

Empirical Study on Bank Profitability and Efficiency in Sri Lanka

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Abstract

In this study, analysis the efficiency and profitability of Sri Lankan banking industry from 2010-2014. It uses a non-parametric approach, the data envelopment analysis (DEA) to measure bank' efficiency to analyze the technical efficiency of the Sri Lankan banks. This research has used only secondary data for the purpose of analysis and the sources of data include the annual publications of the Central Bank and the annual reports of listed domestic commercial banks and listed foreign commercial banks. In order to obtain yearly figures of listed commercial banks this study have selected fourteen domestic commercial banks and two foreign commercial banks. The reason behind the selection of the banking industry in Sri Lanka is mainly due to the reasons of competition among the banking sector and the key role they play in the country to protect the stability of the financial system. The efficiency of the banking industry is important when determining stability of the payment and settlement system of the economy. Therefore, objective of the study is to find the efficiency of the banking industry by using DEA as a new approach for measuring efficiency. The problem of the study is to find whether profitable banks are efficient. Results indicate that banks are operating at a higher level of efficiency recording an overall technical efficiency of 84.46 percent. In accordance with the regression result, there is a positive relationship between bank profitability, efficiency and loan diversification factors.

Keywords: *bank efficiency; data envelopment analysis; Profitability; technical efficiency; Banking industry.*