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CONTENTS

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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

JOURNAL AND OTHER ARTICLES

- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

CONFERENCE PAPERS

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EVALUATING THE FINANCIAL SOUNDNESS OF SELECTED COMMERCIAL BANKS IN SRI LANKA: AN APPLICATION OF BANKOMETER MODEL

NIMALATHASAN, B.
SR. LECTURER
DEPARTMENT OF ACCOUNTING
FACULTY OF MANAGEMENT STUDIES & COMMERCE
UNIVERSITY OF JAFFNA
THIRUNELVELY

BALAPUTHIRAN, S
SR. LECTURER
DEPARTMENT OF ACCOUNTING
FACULTY OF MANAGEMENT STUDIES & COMMERCE
UNIVERSITY OF JAFFNA
THIRUNELVELY

PRIYA, K
ASST. LECTURER
DEPARTMENT OF ACCOUNTING
FACULTY OF MANAGEMENT STUDIES & COMMERCE
UNIVERSITY OF JAFFNA
THIRUNELVELY

ABSTRACT

Financial system of a country is broadly the mechanism in the financial market which deals with the business or transactions in money. The banking sector is moving towards the goal of integrated financial services because of the strong competition and quick changes of technology. In developing countries like Sri Lanka, banking sector provides fund for other organizational developments. Economic development of the economy is reflected through the soundness of the banking system. Therefore, the present study is initiated for evaluating financial soundness of selected commercial banks in Sri Lanka during from 2006 to 2010 (05years). The study concluded that state banks are in sound position in comparison to private banks. Bankometer will help the banks internal management to avoid insolvency issues with a proper control over their operations. For improving financial position, therefore, the necessity of qualified trained and experienced management personnel; Government realistic measure, following participative management, supply of adequate working capital, setting realistic goals, fixation of accountability and motivation for achievement of performance and penalisation for non-achievement of the same etc must be ensured in the sample selected listed companies

KEYWORDS
Financial Soundness, Commercial Banks, Bankometer model.

BACKGROUND AND STATEMENT OF THE PROBLEM

The increasing competition in the national and international banking markets, the change over towards monetary unions and the new technological innovations herald major changes in banking environment, and challenge all banks to make timely preparations in order to enter into new competitive financial environment(Velnampy & Nimalathasan, 2010).

Managers, stockholders, lenders and employees are concerned about their firm's financial condition. The job security of managers and employees is not assured should their firms struggle financially. According to the Mingo (2000) stockholders' equity position and lenders' claims are also not guaranteed. Government, as a regulator in a competitive market, has concerns about the consequences of financial distress for firms, and it controls capital adequacy through the regulatory capital requirement. The banking sector is one of the most important instruments of the national development, occupies a unique place in a nation's economy. Economic development of the economy is reflected through the soundness of the banking system (Gaur, Sukhija & Julee, 2012).

The improvement in the performance of has been achieved despite several hurdles appearing on the way, such as temporary slowdown in the economic activity. Therefore any issue relating to banks directly impacts the well being of the economy. Sound financial health of the banks is the guarantee not only to its depositors but is equally significant for the shareholders, employees and the whole economy as well. The tightening liquidity situation and changes in regulations. Davies (2010) stated that banking system soundness matters because it gives some indication of how the financial problems would be transmitted to the real economy. Financial soundness (solvency) of the bank means the ability of the bank to meet its long term fixed expenses and accomplishing long term expansion and growth plans. The better the banks solvency position, the better it is financially.

OBJECTIVES

The study covers the following objectives as stated below

1. To measure and evaluate the financial soundness of the state and private sector banks in Sri Lanka.
2. To compare the state and private sector banks on the basis of their financial soundness.
3. To suggest some line of actions for solving problems.

REVIEW OF LITERATURE AND HYPOTHESES DEVELOPMENT

Bhattacharya (1997) found that during the post liberalisation ear efficiency of public sector banks declined whereas that of private and foreign banks has improved overtime. Maria, Silva and Thannassoulis (2003) evaluated the Japanese banks and concluded that major problem of failed banks was not the inefficiency of management but the below standard capital adequacy ratio and considerable problem in their asset quality.

According to Kumbhakar and Sarkar (2003) revealed that the performance of private sector banks but not the public sector banks have improved in response to deregulation measures. Das and Ghosh (2006) found a close relationship is observed between efficiency and soundness of banks as determined by capital adequacy ratio. The study of Kumar and Gulati (2008) exhibited that the overall technical inefficiency of Indian commercial banks was due to both poor input utilization and failure to operate at most productive scale size.

Wu and Zhang (2005) found that industry factors and the corporate size played a great role in affecting the financial distress: cost of financial distress became great when enterprise in financial distress stood in a poor business environment, and asset size of enterprises had a positive relationship with financial distress cost.

Zhang C, Zhang YP, Zhang YC Chen, and Wan (2006) selected 15 financial indicators to forecast EPS: equity per share, dividend pay-out ratio, dividend per share return on net assets, retained earnings ratio, current ratio, quick ratio, total debt to total assets, long-term debt to total assets, sales to accounts receivable, sales to inventory, gross margin ratio, net income to sales, return on investment and return on equity. According to the Nimalathasan (2008), it is evident from the discussion that average financial position of selected listed manufacturing companies was not sound during the period understudy. Moreover, test of the soundness as revealed by Z score (Altman Model) showed that the selected companies were on verge of failure.

Based on the literatures, various studies have done in the context of financial position or performance; however, there are no sufficient studies for evaluating the financial soundness of commercial banks in Sri Lanka. Hence, in attempt to fill this research gap, the present study is initiated on evaluating the financial soundness of commercial banks in Sri Lanka using bankometer parameters.

RESEARCH METHODOLOGY

These describe data sources and sampling design, period of the study, reliability and validity of the data, and tool of mode of analysis.

DATA SOURCES AND SAMPLING DESIGN

To accomplish the above mentioned research objectives and hypotheses, the data for this study are gathered from the bank's financial statements as published by state banks [BOC (Bank of Ceylon) and PB (Peoples' Bank)] and private bank (Commercial Bank of Ceylon Plc (CBC) and Hatton National Bank Plc. (HNB). In addition, another source of data was through reference to the review of different articles, papers, and relevant previous studies.

PERIOD OF THE STUDY

All branches are taken for the study representing the period of 2006 to 2010.

RELIABILITY AND VALIDITY OF THE DATA

Secondary data for the study are drawn from audit accounts (i.e., income statement and balance sheet) of the concerned bank; therefore, these data may be considered reliable for the purpose of the study. Necessary checking and cross checking were done while scanning information and data from the secondary sources. All these efforts were made in order to generate validity data for the present study. Hence researcher satisfied content validity.

TOOL OF DATA ANALYSIS

Bankometer ratios are derived from both the CAMELS and CLSA stress test parameters with some modifications. The changes in the selected ratios are made only to synthesize the measurement of banks soundness. Following IMF (2000) recommendations, we used the procedure of Bankometer to measure the state and private sector bank in Sri Lanka. This procedure has the quality of minimum number of parameters with maximum accurate results.

BANKOMETER PARAMETERS

Capital Adequacy Ratio : 40 %≤CAR≥08%
Capital to Assets Ratio - Capital / Asset : ≥04%
Equity to total Assets - Equity / Asset : ≥ 02%
NPLs to Loans - NPLs / Loans : ≤15%
Cost to Income ratio - Cost / Income : ≤40%
Loans to Assets - Loan / Asset : ≤ 65%

These percentages explain a bank that;

- has capital adequacy ratio between 8% to 40%,
- has more than 4% capital to assets ratio,
- has equity to assets ratio greater than 2%,
- has controlled non-performing loans (NPLs) ratio below 15% and
- has maintained liquidity by controlling loans to assets ratio below 40%,

It is therefore important for management to focus more on trying to predict the banks that are vulnerable to financial distress in near future using bankometer ratio, which is:

S = 1.5* CA+1.2* EA +3.5 * CAR+0.6*NPL+0.3*CI+04*LA

Where '**S**' stands for solvency
CAR stands for capital adequacy ratio
CA stands for capital assets ratio
EA stands for equity to assets
NPL stands for non performing loans to loans
CI stands for cost to income
LA stands for loans to assets
and 50<S<70

According to the Altman (1968) stated that all banks having 'S' value greater than 70 are solvent and termed as super sound banks, while those banks having 'S' value below 50 are not solvent. The area between 50 and 70 is defined as gray area because of the susceptibility to error classification.

DATA ANALYSIS AND FINDINGS

The financial soundness of banks has been measured by using the Bankometer procedure which is discussed in Table-1.

TABLE - 1: RESULTS OF THE BANKOMETER

Variables		CAR	CA	EA	NPL	CI	LA	S
Percentage		40 %≤CAR≥08%	≥04%	≥ 02%	≤15%	≤40%	≤ 65%	Max 70 % & Min. 50 %
Name of the Bank								
State Banks	BOC	13.49	0.01	0.05	0.05	64.54	0.57	69.00
	PB	12.92	0.03	0.09	0.07	54.20	0.06	61.90
Private	CBC PLC	9.84	0.00	0.04	6.30	59.74	0.62	58.68
	HNB PLC	12.12	0.02	0.08	0.08	55.70	0.62	61.80

It is evident from the table-1; the results of solvency revealed that all the banks have sound financial position as all of them having Solvency Score 50-70 percentage (i.e., bankometer procedure).

BOC (69.00) stood at the first position followed by PB (61.90) and HNB PLC Bank (61.80). CBC PLC (58.68) placed at last position. On the basis of the Bankometer results it is found that state banks are in sounder solvency position in comparison to private sector banks. Bankometer will help the banks internal management

to avoid insolvency issues with a proper control over their operations. This new procedure will help the banks to gauge the solvency problems and to eradicate the shortcomings through a proper channel.

CONCLUDING REMARKS

For improving financial position, therefore, the necessity of qualified trained and experienced management personnel; Government realistic measure, following participative management, supply of adequate working capital, setting realistic goals, fixation of accountability and motivation for achievement of performance and penalization for non-achievement of the same etc must be ensured in the selected banking sector. The study concluded that state banks are in sound position in comparison to private banks. Bankometer will help the banks internal management to avoid insolvency issues with a proper control over their operations.

This new procedure will help the banks to gauge the solvency problems and to eradicate the shortcomings through a proper channel. The study suggests that the private banks required taking some corrective measures to improve their respective ratios performance to compete with private banks.

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