The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Sri Lanka's Postal Financial Services

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Global Information and Communication Technology

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Author's Note

This report discusses the role of postal networks in Sri Lanka and its current and potential role of providing access to financial services. The report reviews the postal sector development in the country and the role of the postal network in the development of the financial sector, with an emphasis on its accessibility to financial services. The report concludes with an evaluation of the Sri Lanka Post as a provider of financial services and highlights options that can be taken into consideration for further development of the postal financial services in Sri Lanka.

The case study has been prepared with desk research in 2004. The study benefited from information and an interview with the chief executive officer of Sri Lanka Posts during the World Post Congress in Bucharest in October 2004.

While this country case on Sri Lanka can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (*Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam*) and 5 regions (*Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa*).

Glossary of Abbreviations and Acronyms

ATM	Automated Teller Machine
CRB	Cooperative Rural Banks
EBPP	Electronic Bill Presentation and Payment
EFT POS	Electronic Fund Transfer at Point-of-Sale
ICT	Information and Communications Technology
IMF	International Monetary Fund
LKR	Sri Lanka Rupee
MFI	Microfinance Institution
NSB	National Savings Bank
RRDB	Regional Rural Development Bank
SLT	Sri Lanka Telecommunication Corporation
SWOT	Strengths, Weaknesses, Opportunities, and Threats matrix
TCCS	Thrift and Credit Cooperative Societies
UAE Post	United Arab Emirates Post
UPU	Universal Postal Union
USD	United States Dollar

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Summary

SWOT Analysis of Sri Lanka Postal Financial Services

Strengths	Opportunities
• Has operated postal financial services for more than 125 years; currently 4,600 post offices spread across the country, including rural areas • Mobilizes small deposits from a minimum of LKR 5; more than 4.8 million accounts, totaling LKR 12 billion (year-end 2002) • Processes some 17 million transfers per year (money orders, pensions, and electricity bills) with a value of LKR 13 billion. • Has a non-bank status in the view of population; rural areas have a high level of personal trust in postmasters • Has never defaulted in payments to depositors	• Postal banking offers potential to increase savings propensity, financialize savings, and provide banking services to the rural poor • With proper marketing and improvement in efficiency, postal banking can capture 15%–25% of incremental growth of domestic household deposits • In the medium term, has potential to offer other products, such as life insurance, trust units, and microcredit, sold through the post offices (linked to existing savings/payments accounts) • Transfer operations can grow rapidly to include direct credit transfers (salaries) into personal accounts and chip-card technology for small-value payments
Weaknesses	**Threats**
• Stagnant growth in number of accounts and deposits mobilization; since 1971, continuous decline in market share (from more than 25% in 1971 to less than 1.5% in 2002). More than 85% of accounts presumed to be dormant • Transfer services do not grow, but remain stable in a growing market. • Agency with National Savings Bank under-developed; potential of savings mobilization and retail banking underutilized • Management lacks marketing, banking, and technology skills; risk control and management accounting virtually non-existent; computerization in early stage only • Heavily reliant on inefficient staff and operations in post offices, very limited training and no performance incentives to staff and management; inefficient, paper-based, manually-processed operations • Operates as a government department, with bureaucratic management and procedures, and civil service practices	• Complexity of overall postal reform distracts management's attention and dilutes priority from this demanding project to implementing a postal financial services system • Labor, Treasury, and National Savings Bank potentially resistant • Profit contribution may not be feasible because of high up-front costs to improve post office interiors, technology, and staff capability • In Sri Lanka's environment for consumer financial services, which features overbanking, and a near-saturation for the currently perceived profitable consumer market segments, other banks may effectively prevent Sri Lanka Post from capturing opportunities • Sri Lanka Post may have to focus on its social dimension to reach out to the poor

1—Postal Sector Development

Sri Lanka has a long and rich history in providing financial services through the post offices. In 1798, two years after the Dutch were expelled and the island came under British rule, five post offices were created in its main cities, marking the beginning of a state postal system. Postal money orders were introduced at an early stage, but became a nationwide system in 1877 when the Inland Postal Money Order System was inaugurated, and this service still functions—basically unchanged—today.

In 1885 Queen Victoria had passed the Ceylon Post Office Savings Bank Act, and the Post Office Savings Bank opened for business, offering easy access for deposits and withdrawals through the network of national post offices. In 1909, a telegraph money order service was launched between Colombo and India; this marked the beginning of rapid money transfer services as well as cross-border payment services, which continue to day. In 1936 the Post Office Savings Bank obtained authority to issue savings certificates and began offering them in 1938. Then, in 1941, governance of the Post Office Savings Bank was handed over to a board of trustees comprised of the Permanent Secretary to the Ministry of Posts, the Deputy Secretary to the Treasury, and the Postmaster General. (The last two officials sit on the board of directors of the National Savings Bank.)

The post office gained a leading position in mobilizing small deposits throughout the country. Its market share (value) in deposits exceeded 30 percent in 1970 with more than 4 million savers. But the Post Office Savings Bank was not the only state-owned savings institution. By 1970 there were three state institutions mobilizing savings, but they were limited in services. Even though the potential for savings banks was very high and the benefits to the economy were enormous, the existing Sri Lankan savings institutions did not exploit these opportunities. The government felt the need to follow the example of other countries and to create a stronger organization to fill the gap.

Thus, the National Savings Bank (NSB) was brought into the banking system in 1972 by an act of Parliament (in line with the economic thinking in that era), as a fully state-owned institution. It was charged by Parliament to channel the idle money lying in every corner of the island toward the development of the country. Links with between the NSB and the post office were maintained through an agency agreement and the Postmaster General as an *ex officio* member of the board of the NSB.

With the advent of social security, the post office was charged in 1947 with paying out monthly public assistance benefits. In 1949 the disbursement of government pensions also became a task for the post office. Gradually other payment functions were added in the 1960s and 1970s: payment services for the Electricity Board, the Water Supply Board, TV and radio licenses, and on-the-spot fines for the police. In the 1980s and 1990s, the post office took over payments for rural pensions and the collection of other bills, and more recently, collecting premiums for life insurance and pensions. In 1997, a new product, the fax money order was proffered (a sequel to the telegraph money order), and in 2004 the e-money order was added.

Until 1980 "Sri Lanka Post" was the parent institution for all forms of communications (telegraph, telex, telephone, etc.). Sri Lanka Post today has an extensive communications infrastructure and service network with real potential to "bind the nation together."

Sri Lanka Post

Sri Lanka Post currently delivers to 99 percent of the addresses in the country six days a week. Postage tariffs on the island are uniform; essentially, business users in the more urban Colombo region subsidize rural users. Many of these post offices, particularly in rural areas, are presumed to operate at a loss. Sri Lanka has an active mail demand of 26.5 items per capita per year, comparable to other low- and middle-income countries. Each Sri Lankan post office serves around 4,160 people on average, on par with developed countries.

Prior to 1997, government funds were used to expand the postal network, but since then, it has been expanded through private sector participation in the form of agency contracts. In 1995 there were 181 post office agents; in 2000 they increased to 455, and in 2002 to 602. Since 1997, the number of government-owned post offices has remained level, at about 4,035, because every year 20–30 new post offices are opened, 20–30 closed, and

30–40 post offices renovated. The share of privately run postal agencies is nearly 15 percent (up from 4.5 percent in 1996). This has been achieved by opening new agencies, not through a transfer of existing state-owned post offices to private entrepreneurs.

Sri Lanka's postal service is plagued with **several chronic problems**. There are no standards for mail service or for customer service. Two surveys conducted in the 1990s showed that only 34–50 percent of mail was delivered the next day. Public perception is that service is poor, which is supported by the large number of courier companies (currently more than 50, both licensed and unlicensed) that deliver mail in Colombo. There are no performance or market research data to help the postal service identify the causes of poor service and service failure (for example, rail transport failures), and the reasons underlying poor public opinion.

The **postal service's budget for each upcoming financial year is determined by the Ministry of Finance**, based on a bid from Sri Lanka Post, which is then **voted on by Parliament**. In Parliament, the investment budget is often reduced[1] due to limited public funds available, with little consideration of the investment needs of the post office. As a result, **investment decisions are short-term** and there is no medium-term or strategic planning by the post office. There is no operational requirements plan in the capital budget, or a capital priority list that ranks investment projects. The laborious tender process for capital projects plus limited power delegated to regional managers means an extremely slow process for needed capital investment.

Staff morale at Sri Lanka Post appears to be low, reflected in the support for reactionary and potentially militant labor unions. Staff sees their work as *completing a defined task* rather than *fulfilling a defined need*. Even though postal service is considered a public duty, strikes have occurred occasionally throughout the past seven years. **Politicians also interfere** in the affairs of the post office, and recruitment procedures are not always strictly applied. Work rules and practices are rigid and the design of many operational tasks leads to **overstaffing and high levels of inactivity**. Power to discipline staff is weak and disciplinary action is subject to lengthy appeal procedures.

Until 1997 all government departments and some other agencies were entitled to unlimited free postage. This led to a shortfall in revenues of approximately 15–20 percent. This privilege has gradually been discontinued over the past few years.

The price of an ordinary letter increased from LKR 1 to LKR 2 in 1995, and was increased again in 1997 to LKR 2.5, followed by several more rate hikes. In 2002 the government agreed with the International Monetary Fund (IMF) advice to raise the tariffs. In 1996 a World Bank study put the cost of delivering a letter at LKR 4, so there is little doubt that **current rates still do not cover the cost**. Increased mail volume is increasing losses, rather than increasing profits.

It is estimated that Sri Lanka Post has about 1 percent market share in express mail items, and very little presence in the parcels market segment. Market intelligence and analysis of demand patterns also indicate that there is growing competition in domestic letter mail delivery (especially to businesses) in western Sri Lanka, and perhaps in other major urban centers as well.

Sri Lanka Post's continuing poor performance has been a significant financial burden to the government. The taxpayers have underwritten the post office's significant losses for the past several years. Additionally, the government has also provided funds annually for capital expenditure. The **cumulative net cash drain** for the Sri Lankan government, in nominal terms, has exceeded LKR 10 billion over the past 15 years. If one added the cost of financing the losses at an average of 10 percent per annum, the accumulated loss amounts to nearly LKR 20 billion (USD 200 million). Operating losses over the past 10 years (excluding budget for capital expenditure and financing) amounted to more than LKR 5.2 billion.

Sri Lanka Post **would have been considered bankrupt long ago** by any commercial standards. In 1996, the operating losses of Sri Lanka Post were LKR 112 million; in 2003 they had increased to LKR 583 million. The annual losses vary 10–33 percent of total post office revenue, which has been major hindrance to sector development and network rehabilitation.

[1] For example, the 1997 Sri Lanka Post budget for 1997 was reduced by 20 percent—from LKR 2.4 billion to LKR 1.9 billion—before approval by Parliament. In 2003 the proposed budget was cut by 29 percent.

In a message to the press in January 2004, the Minister of Posts and Telecommunications stated that the post office should become financially self-sufficient. The management of Sri Lanka Post was directed to prepare a plan to bring the current operational deficit to break even. The draft plan is currently being reviewed at the ministry.

Current Institutional Framework

In 1980 the Department of Posts and Telecommunications was split into two departments. Government ownership was significantly reduced by the privatization of Sri Lanka Telecomm, the participation of the Japanese telecommunications company NTT, and the subsequent floatation of Sri Lanka Telecomm stock on the Colombo stock exchange. An independent regulatory commission for Telecomm was established, and licenses awarded to various operators. With the advent of the Internet, a growing number of internet service providers have also entered the market.

The postal sector has not evolved like telecommunications. The Ministry of Posts and Telecommunications houses the owner, operator, and regulatory functions of the postal sector. Sri Lanka Post is formally the Department of Posts in the government, and subordinate to the ministries of Finance, Posts and Telecommunication, and Labor. The **policy staff of Posts and Telecommunications generally oversees the running of Sri Lanka Post, and its budget is set by the Ministry of Finance** (for approval by Parliament). Individual members of Parliament and ministers continue to interfere in the running of the postal service.

It is clear that the current institutional framework handicaps Sri Lanka's postal sector. Too much political interference, too many actors involved in operational decisions, too rigid a civil service regime, inability of post office to allocate resources optimally, and a bureaucracy that hinders commercial responsiveness and capital investment all contribute to the poor performance of Sri Lanka Post.

Postal and Telecommunication Reforms in Sri Lanka

In a letter to the IMF in March 2002, the government pledged to reform the post office and bring in private sector participation. Although outright privatization was considered too sensitive, greater collaboration with the private sector to expand services was considered a feasible option. Reform of the Sri Lanka Post has been on the legislative agenda for more than 10 years, and finally in September 1994, reform of Sri Lankan Post was included in a new economic strategy and elaborated in subsequent policy statements and annual budget speeches.

Telecommunications Sector Reform

The Ministry of Finance and Planning designed a public investment program for 1996–2000. The postal sector was part of the development of the infrastructure, which had high priority. Investments in power, roads and highways, telecommunications, and transport amounted to some 33 percent of the government's capital budget from 1995 to 2000. The investments in the post and telecommunications sector mainly expanded telecommunications infrastructure; investments in the postal sector were marginal (0.21 percent of LKR 71 million), which was not enough for Sri Lanka Post to introduce new services or improve service.

In 1991 Sri Lanka Telecom Corporation (SLT) was licensed (per the Telecommunication Act No. 25 of 1991) to provide both domestic and international telecommunication services, as a government-owned but autonomous enterprise headed by a board of directors and chairman appointed by the government. The Act also designated Sri Lanka Telecommunication Authority as the regulatory authority under a director general of telecommunication within the Ministry of Post and Telecommunication. (It later became an independent regulatory authority.) With rapidly increasing demand, funding to upgrade the telecommunications infrastructure was difficult to meet from public resources. **Through the government privatization program, the SLT was transformed into Sri Lanka Telecom, Ltd., in 1995**, and took over all assets, liabilities, and personnel of SLT. After a strategic alliance with NTT of Japan in 1997, an initial public offering of stock in 2002 put the majority of ownership in private hands.

Sri Lanka counted only 326,000 telephone subscribers in 1996; in 2003 the number of fixed-line and cellular telephones had passed the 2.3 million mark. Yet, an estimated 50 percent of households does not have telephone service. For them, public telephone booths (in most post offices) remain the only way to access telecommunications.

Information and Communications Technology Policy

In the late 1990s, the focus of the post and telecommunications sector shifted to information and communications technology (ICT). Sri Lanka has an explicit government policy to enhance access to ICT as a means of reducing poverty and closing the "digital divide." Among the programs initiated by the Telecommunications Regulatory Commission, **"e-Sri Lanka"** features prominently. In June 2004, the newly-elected government announced higher priority for the program. It is unfortunate that the postal system with its extensive network and its traditional role in providing access to communication and information did not implement the "e-Sri Lanka" program.

ICT and the Internet are relatively new in Sri Lanka. The number of Internet users in Sri Lanka is estimated at 150,000—a small number but growing quickly. Many Sri Lankans do not have access to the Internet at home or at work, and access will remain technically or economically difficult for the next decade. While Internet cafes and similar outlets mushroom in Colombo and other cities, the postal system has the initiative ("Community Locale") and provides a full range of Internet access facilities at 150 post offices. These post offices are also interconnected for other applications.

Postal Sector Reform Program

A comprehensive reform program for the Postal Sector was finally initiated in 1996 after consultation with the Ministry of Posts and Telecommunications, Sri Lanka Post, and the Public Enterprise and Reform Commission, and support from the World Bank. In March 1997, a World Bank report ("Reforming Sri Lankan Postal Service, Phase I Results of the Postal Sector Reform Initiative") highlighted the drain of the postal system on the Sri Lankan treasury and identified the main elements of structural change for the postal sector:

- Commercialize the operations
- Increase private sector participation
- Develop competition
- Institute regulation

The overall objective was to transform Sri Lanka Post into a profitable, high-quality service provider and a good employer that would be able to attract and retain qualified staff. Specifically, Sri Lankan Post needed to:

- provide an enhanced portfolio of market-driven services and products, for greater choice of communication services (including traditional mail service) to all residents of Sri Lanka;
- set and meet standards of high quality in the provision of basic products and services;
- provide core services at low cost;
- attain financial self-sufficiency, and be able to finance new investments, service expansion, renewal, rehabilitation, and new product development within four to five years; and
- continue to offer universal service with a uniform tariff structure for regulated service and products.

The program identified developing delivery of financial services at postal counters as a key area to initiate postal reform and to generate revenues.

The government attempted a strategic partnership between a strong, competent financial institution and the Sri Lanka Post, but resistance from politicians and labor unions, culminating in strikes, aborted this at an early stage. As a result, Sri Lanka Post continued to provide existing financial services and added new versions of existing products supported by new technologies. In 1998 the fax money order was added and in 2004 a pilot for the electronic money order[2] was launched and then rolled out to 75 post offices.

Postal Network Development

Even though the investment budget available to the postal system in Sri Lanka has traditionally been small, until 1997 **investment mainly focused on expanding the post office network, without analyzing the expected return on investments.** This misdirected capital expenditure should have been used to increase efficiency, such as computerizing the post offices.

When analyzing the correlation between the expansion pattern of the post office network and the development of the financial results of Sri Lanka Post (see tables below), then the impact of this expansion policy becomes clearer. Although current financial data do not provide full evidence that the growth in postal network could be the main cause of the increasing deficits, there are sufficient reasons to point out the **growing negative financial burden** resulting from the development of this post offices infrastructure.

Financial Results Sri Lanka Post 1992 -2002 (In 000s of LK rupees)

Category	1993	1994	1995	1996	2002
Operating income	1,130,167	856,304	1,320,943	1,402,640	2,125,000
Operating expense	1,032,702	1,397,216	1,557,915	1,713,200	2819,000
Capital investment	138,933	124,121	168,845	150,700	
Profit/loss	(41,468)	(665,033)	(405,817)	(461,440)	(694,000)

Source: Reforming Sri Lankan Postal Services, Phase I, UPU Statistics 2002 (Washington D.C.: World Bank, 1997)

Financial Impact of Post Office Network Development (in 000s of LK rupees)

Category	1993	1994	1995	2002
Operating income	1,130,167	856,304	1,320,943	2,125,000
Number of post offices	4043	4058	4151	4452
Income per post office	279.54	211.02	318.22	477.31
New post offices	27	15	93	23*
Capital expenditure	138,933	124,121	168,845	
Capital expenditure per post office	34.36	30.59	40.68	
Operating expense	1,032,702	1,397,216	1,557,915	2,819,000
Operating expense per post office	255.43	344.31	375.31	633.20
Loss per post office	(10.25)	(163.88)	(97.77)	(155.90)

* Agencies only

The lack of a business process that questions or reviews how the individual post office manages its primary business of collecting, processing, and sorting mail has also exacerbated the tendency to expand the network. Post offices and sub-post offices feature **separate counters for each type of transaction**, and only a few post offices (less than 150) have automated counters. This results in a high number of underutilized staff and

[2] The electronic money order is a creative alternative available to people who cannot afford, or do not have access to, credit cards. The e-money order is a standard money order enhanced by an electronic aspect to allow faster, reliable, and more convenient service to a wider section of the population.

inconvenience for clients because they must queue for each transaction. The lack of other projects (e.g., sorting centers, computerization), however, suggests an investment policy directed at expanding the postal infrastructure and increases of fixed cost (to maintain the post office and to hire staff) without business rationale.

The privatization of the ownership and management of a significant number of the 3,500 sub-post offices is expected to have a dramatic impact on the Sri Lanka Post, its culture, quality of service, and financial performance. The transformation could release a sizeable amount of cash currently tied up in non-earning fixed assets that could be redirected into commercially/economically sensible projects. The Sri Lanka Post would also see a sharp reduction in fixed cost (related to employment and maintenance of the postal offices), and would have to deal with flexible cost related to earnings. Private entrepreneurs would commercially manage the small post offices, challenge government-owned post offices to match quality and customer-oriented services, and broaden sales with other products and value-added services to generate sufficient turnover per square meter or per person employed. The postal network would need to increase overall cost-efficiency and, most of all, implement commercial management and MIS.

2—Postal Financial Services in a Market perspective

While the existing postal financial services have seen little change over the past decades, **the financial sector in Sri Lanka has been undergoing quite a metamorphosis, and has developed into a relatively sophisticated, competitive, and diverse sector of industry.** The banking system includes the Central Bank of Sri Lanka, two large state-owned banks, and more than 20 privately-owned commercial banks. Moreover, there are more than 10 regional rural development banks plus co-operative lending societies, development finance institutions, and a state mortgage and investment company, as well as the National Savings Bank. In addition, 13 insurance companies (all private), pension funds, and employee trust funds have begun to mobilize large pools of long-term resources.

In spite of the diversity of the banking sector, the government-owned institutions (Bank of Ceylon, People’s Bank, and NSB) still dominate the financial system. Private banks do compete, but not through aggressive pricing—they prefer to increase their margins, which are quite wide because the government-owned banks suffer from many inefficiencies and weaknesses in their operations. (These are being addressed through specific programs and measures, under the supervision of the Central Bank). Private banks offer a range of sophisticated, up-to-date services for those people with higher incomes. The services packages include high-tech features, such phone banking, mobile banking, electronic banking, debit and credit cards, as well as personal banking relationship officers and private bankers and advisers. It is estimated that these banks serve more than a half million individuals, mainly in urban areas.

The banking sector operates through nearly 1,200 outlets. For commercial banking purposes, this may arguably be a high figure; for consumer banking, it indicates **a low level of “bankarization**.” A ratio of 1 outlet per 16,700 inhabitants is low compared to developed countries where the ratio varies in the range of 1 outlet per 1,000–5,000.

The Payment System

The payment system in Sri Lanka is relatively well developed. For cashless payments, the Central Bank of Sri Lanka developed payment systems and instruments that comply with the core principles for payment systems defined by the Bank for International Settlements in Basel. The payment system consists of a real-time gross settlement system, (mainly for large payments), the Sri Lanka interbank payment system (mainly for credit transfers, direct debit transfers, standing orders, and paperless payment instructions), four check clearing houses, and several smaller regional check clearing houses.

Although critically important steps have been implemented to ensure a sound payment system, the system is essentially paper-based and check-based. A project to image-process checks is underway, but most checks require manual data entry and processing.

The volume of (retail) cashless payments in Sri Lanka in 2003 was:

- 36.5 million checks;
- 2.1 million direct transfers (SLIPS);
- 33 million cash withdrawals at automated teller machines (ATM); and
- 7.7 million electronic fund transfers at point-of-sale (EFT POS).

Total cashless payments were below 80 million in 2003, and translated into slightly more than four cashless payments per capita. This is relatively very low, especially if GDP per capita is taken into account. Fewer than 500,000 credit/debit cards were issued in Sri Lanka as of year-end 2003 (mainly credit cards, and relatively few debit cards.) Approximately 528,000 customers made use of other options, such as Internet banking, mobile banking, and telebanking. The total number of these transactions was 293,812 in 2003, suggesting that these **advanced payment instruments were actually used by** a privileged group of about 500,000 Sri Lankans—**about 10 percent of the population**. At 2003 year-end, this group had about LKR 76 billion in transferable deposits, or an average of USD 1,347 per account.

The **other 90 percent** of Sri Lankans is essentially excluded from cashless payments instruments and are **confined to using cash,** since they do not qualify for checking accounts or credit cards. The cash component in M1 (currency in circulation with the public) amounted to LKR 85 billion and represented 52 percent of M1 at the end of 2003, the equivalent of USD 39 per capita. Sri Lanka has not significantly progressed in transforming M1 from cash to cashless: at the end of 1996, the cash component was 55 percent (then LKR 47 billion).

Sri Lanka had 721 ATMs at the end of 2003, increasing by 20–25 percent per year. Currently there is 1 ATM per 27,000 inhabitants. There were 5,114 EFT POS terminals in Sri Lanka at the end of 2003, a significant increase from 4,250 at the end of 2002 (1 terminal per 3,800 inhabitants).

The post office fulfills a valuable function in the payments system of Sri Lanka. It processes about 2.2 million (inland) postal money orders, a person-to-person money transfer instrument. The averaged payment was USD 31 in 2002, and increased by 20 percent in 2003. Telegraph and fax money orders also increased in demand and value. Total value of money orders processed in 2003 exceeded LKR 13 billion (USD 11 million), or about 15 percent of cash in circulation. The post offices processed 15 million other payments, such as pensions, social benefits, collection of utility bills, collection of spot fines, and fees for radio and television licenses. These transactions are a small part of the total operations volume of Sri Lanka Post, compared to mail, estimated at about 600 million (mail) pieces in 2002. However the **financial service transactions are a significant flow of business**, estimated to be 30 percent of total over-the-counter transactions. The 17 million financial service transactions per year translate into an average of 13 transactions per day per post office.

Recurrent payments (for utility, rent, taxes, etc.) can also be made at bank branches and the NSB. The volumes and value of these payments are not reported by the Central Bank, but it suggests that the postal network processes a significant number of the bulk small-value payments and person-to-person payments, more than 10 percent of the overall market. There also appears to be a **tendency by commercial banks to outsource cash-based, small-value payments to Sri Lanka Post**, and other retail networks.

It is widely accepted that the use of cashless payment instruments contributes to financial sector stability and efficiency and economic growth. For rapid (i.e., within 7 to 15 years) transformation from cash to a cashless payment system, a dense network with easy access to cost-efficient payment products, such as offered by Sri Lanka Post, is a prerequisite. Also, economies of scale need to be achieved to earn back the capital expenditure in a payments infrastructure including ATMs, EFT POS, and EBPP (electronic bill presentation and payment) terminals.

The post offices could build upon its existing competence and reputation in payments processing, and add modern ICT to provide an accessible and economical infrastructure providing payments services that do not include individual credit risk assessment, such as debit cards, and (giro) credit transfers. The current infrastructure of bank branches, their location, and profile in the market are unlikely to contribute to rapid transformation from cash to cashless payments. **Commercial banks are unlikely to consider low- and medium-income visitors for cash payments as attractive business,** and these individuals are unlikely be comfortable enough to request account and payment card products. Alternative networks—retail chains, petrol stations and micro finance outlets—should be considered too. However none of these networks have the density, standardization/uniformity of service, and low threshold profile of the postal network, which is, already significantly involved in payments processing.

Even though the use of the financial services at post offices is not intensive, it appeared from previous visits and interviews that most adult Sri Lanka citizens are aware of the existence of these products, and the role of the post office. This awareness is not created by advertisement campaigns, but stems from visits to the post offices. If marketing were applied, the profile of the post office and the usage could be increased.

Savings and Deposits

Sri Lanka's low savings quote, 12 percent of GDP in 1996 which improved to 14.4 percent in 2002, is significantly lower than in neighboring countries (more than 20 percent) and is a major constraint on economic development. As a consequence, Sri Lanka relies on more costly finance from abroad.

The inefficiency of the state-owned banks and the focus of private banks on widening margins explain in large part the **absence of true competition for the deposits of the mass of consumers with average and below average incomes.** Unattractive pricing and inadequate products do not promote a demand for services, which explains to a certain extent why a large percent of the working population still receives regular income in cash, rather than in an account, and why a significant large part (greater than 52 percent) of M1 remains in cash, unlike other countries where only 20–30 percent of M1 is cash.

Sri Lanka Post's role in mobilizing savings has gradually been marginalized as shown in the table below. Market share of household deposits held in the post offices has declined from more than 25 percent in 1971, to less than 3 percent in 1995, to 1.5 percent in 2002.

Postal Savings

	1995	2000	2001	2002
Postal savings accounts (in millions)	4.3	4.7	4.7	4.8
Total savings accounts NSB (in millions)	11.6	12.9	13.1	13.5
Share of post office (in NSB)	37.2 %	36.4 %	35.9 %	35.6 %
Postal savings balances (in LKR billions)	7.2	7.4	6.6	7.1
Total NSB balances (in LKR billions)	60	105	118	134
Share of post office (in NSB)	12 %	7.05 %	5.59 %	5.30 %

From NSB annual reports; UPU Statistics; Central Bank of Sri Lanka annual reports 1995–2002

Currently, **more than 4.8 million people (about half of the adult population) have a savings account with the post offices.** With 2 million transactions per year only, and an average balance per account of USD 11.29 (down from USD 30 in 1995), one can presume that a large number (greater than 80 percent) of the accounts are dormant. This points to about 900,000 active savers, who make two or three deposits or withdrawals per year and have an average balance of USD 75–100. The active client group is probably made up of small rural savers and senior poor urban citizens who would not have access to other financial outlets, and who continue using the post offices as a matter of habit.

NSB figures suggest that 2 of every 3 Sri Lankans are depositors with NSB. However, it is also assumed that **many of the 8.7 million accounts of this group are dormant or inactive**. Fitch Ratings—on the basis of information provided by NSB—reported that about 50 percent of the accounts are dormant. This still seems an optimistic estimate. If the same of other savings banks that provide pass books and certificates (i.e., 85 percent inactive) also apply to NSB, the number of active savers would be around 1.3 million. This figure matches the actual size of the NSB network, with 101 branches and 245 school branches.

The continuous decline of postal savings should be attributed to the weak marketing strategy of NSB that tends to ignore the benefits of postal network and to focus only on sales through its own 101 branches that are mainly located in urban areas. There are no products geared to the needs of the visitors of the postal network, and no advertisements or promotions to attract potential clients to NSB services at post offices. Apparently to appease the post office, in the late 1990s, NSB established seven bank branches in the largest post offices.

NSB has very limited products for the retail clients because it is basically a savings bank. It does not widely offer payment products although it is involved in bill collection, transfers, and issues cards. It does not offer consumer credit, microenterprise credit, insurance, securities, or mutual funds. Deposits coming through the postal network are relatively insignificant for NSB, and from interviews it was learned that NSB views the quality of service at post offices as poor and inadequate compared to its own levels of service. Given its own constraints, NSB cannot upgrade the operations at post offices or provide staff training and incentives either. In a strategic review of NSB, one might question why NSB should continue the operation through the post offices.

The NSB—as a narrow state savings bank with its own branch network—is possibly not the most suitable partner for the Sri Lanka Post to develop and modernize its financial services and to provide financial services through its dense network. The current agency agreement is a historic legacy. Moreover NSB's own institutional weaknesses and need to modernize preclude an effective and innovative process with Sri Lanka Post. NSB's unproductive relationship with the post actually contributes to the drain of the Post on the government budget and effectively prevents the introduction of competitive and attractive financial services to the post.

If the postal network with its 4,600 outlets were to effectively provide access to financial services, and contribute to greater efficiency in the financial intermediation, terminating the exclusivity in the arrangement with the NSB is the first prerequisite step. The Sri Lanka Post has the market penetration to capture a larger part of the idle money by collecting deposits on a competitive basis. To this end, it should be able to conclude a partnership with a different financial institution that has a strategic interest in marketing through the post office. The combination of cashless payments instruments (cards, accounts), particularly, and deposits could form the basis for the postal network to re-enter the financial infrastructure, by providing low-threshold access to basic financial services.

Remittances

The remittance flow from the approximately 1 million Sri Lankans abroad was estimated at more than USD 1 billion in 2003. About 800,000 of the expatriots are women employed in Middle East as domestic help. The **remittances are critically important, and funded about 73 percent of Sri Lanka's trade deficit in 2003**. Over the past 10 years, the flow of remittances has been consistently larger than aid and foreign direct investment in Sri Lanka. Global operators, such as Western Union and MoneyGram, have a relatively small share of this business, less than 15 percent of the total.

It is remarkable is that NSB is not involved in capturing these international remittances. NSB would be the obvious vehicle for this, allowing overseas workers to send money home to a savings account of the beneficiary family member. This could be a convenient solution for the postal savers as well. NSB reportedly has considered linking up with international providers of remittances, but has not concluded any arrangement yet. If NSB entered this business, it would probably introduce a stand-alone product, because it cannot comply with IT and operation requirements for such service.

Sri Lanka Post has had a long-standing though relatively insignificant role in processing remittances. It deals with about 20,000 remittances, mainly from India and the U.K. per year, with a value of LKR 400 million in 2003 (about USD 4 million)—less than 0.5 percent of the market. Sri Lanka Post has been approached by representatives of MoneyGram and Western Union among others to become an agent, but contracts have not been signed.

On a bilateral basis, **Sri Lanka Post has struck an agreement with the United Arab Emirates Post to exchange postal money orders electronically**. UAE Post will help Sri Lanka Post with the installation of necessary software and training. This appears as a useful step to improve the level of service with one of the key markets from whence remittances originate. Eurogiro membership might also be helpful and implementation of the newly developed tele-money order might provide much better coverage.

Insurance

The Sri Lankan insurance industry was nationalized in 1961, liberalized in 1987, and is now almost entirely run by the private sector. There are a total of 13 insurance companies, two of which deal solely with life insurance. The sector accounts for around 2.5 percent of total financial sector assets, and is becoming increasingly competitive as a larger number of market participants appear. In 2003, premiums written grew by 16 percent. Despite its strong growth and improving penetration levels, the Sri Lanka insurance market is still small in scale with total gross premiums written amounting to LKR 24 billion (USD 250 million) split between life and other insurance premiums. Access to insurance products seems to be very limited.

Sri Lanka Post has concluded agency agreements with several of the smaller insurance companies to collect premium payments. One approach to utilizing the postal network to sell insurance products could be to launch innovative, yet very simple standard “sure savings” plans that promote savings propensity and usage of life insurance.

Credit

Like other sophisticated retail banking products, the portfolio of consumer credit appears very limited in Sri Lanka. It stood at approximately LKR 40 billion at the end of 2003. Credit extended by commercial banks to individuals for consumption equals USD 21 consumer credit per capita. Although detailed data is lacking, it is assumed that only a portion of the 500,000 Sri Lankans that have check books and/or credit cards actually qualify for consumer loans from commercial banks. In that case, the total consumer credit portfolio would include 200,000–250,000 contracts with an average value of USD 2,000 per loan.

The Sri Lankan experience with microcredit or **microfinance** differs substantially from Indonesia and the Philippines. **Dominated by co-operatives and government microcredit programs, it also has a long history of subsidization**—about 33 percent of microcredit comes through government programs, which are supply driven and not sustainable. Because microfinance is highly subsidized, only a few private commercial banks have entered the sector. Outreach appears broad although commercialization is still in early stages. The types of institutions engaged in microfinance include cooperative rural banks (CRB) and their branches, registered primary societies of the thrift and credit cooperative societies (TCCS), and non-governmental organizations (NGOs) and microfinance institutions (MFIs).[3]

While these organizations have a commercial orientation to microfinance, there are substantial disincentives for much of the private financial sector pursuing microfinance. Less than one-third of the credit provided is estimated to come from commercial programs. Non-commercial providers of microfinance include unsustainable government microfinance programs, many poorly performing CRBs and TCCSs, and 200 or more small or medium-size NGO MFIs that are weak. Co-ops provide 50 percent of the microfinance loans, with another 42.5 percent coming from government and quasi-government sources. NGOs provide only 5 percent of the loans, and the private sector only a bit more than 1 percent.

[3] Data and comments on Sri Lanka have been drawn from Stephanie Charitonenko and Dulan de Silva, “Commercialization of Microfinance: Perspectives from Sri Lanka” (Manila: Asian Development Bank, 2002).

Constraints to commercialization and sustainability in microfinance stem from a lack of standard accounting and best-practice management principles,[4] and co-operatives ownerships which put the microfinance activities under the ownership and management of multi-purpose co-op societies, which often absorb the profits of the CRBS into their other loss-making activities. High costs, along with weak administrative and financial controls, are common throughout the MFI sector.

Unlike the experience in India and other Asian countries, **the Sri Lankan market is considered to be approaching saturation with nearly 80 percent of potential demand for microcredit being satisfied**. Based on household data and the current average outstanding microloan (USD 193), demand is estimated to be around USD 259 million, with 2.3 million loans. Although explicit data regarding points of service are not available, there are 8,000 registered TCCSs, as well as more than 200 NGO MFIs, the networks of the CRBs, and a few commercial banks engaged. This compares well to the dense postal network, which is not active in microfinance. A deeper assessment would be useful to compare the TCCSs to the post offices with an eye to strengthening and commercializing the provision of microfinance.

If the postal network were to offer an enhanced portfolio of financial services and provide outreach to rural area through its network, the inclusion of standard credit products (linked to the actual usage of payments and savings and/or insurance accounts) would be a logical step. If Sri Lanka Post were partnered with a commercially-driven private-sector institution, it could contribute to the competition and commercialization of the microfinance industry in Sri Lanka.

Assessment of Sri Lanka in Providing Access to Financial Services

As the previous sections have shown, Sri Lanka Posts has been a national channel for payments and savings collection for more than 125 years. Today, it provides a limited range of basic financial services in a competitive environment, but they are a marginal, loss-making element in both the postal and financial sectors. One might therefore expect that postal financial services will be gradually phased out, unless Sri Lanka Post replaces the current, antiquated operations, develops cost-effective and efficient services, and eventually links up with private-sector, market-driven, capable financial institutions.

The rationale for Sri Lanka Post to do this should be the draw of additional income that it could realize by exploiting its network and infrastructure. It could become financially self-reliant and be able to upgrade its overall service level. It would also contribute to employment and to improve labor conditions. For the government of Sri Lanka, the rationale to promote postal financial services is wider, not restricted to only transforming Sri Lanka Post into a financially self-reliant company. The postal financial services could also support the government's intent to:

- broaden access to ICT;
- make the transformation to a cashless payment system and thus support financial sector stability and efficiency;
- provide more formal channels for remittances; and
- provide wider access to financial services and the formal financial sector to more of the population, including those people living in rural areas and low-income segments, whom banks do not target.

The business mission of Sri Lanka Post regarding financial services should be to actively position itself as a national channel for payments and transfer instruments among all sections of the population, and eventually become a full-fledged distribution channel for a range of financial services for mass consumers.

[4] CRBs are part of multi-purpose co-operative societies and as such do not have separate financial statements. Their profitability is difficult to estimate although their potential is regarded as quite good with revised practices. About 80 percent of the portfolios of CRBs are microfinance.

Assessment of the Current Condition of Sri Lanka Postal Financial Services

Aspects	Focus/Capabilities	Weaknesses	Improvements
Marketing	• Post office location policy	• Absence of client orientation • Market performance responsibilities	• Market and business oriented approach required • Commercial management needed
Management	• Budget oriented • Increasing momentum for change	• Procedure oriented • Lack of market orientation • No clear business strategy	• Postal reform may offer rehabilitation • Labor unions more open to overall change program
Organization	• Organic structure without clear accountabilities	• Bureaucratic • Not market oriented • No quality management	• Total restructuring required • Need for 5-year program of change
Human resources	• Under-developed • Serious cultural lag and quality gap with business sector	• Urgent need for professionalization • Need for upgrading program which covers all aspects of HR	• Training must have priority • Review of curricula for training together with main clients • Need for external trainers • Need for “training-the-trainer” program
Financial accounting	• Mainly cost accounting • Poor level of performance • Serious backlog in processing money orders • MIS non-existent	• Urgent need for professionalization • Priority commercial accounting • Priority financial and cost accounting • Set up management accounting	• Computerization of money orders • Computerization is high priority for administration and improvement of MIS
Technology	• Under-developed • Need to review mail and counter processing and upgrade to postal technology	• Poor performance of front office and back office services	• Technology at lower cost available in the future
Finance	• Increasing deficits • Budget deficits absorb much management attention	• Review of investment priorities is needed • Upgrading core post offices is a priority	• Need for franchising of post offices and • Full cost coverage of services

3—Options for Development

Sri Lanka Post should try to conclude more arrangements with overseas postal entities to capture a bigger slice of the remittance flows, such as joining the Eurogiro network (more than 41 countries participate) and implementing the new tele-money order service. Also, Sri Lanka Post should seek to capture more business by offering its services to various institutions, such as Bank of Ceylon, the Sri Lanka National Insurance Corporation, to collect bills and premiums on their behalf. Most of these institutions are interested in the dense post office network as a low-cost channel for collection of bills from people who do not have an account or an established relationship with a bank or financial institution.

Eventually, **these collection services could be offered to *all* financial institutions, as well as to government departments** (e.g., tax collection), which presently maintain their own collection mechanisms and networks.

For various reasons, cooperation with the Bank of Ceylon would be a particularly interesting option to generate more business in the short term. Bank of Ceylon is the state-owned commercial bank, which services the current accounts of most state enterprises, including public utility enterprises. Therefore, it deals with bulk flows of small value transactions. Currently, these payments are settled through its own network of approximately 300 outlets. Expanding this network is not foreseen in the short term,[5] and the Bank of Ceylon may want to consider transferring the less attractive, costly operations and non-clients to the post offices, which could act as an ancillary network for the banks. This would be particularly realistic if Sri Lanka Post continues to computerize its counter operations at main post offices, and if the terminals at counters communicate with the computer systems of the Bank of Ceylon (or other banks). Alternatively, the post office computer terminal could transmit payment data into the banks' automated clearing house.

It should also be noted that the revenues from these services are not likely to be sustainable in the medium and longer term. As the development of the financial sector continues, increasingly more people will establish a banking relationship (including a current account and a credit or debit card), so the need for an ancillary network for bill collection may gradually diminish. **Sri Lanka Post needs to pursue a veritable partnership with a banking institution as low-cost distribution and retail outlet channel for basic financial services,** as well build up a profile and position as a key network for consumer banking. It could also support direct banking or direct marketing through its post office network.

If Sri Lanka Post partners with the banks, the 19.5-million people in Sri Lanka would have access to the formal financial sector through more than 5,800 points rather than the 1,200 bank branches and agencies. However, at this moment the gap between current operations and management culture is very wide, and Sri Lanka Post would need to meet a number of minimum requirements before inviting such institutions into such a partnership, such as:

- An accountable entity within Sri Lanka Post with responsibility for the execution of the postal financial services, and which can introduce new products. This could be realized by setting up a specific management team for the business of postal financial services.
- Recent, consistent, externally audited and certified accounts (balance sheet, income statement, annual report) of the Sri Lanka Post, which the partner banking institution could check as a matter of due diligence, and which would give reliable insight into the market and financial performance of the Sri Lanka Posts, and its financial condition. Currently, Sri Lanka Post only produces an "administration" report with very limited information.
- A minimum degree of financial management and management accounting, including product profitability analysis and planning based on a detailed cost study, and including a cost allocation model.
- More efficient accounting procedures for customer transactions, supported by computerized counter transactions. Where computerization will not occur in the near future, a higher level of efficiency, timeliness, and reliability should be attained. The current practice, in which all operations are manually processed at different counters with a large number of forms, is inefficient and at high risk for inaccuracy and fraud.
- New post office "retail" formulas, defined for the approximately 3,800 sub-post offices and agencies, where existing staff or local private entrepreneurs operate under performance-based franchise agreements. This is essential to reduce the high number of fixed cost and fixed assets within Sri Lanka Post and to enhance customer orientation. The post office agents may need SME loans to train managers and sales staff, install IT equipment, and refurbish the post office. It is estimated that the transformation might take 7–12 years.

[5] The Central Bank of Sri Lanka has prohibited the state commercial banks from opening any new branches unless satisfactory profits are attained.

- One or several small-scale demonstration projects to showcase the potential of Sri Lanka in providing better, and new, client services, such as extending the e-money order to include international e-money orders.

Summary of Roles, Responsibilities, and Tasks for Sri Lanka Post and Partner Financial Institutions

SRI LANKA POST	PARTNER FINANCIAL INSTITUTION
Marketing and Sales • Promotions in post offices (posters, displays, brochures, etc.) • Opening of accounts (intake of application forms) • Advice and information on product features • Cross-selling between postal and financial products	**Marketing and Sales** • Marketing strategy and planning • Product development, product definition • Communications campaigns in public media and direct mail • Pricing for clients and end-users
Operations • Front office operations, cashier/teller • Acceptance and handling of forms and cash • Reporting to bank, data communication with bank on transactions	**Operations** • Back office operations • Computerization/application of Information technology • Determination of procedures and processes
Staff • Recruits and employs staff at post office counters • Manages and controls staff • Counterpart staff for co-operation with bank	• **Staff** • Determines staffing requirements for post office clerks • Develops and provides training • Develops performance measurement instruments • Provides incentive schemes
Finance • Charges for work performed on a full-cost basis • Charges for sales performance • Charges for promotions in post offices • Charges for investments in post offices, specifically made for financial services • Charge for availability of the network	**Finance** • Remains fully responsible for asset and risk management of funds attracted or extended through the post office network • Determines accounting procedures, processes, and systems • Compensates SLP for costs made for promotions, administration, sales, processing • Co-finances investments in the post offices related to the execution of financial services • Provides cash management

Partnership with Private Sector Financial Institutions

Linking Sri Lanka Post with privately owned financial institutions for a stable and sustainable platform to create a postal financial services system still seems a somewhat distant option, given the failure of the attempt to establish such partnership in 1999–2000. Reputable institutions would probably not want to associate their image with the poor service quality and unreliable and untimely accounting procedures at the post offices, and risk their client relationships and financial performance. Co-operation with a private sector financial institution would necessitate significant reform and modernization of the post offices (including performance management and commercial accounting systems). Should pilot projects achieve tangible progress—presumably after 1–2 years—this option could be reassessed and might have a better chance. In the meantime, Sri Lanka Post could continue to cooperate with various private sector financial institutions (e.g., SANASA) to franchise postal agents in the bank's branches, to reduce the proprietary network of the postal system and better utilize the unprofitable bank sub-branches. Partnerships with privately owned financial institutions are the most preferable option, as it would keep the division between the postal and financial sector distinct. There are several modalities for this partnership: it could be a long-term agreement, a concession styled agreement, or a "build-operate-transfer" (BOT)-style operation.

Partnership with a State Commercial Bank

To link Sri Lanka Bank with one of the state commercial banks (Bank of Ceylon or the People's Bank) would not seem a desirable option because this might complicate or protract the reform of these banks to into more cost-efficient and profitable institutions. Moreover, these two state commercial Banks dominate the banking scene with strong, extensive branch networks (together some 800 outlets). They also have many government/public enterprise accounts and a market share in assets of more than 45 percent. Access to the postal network would actually lead to further market concentration in these banks and they could prevent competitors from gaining instant access to widespread network. However, in the short term, Sri Lanka Post's agency agreements for bill collection for the Bank of Ceylon may be an opportunity worth continuing and expanding to produce more revenues for Sri Lanka Post.

Partnership with Other Banks and Finance Companies

The State Mortgage and Investment Bank is a relatively small bank, specialized in long-term lending for housing purposes. This bank presumably lacks the orientation, mission, and financial capability to set up a postal financial services system with Sri Lanka Post. The same applies to various other financial institutions, such as the Development Finance Corporation of Ceylon, and the National Development Bank, both of which are primarily interested in long-term resources to match their long-term lending. Taking the differences of finance companies, leasing companies, merchant banks, and venture capital companies into consideration, there seems to be little or no common business interests for joint venture with a postal bank. Venture capital companies perhaps might co-invest in a postal bank program, provided the expected rate of returns is attractive enough.

Partnership with Regional Rural Development Banks

There might be common business ground with the various rural and cooperative lending institutions. The regional rural development banks (RRDBs), which undergoing reform and privatization, operate in similar client segments as does Sri Lanka Post in its current operations.

The RRDBs would be interested in low-cost resource mobilization, including demand deposits, and in expanding their branch networks, especially in rural areas. One could therefore imagine a partnership between RRDBs and Sri Lanka Post, in which Sri Lanka Post's role would be savings mobilization, payment processing (including collection of loan installments) while the RRDBs would focus on client data base management, client acquisition, credit analysis and loan processing. Although it might be worthwhile to explore the possibility further of such a partnership, there are a few drawbacks in the development of a long-term, sustainable, joint operation of a postal financial services system.

Most of the RRDBs operate in specific regions or provinces only, whereas Sri Lanka Post operates nationwide and manages its operations from a national perspective. Regionalizing the postal services has not been contemplated, and from a managerial point of view, a relationship with the RRDBs would be more difficult to manage than with one national institution. Moreover, the operation volumes of the RRDBs are relatively small compared to Sri Lanka Post, and would not substantially contribute to Sri Lanka Post revenues. RRDBs are dependent on donor funding and government subsidies, especially now as they are undergoing reforms toward privatization, and are unlikely to have the necessary financial and managerial capability to develop a modern, efficient postal financial service system with Sri Lanka Post.

Partnership with Insurance Companies

The insurance market in Sri Lanka is growing rapidly, but is still very small in absolute terms. Sri Lanka Post might over time develop into an attractive channel for private insurance companies to sell policies and to collect premiums. To this end, Sri Lanka Post would need to explore the interest of the insurance companies in repackaging life insurance products into affordable, easy-to-understand products that can be sold over the post office counter. Sri Lanka Post would act as a sales agent for the insurance companies. The introduction of insurance products in post offices would also require investments in human capital, and proper and timely accounting procedures for the premiums collected.

Moreover, if an insurance company allied with a bank, a full range of financial services could be developed. It is noteworthy to mention neither direct writing nor bank assurance has been tested in Sri Lanka. If Sri Lanka Post was successful in forging relationships with both one or more banks and an insurer, it actually could emerge as an innovator in providing access to small-value, basic financial services.

A partnership with the Sri Lanka (National) Insurance Corporation could also be considered, but it already has a large established network of agents and the additional value of the post office network would be limited. The role of the post office network, though, in collecting premiums for the Sri Lanka Insurance Corporation, would be well within the current scope and capability of Sri Lanka Post, and could generate substantial additional revenues.

Rehabilitation of the Partnership with the National Savings Bank

Sri Lanka Post has had a working relationship with the National Savings Bank for more than 100 years. Moreover the postmaster general is a statutory member of NSB’s board of directors, and post offices are statutory outlets of the NSB. Sri Lanka Post provides a valuable service for the NSB with relatively low administration costs: only 0.3 percent of total collected deposits as compared with 1 percent for deposits through NSB’s own branches.

Nearly 4.8 million, mostly adult inhabitants of Sri Lanka have a postal savings pass book, which represents a market penetration of nearly 45 percent, even though its market share though has declined to less than 1.5 percent. NSB’s own position has come under increasing pressure due to its continual decline in market share[6] and more alternatives available to consumers for banking their savings. There are an increasing number of competing financial institutions who offer a more and more competing products, including life insurance, pension plans, trust units, and modern deposit products.

Moreover, the function of the NSB as a low-cost funder of the Treasury, which bypasses the capital and money market, should become less relevant with the liberalization of the capital market and an open treasury bill market. This should undoubtedly add to a greater efficiency in the mobilization and allocation of financial resources.

Transforming NSB into a full-fledged commercial bank is a huge task and not feasible in the short or medium term. It would not only require additional capital injections but also reinforcement of management with a strong commercial orientation and a far-reaching recruitment and training program for staff in commercial bank operations and retail efficiency. A program that would transform NSB into a market driven, efficient, consumer-bank operation, which could later link with a private commercial bank (or be privatized) would be a more effective, sustainable and less costly course to pursue.

In this context, it is more a fall-back option for Sri Lanka Post—if a partnership with a private sector bank isn’t feasible—and taking the steps in the coming years to improve the intrinsic strength of Sri Lanka Post as an intermediary sales network for financial services would be more productive and have a more positive financial impact on Sri Lanka Post. It would be a most difficult task to transform and commercialize two public enterprises, Sri Lanka Post and NSB, than Sri Lanka Post only in conjunction with a private, competent

[6] It has dropped from more than 47.5 percent in 1986, to 32 percent in 1988, to 24 percent in 1996, to 17 percent in 2002.

institution. Intervention and supervision through outside catalysts (external consultants, central bank, and financiers) could be highly supportive to keep momentum in the process.

Annex 1 - Outline for Developing Financial Services Delivery in Sri Lanka

This is a preliminary road map to develop and expand the financial service delivery through Sri Lanka Post. The development could be subdivided into three major phases:

A. Preparatory and pilot phase (1–2 years)
B. Implementation phase (2–3 years)
C. Roll out and expansion phase (3 years)

The first phase should aim at preparation and implementation of:

- Financial service business unit management;
- Financial accounting processes;
- Marketing and management information systems;
- Business process redesign for postal counters;
- Pilot projects; and
- Preparation of partnership agreements.

Focus should be on repositioning the post office retail network to provide broad-based access to simple, standardized financial services, as well as other services that make use of information and communication technology. In phase 1, Sri Lanka Post should also expand its services in electronic international remittances and bill collection with support of counter automation and on-line data communication. The network that has been created for the e-money-order service could be used as an initial platform for remittances and bill collection, and gradually more post offices could be involved. In addition, networked post offices could function as "hubs" for data entry of bills paid at other post offices in the same area, and for hybrid money orders, to be disbursed at the post offices in the area or district of the connected post office.

A second phase could introduce card-based payment services, including accounts that can be linked to deposit accounts, credit accounts, and insurance policies.

As a follow-up phase, the information and communication technology infrastructure could be further expanded and applications expanded to make the post office a central access point for a broad range of financial and other services, such as e-government, e-learning and e-commerce.

Gradually expanding the network and applications makes allowance for a learning curve for the organization and its staff, clientele, and stakeholders. Another suggestion is that network development start with upgrading and expanding those existing business flows where Sri Lanka Post has a certain amount of competence and turnover. It should not start by entering new markets, with their higher hurdles and new requirements.

Starting with international remittances and processing bill payments could lead to a positive cash flow within a relatively short time. It is assumed that positive operational results and subsequent profitability will be re-invested into expanding the network, through a separate accountable entity. Earnings should not be absorbed by the deficits in the mail section, and capital expenditure should become a function of business performance and prospects rather than being part of the annual government budget.

If the option of developing partnerships with the private sector is pursued, it will require engineering a specific public-private sector partnership. A possible constellation is depicted in the chart below, in which a new company for e-services (through post offices) is the vehicle for the public-private sector partnership.

Annex 2 - Matrix of Options for a Postal Financial Services System in Sri Lanka

	Option 1 **Posts**	Option 2 **Private Sector Bank**	Option 3 **Private Sector Insurance Company**	Option 4 **National Savings Bank**	Option 5 **a State Commercial Bank**	Option 6 **Sri Lanka Insurance Corporation**	Option 7 **Other Financial Institutions**
Regulatory Framework	No license for banking or insurance	Under license of the private sector bank	Under license of the insurance company	Under the 1971 National Savings Bank Act	Under license of the bank	Under license of the insurance corp.	Under license of the bank(s)
Institutional Arrangement	Not applicable; service agreements with various entities possible	Contract; future joint venture and/or specific business units with Sri Lanka Post and bank	Contract; future joint venture and/or specific business units	In accordance with the 1971 NSB Act; organizational interfaces need to be strengthened	Contract, on non-exclusive basis	Contract on non-exclusive basis	Contract, on non-exclusive basis with rural regional development banks, SMIB
Product Portfolio	Confined to money orders, bill collec-tion, disbursement of pension payments	Can develop a full package of consu-mer and retail banking services, targeting different age groups, income groups, etc.	Can develop as an attractive service in addition to banking	Can gradually evolve from current savings products with existing 4.3-million client base to full range of banking services	Can develop from bill collection service to a package of basic services	Might develop from premium collection service to sales of some policies	Emphasis likely to be low-cost funding, and low cost pay-ments processing
Managerial Capabilities	Limited capabilities required	Recruit from private sector and banks; five competent managers to be responsible for a business unit	Recruit from private sector, see option 2	Already available to a certain extent, with NSB; needs further strength-ening: for Sri Lanka Post, see option 2 ; technical assistance needed	See option 2	See option 2	See option 2. plus relationship with management at regional and local level, and with product developers and marketers
Technological Requirements	Limited, can be restricted to back-office data entry and some communica-tion	To be agreed on or determined by the bank, ascertain state-of-the art applications (chip cards)	To be agreed on or determined by the insurance company; ascertain state-of-the-art application	Available for a few areas, needs con-siderable develop-ment; determine in joint project	To be agreed on with the bank, and/or provided by the bank	To be agreed on and/or provided by the insurance corporation	To be determined by Sri Lanka Post, taking into account user requirements
Human Resources Development	Within existing HR; further attention to timely processing	Program to be agreed on, and implemented by bank; might imply skilled banking officers in main post offices to supervise	Program to be agreed on, and implemented by insurance company; might imply insurance officers in main post offices	Program to be jointly implemented with NSB; 3 years technical assistance needed	Program to be determined with the bank and imple-mented by the bank	Program to be determined with the insurance corpora-tion; training pro-vided by the insur-ance corporation	Program to be developed by Sri Lanka Post, with inputs/contribution of local banks