

The Efficiency of the Licensed Domestic Commercial Banks
In Sri Lanka

By

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“The work described in this thesis was carried out by me under the supervision of Mr 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/Diploma”.



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



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LIST OF ABBREVIATIONS

BCC	Banker-Charnes-Cooper
CCR	Charnes-Cooper-Rhodes
CEF	Cost Efficiency
CRS	Constant Returns To Scale
DEA	Data Envelopment Analysis
DFA	Distribution Free Approach
DMU	Decision Making Unit
LCB	Licensed Commercial Bank
NIRS	Non-Increasing Returns To Scale
QRA	Quantile Regression Analysis
ROA	Return On Assets
ROE	Return On Equity
SFA	Stochastic Frontier Approach
SLAS	Sri Lanka Accounting Standard
PAT	Profit After Tax
VRS	Variable Returns To Scale

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ABSTRACT

As per the Central Bank Annual Report of 2007 there are 11 domestic licensed commercial banks operating in Sri Lanka. Over the last five years the banking Industry has been recording significant levels of growth in terms of profitability. Profits have been made irrespective of the size of the bank or the ownership type of the bank. But a question remains whether the profits made are as a result of the increased efficiencies or whether the profits are made in an inefficient manner.

There is a large gap in terms of the literature that is available with respect to efficiency of Domestic Licensed Commercial Banks in Sri Lanka.

In measuring the efficiency of the domestic licensed commercial banks a non-parametric frontier based efficiency measurement approach known as Data Envelopment Analysis (DEA) is utilised together with the widely used traditional ratio analysis in this study. The input-oriented DEA model constructed consisted of two outputs, interest income and non-interest income and three inputs labour, capital and interest bearing liabilities. The traditional ratios used in the study are Return on Equity, Return on Assets, Efficiency Ratio and an Employee Cost Ratio.

While profitability has increased over the period 2003-2007, there was no statistically significant relationship found between efficiency and profitability.

The maximum number of banks on the efficiency frontier for a particular year was two.

The result showed that there are no significant differences between the efficiency levels of the individual banks. The mean efficiency of a individual bank for the period under study was at its lowest at .73720 and was at its highest at .99180.

It was found that there are efficiency level differences between the larger banks and the smaller banks. The mean efficiency of Small banks is 7.79% above the mean efficiency level of the larger banks. The result obtained also showed that the efficiency level of the privately owned banks were higher than the efficiency level of the Government owned banks. The mean efficiency of private banks is 9.62% above the mean efficiency level of the government banks.

The results of DEA indicate that the licensed domestic commercial banks could improve their cost efficiency by 16% on average. It was also found that the dominant source of cost inefficiency is allocative rather than technical. Allocative inefficiency is 8.7% while technical inefficiency is 8.3% on average. The magnitude of the difference is however a small difference.

No significantly high relationship was found between the DEA efficiency measurements and the traditional ratios.