DETERMINANTS OF FINANCIAL PERFORMANCE OF BANKING SECTOR IN SRI LANKA

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ABSTRACT

Banks play a very important roles in the economic development of Sri Lanka as well as other countries. Therefore, a strong banking sector is vital for economic growth, creating jobs, generating wealth, and reducing poverty..etc. However, there are more factors affect to the bank performance. Therefore, the problem of the study identified "what are the determinants of the financial performance of banking sector in Sri Lanka."

Based on the research question researcher identified five research objectives as, to examine impact of inflation on financial performance of banking sector in Sri Lanka, to examine impact of bank size on financial performance of banking sector in Sri Lanka, to examine impact of credit risk on financial performance of banking sector in Sri Lanka, to examine impact of liquidity on financial performance of banking sector in Sri Lanka, and to examine impact of capital adequacy on financial performance of banking sector in Sri Lanka. These objectives are mentioned in chapter one.

Chapter two discussed about the theoretical background of the study. Through the previous researchers it reveals the independent and dependent variables and the relationship between these two variables. Conceptualization and operationalization of the study discussed in chapter three and also it described the measurement of independent variables such as inflation, bank size, liquidity, credit risk, and capital adequacy of the banks in Sri Lanka. As well as it discussed the measurement of financial performance as ROA, ROE and NIM.

To accomplish the research objectives researcher followed quantitative approach. This study used secondary data from the interim reports of the commercial banks listed in the Colombo Stock Exchange. The sample covered 10 banks. And also Quarterly inflation rate was collected published movements of the CCPI report of Department of census and statistics in Sri Lanka. These are discussed in chapter four.

Data were analyzed by using descriptive, correlation and ordinary least square (OLS) regression model. Additionally, Unit root test are used for the analysis Stationarity of variables, F – Value and Durbin Watson value are used for the data analysis under the regression model. Analysis part of the study included in chapter five.

Study results exhibits that there is a positive and negative impact between bank's financial performance, inflation, bank size, credit risk, liquidity and capital adequacy in Sri Lanka. Further, the results show that Bank size has negative significant impact on ROA also Credit risk has negative significant impact on ROA. Inflation and capital adequacy have positive impact but it not significant on ROA and also liquidity has negative insignificance impact on ROA.

According to ROE model, Inflation has positive significant impact and Bank size and credit risk have negative significant impact. Liquidity has negative insignificance impact on ROE and also Capital adequacy has positive insignificance impact on ROE.

Further, Bank size has negative significance impact on NIM this only one significant variable in the NIM model. Liquidity and Capital adequacy have positive but insignificance impact on NIM and also Credit risk has positive insignificant impact on NIM.

Financial performance will increase when decreasing the credit risk as negative impact of credit risk on financial performance. Therefore, researcher recommend to managers and directors of banks should control high risk loan and the accumulation of unpaid loans for increase the financial performance of banks. When banks didn't invest, profitability will low, so managers have to consider banks profitability by investing in investment portfolio (Due to unnecessary reserve in the bank).

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