The Relationship between Credit Risk Management and Profitability; Evidence from Commercial Banks in Sri Lanka

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The banking sector which acts as the backbone of the financial system in Sri Lanka has contributed the country by maintaining an economic growth However, at present banks in Sri Lanka face the problem of credit risk due to deteriorating credit quality. This credit risk management connects with the liquidity as well as profitability and overall risk management of the banks. This study analyzed the impact of credit risk management on profitability of commercial banks in Sri Lanka by using CAMEL model. CAMEL model indicators used to measure credit risk management and model included capital adequacy, asset quality, management efficiency, earning efficiency and liquidity which are influencing to the credit risk management. The study based on secondary data published by commercial banks in Sri Lanka. The sample was 10 banks for 2009 to 2010. Ordinary Least Square (OLS) regression method was used for data analysis. Findings noted that there is a positive relationship between credit risk management and bank performance of commercial banks in Sri Lanka. Further, Capital adequacy, earning efficiency, Liquidity coverage ratio have significant positive relationship with the profitability of commercial banks in Sri Lanka. Asset quality and management efficiency have negative relationship with financial performance of Sri Lankan commercial banks. The study envisaged that these ratios should be improved by the banks for the better performance and CAMEL is a significant tool to analysis of credit risk management.

Keywords: Banking sector, Credit risk management, Profitability, CAMEL model