

Investigation Credit Risk Management Practices and Financial Performance of Commercial Banks in Sri Lanka

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Abstract

The financial system in Sri Lanka is one of the rapidly booming sectors in Sri Lankan economy. It comprises different aspects and financial institutions. This research investigate the relationship between credit risk management and banks performance. The set objectives were the following; to examine what extent credit risk management and bank financial and to identify the relationship between credit risk management and bank financial performance. The performance to find out problems faced by credit risk managers of BOC in managing credit risk and to evaluate the relationship between credit risk management and financial performance of BOC. This study is expected to be significant to all Sri Lanka banking sectors, university of Jaffna, future researchers and the general public and the specially banking sector in Sri Lanka. The study used BOC Ampara area branch and 20 branch as a sample to represent other commercial banks in Sri Lanka. Out of 170 staff of Ampara area branch the researcher took a sample of 50 respondents to represent others. Primary data was obtained by extracting information from questionnaires designed and provides to the staff to get answers from different respondent composed of BOC staff from different level.

The researcher used a descriptive and analytical research based on both qualitative and quantitative data. Secondary data were collected from annual reports, books, journals, newspapers and internet materials. In research data is presented in form of tables, while analysis and interpretation were based on frequencies and percentages and correlations table. The research found that BOC has a credit management system though it needs to be reviewed and adopted more to current Sri Lankan environment. The research found that there is a direct relationship between credit risk management and financial performance of commercial banks. The research recommended that BOC should review and improve its credit policy and adopt it to Sri Lankan market and context and BOC should provide continuous training and updates to its staffs and BOC also should be market orientation.

Keywords: Credit risk management • Bank performance • Credit risk • Econom

Introduction

This research aim at investigation the effect of credit risk management practices on financial performance of the Sri Lankan commercial banks at the current situation. Banks are exposed to different types of risks, these banks has primary goal is to maximization of the shareholders value. Credit management practices, credit risk is one of the most significant risks that banks face, considering that granting credit is one of the main sources of the income in a bank. There for credit risk management is most important factor for consider. Cash flows are related to the loan process that effect on the bank operations because the main income sours is the loans. In a Sri Lanka has bank products can be catagiose micro credit and development loans and other loans. Then every banks have to consider to particular credit management practices. Commercial banks are in the risk business in the related of business process has a various kinds of risks such as operational,

interest rate risk, liquidity risk, legal risk and the credit risk. As a government sector bank they have 70 years old experience of the financial intuition of the market. BOC is one of the commercial banks operating is Sri Lanka and it is exposed to credit risks, the aim of the research study is to investigate the correlation between proper credit risk management by BOC and its income in the period of year 2010-2016 [1].

Credit risk was the major reason for the huge banking crisis that bank had to face. This was due to the banks are getting involved in credit operations without fully analyzing the customer and also without having diversifying their credit operations properly. As a result of that, bank had to face a huge war few years back in the Sri Lanka. With the involvement of the government through the regulatory mechanism, government stabilized the economy up to some extent in Sri Lanka. With the development of financial market, banking sector gets more complex and they have more concern on risk management practices. With this government, tries to stabilize

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the banking sector through the regulatory mechanism. In a bank has credit risk its should be get to the accountability of the their aim of the maximization of the shareholders wealth, main business is the in a bank credit process if the more has it will be effect on the performance. This research want to investigate to the find the relationship between the credit risk management and bank financial performance of commercial bank, and the however extent to the which way the impact on that credit risk practices for performance. Following research questions are answerable to the as a research questions [2].

Research questions

- How does BOC apply credit risk management system?
- What are the actual problem face by credit risk officers of BOC?
- What is the relationship between credit risk management and financial performance of BOC?

Objectives: The main objective is to investigate the relationship between credit risk management and bank financial performance of commercial banks. Flowing below other objectives as use to the research.

- To investigate how to apply credit risk management in BOC.
- To find out the relationship between credit risk management and financial performance of BOC.
- To find out the actual problem face by the credit officers?

Research design: A research design is to decide of conditions of collections and analysis of data in a manner that aims to combine relevant data to the research purpose with economy in procedures. It is a conceptual structure within which research is conducted and base on the primary data preparing questinnaring and distribution to them and getting the answer and put the data sheet. The researcher used a case of BOC bank was selected to represent other commercial banks in Sri Lanka. This was selected because of its most close to the customers and wide area in the country [3].

The researcher used judgmental sampling in which BOC is the representative of the population of interest within the customers and the information were generally based on perception that it would give better indications of the futures patterns of credit risk management. Qualitative methodology was used to make a causative analysis of effectiveness of credit risk management towards financial performance of commercial banks in Sri Lanka. Quantitative

methodology were used to collect and assess the extent to which BOC uses appropriate techniques and tools to manage risks in their daily operations. Use to the population as to the 150 staff and whole the 15 branches. The ampara area most close bank is the customers this area, from that population fifty responds was consider. Especially credit officers, branch managers and assistant managers, executive officers are consider the questionnaires. Sampling random sampling selected [4].

Material and Methods

Data collection

The main sources of data is collected both primary and secondary sources of information. Primary data collect from the staff using the questionnaires and the interviews, nest secondary data collected annual reports and prospective reports books. Then research going to the design is both quantitate and qualitative as investigate.

Questionnaires

Questionnaires is structured were designed in the Sinhala medium and English medium The questionnaire was consisted with open questions which were used to obtain the detailed information on the study and closed open ended and closed ended or unstructured questions to get short and precise responses from the respondents on the same issue [5].

Results and Discussion

Interview

An interview was used to help the researcher capture all the required information by providing any clarification during the discussion because the at that situation researcher in the internship trainee purpose of the degree fulfilment and it also helped the researcher to seek more explanations on some matter where the written answer may not be very clear. The interviewer took a single interviewee at a time and base on the research most value of their ideas, while recording the information on ready to paper for each question that was asked (Tables 1 and 2) [6].

Item	Strongly agree	Agree	Don't know	Disagree	Strongly disagree
Scale	5	4	3	2	1

Table 1. Data measurement.

Range years	Frequency	Percentage
20-30	5	10%
31-40	30	60%
41-50	9	18%
51-60	6	12%
60 above	0	0

Table 2. Data analysis and presentation.

Researcher provide the data in such a way that it answered the research questions and met the objectives under study. The logical arrangement of findings from general information to specific information to meet objectives was a major researcher's concern.

Most staff responds contacted were found to be male 68 of the responders and rest of 32 is females. BOC staff consists of peoples differ to the various age group but 10% were aged below 30 years and the most peoples representing 60% of its staff is between 31-40 years old, 10% were between 41-50 and 6% were between 51-60 years old (Table 3) [7].

Educational level	Frequency	Percentage
Masters level (MBA)	10	20%
Degree level	31	62%
Diploma level	5	10%
A/L	4	8%
Others	0	0
Total	50	100

Table 3. Responders staff educational level.

The higher percentage is 62% its belongs to the degree level representing staff members. BOC have the management trainee system they are mostly management degree qualified and second

upper or first class obtain, 20% of staff are master level completed staff. And the BOC having 10% diploma stream that's is related to the DBF (Diploma in Banking and Finance) banking sector qualifications. Others of 8% was selected responds (Table 4) [8].

Experience	Frequency	Percentage
0-5	11	22%
6-10	35	70%
11-20	4	8%
Above 21	0	0

Table 4. Responder's staff with experience.

The responders more experience mean 70% staff is 6-10 years range. 22% is staff 11 are responds, 11-20 range staff responds,

as to the only 8% (Table 5).

Alternatives	Frequency	Percentage
Strongly agree	50	100%
Agree	0	0
Don't know	0	0
Disagree	0	0
Strongly disagree	0	0

Table 5. Confirm of the credit risk management process at BOC.

Staff confirm the there is the strong credit is management practices having of them. They ensure the 100% because the loans

are granted and facilities by them. It's done on the most carefully they know it (Table 6).

Alternatives	Frequency	Percentage
Strongly agree	0	-
Agree	24	48
Don't know	5	10
Disagree	13	26
Strongly disagree	8	16

Table 6. Appropriateness of credit risk management process.

This table is the summary of staff responded about the appropriateness of the credit risk management process of BOC. 48%

of the responders accepted they have risk minimize system having of them (Table 7).

Alternatives	Frequency	Percentage
Strongly agree	30	60%
Agree	14	28%
Don't know	0	0
Disagree	6	12%
Strongly disagree	0	0

Table 7. Impact of non-performing loans to credit risk management.

As con irm by 88% further the increment of nonperforming loan rate is directly caused by lower credit risk management process of

BOC but 60% accepted that credit risk management is the major cause. And the agree level also 28% was represented (Table 8) [9].

Alternatives	Frequency	Percentage
Strongly agree	25	50%
Agree	10	20%
Don't know	0	0
Disagree	10	20%
Strongly disagree	5	10%

Table 8. Financial performance of BOC.

This table showing that 70% (50%+20%) responds and con irm BOC gain last ten years made a pro it as strongly. But they didn't satisfy the proportional to total assets it has investigate compare with

assets not much the profit. This for analysis secondary data using spss software and imprecated data as to using the correlation analysis (Table 9) [10].

Correlations		NPL	Profit
NPL	Pearson correlation	1	0.438
	Sig. (2-tailed)	-	0.461
	N	5	5
Profit	Pearson correlation	-0.838	1
	Sig. (2-tailed)	0.461	-
	N	5	5

Table 9. Last ive years pro it and NPL.

The rate of correlation is 0.838 which means that here negative correlation between the NPL and finance performance of the commercial banks. This correlation was confirm by the primary data

also 70%, staff has answered for above questions that there is a directly relationship between financial performance of BOC and the credit risk management (Table 10).

Alternatives	Frequency	Percentage
Strongly agree	20	40%
Agree	30	60%
Don't know	0	0
Disagree	0	0
Strongly disagree	0	0

Table 10. Positive relationship between financial performance and risk management at BOC.

As them confirmed by 100% of the respondents, if the credit management is impact NPLs will increase and provision will also increase leading to decrease in pro its (Table 11) [11].

Alternatives	Frequency	Percentage
Strongly agree	20	40%
Agree	25	50%
Don't know	5	10%
Disagree	0	0
Strongly disagree	0	0

Table 11. Implementation of credit process at BOC impact on financial performance.

As the staff confirm 90% of responds the impact at effective process of credit risk management affects performance of commercial banks.

Problem faced by the credit officers

Respondents staff different issues that they face in their work of credit management. Some of problems are the following:

- Not much of skill for some of credit officers
- Customer not much of more securities for loans
- Credit analysis problem

Total overall data analysis

Data analyzed was extracted from primary data gathered using questionnaires and secondary data got from different reports and each banks notice board financial reports. Its presentation was guided by the research question and objectives. BOC is dominated by male staff with the average of 68% of the respondents; the reason for male dominance was explained that credit management job

consists of more field work and men a good at field work than women. The employees of BOC Ltd are dominated with people ranging from 31-40 years old which is an advantage as this is good time for everyone to work with more strength. It was revealed that BOC has qualified personnel with management, degree and all these staff the study found that most of them are experienced in the domain. And they confirm the there is negative correlation between the credit risk management and bank financial performance. When the NPL increase its impact on the performance. Because the negatively adjusted to the profit at the relevant losses, therefore NPL will increase profit will decrease. Profit that 70% (50%+20%) responds and confirm BOC gain last ten years made a profit as strongly [12].

Results and findings

This part presents the summary of the research findings in line with the objectives of the research. The findings are in relationship to credit risk management and profitability of commercial banks in Sri Lanka specifically BOC. Major findings of the study are summarized in the following table which are organized according to the objectives of the study (Table 12).

Research objectives	Results	Remarks
To investigate how to apply credit risk management in BOC	As confirmed by 100% of the respondents BOC has a credit policy which was set to manage and mitigate credit risk while increasing the profitability of the bank, so it is certain that the bank has a credit risk management system	95% significance
	The issue of causes of continuous increase of NPLs in BOC, 88% of the respondents answered that this increase is caused by many factors including credit risk where as 12% answered that the major cause of this increase of NPLs is weak credit risk management. So it is very necessary to underline the importance of credit risk and others factors in increasing the non-performing loans rate	
	According to findings BOC has been making profits for the last three years. This has been confirmed by 70% of the respondents	

	but the remaining 30% confirmed that even though the bank has been making profits but this profit was not proportionate of the bank's portfolio and assets	
To find out the relationship between credit risk management and financial performance of BOC	Primary and secondary both data results showing the negative relationship between profit and financial performance And the correlation table showing the negative correlation between NPL and performance has relationship NPL is decrease profit will increase that relationship showing the correlation analysis	80% significance
To find out the actual problem face by the credit officers?	Not much of skill for some of credit officers Customer not much of more securities for loans Credit analysis problem	Actual problem identify the interview by them

Table 12. Study findings.

Conclusion

The data interpretation of collected data during the course of the study, the researcher came up with the following conclusions and discuss with the by the interview. BOC has put in place a credit process to guide all staff involved in loan granting, but it needs to work on it once again and make sure that the policy is convenient and fit for Sri Lanka banking sector. The researcher further concluded that there is a direct relationship between credit risk management and performance of the bank, so as a profit oriented organization BOC must improve on the available mechanisms of minimizing risks in order to make more profits. And the most implementation of the credit risk management. When the credit risk management major function of the compare with other risks. It was related to that some of the causes of a gradually increase of NPL are out of the control of credit officers so those causes constitute problems faced by credit officers which need to be investigate to enable them perform their work as it is supposed. This is one of the bank Sri Lanka but its showing overall banks. Credit risk management has positively impact on the performance. Managers have to consider credit risk management over the achieving goals.

Recommendations

- BOC should review and improve its credit policy and adopt it to Sri Lankan banking sector and context of market. BOC staff involved in loan granting should be getting a continuous training on different methods of minimizing risk and updates in risk management. Risk department should be in positive aspects in order to perform their duties effectively, so it is recommended that the management of BOC should address the issues raised as problems faced by credit risk officers.
- Maintaining a good credit policies and standards match to banks overall objectives and current situation. According to the analysis, Sri Lankan banks need to implement the bank policies to increase the investment more on cost per loan asset and reduce the investment on non-performing loan ratio and provision for loan losses at the period of time.
- At the same time non-performing loan ratio is negatively influenced on financial performance, banks need to reduce the

non-performing loan ratio. Therefore, banks should maintain a good risk management system. Then banks can diversify the risk experienced from non-performing loans ratio and other types of credit risks.

Suggestion for Further Study

As this study focused on credit risk management and performance of commercial in Sri Lanka the researcher tackled only issues related to the subject matter however there are areas that would be interesting for further study and these include the suggestion. Other risks influencing commercial banks profitability apart from credit risk management. Future researchers should investigate on determinants of financial performance of Sri Lankan commercial bank. This are the risk further more have to study of the other market also have to investigate the as banking prospective.

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