



## Efficiency of Sri Lankan Banking Sector – An Empirical Study

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### Abstract

*As bank credit represents a major source of finance in Sri Lanka, ensuring efficiency in the banking sector is a major issue of concern for the country. This paper applies Data Envelopment Analysis and aims at analyzing the level of efficiency in Sri Lankan banking sector. More specifically, this paper investigates the level of bank efficiency and its time dynamics by examining the macro level impact on bank efficiency. The average efficiency score for Sri Lankan commercial banking sector is calculated as 0.51 for the sample period. This score is an indication of moderate level efficiency of Sri Lankan commercial banking sector. However, the average efficiency of domestic banks had been high during the study period. It lies in the range of 0.57 and 0.96. More interestingly, the average efficiency score of Systematically Important Banks for the sample period is calculated as 0.91, indicating a higher level of efficiency. The annual averages confirm this score and had been stable during the sample period except in few observations. These findings show that all the six banks, including two state banks, are efficient in quite similar manner. However, analysis of the time series behavior of bank efficiency scores supports evidence for effects of macroeconomic shocks on bank inefficiencies. This effect is strong irrespective of the ownership and systematically importance of the bank. Thus the findings of the study point out the need for continuous financial reforms with proper monitoring mechanisms to facilitate efficiency in the banking sector.*

**Key words:** Bank efficiency, Data Envelopment Analysis, macroeconomic shocks, Sri Lanka