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Determinants of Non- Performing Loans in the Banking Sector: Evidence from Sri Lanka

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ABSTRACT

Purpose: In Sri Lankan context, Non-Performing Loans of banks have significantly increased during last few years due to the pandemic, and it has bad effect on bank performance. Non-performing loans have a negative impact on banks' profits directly. Therefore, this study aims to identify determinants of non-performing loans and banking sector taking evidence from Sri Lanka.

Design/Methodology/Approach: The sample of the study consists of 10 banks as included CSE main board in Sri Lanka. 10 years from 2012 to 2021 was used as the period for data collection. All the collected data were analyzed using STATA software, which included statistical tests such as multicollinearity, normality, and panel regression analysis.

Finding: The findings show that return on equity ratio had a statistically significant negative relationship with the dependent variable (non-performing loans). while other variables (capital adequacy ratio, loan to deposits ratio, return on assets ratio, public debt as % of GDP, Annual average inflation rate, interest rate) are statistically insignificant. Also, the control variable firm size is statistically insignificant. Hence, banks should focus more on these dimensions while making a concerted effort to reduce non-performing loans.

Originality: This study considers the pandemic period and it's a novelty in this research.

Keywords: *NPL, Return on Assets, Return on Equity, Capital Adequacy Ratio, Loans to Deposit Ratio*