THE IMPACT OF CREDIT RISK ON BANK PROFITABILITY: *With Special Reference to Sri Lankan Commercial Banks*

Wickramasingha M.P. [1] **and Abeywardhana D.K.Y.**[2]

[1]*maheshprasad98622@gmail.com;* [2]*dilyapa@kln.ac.lk*

Abstract

Credit granting is one of the main incomes generating activity in commercial banks. The risk related to credit affects the profitability of the banks. A number of researches have also revealed that there is a powerful relationship between credit risk and profitability. The objective of the study is to assess the impact of credit risk on profitability. Foreign countries have conducted number of studies related to this topic. Similarly, there are no sufficient studies have been conducted in Sri Lanka.

Four commercial banks were selected for the study and data was collected through the published annual reports of the Central Bank of Sri Lanka (CBSL). The selected four banks consisted with two state owned banks and two private banks from Sri Lankan commercial banking sector. Return on Equity (ROE) and Return on Asset (ROA) were used as profitability indicators while Gross Non-Performing Loan (GNPL) ratio was used as an indicator of credit risk. The impact of credit risk on profitability is assessed using Ordinary Least Square (OLS) regression and exploratory data analysis.

Furthermore, results indicated a statistically significant positive relationship between credit risk and profitability of commercial banks. Therefore, the findings concluded that credit risk positively affects the profitability in commercial banks. Findings of this study contribute to formulate efficient and effective credit risk management control policies for commercial banks.

Keywords: *Commercial Banks, Credit Risk, Profitability.*