

## **Effect of Good Governance on Bank Lending: Evidence from Commercial Banks in Sri Lanka**

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This study primarily aims at investigating the effect of good governance on bank lending in Sri Lanka. In this regard, the direct effect of governance on bank lending and how governance mediates bank deposits in influencing bank lending are studied. The sample includes data on 13 commercial banks and worldwide governance indicators from 2011 to 2016. When estimating the direct effect, two step system-GMM dynamic panel model is used. Meanwhile, Three Stage Least Squares model is employed in estimating the mediation effect. Results for the system-GMM model show that, good governance indices have significant impact on bank lending. Control of corruption and government effectiveness have significant negative effect on bank lending and political stability, rule of law, regulatory quality, voice and accountability show significant positive relationship. Further, Three Stage Least Squares result indicates the presence of a significant mediation effect through bank deposits. However, the common component developed from the six governance indicators, to represent overall governance, depicts an insignificant result.

**Keywords:** bank deposits, bank lending, good governance, macroeconomic stability