



# Liquidity And Profitability Management in Commercial Banks

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## ARTICLE INFO

## ABSTRACT

Banks play a key role in financial system of a country. Banking refers to a financial activity to manage and safeguard the hard-earned money of customers. Banking refers to the system of financial institutions, such as banks and credit unions, that provide various financial services to individuals, businesses, and governments. Banking services mainly include accepting deposits, lending money, facilitating transactions, and offering various financial products like savings accounts, loans, and credit cards. Banking plays a crucial role in the economy by facilitating the flow of money and enabling economic activities. Finance is the primary key which controls all production and operational activities in any business, it plays major role in management of funds for smooth flow of business. Appropriate allocation of funds can happen with proper maintenance of liquidity. Liquidity is the term used to measure the ability of a firm in maintenance of cash. Liquidity is required to meet the prompt demands of customer and shows effect on profitability of the business. Profit is the main reason for the continued existence of every commercial organization and profitability depicts the relationship of the absolute amount of profit with various other factors. In this present study liquidity and Profitability of Union Bank of India and HDFC is measured. The impact of liquidity on profitability is analysed.

**Keywords-** Finance, liquidity, profitability performance, operations, allocation, Banks, ability.

## INTRODUCTION

Banking industry is one of the key financial players of the country. Banks are play significant role in the development of economic condition of the country. It generally performs various financial related roles. But the prime one is to encourage saving habits of the people by depositing their surplus money into bank and it also provide good return in the form of interest to their customers. Banks generally uses their deposits into different investment and gets handsome return on their investment, it channelizes the saving funds into investment. The second role is it to render facilities to their customer to withdraw their money when they require. Besides, these roles banks also provide numerous facilities to their customers for their growth and development. Thus, in this sense, it can be considered that Bank is the backbone of the country.

Appropriate allocation of funds can happen with proper maintenance of liquidity. Liquidity is the term used to measure the ability of a firm in maintenance of cash. Liquidity is required to meet the prompt demands of customer and shows effect on profitability of the business. Profit is the main reason for the continued existence of every commercial organization and profitability depicts the relationship of the absolute amount of profit with various other factors.

### Need and Importance of the Study:

A bank's liquidity framework should maintain sufficient liquidity to withstand all kinds of stress events that will be faced. The need and importance of the study is to analyse the liquidity and profitability management of Union Bank of India and HDFC to show the effect of liquidity management on profitability, as liquidity and Profitability management is important to show the financial status of any Banks or Companies

## REVIEW OF LITERATURE

1. A study on profitability and liquidity position of cement industry in India. by <sup>1</sup>Priya Rathna. R, in 2020, in the study liquidity and profitability position it is examined and concluded that the compounded annual growth rate of cement companies shows negative value therefore the profitability of the cement companies are not found cement factory and there is significant relationship involving in actual in trend values of selected cement companies in India.
2. Liquidity management and profitability a perspective of Sri Lankan Licensed commercial banks by Anandsayanan<sup>2</sup>. S in the year 2020, in this study the objective, to examine the effect of licensed commercial banks in Sri Lanka and to study this a hypothesis is framed has liquidity management significantly impacts on profitability and regression analysis is used to and analysed the study. He researches findings shows that liquidity management has impact on profitability.
3. An evaluate the study of liquidity and profitability of automobile companies as in India by <sup>3</sup>Sharma Varun under the guidance of Jain, Abha Nagawat in the year 2018 from university of Rajasthan in this study the objective, is to have relative study of liquidity position of Maruti Suzuki limited and Tata motors is studied and the objective is analysed through the application of current ratio for the period of 10years on Maruti Suzuki &Tata motors. It has been observed that the liquidity position of both companies is a declining trend but when comparative study is made Maruti Suzuki was better than TATA motors.
4. <sup>4</sup>Awlo and al (2019) studied the impact of liquidity on bank profitability in Ethiopia over the period (1986...2017) Auto regressive distributed lag model (ARDL) is used to investigate the short run and long run effect of liquidity on profitability Current ratio and loan to deposit ratio of the bank were used to measure liquidity while ROA is dependent variable (measure of profitability). They found that loan to deposit ratio negatively affect return on assets in the long run, while current ratio significantly and positively affects ROA in the long run.
5. Comparative study of liquidity management in public sector &private sector banks by Hussain Kashif the university <sup>5</sup>Mahatma Jyotiba Phule Rohilkh and university in 2016 has focused on the objective to study and analyse the liquidity position of public sector as well as private sector banks. And analysed the liquidity position of banks by the application of ratios like quick ratio, cash ratio, capacity ratio, purchased fund ratio and concluded that liquidity risk is managed by controlling concentrations and relative market sizes of portfolio in the case of asset liquidity risk and through diversification cash-flow gaps will be filled.
6. An analytical study of credit risk management in Indian commercial banks a case study by<sup>6</sup> Asha Singh in 2015 Merwar university, in the study the researcher has included the objective , To examine the performance of selected public & private sector banks and analysed the data related to Gross NPAs of public and private sector banks and observed that Gross NPAs are absolute and the percentage of Gross advances in public sector banks have decreased in the year 2002-03 to 2008-09 and also observed that in private sector banks the Gross NPAS decreased from 202-03 to 2007-08 but in public sector banks the decreased percentage was from 9.36% to 2.00% whereas in private sector it has from 8.08% to 2.30%. the result shows that in public sector banks the percentage of NPAs are more when compared to private sector banks this effect on profitability position.
7. Liquidity management of public sector Iron and steel enterprises in India by Dhunia, <sup>7</sup>Amalendu from university of Kalyani in 2005, has studied to search for the relations between liquidity and profitability and analysis co-relation is applied and interpreted that there is relationship between liquidity and profitability.
8. Management of liquidity and profitability a Bharat heavy electrical limited A case study by <sup>8</sup>Acharyarup Anjali in 2011 from Chaudhary Chahan Singh university, in the study the objective is to assess the present profitability efficiency of BHEL in terms of different financial parameters and data is analysed by applying profitability ratios such as Gross profit net profit ratio, operating ratios and concluded that the profitability performance of BHEL is in increasing trend.

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<sup>1</sup>Priya Rathna. R, in 2020, A study on profitability and liquidity position of cement industry in India.

<sup>2</sup> Anandsayanan. S in the year 2020, Liquidity management and profitability a perspective of Sri Lankan Licensed commercial banks

<sup>3</sup> Sharma Varun under the guidance of Jain, Abha Nagawat in the year 2018 from university of Rajasthan An evaluate the study of liquidity and profitability of automobile companies

<sup>4</sup> Awlo and al (2019) studied the impact of liquidity on bank profitability in Ethiopia over the period

<sup>5</sup> Hussain Kashif the university Mahatma Jyotiba Phule Rohilkh and university in 2016 Comparative study of liquidity management in public sector &private sector bank

<sup>6</sup> Asha Singh in 2015 Merwar university, An analytical study of credit risk management in Indian commercial banks a case study

<sup>7</sup> Amalendu from university of Kalyani in 2005, Liquidity management of public sector Iron and steel enterprises in India

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### OBJECTIVES OF THE STUDY:

- 1.To evaluate the comparative Liquidity and Profitability performance of Union & HDFC bank with the selected parameters.
2. To show the impact of liquidity on profitability of selected banks.

### SCOPE OF THE STUDY:

The scope of the study is limited to study of liquidity and profitability performance of Union & HDFC Banks of India.

### RESEARCH METHODOLOGY:

**COLLECTION OF DATA:** The data is collected through secondary sources such as Annual reports of Union Bank and HDFC, Book, Journals, Magazines etc.

**TOOLS OF ANALYSIS:** Anova, Correlation and Ratio analysis is used to measure the liquidity and profitability position of Union & HDFC Bank of India.

**PERIOD OF THE STUDY:** The study is conducted by considering the data of 10 years from 2014-2023.

### LIQUIDITY:

Liquidity is a very critical part of a business. Liquidity is required for a business to meet its short-term obligations. Liquidity ratios are a measure of the ability of a company to pay off its short-term liabilities. Liquidity ratios determine how quickly a company can convert the assets and use them for meeting the dues that arise. The higher the ratio, the easier is the ability to clear the debts and avoid defaulting on payments. This is a very important criterion that creditors check before offering short term loans to the business. An organisation which is unable to clear dues results in creating impact on the creditworthiness and also affects credit rating of the company.

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#### Types of Liquidity Ratio

There are following types of liquidity ratios:

- 1.Current Ratio or Working Capital Ratio
2. Quick Ratio also known as Acid Test Ratio
3. Cash Ratio also known Cash Asset Ratio or Absolute Liquidity Ratio
4. Net Working Capital Ratio

#### Current Ratio or Working Capital Ratio

The current ratio is a measure of a company's ability to pay off the obligations within the next twelve months. This ratio is used by creditors to evaluate whether a company can be offered short term debts. It also provides information about the company's operating cycle. It is also popularly known as Working capital ratio. It is obtained by dividing the current assets with current liabilities.

Current ratio is calculated as follows:

Current ratio = Current Assets / Current Liabilities

#### Quick Ratio or Acid Test Ratio

Quick ratio is also known as Acid test ratio is used to determine whether a company or a business has enough liquid assets which are able to be instantly converted into cash to meet short term dues. It is calculated by dividing the liquid current assets by the current liabilities

It is represented as

Quick Ratio = (Cash + Marketable securities + Accounts receivable) / Current liabilities

#### Cash Ratio or Absolute Liquidity Ratio

Cash ratio is a measure of a company's liquidity in which it is measured whether the company has the ability to clear off debts only using the liquid assets (cash and cash equivalents such as marketable securities). It is used by creditors for determining the relative ease with which a company can clear short term liabilities.

It is calculated by dividing the cash and cash equivalents by current liabilities.

Cash ratio = Cash and equivalent / Current liabilities

### **Net Working Capital Ratio**

The net working capital ratio is used to determine whether a company has sufficient cash or funds to continue its operations. It is calculated by subtracting the current liabilities from the current assets.

Net Working Capital Ratio = Current Assets – Current Liabilities

### **Good liquidity Ratio**

A good liquidity ratio can be any value that is greater than 1. It indicates that a company is having a sound financial position and can meet short-term obligations efficiently.

Current assets = cash and bank balance+ bank with and call money market+ advances

Liquidity management is the proactive process of ensuring a company has the cash on hand to meet its financial obligations as they come due. It is a critical component of financial performance as it directly impacts a company's working capital. Working capital can be defined as the difference between a company's current assets and liabilities. If a company has a positive working capital, it has more assets than liabilities and is in good financial health. On the other hand, a negative working capital shows that a company has more liabilities than assets and is at risk of defaulting on its financial obligations.

### **Profitability**

Profitability is the ability of the company to utilize their resources in such a way that they can generate more revenue than what they must pay in expenses. A company generate profits through operations, if a company is not operating, it will not make any money.

**Profitability Ratios :** Profitability ratios are a type of accounting ratio that helps in determining the financial performance of business at the end of an accounting period. Profitability ratios show how well a company is able to make profits from its operations.

### **Types of Profitability Ratios**

#### **Gross Profit Ratio**

Gross Profit Ratio is a profitability ratio that measures the relationship between the gross profit and net sales revenue. When it is expressed as a percentage, it is also known as the Gross Profit Margin.

Formula for Gross Profit ratio is

Gross Profit Ratio = Gross Profit/Net Revenue of Operations × 100

A fluctuating gross profit ratio is indicative of inferior product or management practices.

#### **Operating Ratio**

Operating ratio is calculated to determine the cost of operation in relation to the revenue earned from the operations.

The formula for operating ratio is as follows

Operating Ratio = (Cost of Revenue from Operations + Operating Expenses)/

Net Revenue from Operations ×100

#### **Operating Profit Ratio**

Operating profit ratio is a type of profitability ratio that is used for determining the operating profit and net revenue generated from the operations. It is expressed as a percentage.

The formula for calculating operating profit ratio is:

Operating Profit Ratio = Operating Profit/ Revenue from Operations × 100

Or Operating Profit Ratio = 100 – Operating ratio

#### **Net Profit Ratio**

Net profit ratio is an important profitability ratio that shows the relationship between net sales and net profit after tax. When expressed as percentage, it is known as net profit margin.

Formula for net profit ratio is

Net Profit Ratio = Net Profit after tax ÷ Net sales

Or Net Profit Ratio = Net profit/Revenue from Operations × 100

It helps investors in determining whether the company's management is able to generate profit from the sales and how well the operating costs and costs related to overhead are contained.

### **Importance of Liquidity and Profitability in commercial banking**

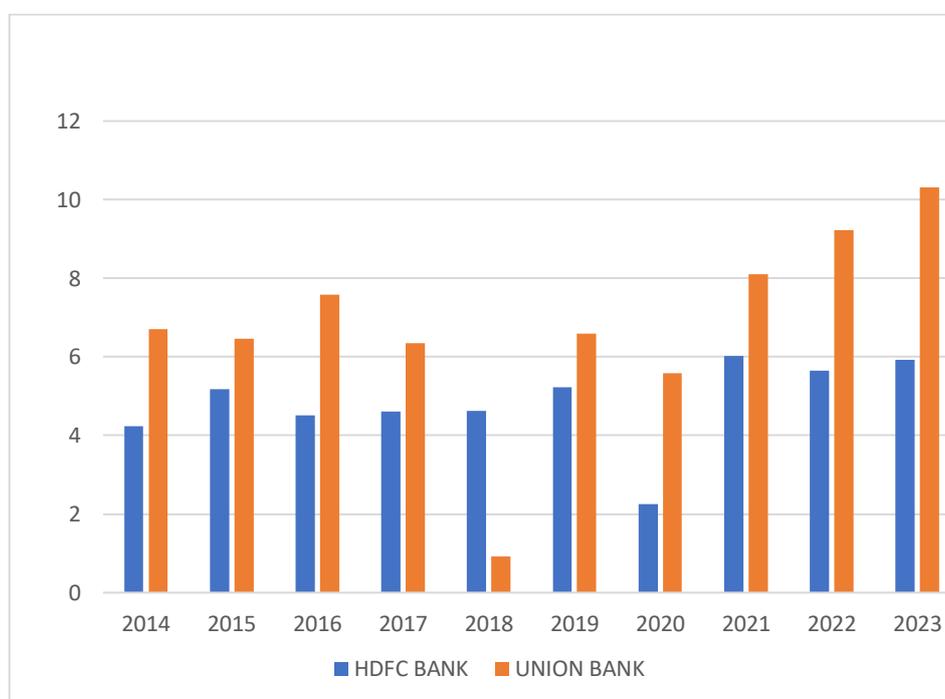
Liquidity ensures short-term survival. Profitability ensures long-term survival. Both are essential for any company to survive. In the context of an asset, Liquidity implies convertibility of the same ultimately into Cash and it has two dimensions in it, viz., time and risk. Profitability of a firm is represented by the rate of return on its capital employed. Liquidity measures the ease at which a business can meet its immediate and short-term financial obligations. Profitability is a measure of business success. It ensures the financial sustainability of the business and gives the business the capacity to endure. The liquidity is normally measured with the help of the following financial ratios. Liquidity for a bank is primarily influenced by how much assets (loans & investment in treasury bills) it has, how much liabilities (deposits), it has, and how much reserves it keeps. Low liquidity

means that it would not be able to withstand a run on the bank. If a bank is unprofitable, most like due to loan losses or lawsuits, it will impact the liquidity of the bank. Even with healthy liquidity, no company can have sustained losses over a long period of time. The lower the liquidity ratio, the greater the chance the company is, or may soon be, suffering financial difficulty. Profitability is the main motive of every business, It is one of the financial indicator ,which indicates the exact status of the business. Liquidity shows the impact on the profits.

**TABLE NO: 1 CURRENT RATIO OF HDFC AND UNION BANK**

YEAR	HDFC BANK	UNION BANK
2014	4.240	6.701
2015	5.175	6.468
2016	4.506	7.589
2017	4.616	6.343
2018	4.626	0.924
2019	5.231	6.584
2020	2.256	5.589
2021	6.018	8.095
2022	5.650	9.223
2023	5.931	10.31

Source: Computed data from Annual reports of Bank



The above table depicts the current ratio of Union and HDFC Bank; it is observed from the data that the performance of Union bank current ratio is more than HDFC current ratio. It is clear from the analysis that liquidity performance of Union Bank is more than HDFC. As the higher the current ratio, the capability to pay off debts will be more.

H<sub>0</sub>: There would be no significant difference in average current liquidity margin of selected union and HDFC banks.

H<sub>1</sub>: There would be significant difference in average current profit margin of selected union and HDFC banks.

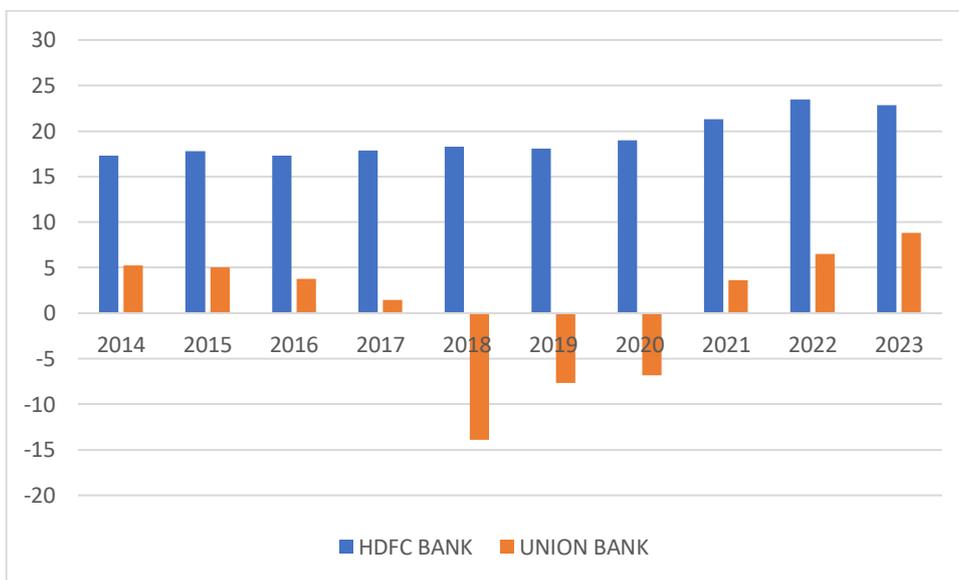
Source of Variation	SS	Df	MS	F	P-value	F crit
Rows	45.2034	9	5.0226	2.018455	0.155114	3.178893
Columns	19.16295	1	19.16295	7.701101	0.021573	5.117355
Error	22.39505	9	2.488339			
Total	86.7614	19				

The above ANOVA table shows that the calculated P value is 0.155, which is less than the 5% level of significance. Hence the null hypothesis stands rejected and H1 is accepted. It means that there would be significant difference in current ratio of Union and HDFC Banks.

**TABLE NO: 2 NET PROFIT RATIO OF HDFC AND UNION BANK**

YEAR	HDFC BANK	UNION BANK
2014	17.28	5.272
2015	17.77	5.003
2016	17.32	3.772
2017	17.83	1.47
2018	18.31	-13.90
2019	18.07	-7.647
2020	19.01	-6.819
2021	21.30	3.627
2022	23.50	6.502
2023	22.87	8.84

Source: Computed from Annual Reports of the Bank



The above table reveals that the Net profits of Union Bank is negative in 2018 ,2019 and 2020, but again profits stated increasing from 2021.HDFC net profits are good in all 10 years,

Ho: There would be no significant difference in average liquidity margin of selected union and HDFC bank  
 H1: There would be significant difference in average total profitability margin of selected Union and HDFC Banks.

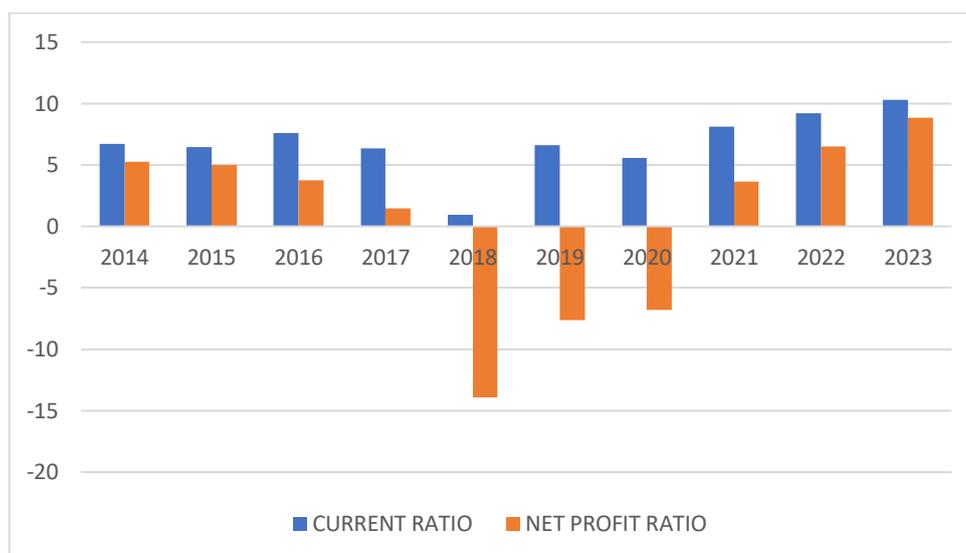
ANOVA						
Source of Variation	SS	df	MS	F	P-value	F crit
Rows	336.5166	9	37.39073	1.601158	0.247068	3.178893
Columns	1751.069	1	1751.069	74.98483	1.17E-05	5.117355
Error	210.1708	9	23.35231			
Total	2297.756	19				

The above ANOVA table shows that the calculated P value is 0.247, which is less than the 5% level of significant. Hence the null hypothesis stands rejected, Alternative hypothesis is rejected. It means that there would be significant difference in net profit ratio of Union Bank and HDFC Bank.

**TABLE NO: 3 COMPARISON OF CURRENT RATIO TO NET PROFIT RATIO OF UNION BANK**

YEAR	CURRENT RATIO	NET PROFIT RATIO
2014	6.701	5.272
2015	6.468	5.003
2016	7.589	3.772
2017	6.343	1.47
2018	0.924	-13.90
2019	6.584	-7.647
2020	5.589	-6.819
2021	8.095	3.627
2022	9.223	6.502
2023	10.31	8.84

Source: Computed data from Annual reports of Bank



From the comparative observation of Current Ratio and Net profit ratio of Union Bank, it is noted that with the increasing level of current ratio, net profit of the Bank is affected. In the year 2018, current ratio is declined therefore net profit declined to negative figures. It is observed that in the year 2023 both current ratio and net profit ratios are high.

### CORRELATION

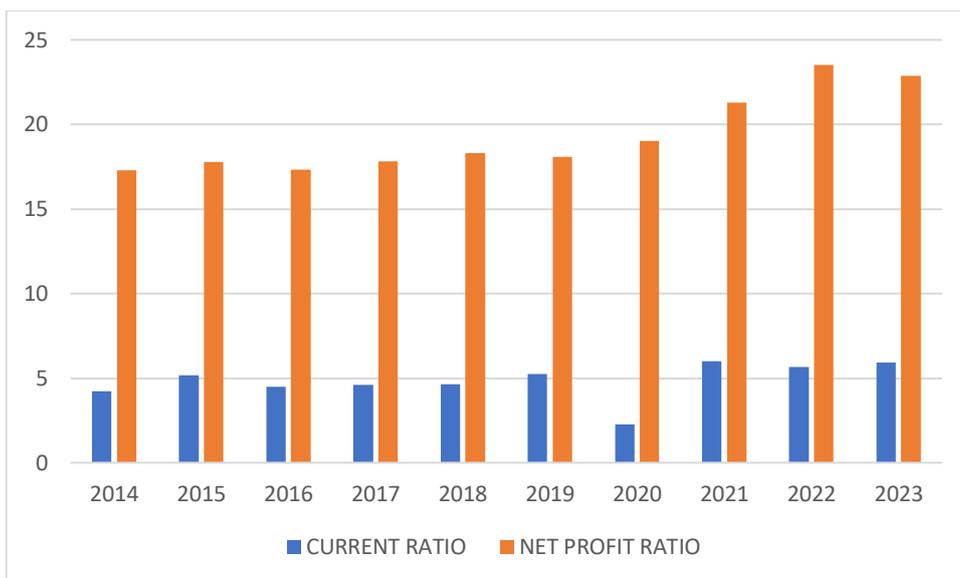
	Column 1	Column 2
Column 1	1	
Column 2	0.852229	1

When Rank correlation is applied it is resulted that correlation between current ratio and net profit ratio is 1. If the value is closer to +/- 1, the stronger the relationship between variables. The result indicates that there is impact of liquidity on Profitability for Union bank, as the liquidity performance increases, the profitability efficiency increases.

**TABLE NO: 4 COMPARISON OF CURRENT RATIO TO NET PROFIT RATIO OF HDFC**

YEAR	CURRENT RATIO	NET PROFIT RATIO
2014	4.240	17.28
2015	5.175	17.77
2016	4.506	17.32
2017	4.616	17.83
2018	4.626	18.31
2019	5.231	18.07
2020	2.256	19.01
2021	6.018	21.30
2022	5.650	23.50
2023	5.931	22.87

Source: Computed data from Annual reports of Bank



It is evident from the above analysis of current and Net profit ratio of HDFC Bank that with every point of slight increase in the current ratio, resulted in the high increase of Net Profit ratio. The liquidity has high impact on Profitability. The highest profitability is seen in the year 2023.

**CORRELATION**

	Column 1	Column 2
Column 1	1	
Column 2	0.513133	1

When Rank correlation is applied it is resulted that correlation between current ratio and net profit ratio is 1. If the value is closer to +/- 1, there will be stronger relationship between variables. The result indicates that there is impact of liquidity on Profitability for HDFC bank, as the liquidity performance increases, the profitability efficiency increases.

**Conclusion:**

The study concludes that there is relation between the liquidity position of HDFC and Union banks on the profitability position of the banks. It reveals that liquidity shows impact on Profitability of the firm. While it is noticed that Union Bank has more liquidity as it is maintaining good ratio of current assets, but even though it's Net profits are less than HDFC. Is maintaining less current assets but resulted in more amount of Profits. It is concluded that HDFC liquidity maintenance should be optimum but the excess working capital also leads to losses. Therefore funds should be properly invested to reach high profits.

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