

IMPACT OF CREDIT RISK ON FINANCIAL PERFORMANCE: A CASE OF SRI LANKAN LISTED COMMERCIAL BANKS

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ABSTRACT

The purpose of this investigation is to extend earlier research on the impact of credit risk on financial performance. The study confines only nine listed commercial banks in Sri Lanka through the purposive sampling due to the minimize of missing data and links secondary data derived from the annual financial reports of commercial banks using the CSE's database. The analyzed credit risk indicators include non-performing loan ratio and capital adequacy ratio while financial performance indicator includes return on Equity (ROE). Regression and Correlation analysis have been employed for the study to investigate the effects of credit risk indicators on Return on Equity. The results of the analysis has revealed that both credit risk attributes including Non-Performing Loan ratio and Capital Adequacy ratio have a negative and significant impact on Return on Equity. The prominent finding of the research utterly reveals that, Credit Risk significantly influences the financial performance of listed commercial banks in Sri Lanka with the negative relationship. Based on the Finding, researcher recommends banks to devise new strategies and implement effective policies relating with credit risk management to improve their financial viability as credit risk is one of the significant factors that determine the financial performance which this study concluded. Thus, this study will be useful for the management personnel of banks to create the ideas for protect banks from crisis and enhance the performance of banks. The study suggests that the growing banks need to refocus on the effective management of its financial risk and devise new strategies like minimizing the lending rates and fee charges and critically assessing the customers who demand the extension of credit or loan before granting such, to reduce credit risk will make an improvement in the financial Performance.

Keywords: Credit Risk, Financial Performance, Listed Commercial Banks