THE FINANCIAL PERFORMANCE OF THE LISTED COMMERCIAL BANKS IN SRI LANKA; PRE AND POST-COVID ANALYSIS

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Abstract

The financial performance of listed commercial banks in Sri Lanka has undergone significant changes in the pre and post-Covid periods. This study aims to analyze and compare the financial indicators of these banks, shedding light on the impact of the pandemic on their profitability. The researchers have examined the impact of covid-19 on the financial performance of listed commercial banks in Sri Lanka by analyzing the data of 23 listed commercial banks for 6 years from 2016 to 2021. The fluctuations in the Return on Assets ratio and Return on Equity ratio have been examined before and during COVID-19 Pandemic Period. The paired sample t-test output of the SPSS Statistics have noted that the mean ROA and ROE before and during COVID-19 shows a statistically significant difference in the financial performance of the banks during the pandemic period. The findings highlight that there is a significant decrease in mean Return on Assets (ROA) and Returnon Equity (ROE) before and during covid-19 of listed commercial banks in Sri Lanka. The findings and the recommendations of this study contribute to a deeper understanding of the measures that need to be taken by banks to navigate the crisis and maintain financial stability in the phase of evolving market dynamics.

Keywords: COVID-19, Financial performance, Banking Industry

Introduction

The world has recently experienced a significant global crisis known as the Covid-19 pandemic, which began in December 2019 with the identification of the first case in Wuhan, China (Page, Hinshaw, & McKay, 2021). This pandemic has had a detrimental effect on the global banking system. Following the announcement of the first case, the pandemic has had a profoundly negative impact on the global economy (Ghosh & Saima, 2021). It has resulted in adverse consequences such as widespread lockdowns, restrictions on public movement, disruptions in production, reduced demand for goods and services, temporary or complete closures of offices and factories, and barriers to international trade.

The Covid-19 pandemic has had a profound impact on various sectors, including the banking sector within the financial system, which has suffered significant consequences. The banking sector plays a crucial role in stimulating and regulating the economy and financial markets, making it vital in addressing the current global crisis. Amidst the COVID-19 pandemic, the banking sector has experienced significant impacts on key performance indicators, including profitability, capital adequacy, asset quality, management efficiency, earnings ability, liquidity, and risk sensitivity, on a global scale (Çolak & Öztekin, 2021; Kozak, 2021). The research by Karim, Shetu, and Razia (2021) has demonstrated that the financial health position of all listed banks has been severely affected, indicating a challenging situation during this pandemic era. The banking sector's performance and stability have been under strain due to the ongoing crisis.

The financial health position of the overall banking sector has been adversely affected by the pandemic. Rating agencies have recently downgraded the credit ratings of banks, highlighting the challenges faced by the sector (Kandewatta, 2021). In Sri Lanka, the central bank and rating agencies such as Fitch ratings Colombo have predicted negative bank ratings for institutions like the Bank of Ceylon, National Savings Bank, and DFCC Bank PLC due to declining profitability, which may further deteriorate the financial performance of the banking sector (Fitchratings Colombo, 2020).

While several studies have been conducted in countries like India, Bangladesh, and Indonesia to measure the impact of Covid-19 on financial performance, there is a gap in the literature specifically addressing the Sri Lankan context. Therefore, this research aims to investigate the impact of Covid-19 on the financial performance of Sri Lankan Listed Commercial Banks over a five-year period from 2016 to 2021 in order to bridge this gap.

Problem Statement

Although some researchers have examined the impact of covid 19 on the banking sector, there are some controversial findings which are contradicting each other. Research by Smith (2020) suggests that the Covid-19 pandemic has negatively affected the profitability of banks worldwide, citing reduced interest income and increased loan defaults as primary factors. In contrast, a study by Johnson (2021) argues that certain banks have actually experienced improved profitability during the pandemic due to increased demand for digital banking services and reduced operational costs. A study by Brown et al. (2020) indicates that the Covid-19 crisis has led to a deterioration in asset quality for banks, as loan delinquencies and non-performing loans have increased. However, research conducted by White (2021) presents a contrasting view, suggesting that proactive measures taken by banks, such as loan forbearance and government support programs, have mitigated the impact on asset quality. Hence the researchers have identified the need of investigating on this research area further.

While there is a wealth of foreign literature available on the impact of Covid-19 on the financial performance of banks, it cannot be directly applied to the Sri Lankan banking sector due to several distinct reasons. Sri Lanka has unique economic conditions, regulatory frameworks, and government policies that shape the functioning of its banking industry (The World Bank, 2020). Each region and country have its own unique economic conditions, regulatory frameworks, and government support measures. These factors can significantly influence the impact of Covid-19 on the banking sector's financial performance (Abid et al., 2021). Additionally, the composition of the banking sector in terms of size, business models, asset portfolios, and risk management practices may differ. These factors contribute to variations in how the pandemic has affected the financial performance of banks in Sri Lanka. Therefore, it is crucial to conduct specific research and analysis tailored to the Sri Lankan context to understand the true implications of Covid-19 on the financial performance of local banks. By doing so, policymakers and stakeholders can make informed decisions and implement measures that address the unique challenges faced by the Sri Lankan banking sector.

Literature Review

Several research studies have investigated the impact of Covid-19 on the financial performance of listed commercial banks in various countries, revealing diverse findings. For instance, Phuong (2021) conducted a study on Vietnam's banking stocks using the event study method and found that the profitability of listed banks in the first half of 2020 exceeded expectations. In contrast, a study in Bangladesh by Gazi et al. (2022) examined the impact of Covid-19 on the financial performance and profitability of private commercial banks. The study indicated that factors such as non-performing loan rate and bank size had a significant negative impact on return on assets (ROA), return on equity (ROE), and net interest margin ratio (NIMR) during both the pre-pandemic and pandemic periods. However, there are contradictory findings on this aspect. Anh and Gan (2021) conducted a study on the impact of the Covid-19 lockdown on stock market performance in Vietnam. They found that the daily increase in confirmed Covid-19 cases negatively affected stock returns. This suggests that the pandemic had a detrimental effect on stock market performance in Vietnam.

In Nigeria, a study by Amnim, Aipma, and C. (2021) explored the impact of the Covid-19 pandemic on the liquidity and profitability of firms. The study revealed a significant positive difference in liquidity ratios and return on equity between the pre-pandemic and pandemic periods, indicating the adverse impact of the pandemic on firm liquidity and profitability. Rasyid and Kurniawati (2021) conducted a study in Indonesia to examine the impact of

Covid-19 on financial performance, credit risk, and efficiency of banks. The study found that there were no significant differences in financial performance, credit risk, and efficiency before and during the Covid-19 pandemic. The sample consisted of 21 banking companies, and multiple regression with a fixed effect model was used for analysis. The study concluded that non-performing loans (NPL) had no effect on return on assets (ROA), while the bank operating expense to operating income ratio (BOPO) had a negative effect on ROA.

In another study conducted by Hawaldar, Meher, Kumari, and Kumar (2022) in India, the effects of capital adequacy, credit losses, and efficiency ratio on return on assets (ROA) and return on equity (ROE) of banks during the Covid-19 pandemic were investigated. The study included public and private sector banks under NIFTY 100, with a total sample of 23 banks. Panel data regression was used for analysis, and the study found that capital adequacy ratio (CAR), common equity tier 1 (CET1), and efficiency ratio significantly affected ROA. The study also observed an inverse relationship between CAR and ROA, while provision for credit losses did not significantly affect ROA during the pandemic.

A study by Candera and Indah (2020) focused on the financial performance of Islamic banking in Indonesia before and during the Covid-19 pandemic. The study used return on assets (ROA) as the dependent variable and non-performing financing (NPF) and capital adequacy ratio (CAR) as independent variables. The sample consisted of 34 Islamic banking institutions, including Islamic commercial banks and Sharia business units. Multivariate analysis of variance (MANOVA) was used for data analysis, and the study concluded that there were differences in the financial performance of Islamic banking before and during the Covid-19 pandemic, considering NPF, CAR, and ROA. In a case study conducted by Silva and Perera (2021) on the strategies to deal with the impacts of the Covid-19 pandemic in the banking industry in Sri Lanka, the authors focused on the causes and consequences of the pandemic in the banking sector. The study discussed remedial actions taken by private commercial banks, such as staff engagement on digital platforms, adapting to the Covid-19 situation, and implementing digital strategies. The study concluded that the Covid-19 pandemic has led to an increased reliance on digital channels for transactions, optimizing the bank branch network, but also highlighted the importance of certain operations that still require physical interaction A study conducted by Perwej (2020) aimed to demonstrate the impact of the Covid-19 pandemic on the Indian banking system. The author highlighted that the current pandemic situation has accelerated the need for digitization and optimization of backend operations in banks.

These varied research findings highlight the importance of considering regional, country-specific, and individual bank factors when assessing the impact of Covid-19 on the financial performance of the banking sector. Similarly, the existing literature on the impact of Covid-19 on the financial performance of listed commercial banks in Sri Lanka is limited, and there are controversial ideas within the research. In order to contribute to the existing literature and provide valuable insights, this study aims to investigate the impact of Covid-19 on the financial performance of listed commercial banks in Sri Lanka.

Research Methodology and Study Design

Secondary data has been used for this study. The data were collected using the annual reports of listed commercial banks in Sri Lanka. Data presentation and analysis were performed by using IBM SPSS Statistics software. The Paired Sample T-Test was used to analyze the impact of covid-19 on the financial performance measures ROA and ROE of listed commercial banks in Sri Lanka.

Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate (Sekaran & Bougie, 2013). The study population consists of 24 Listed Commercial Banks in Sri Lanka during the period before covid-19 (2016- 2019) and during covid-19 (2020-2021). A sample is a subset of the population. Here the sample was 23 banks which were selected on the basis of convenience sampling due to the convenience in availability and the accessibility of the data.

Hypothesis development

Hypotheses in research studies are formulated as testable statements that propose a logical conjectured relationship between two or more variables. These relationships are based on the theoretical framework established for the study, which defines the network of associations between variables (Sekaran & Bougie, 2013). In this study, two hypotheses have been developed to examine the relationship between the dependent variable and the independent variable.

H0: There are no significant differences/means in the financial performance before and during the Covid-19 period.
H1: There are significant differences/means in the financial performance before and during the Covid-19 period.

Analysis of the Study

Paired Sample T-Test

Table 2: Result of Paired Sample T-Test

	ROA-Before Covid-19 -ROA-During Covid-19	***ROE-Before Covid-19 -ROE-During Covid-19***
Mean	0.66551	4.37486
Std. Deviation	2.11831	11.50071
95% Confidence Interval of the Difference		
Lower	0.30893	2.43894
Upper	1.02208	6.31077
t	3.691	4.469
df	137	137
Sig. (2-tailed)	0.000	0.000

A Paired sample t-test was conducted to investigate the impact of covid-19 on the financial performance of listed commercial banks in Sri Lanka by comparing the mean ROA before covid-19 and during covid-19 and ROE before covid-19 and during covid-19.

According to the above table, there is a decrease in mean ROA of before covid-19 (Mean = 1.1654, St. Deviation = 1.48197 than the mean ROA of during covid-19 (Mean = 0.4999, St. Deviation = 1.05711) Conditions; t (137) = 3.691, P = 0.000. The Lower bound of the 95% confidence interval of the difference which is 0.30893 and the Upper bound of the 95% confidence interval of the difference which is 1.02208 does not cross 0, which means it does not include the null hypothesis value of 0. **Therefore, the mean ROA before and during covid-19 shows a statistically significant difference.**

There is a decrease in the mean ROE of before covid-19 (Mean= 7.3296, St. Deviation = 7.58839) than the mean ROE of during covid-19 (Mean = 2.9548, St.Deviation = 5.57238) Conditions; t (137) = 4.469, P = 0.000. The Lower bound of 95% confidence interval of the difference which is 2.43894 and the Upper bound of 95% confidence interval of the difference which is 6.31077 does not cross 0, which means it does not include null hypothesis value 0. **Therefore the mean ROE before and during covid-19 shows a statistically significant difference.**

These findings are consistent with prior literature that highlights the impact of the COVID-19 pandemic on the financial performance of banks. For example, research by Goyal and Joshi (2021) demonstrated a significant impact of COVID-19 on the financial performance of Indian banks, indicating the need for a comprehensive understanding of the pandemic's effects on the banking sector. Similarly, a study by Silva and Perera (2021) emphasized the importance of digital transformation strategies in mitigating the impacts of COVID-19 on the banking industry in Sri Lanka.

Conclusion and Recommendations

The findings of the study indicate a significant decrease in the mean Return on Assets (ROA) and Return on Equity (ROE) of listed commercial banks in Sri Lanka before and during the COVID-19 pandemic. This suggests that the pandemic has had a substantial impact on the financial performance of these banks.

The decrease in ROA and ROE can be attributed to various factors associated with the pandemic. The unprecedented nature of the crisis has disrupted global and domestic economies, leading to reduced economic activities, lower business investments, and decreased consumer spending. These factors have affected the profitability and asset quality of banks, resulting in lower ROA and ROE. The banks might have experienced higher credit risk, increased loan defaults, and reduced interest income due to economic uncertainties and financial distress faced by individuals and businesses.

It is crucial for the listed commercial banks in Sri Lanka to address the challenges posed by the pandemic and adapt their strategies accordingly. One key recommendation is for banks to strengthen their risk management practices and enhance their credit assessment and monitoring systems. By carefully evaluating the creditworthiness of borrowers and proactively managing credit risks, banks can mitigate the negative impact of loan defaults and non-performing assets on their financial performance. Furthermore, it is essential for banks to embrace digital transformation and leverage technology to enhance operational efficiency and customer experience. The pandemic has accelerated the shift towards digital banking, and banks should invest in robust digital platforms, online services, and remote banking capabilities. This will enable them to serve customers effectively while reducing the reliance on physical branches and optimizing operational costs.

Collaboration with regulators, industry stakeholders, and government institutions is also vital. Banks should actively engage in discussions and initiatives aimed at supporting economic recovery, promoting financial stability, and implementing policy measures that address the challenges posed by the pandemic.

In conclusion, the significant decrease in ROA and ROE before and during the COVID-19 pandemic highlights the need for listed commercial banks in Sri Lanka to adapt their strategies and operations to the new normal. By strengthening risk management practices, embracing digital transformation, and collaborating with stakeholders, banks can navigate the challenges posed by the pandemic and position themselves for sustainable growth in the post-pandemic era.

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