The Impact of Risk Management on Firm Profitability: With Special Reference to the Commercial Banks in Sri Lanka

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ABSTRACT

Introduction: Banks are crucial to the sustainability of any economy, because they facilitate business, trade, and the efficient deployment of idle funds. Banks also play an important role in implementing government monetary policies. However, banks' incapacity to satisfy their intermediation commitments exposes the financial system to some risk. Thus, this study aims to identify the effect of risk management on firm profitability in Commercial banks in Sri Lanka.

Design/Methodology/Approach: The research population is commercial banks in Sri Lanka and the study covered a period of 10 years from 2011 to 2020. Based on the market capitalization and relevance to the Sri Lankan context, 12 Domestic Licensed Commercial Banks were recognized as the sample for this study. Return on Assets and Return on Equity were utilized to assess financial performance in the study. Nonperforming advances, net interest income to total assets, loan to deposit and cost to income ratios were used to measure the impact of credit risk, market risk, liquidity risk and operational risk respectively. Further, descriptive statistics, correlation and regression analyses were applied to analyze the data

Findings: According to the regression Analysis all independent variables had a significant impact on commercial banks' financial performance except Loan to deposit ratio which represent the Liquidity risk. It had a positive insignificant impact on ROE. Moreover, still the same variables show a significant positive impact on ROA.

Conclusion: According to the findings, banks should strike a healthy balance between financial risk management methods and financial performance by employing appropriate market, credit, liquidity and operational risk management practices that will protect their banks' safety while also yielding positive profits.

Keywords: *Financial Performance, Credit risk management, Liquidity risk management, Market risk management, Operational risk management*