An Empiricial Study on Impact Liquidity Risk Management on Firm Performance in the Conventional Banking of Pakistan

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Abstract: Liquidity management could be banking perform key and integral a part of the management plus liability method. Most banking business depends on the flexibility of a bank to supply liquidity to their purchasers. The purpose of this study to analyze the lies within the problem of estimating the extent of bank liquidity that Conventional banks should keep that guarantee the fulfillment of all its monetary obligations, and at the same time modify them to maximize investments and profits. The study tested the connection between bank liquidity risk and performance in Conventional banks in Pakistan. Within the bank liquidity risk and performance model, we have a tendency to regard liquidity risk as an associate endogenous determinant of bank performance, and apply panel knowledge instrumental variables regression to estimate this model. Regression analysis could be applied mathematics method for estimating the relationships among variables. Most ordinarily regression analysis estimates the conditional expectation of the variable given the freelance variables that’s, the average worth of the variable once the freelance variables area unit fastened. The current review also highlights that the literature on current state of firm performance with respect to liquidity risk management is very limited especially in context of Pakistan which requires scholarly research contribution to better understand and conceptualize characteristics and complexities surrounding liquidity risk management in banking sector. The contribution of this research is to propose a conceptual framework based on the gaps in the literature for further research in context of Pakistan. Conclusions and future implications for theory, practice are discussed in last section.

Keywords: Liquidity Risk Management; Current Ratio; Loan to Deposit Ratio; Return on Equity; Return on Asset

I. Introduction

Banking is distinct from different such business activities in diversity goods and services banks as establishments, multi-product additionally options avariation vary of activities and in progress renewal. Each in terms the functioning mechanisms of the interior (formed new funds, new services, new technologies, etc. ...) or the extent of the setting (new customers and rising money markets new competitors ... etc) thus is assessing the performance of the banking establishments is a necessary method and necessary for continuation of the activities of the bank to modify the changes and also the continuous challenges.

There is very little doubt that the goals of the assessment method of the performance varies in step with expectations of the recipients of the implementation reports, because the depositors is concentrated, for instance, in managing liquidity and guarantee of deposits, whereas shareholders cares profitableness indicators, whereas the management of the bank cares concerning the bank’s ability of providing services to customers while not exhibiting cash from investors to extra dangers. In spite of the precise targets of every individual beneficiary of those reports, the analysis of the performance is "the method and guarantee to envision the resources offered for bank may need been expeditiously used." a lot of significantly, the analysis of the performance is: "a comprehensive method with all knowledge of the accounting to assess money conditions of banks, and to see however they need managed their resources through a time period"; at a strategic level, the performances analysis is: "the identification of strengths and weakness, the identification contributes to the development and management choices that formulating the assets and liabilities of the banking system."

Management system of assets and liabilities of banks specialize in areas of selections that directly relate to the magnitude relation of return and also the dangers, this relation is marked by conflict with the objectives of the bank and procures best performance while not falling into a liquidity risks, or risk of failure and losing the link to the depositors. consequently, the choice areas that have an effect on this relationship is
especially within the fields of money management, and also the investment policies, and also the loans portfolio, capital and also the commitments the management and sensitivity to the interest rates, that represent areas of the management the chance for the bank. Management of this relationship expeditiously may be a guarantee of the continuation of the bank achieving its goals. Analysis of this trend the administration reflects the gains and disadvantages of this administration and outcomes the evaluation process forms the base for judging the performance of the bank in the present and in the future.

1.1. Objective of the study

The main objective of this study to analyze the lies within the problem of estimating the extent of bank liquidity that Conventional banks should keep them that guarantee the fulfillment of all its monetary obligations, and at the same time modify them to maximize investments and profits. This sub objective of this study to investigate the impact of liquidity risk management (Current Ratio & Loan to Deposit Ratio) on firm performance (ROA& ROE)

II. Review Of Literature And Conceptual Framework

1.2. Liquidity management

Liquidity management could be banking perform key and integral a part of the management of plus liability method. Most banking business depends on the flexibility of a bank to supply liquidity to their purchasers. Most of monetary transactions or commitments have the implications for liquidity. Banks are unit particularly susceptible to liquidity issues as at the extent specific establishment and in terms of general or markets. The supply of the deposits (which provides funding) adds to the volatility of the funds, as some creditor’s area unit a lot of sensitive to promote events and credit than others. Diversification of funding supply’s and deadlines permits a bank to avoid the vulnerability related to the concentration of funding from one management policies liquidity source. Bank ought to embrace a risk management (decision-making) the structure, management strategy liquidity and funding, variety of limits to exposure to liquidity risk, and a collection of procedures for liquidity coming up with beneath various eventualities, as well as crisis things.

1.3. Liquidity Risk Management Techniques

The framework for the management of liquidity risk has 3 aspects: measuring and managing net funding requirements, market access and emergency plans. Forecast possible future events an important a part of the liquidity coming up with and management of risk. AN analysis of web funding the wants includes the development of a maturity ladder and calculation of the accumulative web surplus or deficit funds within the hand picked dates. The banks ought to regular basis estimating the expected future money flows instead of focusing solely on written agreement periods within which liquidity will scroll forwards or backward. for instance, the money outflows will be hierarchical consistent with the date on that the liabilities fall due inside the primary date a liability holder of could exercisean possibility of early redemption, or the primary date that the contingencies will be known as.

An analysis whether or not a bank is sufficiently liquid depends upon the behavior of the flows in numerous conditions. Management of the liquidity risk ought to so involve many eventualities. The state of affairs “business continuity” has set a benchmark for money flows within the record within the traditional course of business. This state of affairs is generally applied to the management of the banks use of deposits. A second state of affairs considerations the liquidity of a bank in a crisis scenario within which a major portion of its liabilities can’t be came or replaced - which means the contraction of bank record. This state of affairs applies to several provisions of existing money or liquidity measures of management. A 3rd state of affairs refers to a general market crisis, within which liquidity is affected the whole industry, or a minimum of a major a part of it.

Liquidity management during this state of affairs relies on credit quality, with vital variations in access funding between banks. From the purpose of read of liquidity management, AN implicit assumption will be created that the central bank can guarantee access to finance in some kind. The central banks in fact has an interest in learning this state of affairs owing to the requirement to form a buffer of total liquidity for the banking sector, and for a practicable suggests that to unfold the burden of liquidity issues among the key banks.

1.4. Profitability Indicators

The profit has rock bottom line or latest result performance that shows information superhighway impact of the policies and banking activities during a year. Trends of the steadiness and growth area unit best composite indicators of banks’ performance in each the past and future. Profitableness is usually measured by all or a part of a group of monetary reports. The key indicators embrace a return on the average equity, that measures the speed of Return on Assets of the shareholders, and return on assets, that measure the effectiveness of use the potential of banks.
Alternative ratios activity the profitableness of the core business of a bank (for example, margin rates, 
the contribution to the profit of varied sorts of activity, the potency with that the bank operates, and also 
the stability his profits. Reports area unit discovered for a amount of your time so as to spot the trends 
of profitableness. This analysis of the changes within the varied reports over time reveals changes in 
policies and methods and / or in its business atmosphere of banks.

Variety of things might have an effect on the profitableness of bank. In bound cases, inflation 
might increase the value of managing quicker. Marking financial gain worth of the products market needs that 
capital gains is recognized as financial gain, as a result of these gains area unit still to be 
completed, it'd negatively impact on earnings quality. Given the normal slim margin within which banks 
operate, a modification within the. level of interest rates it'll trigger changes within the earnings share as a result 
of banks area unit plagued by the amount of competition within the banking system, several have done the 
many investments in infrastructure-connected activities particularly as regards the knowledge technology like a 
part of their competitive strategy. Investments like this have each multiplied its environmental price of the 
banking sector and negatively affected profitableness. Seen within the context of monetary things to that they're connected, the operational relationships enable an analyst to assess the 
efficiency with that the body produces financial gain. Industry efficiency within the trade facilitates a 
comparison between the individual banks and therefore the industry. A review of the interest margin 
in relevance credit permits AN analyst to work out the return on assets of loan. Similarly, a comparison 
between disbursal and finance indicates the relative value of funding. This method highlights the impact 
of financial policy on the industry and therefore the impacts of fluctuations within the official interest 
rates wear the gain of a bank. 

Reports may also be employed in a broader context. The structure of the prices and revenues of 
the industry is assessed by scheming and analyzing provisions on loans and advances; interest margin to gross 
income; financial gain from capital investment; and leading the gross financial gain. The accessorial worth for 
the industry is determined by calculating net income after tax in relation to average total assets (i.e., 
the return on the average assets) and a profits once tax in regard to equity owner (i.e. the return on equity). 
Definition of liquidity: a bank's capability to fulfill money obligations as they are available due within the short 
term while not interrupting the traditional operation of the bank, measured by: 
current magnitude relation

\[ Cr = \frac{\text{Current Assets}}{\text{Current Liabilities}} \]

Basic indicator of debt service within the short term and / or cash flow capacity. Indicates the extent 
to those current assets once liquidated can cover current obligations.

1.5. Related studies on the relationship between Liquidity Risk management and Firm Performance

1. The Al-Zubi and Ballou (2005)

The study tested the link between the market powers and to value efficiencies and performances of 
Jordanian business banks throughout the amount from 1992 to 2002. The SFA utilized in the study consistent 
with Cobb-Douglas perform for estimating the points value efficiencies. The findings of the study to the failure 
of the variable value effective for explaining performance of the business banks in Jordan, that the 
link with instead of applied mathematics lives the performance for the banks.

2. Kour and Fayoumi (2007)

This study evaluated inefficiencies in terms of value and profit (standards and alternative) for 
the business banks of Jordan, with distribution technique Free Approach (DFA) supported the Cobb-
Douglas perform and take a look at their relationships with banks. If results are in favor of competition, and 
picked up the potency the link with profit performance is comparatively strong, and that they have provided an 
online of performance of the banks and also the levels of efficiency.


The purpose of the study to research the potency levels of the banks in Pakistan, Egypt, Asian nation and 
Bahrain within the amount from 1992 to 2000. And use the tactic that within which the curve flex Fourier-
flexible (Ff) and outcomes of the study indicate that the common levels for value efficiencies 
was inside the vary of regarding ninety fifth, and also the average level of potency and for profit different was 
to sixty six and fifty seven, severally. Results conjointly indicated that the Jordanian 
the Moslem banks are less economical than in terms of the prices and profits. Studio
4. Al-Kour study (2008)
This study was aims at estimate the inefficiencies in ancient industrial banks and Islamic Jordanian (fifteen banks) and through the amount from 1993 to 2006 with the translog operate and methodology of reducing constant fortuitous (SFA). The findings of the study showed the existence of great deviations than best, and reduced levels value efficiencies and profit potency and different customary. The findings conjointly show the enjoyment of Moslem banks with high level of efficiency gains, however is way from being best with relevance the price economical, which can lead to economical legislation and developing laws that force them to maintaining high levels of liquidity in owing to lack of the money instruments, the twins within the short term between liquidity and profitableness of line with law.

This study aims to help Jordanian banks to use a best observe in management of liquidity risk through the implementation the principles projected the liquidity management as counseled by the Committee of basil. The study wanted to spot degree of commitment on the a part of the banks in Jordan, and responsive queries from analysis drawback. The study finished and recommends the banks ought to have overall framework for managing the liquidity risk and to develop a technique, policies and practices of and may have adequate instruments to live, monitor and management liquidity risk. Jordanian banks ought to in public disclose at info on regular basis that permits market participants build judgment concerning the soundness of their management structure for liquidity risk and therefore the liquidity position. The super ordinate authorities ought to even be often perform a comprehensive analysis the liquidity position and therefore the risk management frameworks overall liquidity of a bank so as to work out whether or not they offer associate acceptable level of stress resistance in liquidity given the bank’s role to the financial set-up

Liquidity risk within the banking system was allotted to the deposits transactions and also the potential to trigger strokes or a panic. We have a tendency to show instead that the transactions deposits facilitate banks covering for liquidity risk by loan commitments of unused. Bank of return volatility will increase as commitments not used; however just for the banks have low levels of deposits transactions. This coverage deposits loan becomes most powerful throughout the periods of low liquidity, once nervous investors move funds into their banks. Our findings to reverse the notion of series for liquidity risk in banks, wherever it goesfrom the depositors was seen because the reason for hassle

Both investors and borrowers are involved concerning the liquidity. Investors wish money as a result of them unsure concerning after they wish to eliminate their conduct a money quality. Borrowers a concerned involving the liquidity, as a result of they unsure on their ability to continue attract or retain the funding. As a result of the borrowers typically can’t repay the investors for the asking, investors’ need a premiums or a big rights of management after you are give on to borrowers, as a compensation for the investors be the topic of illiquidity. We tend to argue that the banks will solve these liquidity problems that arise during a loan. Banks enable the depositors to withdraw on low price, furthermore as businesses swab from liquidity wants their investors. Show USA the bank should have a capital structure of fragile, subject to bank runs, so as to play those functions. Faraway from aberration to be the regulated via the funding of illiquid loans by a bank with sight deposits volatile is rationalization of within the context of the functions it performs. This model may be used for investigate problems like slender banking and capital necessities of banks.

III. Research Methodology
1.6. Research hypothesizes
H1: There is a relationship between Loan-deposit ratios (LTD) on the rate of return on equity (ROE) in Pakistan banks.
H2: There is a relationship between Loan-deposit ratio (LTD) and Return on Assets (ROA) in Pakistan banks.
H3: There is a relationship between current ratio on the rate of return on equity (ROE) in Pakistani banks.
H4: There is a relationship between current ratio on the rate of Return on Assets (ROA) in Pakistani banks.

1.7. Research model
We will think about during this analysis of performance and performance indicators as (rate of return on Assets, the rate of return on equity) because the variable either liquidity or liquidity indicators are thought of as independent variables.

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1.8. Measurement

**Performance**

We will use two indicators (rate of Return on Assets and rate of return on equity) to live the performance of the banks.

**Rate of Return on Assets’**

This rate measures the extent of profitableness achieved by the bank to speculate its assets in its numerous activities. So-called dropped the speed of return on total assets, and is calculated the speed of Return on Assets by dividing web income (net profit once tax) on total assets, as follows:

\[
\text{ROA} = \frac{\text{Profit after taxes}}{\text{Assets}}
\]

**Rate of return on equity**

Is calculated rate of return on equity by dividing net (net profit once tax) on capital property (property rights), and this implies that this rate measures the extent of management potency within the use of bank funds, and generating profits, and may be expressed during this rate as follows.

\[
\text{ROE} = \frac{\text{Profit after taxes}}{\text{Equity}}
\]

**Liquidity**

Liquidity means that the general economic sense: the cash offer (M2), consisting of money, demand deposits (M1), additionally to fastened Deposits. Consistent with this definition, graduated foreign deposits of non-residents of the thought of liquidity destruction.

The liquidity of the banking industry, it means: the distinction between the resources accessible to him, and the money employed in numerous varieties of assets, at intervals the balance obligatory by the banking assets accepted. The banks are in a state of abundance of liquidity, once the accessible funds in way over the bank's ability to lend, and therefore the limits of the investment balanced in different budget lines, therefore they are forced to speculate these surpluses at intervals quick assets, such as securities, or within the variety of balance with banks, or perhaps idle balances with the financial organization.

**Current Ratio**

We will use current magnitude relation to measure liquidity within the banks. The current magnitude relation may be a fashionable monetary magnitude relation used to test a bank’s liquidity (also cited because its current or working capital position) by account the proportion of current assets on the market to hide current liabilities. The idea behind this magnitude relation is to establish whether a company’s short assets (cash, money equivalents, marketable securities, assets and inventory) are pronto on the market to pay off its short liabilities (notes payable, current portion of term debt, payables, accrued expenses and taxes). In theory, the upper the current ratio, the better

\[
\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

**Loan To Deposit Ratio (LTD)**

An ordinarily used datum for assessing a bank’s liquidity by dividing the banks total loans by its total deposits. This range, conjointly called the LTD quantitative relation, is expressed as a proportion. If the quantitative relation is just too high, it means that banks won't have enough liquidity to hide any unforeseen fund requirements; if the quantitative relation is just too low, banks may not be earning the maximum amount as they may be.

\[
\text{LTD} = \frac{\text{LOANS}}{\text{DEPSOITS}}
\]
1.9. Population of the Study
The Community of study is the banking system in Pakistan that consists of following banks:-

<table>
<thead>
<tr>
<th>Rank</th>
<th>Bank</th>
<th>Facilities (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Askari Bank</td>
<td>40,500</td>
</tr>
<tr>
<td>2</td>
<td>Muslim Commercial Bank</td>
<td>1,300</td>
</tr>
<tr>
<td>3</td>
<td>Habib Metropolitan Bank</td>
<td>9,900</td>
</tr>
<tr>
<td>4</td>
<td>Standard Chartered Bank</td>
<td>9,900</td>
</tr>
<tr>
<td>5</td>
<td>Bank Alfalah</td>
<td>27,100</td>
</tr>
<tr>
<td>6</td>
<td>United Bank Limited</td>
<td>3,600</td>
</tr>
<tr>
<td>7</td>
<td>Bank Al-Habib Limited</td>
<td>1,000</td>
</tr>
<tr>
<td>8</td>
<td>National Bank Pakistan</td>
<td>12,100</td>
</tr>
<tr>
<td>9</td>
<td>Habib Bank limited</td>
<td>9,900</td>
</tr>
<tr>
<td>10</td>
<td>Allied Bank Limited</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Source: Association of Banks in Pakistan.

1.10. Sample of the study
The sample of study is:

1. Askari Bank
2. Muslim Commercial Bank

Justification for the choice of the two banks because they give the highest facilities in Pakistan and the biggest two bank in Pakistan. Statistical methods used to test the research hypotheses (Regression analysis)

Regression analysis could be applied mathematics method for estimating the relationships among variables. It includes several techniques for modeling and analyzing many variables, once the main focus is on the connection between a variable and one or a lot of freelance variables. Alot of specifically, multivariate analysis helps one understand however the standard worth of the dependent variable (or 'Criterion Variable') changes once anyone of the independent variables is varied, whereas the opposite independent variables area unit control fastened. Most ordinarily regression analysis estimates the conditional expectation of the variable given the freelance variables that’s, the average worth of the variable once the freelance variables area unit fastened. Less ordinarily, the focus is on a quartile, or alternative location parameter of the conditional distribution of the dependent variable given the independent variables. Altogether cases, the estimation target could be a perform of the freelance variables called the regression.

2. Findings and testing of hypothesis
We will examine the hypotheses by regression analysis.

According to the equation

Y = a + b (x)

1. Test the relation of CR and ROA

<table>
<thead>
<tr>
<th>ASKARI BANK (Rs millions)</th>
<th>YEAR</th>
<th>CA</th>
<th>CL</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>23445</td>
<td>239378</td>
<td>0.979392</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>290566</td>
<td>298740</td>
<td>0.972638</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>318462</td>
<td>325980</td>
<td>0.976937</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>328724</td>
<td>333688</td>
<td>0.986009</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>367086</td>
<td>376099</td>
<td>0.976036</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MUSLIM COMMERCIAL BANK (Rs millions)</th>
<th>YEAR</th>
<th>CA</th>
<th>CL</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>468169</td>
<td>439484</td>
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<td></td>
</tr>
<tr>
<td>2010</td>
<td>538900</td>
<td>488348</td>
<td>1.105516</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>600591</td>
<td>564622</td>
<td>1.063705</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>701816</td>
<td>664604</td>
<td>1.055991</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>779957</td>
<td>705277</td>
<td>1.105887</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ASKARI BANK (Rs millions)</th>
<th>YEAR</th>
<th>NPAT</th>
<th>ASSETS</th>
<th>ROA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>1098</td>
<td>254327</td>
<td>0.003431</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>943</td>
<td>314745</td>
<td>0.002996</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>1628</td>
<td>343750</td>
<td>0.004736</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>1263</td>
<td>353025</td>
<td>0.003578</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>-5480</td>
<td>394827</td>
<td>-0.01388</td>
<td></td>
</tr>
</tbody>
</table>
An Empirical Study on Impact Liquidity Risk Management on Firm Performance in the...
An Empirical Study on Impact Liquidity Risk Management on Firm Performance in the...

Regression equation for LTD and ROA (Askari bank)
Intercept (a) = -0.021981472
Slope (b) = 0.040963625
Y = -0.021981472 + 0.040963625(X)
ROA = -0.021981472 + 0.040963625(LTD)
When LTD = 0, ROA = -0.021981472
When LTD = 1, ROA = 0.018982153
R² = 0.163714288 that means the change in ROA is 0.163714288 resulting from the change in LTD

Regression equation for LTD and ROA (Muslim Commercial Bank)
Intercept (a) = 0.022165358
Slope (b) = 0.012566133
Y = 0.022165358 + 0.012566133(X)
ROA = 0.022165358 + 0.012566133(LTD)
When LTD = 0, ROA = 0.083221822
When LTD = 1, ROA = 0.034731491
R² = 0.687888625 that means the change in ROA is 0.687888625 resulting from the change in LTD

Regression equation for LTD and ROE (Askari bank)
Intercept (a) = -2.530810042
Slope (b) = 0.927681863
Y = -2.530810042 + 0.927681863(X)
ROE = -2.530810042 + 0.927681863(LTD)
When LTD = 0, ROE = -2.530810042
When LTD = 1, ROE = -1.603128179
R² = 0.15901052 that means the change in ROE is 0.15901052 resulting from the change in LTD

Regression equation for LTD and ROE (Muslim Commercial Bank)
Intercept (a) = 0.008830168
Slope (b) = 0.08949931
Y = 0.008830168 + 0.08949931(X)
ROE = 0.008830168 + 0.08949931(LTD)
When LTD = 0, ROE = 0.008830168
When LTD = 1, ROE = 0.098329478
R² = 0.739066718 that means the change in ROE is 0.739066718 resulting from the change in LTD

IV. Conclusions
This study investigates the reasons of liquidity risk and the effect between bank liquidity risk and performance for two banks of the years 2009-20013. The model is calculable through mounted effects regression. Within the bank liquidity risk and performance model, we have a tendency to regard liquidity risk as associate endogenous determinant of bank performance, and apply panel knowledge instrumental variables.
regression to estimate this model. During the take a look at of the correlation and Regression analyze and take a look at hypotheses of the study reached the following conclusions:

i. There is statistically important impact for Loan-deposit quantitative relation (LTD) on the speed of return on equity (ROE) in Pakistani banks, and also the relationship between LTD and ROA is direct.

ii. There is statistically important impact for Loan-deposit quantitative relation (LTD) on the rate of Return on Assets (ROA) in Pakistani banks and also the relationship between LTD and ROA is direct.

iii. There is statistically important result for current magnitude relation (CR) on the speed of return on equity (ROE) in Pakistan banks.

iv. There is statistically important result for current magnitude relation (CR) on the speed of Return on Assets (ROA) in Pakistan banks.

Will reject the most hypotheses and settle for the alternative hypothesis:

**H1**: there is statistically important result for liquidity on the performance of Pakistani banks

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