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Liquidity Management in Financial Service Sectors – With Special Reference to Public Sector Banks of India

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Abstract-

Liquidity risk in Indian public sector banks is strongly influenced by structural and business cycle factors over many years. Sudden change in technological development and market globalization has posed serious challenge to the Indian public sector banks to manage liquidity. The deposit collections made were not able to keep up with the sudden loan growth. This paper summarizes the theoretical findings on the determinants of Liquidity Management by banks. The findings are summarized in a series of predictions.

Keywords---Financial Intermediary, Liquidity Management, Demand Deposits, Term Deposits, Money at call & short notice

I. INTRODUCTION

Liquidity Management measures the ability of Financial Intermediary to meet demand for deposits, withdrawal and other cash outflows. Financial Intermediaries are those middle men who transact in financial instruments between two parties. Public sector banks are typical Financial Intermediaries; it also includes Investment banks, Insurance companies, mutual funds, brokers, dealers and pension funds. Public sector banks are those banks whose majority of stake is held by the Government and the share of these banks are listed in stock exchanges. In India, there are 26 public sector banks. As we all know, these financial intermediaries are large players in the money and security market and if the liquidity management of these financial intermediaries fails, a lack of confidence prevails in the economy which leads to intolerable inflation. If the Government monetary policies fail to curb inflation, then it weakens the economic growth and development in any country. The recent fall in rupee, spurt in oil prices, instability in bullion and security markets in India, Sub-Prime crisis in United State, instability of euro in the European Market are examples of part of mismanagement of liquidity by banks across the globe and failure of government to manage the monetary and Fiscal policies. In this paper, we have made an attempt to explain why such crises arise and how to overcome or minimize such occurrences.

II. OBJECTIVES

- To know the current position of liquidity Management in Indian public sector banks
- To study whether the current tools applied by public sector banks for measuring liquidity as prescribed by the regulatory authority are effective or not.
- To suggest measures to reduce illiquidity position from the current status.

III. NEED FOR STUDY

Whenever an economy passes from one stage to another, the economic condition changes its macro and micro situations, which affects the economic progress of a nation and there is a need for correction in the market scenario. The success and failure of market scenarios depend upon many factors including those related to policy, supply side constraints and macro economics condition. Out of this, liquidity management is one of the important factors that play its role in the correction of macroeconomic condition. Now India is facing the same situation and around the globe each and every economy is passing through the same stage. The need of the hour is to call for correction of liquidity management at large. To bring equilibrium in liquidity is however a hard task, but one can adjust the liquidity positions by bringing the willful defaulters of loans from banks to be punished for renege on their payment. The bad assets do not reveal the gravity of problem but they need to be seen along with the restructuring of assets. Corporate at large that are finding it difficult to repay foreign loan will have to be dented .Though a certain portion has been hedged, while hit will be on the un-hedged portion. As if these are not enough, there are problems in bank portfolios too. On rupee and FCNRB (Foreign Currency Non-Resident Banking) front, the RBI (Reserve Bank of India) raised rupee rate to 8%, It took a long time to raise FCNRB by RBI and by the time rupee rate was raised by 8-9%. The exposure rate of risk between the domestic rate and NRI got contracted. That is why we are seeing relatively slow dollar flow. If proper adjustment is made in the monetary and economic policy, then these payments can be recovered with fewer hurdles and further, these payments can be used for cushioning economic risk. The top contender to lead the **Federal Reserve Ms. Janet Yallen*** has said in her statement that the financial crisis in US led her to believe that regulators had too much discretion and the regulatory system needs to be tightened. The Finance service secretary **Rajiv Takur**,** in a statement to the industrialist and bankers, told in Mumbai on Wednesday August 13, 2013 “If you are a willful defaulter you are going to lose control of

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your company and certain section of people who rejoice when the system is in financial distress are to be taken care of." The message given by these people shows that mismanagement by banks in lending the loan to the corporate is crumbling liquidity management. Therefore, it is essential to study the components of Liquidity management such as the demand deposit to Total deposit ratio , Liquid Asset to total assets and Loan to liquid ratio behavior from 2010 to 2013.

* "Fed's Yellen Hardens her stance on banks ", Wednesday, August14, 2013, Delhi. Mint page 20

** TakurRajiv "Bank should wrest control of firms from willful defaulters", Wednesday, August 14, 2013, Delhi .Mint page10

IV. REVIEW LITERATURE

Liquidity Management is a central theory for all Financial Intermediaries. Equity capital plays an important role in Liquidity function of commercial banks .Diamond and Rajan (2000) said equity capital can act as a buffer to protect depositors in the time of distress .But holding excessive equity capital can reduce Liquidity. Beger and Bouwman(2010) explained that higher level of capital out of depositors reduces the liquidity creation at small banks . Sambhav Garg , Priya Jindal and Dr.Bhavet (2013)in their paper emphasized that banks run on confidence and trust . Confidence enjoyed banks enable them to mobilize the dormant funds of public and make them available for productive purpose. Guillermo Alger and Ingda Alger (1999) determined that Banks with relatively more demand deposits have relatively less liquid assets. Karthik Srinivasan and Vineet Gupta (2007) stated that with the splurge in the credit off-take, banks have to increase their reliance on bulk funding short term sources .At the same time many of them have also been pairing their excess statutory Liquid ratio (SLR) portfolio to fund the credit growth.

V. METHODOLOGY

In this paper, 26 public sector banks are considered for evaluating Liquidity Management. The status of the banks has been considered as information provided by RBI during FY10 to FY13. The Groups of public sector banks includes nationalized banks and State Bank of India & its associates. Researchers have not included co-operative banks and Regional Rural banks. The information about the banks is collected from RBI, respective bank's annual reports and website of respective banks. The Liquidity Management is measured on the basis of following parameters such as total Deposits, Total Assets, Liquid Assets and Advances.

- Total Deposits = Demand Deposits + Savings Banks Deposits + Term Deposits
- Total Assets = Cash in Hand + Balance with RBI + Balances with the banks inside/Outside India + Money at calls + Investments + Advances + Fixed Assets + other Assets.
- Liquid Assets = Cash in hand + Balance with RBI+ Balance with other banks + Money at Calls and short notice
- Advances=Type wise +security wise +sectors inside and outside India

Followings ratios are used in the analyzes of Liquidity in banking sectors

- Demand Deposits to Total Deposits
- Liquid Assets to Demand deposits
- Liquid Assets to Total Assets
- Advances to Total Assets
- Advances to Total Deposits

VI. FINDINGS

A. Demand Deposits to Total Deposits

Deposits are main ingredient of banking Business. They help the banks to provide credit to the Industries in an economy. The higher deposits mobilization will pave way to deploy funds in the economy. Therefore, banks raises deposit in two ways. 1) Demand Deposits or on call. It means an account holder can withdraw at any time through teller, ATM and online banking. 2) Term deposits- A customer cannot withdraw the fund deployed for the specific period. Once the term ends then the money can be withdrawn. The ratio between Demand Deposits to Total Deposits tells us the amount of demand or likely to be demanded by depositor are maintained by banks from the Total deposits raised in a financial year. Higher ratio indicates illiquidity of banks

Table -1: Demand Deposits to Total deposits (` crores)

Year	Demand Deposits	Saving Bank Deposits	Term Deposits	Total Deposits	Ratio
2010	368528	887267	2436224	3692019	0.0998
2011	410109	1083001	2879874	4372984	0.0937
2012	384383	1214049	3403581	5002013	0.0768
2013	448968	1389267	3907462	5745697	0.0781

Sources: Data base of Reserve Bank of India 2010-2013

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In the above Table 1 demand deposits have increased by 415.81 billion rupee from 2010 to 2011 and again by 645.85 billion rupee from 2012 to 2013. In comparison the term deposits have increased 18% for two years continuously from 2010 to 2012 and dropped to 14% in the year 2013 when compared with 2012. This change due to raise in savings banks interest rates from 2% to 4% and Term loans from 8.5% in 2010 and 2011 to 9.5% in 2013 made by certain banks has attracted increase in savings deposits and Term Deposits.

B. Liquid Assets to Demand Deposits

This ratio indicates the ability of bankers to raise demand deposits in a financial year and how these deposits are invested in highly liquid assets to meet the demand. How banks are investing in high liquid asset is determined.

Table-2: Liquid Assets to Demand Deposits (` Crores)

Year	Cash in Hand	Bal with RBI	Balance with other Banks	Money at call & Short notice	Liquid assets	Demand Deposits	Ratio
2010	18387	252471	70308	44091	385257	368528	1.045
2011	20992	331387	83969	48256	484604	410109	1.182
2012	27759	252233	111903	64090	455985	384383	1.186
2013	30603	248770	157351	85546	522270	448968	1.163

Sources: Data base of Reserve Bank of India 2010-2013

Table-2 shows the deployment of funds by public sector commercial banks in India. The public sector banks have shown encouraging results for two years from 2010 to 2012 and suddenly the ratio declined due to decrease in investment with RBI and increase in investment with other banks and using money at call & short notice .This shows banks have shown less interest in bank rate offered by RBI and retained excessive amount of cash in hand thus the profitability of banks got reduced

C. Liquid Assets to Total Assets

This ratio shows the amount of Liquid Assets present in the total asset structure of banks. Higher amount of liquid assets indicate higher liquidity of banks.

Table-3: Liquid Assets to Total Assets (` Crores)

Year	Liquid Assets	Total Assets	Ratio %
2010	385257	4440827	8.675
2011	484604	5293817	9.154
2012	455985	6039620	7.550
2013	522270	6961967	7.502

Sources: Data base of Reserve Bank of India 2010-2013

Table-3 this table shows higher liquidity of banks in 2011 when compared with 2010, but the ratio suddenly declined in 2012 by 1.6% , further reduced by 0.05% in 2013 .This may be due to decrease in investment with RBI (Table -2)

D. Advances to Total Assets

This ratio shows the amount of loan in total asset present. Increase in the ratio shows lower liquidity need to analyze liquid ratio.

Table-4: Advances to Total Assets (` Crores)

Year	Advances	Total Assets	Ratio %
2010	2701019	4440827	60.82
2011	3305632	5293817	62.44
2012	3878312	6039620	64.21
2013	4472774	6961967	64.24

Sources: Data base of Reserve Bank of India 2010-2013

Ratio between Advances made by banks with the available Total assets with the banks is shown in table -4. As this ratio is increasing from 2010 to 2013, it indicates lower liquidity need to be analyzed.

E. Advances to Total Deposits

Under this ratio, Advances are compared with the deposits to know how the bank loans are funded through the bank deposits. A higher loan deposit ratio indicates that a bank has fewer funds invested in readily marketable assets, which provide a greater margin of liquidity to the banks is shown in table-5 .

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Table-5: Advances to Total Deposits (` Crores)

Year	Advances	Total Deposits	Ratio %
2010	2701019	3692019	60.82
2011	3305632	4372984	62.44
2012	3878312	5002013	64.21
2013	4472774	5745697	64.24

Sources: Data base of Reserve Bank of India 2010-2013

VII. CONCLUSION

As per the data shown by RBI, the profitability of public sector banks have started declining from 2010 to 2013 when we compare the total assets employed by bank with reserve & surplus earned . The reason behind this is a record low of 8% in July 2010 bank lending rate in India is reported by RBI and there on frequent change in the lending rate from July26,2011 to October 25,2011 between 8 to 8.5%. This reduced the confident of bankers to deploy funds with RBI. One should not forget the Inflation rate that backed up and stayed near double digits during 2010-2011 and 2011-2012 before showing some moderation in 2012-2013.The deceleration of growth failed to contain inflation.

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