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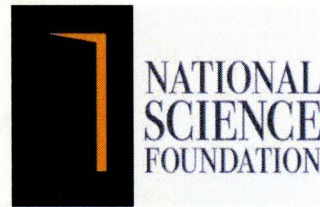
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The Global Financial Crisis and the Technical Efficiency of Commercial Banks in Sri Lanka: A Data Envelopment Analysis

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Introduction

Data envelopment analysis (DEA) introduced by Charnes et al. (1978) based on Farrell (1957), is a non-parametric technique for measuring the relative efficiency of a set of similar units, usually referred to as decision-making units (DMUs). It was initially used to assess the relative efficiency of not-for-profit organisations; but gradually its application was extended to cover for-profit organisations as well. Its first application in banking industry appeared with the work of Sherman and Gold (1985). DEA provides the technical efficiency score of a bank or any institution.

Technical efficiency of a firm is a comparative measure of how well it actually processes inputs to achieve outputs, as compared to its maximum potential for doing so, as represented by its production possibility frontier (Barros and Mascarenhas, 2005). Technical efficiency relates to the productivity of inputs (Sathye, 2001). A bank is said to be technically inefficient if it operates below the frontier. A measure of technical efficiency under the assumption of constant returns-to-scale (CRS) is known as overall technical efficiency (OTE). Technical efficiency of banks is determined by internal and external factors. A financial crisis is an important external factor. A financial crisis is a situation in which some financial institutions or assets suddenly lose a large part of their value. It is a testament to the shortcomings of international capital markets and their vulnerability to sudden reversals of market confidence. It can be classified into five categories, macroeconomic policy-induced crisis, financial panic, bubble collapse, moral hazard crisis, and disorderly workout. There was a financial crisis in 2007 and 2008 in the world. It affected the efficiency of financial institutions directly or indirectly. In this view, the study focuses on the impact that financial crisis 2008 had on the efficiency of commercial banks in Sri Lanka.

Objective and Methodology

The objective of the study is to find the impact of the financial crisis of 2007/2008 on the efficiency of commercial banks in Sri Lanka using DEA. The study selected only four commercial banks (People's Bank, Bank of Ceylon, Commercial Bank of Ceylon, and Hatton National Bank) and only studied six years between 2005 and

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