Factors Influencing the Capital Adequacy Ratios of Sri Lankan Banks- A Panel Data Analysis

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Regulations of banking industry are being changed from time to time through the international standards and thereby the regulators. The important aspects of the banking sector regulations started with the introduction of Basel accords which successfully help to face the financial crisis at present and in the future. When introducing such regulations, there were more discussions on the banks' capital. Even though the capital is more significant factor of a bank, Basel guidelines stressed to maintain higher capital ratios for a bank. Basel I, Basel II, Basel III and discussions for Basel IV, capital is the main target as a resolution factor for any financial crisis. Hence, this paper examines the factors influencing the capital adequacy ratio (CAR) of ten largest domestic commercial banks in Sri Lanka during the period from 2010 to 2019. CAR is an important ratio which protects banks against excess leverage, insolvency and protects them out of difficulty. This study employs ten bank's specific variable i.e., bank size (BS), Loan to Asset Ratio (LAR), Return on Equity (ROE), Deposit Asset Ratio (DAR), Risk Asset Ratio (RAR), Return on Assets (ROA) and Equity Ratio (EqR) whereas dependent variable is the CAR of domestic licensed banks in Sri Lanka. The results show that many factors affect towards the CAR which is the main factor of absorbing losses in a bank. In this study, linear regression model uses to test the relationship between variables and to test how banks' specific factors influence on CAR, the research further employees the panel data analysis with fixed effect model. The results from the panel regression revealed that banks' specific factors such as EqR, RAR, ROE and ROA are influencing factors for the changes of CAR in domestic licensed banks in Sri Lanka. Further, it is required to strengthen the supervisory mechanism of banks by the regulator as these factors are very crucial and affect to maintain financial system stability of the county.

Keywords: Bank Ratio, Bank Size, Capital Adequacy Ratio, Panel data analysis, Risk Weighted Assets

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