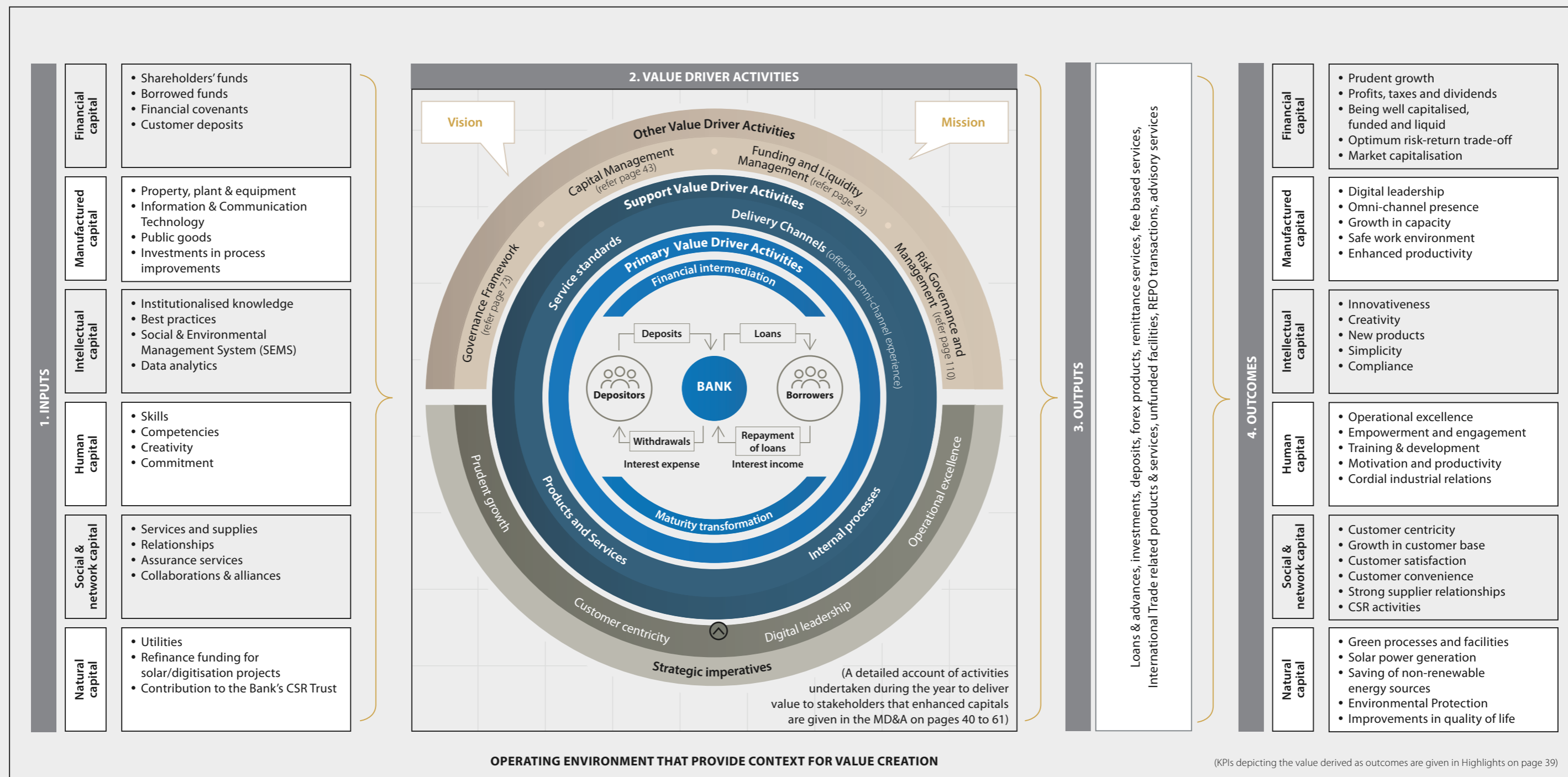


The Bank's business model that delivers value to and derives value from the stakeholders, leading to sustainable value creation Figure - 07



1. INPUTS

"Raw materials" for the value driver activities drawn from capitals. Please refer page 38 of the Statement of Capital Position for the opening capital position as at January 1, 2019 of different capitals built by the Bank over the past 100 years.

2. VALUE DRIVER ACTIVITIES

Include primary value driver activities that promoted growth, support value driver activities that promoted positive stakeholder interactions and other value driver activities that minimised risk. It is the inputs from the capitals together with relationships, interactions, interdependencies and trade-offs among capitals that generated outputs, leading to creation of value reflected in capitals.

3. OUTPUTS

Products and services and negative externalities generated through the value driver activities.

4. OUTCOMES

Consequences of our activities and outputs manifested in capitals as value created. Please refer page 39 of the Statement of Capital Position for the closing capital position as at December 31, 2019 of different capitals.

Business Model for Sustainable Value Creation

Business model of the Bank revolves around the two primary value driver activities of **financial intermediation and maturity transformation**. They directly accounted for 71.51% of the total operating income, 66.35% of total assets and 83.98% of liabilities as at December 31, 2019. However, since the Bank accommodates few walk-in customers, a substantial portion of the rest of the operating income, assets and liabilities too arose from or related to these two activities. A number of other value driver activities enhance the quality of stakeholder interactions and minimise risk.

Financial intermediation and maturity transformation

Financial intermediation refers to the intermediary role the Bank plays between various stakeholders – depositors and borrowers in particular that enable channelling savings into investments. Maturity transformation refers to the process of converting short-term funds into long term lending and investments. These are two activities essential for economic development of the countries through efficient allocation of resources by ensuring credit reaches the needy without jeopardizing the interests of those who invest such funds.

Capitals

By sustainably delivering and deriving value over a century of its existence, the Bank has been able to build a base of loyal stakeholders and “stocks of value” we respectfully call “capitals”. Besides financial and intellectual capitals that reside within the Bank, these include manufactured, human, social & network and natural capitals. It is these capitals that provide “inputs” for our value driver activities that enable delivery of value to and deriving of value from the stakeholders. Similarly, it is in these capitals that the “outcomes” and consequences of our activities leading to value creation manifest.

Statement of capital position

The activities we undertake in furtherance of financial intermediation and maturity transformation and the consequent interactions among

the capitals augment the capitals, a reflection of value created. See Table 07 on pages 38 and 39 for the Statement of Capital Position of the Bank as at January 1, 2019 and December 31, 2019 and growth during the year that reflect the value created during the year.

Besides the value derived as reflected in the enhanced positions of the other capitals, the two broader categories of income – net interest income from fund-based operations and fee and commission income from fee-based operations – enable the Bank to enhance its financial capital. Fund based operations involve the process of mobilising funds from depositors and borrowing from others incurring interest expenses and lending such funds to borrowers and investors earning interest income. The interest margin which is the difference between the lending rate and the borrowing rate compensates the Bank for credit risk, funding risk and interest rate risk. All other services provided by the Bank not involving funds are fee-based operations. Reflecting efficient financial intermediation, the Bank generated 71.51% of its total operating income by way of net interest income (70.57% in 2018).

Gearing

Financial intermediation and maturity transformation cause the business model of banks to substantially differ from other corporates. Principal difference is the substantially lower Return on Assets (ROA) which is less than 2% in general in stark contrast to between 10% – 20% earned by corporates in other sectors. This prompts banks to resort to the process of gearing in order to make the returns to the investors attractive in terms of Return on Equity (ROE). Gearing involves expanding the business volumes by mobilising more and more funding from depositors and other providers of funds to the banks and lending or investing such funds to grow the loan book, and investment portfolios on the strength of a given amount of capital.

Gearing primarily remains the foundation of our business model, which enables us to operate at around 10 times higher business volumes

compared to the shareholders’ equity. It is our license to mobilise deposits from the public that has made it possible. However, we are well aware that gearing exposes the Bank to a multitude of internal and external risks. In addition, certain emerging global developments are now threatening to disrupt this conventional business model. As explained later in the report, the Bank has established a sound risk management framework with necessary oversight of the Board of Directors and thereby has been able to successfully manage such risks.

Stakeholder returns

As shown in Table 07 on pages 38 and 39, Commercial Bank has been able to improve its profitability over the years while prudently maintaining gearing at acceptable levels. This improvement in profitability reflects the net impact of the value we have been able to create by delivering value to and by deriving value from our stakeholders. From investors’ perspective, this value creation is reflected in the returns the Bank has been able to generate for them in terms of earnings, dividends and appreciation in market price of shares. The market capitalisation of the Bank’s shares remained the highest among the Banking, Finance and Insurance institutions as at end 2019 while its shares ranked fourth among all listed companies in the Colombo Stock Exchange as at end 2019. Further details on the performance of the Bank’s shares are found in the section on “Investor Relations” on pages 288 to 305.

While growing organically and in the domestic market, the Bank has taken steps to leverage inorganic and regional growth opportunities, primarily to geographically diversify its risk exposures and sources of revenue and thereby enhance its sustainability of operations and long-term value creation. These efforts have now made the Bank a well-established regional bank.

Statement of

Financial capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create financial capital *	Value derived as at December 31, 2019	Growth in value created
Shareholders’ Funds	Rs. 118.4 Bn.	Grew the business volumes prudently through robust and efficient financial intermediation and maturity transformation, thereby strengthening the leadership position	Rs. 133.2 Bn.	12.5%
Subordinated liabilities	Rs. 38.0 Bn.		Rs. 38.0 Bn.	-
Deposits from customers	Rs. 983.0 Bn.		Rs. 1,053.3 Bn.	7.1%
Borrowings from banks/other borrowings	Rs. 50.1 Bn.		Rs. 51.5 Bn.	2.8%
Market share in total assets	11.1%		11.1%	-
Market capitalisation	Rs. 114.9 Bn.		Rs. 96.8 Bn.**	-15.8%
CSE ranking in market cap	3		4	
Price to Book Value	Highest among the BFI sector		Highest among the BFI Sector	

Manufactured capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create manufactured capital *	Value derived as at December 31, 2019	Growth in value created
Branch network	285	<ul style="list-style-type: none"> Maintained profitable mix of owned and rented buildings Delivery channels Conducted cost-efficient transport arrangements Improved procurement services 	287	0.7%
Number of ATMs	690		685	-0.7%
Number of CRM	160		200	25%
Bank on Wheels	2		3	50%
Investment in capital expenditure	Rs. 15.3 Bn.		Rs. 15.2 Bn	-0.7 bps

Intellectual capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create intellectual capital *	Value derived as at December 31, 2019	Growth in value created
Brand equity	Rs. 29.3 Bn.	<ul style="list-style-type: none"> Invested in centralisation and procedures Developed new products and services Expanded network, conducted research and development Deepened technological expertise Supported knowledge sharing initiatives 	Rs. 37.3 Bn.	27.3%
Value of intangible assets	Rs. 0.9 Bn.		Rs. 1.1 Bn.	22.2%
Receipt of awards and accolades	Most awarded bank in Sri Lanka		Most awarded bank in Sri Lanka	
World’s Top 1000 Banks	Included in 2018		Included in 2019	
Fitch rating	AA (lka)		AA (lka)	
Employees serving for > 20 years	834		791	-5.2%

Capital Position Table - 07

Human capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create Human capital *	Value derived as at December 31, 2019	Growth in value created
Number of employees	5,027	<ul style="list-style-type: none"> • Improved quality of new recruits • Conducted employee surveys • Invested in training and development • Enriched career development • Re-enforced performance management and appraisals 	5,062	0.7%
Number of new recruits	312		264	-15.4%
Retention ratio	96%		93.8%	220 bps
Return to work from maternity	100%		100%	-
Profit per employee	Rs. 3.5 Mn.		Rs. 3.4 Mn.	-2.9%
Average service period	11 years and 10 months		12 years and 2 months	4 months

Social and Network capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create Social and Network capital *	Value derived as at December 31, 2019	Growth in value created
Number of customers	Over 3.5 Mn.	<ul style="list-style-type: none"> • Promoted financial inclusion • Co-created products and services • Collaborated with business partners • Improved capacity of SMEs • Expanded Bank's footprint • Supported the community 	Over 3.5 Mn.	-
Market share in imports	11.3%		11.0%	-30 bps
Market share in exports	19.5%		18.3%	-120 bps
CASA ratio	37.6%		37.1%	-50 bps
Number of suppliers	Over 1,100		Over 1,200	-
Number of correspondent banks	54		55	1.8%
CSR Trust investment in society	Rs. 475.4 Mn.		Rs. 549.2 Mn.	15.5%

Natural capital

Indicator of value derived	Value derived as at January 1, 2019	Activities undertaken to create Natural capital *	Value derived as at December 31, 2019	Growth in value created
Energy consumption	49,958 GJ	<ul style="list-style-type: none"> • Screened loans through SEMS • Promoted paper reduction and recycling • Increased usage of renewable energy • Switched to energy-efficient appliances 	50,296 GJ	0.7%
Solar panel installation locations	34		49	32.4%
Number of facilities subjected to SEMS screening	9,685		10,074	4.02%
Online banking users	279,254		280,634***	0.5%
Mobile banking users	630,030		671,699	6.6%

* Please refer Management Discussion and Analysis for details of the activities undertaken.

** Reflects the overall market trend

*** Over 92,000 inactive customers were deactivated during 2019.