

# A Study on Liquidity Risk Management in Private and Public Sector Banks

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**Abstract:-** Due to concerns about poor identification and management of liquidity risk, which were made worse by the financial crisis, and growing difficulty of the financial markets, authorities are currently focusing heavily on this issue. A lack of liquidity at one institution can have system-wide repercussions because of how interconnected the financial sector is becoming. This paper aims to provide explanations of how important decisions made by bank managers can influence the capability of the bank during a financial crisis. Primary and secondary data are used to study and analyze the cause of liquidity and strategies used for effective liquidity risk management. 10 banks are selected and the Data is collected from 50 respondents who are working in banks. The variables discovered from the evaluations of the literature have been used to frame the questionnaire. The questionnaire also contained the name of the bank, a liquidity risk strategy, and a crisis management technique. These are qualitative aspects of liquidity risk in banks. The study's conclusion was that regulators are currently focusing heavily on controlling liquidity risk due to the growing complexity of the financial markets and worries about insufficient documentation and managing liquidity risk, which have been made worse by the financial crisis. To conclude This paper aims to provide empirical descriptions on how important decisions made by bank managers can influence the capability of an institution to increase financial assets and meet their cash flows during a financial crisis.

## I. INTRODUCTION

### ➤ *Concept of Liquidity:*

Liquidity stands for the readiness of liquid assets to an organisation. Liquidity, according to Krasner (2008), is the capacity to finance the growth of marketable securities and pay obligations when they become due. Similar to this, Nikolaou (2006) defines liquidity as unrestricted flows among the financial system's actors, with a focus on flows between the central bank, commercial banks, and markets.

A bank's liquidity is the capability of the bank to pay the outstanding amount without suffering catastrophic losses. When a bank's turnover or profits are almost enough to cover its obligations, the bank is considered to be solvent. In other words, a bank is considered to be solvent if the value of all of its assets exceeds the value of all of its obligations (other than its equity/owned money). Effective liquidity management is essential for boosting a bank's

cost-effectiveness and long-term survival since banks must be both solvent and liquid. The finest liquid risk management procedures must be in place at the banks.

### ➤ *Concept of Liquidity Risk Management:*

Banks are subject to a variety of dangers. Generally speaking, there are four different risk categories for banking risks:

- *Risks Associated With:* Credit; Market; Operational; and Liquidity.

Due to the recent financial crisis and changes in financial regulation, liquidity risk in banking has been given some attention. The need to analyse, evaluate, and manage the impact of liquidity risk on bank management has grown. The stability of the economy and monetary institutions have recently depended heavily on liquidity risk. The deployment of sophisticated liquidity risk management strategies and liquidity risk measuring techniques has been endorsed by the financial crisis.

The biggest effects of the liquidity issue are shown in the model below. These have a negative effect on the bank's capital adequacy and earnings. severe circumstances, even though the bank may otherwise be viable, might even cause the bank to fail. A bigger risk is that a liquidity crisis at a sizeable bank might have systemic repercussions that affect other banks and the nation's financial system as a whole. Payment systems and other financial markets may not operate properly due to liquidity issues.

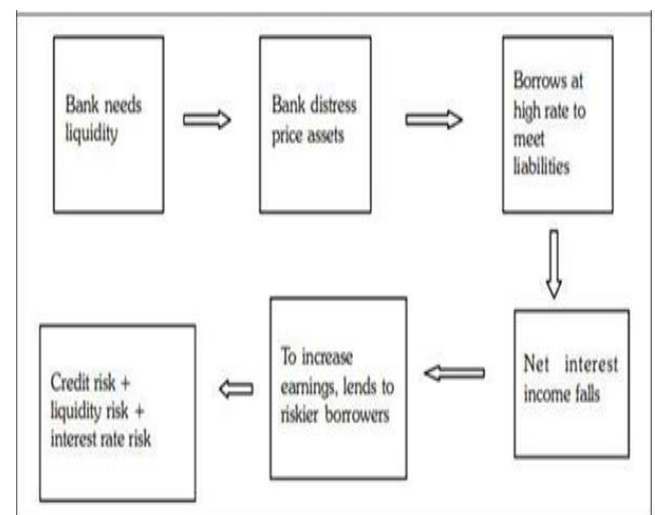


Fig 1 Anatomy of Liquidity Risk

➤ *Motivation of this Study:*

Due to the growing complexity of the financial markets and worries about insufficient documentation and the handling of liquidity risk, which have been made worse by the financial crisis, authorities are currently focusing extensively on this topic. Due to the growing interconnectedness of the financial market, a liquidity shortage at one institution may have systemic repercussions. The purpose of this study is to provide empirical explanations of how significant actions made by bank management might affect an institution's capacity to grow its financial resources and satisfy its cash flow needs.

➤ *Statement of Research Problem:*

The purpose of this study to investigate the liquidity risk management in public and private sector banks because Liquidity risk is the potential inability of a bank to honor its obligations as and when they become due. The research is to discover the liquidity risks and the ways a bank tackles and deals with.

➤ *Background Study:*

According to Arif and Anees (2012), banks are highly vulnerable to liquidity risk. Because customers withdraw too much money from banks, there is a high liquidity risk in the banking sector.

By deterring potential customers and manageable purchasers from the bank, this negatively impacts banking performance. As a consequence, the bank's utility plummets and its advantages are significantly reduced (Ejoh et al., 2014). In other words, according to Diamond and Rajan (2005), liquidity risk results from an unanticipated outflow of money and the lack of enough liquidity to satisfy a bank's short-term commitments. A financial organisation's liquidity risk can be greatly influenced by its cash surplus and deficit. Therefore, since banks attempt to reduce their risk of liquidity by raising their cash balance by issuing long-term obligations, liquidity is a result of the discord between assets that are long-term and liabilities that are short-term (Matz & Neu, 2007).

## II. LITERATURE REVIEW

- Ionic Munteanu (2012) In order to better comprehend the idea and to position the risk of liquidity in respect to other financial risks, this study focuses on defining the factors that determine bank liquidity. Liquidity, the dependent variable evaluated by the other ratios, is thought to be explained by both internal and external factors. The goal of this research paper's conclusion is to discover the variables that affect bank liquidity using a model of multiple regression on a sample of Romanian commercial banks. The findings are in line with other research on the subject and show both shared and unique factors for both of the liquidity indicators examined. Due to the misconception of liquidity risk, many profitable banks encountered issues controlling their own capital.
- Isam Saleh and Malik Abu Afifa (2020). By analysing empirical data from an emerging economy, this article

seeks to determine the impact of risk associated with credit, liquidity, and bank capital on the profitability of banks over the course of nine years (2010–2018). The author concludes by saying that the findings show that bank profitability is influenced by risks related to credit, liquidity, and capitalization factors.

- Management Techniques for Liquidity Risk in Banks (2017) This essay tries to offer analytical justifications for how crucial choices taken by management at a bank might affect an institution's capacity to fund asset growth and fulfil obligations without compromising cash flow. This essay examines the effects of managers' choices on liquidity ratios while outlining some of the difficulties in managing liquidity risk. Depending on their particular business characteristics, banks can change liquidity ratios in a variety of ways.
- Muhammad Saifuddin Khana, Harald Scheulea, Eliza Wub. (2016) The literature's already-existing theoretical frameworks provide strong support for this empirical analysis. development of a hypothesis It has been established that the relationship between bank credit risk and liquidity risk is neither causative nor contemporaneous. The results of this study demonstrate that, in general, capital buffers and scale assist in limiting banks' risk-taking behaviour in response to reduced financing liquidity risk.

➤ *Identification of Research Gaps:*

A research gap is a subject or issue that no previous studies or study in your field have been able to resolve. A research gap occasionally develops when a thought or novel idea is there but hasn't been thoroughly investigated. If all the current research is stale and requires new/updated research, you could occasionally uncover a research gap. Research gaps happen when a notion or novel idea hasn't been thoroughly investigated; here are a few of the gaps I've found. Finding research gaps will need some reading and study. You must be well familiar with all previously conducted research and the contributions they made to the body of information concerning that topic.

Funding (cash-flow) and market (asset) liquidity risks are two different types of liquidity risk. Credit risk, or defaults brought on by the inability to pay liabilities, sometimes appears as funding liquidity. Market risk, or when an item cannot be sold and its market price falls or, worse still, becomes unknowable, is a manifestation of market liquidity risk.

## III. RESEARCH METHODOLOGY

➤ *Scope of Study:*

The main scope of this study is to know the cause of liquidity risk and how liquidity risk is managed in selected banks. This paper firstly aims to study the financial statements of the selected private banks and identify the cause of liquidity in public and private banks. This paper then aims to analyse the liquidity strategy and how it managed in the banks. The study focusses to know if the strategies adopted for liquidity risk is revised by the banks

management and to analyse the ways in which liquidity risk affects the banks management during a crisis situation.

➤ *Research Objectives:*

- To identify the cause of liquidity risk in public and private banks.
- To analyze the strategies for liquidity risk management adopted by the banks.
- To analyze the ways in which liquidity risk management affect the banks performance.

**IV. DATA ANALYSIS AND INTERPRETATION**

➤ *Techniques for Data Analysis:*

• *Data Collection:*

The study is based on both secondary and primary data collection with the survey conducted based on the questionnaires framed from variables identified.

• *Secondary Data:*

The secondary source of data collected from text books, published journals in national and international citation, public articles and related websites.

• *Primary Data:*

The primary data collected through personal interview with banks in Bangalore. Observation and discussion with managers who are working in banks. The questionnaire was designed to collect the responses from the respondent of selected area.

➤ *Frame of Questionnaires and Planning of Survey:*

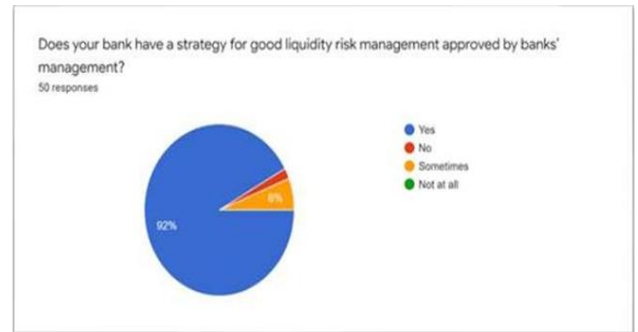
The questionnaire has been framed based on the variables identified from the literature reviews and I have utilized more of yes or no questions i.e., 1. Yes 2. No 3. Sometimes 4. Not at all and also, Likert scale ie.1-strongly disagree, 2- disagree, 3- neutral, 4-agree, 5-strongly agree. The questionnaire was included with the qualitative aspect of liquidity risk in the banks like Name of the bank, liquidity risk strategy and crisis management method.

➤ *Sampling Technique:*

The sampling technique used for the collection of data through the questionnaire. In this study convenient sampling technique was used for collecting the data from the 50 respondents.

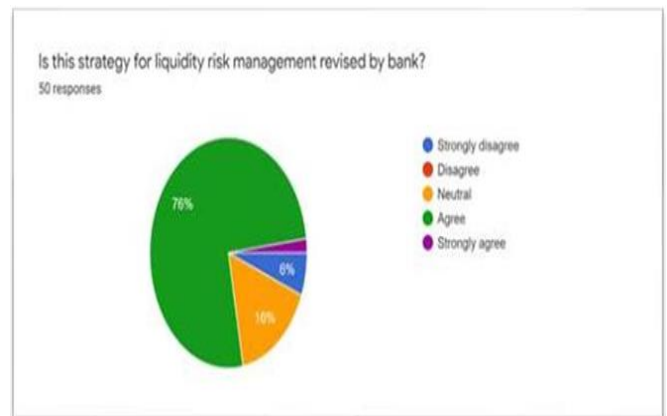
➤ *Data Interpretation:*

Interpretation of graphs based on responses from respondents which was done through survey questionnaire.



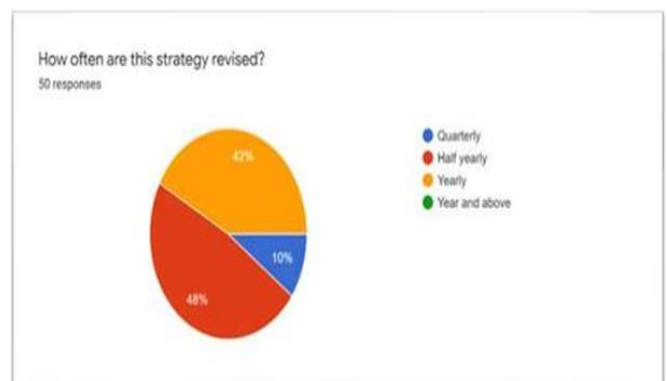
Graph 1 Liquidity Risk Management Strategy

Above graph represents out of 100 percentage 92 percentage of the banks have told that they have a good strategy for liquidity risk management which approved by bank's management. And 2 percent of the managers say that the bank does not have a good strategy approved by the banks management and the remaining 6 percent have told that their strategies are sometimes approved by the bank's management. This question was asked to know if the banks follow a good strategy to manage its liquidity risk.



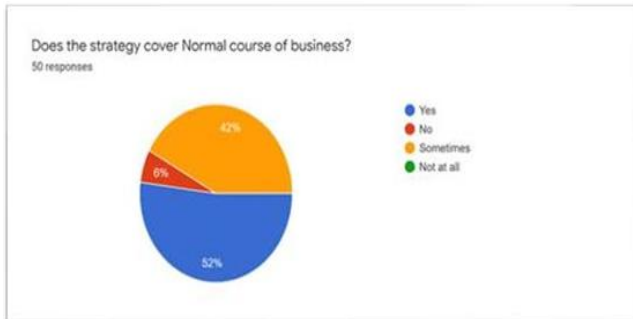
Graph 2 Revised Liquidity Risk Management Strategy

Above graph represents out of 100 percentage 76 percentage of the banks have told that they have revised strategy for liquidity risk management which approved by bank's management. And 16 percent of the managers say that they are neutral remaining 6 percent have told that their strategies are not revised.



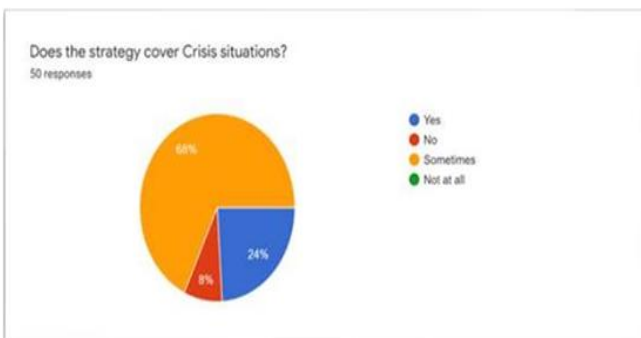
Graph 3 Periodicity of the Strategy being Revised

Above graph represents out of 100 percentage 76 percentage of the banks have told that they have revised strategy for liquidity risk management which approved by bank’s management. And 16 percent of the managers say that they are neutral remaining 6 percent have told that their strategies are not revised.



Graph 4 Normal Course of Business Strategy

Above graph represents out of 100 percentage 52 percentage of the banks have told that they cover normal course of business strategy for liquidity risk management which approved by bank’s management. And 42 percent of the managers say that they adopt the normal course of business strategy only sometimes 6 percent have told that their strategies are not normal course of business actions.



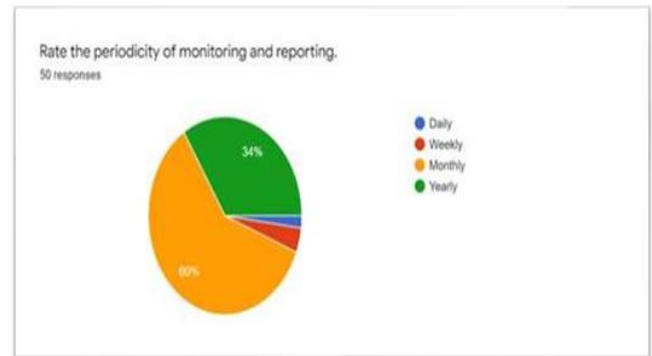
Graph 5 Crisis Situation

Above graph represents out of 100 percentage 60 percentage of the banks have told that sometimes they cover crises situations for liquidity risk management which approved by bank’s management. And 24 percent of the managers say that they cover crises situations for liquidity risk management only 8 percent have told that they do not cover crises situation.



Graph 6 Liquidity Monitoring and Management

Above graph represents out of 100 percentage 64 percentage of the banks have told that sometimes they include regular liquidity monitoring and management for liquidity risk management which approved by bank’s management. And 32 percent of the managers say that they include regular liquidity monitoring and management only 4 percent have told that they do not include regular liquidity monitoring and management.



Graph 7 Periodicity of Monitoring and Reporting

Above graph represents out of 100 percentage 60 percentage of the banks have told that monthly they rate periodicity of monitoring and reporting management for liquidity risk management which approved by bank’s management. And 34 percent of the managers say that yearly they rate periodicity of monitoring and reporting liquidity risk management, 4 percent have told that weekly they rate periodicity of monitoring and reporting and 2 percent have told that daily they rate periodicity of monitoring and reporting.

## V. CONCLUSION AND FUTURE DIRECTIONS

### ➤ Conclusion:

The main scope of this study is to know the cause of liquidity risk and how liquidity risk is managed in selected banks. This paper firstly aims to study the financial statements of the selected private banks and identify the cause of liquidity in public and private banks. And also aims to analyse the liquidity strategy and how its managed in the banks.

The study focusses to know if the strategies adopted for liquidity risk is revised by the banks management and to analyse the ways in which liquidity risk affects the banks management during a crisis situation.

One of the most significant concerns in banking economics is liquidity risk. In recent years, it has gotten little attention. The current economic downturn has, however, highlighted the significance of the risk of liquidity for financial stability at the business and sector levels of study. The use of considerably more sophisticated liquidity risk management procedures and liquidity risk assessment techniques has been encouraged by the financial crisis. Due to the growing complexity of the financial markets and worries about insufficient documentation and

the handling of liquidity risk, which have been made worse by the financial crisis, authorities are currently focusing heavily on this topic. Due to the growing interconnectedness of the financial industry, a liquidity shortage at one institution may have system-wide repercussions. To sum up The purpose of this study is to offer empirical explanations of how crucial actions taken by the management of banks might affect an institution's capacity to grow its financial assets and satisfy its cash needs amid an economic crisis.

➤ *Findings:*

- Few of the private banks needs to strengthen the bank's capital and reduce non- performing loans, and increase in the level of deposits. A closer monitoring of these factors could improve the efficiency in the liquidity management of these institutions.
- Adoption of much more advanced liquidity risk management policies and liquidity risk measurement methodologies will help the banks to overcome the financial crisis and liquidity crunch.

❖ *Limitations:*

- The survey is limited to 50 banks. As the sample size is small the accuracy is less.
- Data provided by the banks may or may not be accurate.
- The major limitation of this paper is that the data provided by the banks cannot be reliable as the bankers may not disclose the information.

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