IMPACT OF CREDIT RISK MANAGEMENT ON BANK PERFORMANCE; THE MEDIATING ROLE OF LOAN LOSS PROVISIONING AND ASSET QUALITY IN BANKING, WITH CAPITAL ADEQUACY AS A MODERATOR

Jagoda, M.L.[1*] and Menike, L.M.C.S.[2]

[1,2]Department of Accountancy and Finance, Faculty of Management Studies, Sabaragamuwa University of Sri Lanka, Belihulaya, Sri Lanka
**maneshijagoda@gmail.com*

1. Introduction

The banking sector acts as the backbone of the economy. While individual impacts of loan loss provisioning (LLP), asset quality (AQ), and capital adequacy (CA) on bank performance are well studied, their combined roles are less understood. This study fills this gap by examining the direct effects of credit risk management (CRM), loan loss provisioning (LLP), and asset quality (AQ) on bank performance, with loan loss provisioning (LLP) and asset quality (AQ) as mediators and capital adequacy (CA) as a moderator.

2. Research methodology

Twenty-four licensed commercial banks were considered as the population, and using the "purposive sampling technique," 15 banks were selected as the sample. Panel data from 2012 to 2023 were obtained from financial reports to analyze the relationship among the variables BP, CRM, LLP, AQ, and CA variables. The 3SLS model in STATA for hypothesis testing and the Sobel Test for mediation analysis were used.

3. Findings and Discussion

The results indicate a positive and significant relationship between CRM and BP. Both LLP and AQ mediate the relationship between CRM and BP, while CA moderates it, highlighting the need for financial stability. However, excessive LLP and AQ negatively impact the performance.

4. Conclusion and Implications

Theoretically, effective risk mitigation strategies, newer risk models, and stress testing practices are needed to reduce non-performing loans and LLP. Practically, policymakers need to implement capital standards and asset quality regulations based on the banks' risk profiles to enhance the market disciplines, assist investors, and estimate better loss-given credit.

Keywords: Asset quality, Bank performance, Credit risk management, Loan loss provisioning, Mediating and moderating effects