# EXECUTIVE SUMMARY

A sound financial system is a prerequisite of economic development of a country. Soundness of financial system depends on the stability of the elements that constitute the financial system namely financial institutions, financial architecture, financial markets and instruments, regulatory and supervisory authorities and economic agents. Non Bank Financial Institutions (NBFI) sector forms an integral part of the financial system of Sri Lanka which is interconnected than ever before. It serves subprime customers across the country often neglected by the banking sector. As a result of the attractive return for investments and the flexible lending terms public all over the country has been rallying round the NBFI to satisfy their financial requirements.

Central Bank of Sri Lanka being the official regulator of financial sector has placed more emphasis on the NBFIs due to the systemic importance it carries and the number of customers it serve. From its origination in 1940, until present day failures of finance companies are noted at regular intervals questioning the effectiveness of regulator in terms of regulation and supervision of the industry. Amidst continuous efforts by Central Bank to strengthen the regulatory leniency over finance companies, the trend of finance company failure continued shaking the public confidence on the industry. Accordingly the survey was designed with the objective of identifying the reasons for finance company failure from NBFI perception and contributing insights to the Non Bank Financial Institutions on the focal areas to be addressed in preventing future failures.

The study framework was developed on eight dimensions identified through literature on studies of banks and finance companies in local and international context. Survey was built on the operationalization centered on the said eight dimensions. Questionnaire the primary method of data collection was designed to recognize reasons for finance company failure from perception of the employees in and above executive grades of finance companies. 1011 responses were collected 97% of which were printed hard copies while rest was collected from online version of the survey questionnaire. Responses for questionnaires were recorded in SPSS software for improved analysis of survey outcomes with the assistance of graphical presentations. A sample of three focus groups representing three finance companies and consisting four members each were carried out to uncover qualitative secondary data.

Findings revealed the regulatory framework to govern finance companies were adequate to prevent finance company failures while high perception levels were also observed for the compliance with requirements such as customer protection framework, obtaining risk rating from a reliable rating agency, and listing in Colombo Stock Exchange in order to up hold public trust on the industry. In addition NBFI sector employees admitted financial affiliation from a parent company or a bank assist finance companies to cruise through financing obstacles while enhancing public perception on stability of finance companies. Competency of frontline employees in assessing creditworthiness of prospective customers and faith in approving authority to adhere the established risk parameters was also stressed.

Survey findings also emphasized some thought provoking negative aspects of finance companies in Sri Lanka. Absence of compliance to regulatory requirements and fundamental policies and practices due to the urgency created by target driven mindset was identified as a main contributor for finance company failure. Absence of effective monitoring and supervision from the regulators' end has heightened the woes of finance companies. Target driven sentiment has also resulted in low ethics and integrity not only among ordinary employees but also the governance bodies of finance companies. Dependency on narrow portfolios lead by short sighted profit targets has resulted nothing other compromising asset quality and long term sustainability. The survey findings call for urgent intervention from the Government to curtail unfair competition while alarming regulator to strengthen law enforcement and early intervention to revive distressed companies than revoking license once companies fail. Survey findings also serve as an eye opener to governance entities to establish sound governance structures with adequate emphasis on risk management to achieve long term sustainability of organizations.