

The Determinants of Net Interest Margin of Licensed Commercial Banks of Sri Lanka

D.A.C.A Gunasekara¹ and L. A. S. Perera²

Department of Finance, University of Kelaniya, Sri Lanka^{1,2}
anugunasekara1996@gmail.com¹, shanakala@kln.ac.lk²

ABSTRACT

Introduction – Banking sector plays an essential role in the economy provide smooth infrastructure to financial sector, while transferring the risk characteristics of assets and channelling of funds from surplus parties to deficit parties, that allows entrepreneurs to make their investment without financial difficulties. Therefore, with the higher efficiency, banks would able to maintain the Net Interest Margin (NIM) at a lower level. The banks need to maintain a balance between the profitability and the liquidity. Therefore, to achieve higher profitability banks should maintain higher interest rate margins. To maintain the balance between high and lower NIM the banks should be well aware of the main factors that affect the NIM. Purpose of this paper is to investigate the impact of Bank Specific Factors (BSF) on NIM of LCB's in Sri Lanka over the period of 2009-2018.

Design/Methodology/Approach – The sample in this study includes top 10 license commercial banks which cover the period of 2009-2018. Secondly data obtained from financial statements of individual license commercial banks, central bank annual report and other journals.

Findings – This research provide results found that there is a Liquid position in the bank also positive correlation with Leverage level they are maintaining, furthermore non-interest bearing reserves showing negative relationship with management quality relating to bank. Implicit payments relating to bank also shows positive relationship with management quality. On the other hand, non-performing loans and the interest rate risk in the banking sector negative correlated with liquidity requirement in the banking sector. Furthermore, implicit payments negatively correlated with leverage.

Conclusion - The results derived from this study may serve to policymakers for orienting towards issues that are more related to NIM determinants. Greater attention must be paid to capital adequacy, implicit interest payments and management quality.

Keywords - *Net Interest Margin, Credit Risk, Interest Rate Risk, Liquidity Risk, Implicit Interest Payment, Non-Interest-Bearing Reserves, Non-Interest-Bearing Reserves, Management Quality*