International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 3 Mar 2022, pp: 1324-1329 www.ijaem.net ISSN: 2395-5252

Impact of Profitability and Liquidity on Financial Performance of Private Sector Banks

Uma Maheswari S

Department of Management, Amrita School of Business, Kochi, India

Submitted: 20-03-2022 Revised: 28-03-2022 Accepted: 31-03-2022

ABSTRACT: The purpose of this study is to show how profitability and liquidity affect the private bank's financial performance. For the study, ten private sector banks were chosen to cover the years 2012 to 2021. Profitability ratios such as Net Interest Margin (NIM), Net Profit Margin (NPM), and liquidity ratios such as Current Ratios (CUR) have been used as independent variables, while external variables such as Inflation (INF), Total Assets (TA) to indicate firm size have been used as dependent variables for bank profitability. The analysis relies on secondary data from the selected companies' annual reports and financial statements.

KEYWORDS:Financial Performance, Net Profit Margin, Net Interest Margin**.**

I. INTRODUCTION

The banking sector plays an essential role in the modern economic world. Banks are the fulcrum of any economy's financial system. The primary function of banks is to gather money from the public in the form of deposits and then use that money, along with its own capital, to swift service client needs, pay interest on deposits and cover operating expenses. Banks accomplish this by maintaining adequate liquidity and profiting from their operations. They offer specialist banking services that lower the cost of acquiring information about saving and borrowing options. These financial services contribute to the overall efficiency of the economy. Banks are crucial in the transmission of monetary policy and are one of the government's most essential weapons for stimulating economic development without inflation. As per the data published by the Reserve Bank of India on January 14th overall bank credit growth surged to 9.2 percent year over year in December 2021. Investors can learn about a bank's overall health by looking at its financial performance. It's a snapshot of the company's economic health and management performance, offering an insight into the future of operations and profit are on track to grow, as well as the stock's future. Liquidity is crucial to the success of banking firms, especially banks. It influences the bank's growth and development, as well as the smooth operation of the financial system. It's all about liquidity when it comes to cash reserves. Bank requires capital in order to lend: otherwise, they risk going bankrupt. Deposits are created by lending, however not all deposits are created by lending. Whenever deposits are drawn banks require funding or they risk running out of money. Profitability ratios show how well a business generates profits and value for its shareholders. Results with a greater proportion are frequently more positive. The company's most crucial key performance metrics are liquidity and profitability. It will indicate the firm is already or can be successful in its growth and sustainability. The study evolves among the private banks, public sector banks are those in which the federal or state government owns more than 50 percent of the stock. Private sector banks are those in which private firms or individuals own the majority of the stock. They have also been employing direct salespeople to market credit products. This has allowed private banks to providegreater services and amenities to their customers, giving them a leg up on their public sector counterparts. The capability of an organization to bring success by effectively exploiting resources in order to achieve the expected outcomes is measured by its performance. Finance performance metrics (FPIs) are measurable metrics that are used to evaluate the performance of the company. Debt holders, investors, shareholders, personnel, and managers are only a few of the stakeholders of a firm. Each group has a vested interest in monitoring a company's financial success. Financial performance measures a company's ability to produce income and manage its assets, obligations, and the financial interests of its stakeholders and stockholders.

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 3 Mar 2022, pp: 1324-1329 www.ijaem.net ISSN: 2395-5252

II. LITERATURE REVIEW

The study has undergone several research papers. Liquidity and bank performance (2015) done by Godfrey Marozva, CFA, University of South Africa. The article is based on the empirical research conducted between 1998 and 2014 on the relationship between liquidity and bank performance in South African banks. The main of the study is to investigate the relationship between net margin and liquidity, the researchers used the Autoregressive Distributed Lag (ARDL) which is a bound testing strategy, and (OLS) Ordinary Least-squares method. The result of the study indicated that Net interest margin and funding liquidity risk have a negative substantial deterministic relationship, according to the study.

Impact of liquidity management on profitability: An Empirical analysis in private sector banks of India (2019) the paper done by MISHRA, Satyakama 1 & PRADHAN, Bibhuti Bhusan 2. The paper attempts to explain the impact of liquidity management on private sector bank profitability in India. It was discovered that when all variables are considered there is no significant association between bank profitability and liquidity for any of the selected commercial banks in India. As a result, commercial banks can concentrate on expanding their profitability without compromising their liquidity, and vice versa.

The impact of liquidity on bank profitability: Post-crisis Evidence from European banks (2016) done by Dimitrios Kalanidis, School of economics. The study examines the influence of liquidity on the profitability of 50 significant European banks from 2009 to 2015. This study looked at the impact of liquidity on the profitability of 50 European banks, as measured by ROAA, ROAE, NIM, and PBT. Liquidity as measured by several balance sheet measures (e.g. cash, deposits), Liquidity ratios (e.g. Loans to Total Assets, Impaired loans to Gross Loans), capital ratio, and external macroeconomic factors. The result of the study is that ROAA, ROAE, and PBT, all liquidity measures derived from the balance sheet and the liquidity ratios had a negative impact on profitability.

Marozva (2015) analyzed the relationship between liquidity and bank performance over the period 1998 to 2014 for banks of South Africa and found an adverse relationship between net interest margin and funding liquidity risk. The relationship between liquidity ratios and profitability ratios might be negative. Malik, Awais, & Khursheed (2013), supported that profitability ratio and liquidity ratios have a negative relationship in their study which has been conducted on 22 private banks of Pakistan over the five years.

Bordeleau & Graham (2010) using a sample of large US and Canadian banks, explore that
profitability is generally increased for banks that hold some liquid assets; however, there is a point at which holding further liquid assets decreased profitability of banks, Ceteris Paribas. Moreover, the findings suggested that this relationship fluctuates as per bank's business model and the state of the economy. Shahchera (2012), using a sample of Iranian listed banks using panel data over the period of 2002 to 2009 explore evidence of a nonlinear relationship between profitability and liquid assets holding.

The influence of the liquid asset ratio on bank profitability has been reported in a number of empirical studies. For instance, Bordeleau and Graham (2010), Ibe (2013), Lartey et al. (2013), Nimer et al. (2013), Rasul (2013) found the positive effect of liquidity on bank profitability. Accordingly, the maintenance of liquidity at a mild level can help ensure the safety of bank operations as well as reduce external costs for the guaranteed liquidity, which in turn boosts the performance. However, it is believed that liquidity can exert a negative impact on bank profitability by some scholars like Eljelly (2004), Olagunju et al. (2011), Nimer et al. (2013), and Nimer et al. (2015). This shows that (Godfrey Marozva, 2015) (Vithalbhai1, 2020) (Kalanidis, 2016) (MISHRA, 2019) (Pokharel, 2019) (Marozva, 2015) (Bordeleau, 2010) (Dr. Pratibha Garg, 2015) (Namita Rajput, 2019) (Tanveer Bagh, 2017) (Sujan paul, 2021) (Dr Mohamed Aymen Ben Moussa, 2020) more liquid liabilities may take away more business opportunities from banks, leading to a risk of decreasing profits.

Financial performance of banks in India: A study of selected private sector banks done by Vasani Sureshbhai vithalbhai, Research Scholar, Department of Commerce, Saurashtra University, India. The purpose of this study is to assess the performance of a few private sector banks in India. The goal is also to investigate the profitability of these selected banks. The findings of the study demonstrate that the Net Profit of the selected banks differs significantly.

This research looks at how differences in liquidity and profitability affect the bank's financial performance. The impact of liquidity on bank profitability has traditionally been the subject of research. The impact of profitability of private sector banks in India is investigated in this article. Thus the main objective of this study is to determine

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 3 Mar 2022, pp: 1324-1329 www.ijaem.net ISSN: 2395-5252

- Whether there is a relationship between liquidity and financial performance of private banks.
- Whether there is a relationship between profitability and financial performance of private banks.
- Whether the effect of profitability and liquidity on the financial performance of the banks.

III. RESEARCH METHODOLOGY

A. DATA

The research design implemented for the study is descriptive and explanatory. The data collected for the study is based on secondary data. It is collected from the annual reports of the bank and the financial statements published from 2012 to 2021. 10 private banks were selected as a sample for the study. Table1. Demonstrates the banks were selected on the basis of their market capitalization.

Table 1.

Sl.No	Bank Names	Market capitalization
1	HDFC Bank	837864.38
2	ICICI Bank	521959.61
3	Kotak Mahindra	365438.03
4	Axis Bank	2391129.12
5	IndusInd Bank	72759.66
6	Yes Bank	34099.77
7	IDBI Bank	47525.62
8	Federal bank	20906.85
9	Karur Vyasa bank	3863.54
10	South Indian Bank	1718.14

B. VARIABLE DESCRIPTIONS

To achieve the objective of the study a new research model is developed (Fig.1) here the figure demonstrates to determine the financial performance of the financial institution's Return on Equity (ROE) is taken as the dependent variable along with this the right side of the figure shows the independent variables like Firm size, Inflation, Liquidity, and Profitability. Since it will identify the characteristics of the primary components of the research topic, making it descriptive and then evaluating the impact of the independent variables on the dependent variable, this study is descriptive explanatory research.

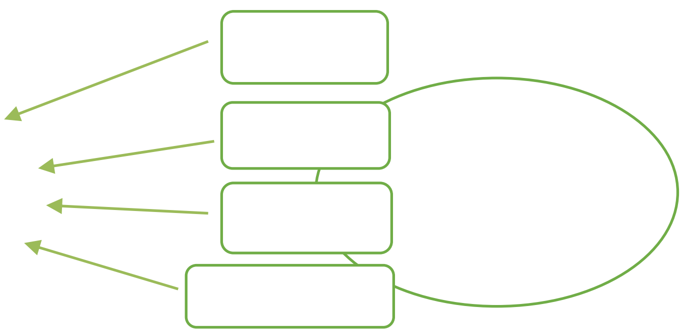

Fig.1 Research model for measuring the financial performance of the private sector banks.

B 1) Dependent Variables Include

The paper includes one dependent variable that is financial performance. To measure the financial performance of the financial institution Return on Equity is considered in the study. (ROE) is a metric that indicates to investors how well a firm (or, more particularly, its management team) manages the money that shareholders have put into it. The Return on Equity is frequently used to evaluate a company to its competitors and the wider market. It is a measure of a company's profitability and how effectively it makes money.

B 2) Independent variables Includes

1. Firm size – The size of a business unit is the same as the size of a company. It defines the size or amount of work produced by a particular company. For computing the size of the firm Total Assets of the firm which is taken from the financial statements of the banks. The aggregate of the book values of all assets owned by an individual, firm, or institution is referred to as total assets. The bank's assets are the items it owns. Loans, securities, and reserves are all included. Deposits and bank borrowing from other institutions are examples of liabilities that the bank owes to others.
2. Inflation- Inflation is defined as the rate at which prices rise over time. Inflation is usually defined as a wide measure of price increases or increases in the cost of living in a country.
3. Liquidity- The ease with which an asset, or security, can be changed into immediate cash without impacting its market price is referred to as liquidity is typically measured using current, quick, and cash ratios. The current ratio is a liquidity ratio that evaluates a company's ability to satisfy its short-term obligations. It is critical to the success of financial institutions, especially banks. It influences bank growth and development, as well as the efficient functioning of the financial market.
4. Profitability- Profitability is a metric that contrasts an organization's profit with its expenses. It is a company's ability to generate income that exceeds its expenses by utilizing its resources. For measuring the profitability ratios like Net interest margin (NIM) and Net profit margin (NPM) are taken into consideration. Net Interest margin (NIM) is the difference between interest paid and interest received, adjusted for the total amount of interest generating assets owned by the bank, which is known as net interest margin. The difference between investment income and interest expenses is divided by the average earning assets to arrive at the net interest margin formula.

C. HYPOTHESIS

- H1: Profitability has a significant impact on the financial performance of banks
- H2: Liquidity has a significant impact on the financial performance of banks.
- H3: The size of the firm has a significant impact on the financial performance of banks.
- H4: Inflation has a significant impact on the financial performance of banks.

IV. EMPIRICAL ANALYSIS

Table.2

Variables	**Coefficient**	**P-Value**
NIM	**0.17**	**0.04**
TA	**0.23**	**<.01**
INF	**0.10**	**0.14**
NPM	**0.59**	**<.01**
CUR	**0.06**	**0.27**

Regression is a statistical tool for the investigation of relationships between variables it depicts that profitability has a major significant impact on financial performance. Table 2. Depicts Net Interest Margin (NIM) and Net profit margin (NPM) has a positive relationship with coefficients

0.17 and 0.59. Here 1 unit increase in the Net Interest Margin the financial performance increases by 0.17 in the case of (NIM) along with a 1 unit increase in the Net Profit Margin the financial performance increases by 0.59. A positive Net Interest Margin means the bank is investing effectively. A positive Net Profit Margin indicates that the business is profitable.

Firm size has a positive relationship with a coefficient of 0.23 and it has a significant impact on financial performance. Here the 1 unit increases in the Total Assets the financial performance increases by 0.23. The size of the firm of financial institution can imply that it is growing and expanding, leading the market to react positively. The size or scale of an institution is determined by its total assets and sales.

Liquidity has a negative relationship here current ratio is with a coefficient of 0.06 statistically it seems there is no significant impact on financial performance. Along with liquidity, Inflation also has a negative relationship with a coefficient of 0.10. When there is an increase in the firm size and liquidity is by 1 unit then the financial performance decreased by 0.06 and 0.10 units. It further signifies the change in the increase and decrease of liquidity and Inflation.

From the analysis, the results of the study draw that Hypothesis 1 and Hypothesis 3 have a significant relationship among Net Profit Margin (NPM) and Net Interest Margin (NIM) while Hypothesis 2 and Hypothesis 4 there is a significant relationship among liquidity and Inflation is not supported.

V.CONCLUSION

Private Banks in India seem to be doing well and since globalization, more and more private banks are establishing high-quality standards. Any shareholder, investor, creditor, banker, or other stakeholder concerned with the company's financial performance can benefit from ratio analysis. The paper reported that the profitability and size of the firm have a significant and positive impact on the financial performance of the private banks. Since profitability management increases financial performance so the banking sector should ensure effective profitability management and they can implement methods to increase the firm size. Over several firms, profitability is one of the most important components of financial performance. Profitability is important to a firm's management, shareholders, as well as other investors interested and linked with the company because it gives a specific picture of firm performance. The limitation of the study is that the study here is restricted to 10 private sector banks on the basis of market capitalization, in the future the researchers can expand the sample size by including more banks. The period of the study is between "2012-202", researchers can further increase the span of study if they want to be. Apart from all in the future, the researchers can include more variables and sample sizes that will lead to a meaningful study. They can also include more profitability ratios and liquidity ratios for evaluating financial performance.

REFERENCES

[1]. Bordeleau, É. &. (2010). The Impact of Liquidity on Bank Profitability. Ottawa, Ontario, Canada K1A 0G9: Bank of Canada.

[2]. Dr Mohamed Aymen Ben Moussa, A. b. (2020). THE IMPACT OF LIQUIDITY ON BANK PROFITABILITY: CASE OF TUNISIA. European Journal of Accounting, Auditing and Finance Research Vol.8, No.2, pp.20-37.

[3]. Dr. Pratibha Garg, S. K. (2015). An Empirical Analysis of Profitability Position of Selected Private Sector Banks in India. Garg & Kumari, Apeejay - Journal of Management Sciences and Technology 2 (3), June - 2015.

[4]. Godfrey Marozva, C. U. (2015). Liquidity And Bank Performance. International Business & Economics Research Journal Volume 14, Number 3.

[5]. Kalanidis, D. (2016). The Impact of Liquidity on Bank Profitability: Post Crisis Evidence from European Banks. Dimitrios Kalanidis.

[6]. Marozva, G. (2015). Liquidity And Bank Performance. International Journal of Economics and Business Research.

[7]. MISHRA, S. 1. (2019). Impact of Liquidity Management on Profitability: An Empirical Analysis in Private Sector Banks of India. Raavista Espacios.

[8]. Namita Rajput, A. K. (2019). Indian Banking Sector a Major Contributor to Economy: Constancy Major Concern. International Journal of Recent Technology and Engineering (IJRTE).

[9]. Pokharel, S. P. (2019). Impact of liquidity on profitability in Nepalese Commercial Bank. Patan Pragya (Volume: 5 Number: 1 Sept. 2019).

[10]. Sujan paul, P. K. (2021). Impact of Liquidity on Profitability: A Study on the Commercial Banks in Bangladesh. ReasearchGate.

[11]. Tanveer Bagh, S. R. (2017). The Causative Impact of Liquidity Management on Profitability of Banks in Pakistan: An Empirical Investigation. International Journal

of Academic Research in Economics and Management Sciences Vol. 6, No. 3.

[12]. Vithalbhai1, V. S. (2020). Financial Performance of Banks in India: A Study of Selected Private Sector. Journal of Advanced Research in Economics and Administrative Sciences ISSN: 2708-9320.