations. The export/import business was limited due to import restrictions and domestic banks competed with the existing foreign banks. By the end of 1976, more than 30 per cent of bank credit went to state corporations. Due to low interest rates, mobilisation of funds within the economy was low and commercial banks were unable to cope with the demand for funds. The severe shortage of loanable funds resulted in the rationing of private sector credit. Table 10.5 illustrates the assets/liability structure of commercial banks during 1961 to 1976.

As shown in Table 10.5, several significant changes were observed in the assets structure of commercial banks during the latter part of the 1970s. Investments in Treasury bills which recorded a gradual decrease during the late 1960s (about Rs.50 million) rose to an unprecedented level (Rs.308 million) in 1971 due to the use of bank funds to finance government debt. The Treasury bill holdings however, dropped to Rs.80 million by 1976 due to low interest rates paid on them. The liquid assets/demand deposits ratio rose from 55 per cent in 1961 to a peak of 73 per cent in 1971 and gradually dropped to 56 per cent in 1976. Meanwhile, the loans and advances/total deposits ratio increased from 42 per cent to 77 per cent during this period, indicating a gradual shift from the policy of holding more liquid assets in commercial bank portfolios. The liability structure of banks changed after 1972 when banks began to canvass for more time and savings deposits. The demand deposit component came down from 65 per cent in 1961 to 53 per cent by the end of 1976. The need to launch an aggressive deposit mobilisation scheme through positive interest rates was felt throughout the latter part of the 1970s. Yet, the highly regulated systems, administrative controls and the selective credit policy postponed the implementation of high interest rates.

**Table 10.5**  
**(2) Assets and Liability Structure - 1961-1976**  
**Average of Monthly Figures**

	1961	1963	1965	1967	1969	1971	1973	1975	1979
Cash on Hand & Deposits at Central Bank (inclusive of Statutory Reserve Requirement)	148	164	224	218	250	369	483	480	476
Foreign Balances	54	44	55	57	63	51	66	89	99
Treasury Bills	51	128	89	80	50	308	132	46	80
Bills Discounted	122	114	173	198	241	158	231	520	597
Total Liquid Assets	375	450	541	553	604	886	912	1,135	1,252
Total Investments**	290	313	329	300	275	373	360	331	412
Total Loans & Advances	435	495	669	809	1,240	1,490	1,861	2,954	3,251
Demand Deposits +	677	789	917	914	945	1,219	1,434	1,812	2,238
Time & Savings Deposits	359	460	572	649	915	1,238	1,346	1,666	1,988
Total Deposits	1,036	1,250	1,490	1,564	1,863	2,458	2,785	3,478	4,227
Ratio of	%	%	%	%	%	%	%	%	%
Cash to Demand Deposits	21.9	20.8	24.4	23.8	26.4	30.3	33.7	26.5	21.3
Cash to Total Deposits	14.3	13.1	15.0	13.9	13.4	15.0	17.3	13.8	11.3
Liquid Assets to Dem. Deposits	55.4	57.0	59.0	60.5	63.9	72.7	63.6	62.6	55.9
Investments to Total Deposits	28.0	25.0	22.1	19.2	14.8	15.2	12.9	9.5	9.7
Loans & O/Ds to Total Deposits	42.0	39.6	44.9	51.7	66.6	60.6	66.8	84.9	76.9

Source: Central Bank of Sri Lanka

\*\* Include Government and Government guaranteed securities and Central Bank issues.

+ Exclude domestic inter-bank deposits.

The traditional banking system inherited from the colonial era thus underwent radical changes in the 1970s due to government policies, international events and demands made by the domestic economy. Important structural changes that resulted in policy and operational changes included the following: the departure from heavy security oriented and trade finance biased lending to development oriented activities; the shift from "unit banking" to "branch banking"; the emergence of a non-viable state sector within the banking sector; the emergence of weak financial indicators due to under-capitalisation of the two state banks; and the problem of the maintenance of loss making branches of the state banks .

### **Sophisticated and Innovative Banking: 1977-1989**

The post-1977 period recorded the fastest development in commercial banking. The year 1977 is considered a landmark in the development of commercial banking activities in Sri Lanka. The new economic policy package introduced competition into the banking industry and challenged the conventional attitudes of old foreign banks and the monopolistic position held by the two state banks during the previous two decades. The government's call for the private sector's active participation in the development process and the alleviation of the fear of nationalisation created a conducive environment for banks to adopt new approaches in the post-1977 period. Increased investment and the rapidly growing export/import trade necessitated more complex and sophisticated banking. Commercial banks were further supported by the introduction of more market oriented interest rates, establishment of new sub-markets and Central Bank support for the development of the financial and banking structure throughout this period. On the other hand, the rural economy needed non-traditional, flexible and innovative approaches towards risky lending.

As part of the liberalised policy package, foreign commercial banks with international recognition were permitted to commence banking business in Sri Lanka. The entry of new foreign banks introduced dynamism and competition and encouraged foreign investments. A total of 14 branches of foreign banks and two representative offices were opened in Sri Lanka during the 1977 - 1983 period.



While the open economic policies and competition resulted in more sophisticated and innovative banking and improved banking services, the Central Bank attempted to direct credit flows towards priority sectors through the National Credit Plan (NCP). Credit planning was introduced in 1981 and through moral suasion, commercial banks were requested to engage in priority sector lending with a view to achieving supply side objectives. Agriculture, Exports, Industry and Tourism were declared as priority sectors and lending to these sectors was exempted from credit ceilings imposed as supplementary measures to general monetary policy instruments.

The post-1977 policy changes, on the one hand reflected financial sector development strategies adopted by the government and the Central Bank and the importance of cost effectiveness, prudence and portfolio management, on the other. Due to the limited inflow of foreign capital and the need for the harnessing of domestic resources, banks introduced novel deposit mobilisation schemes. This move was further supported by the high interest rate policy pursued in the post-1977 period. The liability management of commercial banks therefore, benefitted from tight monetary policy, high interest rates, financial innovation and competition among banks. Table 10.6 indicates the distribution of bank offices and deposits of commercial banks during 1977-1989.

As observed in the table, the drive towards branch banking continued at a moderate level, reaching a peak of 879 in 1980. However, due to civil disturbances, loss-making operations and the security situation in the outstations, the Bank of Ceylon and the People's Bank relocated, amalgamated and down-graded several of their branches from 1980 onwards. As a result, the number of bank branches dropped to 672 by the end of 1989. In the meantime, the main offices and branches of foreign banks were reduced from 24 in 1982 to 21 by the end of 1989. The Bank of America and the Union Bank of the Middle East (later Emirates Bank International Ltd) ceased to operate in Sri Lanka in 1987 and 1989, respectively. The Hatton National Bank Ltd took over the Emirates Bank International Ltd in 1989. The two outstation branches (Anuradhapura and Matara) of the State Bank of India and the Indian Overseas Bank were closed in 1986 and 1989, respectively. Despite extensive branch banking by the state banks and domestic private banks, their share of deposits in the total deposits dropped from a peak of 88 in

**Table 10.6**  
**Distribution of Bank Offices and Deposits**  
**1977 - 1989**

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
<b>1. Sri Lanka Banks</b>													
(i) No. of Offices	707	729	799	861	915	951	655*	623*	628*	634*	635*	638*	651*
(ii) Deposits (Rs. Mn)	5,998	7,811	11,020	14,910	17,907	21,789	25,707	30,783	35,683	36,977	41,633	46,805	55,995
(iii) % Share of the Total Deposits	88	88	89	86	84	79	76	77	78	78	77	78	80
<b>2. Foreign Banks</b>													
(a) (Established prior to 1979)													
(i) No. of Offices	8	8	8	8	8	10	10	10	10	9	9	9	9
(ii) Deposits (Rs. Mn.)	795	1,035	1,322+	1,599	1,594	2,602	3,113	3,809	4,030	4,495	5,390	6,142	6,465
(iii) % Share of the Total Deposits	12	12	11	9	7	9	9	10	9	10	10	10	9
(b) (Established in 1979 and thereafter)													
(i) No. of Offices	-	-	3	10	13	14	14	15	15	13	13	13	12
(ii) Deposits (Rs. Mn.)	-	-	-	782	1,902	3,165	5,107	5,339	5,746	5,829	6,720	7,041	7,526
(iii) % Share of the Total Deposits	-	-	-	5	9	12	15	13	13	12	13	12	11
<b>3. Total</b>													
(i) No. of Offices	715	737	810	879	936	975	679	648	653	656	657	660	672
(ii) Deposits (Rs. Mn.)	6,793	8,846	12,343	17,291	21,403	27,556	33,927	39,931	45,459	47,301	53,743	59,989	69,986

Source : Central Bank of Sri Lanka

\* Excludes ASC branches, extension offices, pay offices and Kachcheri branches relocated during the year.

+ Includes deposits of banks established during 1979.

1977, to 80 per cent in 1989. On the other hand, due to novel approaches in deposit mobilization and the concentration on wholesale and corporate customers, the foreign banks' share in total deposits rose from 12 in 1977, to 20 per cent in 1989. RRDBs, which commenced operations in 1985 as semi commercial banks, increased their branch network to 89 at the end of 1989 with a deposit base of Rs. 172 million.

## **Innovative Banking**

### **(a) New Money Market Instruments**

To provide comprehensive banking facilities to the free trade /investment promotion zones and approved business organisations, and to make Colombo an international financial centre, limited offshore banking activities were introduced in 1979. This move was considered a significant step towards rapid expansion in banking services. Commercial banks were permitted to engage in limited offshore banking activities through Foreign Currency Banking Units (FCBUs) established as a forerunner to fully-fledged offshore banks.

Under this scheme, FCBUs are permitted to engage in off-shore banking transactions with non-residents and approved residents. Acceptance Finance and Syndicated Loans were novel instruments introduced through FCBUs. The FCBUs gave their customers the interest rate advantage of borrowing abroad at times when domestic interest rates were high. Sri Lanka's late entry into off-shore banking was well received despite its highly competitive location between two well developed off-shore centres. FCBU transactions also introduced several changes in the lending portfolios of commercial banks due to trade credit arrangements with banks abroad. A large number of joint ventures and foreign collaborations benefitted from these facilities. Although offshore operations are kept separate from domestic banking, FCBU funds provide a cushion for foreign exchange operations of commercial banks. Total assets/liabilities of FCBUs are shown in Table 10.7

Total assets of FCBUs recorded a remarkable increase from Rs. 596 million to Rs. 20,458 million within the first 5 years. However, between 1983 and 1988, total assets remained virtually unchanged but rose by 35

**Table 10.7**  
**Assets and Liabilities of Foreign Currency Banking Units (FCBUs)**  
(Rs.Mn.)

	Assets				Liabilities			Total Assets/ Liabilities
	Loans and Advances		Other Assets	Deposits and Borrowings	Non-Residents	Residents	Other Liabilities	
	Non-Residents	Residents						
1979 Dec.	453.2	70.6	72.4	220.4	298.4	77.7	596.3	
1980	2,052.7	1,567.7	175.9	2,349.7	1,237.8	208.7	3,796.2	
1981	4,212.5	2,950.0	353.8	4,756.7	2,326.7	432.9	7,516.4	
1982	8,090.4	5,050.0	687.2	9,121.4	3,872.6	833.6	13,827.6	
1983	13,630.0	5,880.0	947.5	16,010.0	3,350.0	1,097.5	20,457.5	
1984	12,162.4	6,420.2	1,287.7	13,074.3	5,211.3	1,584.7	19,870.3	
1985	12,541.6	6,671.0	866.1	13,399.5	5,423.9	1,255.3	20,078.7	
1986	12,263.6	6,770.6	584.6	12,756.9	5,632.7	1,229.2	19,618.8	
1987	11,735.9	7,604.4	1,064.4	12,544.9	5,721.8	2,138.0	20,404.7	
1988	13,926.5	5,486.7	2,203.3	12,245.2	6,025.1	3,346.2	21,616.5	
1989	19,712.0	7,123.0	2,404.0	15,992.0	9,284.0	3,968.0	29,244.0	

Note: 1. A Foreign Currency Banking Unit (FCBU) is a unit in a commercial bank, established in terms of Central Bank Circular No. 380 of 2nd May, 1979, which accepts deposits and grants advances in designated foreign currencies from and to: (a) Non-residents (b) Commercial banks (c) Greater Colombo Economic Commission(GCEC) Enterprises, and (d) Other residents approved by the Central Bank

Source: Central Bank of Sri Lanka

per cent during 1989. As at the end of 1989, the total size of the FCBUs' assets stood at Rs 29,244 million(US dollars 731 million).

As a new money market instrument, the Non-Resident Foreign Currency (NRFC) accounts were introduced and attractive concessions were made available under this scheme. The NRFC accounts are free of exchange control and are non taxable. The increased number of NRFC accounts in commercial banks also helped to build up a foreign exchange cushion as they form a part of gross reserves of banks. Commercial banks are permitted to invest NRFC funds in profitable investments abroad and in many instances these deposits were placed in their own FCBUs. The counterpart domestic transactions of NRFC accounts allowed commercial banks to cater to a wider clientele, in particular, families of Sri Lankan income earners abroad.

Commercial banks commenced the issue of Certificates of Deposits (CDs) of various maturities and they formed a novel money market instrument. The American Express Bank was the first to issue CDs in Sri Lanka to attract black money into the banking sector. CDs are issued to anonymous purchasers and are freely transferable. Within a short time CDs became acceptable collateral for bank advances. Interest on CDs are paid upfront while effective rates (yield) vary among banks.

Some commercial banks introduced "High Yield Deposit Schemes" or "Money Market Accounts" to mobilise deposits on a large scale after 1980. These deposits are accepted for a period of one year at preferential rates of interest and are repayable only at maturity. The interest paid varies weekly depending on changes in the Inter-Bank Call Money Market. Banks also introduced Negotiable Savings Certificates for denominations varying between Rs.100 and Rs.10,000, which are freely transferable. These certificates are valid for periods of 12 to 24 months and are repayable only on maturity.

Up Front Fixed Deposit Schemes were introduced by the People's Bank with a minimum deposit of Rs. 50,000 and certificates are issued for periods of 3, 6 and 12 months. Withdrawals are allowed prior to maturity and interest is paid upfront. The People's Bank has also introduced Short Term Special Deposits, starting from a minimum deposit of Rs. 250,000, for periods of three months. Interest on these deposits vary

according to the Secondary Treasury bill market rates. To assist farmers, the People's Bank has introduced the Farmers' Credit Card System whereby creditworthy farmers receive preferential treatment and loans during non-harvest seasons.

As a new way to mobilise deposits at grass root levels and in the rural areas, the state banks and RRDBs commenced mobile banking services which became popular among rural depositors. RRDBs also introduced savings schemes for school children, discounting of local bills/goods receipts and "Group Lending Schemes". The bill discounting scheme eliminates delays experienced by small scale rural entrepreneurs in receiving sales proceeds and the group lending scheme helps rural borrowers to overcome the collateral problem as they borrow on the strength of group responsibility. These new instruments not only add variety into asset/liability structure, but also help banks to build up their deposit base, thus improving fund management in a more efficient manner. Table 10.8 shows mobilisation of savings by commercial banks and the RRDBs during 1985-1989.

The table shows the rate of mobilisation of time and savings deposits by commercial banks (an increase of 47 per cent) during the 1985 - 1989 period, following the high interest rate policy, the introduction of novel money market instruments and competition in the banking industry. Correspondingly, the reduction in current accounts in total deposits from 30 per cent in 1985 to 25 per cent in 1989 emerged as a notable change, reflecting structural changes of commercial banks during this period. Savings deposits accounted for 84 per cent of RRDB deposits and this reflected their ability to mobilize small scale rural savings.

#### **(b) Access to Sub-Markets**

Following the financial sector development policies of the Central Bank, the renewed transactions of the Inter-Bank Call Market (IBCM) provided a short term investment outlet and a borrowing market for commercial banks after 1977. Since 1977, market forces have been allowed to determine rates in the Inter-Bank Call Market. Initially, due to their large deposit base, the two state banks dominated lending and foreign banks were the main borrowers. Gradually, both foreign and private local banks expanded their activities and brought down rates to

competitive levels. Rates in the Inter-Bank Call Market are also influenced by Bank Rate, Treasury bills rates and speculation on the exchange rate. Intermittent transfers of short term funds take place between Treasury bills and call deposits. Faster growth in the Inter Bank Call Market has been hindered by the imposition of the Business Turnover Tax (BTT) placed on lending transactions. This tax not only raises lending rates, but also discourages commercial banks from placing funds in the market. Placement of short term funds by banks in this market would improve trade among themselves, thereby avoiding dependence on Central Bank funds.

**Table 10.8**  
**Savings Mobilisation**

(Rs.Mn.)

Year	Commercial Banks				Current	Total	RRDBs		
	Domestic		Foreign				Savings	Fixed	Tota
	Savings	Fixed	Savings	Fixed					
1985	10,281	14,704	874	7,155	11,466	44,480	3	-	3
1986	11,127	14,341	1,084	7,322	12,236	46,110	16	5	21
1987	13,179	15,606	1,325	8,382	13,861	52,353	44	9	53
1988	16,240	15,476	1,731	8,371	18,313	60,131	90	14	104
1989	20,572	17,109	1,942	8,925	21,439	69,986	144*	28*	172

Source: Central Bank of Sri Lanka

\*provisional

Treasury bills became a popular and a high-yielding short term investment of commercial banks in the post-1977 period. Since 1981, the Central Bank has introduced a Secondary Market for Treasury bills (SMTB), trading in treasury bills from its portfolio. Since 1987, the Central Bank has popularised primary market Treasury bills among the bank and non bank public, by offering competitive rates. Investments in Treasury bills, therefore, provided commercial banks with a ready source of liquidity and enhanced short term investment opportunities.

The Central Bank allowed commercial banks to operate in the Repurchase Market after 1988. Commercial banks are allowed to engage in repurchase market activities by purchasing or selling acceptable

money market instruments. The limited number of instruments available for trading has hindered growth in this market.

Table 10.9 indicates percentage changes of assets and liabilities of commercial banks during 1977 - 1989. The table highlights two key features with regard to liquidity of commercial banks. The liquid assets/demand deposits ratio rose from 66 per cent to 160 per cent during 1977-1985, partly reflecting excess liquidity in commercial banks. Secondly, it revealed an unprecedented increase in Treasury bill investments from Rs. 13 million in 1977 to Rs. 5,289 million in 1989, following market oriented rates offered on Treasury bills. Total investments of commercial banks which rose to a peak (Rs. 2,139 million) in 1987, dropped to Rs. 1,823 million at the end of 1989 due to political and money market uncertainties and civil disturbances which occurred during this period. Commercial banks also managed to keep loans/deposit ratio within prudent levels. On the liability side, the ratio of demand/total deposits dropped from 51 per cent in 1977 to 28 per cent by end 1989, indicating important structural changes during this period. The time and savings weighted deposit structure attracted resources into the banking sector, but raised the cost of funds.

Since 1982, money brokers have been permitted to operate in the Inter-Bank Call Market, Secondary Treasury Bill Market and the Foreign Exchange Market (FCM) to facilitate fund mobility between sub-markets. Money brokers activated operations in these markets and hence increased short term investment outlets for banks. At the end of 1989 there were seven money brokers operating in the money market.

Commercial banks ventured out to establish merchant banks in the early 1980s. The Merchant Bank of Sri Lanka, a subsidiary of the Bank of Ceylon, and the People's Merchant Bank, a subsidiary of the People's Bank were established in 1982 and 1983, respectively. The commencement of merchant banking expanded commercial bank operations in share market activities, portfolio management, management consultancy, financial advice, project promotion, bridging finance and corporate finance.

While the financial market development became an on-going process, the Central Bank ensured that banking expansion does not go beyond



**Table 10.9**  
**Selected Items of Assets and Liabilities of Commercial Banks**  
**(Average of Monthly Figures)**

Item	1977	1979	1981	1983	1985	1987	1989
	(Rs.Mn.)						
Cash on Hand and Deposits at the Central Bank (inclusive of Statutory Reserve Requirements)	817	1,414	2,414	3,746.	6,132	6,072	6,826
Foreign Balances	131	449	935	2,696	3,388	5,154	7,994
Treasury Bills	13	65	172	154	2,260	3,242	5,289
Bills Discounted	961	2,259	3,358	3,359	4,281	4,728	6,112
Total Liquid Assets	1,923	4,187	6,879	9,955	16,060	19,056	26,205
Total Investments <sup>(a)</sup>	586	589	1,078	1,600	1,965	2,139	1,823
Total Loans & Overdrafts	4,248	8,660	16,195	25,310	32,062	40,250	56,083
Demand Deposits <sup>(b)</sup>	2,911	4,301	5,938	7,531	10,036	12,324	18,343
Time & Savings Deposits	2,752	6,621	13,109	22,549	32,709	37,619 <sup>(c)</sup>	46,115 <sup>(c)</sup>
Total Deposits	5,663	10,923	19,047	30,080	42,745	49,943	64,458
Ratio of Cash to Demand Deposits	%	%	%	%	%	%	%
	28.1	32.9	40.6	49.7	61.1	49.3	37.2
Cash to Total Deposits	14.4	12.9	12.6	12.5	14.4	12.2	10.6
Liquid Assets to Demand Deposits	66.1	97.3	115.8	132.2	160.0	154.6	142.9
Investments to Total Deposits	10.3	5.4	5.6	5.3	4.6	4.3	2.8
Loans & Overdrafts to Total Deposits	75.0	79.3	85.0	84.1	75.0	80.6	87.0

Source: Central Bank of Sri Lanka

(a) Government & Government Guaranteed Securities and Private Securities

(b) Excludes Domestic Inter Bank Deposits

(c) Includes sum of Rs. 1,390 million & Rs. 1,708 million being long-term deposits mobilised by the two state banks under the special savings scheme in 1987 and 1989 respectively.

Note: Assets & Liabilities denominated in foreign currencies have been converted into Sri Lanka rupees at exchange rates prevailing at the end of the relevant month.

**TABLE 10.10**  
**Purposewise Distribution of Advances by Commercial Banks**  
**to the Private Sector**  
**1977 - 1989**

	(Rs. Mn.)						
Purpose of Loan/Advances	1977	1979	1981	1983	1985	1987	1989
1. Agricultural	1,017.7 (17.2)	1,763.5 (14.8)	2,776.9 (13.2)	3,418.5 (10.9)	3,539.8 (9.3)	5,207.0 (10.7)	5,962.5 (9.3)
1.1 Traditional Plantation*	93.0	471.9	1,086.2	1,178.2	926.8	2,419.3	3,016.1
1.2 Paddy	586.5	686.9	884.6	1,132.4	1,190.3	1,234.0	1,208.4
1.3 Other Agricultural Crops	338.2	604.7	806.1	1,107.8	1,422.7	1,553.7	1,737.9
2. Commercial	2,623.3 (47.7)	5,723.3 (48.0)	10,181.4 (48.5)	15,262.1 (48.5)	18,957.5 (49.6)	24,859.6 (51.1)	34,369.1 (53.7)
2.1 Export Trading	1,469.7	2,067.4	3,086.9	5,005.5	5,990.2	8,757.3	10,017.4
2.2 Import Trading	702.9	1,664.2	2,685.4	4,517.1	5,223.8	6,195.9	7,175.9
2.3 Other	650.7	845.3	4,409.0	5,739.5	7,743.5	9,906.3	17,175.7
3. Industrial	1,272.9 (21.5)	2,708.7 (22.7)	3,854.3 (18.4)	6,830.7 (21.7)	7,740.5 (20.3)	9,003.3 (18.5)	12,535.7 (19.6)
3.1 Mechanical Processing of Agricultural Commodities**	19.9	51.1	151.3	321.5	501.7	210.3	265.5
3.2 Other Manufacturing	1,253.0	2,657.6	3,703.0	6,509.2	7,238.8	8,793.0	10,412.3
4. Engineering & Construction	72.1 (1.2)	225.6 (1.9)	563.7 (2.7)	964.6 (3.0)	1,067.6 (2.8)	1,036.3 (2.1)	1,654.7 (2.6)
5. Mining/Fishing	42.6 (0.7)	148.4 (1.2)	205.6 (1.0)	238.0 (0.7)	248.1 (0.7)	237.6 (0.5)	203.1 (0.3)
6. Financial	13.5 (2.2)	229.5 (1.9)	301.1 (1.4)	711.1 (2.3)	730.3 (1.9)	1,022.4 (2.1)	1,182.5 (1.8)
7. Tourism	- (-)	- (-)	294.3 (1.4)	606.8 (1.9)	819.2 (2.2)	807.3 (1.7)	851.2 (1.3)
8. Housing	212.4 (3.6)	436.2 (3.7)	1,181.4 (5.6)	1,982.4 (6.3)	2,868.6 (7.6)	3,953.0 (8.1)	5,365.3 (8.4)
9. Consumption	215.9 (3.6)	340.4 (2.9)	397.0 (1.9)	487.9 (1.6)	644.6 (1.6)	850.6 (1.7)	1,288.8 (2.0)
10. Other Loans	133.8 (2.3)	338.8 (2.8)	1,241.5 (3.9)	8,916.2 (2.9)	1,567.6 (4.0)	1,625.5 (3.3)	2,394.7 (3.7)
<b>Total</b>	<b>5,922.0</b>	<b>11,914.0</b>	<b>20,997.2</b>	<b>31,418.2</b>	<b>38,184.0</b>	<b>48,602.6</b>	<b>63,949.6</b>

Source: Central Bank of Sri Lanka

\* Tea, Rubber and Coconut

\*\* Excludes fishing

Percentages of the total loans and advances are entered within brackets.

**TABLE 10.10**  
**Purposewise Distribution of Advances by Commercial Banks**  
**to the Private Sector**  
**1977 - 1989**

	(Rs. Mn.)						
Purpose of Loan/Advances	1977	1979	1981	1983	1985	1987	1989
1. Agricultural	1,017.7 (17.2)	1,763.5 (14.8)	2,776.9 (13.2)	3,418.5 (10.9)	3,539.8 (9.3)	5,207.0 (10.7)	5,962.5 (9.3)
1.1 Traditional Plantation*	93.0	471.9	1,086.2	1,178.2	926.8	2,419.3	3,016.1
1.2 Paddy	586.5	686.9	884.6	1,132.4	1,190.3	1,234.0	1,208.4
1.3 Other Agricultural Crops	338.2	604.7	806.1	1,107.8	1,422.7	1,553.7	1,737.9
2. Commercial	2,623.3 (47.7)	5,723.3 (48.0)	10,181.4 (48.5)	15,262.1 (48.5)	18,957.5 (49.6)	24,859.6 (51.1)	34,369.1 (53.7)
2.1 Export Trading	1,469.7	2,067.4	3,086.9	5,005.5	5,990.2	8,757.3	10,017.4
2.2 Import Trading	702.9	1,664.2	2,685.4	4,517.1	5,223.8	6,195.9	7,175.9
2.3 Other	650.7	845.3	4,409.0	5,739.5	7,743.5	9,906.3	17,175.7
3. Industrial	1,272.9 (21.5)	2,708.7 (22.7)	3,854.3 (18.4)	6,830.7 (21.7)	7,740.5 (20.3)	9,003.3 (18.5)	12,535.7 (19.6)
3.1 Mechanical Processing of Agricultural Commodities**	19.9	51.1	151.3	321.5	501.7	210.3	265.5
3.2 Other Manufacturing	1,253.0	2,657.6	3,703.0	6,509.2	7,238.8	8,793.0	10,412.3
4. Engineering & Construction	72.1 (1.2)	225.6 (1.9)	563.7 (2.7)	964.6 (3.0)	1,067.6 (2.8)	1,036.3 (2.1)	1,654.7 (2.6)
5. Mining/Fishing	42.6 (0.7)	148.4 (1.2)	205.6 (1.0)	238.0 (0.7)	248.1 (0.7)	237.6 (0.5)	203.1 (0.3)
6. Financial	13.5 (2.2)	229.5 (1.9)	301.1 (1.4)	711.1 (2.3)	730.3 (1.9)	1,022.4 (2.1)	1,182.5 (1.8)
7. Tourism	- (-)	- (-)	294.3 (1.4)	606.8 (1.9)	819.2 (2.2)	807.3 (1.7)	851.2 (1.3)
8. Housing	212.4 (3.6)	436.2 (3.7)	1,181.4 (5.6)	1,982.4 (6.3)	2,868.6 (7.6)	3,953.0 (8.1)	5,365.3 (8.4)
9. Consumption	215.9 (3.6)	340.4 (2.9)	397.0 (1.9)	487.9 (1.6)	644.6 (1.6)	850.6 (1.7)	1,288.8 (2.0)
10. Other Loans	133.8 (2.3)	338.8 (2.8)	1,241.5 (3.9)	8,916.2 (2.9)	1,567.6 (4.0)	1,625.5 (3.3)	2,394.7 (3.7)
<b>Total</b>	<b>5,922.0</b>	<b>11,914.0</b>	<b>20,997.2</b>	<b>31,418.2</b>	<b>38,184.0</b>	<b>48,602.6</b>	<b>63,949.6</b>

Source: Central Bank of Sri Lanka

\* Tea, Rubber and Coconut

\*\* Excludes fishing

Percentages of the total loans and advances are entered within brackets.

**Table 10.11**  
**Commercial Banks' Advances\*by Purpose and According to Maturity**

(Rs.Mn.)

End of Period	Short-term (below 1 yr.)		Medium-term (1-5 yrs.)		Long-term (Over 5 yrs.)		Total	
	(1)	(2) (1) as % of (7)	(3)	(4) (3) as % of (7)	(5)	(6) (5) as % of (7)	(7)	(8) (7) as % of Total
<b>1.Commercial</b>								
1977	2,508.4	88.8	283.7	10.0	31.2	1.1	2,823.3	47.7
1979	4,725.3	82.6	872.7	15.2	125.3	2.2	5,723.3	48.0
1981	8,272.4	81.2	1,558.7	15.3	350.3	3.5	10,181.4	48.5
1983	12,619.5	82.7	2,078.0	13.6	564.6	3.7	15,262.1	48.6
1985	15,516.9	81.8	2,877.3	15.2	563.3	3.0	18,957.5	49.6
1987	20,381.0	82.0	3,281.6	13.2	1,197.1	4.8	24,859.6	51.2
1989	29,480.2	85.8	3,249.7	9.5	1,639.1	4.8	34,369.1	53.7
<b>2.Financial</b>								
1977	73.4	55.8	32.5	24.7	25.6	19.5	131.5	2.2
1979	120.5	52.5	82.4	35.9	26.6	11.6	229.5	1.9
1981	131.4	43.6	145.1	48.2	24.6	8.2	301.1	1.4
1983	184.2	25.9	346.5	48.7	180.4	25.4	711.1	2.3
1985	254.9	34.9	440.9	60.4	34.5	4.7	730.3	1.9
1987	503.7	49.3	459.9	45.0	58.9	5.7	1,022.4	2.1
1989	575.5	48.7	353.6	29.9	252.4	21.4	1,181.5	1.8
<b>3.Agricultural</b>								
1977	789.4	77.6	209.4	20.6	18.8	1.8	1,017.7	17.2
1979	1,269.5	72.0	439.1	24.9	54.9	3.1	1,763.5	14.8
1981	1,690.0	60.8	921.5	33.2	165.4	6.0	2,776.9	13.2
1983	1,942.6	56.8	1,250.0	36.6	226.0	6.6	3,418.5	10.9
1985	2,280.1	64.4	717.8	20.3	541.9	15.3	3,539.8	9.3
1987	2,638.9	50.7	902.0	17.3	1,666.1	32.0	5,207.0	10.7
1989	2,832.5	47.5	892.1	15.0	2,237.9	37.5	5,962.5	9.3
<b>4.Industrial<sup>+</sup></b>								
1977	1,053.9	76.0	220.6	15.9	113.1	8.1	1,387.6	23.4
1979	2,480.0	80.4	455.7	14.8	146.8	4.8	3,082.7	25.9
1981	3,357.5	72.6	952.2	20.6	313.9	6.8	4,623.6	22.0
1983	6,166.1	76.8	1,389.6	17.3	477.5	6.0	8,033.3	25.6
1985	6,869.1	75.8	1,485.7	16.4	701.4	7.8	9,056.2	23.7
1987	7,911.0	77.0	1,511.1	14.7	855.0	8.3	10,277.1	21.2
1989	9,202.4	73.4	1,797.7	14.3	1,535.6	12.2	12,535.7	19.6

Source: Central Bank of Sri Lanka

\* Advances include loans, overdrafts and bills discounted and exclude cash items in process of collection.

+ Includes advances granted for Engineering, Building Trade, Mining & Fishing.

1989 figures are as at end of September, 1989.

Table 10.11

(Rs.Mn)

(Continued)

End of Period	Short-term (below 1 yr.)		Medium-term (1-5 yrs.)		Long-term (Over 5 yrs.)		Total	
	(1)	(2) (1) as % of (7)	(3)	(4) (3) as % of (7)	(5)	(6) (5) as % of (7)	(7)	(8) (7) as % of Total
<b>5.Housing</b>								
1977	18.4	8.7	95.2	44.8	98.7	46.5	212.4	3.6
1979	51.0	11.7	192.0	44.0	193.2	44.3	436.2	3.7
1981	276.3	23.4	357.3	30.2	547.8	46.4	1,181.4	5.6
1983	424.8	21.4	570.2	28.8	987.4	49.8	1,982.4	6.3
1985	572.3	19.9	873.8	30.5	1,422.5	49.6	2,868.6	7.5
1987	768.8	19.5	1,015.8	25.7	2,168.4	54.8	3,953.0	8.1
1989	929.3	17.3	1,185.1	22.1	3,250.9	60.6	5,365.3	8.4
<b>6.Consumption</b>								
1977	111.1	51.5	90.8	42.1	13.9	6.4	215.9	3.6
1979	145.4	42.7	163.3	48.0	31.6	9.3	340.4	2.9
1981	557.8	36.3	267.6	9.6	710.5	46.2	1,536.3	7.3
1983	712.5	46.8	581.5	38.2	228.0	15.0	1,522.0	4.8
1985	415.0	64.4	195.7	30.4	33.9	5.2	644.6	1.7
1987	500.0	58.8	268.1	31.5	82.4	9.7	850.6	1.7
1989	787.9	61.1	371.5	28.8	129.5	10.0	1,288.8	2.0
<b>7.Others</b>								
1977	36.3	27.1	44.7	33.4	52.8	39.5	133.8	2.2
1979	145.8	43.0	109.7	32.4	83.4	24.6	338.8	2.8
1981	183.2	46.2	178.4	44.9	35.4	8.9	397.0	1.9
1983	256.4	52.5	192.9	39.5	38.6	8.0	487.9	1.5
1985	1,070.7	44.9	807.6	33.8	508.7	21.3	2,387.0	6.3
1987	1,110.3	45.6	687.4	28.3	635.1	26.1	2,432.8	5.0
1989	986.2	41.2	748.7	31.3	659.8	27.5	2,394.8	3.7
<b>8.Total</b>								
1977	4,591.0	77.5	976.9	16.5	354.1	6.0	5,922.0	100.0
1979	8,937.6	75.0	2,314.9	19.4	661.8	5.6	11,914.4	100.0
1981	14,468.6	68.9	4,380.8	20.9	2,147.8	10.2	20,997.2	100.0
1983	22,306.0	71.0	6,408.6	20.4	2,703.5	8.6	31,418.2	100.0
1985	26,979.0	70.7	7,398.8	19.4	3,806.2	9.9	38,184.0	100.0
1987	33,813.6	69.6	8,126.0	16.7	6,663.0	13.7	48,602.6	100.0
1989	45,242.3	70.7	8,673.3	13.6	10,034.0	15.7	63,949.6	100.0

period, while the share of long term advances rose from 6 to 16 per cent.

The Central Bank, in its attempts to provide banking facilities in the outstation areas, set up three Regional Offices in Matale, Anuradhapura and Matara. The Regional Offices co-ordinate banking services and ensure that regional funds are used within the regions. At times commercial banks find it more profitable to lend resources mobilised in rural areas in more lucrative urban centres, thus neglecting the original objectives of branch banking. The shift of funds from rural to urban sectors has created a "credit gap" in the rural sector. To rectify this situation, Regional Rural Development Banks were set up in 1985 by the RRDB Act No. 15 and they engage in "barefoot banking". The expansion of RRDB branches has increased its outreach to the rural poor in a significant manner. Among the 11 RRDBs established thus far, the majority operate on a cost covering basis. The innovative banking introduced by the RRDBs, though on a small scale, has proved to be successful. At grassroots level, the RRDB concept has been attractive to the rural poor.

To further banking services throughout the country, the limit placed on the expansion of foreign bank branches was further liberalised in October, 1988, by allowing foreign banks to open upto a total of 10 branches anywhere in the country. With the change of government policies and attitudes towards development, commercial banks are required to adopt new policies within the liberalised policy framework. Table 10.2 indicates the distribution of bank offices and deposits throughout the period 1939-1989. Rural banking and regional activities increased banking habits throughout the country. Table 10.12 shows the changes in banking density during the 1950 - 1989 period.

The banking density index which was 0.04 in 1950, rose to a peak of 0.59 in 1980. A slight decrease was recorded during the last decade with the index dropping to 0.42 by 1989, largely due to civil disturbances. A branch office, which served 274,214 people in 1950, serves approximately 23,637 people at the end of 1989.

Another attempt made by the Central Bank to regulate commercial bank operations was the enactment of the Banking Act No. 30 of 1988, which incorporated all scattered provisions relating to commercial banks. This

Act increased the regulatory power of the Central Bank over commercial bank operations.

**Table 10.12**  
**Banking Density in Sri Lanka**  
**1950-1989**

Year	No.of Bank Offices	Population	Banking Density
1950	28	7,678,000	0.0365
1955	33	7,876,000	0.0419
1960	45	9,896,000	0.0455
1965	97	10,903,000	0.0890
1970	165*	12,516,000	0.1318
1975	562*	13,496,000	0.4164
1977	715*	13,942,000	0.5128
1980	876*	14,747,000	0.5940
1985	653	15,837,000	0.4123
1989	711	16,806,000	0.4230

Source: Central Bank of Sri Lanka

Banking density could be expressed in several ways. In the Table, a simple measure is used which relates the number of bank offices to the total population. On the assumption that a bank office is required for every 10,000 persons, the index is calculated using the following formula

$$\frac{\text{No. of bank offices} \times 10,000}{\text{Total Population}}$$

\* Includes ASC branches.

### (c) Diversification of Customer Services

As a corollary to the policy of structural and operational changes and financial innovation, commercial banks also introduced several customer services. Twenty four hour Automatic Teller Machines (ATMs) have been introduced by a few banks, granting current and savings account holders the facility of cash deposits/withdrawals and weekend money encashment facilities through access to their accounts, 24 hours a day, 7 days a week. The Hongkong & Shanghai Banking Corporation was the first to launch this facility and this was followed by the Sampath Bank Ltd under the Sampath Electronic Teller (SET) system. The SET

Savings Accounts of the Sampath Bank Ltd are especially designed for the monthly salary earner. It provides a 24-hour service to a SET Savings Account holder to withdraw money from any SET machine and an opportunity of earning extra income by way of interest on residual balances. The Instant Savings Account of the Sampath Bank Ltd is a scheme whereby interest is calculated on the daily balance in the Savings Account.

The Cheque Encashment Card System was introduced for the first time in Sri Lanka by the Hatton National Bank Ltd to facilitate encashment of cheques by reputed customers at any one of their branches. To mobilise savings deposits and provide special facilities to Sri Lankan workers in the Middle East, the Hatton National Bank Ltd also introduced the Intro-Card System (ICs), whereby drafts issued in the Middle East on presentation of the Hatton National Bank Intro Cards guarantee safe receipt of funds by the beneficiaries in Sri Lanka. Several other commercial banks have introduced the Cheque Guarantee Card as a form of guarantee given to the payee. The card holder is entitled to withdraw cash over the counter up to a certain limit, at any of the branches of the bank that issues these cards.

The Petro Card system was introduced by the Bank of Ceylon in 1990 to help customers purchase fuel and oil for vehicles. To facilitate money transfers by customers, the Bank of Ceylon introduced Sight Payment Orders (SPO). The Sight Payment Order is a non-transferable document valid for 30 days from the date of issue. This system rectified several shortcomings in the existing money transfer instruments, such as mail transfers, telegraphic transfers, drafts and inland travellers cheques. The Bank of Ceylon also introduced the Ceybank Visa Card system in 1989. Subsequently, the Sampath Bank Ltd issued "Sampath Master Cards" enabling card holders to purchase goods and services at any retail outlet where Credit Cards are acceptable.

Some commercial banks allow customers to transfer money between demand and savings deposits, especially when it is advantageous to banks with regard to the maintenance of statutory reserve ratios. Between 1977 and 1988, statutory reserve ratios varied on different classes of deposits and banks economised on idle funds and improved their liability



management. The reserve ratios were unified in September 1988 and were fixed at 15 per cent on all classes of deposits.

The opening of the Sri Lanka Automated Clearing House (SLACH) in 1988 by the Central Bank allowed for rapid and accelerated cheque clearing among commercial banks. In addition to speedy processing, the SLACH provides detailed reports on daily clearings to commercial banks.

To facilitate the loan operations of commercial banks, two important steps were taken in 1990. The first relates to the passing of the Debt Recovery Act<sup>6</sup> in March, 1990 and the second to the establishment of the Credit Information Bureau<sup>7</sup>. It is expected to further facilitate recovery of loans by commercial banks, development banks and finance companies as these institutions are given more powers under the debt recovery law. The new laws are being enacted because some aspects of the present laws and procedures are antiquated and tended to obstruct the speedy recovery of debts. The excessive delays in debt recovery have increased holdings of a large volume of non-performing advances by commercial banks and development banks and have threatened the viability of these institutions. On the other hand, the provisions of the Act would safeguard the interests of depositors and reduce the cost to legitimate borrowers.

To improve the quality of credit, help in the identification of creditworthy customers and to form a deterrent to wilful defaulters, the Credit Information Bureau Act of Sri Lanka was passed by Parliament in March 1990. The Central Bank of Sri Lanka holds 51 per cent of the capital of the Credit Information Bureau and the balance share capital will be subscribed jointly by commercial banks, development banks, the National Savings Bank, the State Mortgage and Investment Bank and, at a later date, by RRDBs.

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6 Debt Recovery Act- Economic Bulletin (Vol.2 No.2 March/April 1990) Central Bank of Sri Lanka.

7 Credit Information Bureau - Economic Bulletin (Vol. 2 No.2 March/April 1990) Central Bank of Sri Lanka.

Table 10.13 sets out the overall changes in the assets/liability structure of commercial banks during 1950-1989. The ratio of liquid assets/demand deposits rose from about 66 per cent in 1977 to 160 per cent in 1985 indicating excess liquidity in the banking sector. This ratio decreased to 143 per cent by 1989. Cash balances, which remained in the range of 40 to 42 per cent of total liquid assets upto 1977, declined to 26 per cent by 1989 due to the emergence of new short term investment outlets for commercial banks' funds. The share of Treasury bills, which was only 1 per cent of liquid assets in 1977, rose to 20 per cent by 1989. The investments/total deposits ratio gradually dropped from 34 per cent in 1950 to 3 per cent in 1989, while loans and overdrafts/total deposits rose from 23 per cent in 1950 to a notable 87 per cent in 1989. The loans and overdrafts ratio of foreign banks which commenced business after 1977 exceeded prudent ratios in the early 1980s. However, due to successful deposit mobilization, they were able to reduce the ratio to more prudent levels. On the liability side, the ratio of demand deposits/total deposits dropped from 90 per cent in 1950, to 51 per cent by 1977 and to 28 per cent by 1989.

Despite the unsettled business environment in the last few years due to civil disturbances and the restrictive monetary policy stance of the Central Bank, most commercial banks performed satisfactorily in terms of liquidity and profitability. The pressure for short term funds from deficit banks as well as the continuing high interest rates in other sub-markets caused the interest rates in the Inter Bank Call Money Market to remain high. However, with the pressure of competition, commercial banks continued to improve the quality of customer services during the last several years. Similarly, the high interest rate policy, innovative banking and aggressive deposit mobilisation schemes contributed towards the diversification of the deposit structure of commercial banks.

Table 10.13

### Commercial Banks: Liquidity and Asset Liability Relationships Average of Monthly Figures

Item	1950 <sup>+</sup>		1955		1960		1965		1970*		1975		1977		1980		1985		1989	
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%
Cash on Hand and Deposits at Central Bank (inclusive of Statutory Reserve Requirements)	199	41	149	37	132	40	224	41	248	41	480	42	817	42	1,881	34	6,132	38	6,826	26
Treasury Bills	54	11	51	13	28	8	89	16	41	7	46	4	13	1	26	1	2,260	14	5,289	20
Bills Discounted	53	11	94	23	115	35	173	32	275	46	520	46	961	50	2,914	52	4,281	27	6,112	23
Foreign Balances	180	37	112	27	58	17	55	11	36	36	89	8	131	7	749	13	3,388	21	7,994	31
Total Liquid Assets	487	100	406	100	333	100	541	100	600	100	1,135	100	1,923	100	5,571	100	16,060	100	26,205	100
Total Investments <sup>(1)</sup>	271		245		284		329		263		331		586		687		1,965		1,823	
Total Loans & Overdrafts	182		244		430		669		1,391		2,954		4,248		11,820		32,062		56,083	
Demand Deposits <sup>(2)</sup>	730		675		657		917		958		1,812		2,911		5,315		10,036		18,343	
Time & Savings Deposits	77		190		340		572		989		1,666		2,752		8,807		32,709		46,115	
Total Deposits	807		869		998		1,490		1,948		3,478		5,663		14,122		42,745		64,458	
Ratio of Cash to Demand Deposits	27.3		22.1		20.1		24.4		25.9		26.5		28.1		35.4		61.1		37.2	
Liquid Assets to Demand Deposits	66.6		60.1		50.7		59.0		62.6		62.6		66.1		104.8		160.0		142.9	
Investments to Total Deposits	33.6		28.2		28.5		22.1		13.5		9.5		10.3		4.9		4.6		2.8	
Loans & Overdrafts to Total Deposits	22.6		28.1		43.1		44.9		71.4		84.9		75.0		83.7		75.0		87.0	

Source: Central Bank of Sri Lanka

(1) Government &amp; Government guaranteed securities &amp; Central Bank issues

(2) Excludes domestic inter-bank deposits

The figures given are as at end of 1950 as average of monthly figures are not available.  
 \* On account of the distortion in the pattern of assets and liabilities of the Commercial banks in the last three months of 1970 as a result of the demonetisation of Rs 100 & 50 notes the averages in this column have been worked out on the figures from January to September.

## **Challenges and Opportunities in the 1990s - Development Banking**

The term "Development Banking" often refers to development financial institutions associated with public and quasi-public institutions providing capital for development projects.<sup>8</sup> However, in its broadest sense it can refer to any government intervention in financial markets with development objectives. This includes requesting commercial banks to lend to priority sectors. While the present financial structure in Sri Lanka appears to be conducive to further financial liberalisation, commercial banks try to compete and consolidate their positions. Social demands for direct lending to priority sectors, in particular, the rural sector and the poorer sections, have recently increased demands on commercial banks to adjust to suit the situation. Following the government's persuasion of banks towards development-oriented lending, particularly for self-employment and for unemployed rural youth, both state and private banks introduced several special lending schemes.

Towards the latter part of 1988, the two state banks introduced the concept of "Agency Banking", operated through the appointment of Praja Naya Niyamakas who function as the intermediary between the bank and the borrower. Most Praja Naya Niyamakas are informal money market operators and they are now being brought into the banking sector by providing credit lines to them. They, in turn, provide credit to borrowers who have little or no access to bank funds. The credit risk is borne by the agent and the bank charges them 18 per cent per annum. The on lending rate is 30 per cent per annum. The introduction of agency banking into the main banking stream was an innovation in the commercial banking scene. This not only changed the asset structure of banks, but also resulted in policy and operational changes with regard to development banking.

In addition to the Praja Naya Niyamaka scheme, the two state banks have introduced revolving credit schemes and inland bill schemes for rural

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8 Jayamaha R. and Wilson P. (1990), "Development Banking in Sri Lanka: Coercion or Moral Suasion", *International Journal of Development Banking* Vol. 3 (1990).

borrowers and have simplified loan procedures in rural lending. The "Gami Pubuduwa Scheme", introduced by the Hatton National Bank Ltd with the objective of uplifting the rural sector in Sri Lanka, came into operation in 1989. This scheme caters to a wide spectrum of self-employment projects such as agro-based industries, animal husbandry, trade, etc. The disbursement of loans is handled by trained personnel who are staff members of the bank. The Seylan Bank's "Swayan Rakiya Scheme" is specially designed for small scale entrepreneurs. Loan categories include agriculture, cottage industry, light industry and trade. The rate of interest payable on these loans is 24 per cent per annum. The Commercial Bank of Ceylon Ltd introduced several new credit schemes in its involvement in development banking. They are the self-employment for youth scheme (Kurunegala); export production village scheme (Dambulla); village adoption scheme (Pahalaweve tank area-Dambulla); refugee village loan schemes (Dambulla) and industrial production village schemes (Giriulla). The Sampath Bank Ltd introduced a new scheme on a pilot basis, known as "Sampath Seva Sanyojaka Scheme" (SSS) in 1989. The objectives of this scheme were to identify viable projects, deliver credit at grassroots level, mobilise savings in the area and employ Sampath Seva Sanyojakas to play a catalyst role in the village.

The government's call to reduce unemployment and rural poverty has placed commercial banks in a dilemma as they are also expected to pursue financial liberalisation. Commercial banks and development banks are under pressure to be commercially motivated and financially viable in the long run, but are simultaneously expected to engage in risky and low income lending to the poorer sections of the rural economy. This raises two key issues; firstly, whether viable development banking is compatible with a programme to increase credit to the rural poor; and secondly, whether 'social' banking is sustainable in the 1990s within a climate of continued economic and financial liberalization. The proposals of an externally funded National Development Trust Fund and an internationally funded Voluntary Credit Fund may strengthen commercial banks' and RRDBs' efforts in development banking.

The two state banks also face the dilemma of pursuing public sector objectives and engaging in development/social banking and participating in the liberalization process, which leads logically to privatisation. The

pace of privatisation can be expedited only when the two banks improve their position and remove constraints so that they can become more marketable. The biggest challenge in this regard would be the enlarging of the capital base of the two banks. The more dynamic private commercial banks effectively compete with the state banks and are likely to do so in the 1990s with their expanding branch network, new deposit mobilisation instruments and specialised services. Meanwhile, foreign banks make most of their money from trade finance and to a lesser degree, from domestic business. They await government commitment to further liberalization which will give them more opportunities in the coming years. To strengthen the banking and financial structure, the Central Bank continues to pursue a flexible monetary policy package but emphasizes that commercial banks should operate in a prudent manner.

The growth of recent activities in the Colombo share market and the stock exchange has offered a prototype for the capital market takeoff planned by the government in the 1990s. After several years of inactivity, the past 3 to 4 months have seen more than a tripling in share prices. Among other things, the market surge has been caused by foreign interest in share market activities. The boom in the share market has offered numerous opportunities for commercial banks to further the diversification process. This will also enable commercial banks to act as vehicles in shifting excess funds from the money market to the capital market. New issues have been an invitation to equity investments for many individuals, and to the creation of a new investor class. This would no doubt enhance opportunities for banks to promote the new investor class in the 1990s. As in the past, commercial banks are expected to take up challenges and make the best use of opportunities in the 1990s.

## **Summary**

The origin of commercial banking in Sri Lanka can be traced to the colonial era. Starting with exchange banks which engaged in export/import trade, commercial banks diversified banking services to suit the requirements in the post-Independence period. During this period, the establishment of the Central Bank, the People's Bank and the nationalization of the Bank of Ceylon influenced commercial banks to diversify operations and widen their spectrum of activities. The regulative environment and state dominated banking during 1960-76 directed commercial banks to undertake financing in rural and

agriculture lending in accordance with the policy of self-sufficiency in food pursued during this period. In this endeavour, commercial banks, through their extensive branch network, made a significant impact in mobilising rural savings and financing rural activities. The private commercial banks which commenced business in the late 1960s and early 1970s also followed similar policies, but were more cautious with regard to their engagement in rural lending. In this regulatory environment the role of foreign banks was marginal.

The most spectacular growth in banking was observed in the post 1977 period following the liberalized economic and financial policies. The entry of new foreign banks, financial innovation in terms of new instruments, new sub-markets and diversification of customer services transformed commercial banking from a non-competitive and traditional framework into a competitive, sophisticated and innovative sector. Today, in terms of its contribution to economic growth, the banking and financial sector records the most impressive growth and is unparalleled by any other sector's contribution.

In the 1990s, calls for commercial banks' engagement in the maintenance of "social banking" in a viable manner and "development banking" within the context of financial liberalization have posed newer challenges to commercial banks. There are doubts, however, that the reliance on moral suasion on banks to increase their lending to the rural sector will be sufficient to address the problem of unemployment and poverty. Yet, more coercive measures will conflict with the government's general policy of liberalization. To satisfy the demand for sophisticated and specialised banking, banks have to ensure that their staff is adequately trained. The staff training aspect becomes an important issue and to solve it, some commercial banks have even established their own training schools to enhance training facilities.

The financial liberalisation process in Sri Lanka since 1977 has undoubtedly increased the magnitude and range of financial instruments and has facilitated the monetary transmission process. Yet, there is insufficient evidence to guarantee that development/social banking requirements can be fulfilled while maintaining financial viability and cost effectiveness.

Current trends however indicate that viable development banking is both feasible and desirable and that the approach presently adopted in Sri Lanka conforms quite closely to that suggested by development banking literature. In 1989 and early 1990, commercial banks invented several new methods to deal with newer versions of development banking. The agency banking system of the two state banks, 'barefoot banking through RRDBs' and village friend schemes of private commercial banks demonstrate that viable development and social banking are both possible and desirable. Despite some weaknesses inherent in some of these schemes, there is potential to proceed further on these lines.

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