Impact of Financial Distress on Financial Performance: Special Reference to Licensed Commercial Banks in Sri Lanka

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Abstract

This paper examines the impact of financial distress on financial performance, employing a panel of licensed commercial banks in Sri Lanka. Thirteen listed commercial banks in Colombo Stock Exchange have been selected from 2017 to 2021 and use secondary data gathered from annual reports of these companies. Return on Assets, and return on equity are used as dependent variables to measure financial performance. Altman Z score is used as independent variables, leverage ratio, firm size, tangibility, sales growth, interest rate, inflation, and gross domestic product are used as control variables in the model. The fixed effect regression analysis shows that financial distress significantly impacts the firm's financial performance since the overall significance of the model is there and observed that the lower the bank's Z scores, the lower the return on asset ratio and vice versa. This showed that financial distress affected the financial performance of banks negatively. The study's findings will be useful for banks to take corrective measures in due time if they find themselves in distress.

Keywords: *Altman's Z score, financial distress, financial performance*

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