PERFORMANCE AND STABILITY OF LICENSED COMMERCIAL BANKS IN SRI LANKA

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Introduction

Performance and stability is a cornerstone of prudent banking practice. Today's competitive and dynamic market environment has created new set of challenges for any business. Undoutfully all banks in present day volatile environment are facing a large number of risks. Risk triggers corporate growth which is essential for sustaining the viability, dynamism and value enhancing capability of a financial institution, which lead to higher profits and better the shareholders' value. To achieve the desired growth, the firm has to be competitive in all functional areas especially in performance and stability which is the back bone of any business (Kannadhasan and Nandagopal 2008). Just like in any other business, profit in banking acts as a stimulant factor for management to expand and improve their services. Though profit maximization is secondary for public sector banks, adequate profit is necessary for their survival and healthy operations because even socioeconomic obligations, like branch expansion in rural areas and priority sector advances cannot be fulfilled without adequate profit. Private sector banks have set a blistering pace of growth, easily beating the growth rate of public banks.

The banking sector remained stable and resilient despite the challenges caused by the global financial crisis and the failure of some domestic unauthorized institutions engaged in finance related businesses. Improvements in performance gains in financial institutions are a vital requirement for providing a more efficient system of asset allocation in the financial services sector. Since Sri Lanka has a bank-led financial services sector performance gains in firms in the banking industry are more important for providing supportive financial infrastructure for economic development (Seelanatha, 2010). The present study is focused to compare the performance and stability of public sector and private sector Licensed Commercial Banks (LCBs) in Sri Lanka. Hence, the key objective of the present study is to compare the performance and stability of two sectors.

Methodology

This study is confined to two (2) public banks and eight (8) private banks. Data

collected for eight (8) years period commencing from 2005/2006 to 2011/2012. Annual reports of the sample were used as the data source. Performance is measured by profitability and productivity. The variables studied are interest paid, interest earn, total deposit, loan and advance, non operating income and expenses, number of employees, number of branches and establishment expenses. Following ratios which were extracted from the above variables were computed for measuring the performance and stability.

Profitability = Spread ratio - Burden ratio.

The ratios used for measuring Productivity are:

1. *Deposit per employee = Total Deposit/Total Staff*
2. *Advances per employee Ratio = Total Advances/ Total Staff*
3. *Total Business per employee = Total Business/ Total Staff*
4. *Deposit per Branch Ratio = Total Deposits/ No. of Branches*
5. *Advances per Branch Ratio = Total Advances/ No. of Branches*
6. *Total Business per Branch = Total Business/ No. of Branches*

The non-performing loans (NPLs) ratio is used to compute the stability of the banks.

The non-performing loans (NPLs) ratio = Non-Performing Loans / Total Loans

Results and Discussions

It is found that the public sector banks are less profitable than the private sector banks in terms of overall profitability though their profitability is improving over the last 8 years. Analyzing further, it is revealed that public sector banks have less spread ratio and it was gradually decreasing throughout the period in terms of private sector banks. Public sector banks have been gradually decreasing burden ratios which makes them less profitable as compared to the private sector banks. This result is consisted with the findings of Swarnapali, Kumari and Pathmasiri (2012). The interest earned ratio is escalating over the years for both categories of banks. It is noticeable that total interest earned has dramatically increased over the eight years in each LCB.

It is indicated that public sector banks have more number of average staff and average branches than the private sector. This means public sector banks have a higher denominator as compared to private sector banks. The results highlighted that the deposit per employee ratio, can easily infer that private sector banks are far ahead of the public banks. The advances per employee and business per employee ratios are better public sector than private sector. It is true that the public sector banks have a large network of branches and have their presence in the

rural and semi urban areas (Central Bank, 2012). Furthermore, per branch bank deposit, advance and business ratios of public banks were much higher than the private sector banks. Public sector banks have not been as profitable as the private sector banks primarily because of the low interest earned ratio. To overcome this drawback public sector banks should chalk out a program to increase interest income.

NPLs ratio of public sector banks has deteriorated. But NPLs ratio of private sector banks has slightly increased over the period. Therefore, in assessing the actual level of credit risk of banks, credit risk mitigating tools such as the level of loan loss provisions, value and availability of collaterals should be considered. Further, the banks need to continue to strengthen their credit risk mitigation measures to maintain the stability of the banking sector. The key to success in the competitive environment is increased productivity and profitability along with stability. Sri Lankan banks especially the public sector banks are lagging far behind their competitors in terms of profitability.

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