

**THE IMPACT OF BANK INTERNAL FACTORS ON THE
PROFITABILITY OF COMMERCIAL BANKS IN SRI LANKA:
WITH SPECIAL REFERENCE TO THE SELECTED LISTED
COMMERCIAL BANKS IN SRI LANKA**

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Abstract

The banking sector is considered as one of the most vital sectors for the national economy, as it is considered a lifeline for the state's economic activity through the mediating role it plays in collecting deposits from individuals and companies that own money and providing loans to the government, companies, and individuals that need these funds. Maximizing profits in commercial banks is restricted by many considerations. Maintaining sufficient liquidity and striving for the safe use of funds, ensuring the rights of depositors, and avoiding many risks limit the commercial bank's ability to maximize profits. The aim of this study is to examine what extent bank internal factors impact on the profitability of commercial banks in Sri Lanka. Capital adequacy, Operating cost efficiency, Non-performing loans, Bank size, Liquidity, Assets Quality and Managerial efficiency are considered as bank internal factors while Return on assets is considered as a profitability measure of this study. Panel data has been collected from published financial statements of ten commercial banks listed on the Colombo Stock Exchange (CSE) for the period of ten years from 2015 to 2019. Fixed effect and random effect models are performed to investigate the best model to evaluate the impact of bank internal factors on profitability. The results of the study reveal that the random effect model is the best model using the Hausman specification test. As per the random effect model, capital adequacy has a positive and significant impact on profitability while non-performing loans and operating cost efficiency have a negative and significant influence on profitability. The rest of the selected variables such as bank size, liquidity, assets quality and managerial efficiency don't have any significant impact on the profitability of commercial banks in Sri Lanka. The finding of this study provides information to present and future investors for making the best decision on which internal factors should be well analyzed when they make investments on the banking sector in Sri Lanka.

Key words: *Bank Internal Factors, Profitability, Capital Adequacy, Operating Cost efficiency, Non-performing loans.*