


DETERMINANTS OF NON PERFORMING LOANS (NPL) IN COMMERCIAL BANKS OF SRILANKA



MBA 69

Thesis
Library - EUSL



KANESHAN NITHILAN

(EU/MBA/136)

A Skill Report

**Submitted to the Faculty of Commerce and Management, Eastern
University as a partial fulfillment of the requirements of the Master of
Business Administration (MBA)**

**Postgraduate Unit
Faculty of Commerce and Management
Eastern University, Sri Lanka**

JANUARY 2023

Abstract

This study investigates the factors impacting non-performing loans in commercial banks in Sri Lanka. The primary objectives include determining the extent of non-performing loans and identifying their key determinants, namely credit growth, profitability, operational efficiency, equity to capital ratio, and income diversification. Additionally, the study aims to analyze the relationships among these factors and their influence on non-performing loans in Sri Lankan commercial banks.

To achieve these goals, the study utilized 120 observations from the financial statements of 12 commercial banks over a 10-year period from 2011 to 2020. Secondary data were employed to conduct descriptive statistical analyses on non-performing loans, credit growth, profitability, operational efficiency, equity to capital ratio, and income diversification using SPSS 22.0. The study also explored correlations and regressions between non-performing loans and the influencing factors.

The descriptive statistics reveal that the average non-performing loan in commercial banks of Sri Lanka is 2.24%, with a standard deviation of 1.8%. Correlation analysis indicates a negative relationship between bank-specific factors such as credit growth, operational efficiency, equity to asset ratio, and income diversification, and non-performing loans. Conversely, a positive correlation is observed between profitability and non-performing loans. Regression analysis further confirms that all banking-specific variables—credit growth, profitability, operational efficiency, equity to asset ratio, and income diversification—significantly influence non-performing loans in commercial banks in Sri Lanka.

Key words: Non-performing loans, Credit growth, Profitability, Operational Efficiency, Equity to asset and Income Diversification.

Tables of Contents

	Page No
List of Tables	X
List of Figures	XII
Abbreviations	XII
1.0 Chapter 1	
1.1 Background of the study	01
1.2 Problem statement	06
1.3 Research Questions	08
1.4 Research Objectives	09
1.5 Scope of the study	09
1.6 Significance of the study	09
1.7 Chapter summary	10
2.0 Chapter 2: Conceptual Framework and Methodology	
2.1 Introduction	11
2.2 Brief Literature Review	11
2.3 Structure of commercial banks in Sri Lanka	15
2.4 Conceptualization of variables	16
2.4.1 Conceptualization of non-performing loans	16
2.4.2 Conceptualization of determinants of non-performing loans	17
2.5 Operationalization of variables	18
2.6 Study design	24
2.7 Sampling and sample size	24
2.8 Data collection	24

2.9	Data analysis and evaluation	25
2.10	Chapter summary	26
3.0	Chapter 3: Data presentation and analysis	
3.1	Introduction	27
3.2	Analysis of NPL of commercial banks in Sri Lanka	28
3.3	Analysis of credit growth of commercial banks in Sri Lanka	31
3.4	Analysis of profitability (ROA) of commercial banks of Sri Lanka	34
3.5	Analysis of operational efficiency of Sri Lanka	37
3.6	Analysis of equity to asset of Sri Lanka	40
3.7	Analysis of income diversification of Sri Lanka	43
3.8	Analysis of descriptive statistics of operational variables of Sri Lanka	46
3.9	Analysis of correlation between non-performing loans and its determinants of commercial banks of Sri Lanka	48
3.10	Regression analysis of non-performing loans and its determinants of commercial banks of Sri Lanka	50
3.10.1	Model summary of regression analysis of non-performing loans and its determinants of commercial banks of Sri Lanka	50
3.10.2	ANOVA of regression analysis of non-performing loans and its determinants of commercial banks of Sri Lanka	50
3.10.3	The co-efficient of regression analysis of non-performing loans and its determinants of commercial banks of Sri Lanka	51
3.11	Chapter summary	53
4.0	Chapter 04: Conclusion and Recommendation	
4.1	Introduction	54
4.2	Conclusion	54

4.3	Recommendation	65
4.4	Limitations of the study	67
4.5	Direction for future research	68
	References	73

LIST OF TABLES

Table 1.1	Non Performing Loans of selected commercial banks in Sri Lanka.	03
Table 2.1	Licensed Commercial Banks in Sri Lanka	15
Table 2.2	Operationalization	23
Table 3.1	Average NPL Ratio of Commercial Banks in Sri Lanka	29
Table 3.2	Trend in NPL in the industry of CBs from 2011 to 2020.	30
Table 3.3	Average Credit Growth Ratio of Commercial Banks in Sri Lanka	32
Table 3.4	Trend in Credit Growth in the industry of CBs from 2011 to 2020.	33
Table 3.5	Average Profitability (ROA) of Commercial Banks in Sri Lanka	35
Table 3.6	Trend in Profitability (ROA) in the industry of CBs from 2011 to 2020.	36
Table 3.7	Average Operational Efficiency of Commercial Banks in Sri Lanka	36
Table 3.8	Trend in Operational Efficiency in the industry of CBs from 2011 to 2020.	39
Table 3.9	Average Equity to Asset of Commercial Banks in Sri Lanka	41
Table 3.10	Trend in Equity to Assets in the industry of CBs from 2011 to 2020.	42
Table 3.11	Average Non Income Ratio of Commercial Banks In Sri Lanka.	44
Table 3.12	Trend in Non Interest Income Ratio in the industry of CBs from 2011 to 2020.	45

Table 3.13	Descriptive statistics of operational variables of the study of Non performing loans of Commercial Banks in Sri Lanka.	46
Table 3.14	Correlation coefficient of operational variables of the study of Non performing loans of Commercial Banks in Sri Lanka.	49
Table 3.15	The model summary of operational variables of the study of Non performing loans of Commercial Banks in Sri Lanka	50
Table 3.16	The ANOVA of operational variables of the study of Non performing loans of Commercial Banks in Sri Lanka.	51
Table 3.17	The coefficient of operational variables of the study of Non performing loans of Commercial Banks in Sri Lanka.	52

LIST OF FIGURES

Chart 1.1	Non Performing Loans of selected commercial banks in Sri Lanka	04
Chart 1.2	Average Non Performing Loans of commercial banks in Sri Lanka	05
Figure 2.1	Conceptualization	18
Chart 3.1	Average NPL Ratios of Commercial Banks in Sri Lanka	30
Chart 3.2	Trend in NPL in the CBs industry from 2011 to 2020.	31
Chart 3.3	Average Credit Growth Ratios of Commercial Banks in Sri Lanka	33
Chart 3.4	Trend in Credit Growth in the CBs industry from 2011 to 2020.	34
Chart 3.5	Average Profitability of Commercial Banks in Sri Lanka	36
Chart 3.6	Trend in Profitability in the CBs industry from 2011 to 2020.	37
Chart 3.7	Averages Operational Efficiency of Commercial Banks in Sri Lanka	39
Chart 3.8	Trend in Operational Efficiency in the CBs industry from 2011 to 2020.	40
Chart 3.9	Average Equity to Assets of Commercial Banks in Sri Lanka	42
Chart 3.10	Trend in Equity to Assets in the CBs industry from 2011 to 2020.	43
Chart 3.11	Average Income Diversification of Commercial Banks in Sri Lanka	45
Chart 3.12	Trend in Income Diversification in the CBs industry from 2011 to 2020.	46

Abbreviations

CG - Credit Growth

NPL - Non performing loan

ROA - Return on Asset