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Impact of Liquidity Management on Profitability in Banking Sector of Pakistan

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Abstract

Profitability play very important role in every organization. In banking sector t tells about how much we have earn against its expenses and how much we have to bear within a year or more than one year. And this research paper shows the impact of liquidity management on profitability. Liquidity means that easily covetable to cash in other words those assets which are can be converted into cash in short term period. And profitability means revenues more than its total expense is called profitability. And the banking sector of Pakistan is chose as sector and country is Pakistan and there is a significant relationship between liquidity and profitability eight 8 banks financial reports are taken and 8 years data is taken from 2004 to 2015 for this research paper and the banks are selected bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, jahangir saddiqui bank and Muslim commercial bank limited are selected. Pooled analysis is used to summarize the data of correlation and regression. There was a short time to collect data more than eight banks and 8 years data and further it is suggested that new researcher can take more than eight 8 banks and can take more than 8 years data from financial reports and also can take other formulas in profitability and liquidity like quick ratio, return on equity, return on investment and net profit margin as for further research and also can take other ratios as dependent and independent variable in different sectors.

Key Words: *Banking Sector, Liquidity Management, Profitability.*

Introduction

Profitability and liquidity are most important part of business which give complete information of business work. Profitability and liquidity are used for long term in each business for strong work and promotion in the business both liquidity and profitability are parallel to one another

Profitability is the important purpose of every business. Without profitability it is not easy to run your business as per continued business and the extension of business is not easy.to create profit for short term business it is necessary to create funds to fulfill its daily needs in operations and other wants business will generate more and more profits when this short term need of funds will be generated by business process not by the external debt.

Return on assets this type of profitability ratio is that it inform about the returns on the assets that how much we have earn (Ahmad, 2016). Return on assets ratio can be calculated as net profit/total assets and it is measured for to generate profits by its total assets on the base of company's efficiency (Dahmash, 2012). The researcher have explained that the profitability and liquidity are two main stockholders of bank. The shareholder have motive to earn more and more profit on the return of investment while the depositors have need to get more and cash on their safety demand to pay their money (Abdullah, 2014).

Profitability means to generate profits by the access of tis cost or to earn profit. Profits determined by the difference of its production cost and selling cost if the selling cost is greater than production cost then its profitable otherwise we are bearing a loss (Boadi, 2013). Profitability refers to the firm's ability to create sufficient profit on invested capital. Then companies will be more interested to invest or to use more efficiently to earn profit. Profitability is also related to solvency. The key is determined on profitability ratios are return on assets (Ndirangu, 2015).

The researcher argued that the liquidity management system of business is plagued by long decision making method. Assets, inventories, and liabilities management sections might not build synchronic selections regarding their policies which will eventually influence liquidity of the business (Ismail, 2016).

The effects of liquidity on the performance of the firm will result in long conclusion that it's the measuring of the amount of profit and promotion of the firm. The extension of influence of profit and liquidity on the expansion and performance of the firm has been arguable and no census has been reached (Umobong, 2015). Liquidity is explained as a large position in assets or in cash which are easily can be changed to cash much liquid assets produce flexibility for a firm with a minimum risk position according to researcher liquidity can be measured through liquidity ratios included current ratio, cash ratio and quick ratio current ratio can be measured through current assets/current liabilities same as it is cash ratio is measured through cash+marketable securities/current liabilities and cash ratio is used to measure company's liquidity (Ngwili, 2013).

The researcher explained that liquidity is the measure of availability of cash for the utilization of cash day by day in business. A liquid asset is cash or it can be shape of cash converted asset liquidity plays a vital role in the internal and external analysis due to its close relationship of daily operations of business (Mahmud, 2014). Liquidity may be explained from various methods. The first is that liquidity is short term creditor so from there point of view that the level of liquidity in different company's should be high this method tells the company's to avail the discounts opportunities the company is explained with different point of view with different ratios with the name of quick ratio, cash ratio and current ratio (Khokhar, 2015).

According to researcher monetary lexicon profit is outlined as a company's total Revenue less its operative expenses, interest paid, depreciation and taxes. Profit is Therefore the capability to form a profit. Profit is measured through profit Ratios. Profit ratios includes net margin, Return On assets (ROA) Net profit margin calculated as profit divided by Revenues return on assets calculated by dividing. A company's annual earnings by its total assets return on equity calculated as profit divided by Shareholders' equity. Relationship between liquidity and profitability the relationship between liquidity and profitability is negative according researcher (Ngwili, 2013).

Liquidity have much money in cash. To get there financial needs in other words we can explain that the easily convertible of assets into cash is called liquidity. On the other hand it explained that profitability is the determinant of money by which a company's incomes increases than its real expense. Difference between liquidity and profitability is that it is a straight line method of two concerns. If u move from one to other then you automatically move from one to other (Kumar, 2012).

Liquidity is refers to the ability to buying and selling of assets like stocks and bonds are the assets of liquidity these are sold at the current price of market and convert it into cash on the other hand liquidity is applied in the large organizations or large financial institutions like banks and they meet cash of collateral obligation to save from loss. Liquidity management explains the struggle of managers or investors to decrease the liquidity risk. The researcher have also explained that the problems arises when banks do not fulfill their demands specially those problems which may create problems between clients and banks trust therefore every commercial bank is trying to increase its profits at the same time to fulfill their financial requirements by its depositors of sufficient amount as liquidity (Alshatti, 2014).

A knowledge of liquidity is main importance to both internal and external analyst because of its nearest relationship of daily basis relationship day to day operations of business liquidity management is to get requirements trade off in liquidity and profitability (Ondigo, 2014). Liquidity means easily convertible into cash which means in banking sector those assets which are used as short term and can be easily converted into cash and there are some following indices of liquidity are explained modern liquidity, comprehensive liquidity index and comprehensive liquidity index is solved related the occurring problems which are not considering the liquidity of repay to current liabilities and current assets

Problem Identification

Problem identification means that identify the problem which is occurring due to your impact of dependent variable on independent variable of liquidity and profitability and the main problem in this research is occur to measure the ratios of liquidity and profitability. Profitability mean to say that to generate profit against its total revenue increased by its total expenses or expenses less than its total revenue is called profitability and there are following some ratios of profitability. Return on assets.

Liquidity ratio means those assets which are easily can converted to cash is called liquidity. And liquidity ratios are given as and cash ratio and current ratio. The problem is this in this article is that both of these variables have negative relationship if we move from one variable then we away from other and to measure and calculate the ratios of profitability and liquidity are not easy to find out the real value real assets as cash and to generate the profit from companies against its revenues and expenses is not easy this is also a major problem.

Problem Statement

The larger problem of these ratios that is not figure that on how liquid the current assets and how much quickly the liabilities are repaid to analyze, measure and to calculate the liquidity and profitability ratio is also create problem that to know about the bank liquid assets that how much time can be taken converted into cash and to measure the ratio of profitability to calculation of this ratio is also create problem to check the profits and loss to determine effectors such as cash ratio, current ratio, and profitability ratio.

Research objectives

To identify the relationship liquidity and profitability
To determine the relationship between cash ratio and return on assets
To explore the relationship between current ratio return on assets

Research questions

What is the relationship of liquidity and profitability?
What is the relationship between cash ratio and return on assets?
What is the relationship between current ratio and return on assets?

Significance of the study

Significance means that to know about the importance of your topic and variables and in the importance. The type of relationship exist in liquidity and profitability that can be differ from sector to sector but the availability of relationship could not be ignored managerial perspective is very important with the point of view liquidity and profitability. A decreasing movement of profitability give a sign of weak strategy of liquidity this study will help management to get information about very important points which are focused minutely to take decisions for good results of liquidity and profitability It is hope that these studies provide information banks, governments and further researcher that factor that guide to improve performance. The purpose of the research is to analyze the financial performance of banks of okara using statistical analysis of summary financial information and selected financial ratios. The main purpose of this research is to analyze the financial performance of banks of liquidity and profitability

Literature Review

In the sector of stock exchange and in the country Tehran the main purpose is to find out the relationship between liquidity and profitability. The relationship is a weak correlation and 5 hypothesis are codified and panel data is used and hypothesis is tested that there is a significant relationship in modern indices of liquidity and profitability and the sample size is that 108 companies out of 5 different industries there is a positive relationship between current ratio and cash conversion cycle (Amin Rostami). The liquidity and pro studied financial management in the area fit ability are the most airline sector is choose all over the world and the sample size is taken 25% from European companies and, 3 from south America, 4 Asian and I African and 3 from Oceania is used form air transport over the world (Roxana & Dian, 2012).

Profitability is used to maximize the profit by increasing its selling cost than its total expenses income after tax are the proxy of profitability in the banking sector of Nigeria. And in Nigeria banking sector three banks are selected to represent the entire in banking sector and in liquidity the proxies are cash short term funds, bank balance, treasury bills and certificates in sector of banking and in the country of Nigeria (Sunny & Obilor, 2013).

The researcher argued that there is a strong negative relationship to change the control leverage, inflation, firm’s earnings, and also included liquidity. Liquidity ratios have an insignificant or negative relation with return on equity and return on assets. And debt ratios also have the negatively associated with return on sales and return on assets. Profitability ratios are positively associated with return on equity and return on assets in the changing of firm’s profitability by the importance of liquidity and leverage of the firm sector foodstuff and country Pakistan (Awan, 2014).

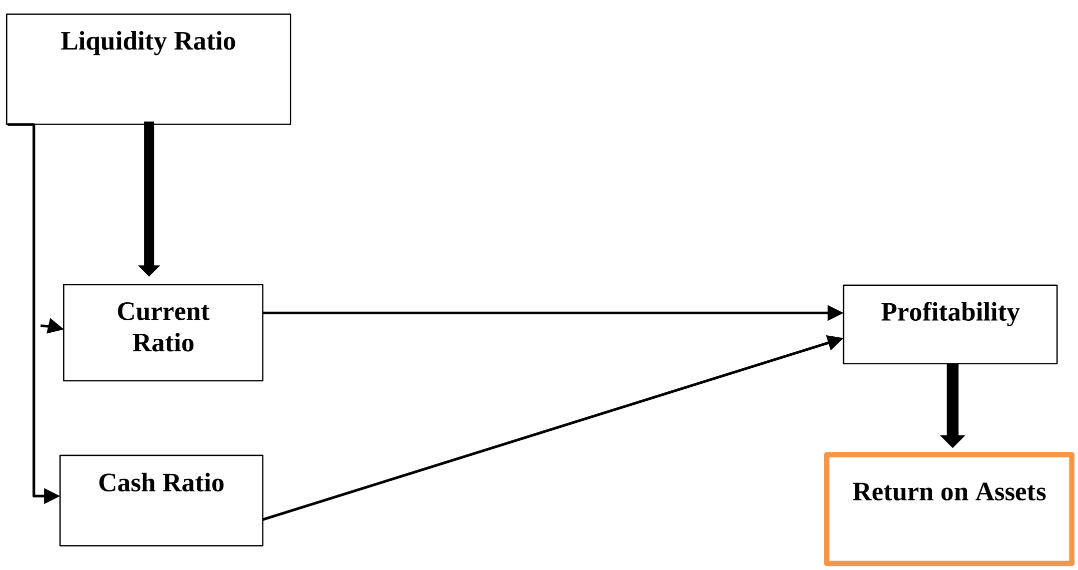
Liquidity and profitability are the main point f the each organization. Liquidity means that those assets which are can be easily converted to cash and profitability means that to earn profit by the excess of selling cost than its expenses. In the manufacturing sector in the country of sri lanka and there is no significant relationship find among profitability and liquidity in the listed manufacturing company of sri lanka and the sample size is used 31 manufacturing companies are selected as a sample size all over the country of sri lanka with in the duration of 5 years from 2007 to 2011 (Niresh, 2012). Financial institutions are concentrating highly on growth sound techniques for tradeoff during profitability and liquidity due to this deal with adequate liquidity assets from non-financial institutes to fulfill the customers demand the study of sri lanka financial institutes used capacity ratio, total deposit ratio cash position indicator like independent variable liquidity to measure on return on assets of financial institutions in the country of Sri Lanka (Shafana , 2013).

In the sector of stock exchange in the country of Pakistan the sample size is of 12 manufacturing companies are used to measure the relationship between liquidity and profitability. The secondary data is used from selected 5 years from 2005 to 2009 financial statement companies And liquidity management of any company is determined in terms of creditor's payment period, debtor's collection period and cash conversion cycle and the profitability also can be measured on return on assets, return on equity and return on investment (Small, 2012).

In the sector of stock exchange in the country of Nigeria liquidity and profitability is discussed that in liquidity there is a positive relationship between current ratio and liquidity ratio and in profitability there is a negative relationship cash conversion period related to manufacturing companies of Nigeria and 30 manufacturing companies are taken as sample size of years from 2006 to 2010 (Olubukunola, 2013). The researcher have explained that liquidity means the ability to maintain adequate funds to pay its maturing obligations. Bank's ability is to meet the cash, withdrawals cheque and cash and new loan demand in this research there is a significant relationship between return on capital and liquidity management banks employees are selected randomly 245 as a target population in banking sector of Nigeria (Osuji, 2013).

The researcher have found the relationship between and there is no significant relationship between cash at bank and return on assets and there is also no statistical significant relationship between advanced total assets and return on equity. In private banking sector in the country of India and the sample size is taken 5 banks out of 20 private bank sectors (Premalatha, 2015).

Research Model



Research Hypothesis

H1: there is significant relationship between liquidity and profitability
H2: there is a significant relationship between cash ratio and return on assets
H3: there is a significant relationship between current ratio and return on assets

Research Methodology

Research is conducted on bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir saddiqui bank and Muslim commercial bank limited. The purpose of this study is determined impact of liquidity management on profitability in banking performance. Data are taken from financial annual reports of banks 2004 to 2015 total 8 years. It is Descriptive methodology and quantitative. It is descriptive methodology and quantitative. Data are collected from past financial statement of on bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir saddiqui bank and Muslim commercial bank limited of Pakistan.

Profitability

Profit is key element in every organization. There are different methods used for checking profitability. In banking sector profit mostly depends upon difference between interest give and take on deposit and credit. Profitability of bank measure through net profit divided by total sale (revenue) and multiplies 100.
Profitability=net profit/total revenue*100

Liquidity

In liquidity take only cash ratio and current ratio. Cash ratio includes cash equivalents + treasury bills/current liabilities and current ratio includes current assets/current liabilities. It shows that bank has most quick assets to pay current liabilities.
Cash ratio=cash+ balance with securities/current liabilities and current ratio=current assets/current liabilities

Population

I chose the banks as a population in Pakistan of bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, jahangir saddiqui bank and Muslim commercial bank limited eight 8 banks are chose in banking sector of Pakistan

Sample size

Sample size is the part of target population. In which population is of bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir saddiqui bank and Muslim commercial bank limited are taken as population. And sample size are eight 8 banks 8 eight years data is taken from financial reports of given above banks are used as sample size

Research instrument

Financial statements of following banks bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir saddiqui bank and Muslim commercial bank limited are taken after audited as research instruments all data is taken from the financial performance of banks.

Data collection

Source of data collection are the banks financial performance and data is taken from the following banks financial reports after audited the financial reports bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, jahangir saddiqui bank and Muslim commercial bank limited these financial reports are also used as research instruments.

Data Analysis

Pooled analysis is used for the data analysis data analysis is used for to know about the relationship of dependent (profitability) and independent (liquidity) variables of banks.

Technique

With the use of pooled analysis we have calculate and to find correlation and regression between dependent variable (profitability) and independent variable (liquidity).

Data analysis:

	Current ratio%	*cash ratio%*	*profitability ratio%*
Mean	1.054444444	0.098444444	3.041777778
Standard Error	0.005725678	0.00237741	0.359413705
Median	1.04	0.1	1.9
Mode	1.1	0.1	1.9
Standard Deviation	0.038409016	0.015948148	2.411020426
Sample Variance	0.001475253	0.000254343	5.813019495
Kurtosis	-0.580672098	5.69414767	1.049794592
Skewness	-0.167662058	-0.754084298	1.515995821
Range	0.15	0.1	8.44
Minimum	0.95	0.05	1.06
Maximum	1.1	0.15	9.5
Sum	47.45	4.43	136.88
Count	45	45	45
Confidence Level (95.0%)	0.01	0.004	0.02

This table shows the result of mean, median and mode qualities of data. In current ratio mean is 1.044 and median is 1.04 and mode is 1.1 which are almost equal. In cash ratio mean is 0.09 and median is 0.1 and mode is also .01 and the results of mean, median and mode are also almost equal. In profitability the results of mean is 3.47 and median is i.9 and is also 1.9 and these results are approximately equal and all of these results shows the quality of data

Data analysis

	cash ratio	*current ratio*	*profitability%*
cash ratio	1		
current ratio	-0.852130622	1	
profitability%	-0.09278142	-0.005634137	1

Cash ratio have a positive relationship with cash ratio with value of 1 and cash ratio have positive relationship with current ratio with value 1 and cash ratio also have a positive relationship profitability with value 1. And current ratio have a negative relationship with cash ratio with the value of (-0.852130622). And current ratio have positive relationship with current ratio with value of 1 and again current ratio also have a positive relationship with profitability with the value of 1. Profitability ratio have negative relationship with cash ratio with the value of (-0.09278142) and profitability have a negative relationship with current ratio with the value of (-0.005634137). Profitability have a positive relationship with profitability with the value of 1

Summary output

Regression Statistics	
Multiple R	0.18654985
R Square	0.034800847
Adjusted R Square	-0.012282039
Standard Error	2.143656976
Observations	44

The value of R square is 3.35%. Which shows the dependence of dependent variable profitability has a strong relationship with independent variable liquidity. Adjusted R square the dispersion of data. The result of adjusted R square shows the value -1.22% in one side

ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*
Regression	2	6.793089202	3.396544601	0.739140056	0.001
Residual	41	188.4058744	4.59526523		
Total	43	195.1989636			

The results of this table shows that the significant level is 0.001. And shows strong relationship between independent variable and dependent variable. So we accept the H1 and H0 is rejected. So there is a significant level between profitability and liquidity.

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	7.815071395	4.329672894	1.80500273	0.078421943	-0.928880404	16.55902319	-0.92888	16.55902
cash ratio	-4.8228552	3.96847836	-1.21529079	0.231207261	-12.83735984	3.191649439	-12.8374	3.191649
current ratio	-4.018473015	3.809688723	-1.054803504	0.297691575	-11.71229548	3.675349445	-11.7123	3.675349

This table shows the results that in intercept that $p<0.07$; and cash ratio shows value of $p< 0.23$; and current ratio shows the results of $p<0.29$

Conclusion

This research paper is examined on the impact of liquidity on profitability of the banking sector of Pakistan constituting 8 years of eight banks. And the Liquidity have much money in cash. To get there financial needs in other words we can explain that the easily convertible of assets into cash is called liquidity. And the Profitability means to generate profits by the access of tis cost or to earn profit. Profits determined by the difference of its production cost and selling cost. Here profitability is dependent variable and liquidity is an independent variable. The banks are bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir saddiqui bank and Muslim commercial bank limited. It defines how factors such as liquidity included cash ratio and current ratio and profitability include return on assets this study is covering eight 8 banks financial reports annually from 2004 to 2015. By using pooled we have analyze the data. We have to use the pooled to calculate or find out the correlation and regression and there is a significant relationship between liquidity and profitability.

Limitations

In this research paper it is examined that the impact of liquidity on profitability on the banking performance of banking sector of Pakistan and in this research paper data is taken from eight 8 banks bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jahangir Saddiqui bank and Muslim commercial bank limited. financial annual reports of of 8 years from 2004 to 2015 are used as population and data is measured of the variables liquidity and profitability and the ratios are taken from liquidity cash ratio and current ratio and from profitability ratio is taken return on assets and I liquidity cash conversion cycle is left and quick ratio also left as a limitation and in profitability return on equity , payout ratio and net profit margin and return on investment also leave as limitation in this research paper

Recommendations

This research paper is examined on two variables as dependent variable is profitability and the other is independent variable is liquidity. And data is taken from the financial reports of eight 8 banks 8 years from 2004 to 2015. The banks are included bank of Punjab, allied bank, united bank, askari bank, alfalah bank, meezan bank, Jjahangir saddiqui bank and Muslim commercial bank limited are used for data collection. It is suggestion for new researcher that he can take more than two variable as dependent and independent like working capital ratio and earning per share can take as a variable. the new researcher should increase the formulas in liquidity and profitability like in liquidity can be quick ratio and cash conversion cycle ratio and in profitability new researcher should take net profit margin, return on equity and return on investment also can take for further research. Researcher should take more than 8 years financial annual reports of banks and banks should be more than eight 8 it is also suggested that the studies should carries by other factors

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