Impact of Loan Portfolio Diversification on Performance of Licensed Commercial Banks in Sri Lanka

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ABSTRACT

Introduction: The empirical studies provide mixed evidence on the relationship between loan portfolio diversification and loan portfolio concentration with the bank performance. This research study is one of the research that has been carried out for the Sri Lankan context with the main objective of, determine the impact of loan portfolio diversification on performance of licensed commercial banks in Sri Lanka.

Design/ Methodology/ Approach: Non probability sampling technique is used to select 10 banks out of 26 licensed commercial bank in Sri Lanka for the period of 2010 to 2019. Data were analysed by using correlation and fixed effect panel regression model. The independent variables of product wise diversification and sector wise diversification calculated from the measurement of Hirschman Herfindahl Index. Return on asset has taken to measure the bank performance and Interest Rate Spread, Capital Adequacy, Liquidity and Bank Size are used as control variables for identifying the model.

Findings: There is a significant negative impact on product wise loan diversification on bank performance and significant positive impact on sector wise loan diversification on bank performance. Further, control variables of interest rate spread and bank size have a significant negative relationship with bank performance while Capital Adequacy has a significant positive relationship with bank performances.

Conclusion: According to the product wise loan diversification bank can earn more profit from concentration strategy while under the sector wise loan diversification bank performance can be improved by following diversify strategy.

Keywords: *Loan Portfolio Diversification, Loan Portfolio Concentration, Bank Performance and Hirschman Herfindahl Index.*