

# **The determinants of Finance Companies' profitability in Sri Lanka**

**By**

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**A research submitted to the University of Sri Jayewardenepura in  
partial fulfillment of the requirements for the Degree of Master  
of Business Administration (Finance)**

The work described in this research was carried out by me under the supervision of Prof. W.M.A.Bandara and a report on this has not been submitted in whole or in part to any university or any other institution for another Degree or Diploma.



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M.Suthakar

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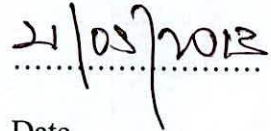
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I certify that the above statement made by the candidate is true and that this research is suitable for submission to the University for the purpose of evaluation.



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Prof. W.M.A.Bandara



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# **The determinants of Finance Companies' profitability in Sri Lanka**

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## **ABSTRACT**

In this study, balanced panel data sets of Sri Lankan Finance Companies were used to investigate the firm specific (endogenous) and macroeconomic (exogenous) determinants of profitability of Finance Companies using the random effects model. For this purpose 130 observations of 26 Finance Companies (out of 43) over the period 2008 – 2012 were included. Return on Assets was considered as a measure for profitability of Finance Companies and Return on Equity was considered as an alternative measure. Capital, Assets Quality, Size, Overhead expenses Management, Composition of loans and advances, Liquidity, Public Deposits and Noninterest income are considered as endogenous factors whereas Interest rate, GDP growth rate and Inflation rate are considered as exogenous factors. The result shows that Capital, Size, Composition of loans and advances, Noninterest income have a positive and significant impact on finance company profitability. However Non performing loans (proxy for asset quality) have a negative and significant impact on profitability. With regard to exogenous variables, GDP growth has significant positive influences on profitability. Based on these findings, this study recommends maintaining healthy capital ratios, concentration on asset quality, improving size with diversified branch networks, investing more on loans and advances and involvement of fee based activities that will enhance the profitability positively.

Further research on impact of Finance Companies' profitability with Management Quality, Corporate Governance and Risk Management will not only add value to explaining profitability of Finance Companies but also add value to the academic literature.

**Keywords:** Financial institutions, Sri Lankan Finance companies' profitability, firm specific factors, macroeconomic factors, panel data

## **ABBREVIATIONS**

ASPI	All Share Price Index
BCBS	Basel Committee on Bank Supervision
CAR	Capital Adequacy Ratio
CBSL	Central Bank of Sri Lanka
CCPI	Colombo Consumer Price Index
CEO	Chief Executive Officer
COIN	Cost to Income Ratio
CSE	Colombo Stock Exchange
DETA	Deposits to Total Assets
DIS	Sri Lanka Deposit Insurance Scheme
EQTA	Equity to Total Assets
EVA	Economic Value Added
GDP	Gross Domestic Product
GMM	Generalized Method of Moments
ICASL	Institute of Chartered Accountants of Sri Lanka
IMF	International Monetary Fund
INF	Inflation Rate
INT	Interest Rate
IPO	Initial Public Offer
LATA	Loans and Advances to Total Assets
LCB	Licensed Commercial Bank
LFC	Licensed Finance Company

LSB	Licensed Specialized Banks
NBFI	Non Bank Financial Institutions
NCBFI	Non Commercial Bank Financial Institutions
NIITA	Non Interest Income to Total Assets
NIM	Net Interest Margin
NPL	Non Performing Loans
OLS	Ordinary Least Squares
RAROC	Risk Adjusted Return on Capital
RFC	Registered Finance Company (Now known as LFC)
ROA	Return on Assets
ROE	Return on Equity
SEC	Securities and Exchange Commission of Sri Lanka
SLC	Specialized Leasing Company
VAT	Value Added Tax
VIF	Variance Inflation Factor