

**Determinants of Non-Performing Loans in Sri Lanka: Evidence from
Licensed Commercial Banks**

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Abstract

A high level of non-performing loans can lead to inefficient financial intermediation and affect the economy as well. Although banks can't eliminate non-performing loans, when dealing with the lending process, it is important to manage the non-performing loan level within the financial system. Hence, it is vital to identify the determinants of these non-performing loans. This study has identified ten significant determinants through literature review and analyzed their relationship and impact on nonperforming loans. According to empirical evidence, under bank-specific factors, five variables have been identified, including the size of the bank, loan growth, return on assets, net interest margin and capital adequacy ratio. Macroeconomic factors include interest rate, export growth, gross domestic production, inflation growth and unemployment. This study uses a quantitative approach and uses secondary data, and the selected sample consists of 10 licensed commercial banks which are considered to be listed domestic banks in Sri Lanka. The study employed panel data for the period of 2011-2020, and EViews 8 statistical software

package has been used to analyze the data. The relationship and impact were measured by correlation and regression analysis. This research has identified bank size and return on assets under microeconomic variables and export growth and gross domestic production under macroeconomic variables as the significant determinants of nonperforming loans in Licensed commercial banks of Sri Lanka and other variables such as loan growth, net interest margin, capital adequacy ratio, interest rate, inflation growth and unemployment were not significant. Hence, Licensed Commercial banks can pay more attention to bank size, return on assets, export growth and gross domestic production and formulate strategies to maintain their non-performing loan ratio at an acceptable level that will ensure the stability of the banking system.

Keywords: *Nonperforming loans, Microeconomic variables, Macroeconomic variables, Licensed commercial banks, Credit risk*

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