

The Impact of Credit Risk Management Practices on Financial Performance: A Comparison between Licensed Commercial Banks and Finance Companies in Sri Lanka.

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Abstract

The performance of financial intermediaries has a direct bearing on the financial stability of the Sri Lankan economy. There are two largest financial intermediaries in Sri Lanka, namely, Licensed Finance Companies (LFC) and Licensed Commercial Banks (LCB). Lending is one of the primary income-generating activities in financial intermediaries comprising banks and finance companies. The credit risk arises due to the failure of borrowers to repay the loans or meet their contractual obligations. Among the different types of risks facing banks and finance companies, credit risk is considered a significant determinant of financial performance. Even though numerous prior studies were conducted to examine the impact of credit risk management on the financial performance of bank and finance companies individually, there were very rare studies available which compared the impact of credit risk management practices on the financial performance of licensed commercial banks and the licensed finance companies in Sri Lanka in parallel. Hence the study aims to fulfill this empirical gap by investigating the impact of credit risk management on the financial performance of Banks and Finance companies. Further, the study investigated the level of the financial performance of the Sri Lankan LCB sector and LFC sector. This study employs the CAMEL rating method in order to compare financial performance between LFC and LCB. The sample comprises 15 LCB and 35 LFC and the examined time period is 2014 to 2019. This study employed the panel regression model to estimate the model. Data was collected through published annual reports, and using Eview Statistic Software was performed Descriptive analysis, Correlation, and Regression analysis. The findings of the study revealed that useful insights to the investors to invest their funds more accurately and earn higher profit with low risk. And also, the Findings of this study contributed to formulating efficient and effective credit risk management control policies for LCB and LFC.

Keywords: Credit Risk, CAMEL method, License Commercial Banks (LCB), License Finance Companies (LFC), Performance.