

**“AN ANALYSIS OF THE BANK SPECIFIC FACTORS AFFECTING
THE NON PERFORMING LOANS IN COMMERCIAL BANKS IN
SRI LANKA”**

BY

**Sathasivam Karthikasan
(5266FM2013034)**

**A Research submitted to the University of Sri Jayewardenepura in partial
fulfillment of the requirements for the Degree of Master of Business**

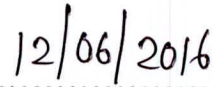
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The work described in this Research was carried out by me under the supervision of Dr.P.J.Kumarasinghe and a report on this has not been submitted in whole or in part to any university or any other institution for another Degree.



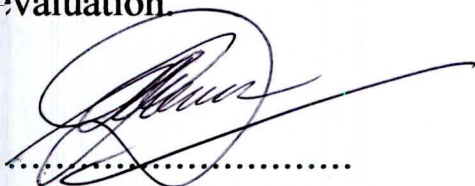
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Sathasivam Karthikasan



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certify that the above statement made by the candidate is true that the
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evaluation.



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Dr.P.J.Kumarasinghe

14.06.2016
.....

Date

Acknowledgment

I have intended the title “An analysis of the bank specific factors affecting to the non performing loans commercial bank, Sri Lanka. As a research study and I submitted to the Faculty of Graduate Studies, University of Sri Jayewardenepura, Sri Lanka in partial fulfillment for the Master of Business Administration (MBA) Degree.

First I thank the god for his gracious help and bless in completing my research work satisfactorily. I wish to convey my sincere thanks and heartfelt gratitude in the first instance to supervisor and coordinator of MBA/MPM/M.Sc. Programme, Dr.P.J.Kumarasinghe Senior Lecturer, University of Sri Jayewardenepura for his generous and untiring efforts extended to me in all phase of the preparation of this research study. He spent several patient and valuable time, with his unhesitant help and valuable suggestions, which no doubt resulted in my successful completion of this book.

I thank Senior Professor (Mrs.) Swarna Piyasiri, Dean, Faculty of Graduate Studies, University of Sri Jayewardenepura. This needs delicate handling and a sense of righteousness.

I express my gratitude to the employees of Commercial bank who have answered the questionnaires properly. I wish to thank the staff of Library, computer unit who helps me to prepare this study.

More ever, I gratitude to my family and friends immensely given support, and me the necessary moral strength that made by research study quite pleasant. I also wish to thank each and every one who has helped in numerous ways to carry on my research smoothly and make the study a great success.

Abstract

Banks role in the economy of any country is very significant. They play intermediation function in that they collect money from those who have excess and lend it to others who need it for their investment. Availing credit to borrowers is one means by which banks contribute to the growth of economics. The principal profit-making activity of commercial banks is making loans to its customers. In allocating funds, the primary objective of bank management is to earn income while serving the credit needs of its community.

NPLs create problems for the banking sector's balance sheet on the asset side. They also create a negative impact on the income statement as a result of provisioning for loan losses. In the worst scenario, a high level of NPLs in a banking system poses a systemic risk. The main objective of the research was to find out the bank specific factors affecting of Nonperforming loan in Commercial bank, Sri Lanka.

The target population comprised a total of 25 Licensed Commercial banks out of which a sample of 10 and 100 employees was using stratified simple random sampling. The data was collected by use of self developed questionnaire issued to the Credit manager, Loan officers and executives. The data was analyzed by using statistical software (SPSS 16) and tabulated by use of tables and figures. The findings revealed, some bank specific factors maximize reflect in case of nonperforming loans.

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CHAPTER 1

INTRODUCTION

1.1 Background

Banks role in the economy of any country is very significant. They play intermediation function in that they collect money from those who have excess and lend it to others who need it for their investment. Availing credit to borrowers is one means by which banks contribute to the growth of economies.

Lending represents the heart of the banking industry. Loans are the dominant asset and represent 50-75 percent of the total Amount at most banks, generate the largest share of operating income and represent the banks greater risk exposure (Mac Donald and Koch, 2006). Moreover, its contribution to the growth of any country is huge in that they are the main intermediaries between depositors and those in need of fund for their viable projects (creditors) thereby ensure that the money available in economy is always put to good purpose.

Therefore, managing loan in a proper way not only has positive effect on the banks performance but also on the borrower firms and a country as a whole. Failure to manage loans, which make up the largest share of banks assets, would likely lead to the episode of high level of non - performing loans.

According to the International Monetary Fund (IMF, 2009), a non- performing loan is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 days' worth of interest has been refinanced on the other hand the Basel Committee¹(2001) puts non performing loans as loans left unpaid for a period of 90 days.

1.2 Problem Statement and Justification

Financial sector in Sri Lanka is dominated by banking enterprises. In 2013, the banking sector comprised with 33 licensed banks with 12 foreign Licensed Commercial Banks (LCBs) and 21 domestic banks which include 9 licensed specialized banks and 12 local LCBs (CBSL, 2014).

The banking sector accounted for about two third of the total assets of the financial system in 2013. Therefore, the strength of the financial system in Sri Lanka to a greater extent dependent on

the soundness of banking institutions. During recent decades, many countries have witnessed banking crises. These crises have a bad impact on the economy. In addition, banking crises have significant cost. Fonseka (2009) conducted a comparison of NPLs in Bangladesh, Indonesia, Philippines, Malaysia, Thailand and Sri Lanka. Results revealed that Sri Lanka's performance is only better than Bangladesh. As World Bank (2013) explained, Sri Lanka account for moderately high NPL ratio among Asian countries except Bhutan and Pakistan. Low asset quality of Sri Lankan commercial banks is more emphasized when compared that with the developed countries. As to World Bank (2013) Australia, United Kingdom, Canada, New Zealand and Sweden account for less than 2 percent of NPLs in their commercial banking industry. Sri Lanka has experienced a distressed situation in number of commercial banks by recording high NPLs showing the early indicators of problematic bank practices which could have lead to bank failures. According to Central Bank of Sri Lanka (CBSL) by end of year 2013 gross NPL ratio of the country increased to 5.6 percent. The amount of total NPLs of Sri Lankan commercial banking sector is Rs 191 billion.

It's on this basis that this research was conducted to find the bank specific determinants of NPL in Sri Lanka.

1.3 Objectives

- To identify the Bank Specific factors which are influencing the Non performing loans in Commercial banks, Sri Lanka.
- To rank the factors based on their importance.
- To analyze the relationship between Bank specific factors and Non performing Loans

1.4 Research Questions

- What are bank specific factors influencing the Non performing loans in Commercial banks?
- What are the relationship between Bank specific factors and Non performing Loan?