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Sri Lanka banking sector needs consolidation: banker

Feb 22, 2009 (LBO) - Sri Lanka's banking sector is not at risk from the global credit crisis but needs consolidation to be able to improve returns and attract fresh capital, a senior banker said.

Clearer regulatory guidelines were needed to cover changes in ownership in the banking sector and to handle the implications of mergers and acquisitions, said Nihal Welikala, Advisor, National Development Bank.

The industry is over-banked and saddled with high costs, especially for distribution, that prevents the optimisation of economies of scale.

This was making it difficult to attract new investments into the sector.

"Banks need capital," Welikala told a seminar on Sri Lanka's response to the global economic crisis organised by the Institute of Policy Studies, a think-tank.

"Investor reluctance to invest is because of the lack of scale of individual banks.

"So mergers and acquisitions need to happen in order to build capital and absorb unforseen losses and reduce fixed costs," Welikala said.

Claims that Sri Lanka is 'over-banked' however contrasts sharply with claims that 'access to credit' is low and interest margins in the sector is too high, which is indicative of insufficient competition.

The island's banking sector is safe from the global credit crisis as it was not exposed to the risky practices that led to it, but does face structural challenges.

"The return on investment is very low in Sri Lanka," Welikala said.

The industry return on equity is around 13.6 percent, well below the inflation rate, which acts as a deterrent to attracting foreign investors.

Welikala said returns are constrained by two factors.

"The taxation on banking income is set at the rate of 60 percent, which is both punitive and inequitable compared with other industries," Welikala said.

"This leaves little room for investment."

Also, Sri Lanka's overheads are among the highest in the region, which is really due to, among other factors, the lack of scale.

"To have 23 banks spending money on distribution networks and ATMs is an unaffordable extravagance for a small economy like Sri Lanka. The banking sector needs some consolidation to reduce overheads and attract capital."

The "pervasive role of the government in the banking sector was also crowding out private banks, Welikala said.