

LIQUIDITY RISK MANAGEMENT IN SELECTED PSUs AND PRIVATE SECTOR BANKS-A STUDY

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Abstract

The economic strength and might of any country traces its origin both in its financial system and financial institution. While the financial system is considered as the backbone of a country and its economy, safety and the stability of the financial institutions are even more important for the growth of the industry, the economy and economic well-being of the people. The banking as an important industry in the financial system plays significant part in the development of a country's economy. Hence, Governments across the globe and their respective central banks created necessary risk management policies and procedures to insulate their respective banking system from risk. However, certain unforeseeable risks inherent in the banking business have shaken the economies in the past. The recent failure of banks in country like PNB is a telling evidence of these facts. Hence, the present study evaluates the liquidity level of selected private and public sector banks. The study conducted to examine the current liquidity risk management practices of selected banks in the Amravati city. In that, 2 Private Sector Banks, 2 Public Sector Banks were chosen for the study, using a convenience sampling method.

Index Terms:-Liquidity Risk, Future Risk Management, NPA, Banking Business.

1.1 Introduction:-

Liquidity risk is the current and future risk arising from a bank's inability to meet its financial obligations when they come due. A bank might lose liquidity if it experiences sudden unexpected cash outflows by way of large deposit withdrawals, large credit disbursements, unexpected market movements or crystallization of contingent obligations. The other cause may be because of some other event causing counterparties to avoid trading with or lending to the bank. A bank is also exposed to liquidity risk if markets on which it depends are subject to loss of liquidity.

Liquidity in banking is very essential, in that a bank needs to keep adequate cash or other liquid assets to meet the withdrawal demands of customers as well as their loan demand. The International Monetary Fund (IMF) defines funding liquidity as "the ability of a solvent institution to make agreed-upon payments in a timely fashion". So by implication, funding liquidity risk is the possibility that within a certain time frame, a bank becomes unable to settle its obligations with immediacy. Linking this to banking, liquidity can be seen as the ability of banks to meet the withdrawal demands of customers, the absence of which can lead to a run on the bank. A run on the bank occurs when all the customers of a bank are seeking to withdraw their deposits for fear of the fact that the bank would not be able to meet their withdrawal demands in the future. Such a situation could actually lead to a bank failure, as the bank liquidity problem could now pose a threat of solvency. The banking business involves the transformation of deposits into loans. This basic function, also known as financial intermediation, relies on a maturity mismatch between the bank's assets and liabilities, making them exposed to bank runs, or more generally, to funding liquidity risk. Over the years, banking has increasingly become a complex business to run, due to the intertwined set of risks involved. The global financial crisis of 2007 gave a dreadful illustration of how severe and damaging these risks could be and how they can adversely affect the real economy. It revealed the importance of sound liquidity risk management.

1.2 Types of liquidity risk

Technically, liquidity risk could be classified into two:

1.2.1 Funding liquidity risk:-

Funding liquidity risk as the risk that a bank faces as a result of its inability to meet its financial obligations as they fall due, because it is unable to liquidate assets (or is having insufficient funding sources). Indicate funding liquidity risk to be the risk that a firm is unable to generate funds by deploying assets held on its balance sheet to meet its financial obligations in the short term or on a short notice. It must be noted that a bank's liquidity position is determined largely by its cash holdings and other readily available marketable assets, and also by its funding structure and the amount and type of contingent liabilities that come due over a specified horizon.

1.2.2 Market liquidity risk:-

Market risk on the other hand is explained as the risk that a bank is unable to offset certain types of exposures without significantly reducing market prices as a result of market disruptions. Market liquidity risk is the ability of banks to execute transactions in financial markets without causing a significant movement in prices. This view of market risk is shared by Rejda (2008), who adds that market risk is usually caused by competitors for example banks which are offering similar products.

In linking funding liquidity and market liquidity risk, one interesting observation made on liquidity risk management is that in the absence of an inadequate practice of it, banks which are facing a liquidity stock usually engage in fire sale of assets, hoard liquidity and reduce their lending to the real economy. The after effect is that this leads to a potential increase in market disruptions and liquidity shocks faced by other institutions resulting in a prolonged deterioration in market liquidity that has a severe impact on real economic growth. Liquidity risks is often triggered by other risks such as credit risk, market risk and operational risk, and vice versa as these risks are very common in the operations of financial institutions.

1.3 How Can a Bank Achieve Liquidity?

Large banking groups engage themselves in substantial capital markets businesses and they have considerable added complexity in their liquidity requirements. This is done to support repo businesses, derivatives transactions, prime brokerage, and other activities. Banks can achieve liquidity in multiple ways. Each of these methods ordinarily has a cost, comprising of

- Shorten asset maturities
- Improve the average liquidity of assets
- Lengthen
- Liability maturities
- Issue more equity
- Reduce contingent commitments
- Obtain liquidity protection

2. 1 Research Methodology:-

Methodology is the systematic, theoretical analysis of the methods applied to a field of study. It comprises the theoretical analysis of the body of methods and principles associated with a branch of knowledge. Typically, it encompasses concepts such as paradigm, theoretical model, phases and quantitative or qualitative techniques. A methodology offers the theoretical underpinning for understanding which method, set of methods, or best practices can be applied to a specific case. The methodology is the

general research strategy that outlines the way in which research is to be undertaken and, among other things, identifies the methods to be used in it. The research is designed to be qualitative in nature. Qualitative study is one in which the data collection technique or data analysis procedure generates non-numerical data. Given the nature of the study to be carried out, it was imperative that only qualitative approaches is used to gather and analyze the data required for the study since banks are conservative about their information and have all rights to maintain secrecy from researcher.

2.1.2 Research Objectives:-

1. To study the factors that affect liquidity risk management practices in the selected banks.
2. To study and identify strategies that is instituted to monitor and control liquidity risk in these banks.
3. To study and examine the challenges faced by these banks in managing their liquidity risk

2.1.3 Research Design:-

Discriptive and Exploratory research design used for the study.

2.2.1 Data Sources and Methods:-

Primary data collection: Primary data are those which are collected as a fresh and for the first time and thus happen to be original in nature. Researcher collected the primary data during the course of doing the research through different ways. That included

- a) Questionnaires
- b) Interview

Secondary data collection:

Secondary data are those which are collected by someone else and which have already been passing through the statistically process. The data required as a baseline or to know the status of banking sector and it is collected through some of the secondary sources such as:

- a) Books
- b) Magazines
- c) Internet
- d) Research papers and Journals
- e) Newspapers

2.2.2 Sampling procedure

Sampling is an essential technique of research; the research work cannot be undertaken without the use of sampling. The study of the total population is not possible and it is also impractical. The practical limitation-cost, time & other factor which are usually operative in the situation, stand in the way of studying total population.

2.2.3 Sampling Universe:-

Sampling universe is the largest entity to be described, of which the sample is a part. The survey is being conducted in Amravati city. Hence the sampling universe is supposed to be all public and private banks in Amravati city.

2.2.4 Sampling Element :-

The sampling element for this research is two private banks namely; Axis bank and HDFC ltd, two public banks namely; SBI and Bank of India.

2.2.5 Sampling Technique:-

For the purpose of this research, non-probability sampling was adopted. Non- probability sampling is more concerned with the relationship between the sample selection technique and the purpose or focus of the research. Consequently, the sample size is dependent on the research questions or objectives, particularly the data needed, what will be useful and credible, as well as what can be done with the available resources, particularly when one intends collecting qualitative data using semi or unstructured interviews.

To be more precise, in considering which financial bank to include in the study, a convenience sampling technique was used. This technique was employed to help the researcher concentrate on financial banks that were willing to be used as cases for the study.

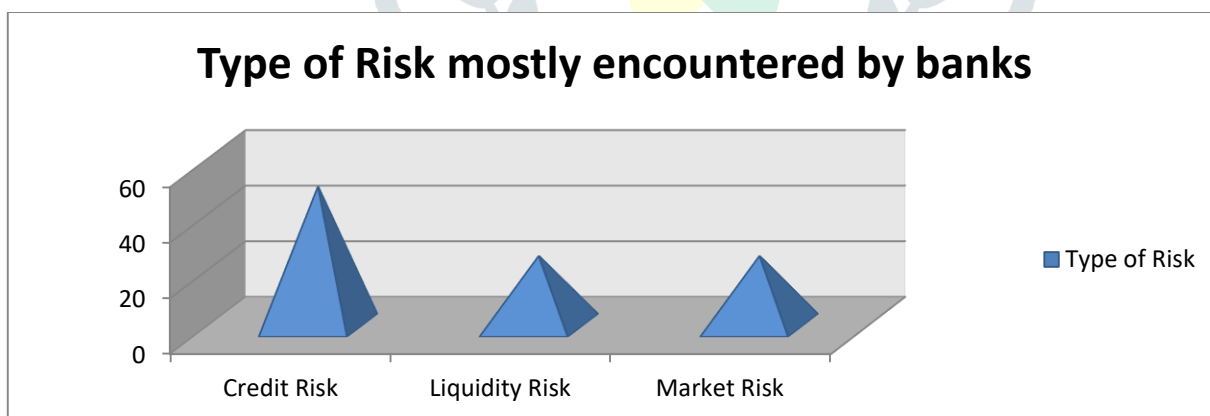
2.2.6 Sample Size :-

Sample size measures the number of individual samples measured or observations used in a survey or experiment. It is primary purpose of a researcher to discover principles that have universal application according to certain samples in cross selection of entire group. For present research study sample size is 4 that are two public and two private banks.

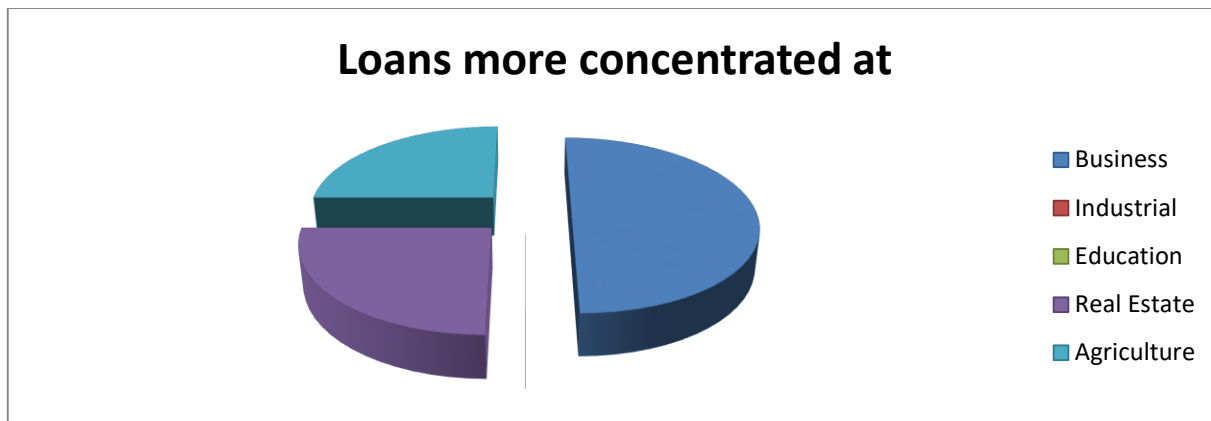
3.1 Data Analysis & Interpretation:-

The researcher conducted interview while getting questionnaire filled with the branch managers who were willing and had the time to do so. Those who could not grant the researcher an interview were nonetheless given the questionnaire to collect the data. By so doing, the researcher was able to fetch equivalent qualitative data at the convenience of the respondents. (Though some information was confidential, and as such, the managers could not disclose them to the researcher.)

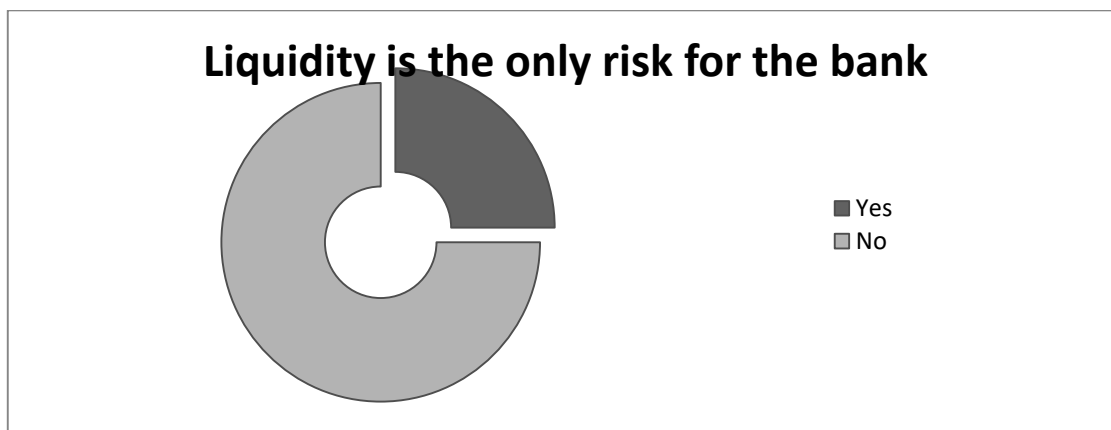
Graph No. 1



Graph No.2



Graph No.3



4.1 Findings:-

- Maximum number of the respondents has said that sudden withdrawal of deposit by the customers is the main problem causing liquidity risk and their percentage is 75%.
- Maximum number of banks manage most of their liquidity requirements both the ways that is stored and purchased liquidity management and their percentage is 75%.
- Most of the respondents said that credit risk is the major risk faced by the banks and their percentage is 50%. Number of respondents who said that liquidity is mostly encountered is only 25%.
- Maximum number of respondents said they give out more loans for the business purpose and their percentage is 50%.
- Maximum number of respondents said liquidity problem does not affect their rate of giving out loans and their percentage is 75%.
- All of the respondents that is 100% respondent said that the government help them in managing the liquidity problem.
- Most of the respondents have said that liquidity is not the only risk that is faced by the banks and their percentage is 75%.
- Maximum number of respondents has said that they do not have a risk manager at their branch and their percentage is 75%.

5.1 Conclusions:-

On the basis of the findings, a number of conclusions can be drawn.

- First of all, there exist no significant differences in the liquidity risk management practices of Public and Private Sector Banks.

- Secondly, the runs on some of these institutions were not necessarily their making, but were as a result of panic withdrawals due to runs on/collapse of similar banks like PNB and government policies like demonetization, which reveal a serious lack of confidence in this section of the banking sector and the need for a more stringent supervision on this area of the banking sector.
- It was found that liquidity is not the only risk that threatens a bank. Credit risk was found to be the greatest risk affecting the banks more than that of liquidity and the market risk.
- Every bank at one point or other have faced liquidity problem during its operation. RBI on account of government always helps these (private and public) banks to overcome liquidity problem.
- Finally, using various strategies like maintaining minimum cash balance, limit on savings withdrawal and cashless transactions liquidity problem can be solved to a great extent.

6.1 Suggestions and Recommendations:

Based on the outcome of the study and conclusions drawn, the following recommendations are made to improve upon liquidity risk management in the financial institutions:

1. From the findings of the study, a major challenge encountered by these banks in managing their liquidity risk is with their customers not informing them in advance before coming to make huge withdrawals, and customers who are fond of withdrawing their funds before maturity. To curb this situation, management should establishing very close and cordial relationships with them, especially the key customers. In that way, customers who usually make huge withdrawals are encouraged to inform the bank in advance, so the necessary arrangements are made before hand, ensuring a smooth run of the business.
2. A substantial amount of depositors' funds should be placed in highly liquid and secured short-term investments, which could be repurchased or liquidated before maturity to cater for customers' needs.
3. Debtors should be required to provide collateral in order to secure long term investments.
4. There is the need to have a balanced portfolio of investments (both short and long-term) in order to avoid too much investment in long term assets which are illiquid.
5. Appointing a risk manager at every branch or at least compulsory regular consultancy with the risk manager would prevent these banks from taking risky decisions, avoid possibility of turning credits into NPA's and better Asset Liability Management.

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