Impact of Financial Risks on Financial Performance of the Commercial Banks in Sri Lanka

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ABSTRACT

Introduction - Stability of the commercial banks is very important to the whole financial system in the world. Therefore, financial performance is a critical factor of the commercial banks. Commercial banks face various type of risks such as credit risk, market risk, operational risk, liquidity risk and legal risk which is vulnerable to the sustainable performance of the bank. Hence, the researcher aims to investigate the impact of financial risks on financial performance of the commercial banks in Sri Lanka.

Design/methodology/approach -This study adopted a quantitative research approach using a sample of 10 licensed commercial banks in Sri Lanka for the 12 years' period. Secondary data was collected using published annual reports. Hypotheses were tested using panel data regression model employing STATA statistical software.

Findings– Capital adequacy ratio has negative insignificant relationship with Return on Equity (ROE) and positive significant relationship with Return on Assets (ROA), whereas Non-performing loan ratio (NPLR) has negative significant relationship with ROE and ROA. Cost to income ratio (CIR) shows an insignificant negative relationship with ROA and ROE. Liquid assets to total liability ratio (LATLR) shows the positive significant relationship both ROA and ROE. When considering Net loans to total assets ratio (NLTAR), has shown the positive relationship in both ROE and ROA. However, it is significant only with ROA. Also Net loans to deposit ratio (NLDR) has negative relationship with ROA and ROE and it is significant only with ROE. Degree of financial leverage (DFL) has negative significant relationship with both ROA and ROE. Interest rate of risk (IRR) shows a positive insignificant relationship between ROA and ROE.

Conclusion-The final result emphasizes that the overall model is statistically significant, and researcher conclude that financial risk affect the financial performance of the commercial banks in Sri Lanka.

Keywords: *Credit Risk, Market Risk, Operational Risk, Liquidity Risk, Financial performance*