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THE IMPACT OF NON PERFORMING LOAN ON PROFITABILITY OF DOMESTIC LICENSED COMMERCIAL BANKS IN SRI LANKA

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ABSTRACT

Non-performing loans is the single most important threat that a bank can face. It is weighted against the total portfolio of all loans and advances to assess its magnitude. Non-Performing Loans have a direct impact on profitability of banks. This study also examines the impact of non-performing loan on profitability of domestic licensed commercial banks in Sri Lanka over a period of past 9 years 2006 to 2014.In this study, Nine domestic licensed commercial banks have been selected on random sample for the purpose of data analysis and Secondary data has been collected to analyze and draw conclusions and recommendations. Hypotheses are examined with help of Pearson's correlation and regression analysis. This study considers non-performing loan ratio as independent variable and return on asset and return on equity as dependent variables. Firm size is a control variable. Data was collected from domestic licensed commercial banks' annual reports, journals and websites. The result of this study has shown that non-performing loan has negative relationship with profitability of domestic licensed commercial banks. So Managers of domestic licensed Commercial banks in Sri Lanka have to work hard to enhance profitability of commercial banks and reduce occurrences of nonperforming loans.

Keywords: *Commercial banks, Non performing loan, Profitability, ROA, ROE*

1. INTRODUCTION

A nonperforming loan (NPL) is the sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. Non- performing loans are also commonly described as loans in arrears for at least ninety days (Guy, 2011). A nonperforming loan is either in default or close to being in default. It is a very critical but frequent issue in bank fund management. It is regressed on three sets of factors in terms of credit, banks size induced risk preference and macroeconomic shocks. The loan performance is put into relation with macroeconomic indicators such as nominal interest rate, inflation rate, change in real GDP, economic growth, unemployment, and the change in terms of trade. One of the problems of such approach, taking macroeconomic variables as exogenous is that they are concurrently affected by a distress in the banking sector. (Foglia, 2008)

A nonperforming Loan is a credit facility in respect of which the interest and or principal amount has remained past due for a specific period of time. Quality of assets in lending technologies is normally measured by the quantum of non-performing loans and has

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