

SUSTAINABILITY REPORT



MANAGEMENT DISCUSSION AND ANALYSIS

CHIEF EXECUTIVE'S MESSAGE

This is our third report on sustainability, included as part of our Annual Report. As the principles and practice of sustainability are very much an integral part of our business strategy and day-to-day operations, additional and complementary aspects are discussed elsewhere in the Annual Report under the relevant sections. We are thus avoiding undue repetition.

The relevance of sustainability to DFCC Bank and its business strategy continues to remain as strong as ever and even more so, as the Nation's premier development bank that continues to retain its focus. However, to be sustainable, we have been responsive and proactive in the fast-changing economic, social and technological environments in which we operate. Our business models and strategies have evolved and changed helping DFCC withstand the test of time. Fifty-five years since its founding and presently operating as a Financial Services Group, we have successfully charted a course to serve our broad spectrum customers -

from SMEs to conglomerates, from small savers to entrepreneurs seeking project finance - with a full range of financial products and services delivered seamlessly through subsidiary, joint venture and associate companies.

We have consistently created value for our shareholders, while conducting our business in a socially and environmentally responsible manner. Our Corporate Responsibility Programmes are largely based on education, entrepreneurship and self-reliance, primarily targeting school children. The benefits are long-term and sustainable, unlike short-lived dole out philanthropy. Likewise, we invest generously in developing and motivating our staff, who are key stakeholders of our institution.

As a principled and responsible investor, our precepts on sustainability have also influenced our customers. Our formal adoption of the Environmental & Social Management System (EMS) as part of our credit policy ensures the promotion of sustainable business ventures. To refrain from undesirable investments, we maintain a negative sector list. We have been and continue to be, the pioneer and leader among financial institutions in the country for promoting, developing and financing renewable energy projects, both on-grid and off-grid.

Our discussion on sustainability broadly covers the DFCC Banking Business (DBB), comprising DFCC Bank (DFCC) and DFCC Vardhana Bank (DVB). However, due to practical reasons pertaining to data verification and analysis some economic and environmental aspects are disclosed separately for the two entities. In time to come we plan to move towards greater consolidation when reporting, with both institutions adopting a common framework based on the Global Reporting Initiative.



Nihal Fonseka
Chief Executive

30 May 2011

ECONOMIC PERFORMANCE

MANAGEMENT APPROACH TO ECONOMIC PERFORMANCE

With a vision of being Sri Lanka's premier financial services group, we strive to provide superior financial solutions and nurture business enterprises, thereby adding value to our customers, shareholders, employees and the country at large. We are driven by a mandate that has sustainable development residing at the very core of our corporate philosophy.

The Group is led by DFCC Bank, one of the oldest and most successful development finance institutions in the Asia-Pacific region. Post World War II

in vintage, yet modern in outlook. DFCC Bank today also provides the whole gamut of commercial banking services through an operationally integrated subsidiary, DFCC Vardhana Bank - resulting in a unique Banking Business that delivers the best of both worlds.

Other complementary businesses, including investment banking, venture capital financing, consulting, IT services, asset management and industrial estate management through subsidiary, joint venture and associate companies.

DFCC has been at the forefront in the development of several economic sectors identified for investment by the private sector. Noteworthy among them are tourism agriculture, healthcare, energy and telecommunications.

Providing financing and nurturing the growth of Small and Medium Enterprises (SMEs) has always been an important component of DFCC's business model - now brought under the umbrella of the DFCC Banking Business. Our contribution to the SME sector is discussed elsewhere in the Annual Report.

As a private sector institution, DFCC places the utmost priority on the interests of its investors and hence, continuously strives to increase the value of its shareholders' equity. Statements giving the Value Added by the two entities that comprise the DFCC Banking Business are given below.

ECONOMIC PERFORMANCE INDICATORS

STATEMENT OF VALUE ADDED - DFCC BANK

For the year ended 31 March

	2011 million	%		2010 Rs million	%	
Value Added						
Gross income	14,191			8,843		
Cost of borrowing and support services	(3,273)			(4,607)		
Provision for bad debts and investments	(244)			(356)		
	10,674			3,880		
Value Allocated						
To employees						
Salaries, wages and other benefits	791	7		715	18	
To providers of capital						
Dividends to shareholders	2,649	25		794	20	
To Government						
Income tax on profit	739			689		
Value added tax on financial services	1,890	2,629	25	659	1,348	35
To expansion and growth						
Retained income	4,488			919		
Depreciation	117	4,605	43	104	1,023	27
	10,674	100		3,880	100	

STATEMENT OF VALUE ADDED - DFCC VARDHANA BANK

For the year ended 31 December

	2010 Rs million	%		2009 Rs million	%
Value Added					
Gross income	3,787			4,447	
Cost of borrowing and support services	(2,276)			(2,952)	
Provision for bad debts and investments	(235)			(234)	
	1,276			1,261	
Value Allocated					
To employees					
Salaries, wages and other benefits	405	32		358	28
To providers of capital					
Dividends to shareholders	55	4		55	4
To Government					
Income tax on profit	263			330	
Value added tax on financial services	190	453	35	182	511
41					
To expansion and growth					
Retained income	221			213	
Depreciation	144	363	28	125	337
27					
	1,276	100		1,261	100

ENVIRONMENTAL PERFORMANCE

MANAGEMENT APPROACH TO ENVIRONMENTAL PERFORMANCE

Consumer behaviour, investment decisions and regulations are changing for the better in an increasingly connected world. Stakeholders today demand information on environmental and social issues relating to the products or services they purchase. Likewise, the safeguard standards that we adopt in our banking operations comply with national requirements, as well as international standards when projects are refinanced through credit lines from multilateral financial institutions. Going further, we have developed our own Environmental & Social Management System (EMS) that is benchmarked against best international practices to supplement our project appraisal and follow up functions. The focus is on prevention, rather than cure.

Internally, we are mindful of our own carbon footprint. We minimise waste, use technology to conserve resources and practise the 3R Concept - Reduce, Reuse, Recycle. It also makes business sense.

ENVIRONMENTAL PERFORMANCE INDICATORS

FINANCING ENVIRONMENTALLY FRIENDLY PROJECTS

As the leader and pioneer in development banking, DFCC considers the promotion of sustainable development an important business and social responsibility. DFCC offers concessionary loans under special programmes such as the E-Friends scheme to prevent industrial pollution and promote waste minimisation and resource conservation. Since 2006, DFCC has disbursed over Rs1.6 billion under this initiative to 126 projects that envisaged the improvement of business processes leading to a reduced carbon footprint.

Loans granted through DFCC Banking Business are subject to prior review to ensure that they finance activities which are compliant with the requirements of the Environmental Protection Act, the Rules and Regulations issued by the Central Environmental Authority of Sri Lanka as well as our own EMS. Qualified and trained in-house staff ensure compliance at loan approval stage and where warranted, also carry out post-disbursement reviews and investigations. Depending on the nature of the project, appropriate environmental safeguards are included in the terms and conditions of the loan facility, which are legally binding.

GOOD HOUSEKEEPING

DFCC Banking Business adopts environmentally friendly operational procedures that are benchmarked on best practices. These include aspects such as energy efficiency, recycling, waste reduction, and proper disposal of waste. The following table indicates the main parameters that are presently monitored for DFCC Bank.

Electricity and Water figures relate to consumption from DFCC Bank Branches islandwide.

	2010/11	2009/10	2008/09
Electricity (kWh) - Avg. per branch	117,109	117,569	134,932
Water (m ³) - Avg. per branch	1,144	1,121	1,032
Fuel (litres) - DFCC Head Office	38,668	42,499	44,803
Number of km - DFCC Head Office	293,874	326,793	330,851
Hired Vehicles - Number of km	12,983	5,848	5,603
White Paper - Packets - Head Office	2,400	1,776	2,470
Average No. of km per Executive	2,894	3,138	3,823
Average No. of km per Litre	7.60	7.69	7.38

During the year, DFCC stepped up its efforts to promote environmentally friendly practices amongst its staff. On average, electricity and water usage remained static due to continuous efforts to minimise wastage. Similarly, travel undertaken at Head Office has also been regulated. While the material contribution from these savings may not be vast, the effort sends a message about DFCC's environmental commitment to its customers, staff and the community at large.

CLEAN ENERGY DEVELOPMENT

In the mid-1990s DFCC financed Sri Lanka's first ever private sector grid-connected mini hydro project. Since then, DFCC's role in the promotion, development and financing of renewable energy projects has grown, particularly through the implementation of three successful national projects. The World Bank and Global Environment Facility-assisted Energy Services Delivery Project, the Renewable Energy for Rural Economic Development Project (RERED) and the follow on RERED additional finance project. These Projects support both commercial electricity generation for the grid, as well as off-grid solutions for rural electrification, typically through Solar Photovoltaics (PV) and micro hydro projects.

By end 2010, these projects contributed nearly 80% of the Non-Conventional Renewable Energy (NCRE) capacity in Sri Lanka and had added 168 MW of capacity to the national grid. The Government has taken a policy decision to generate 10% of total electricity generated in the country through NCRE sources by 2015. DFCC is well-positioned and committed to support this effort by guiding promoters on key issues and structuring finance requirements.

SOCIAL PERFORMANCE

OUR HUMAN CAPITAL

We manage our human capital as one would a partnership, driven by the premise of give and take. While employees are expected to perform at the highest level of capability, they are provided with an environment characterised by open channels of communication, transparency, equity and inclusiveness. We adhere to the highest standards of ethics and compliance in our internal as well as external dealings, while striving to create a dynamic and exciting work environment.

RESOURCING

Recruitment activities during the year continued unabated, primarily driven by the enhanced geographic penetration by our commercial banking arm. The year ended with a staff strength of 1,116 persons at the combined DFCC Banking Business, an increase of 21.4%

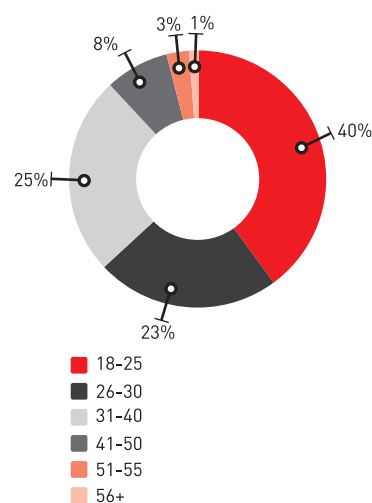
over the previous year. Most of the new entrants were for entry level positions, which required the implementation of comprehensive induction programmes on a year round basis. Our induction programmes are used not only to impart operational knowledge, but also to help the new recruits to integrate effectively with our culture and value system.

To make the best use of available talent and build the capacity of our human capital, formalised processes were refined to offer career paths to employees with high potential. With a significant number of the operational areas of the two banks being merged, we have witnessed the gradual expansion in the scope of some jobs, enrichment in others and numerous opportunities for rotations and secondments. This has provided our staff with enhanced avenues not only to upgrade their own knowledge and skill levels but also opened up paths for career advancement.

ANALYSIS BY GENDER AND AGE

The gender ratio was balanced, with males accounting for 51%, and females the balance 49%. Age-wise, 40% were in the 18-25 year range, while 48% were in the 26-40 year band, reflecting a reasonable balance between youth and experience.

AGE-WISE ANALYSIS



ANALYSIS BY GRADE

	DFCC Bank	DFCC Vardhana Bank	Total	Total %
Senior Management	10	3	13	1
Middle Management	45	22	67	6
Executives	183	130	313	28
Non-Executives	192	333	525	47
Other	22	176	198	18
Total	452	664	1,116	100

STAFF DISTRIBUTION BY PROVINCE

	DFCC Bank	DFCC Vardhana Bank	Total	Total %
Central	31	54	85	8
East	14	19	33	3
North	10	13	23	2
North Central	26	51	77	7
North Western	19	46	65	6
Sabaragamuwa	18	40	58	5
South	28	77	105	9
Uva	17	28	45	4
Western	289	336	625	56
Total	452	664	1,116	100

NURTURING ORGANIC GROWTH

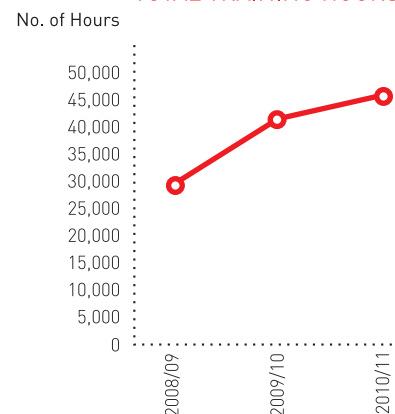
We are committed to nurturing inherent talents and maximising individual potential of our employees. Even in the recent past when the financial sector was facing numerous challenges we continued to invest in staff training and development, as we firmly believe that trained staff provides the competitive edge and the impetus to our continued success. In addition to certain core programmes based on specific jobs and employment grades, staff members are provided with specific needs-based training to address individual skill gaps identified during the annual training needs assessments and performance reviews.

During the year, we provided 46,236 man-hours of training to DFCC Banking Business staff, which translates to over 45 hours per employee on the average. Most of the training on technical skill enhancement was targeted at junior level employees, while those at relatively senior levels were provided with focused needs-based interventions. We continued to build capacity in core areas such as project evaluation, short-term credit evaluation, problem loan management, commercial banking operations, exchange control regulations, risk assessment and treasury operations.

We introduced an e-learning platform in 2009 and as at end March 2011 a total of 30 training modules were available on the system. With increased geographical dispersion of staff, the e-learning system has become a vital and cost effective tool to impart essential technical knowledge especially to entry level staff. It is mandatory for our Banking Business staff to successfully complete identified core modules and related assessments prior to being confirmed in service. Usage levels have shown consistent improvement and a survey conducted in December 2010 confirmed that respondents were satisfied with the quality and usefulness of the modules offered.

We continued to rely on the vast knowledge and experience of the in-house resource pool to develop most business related e-learning modules as well as to structure and conduct technical programmes for junior staff. We appreciate their generosity in devoting personal time and effort towards ensuring the transfer of knowledge and skills that are essential for the continuity of the Group's competitive edge.

TOTAL TRAINING HOURS



BUILDING LEADERSHIP CAPABILITIES

Building a strong leadership pipeline is vital for the growth of the DFCC Banking Business. As part of our succession planning initiative, focused attention was given to building leadership capabilities within the Banking Business. The main thrust being a multi-phased programme initiated with the assistance of international consultants. The initial phase of the programme involved critically reviewing and updating the existing leadership competency framework to ensure more relevance to future strategic business objectives of the DFCC Banking Business. Subsequently, 15 selected members of the management team were assessed against the new leadership competency model. Detailed development plans were formulated indicating priorities, targeted interventions, milestones and timelines. Stemming from the assessment and as one of the development interventions, each participant will be provided with individual coaching by external experts spanning several months in 2011.

As part of our drive to build leadership capacity at middle management, 33 managers were selected to participate in a customised programme modelled on the new leadership competency framework. A five-day programme, conducted by the Malaysian Institute of Management in Kuala Lumpur in early 2011, was very well received by the participants. The programme focused on situational and practical aspects and incorporated many group-based and individual assignments. A post-training assessment will be conducted in 2011 to ascertain the impact of this initiative.

In a further effort to inculcate leadership competencies among junior executives, shortlisted candidates were put through a medium-term management development initiative which commenced in mid-2010. It is scheduled to conclude in mid-2011.

ENGAGING OUR PEOPLE

We have consistently made an effort to initiate and continuously improve on activities that help to create a culture of commitment, foster a sense of ownership and improve productivity within the workplace. We believe that an optimistic and constructive work environment fostered by adherence to our core values such as team work, respect for the individual and ethical conduct helps enhance workforce commitment and allegiance, both from an emotional and intellectual perspective.

Staff are encouraged to treat each other with professionalism, courtesy and respect. Victimisation or abusive behaviour of any kind or form is not tolerated. We pride ourselves on being an equal opportunity employer; proactively driving gender inclusivity, encouraging diversity in ethnic, religious and other affiliations and welcoming multiplicity of thought and opinion.

We strive to be as transparent as possible in our processes and ensure equitability and fairness in addressing employee needs. Employees are encouraged to express suggestions, opinions and grievances in a

constructive manner. The Group has adopted a grievance policy, whereby a structured process is in place to communicate perceived injustice and seek necessary redress. Exit interviews are conducted regularly and action taken as appropriate. Staff of the Human Resources Department and members of the senior management visit branches to interact with employees and give them an opportunity to communicate their views and concerns, if any.

The performance management framework is regularly reviewed and required changes are effected in an effort to improve alignment of individual performance to Group performance. At the beginning of each year, the business objectives are cascaded down to relevant units and subsequently to staff members. Performance against assigned goals is regularly reviewed and measured and supervisors are encouraged to give their direct reports clear and constructive feedback and on-the-job coaching as necessary to help them maximise their potential and contribution. Reward and recognition frameworks are directly related to performance both from an organisational and individual perspective. From time to time remuneration structures are benchmarked against selected comparator institutions and adjustments are made as necessary to ensure that our compensation package is fair and in line with the market. However, we never subscribe to getting involved in bidding wars to either recruit or retain staff as it does not coincide with our value

proposition. As part of this same value proposition we encourage staff joining us from other institutions to serve their requisite notice period and ensure proper transition of work.

We appreciate that opportunities for career progression give an impetus to improving performance levels. While in the banking sector advancement may usually be at a slower pace than in other industry sectors, the rapid growth of the branch network though DFCC Vardhana Bank has opened up new avenues for career advancement within the DFCC Banking Business. As such the number of staff in the management grade has increased from 68 in the previous year to 80 during the year under review. Promotions are based on organisational requirements as well as individual performance and capabilities.

It is commonly accepted that levels of employee satisfaction at the workplace improve significantly when strong relationships with superiors and co-workers are developed. Towards this end, we sponsor many team sports such as basketball, cricket and badminton and encourage the active participation of staff in these endeavours. The DFCC Group Toastmasters Club, affiliated to Toastmasters International, helps individuals to improve their confidence and skills in public speaking and frequently organises contests and interactions with other such clubs. The Welfare and Recreation Club organises a host of events throughout the year such as the sports day, cricket tournament, annual dance, year-end party etc. for staff members and their families.



With productive contributions from teachers and students, Kuliyaipitiya St. Joseph Maha Vidyalaya won the award for the best 5S quality circle in 2010.

GIVING BACK TO OUR COMMUNITY, WITH A DIFFERENT KIND OF EDUCATION

TRAINING YOUNG MINDS

In collaboration with the Ministry of Education, we launched a community development project in 2009 targeting primary school students spread across the country. The objective was to empower young minds with knowledge that enable them to increase efficiency and productivity.

In September 2010, the project was duly recognised as a Distinguished Honoree at the Stevie Awards organised by the International Business Awards, USA. It was also recognised as the best CSR project in the 'Education and Training' category at the Best Corporate Citizens Awards 2010 organised by the Ceylon Chamber of Commerce. The schools which took part in the project have also won awards at different local competitions for their performance.

Despite the recognition and awards, the challenge during the year under review was to ensure the continuity of the progress and performance of the schools which took part in 2009, while extending this project to a new set of schools. Measures taken to ensure sustainability included the appointment and training of audit teams from each school and the introduction of an inter-school audit programme. This required the appointed team from each school to visit the closest school which took part in the same project and audit the level of maintenance of the project initiatives. This was strengthened through prizes for top performers based on an evaluation by an independent judge.

Learning from experience, the project was further improved and extended to a new set of schools during year 2010, which for the first time included, two schools from the Eastern Province. It was a great experience for the schools as well as the teams that drove the project, as they had different cultural

roots but worked harmoniously towards a common goal.

Another striking feature of the project was the enthusiasm of staff, who contributed their time and effort voluntarily. In total, over 131 staff members participated, contributing over 1,300 volunteer hours in guiding the schools and monitoring their progress during the year.

DEVELOPING ENTREPRENEURSHIP AMONGST STUDENTS

The attempt made to encourage schools to raise their own funds to carry out the project initiatives in 2009 proved to be successful. It was thus continued in 2010 as well, with improvements. In addition to the general means of raising funds through organising market fairs and concerts or selling small handmade items, in 2010 the schools took on more challenging initiatives. These included activities such as producing cakes of soap, cultivating cinnamon and fruit trees and producing recycled paper. The amount of funds raised by the participating schools exceeded Rs2.6 million. As matching grants, a maximum of Rs25,000 per school was disbursed to encourage continued participation.

Even though the immediate visible change is in the physical environment of the participating school, the hidden value and sustainability of the project lies in the change that occurs in the mindsets of the students, parents and teachers.

A major change is in attitude - from a typical welfare culture rooted in dependency on the State to a culture of empowerment and self improvement - which will become more visible as the project progresses. To further strengthen sustainability, a number of workshops and seminars were conducted by different resource persons, targeting not only the school principals and teachers, but also the Zonal and Provincial Educational Directors who administer these schools.

IMPROVING ENVIRONMENTAL CONSCIOUSNESS

It is an aim of our project to educate the students on the need for conserving the natural environment and minimising the negative impacts resulting from human behaviour. Tree planting campaigns were organised in all the participating schools in celebration of the World Environment day. Plants were donated to schools, and with the participation of teachers, students and our volunteer staff, the tree planting campaign turned out to be a success. In addition, students were invited to build Vesak lanterns using environmentally friendly materials.

The project has benefitted over 33,000 students and 1,470 teachers directly. Siridhamma Vidyalaya, Galle won the first place in the final evaluation, and have even taken the initiative to obtain an ISO certification for their school. The second place was won by Kirimetiyan Buddha Ladies College, Chilaw with Al Juffria Vidyalaya, Batticaloa coming third. All participating schools were awarded cash prizes. Given the success of the project new schools have been identified for 2011 including ones from the Northern Province.

REALITY TV QUIZ WITH A DIFFERENCE

DFCC MindStar is a unique reality TV quiz that is telecast on the Independent Television Network. Nine contestants, each representing a Sri Lankan province are given the opportunity to answer 10 questions for a chance of winning a million rupees. The questions are drawn from areas as diverse as Geography, History, Politics, Science, Religion, Sports and Current Affairs.



A Primary section classroom at Mawathagama Roman Catholic Vidyalaya, which has successfully implemented 6S principles



Deran Hewawitharana was a Million Rupee Prize winner and a finalist at the first season of DFCC MindStar.

Launched in May 2010, DFCC MindStar quickly garnered a keen following from viewers country-wide due to its unique presentation style and world class production standards.

The DFCC Banking Business entered the realm of Reality TV with two main objectives. Firstly, the show is intended to promote our products and services while raising brand awareness among the general public. Secondly, DFCC MindStar is a corporate social responsibility initiative to provide individuals and students a chance to identify positive role-models and work towards gaining new and useful insights about their world. The ultimate objective is to provide inspiration to citizens to move towards a knowledge-based society.

The initiative has been well received by the public as nearly 10,000 applicants took part in our initial aptitude tests whilst millions more tuned in every week to catch their favourite weekend reality TV show. The first season of the show featured 180 contestants from all 9 provinces of Sri Lanka. A total of 76 contestants won prizes while four won the grand prize of One Million Rupees.

DFCC MindStar was awarded the Best Reality TV Show by the Mass Media Foundation at the Asian Mass Media Awards in December 2010 and it continues to receive high viewer ratings.