

MTI CEO SURVEY 2020

BECAUSE OPINIONS MATTER



MTI Consulting (Private) Limited

8th Floor, Aitken Spence Tower I, No. 305,
Vauxhall Street, Colombo 02, Sri Lanka.
www.mtiworldwide.com
srilanka@mtiworldwide.com
011-230-5551

Enablers



MTI’s Business Review of 2019 & Outlook for 2020

For the 9th consecutive year, MTI Consulting (via their Corporate Finance practice), in partnership with Daily FT, Daily Mirror and Sunday Times, has concluded the MTI CEO Business Outlook Study, collectively outlining the Sri Lankan business community’s perception for the state of business in 2020.

Supplemented by MTI’s experience as a thought leadership-oriented organization, the annual survey collated and analyzed the perceptions of over 100 Sri Lankan business leaders with regard to their business’ past and expected performance, their predictions regarding the state of the local and global economy in 2020, and the main challenges that they believe Sri Lanka and Sri Lankan companies will face in 2020.

The results of the survey, including its supplementary analysis, will assist organizations in streamlining their strategic decision making for 2020, effectively enabling them to gear their operations in accordance with the economic sentiments of their peers.

In 2019, the Businesses perform way below expectations

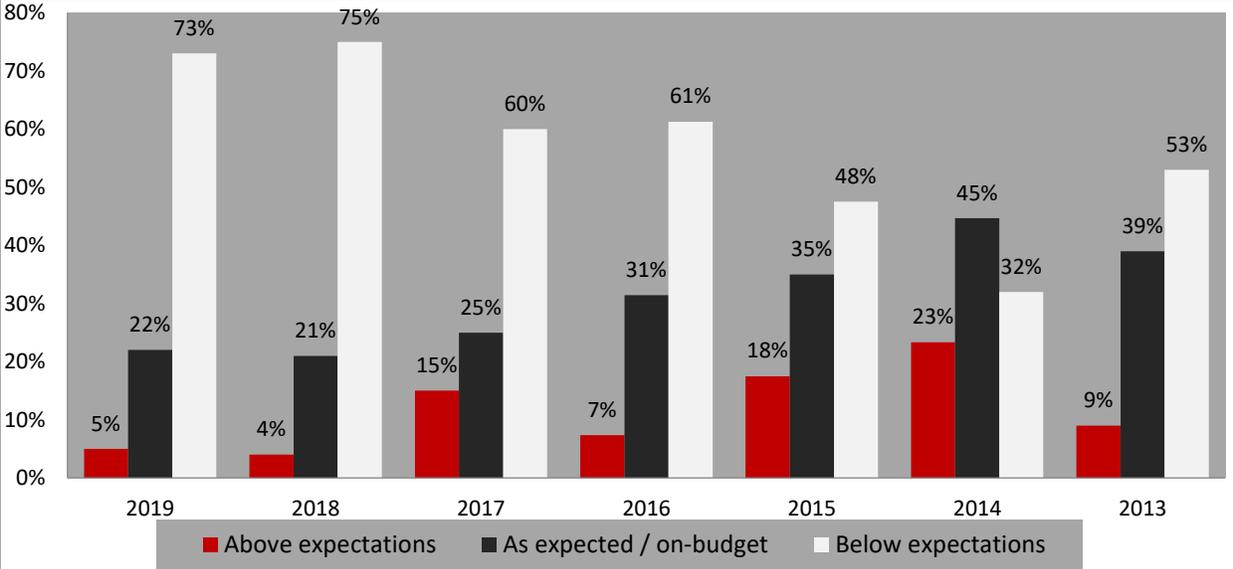


Figure 1 - How did your business perform in the previous year?

Nearly 3/4th of the surveyed Chief Executives were of the opinion that their businesses performed below expectations in 2019.

In contrast, only 5% of the surveyed CEOs felt that their businesses performed above expectations, indicating a similar trend as in 2018.

Macroeconomic Performance

To supplement the CEO perceptions in 2019, MTI analyzed the key macroeconomic indicators of Sri Lanka for 2019.

Real sector performance in 2019

Indicator (at constant prices)	Period	2018 (LKR million)	2019 (LKR million)	Change (%)
GDP	Jan - Sep	6,964,366	7,148,274	2.6
Agriculture	Jan - Sep	486,068	496,483	2.1
Industry	Jan - Sep	1,906,916	1,955,934	2.6
Services	Jan - Sep	4,090,950	4,205,345	2.8

During Jan - Sep of 2019, the Sri Lankan economy recorded a subdued growth of 2.6% compared to the growth rate of 3.3% in the corresponding period of 2018. The IMF expects the real GDP growth of Sri Lanka to rebound to 3.5% in 2020 driven by the recovery in the tourism sector.

According to the World Bank, the Sri Lankan economy grew at a rate of 2.7% in FY 18/19 (ended June 2019) indicating Sri Lanka as one of the poorest performing countries in the South Asian region. Bangladesh leads the South Asian region in terms of economic growth by posting 8.1% GDP growth in FY18/19.

Agriculture, forestry and fishing activities registered a moderate growth of 2.1% during Q3 of 2019, compared to the 4.3% growth in the same period of the preceding year.

Industrial activities and service activities also showed soft growth rates of 2.6% and 2.8% during Q3 of 2019 respectively, in comparison to growth rates of 1.8% and 4.4% in the same period of 2018. Growth in industrial activities was primarily driven by the recovery in construction and mining and quarrying activities during the period, while the service sector was largely supported by the expansion in financial services, wholesale and retail trade activities and other personal services activities.

External Sector Performance in 2019

Indicator	Period	2018 (US\$ Mn)	2019 (US\$ Mn)	Change (%)
Exports	Jan-Oct	9,877	9,960	0.8%
Imports	Jan-Oct	18,734	16,412	- 12.4%
Trade Balance	Jan-Oct	- 8,857	- 6,451	-27.2%
Tourism Earnings	Jan-Oct	3,538	2,806	-20.7%
Workers' Remittances	Jan-Oct	5,876	5,537	-5.8 %

Official Reserve Assets:	As at 30 th Nov	7,018	7,521	7.2 %
Foreign Currency Reserves	As at 30 th Nov	6,164	6,530	5.9 %

During January – October 2019, a marginal growth of 0.8% was recorded in exports attributing to the growth of industrial exports (accounting for 80% of total exports) which expanded by 2.3% compared to the same period in 2018. Agriculture (-4.4%), Mineral (-6.3%) and all other export segments (-3.6%) recorded negative growth rates during the same period leading to an overall trade deficit in the same period.

Import expenditure during the first ten months of 2019 declined by 12.4%, largely driven by lower imports of gold (-99.5%), personal vehicles (-53.2%), rice (-90.1%), fuel (-5.6%) and transport equipment (-17.8%).

Tourism earnings recorded a drop of 20.7% owing to the Easter Sunday Attacks which led to a decline in tourist arrivals. Workers' remittances improved YoY in October 2019, although a cumulative decline was recorded.

According to the Central Bank of Sri Lanka, gross official reserves increased to USD 7.5 billion by Nov 2019 mainly due to the receipt of the International Sovereign Bond (ISB) proceeds, purchase of foreign exchange by the CBSL from the domestic market and the receipt of the sixth tranche of the IMF-EFF.

Fiscal Sector Performance in 2019

Indicator	Period	2018 (LKR Bn)	2019 (LKR Bn)	Change (%)
Budget Deficit	Jan – Jul	- 461.7	- 684.1	-48%
Total Govt. Revenue	Jan – Jul	1,079.9	1,031.9	- 4%
Tax Revenue	Jan – Jul	983.3	944.4	-4%
Non-Tax Revenue	Jan – Jul	96.7	87.5	-10%
Total Govt. Expenditure	Jan – Jul	1,546.6	1,717.1	11%
Government Debt	As at 31 st July	10,959.0	12,645.9	15%

Due to the challenges which arose from the slowdown in economic activities due to the Easter Sunday terror attacks and the delay in implementing certain revenue proposals announced in the 2019 budget, the fiscal sector of Sri Lanka displayed a poor performance during the first seven months of 2019.

Government revenue as percentage of GDP declined to 6.7% in the first seven months of 2019 from 7.5% in the same period of the preceding year driven by the lower tax and non-tax revenue collections. The decline in tax revenue was mainly due to the underperformance of revenue collection from excise duties on motor vehicles and petroleum products, and VAT on domestic goods and services.

During the first seven months of 2019, total government expenditure as a percentage of GDP rose up to 11.1% in comparison to 10.7% in the corresponding period of 2018 supported by the increase in recurring expenditures.

Government debt rose to LKR 12,646 billion as at end-July 2019 from LKR 10,959 billion at end-July 2018, warranted by the expansion in the budget deficit.

Monetary Sector Performance in 2019

Indicator	Period	2018	2019	Change (%)
Policy Interest Rates				
Standing Deposit Facility Rate	As at 28 th December	8.0%	7.0%	-1.0%
Standing Lending Facility Rate	As at 28 th December	9.0%	8.0%	-1.0%
Statutory Reserve Requirement (SRR)	As at 29 th December	6.0%	5.0%	-1.0%
Average Weighted Prime Lending Rate (AWPR) – of Commercial Banks	As at 29 th December	11.9%	9.9%	-2.0%
Domestic Credit (LKR billion)	As at 30 th November	8,689.3	9,258.0	6.5%
Credit to the Private Sector (LKR billion)	As at 30 th November	5,509.0	5,753.1	4.4%
Reserve Money (LKR billion)	As at 30 th November	941.6	918.9	-2.0%

The Central Bank of Sri Lanka (CBSL) adopted a relaxed monetary policy by reducing the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) with a view of fueling economic activity that was challenged by a high interest rate environment in 2018.

As a result of subdued economic activity and high interest rates, credit to the private sector decelerated to 4.4% by end November 2019 compared to a growth of 16.2% in the same period in 2018.

With a view of stabilizing inflation to mid-single digit levels over the medium term, the CBSL moved to a Flexible Inflation Targeting (FIT) regime in 2019 in order to sustain price stability and strengthen financial sector oversight.

How have the major industries performed?

- **Banking** - As a result of the moderation in loans and advances, total assets of the banking sector recorded a soft growth rate of 2.4% in the first eight months of 2019 compared to 7.3% in the same period in 2018. The growth rate of total assets was largely supported by the increase in investments. Consequently, the YoY growth in assets declined to 9.3% in August 2019 from 14.6% registered at the end of 2018. Driven by the lower credit growth due to the adverse business environment observed in the first eight months of 2019, YoY credit growth declined to 9.7% as at the end August 2019 from 19.6% at the end of 2018. As at June 2019, banking sector credit was mainly extended to the consumption (18.4%), construction (15.4%), wholesale & retail trade (15.2%), manufacturing (11.0%) and infrastructure (8.6%) sectors.
- **Tourism** - The tourism sector was adversely affected by the Easter Sunday attacks in April 2019, leading to a noticeable decline of 20.5% in tourist arrivals to 1.3 Million in the first nine months of 2019. In terms of region, tourists from Western Europe who accounted for 18.0% of total tourists arrivals declined by 17.5% YoY during the first nine months of 2019 while tourists from South Asia recorded a YoY decline of 20.0%. In May 2019, an economic relief package was introduced on both capital and interest payments of the loans taken by registered businesses in the tourism industry which is valid till 31 March 2020. Lonely Planet and Travel+ Leisure magazine highlighted Sri Lanka as the number one destination in the world to visit in 2019 which likely contributed to the slow recovery in the tourism industry at the close of 2019.
- **Tea** - During the first half of 2019, tea production grew marginally by 0.2% as a result of the 1.2% decline in tea production witnessed in the first quarter of 2019 due to trade union action coupled with the 1.4% growth in tea production shown in the second quarter of the year supported by favorable weather conditions. During the first half of 2019, the average tea prices at Colombo Tea Auction (CTA) declined by 7.3% from the corresponding period of 2018. The highest YoY decline in average tea prices at the CTA was recorded for medium grown tea (10.4%), followed by high grown tea (8.1%) and low grown tea (6.3 %).
- **Construction** - Construction activities grew 4.7% in the first half of 2019 in comparison to the contraction of 0.8% recorded in the corresponding period of 2018. As reported by the Central Bank of Sri Lanka, construction activities are expected to grow at a higher rate with the acceleration of government-initiated development projects such as the continuation of the Central Expressway and the first phase of the proposed Light Rail Transit System. In addition to the buildings to be constructed in the Colombo Port City, infrastructure developments within and outside the city of Colombo, including an elevated road from the New Kelani Bridge and an underground road connecting Port City to the rest of the Colombo commercial district, are expected to be positive developments in the construction sector for 2020.

- **Apparel** - During the first eight months of 2019, export earnings from textile and garment recorded a growth of 8.3% supported by benefits arisen from the restoration of the European Union's Generalized System of Preferences Plus (EU - GSP+) facility despite trade diversion due to the US - China trade tensions. The increased production of printing of fabric mainly contributed to the positive developments in the textile industry. The manufacture of wearing apparel subsector registered a growth of 2.8% during the first half of 2019 in comparison to the growth of 3.9% recorded in the corresponding period in 2018. Supported by higher demand from Germany, Netherlands and the UK, earnings from garment exports to EU market increased by 5.9% in the first eight months of 2019, while garment exports to the USA increased by 7.7% in the same period.

Stock Market Performance in 2019

Indicator	2017 (LKR Bn)	2018 (LKR Bn)	2019 (LKR Bn)	Change (2018-19 %)
Turnover	209	200	175	-13.0%
Gain (Loss) in Mkt Cap	155	-61	-12	-80.3%
Market Cap	2,900	2,839	2851	0.4%
ASI	6,369	6,052	6129	1.3%
S&P SL20	3,672	3,135	2936	-6.3%
Total net foreign inflow for the year (to the CSE) Jan - Sep	17	-6	-3	-50.0%

The Colombo Stock Exchange (CSE) experienced a decline in its yearly turnover and market capitalization in 2019, primarily affected by the Easter Sunday Attacks followed by political volatility.

Notably, on account of the Easter Sunday attack, the All Share Price Index (ASPI) and S&P Sri Lanka 20 index recorded a single day drop of 3.6% and 4.4% respectively on the 23rd of April 2019.

In addition, policy uncertainty, together with the subdued performance of corporate sector further fueled the negative performance of the market which was amplified by foreign outflows. Further, the CSE raised LKR 0.4 Billion through one Initial Public offering (IPO) in 2019, a decline from the LKR 2 Billion raised through two IPOs in 2018.

World in 2019

Global Economy and Trade | 2019

Global GDP grew at a subdued rate of 2.5% from Jan - Sep 2019, affected by US - China trade tensions and slow growth in Japan and Europe. Trade tensions eased in December, as the United States and China agreed on a Phase One agreement on 13th of December 2019. China agreed to sharply increase its purchases of U.S. agricultural products in exchange of canceling planned tariff increases and reducing the tariff rate on approximately USD 120 Billion worth of Chinese imports to the United States. In addition to tariff reductions, China agreed to reportedly make concessions in areas of intellectual property, technology transfer, agriculture, financial services, and foreign exchange.

Global Financial Conditions and Commodity Market | 2019

Following the announced Phase One agreement, equity markets recorded a positive performance, with the S&P 500 rising 2.6% since the start of December in 2019.

An upward momentum in oil prices was witnessed on account of the OPEC further limiting oil supply from the previous limit of 1.2 Million barrels to 0.5 Million barrels a day in late 2019.

Driven by the output shortfalls in some edible oils (especially palm oil), agriculture prices increased by 3.7% in November 2019. In addition, as gains in aluminum prices were balanced by declines in nickel, lead, and iron ore prices, the metal price index changed up to a certain degree.

Global Economy: Expected to recover in 2020

The World Bank forecasts economic growth in emerging markets and developing economies (EMDEs) to reach 4.6% in 2020, up from 4.0% in 2019. The uptick in the forecast is primarily on account of the waning impact of the financial pressure faced by the EMDEs on the back of the benign global financial conditions of 2019.

The World Bank also expects oil prices to average at USD 65 per barrel in 2020 down from the price point of USD 64.04 per barrel in 2019 and USD 69.78 per barrel in 2018.

Global trade is expected to stabilize to an average of 3.2% in 2020 and 2021 due to subsiding of manufacturing weaknesses.

IMF expects the growth of advance economies to soften to 1.7% in 2020 while US economy is expected to expand by 2.1% in 2020. Further, UK and EU economies are expected to grow at a rate of 1.4% in 2020.

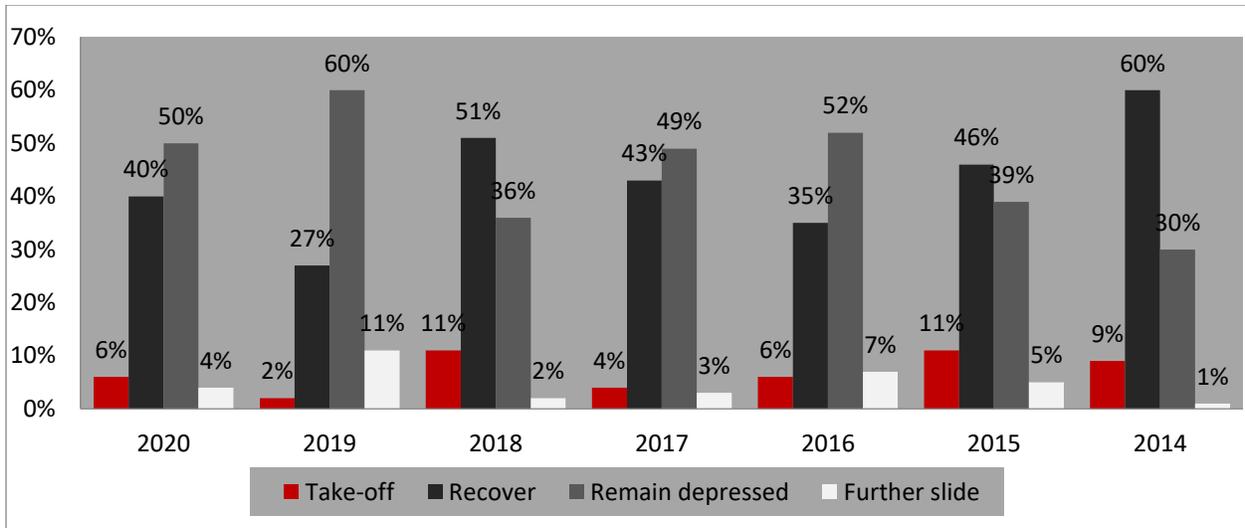


Figure 2 - In 2020, the Global Economy will?

On average, business leaders in Sri Lanka expect that the global economy will remain subdued in 2020. While nearly half of the surveyed CEOs have noted a negative sentiment towards global economic growth in 2020, 46% of the surveyed CEOs have taken an optimistic view that the global economy is expected to recover or take off in 2020.

2020 expected to be a recovering year for the Sri Lankan Economy

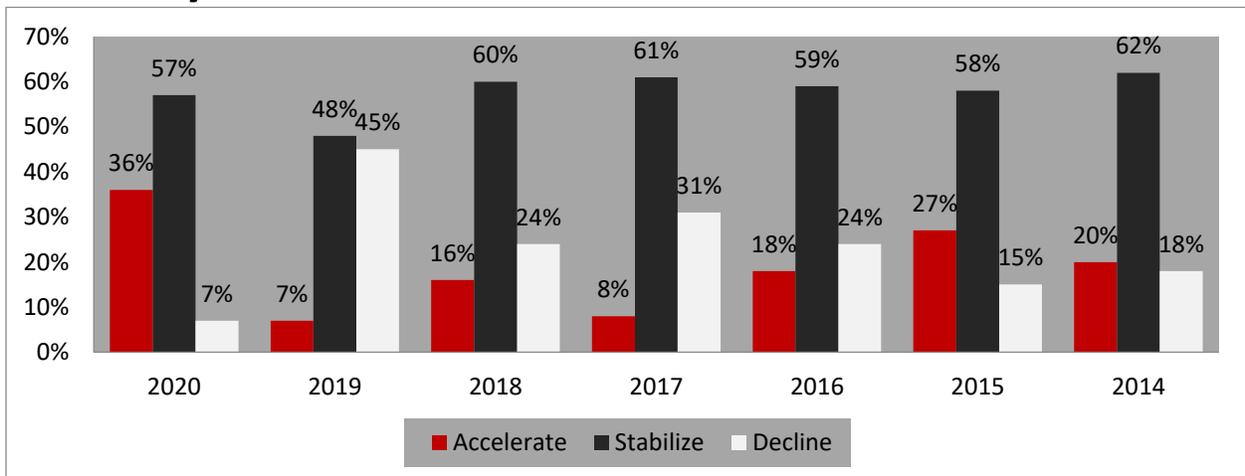


Figure 3 - In 2020, the Sri Lankan economy will?

The survey results reveal a growing confidence among business leaders for the Sri Lankan economy in 2020 as the statistics supporting acceleration of the Sri Lankan economy is at its highest when analyzing survey results with the past years. This is further confirmed with the dramatic drop (from 45% to 7%) in the number of surveyed CEOs who have cited that they expect a decline in the local economy.

More than half of the surveyed CEOs expect the local economy to stabilize in 2020, indicating an overall optimistic view in terms of the Sri Lankan economy in 2020.

Sri Lanka in 2020

The IMF expects the real GDP growth of Sri Lanka to strengthen to 3.5% in 2020 as the country is on the path to recovery from the negative impact of the Easter Sunday terrorist attacks in April 2019.

According to the World Bank, local economic growth is expected to reach 3.3% in 2020 and 3.7% in 2021 supported by recovering investment and exports.

According to the ADB's Country Operations Business Plan (COBP) 2020-22, the proposed lending program for Sri Lanka for the 3-years period is estimated at USD 2.46 Billion. The Lending program is expected to focus on transport focus on transport (39% of the total lending), followed by water and other urban infrastructure and services (16%); agriculture, natural resources, and rural development (14%); energy (12%); education (8%); multisector (6%); and finance (5%).

Projects implemented under the program will include railways, roads, secondary education, power system reliability, irrigation, water supply, urban development, and rural livelihoods.

Economic Policies – the main challenges for Sri Lanka in 2020

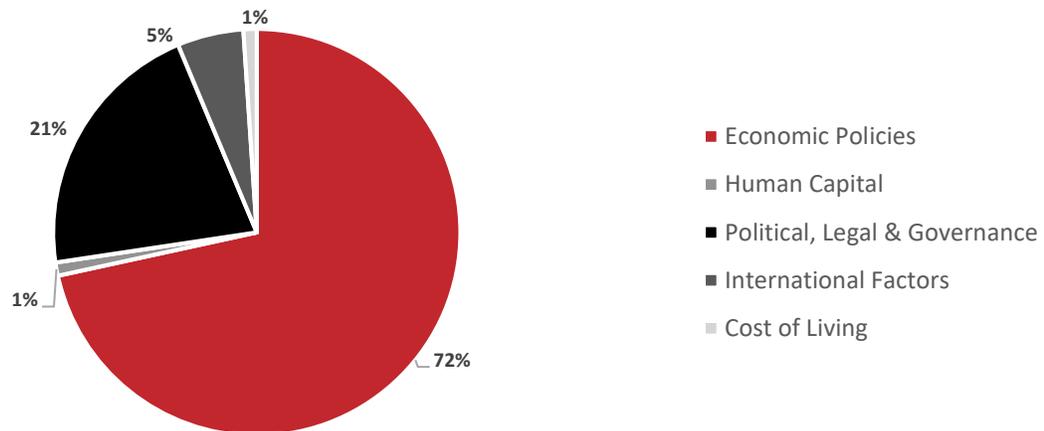


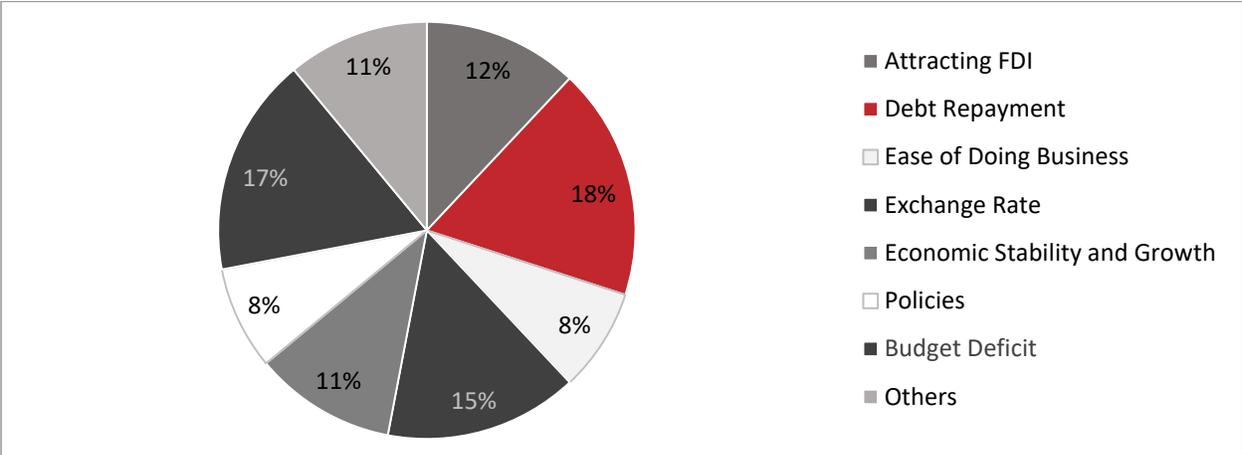
Figure 4 - In 2020, the No. 1 challenge to the Sri Lankan Economy will be?

72% of the surveyed CEOs have identified that Economic Policies will be the biggest challenge to their businesses in 2020, followed by Political, Legal & Governance issues – which were a concern for 21% of the respondents.

The concern for Political, Legal and Governance issues as well as Economic Policies in 2020 remain unchanged when compared to the previous year survey, as political and economic tensions witnessed in 2019 continued to hinder business and investor sentiment in 2020.

Other issues cited as business challenges in 2020 were Human Capital, Cost of living and international factors which amounted to 7% of the overall challenges.

Debt repayment and budget deficit concerns are expected to continue in 2020



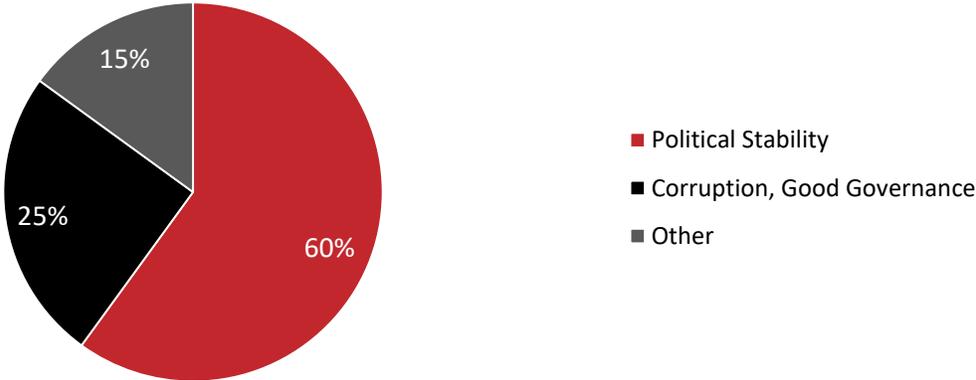
Debt repayment and budget deficit were cited as key economic challenges in 2020 as the overall budget deficit was financed largely through domestic sources leading to a significant increase in government debt stock in 2019.

Exchange Rate Stability (15%) and Attracting FDI (12%) are seen as the 3rd and 4th most challenging economic factors for 2020 respectively. This is mainly attributable to the depreciation of the Rupee and the adverse impact from the Easter Sunday Attacks in April 2019.

Economic Stability and Growth (11%) is the next most concerning economic factor with the effect of recovery in tourism sector.

Monetary policy and business confidence were less cited economic challenges for businesses in 2020.

Political Stability concerns are expected to continue in 2020



Concern for the lack of Political Stability and Corruption & Good Governance are the key political challenges that were cited by CEOs for 2020, on the back of key political events such as the Presidential Election which took place in the latter part of 2019 and the upcoming Parliamentary Election in 2020.

Corruption & Good Governance accounted for 1/4th of the overall challenges highlighted by CEOs, signifying the importance of regenerating business confidence.

Positive Business Outlook for 2020

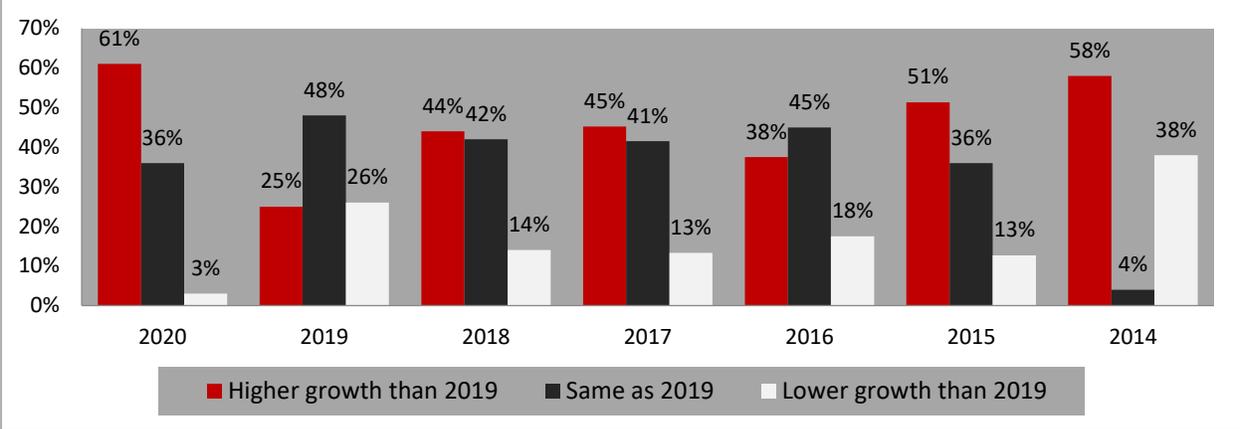


Figure 5 - In 2020, your business will experience?

Since the inception of CEO Survey in 2012, a record high of 61% of the surveyed CEOs believe that their businesses will perform better in 2020 compared to 2019. Meanwhile, 36% of the CEOs believed that their business will achieve the same level of growth in 2020 as in 2019.

Only 3% of the business leaders are expecting a lower growth in their business for 2020, indicating the lowest negative outlook since the initial survey in 2012.

As a whole, there appears to be a positive outlook for business performance with the expectancy for the recovery in global economy as well as in the local economy in 2020.

External Challenges Dominate

54% of the CEOs believe that the success of their businesses in 2020 will mainly be affected by factors external to their business which was recorded as 70% in the previous year.

However, 46% of the CEOs identified internal factors to be the key determinant of their business performance in 2020 compared to the 31% of CEOs who attributed controllable factors as determinants of business performance in 2019.

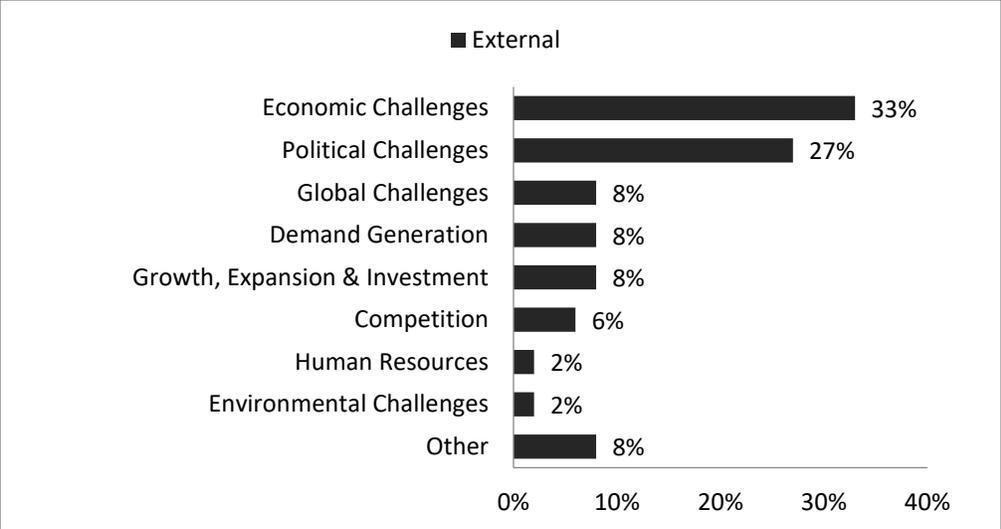


Figure 6 - External Challenges: Breakdown

The main external challenge cited by the CEOs was economic challenges (33%) where many CEOs expressed concern over currency depreciation and inconsistencies in taxation that would lead to a rise in import costs and thus increased costs of living.

Political and regulatory concerns (27%) was another key external challenge that was identified due to inconsistent government policies that have been implemented in 2019, the effects of which is expected to continue on to 2020.

Global challenges (8%) were seen as an external challenge to businesses on account of issues such as slowing consumer demand and political and economic uncertainty brought about by countries such as the US.

CEOs also pointed out that growth, expansion and investment (8%) as well as the demand generation (8%) would pose challenges to their businesses due to the lower consumer spending and negative investor confidence.

In addition, the surveyed Chief Executives found, Environmental and Human Resources to be external challenges to their businesses in 2020, although at a much lower frequency than economic and political issues that are expected to arise in the same period.

Internal Challenges

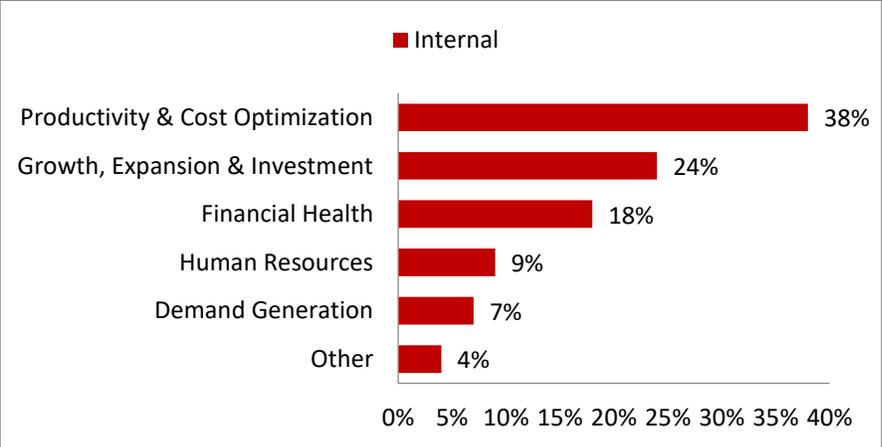


Figure 6 - Internal Challenges: Breakdown

The main internal challenge that CEOs expect to face in 2020 is productivity and cost optimization (38%), especially considering the challenge of keeping costs of operations at a feasible level with the rising cost of imports.

Another key challenge that was discussed is Growth, Expansion and Investment (24%) where safeguarding market share and keeping minimum pressure on company bottom lines were considered as risks.

Financial Health (18%) was cited as the next most concerning internal challenge followed by Human Resources which accounted for 9% of the overall responses. CEOs also cited Demand generation (7%) as a key issue they are likely to face in 2020.

Conclusion

Since the launch of the MTI CEO Business Outlook Survey in 2012, 2020 marks the year in which the most number of surveyed CEOs expressed a more positive outlook in terms of the Sri Lankan economy for 2020.

However, growth forecasts for Sri Lanka and the global economy per the IMF and World Bank remain at a subdued level citing rising debt levels and slowdown in productivity. Policy makers will need to address these challenges to ensure recovery and surpass predicted forecasts to ensure moderate growth in 2020.

The long-term trend (since 2012) of the business environment performing below expectations continued in 2019 where 73% of the CEOs expressed dissatisfaction in the performance of their industry in 2019 with a slight drop from the previous peak of 75% recorded in 2018. The lackluster performance was no doubt on the back of a weak economy and a turbulent political environment prevalent during the previous year.

Hence, it was no surprise that external factors continued to challenge CEOs in their daily operations during 2019 as evidenced by the survey results. However, considering the continuing trend of businesses citing external factors as their number one challenge, this will be the opportune time for CEOs to ensure that reasonable firewalls are in place to mitigate the impact that unexpected challenges can create in the long term.

In addition, robust and effective action by industry stakeholders including the government are likely to result in opportunities for the business sector to capitalize on in the coming year, despite the political and economic headwinds that are expected to arise in 2020.

MTI Corporate Finance

MTI Corporate Finance is the corporate finance arm of MTI Consulting, a boutique strategy consultancy with a network of associates across Asia, Africa and Middle East. MTI Corporate Finance provides a comprehensive range of services, including due diligence, feasibility studies, funding new businesses or capitalization of existing ones – from IPOs to private placement facilitation, M&A facilitation, and advisory on governance, compliances and risk management.

Business Leaders have their say



“The major challenge would be to convince the Corporate Sector to embrace unexpected changes done into the Fiscal Policies and also react and change their mindset to help to propel the Sri Lankan Economy”

Sujeewa Rajapakse
Chairman – People’s Bank
Managing Partner – BDO Partners



“We have seen positive business sentiments in the recent past and certain that the challenges during 2020 could be faced with much confidence”

Chandana Aluthgama
CEO – Sri Lanka Insurance Corporation Limited (SLIC)



“2020 will be a momentous year for both Sri Lanka and Sampath Bank as both are going through transformative changes that would set them apart from the others in the next decade”

Nanda Fernando
Managing Director – Sampath Bank



“Sri Lankan market offers untapped potential for FMCG as penetration across many categories are lower than many other similar markets. The key to unlocking this potential is the right mindset and pro-business government policies. Hoping to see the required changes in both....and the future will be bright.”

Sunil Sethi
Managing Director – Sri Lanka & Indian Sub-Continent,
Fonterra Brands