

DETERMINANTS OF FINANCIAL PERFORMANCE OF LICENSED COMMERCIAL BANKS IN SRI LANKA

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ABSTRACT

This study investigates the determinants of financial performance in 13 licensed commercial banks listed on the Colombo Stock Exchange (CSE) in Sri Lanka. These banks were selected based on their status as licensed commercial banks operating within Sri Lanka during the fourteen years from 2010 to 2023. A purposive sampling technique is employed to select a representative sample of banks based on criteria such as size, ownership structure, and geographical location. The primary focus is on two dependent variables: return on assets (ROA) and equity (ROE). Four bank-specific characteristics are analyzed: capital adequacy ratio, operating cost efficiency, Non-Performing Loans, and liquidity. In contrast, high levels of non-performing loans and liquidity issues negatively impact return on assets, as they reduce asset-use efficiency in generating profits. The study found no significant relationship between operating cost efficiency and return on investments. Further analysis reveals that non-performing loans negatively affect the return on equity, emphasizing that loan defaults diminish the returns derived from shareholder equity, highlighting the critical importance of managing loan quality. This study uses secondary data from the Central Bank of Sri Lanka's annual report from 2010 to 2023 to analyze macroeconomic factors. Research on the financial performance of licensed commercial banks in Sri Lanka is crucial for the country's economic health, as it influences their ability to support growth, provide efficient services, and contribute to financial system stability, enabling informed decision-making and policy implementation. Overall, this study provides valuable insights into the factors driving financial performance in Sri Lanka's banking sector, offering guidance for strategic decisions to improve profitability and sustain long-term growth.

Keywords: Capital adequacy ratio, liquidity, non-performing loans, operating cost efficiency, return on assets