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Impact of Income Diversification on Bank Performance: Evidence from Licensed Commercial Banks in Sri Lanka

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ABSTRACT

Purpose: To diversify their sources of income, banks have started additional operations, such as brokerage, investment banking, and the underwriting and trading of securities. Non-interest income is regarded as an essential source of bank diversification, and it refers to a bank's earnings that are not derived from interest payments on deposits, loans, or investments. The purpose of this study is to look into the impact of income diversification on commercial bank performance in Sri Lanka.

Design/methodology/approach: Ten licensed commercial banks were chosen based on the most significant market capitalization and data availability. Secondary data was collected covering the period of the year 2011 to 2021. Quantitative research techniques and a deductive methodology were used. Return on assets and return on equity are performance measures, while the diversification index measures income diversification, and panel data regression is used fro data analysis.

Findings: findings revealed that income diversification has a perfect impact on bank performance in Sri Lanka (ROA and ROE). Both bank size and ROE significantly influence the performance of banks in both ROA and ROE models. Financial leverage significantly increases ROA while having a negligible effect on ROE. However, the impact of growth rate and lending strategy on bank performance is minimal. Finally, the findings show that income diversification significantly improves bank performance.

Originality: To improve overall aims and objectives and eventually improve bank performance, the banking industry can use the findings of this study as a guide.

Keywords: *Income Diversification, Bank Performance, Diversification Index, Return on Assets, Return on Equity*