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The Practice of Profitability and Liquidity of Nepalese Joint Venture Banks: A Comparative Study

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Abstract:

The paper aims to describe the relationship between profitability and liquidity of Nepalese joint venture banks. The descriptive research design has been used to examine the relationship. In Nepal, a total of 27commercial bans including 7 joint ventures, 20 developments banks and 22 finance companies in operation in this study period of time. Out of 7 Joint venture banks, Everest bank limited and Himalayan bank limited were selected purposively to describe and compare its practice and relationship. The results reveled that a positive relationship exit between profitability and liquidity in both joint venture banks. Therefore, the study conclude that the liquidity status of both banks plays a key role in banking performance of Nepalese banking Context.

Keywords: Profitability, Liquidity, Performance, Banks, Nepal

Introduction

The banking sector is an important element in any economy as it plays the roles of satisfying the needs of investors with new financial instruments that offer a wider range of opportunities for risk management and transfer of resources, lowering transactions costs or increasing liquidity by creating financial instruments such as loans and also works as the operator of the payment system. The role played by financial institutions and financial markets in this process is referred to as the function of financial intermediation. Financial institutions are important financial intermediary channels to maintain sound business operations. Hence, they need to satisfy the various financial demands of customers in a better way. They also need to enhance profitability by continually improving the ways in which they manage risks during business operations and remain in accordance with the major contributing factors of their growth (Karki, 2010). Banks have always been the most important and the targets of the financial intermediating between savings and investments. Moreover, banks and financial systems are channels through which money is mobilized and distributed throughout the economy (Ali & Khan, 2016). Soltani et al. (2013) have conducted a study on evaluating the performance of public and private banks. Eventually, they provide suggestions for improving their performance. The result showed that there is a significant difference between private and public banks in terms of liquidity, earning performance and management quality. It was also found that private banks have poorer performance in qualitative management.

Resources can be mobilized and intended for from less essential uses to more fruitful investments via the efficient Organizational mechanism offered by the financial institutions (Wilner, 2000). Some of the major corporate goals include their need to maximize profit, maintain high level of liquidity, and attain the highest level of an owner's net worth. Profitability and liquidity are most important part of the banking and financial sector. Corporate profitability is affected by the ever-growing liquidity management, which is becoming vital in various sectors these days (Eljelly, 2004). In terms of liquidity and earning performance, the private banks have better performance but the public banks have better performance in terms of management. There was also no significant difference in the performance of public and private banks. Jha & Hui (2012) showed that public sector banks are significantly less efficient when compared to their counterparts; however domestic private banks are equally efficient to foreign-owned (joint venture) banks. Investment policy is one fact of the overall spectrum of policies that guide a bank's investment operation. A bank's investment policy defines its healthy development (Dawadi, 2013).

Liquidity, as the ability of a firm to meet its short-term obligations — plays a crucial role in the successful functioning of a business firm. For the sound management of liquidity risks, a bank is responsible for itself (Bhunia, 2010). It should establish a robust liquidity risk management framework that ensures that it maintains sufficient liquidity. This might include a cushion of unencumbered, high quality liquid assets. The reason behind this is to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources (Kumar & Yadav, 2013). Short-term assets have lower return than the long-term assets. But according to Eljelly (2004), firms with high liquidity have majority portion of their investments in them. As a result, high liquidity is expected to be associated with low profitability and vice-versa. Liquidity risk is said to be the assassin of banks. This risk can adversely affect both banks' earnings and the capital. Therefore, it becomes the top priority of a bank's management to ensure the availability of sufficient funds to meet future demands of providers and borrowers, at reasonable costs. Hence, the purpose of the study was to find out the relationship between the liquidity and the profitability of Everest Bank Limited (EBL) and Himalayan Bank (HBL) of Nepal.

Materials and Methods

This study assesses to describe the practice and relationship between liquidity and the profitability of Nepalese Joint Venture banks i.e., Everest Bank ltd. and Himalayan Bank Limited. For this Descriptive as well as inferential research design was used to get the result of sated objectives. A total of 27 Commercial Banks including 7 Joint Venture Banks, 20 Development Banks and 22 finance companies were in operations in Nepal during the time of this study. Out of 7 Joint venture banks Everest bank limited and Himalayan Bank limited were selected purposively in this study to describe and compare its practice and relationship. Moreover, Everest Bank limited is the Joint venture with Punjab National Bank limited, India, and Himalayan Bank limited with the joint venture with the Habib bank limited, Pakistan. Finally, to meet the objective of the study secondary source like Financial report, Published and unpublished Journals and Books as well as corporate booklets and necessary documents were obtained and analyzed according to the purpose of study by using financial and statistical tools.

Results and Analysis

The cash and Bank balance to total deposit ratio measures the ability of bank withdrawal of fund immediately by their depositors. Higher ratio represents a greater ability to cover their deposits and vice-versa. The larger ratio shows the idle cash and bank balance in banks while small ratio shows the utilization of deposit from a banking perspective. Table 1 illustrates the cash and bank balance of different years and its proportion with regards to total deposit. The table shows that the cash and bank balance to total deposit ratio of EBL in the FY 2015/16, 2016/17, 2017/18, 2018/19 and 2019/20 were 24.46%, 22.48, 26.05, 25.54 and 22.82% respectively. Its average cash and bank balance to total deposit ratio was 24.31 %, Standard deviation was 1.61% and co-efficient of variation was 0.066.

Table 1: Cash and Bank Balance to Total Deposit Ratio

Ration in Percentage.

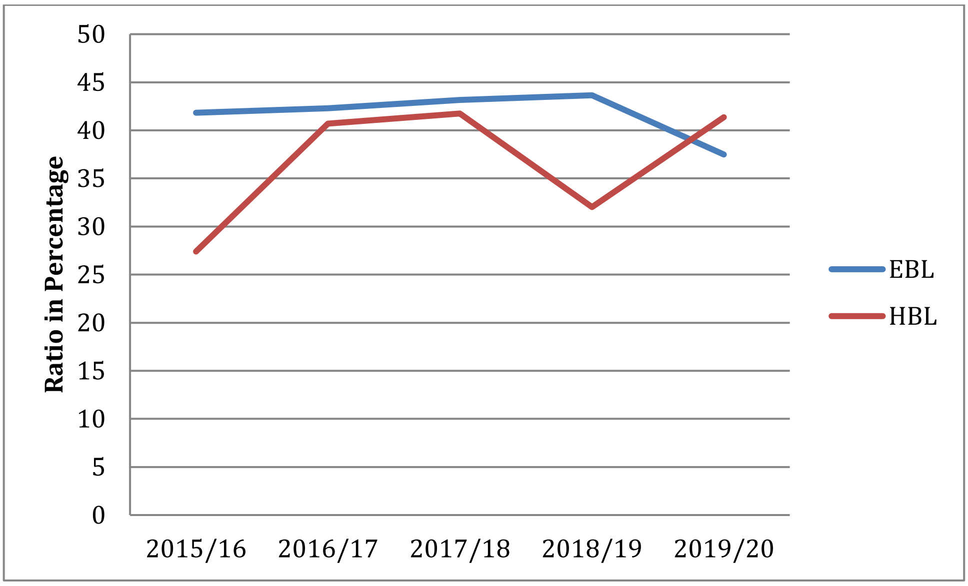
Year	EBL	HBL
2015/16	24.66	11.4
2016/17	22.48	9.015
2017/18	26.05	9.6
2018/19	25.54	15.04
2019/20	22.82	13.5
Average	24.31	11.71
SD	1.61	2.55
CV	0.066	0.218

Source: Annual Report of Sample Bank

Cash and bank balance to total deposit ratio of HBL in the FY 2015/16, 2016/17, 2017/18, 2018/19 and 2019/20 were 11.40%, 9.015, 9.60, 15.04 and 13.50% respectively. Its average cash and bank balance to total deposit ratio was 11.71%. Standard deviation was 2.55% and co-efficient of variation was 0.218. The average ratio of EBL was greater than that of HBL i.e. (24.31%>11.71%). It signifies that EBL had sound liquid cash found to make immediate payment to the depositors from the main point of view. The SD and CV of HBL were more than EBL. Therefore, cash and bank balance to total deposit ratio of EBL was more consistent than HBL.

Figure 1 clearly shows that cash and bank balance to total deposit ratio of HBL and EBL. It was concluded from the average ratio that liquidity position of EBL was better than HBL because of higher average ratio than that of HBL. According to CV, cash and bank balance position with respect to total deposit was better in the case of HBL than EBL.

Figure 1: Cash and Bank Balance to Total Deposit Ratio



Source: Annual Report of Sample banks

The relationship between net profit and operating income. The purpose of net profit was to show the overall profitability i.e efficiency of the bank. Highest the net profit ratio, the better it is considered. Here, net profitability ratio was computed as dividing net profit by operating income. It is shown in table 2.

Table 2: Net Profit Ratio (Ratio in Percentage)

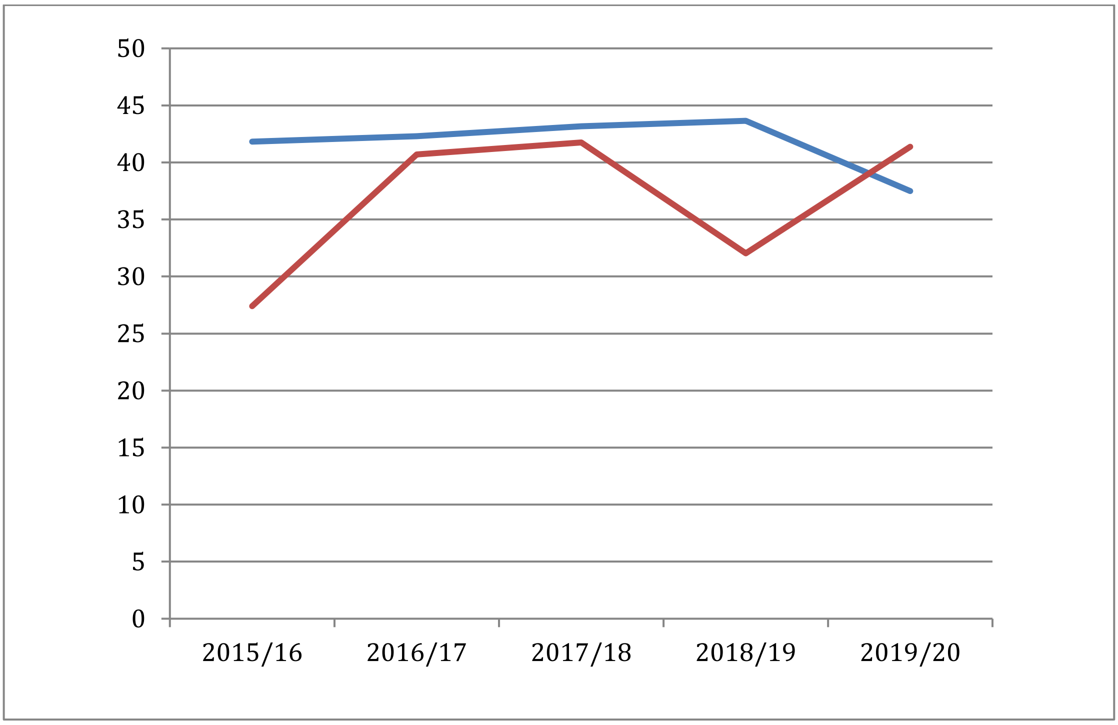
Year	EBL	HBL
2012/13	41.82	27.4
2013/14	42.3	40.69
2014/15	43.17	41.75
2015/16	43.65	32.03
2016/17	37.49	41.37
Average	41.686	36.648
SD	2.453	6.54
CV	0.0588	0.179

Source: Annual Report of Sample Bank

Table 2 and figure 2 depicts that net profit ratio of EBL FY 2015/16, 2016/17, 2017/18, 2018/19 and 2019/20 were 41.82%, 42.30, 43.17, 43.65 and 37.49% respectively. The average net profit ratio of EBL was 41.69%. SD and co-efficient of variation were 2.435% and 0.058 respectively. The net profit ratio of HBL in the FY 2015/16, 2016/17, 2017/18, 2018/19 and 2019/20 were 27.40%, 40.69%, 41.75%, 32.03% and 41.37% respectively. The average net profit ratio was 36.62%. SD and CV of HBL were 6.54% and 0.18 respectively.

The average net profit ratio was higher in EBL than HBL (i.e. 41.686% > 36.648%). It had revealed that EBL earned high rate of profit in the successive FY HBL. Moreover, the higher standard deviation of HBL shows that it have more fluctuations in Net Profit as well as the lower CV of EBL had also suggested it was more consistent in its earnings.

Figure 2: Net Profit Ratio



Source: Annual Report of sample banks

Relationship Between Profitability and Liquidity of Sample Banks in Nepal: Coefficient of Correlation (r) shows the relationship between two or more than two variables. It measures that the two variables are positively or negatively co-related. For this purpose, Karl Pearson's co-efficient of correlation had been taken and applied to find out and analyze the relationship between these two variables. The co-efficient of correlation between two variables X and Y, denoted by r, is a numerical measure of liner relationship between them. In this study, total deposit of bank was traded as in-dependent variable whereas cash and bank balance and net profit were traded as dependent variables.

- *Co-efficient of Correlation between Total Deposit, Cash and Bank Balance*: The correlation between total deposit (X) an independent variable and cash and bank balance (Y) a dependent variable is to measure the degree of relationship between the two variable.

Table 3: Co-efficient of Correlation between Total Deposit (X) and Cash and Bank Balance (Y) of EBL and HBL

Banks	R	r^2	Remarks
EBL	0.952	0.91	Significant
HBL	0.520	0.27	Significant

From table 3, it can be observed that co-efficient of correlation between total deposit and cash and bank balance of EBL was 0.952. It showed the high degree of positive correlation in this case. In addition, co-efficient of determination of EBL was 0.91. It meant that only 91% of total cash and the total number deposits explained bank balance. Similarly, there was positive degree of correlation coefficient between total deposit and cash and bank balance of HBL was 0.520. The value of co-efficient of determination was 0.27. This had indicated that there was a significant relationship between total deposit and cash and bank balance of HBL. From the above analysis, it is becomes clear that in the case of EBL and HBL, there is a high degree of positive correlation in both of them.

- *Co-efficient of Correlation between Total Deposit and Net Profit:* The co-efficient of correlation between total deposit (X), an independent variable, and net profit (Y), a dependent variable, was to measure the degree of relationship between two variables.

Table 4: Co-efficient of Correlation between Total Deposit and Net Profit

Banks	R	r^2	Remarks
EBL	0.013	0.00017	Significant
HBL	0.049	0.0024	Significant

Table 4 shows that the co-efficient of correlation between total deposits and net profit of EBL. It was 0.013, which showed a high degree of positive correlation. In addition, the coefficient of determination of EBL was 0.00017. Hence, it shows a significant relationship between total deposit and net profit of EBL. Similarly, there was positive degree of correlation coefficient between total deposit and net profit of HBL, which was 0.049 and the value of co-efficient of determination, was 0.0024. It had reflected that there was low degree of positive coefficient of correlation between total deposit and the net profit of HBL. From the above analysis, it becomes evident that EBL and HBL had positive degree of correlation.

Conclusion and the way forward

In the above data and calculations, we found that the average cash and bank balance to total deposit ratio of EBL were higher than that of HBL. This shows the ability of withdrawal of funds immediately by their depositors and their even better ability to cover their deposits. The larger ratio also indicates idle cash and bank balance in banks while smaller ratio shows the utilization of deposit from a banking perspective. The coefficient of correlation between total deposit, cash and bank balance of EBL was 0.952. This shows a high degree of positive correlation. Similarly, there was positive degree of correlation co-efficient between total deposit and cash bank balance of HBL, which was 0.520. This had referred to a significant relationship between these three entities. The coefficient of correlation between total deposit and net profit of EBL was 0.013, which shows a high degree of positive correlation. Similarly, there was positive degree of correlation coefficient between total deposit and net profit of HBL, which was 0.049. It reflects the lower degree of positive coefficient of correlation between total deposit and net profit. This study concludes that liquidity status of the bank plays an important role in banking performance in case of Nepalese commercial banks. It is recommended that the finance managers should pay attention to the liquidity of commercial banks as one of the determinants of profitability. Profitability and liquidity reinforce each other and therefore finance managers should not consider the two variables as independent. In the light of growing competition in the banking sector, both banks should be customer oriented. Likewise, they should strengthen and activate their marketing function, as it is an effective tool to attract and retain the purpose.

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