

The Impact of Financial Risk on the Financial Performance of Listed Banking and Financial Sector Companies in Sri Lanka

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Abstract

Financial risk refers to anything that threatens organizational growth and profitability. It may originate from the sources of inside as well as outside. Financial risk is a much important fragment of banking and financial sector companies. If companies do not maintain an appropriate level of financial risk, they may face many difficulties. The objective of the study is to identify the impact of financial risk on financial performances of listed banking and financial companies in Sri Lanka. Credit risk, market risk, liquidity risk, and operational risk were taken as independent variables while financial performance that was measured through Return on Assets (ROA) and Return on Equity (ROE) were taken as the dependent variables. The population of the study is 71 organizations in banking and finance sectors listed in the Colombo Stock Exchange. Among them, 25 organizations are taken as a sample through simple random sampling that comprised 12 commercial banks and 13 financial companies. The study covered a period of 5 years from 2015 to 2019. The impact of financial risk on financial performance was analysed with the use of descriptive, correlation, and multiple regression analysis. The study concluded that credit risk and liquidity risk have a significant negative impact while market risk and operational risk have a significant positive impact on both the financial performance measures of ROA and ROE. The findings have important implications for owners and researchers to follow conservative risk control strategies, for making investment decisions, as well as to the public and everyone interested in the banking and finance. The present study suggests that further studies can be done on the effects of financial risk by using a detailed questionnaire on the financial performance of other financial institutions like microfinance institutions and development financial institutions.

Keywords: Credit risk, financial performance, liquidity risk, market risk, operational risk