The Relationship between Credit Risk and Bank Performance: A Study of Commercial Banks in Sri Lanka

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Credit risk is the most important part of all commercial banks performing their works around the world. The objective of this study is to identify the relationship between credit risk and commercial banks performance in Sri Lanka. This study based on secondary data and data were obtained from various sources such as selected commercial banks annual reports, relevant articles, books and magazines etc. The panel data of a ten year period from 2006 to 2015 from the selected ten banks were used to examine the relationship between credit risk and commercial banks performance. Furthermore, Return on Assets (ROA) used as a profitability indicator while Non-Performing Loan to Total Loan Ratio (NPLR), Capital Adequacy Ratio (CAR) and Total Loan to Deposits Ratio (LTDR) used as credit risk indicators. The correlation and regression analysis was used to examine the relationship between credit risk and profitability indicators during the period and study by using E-views software. According to the empirical results, it was observed that NPLR and CAR has negative significant relationship with the commercial banks profitability and LTDR has positive significant relationship with the commercial banks profitability. Then this study concluded the credit risk has a significant relationship with the bank profitability. Therefore, this study recommended the banks to implement an effective tools and techniques to reduce the credit risk of commercial banks in Sri Lanka.

Keywords: Credit risk, Bank performance, Non-Performing Loan, Capital Adequacy Ratio, Loan and advances, Commercial banks