

Impact of Credit Risk Management on Profitability of Licensed Finance Companies in Sri Lanka

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The Licensed Finance Companies (LFCs) sector plays a prominent role within the financial system in Sri Lanka. LFCs are dealing with massive loan portfolio in the country and credit risk is one of the most significant risks which is faced by LFCs. The main purpose of the research is to investigate impact of credit risk management on profitability of LFCs in Sri Lanka. In the research model, Return On Assets (ROA) and Return On Equity (ROE) are the indicators for Profitability of LFCs, and Gross Non- Performing Loans (GNPL), Provision for Loss Facilities / Credit Facilities ratio (PLFCF), Total Credit Interest/Credit Facilities ratio (TCICF), Credit Recovery Cost/Credit Interest ratio (CRCCI), and Capital Adequacy Ratio (CAR) are indicators for credit risk management. The research collected data from 30 LFCs in Sri Lanka from 2011 to 2016 and formulated five hypotheses to achieve the research objective. A series of statistical tests were performed in order to test the impact of credit risk management on profitability of LFCs in Sri Lanka. Results disclosed that there is a significant negative impact of the credit risk indicators of GNPL and PLFCF on profitability of LFCs in Sri Lanka and Overall findings revealed that there is significant impact of credit risk management on profitability of LFCs in Sri Lanka. This finding indicates that the better the credit risk management is, the higher the profitability to the LFCs in Sri Lanka.

Keywords: Credit risk management, Profitability, Licensed Finance Companies, Non-Performing Loans, Finance companies act.