

The Determinants of Financial Performance of the Commercial Banks in Sri Lanka

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ABSTRACT

Introduction - The Banking sector being one of the major sectors in Sri Lanka, it plays a central role in the operation of the economy and the concept of profitability is more important for financial institutions and banks are the part of them. As efficient and vibrant commercial banking and financial system are essential ingredients for any market economy to become successful, it is expected to provide lifeblood to the efficient and effective functioning of an economy. Hence, this paper aims to examine the determinants of financial performance of the commercial banks in Sri Lanka.

Design/methodology/approach – the study analyses data for 10 license commercial banks from 2010 to 2019 using Eviews. Descriptive statistics and multiple regression models are used to analyse the data. The dependent variables of the study are return of assets, return of equity and stock return while the independent variables of the study are bank size, operating expenses, credit risk, deposits, capital adequacy, inflation, GDP and interest rate. The research follows a quantitative approach.

Findings – Bank specific factors of capital adequacy has contributed significantly and positively to the performance while operating expense, credit risk and liquidity significantly and negatively impact on performance of commercial banks. The specific variable of industry growth under industry specific variables, which was not considered in previous literatures has insignificant and negative impact on performance of the commercial banks. The results further show that macroeconomic determinants of economic growth rate have a significant and positive impact on performance while interest rate has insignificant and negative impact on performance of commercial banks.

Conclusion – By considering industry specific variable of industry growth, this study provides some interesting new insights for a better understanding of the mechanisms that determine the financial performance of commercial banks in Sri Lanka.

Keywords: *ROA, ROE, Industry Growth, Economic Growth, Commercial banks*