

**DETERMINANTS OF PROFITABILITY OF
COMMERCIAL BANKS IN SRI LANKA
(WITH SPECIAL REFERENCE TO THE BANK OF
CEYLON)**

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ABSTRACT

Financial sector plays a pivotal role in the economic development. It is generally agreed that a strong and healthy banking system is a prerequisite for sustainable economic growth. Banks in Sri Lanka have been undergoing major challenges in the dynamic environment over the past few years. In order to resist negative shocks and maintain financial stability, it is important to identify the determinants that mostly influence the overall performance of banks in Sri Lanka. This study aims to give the analysis of the determinants of commercial banks profitability in Sri Lanka over the period 2001-2010. The focus is on the internal factors only. This paper uses the multiple regression analysis method to investigate the impact of capital ratio, credit risk, activity mix, size and overhead expense on profitability indicator return on asset(ROA).

The empirical results have found strong evidence that these variables have a strong influence on the profitability. However, the results show that higher capital ratio may not necessarily lead to higher profits. Also, higher assets contribute towards profitability, credit risk is strongly negative with profitability, when bank of Ceylon invest their capital in diverse options it could earn more profit because of activity mix has a positive relationship with profitability, and finally overhead expenses weakly negative relationship with profitability. This is indicating bank expenses are efficiently allocated to earn much more profit. Most of the situations about overhead expenses are going to heavy negative relationship with profitability, by wastage of expenses. But there researcher significant finding is overhead expenses has weakly negative relationship with profitability. But here when we seeing as a whole there are none of the variable statistically significant with profitability.

Key words: activity mix, capital ratio, credit risk, overhead expense, return on assets, size