

**IMPACT OF BANK-SPECIFIC FACTORS ON FINANCIAL PERFORMANCE:
THE PUBLIC AND PRIVATE LICENSED DOMESTIC COMMERCIAL BANKS IN
SRI LANKA**

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INTRODUCTION

A strong and vibrant economy requires a stable financial system. Any economy's performance is primarily influenced by how well the banking industry performs. At this juncture, the banking sector is one of the most critical financial institutions in the financial system. Its primary function is to transfer funds to deficit parties lacking finances by accepting deposits from surplus parties with sufficient funds. In Sri Lanka, the banking industry is considered a fast-expanding industry and the foundation of the country's financial system as it enables the best use of its financial resources (Thisaranga & Ariyasena, 2021). The determinants of financial success in the banking literature can be divided into internal and external factors (Assfew, 2018). Bank management can control internal factors. Assfew (2018) identified money, capital, liquidity, and expense management strategies as the internal determinants of a bank that are critical to explaining its internal management performance. A healthy and prosperous banking industry is better equipped to absorb adverse shocks and contribute to the financial system's stability (Athanasoglou, 2022). Therefore, researchers, bank management, and supervisors are interested in the factors influencing bank performance. Numerous studies conducted in various countries have examined the factors that affect bank performance. The explanatory factors utilized by the scholars to explain the Return on Assets (ROA) and Return on Equity (ROE) independently were bank size, management efficiency, non-performing loans, asset management, operating efficiency, and capital adequacy ratio (Thisaranga & Ariyasena, 2021). Many prior researchers (Kobika, 2018; Suganya & Kengatharan, 2018; Thisaranga & Ariyasena, 2021; Velnampy & Anojan, 2014) have examined the determinants of bank-specific factors on bank performance and confirmed a negative impact on a bank's performance. In contrast, a few other researchers found that bank-specific factors positively impact a bank's performance. This empirical study examines the factors that impact banks' financial performance in Sri Lanka and will benefit various stakeholders, including the researcher, bank managers and executives, university students, and other researchers. This research examines the financial performance of commercial banks in Sri Lanka. The study population consists of all domestic licensed commercial banks in Sri Lanka. This study has focused on evaluating the financial performance of 11 private domestic and commercial banks listed on the Colombo Stock Exchange (CSE) and two state banks. This research employed the purposive sampling technique and a descriptive research design to gather data within a specific timeframe. The primary aim of this study was to investigate the influence of bank-specific factors on the financial performance of public and private domestic commercial banks from 2016 to 2021. As well as to make a comparative analysis of it. The results of this study will be used as a basis for the researchers' future work, and it encourages managers and

executives of banks to pay sufficient attention to the management of identified factors and provides them with knowledge of practices that can improve banks' performance.

METHODOLOGY

The performance of banks is influenced by critical drivers such as the external and internal economic environments. This study aimed to investigate the impact of bank-specific factors on the financial performance of commercial banks in Sri Lanka over six years from 2016 to 2021. The independent variable was measured in terms of Capital Adequacy Ratio (CAR), Operating Cost Efficiency (OCE), Non-performing Loan (NPL), Bank Size (BS), and Liquidity Ratio (LDR). In contrast, ROA and ROE were the proxies of the dependent variable. The study population consists of all domestic licensed commercial banks in Sri Lanka. Accordingly, the sample was confined to 11 private and 02 public banks. The secondary data was used for the study, extracted from the financial statements of the sample banks. Descriptive statistics, correlation analysis, and multiple regressions on the panel data were employed to achieve the study's objectives. Moreover, the independent samples t-test was conducted to examine whether there is a significant difference between the private and public banks' performance. The intervention of hypotheses for the study is developed as follows: H_{1a}: There is an impact of capital adequacy on ROA, H_{1b}: There is an impact of capital adequacy on ROE, H_{2a}: There is an impact of assets quality on ROA, H_{2b}: There is an impact of assets quality on ROE, H_{3a}: There is an impact of management efficiency on ROA, H_{3b}: There is an impact of management efficiency on ROE, H_{4a}: There is an impact of liquidity statue on ROA, H_{4b}: There is an impact of liquidity statue on ROE, H_{5a}: There is an impact of bank size on ROA, H_{5b}: There is an impact of bank size on ROE.

RESULT AND DISCUSSION

After completing the normality and other basic tests, the data collected for the study was deemed appropriate to proceed with the primary analyses. Consequently, the primary analyses were conducted, and the results were summarized in subsequent sections.

Table 1

Result of Descriptive Statistics

Variable	Mean	SD	Min	Max
ROA	1.110	0.558	-0.340	2.010
ROE	11.935	6.610	0.150	23.470
CAR	16.236	3.140	12.100	24.870
OCE	0.581	0.145	0.426	1.013
NPL	4.213	1.610	1.610	6.730
BS	0.141	0.078	0.001	0.310
LDR	26.066	5.071	21.270	38.940

Descriptive statistics are presented for 78 observations involving five independent and two dependent variables, as summarized in Table 1. The mean values of ROA, ROE, CAR, OCE, NPL, BS, and LDR are 1.110, 11.935, 16.236, 0.581, 4.213, 0.141, and 26.066, respectively, representing measures of central tendency. Measures of variability, such as standard deviation, are used to analyze the distribution's dispersion, with values for ROA, ROE, CAR, OCE, NPL, BS, and LDR being 0.558, 6.610, 3.140, 0.145, 1.6010, 0.078, and 5.071, respectively. The range values for ROE and LDR are 23.32 and 17.67, respectively, indicating a higher deviation from the mean values. In contrast, BS has the lowest deviation (0.078). CAR has the highest

minimum value (12.100), and ROA has the lowest (-0.340). The maximum value for LDR is 38.940, while BS's is 0.310.

Table 2
Result of Correlation Analysis

	ROA	ROE	CAR	OCE	NPL	BS	LQ
ROA	1.000						
ROE	0.492*	1.000					
CAR	0.478*	0.614**	1.000				
OCE	-0.784**	-0.784**	0.578	1.000			
NPL	-0.264**	-0.264**	0.118*	0.190	1.000		
BS	0.041	0.041	0.204	0.092	-0.403	1.000	
LQ	-0.237	-0.237*	0.376	0.146	0.251	0.101	1.000

N= 78, *P<0.05, **P<0.01

The result of the correlation analysis is shown in Table 02. The value of the CAR (-0.478) shows a moderate negative relationship with ROA, implying that when the CAR of banks increases, the ROA tends to decrease. According to the above table, the OCE has a negative relationship regarding the bank's ROA. Further, the NPL and the LDR negatively correlated with the ROA, while bank size represents a positive relationship with the ROA. According to Table 2, OCE has a significant negative correlation with ROE. CAR positively correlates with ROE, while NPL and LQ have a moderate negative correlation with ROE. As a result, when CAR, OCE, NPL, and LQ decrease, ROE increases. According to the correlation between BS and ROE, the sample banks' ROE is increased when their size increases.

Table 3
Result of Panel Regression Analysis

Variables	Model- 1 ROA (fixed-effect)				Model- 2 ROE (Fixed-effect)			
	Coef.	Std. Err.	z	P> z	Coef.	Std. Err.	z	P> z
CAR	0.000	.0151	0.020	0.985	0.490	0.147	3.33	0.001**
OCE	-3.414	0.358	-9.53	0.000**	-21.790	3.571	-6.10	0.000**
NPL	-0.057	.0287	-1.99	0.047*	-0.882	0.254	-3.47	0.001**
BS	-0.116	0.499	-0.23	0.816	3.721	4.164	0.89	0.371
LQ	-0.004	0.006	-0.63	0.530	-0.147	0.063	-2.34	0.019*
Cons.	3.481	0.301	11.55	0.000	39.596	3.249	12.19	0.000
R ²	0.697				0.638			
P- value	0.000				0.000			
Hausman Test					65.83			
Chi- Square	7.13							
P-value	0.004				0.000			

According to the Hausman test result in Table 3, the fixed-effect model was appropriate for both models. With an overall R-square value of 0.6974, independent variables used in model 1 account for 69.74% of the observed variance in ROA, while it is 63.84 for model 2. According to Table 3, both OCE (coefficient = -3.4145, p-value = 0.000) and NPL (coefficient = -0.0571, p-value = 0.047) negatively and significantly impact ROA in this model. However,

the remaining variables did not indicate a significant impact on ROA. In model 2, CAR, OCE, and NPL significantly impact ROE at 0.001, whereas LQ impacts at 0.05. In contrast, BS did not significantly impact ROE. Additionally, independent-sample t-tests were conducted; their results are presented in Table 4.

The correlation analysis revealed that NPL, CAR, and LDR had a negative impact on ROA. This means that when these three variables increase, ROA decreases. Conversely, OCE and BS positively impacted ROA, which means that when these two variables increase, ROA also increases. The correlation analysis showed that CAR and OCE had a significant negative correlation with ROE, while NPL and LQ had a moderate negative correlation with ROE. Thus, ROE increases when CAR, OCE, NPL, and LDR decrease. In contrast, bank size represents a somewhat positive relationship with the ROE.

The researcher used a random effect model and the LM test for the regression analysis. Based on the probability value of the LM test being less than 5%, the random effect model was used for interpretation. The results showed that OCE and NPL had a negative impact on ROA, while CAR, BS, and LDR had no statistically significant impact on financial performance as measured by ROA. The second model examined how specific factors of banks affect their financial performance as measured by ROE. The random effect models showed that CAR, OCE, NPL, and LDR had a negative impact on ROE, while BS had no significant impact on ROE at the 5% significance level. According to the independent sample T-test, the P-values indicate that, at a significance level of 0.05, there is insufficient data to rule out the null hypothesis ($H_0: \text{diff} = 0$). Consequently, it is impossible to conclude that the means used by government and private banks differ significantly.

Table 4

Mean Comparison of Performance: Public Banks versus Private Banks

Performance	Banks	Obv	Mean	SD	Dif.	t- stat	P-value
ROE	Public	12	19.858	1.576	9.431	4.574	0.000
	Private	66	10.427	0.830			
ROA	Public	12	1.425	0.071	0.307	0.772	0.442
	Private	66	1.118	0.052			

The mean ROE for the public is 19.858 compared with the mean ROE of 10.427 for private banks. Public banks have larger mean values of performance in both measures than private banks. ROE's mean difference of 9.431 is statistically significant at the 1 percent level, indicating a significant difference in ROE in both banks. However, ROA's mean difference of 0.307 is statistically insignificant. Thus, the result highlights no significant difference between the ROA of public and private banks.

CONCLUSION AND IMPLICATIONS

The study investigated the impact of bank-specific factors on the accounting-based performance of commercial banks in Sri Lanka. The results revealed that management efficiency (which was proxied by OCE) and asset quality (which was proxied by NPLR) significantly impact banks' performance. The result of OCE highlights that operational expense efficiency improves the financial performance of the sample banks. Further, the results indicated that both CAR and LQ significantly affect ROE. The result of CAR concludes that banks become more financially healthy with more equity capital they have. Moreover, independent-sample t-tests were conducted to examine whether there is a difference in performance between public and private banks. According to the findings, this study revealed

that capital adequacy ratio, non-performing loans, and operating cost efficiency negatively impacted financial performance regarding return on assets. Bank size positively impacted financial performance in terms of return on equity as per the result of two models concerning return on assets and equity. Liquidity did not have any impact on the financial performance of the banks. When the bank's specific factors are changing, investors and other related parties can get an idea about the changing trend of the bank performance. When the banks want to change the trend of bank performance to a high level, they can increase bank size and decrease non-performing loans, operating cost efficiency, and capital adequacy ratio. According to the analysis results, selected factors such as Liquidity insignificantly impact bank performance. When the bank's CAR, NPL, OCE, and BS are changing, investors and other related parties can get an idea about the changing trend of the bank performance. Banks are capable of facing those particular situations without bias. If the banks want to change the trend of bank performance to a high level, they can increase BS and decrease NPL, OCE, and CAR. According to the analysis results, selected factors such as LDR insignificantly impact bank performance.

Keywords: Capital adequacy ratio, financial performance, non-performing loan, operating cost efficiency

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