Impact of Financial Risk Management on the Financial Performance of Licensed Commercial Banks in Sri Lanka

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Abstract

Risk management and financial performance are closely interconnected with each other. In Sri Lanka, the economic crisis after the pandemic situation led to an unpredictable decline in both return on assets and return on equity. The purpose of this study is to investigate the impact of financial risk management on the financial performance of licensed commercial banks in Sri Lanka. The research was conducted based on secondary data which was gathered from annual reports of relevant banks and sample covered only thirteen licensed commercial banks for the period from 2014 to 2023. Altogether 130 observations were taken in this study. Furthermore, financial risk management was measured by credit risk, liquidity risk, market risk and operational risk while the proxies of financial performance are return on assets and return on equity. Bank size and leverage have also been considered as control variables. Descriptive statistics and inferential statistics including correlation and panel data regression analysis were employed in this study. The findings reveal that credit risk harms financial performance while liquidity risk and operational risk have a negative impact on return on assets. Moreover, market risk positively impacts on return on equity. The study recommends that banks should have a close eye on monitoring financial risk as it is associated with financial performance and the government should formulate appropriate policies and procedures regarding risk management to enhance the economic value of the country.

Keywords: Commercial banks, Financial performance, Risk management, Return on assets, Return on equity