

Factors Influencing the Efficiency of Commercial Banks in Sri Lanka

Samangie Bandaranayake
Prabhath Jayasinghe

Abstract

The important status of the commercial banking sector in the financial environment of the economy has encouraged the researchers to inquire into the determinants of bank efficiency. This study focuses on two aspects related to bank efficiency in Sri Lanka. One is to identify the influence of bank-specific and operating environment factors on bank efficiency. The second is to find whether the ownership types of banks matter in explaining bank efficiency. To this end, two efficiency measures have been employed: Net Interest Margin (NIM) and Return on Assets (ROA). The selected sample consists of fourteen licensed commercial banks. Based on the data during the sample period 2001 – 2011, the estimation of parameters has been done using the random effect panel data approach. There are a few important findings. First, the estimation results associated with the two efficiency measures are somewhat different. Second, except for a few cases, we observe the expected sign of the parameters. Third, the determinants of efficiency vary across the ownership type of the banks. Fourth, in terms of the significance of the proposed determinants, ROA is a more suitable efficiency measure for state banks while NIM is a better measure for private and foreign commercial banks. Finally, there is a tendency for operating environmental factors becoming significant when efficiency is measured in terms of NIM, and bank-specific factors are more important in explaining efficiency when ROA is selected as the proxy.

Key words: bank efficiency, commercial banks, bank-specific factors, operating environment factors, net interest margin, return on average assets.

Ms. S U K Bandaranayake is a Lecturer in the Department of Finance, Faculty of Management & Finance, University of Colombo, Sri Lanka. E-mail:samangibandaranayake@yahoo.com

Dr. Prabhath Jayasinghe is a Senior Lecturer in Business Economics in the Faculty of Management & Finance, University of Colombo, Sri Lanka.