Applicability of the Risk Model Identified by Basel Framework on Advancing Financial Performance: Special Reference to Licensed Commercial Banks in Sri Lanka

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The Basel framework is an international regulatory accord that introduced a specially designed set of reforms to improve the regulation, supervision, and risk management of the banking sector. Credit risk, market risk, liquidity risk, and operational risk are the main four risk factors in the Basel III framework. As the risk being the main challenge faced by the banks, they tend to apply the Basel framework to mitigate it but they are exposed to various risks and thus the performance of the freamework is not guaranteed. Therefore, this study endeavored to explore the applicability of the risk model identified by the Basel framework on advancing the financial performance of licensed commercial banks in Sri Lanka. Further, this study expects to identify other risk factors which are not identified by the Basel III framework to develop a new risk model. This study was conducted using a mixed-methods approach. The quantitative method was applied to investigate the risk in Basel framework on financial performance and data were collected from 10 licensed commercial banks for a span of 10 years. The qualitative approach was used to identify other risks faced by the banks and data were collected from 10 bank managers using the in-depth interview method. The panel data regression analysis was used to analyze the quantitative data using E-views software. The thematic analysis was used to analyze qualitative data. The results revealed that there is a significant relationship between capital adequacy ratio in credit risk and the financial performance while other risk factors show an insignificant relationship. Then, the researcher has expanded the Basel Framework by introducing a new risk model using the thematic analysis. The researcher recommended to apply the most compatible risk model to derive better measurement to calculate bank risk in future research.

Keywords: Capital adequacy, Financial performance, Basel Framework, Bank risks