The Effect of Credit Risk Management on Financial Performance of Commercial Banks in Sri Lanka

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Abstract

Risk management is most important part of the financial institutions. Credit risk management is major part of the overall risk management for the worldwide financial institution. This study analyzed the impact of credit risk management on financial performance of commercial banks in Sri Lanka. And also attempted to establish if there exists any relationship between credit risk management and financial performance of commercial banks in Sri Lanka by using CAMEL (capital adequacy ratio, Asset quality, management efficiency, earning, and Liquidity coverage ratio). This research was facilitated by the use of secondary data which was published by commercial banks in Sri Lanka. This study used multiple OLS Regression to analyze the data. Accordingly, it was found that there is an impact of the credit risk managements on the financial performance of commercial bank in Sri Lanka. More specifically, Capital adequacy and Management efficiency have negative significant relationship with financial performance of state commercial banks in Sri Lanka. Asset quality has a positive relationship with financial performance of Sri Lankan commercial banks and Earning and Liquidity have positive significant relationship with financial performance. Finally, this study concludes CAMEL model can be used as a proxy for the credit risk management.

Key words: *Return on Equity (ROE), Capital Adequacy Ratio, Asset Quality (Non-Performing Loan Ratio), Cost to Income Ratio, Return on Asset, Liquidity Coverage Ratio*

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