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Navigating Liquidity Challenges: A Comparative Study Of SBI And HDFC's Resilience To Liquidity Risk.

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ABSTRACT

Liquidity risk is one of the major risks faced by banking companies in India. This may be due to economic turmoil, changes in the regulatory framework, or any internal factors. The liquidity position of a bank directly affects its profitability, so it is very important to understand how banks are mitigating their liquidity risk. In this study, the researchers investigated how HDFC Bank and SBI manage their liquidity risk for the period of 2019-2023. Data has been collected from the financial statements of both these banks, and the results show that HDFC has consistently high quick ratios, implying a proactive approach to maintaining a robust liquidity position and potentially mitigating the impact of unforeseen liquidity challenges. For SBI, the declining trend in both ratios raises concerns about SBI's evolving liquidity position

Keywords. Liquidity risk, Risk resilience.

INTRODUCTION

Liquidity risk poses a threat to banks by impeding their ability to fulfill payment obligations, thereby resulting in undesirable consequences. It can be defined as the risk associated with the probability that a bank may not have sufficient funds when required. Bank liquidity is unique compared to other types of businesses, as the entire banking system revolves around managing cash and other liquid assets through borrowing and lending (Sovaniski, 2018).

Since the 2008 financial crisis, liquidity risk and systemic risk have become major concerns for banks, driving changes in Asset Liability Management (ALM) practices. The Bank for International Settlements (BIS) introduced two critical measures, the Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR), to assess a bank's liquidity health. Excessive liquidity in banks can lead to the formation of asset bubbles, contributing to financial crises like the one in 2008. The International Monetary Fund (IMF) highlighted the vulnerability of banks to liquidity issues, especially in underdeveloped nations, due to events like the COVID-19 pandemic. These global financial distress emphasize the importance of effective liquidity management for banks. In India, banks have faced a paradoxical situation in terms of funding liquidity from 2011 to 2021. (Raavinuthala, 2022)

SBI and HDFC are two prominent banks in India represent both public sector and private sector banks in India. SBI is largest and oldest banks in India, on the other hand HDFC is a new generation bank that completely changes the banking spectrum of India through their innovative banking products and services. These two banks are excellent in their services to customers but also playing a major role in Indian banking landscape. (Angel, 2023). The State Bank of India (SBI) is a prominent bank in India with a rich history dating back to the early 19th century. It originated on June 2, 1806, when the Bank of Calcutta, later renamed the Bank of Bengal, was established. Subsequently, the Bank of Bombay (founded on April 15, 1840) and the Bank of Madras (established on July 1, 1843) were established. These three banks, known as the presidency banks, merged into a joint stock company to issue paper currency under the Paper Currency Act of 1861(Chaudhuri, 2018)

HDFC Bank, or Housing Development Finance Corporation Bank, was established in August 1994 with its registered office located in Mumbai. It started operating as a scheduled commercial bank in 1995. In 1994, it received preliminary approval from the Reserve Bank of India (RBI) to set up a private sector bank as part of the liberalization of the Indian banking industry. HDFC Bank is well-known as India's leading premium housing finance company, with a strong presence in both national and international markets. Since its inception in 1997, the bank has consistently grown and become a market leader in mortgage financing, offering housing loans for millions of dwelling units across India. Presently, the bank operates 4,805 branches across the country, connected through online banking, and provides telephonic net banking services. Additionally, HDFC Bank boasts a network of over 12,860 ATMs in 2,657 cities nationwide. It specializes in housing-related credit facilities and has significant expertise in retail mortgage loans for various market segments. (HDFC, 2023)

Research Objectives

1. To evaluate and compare the liquidity risk exposure of SBI and HDFC

2. To identify and analyze the key determinants and factors that contribute to the liquidity risk resilience of SBI and HDFC

3. To explore the implications of liquidity risk resilience for the overall financial stability of SBI and HDFC.

Statement of the Problem:

In the dynamic and interconnected landscape of the Indian banking sector, financial institutions are facing ongoing liquidity challenges that demand a comprehensive understanding of their liquidity risk management practices. This study aims to investigate and compare the liquidity risk resilience of two prominent players in the sector, State Bank of India (SBI) and Housing Development Finance Corporation (HDFC). In an era marked by regulatory changes and economic uncertainties, it is crucial to evaluate how these banks navigate liquidity challenges and maintain their financial stability. The research seeks to shed light on the ability of SBI and HDFC's to effectively manage liquidity risk and ensure the uninterrupted flow of funds

SBI is one of the largest public sector banks in India, holding the largest market share in the Indian banking sector. In India, most banks follow the benchmarks set by SBI, hence it is recognized as a mammoth among Indian public sector banks. Similarly, HDFC Bank is the largest private sector bank in India in all aspects, and most private sector banks follow the example set by HDFC. Therefore, HDFC represents the face of private sector banks in India. In this context, it is essential to understand how these banks manage their liquidity, especially in the post-COVID era, where there is a significant demand for funds due to accelerated economic growth

LITERATURE REVIEW

Reethika (Reethika, 2021) studied the financial performance of SBI and HDFC banks from 2015 to 2020 and found that the capital adequacy ratio of HDFC Bank was higher compared to SBI. The debt equity ratios were also better for HDFC, indicating a stronger financial position. The leverage ratios of HDFC were better than SBI's. Overall, the financial performance of HDFC Bank was better than SBI during the study period.

Gopal (Gopal, 2022) examined the financial details of SBI and HDFC banks for the period from 2015-16 to 2019-20. The study reveals an upward trend in the amount of loans and advances for both HDFC and SBI. The financial performance, in terms of net profit, fluctuates for SBI but remains constant for HDFC during the study period. Regarding Gross NPA and Net NPA, HDFC Bank outperforms SBI.

Sanjib (Sanjib, 2016) examined the financial performance of SBI and HDFC over a 10-year period from 2005 to 2015. The results indicate that the growth and performance of HDFC Bank are more satisfying than SBI during the study period, suggesting that in India, private sector banks have more room for growth than public sector banks. In terms of reserves, advances, investments, equity dividends, net profit, EPS, etc., HDFC Bank outperforms SBI. Lower variability is observed in aspects such as interest earned and operational expenses for SBI compared to HDFC during the study period.

Anilkumar (Nirmal, 2020) compared the financial performance of SBI and HDFC for the period 2010-2019 and found that the NPA and net profit of HDFC Bank were steadier than those of SBI. Although the Gross NPA and profit of HDFC are not correlated, the Capital Adequacy Ratio is positively correlated with Gross NPA.

Sanjiv (Sanjiv, 2021) studied the management of non-performing assets in both SBI and HDFC banks for the period 2013-2019. The study concluded that NPA poses the biggest challenge for both SBI and HDFC, leading to a decrease in the liquidity positions of the banks. Profitability is also negatively affected by the rising NPA for both banks. The data from the study period indicated that SBI has the highest NPA compared to HDFC. Profitability is inconsistent for SBI compared to HDFC during the study period.

Hiteksha (Hiteksha, 2019) studied the credit risk of HDFC Bank and SBI for the period 2019-2018 using Altman's Z-score. The results indicate that according to the Altman Z-score, HDFC Bank has the highest overall Z-score, while SBI has a lower Z-score than HDFC Bank. HDFC Bank has consistently maintained a Z-score above 2.60 from 2009 to 2018, indicating its strong financial health and safety. However, the regression model is not statistically significant for predicting HDFC Bank's outcome variable. In contrast, for SBI, the regression model is statistically significant in predicting its outcome variable.

Ashok's (Ashok, 2019) study comparing the financial performance of HDFC Bank and SBI from 2014 to 2017 using the Balanced Scorecard framework, it was found that HDFC Bank consistently outperformed SBI across various perspectives, including financial, customer, and social/environmental aspects. The results indicate no significant differences in HDFC Bank's performance across these perspectives, while SBI showed a difference only in the financial perspective when comparing within the company. The study recommends that both banks concentrate on enhancing their performance in non-financial perspectives to positively impact overall financial performance.

Lalitha's (Lalitha, 2023) financial performance analysis of State Bank of India (SBI) and HDFC Bank using the CAMEL model, it is found that HDFC Bank outperforms SBI across all parameters. Despite both banks maintaining strong capital adequacy ratios and asset quality, HDFC Bank excels in management efficiency, earning capacity, and liquidity. SBI, a public sector bank, ranks second to HDFC Bank in all aspects, indicating a need for improvement in asset quality, while HDFC's areas for enhancement include management efficiency and current ratio to cover current liabilities.

Aswin (Aswin,2018) conducted a five-year study (2012-2016) comparing the financial performance of SBI and ICICI. The research revealed that SBI outperformed ICICI in Capital Adequacy Ratio, attributed to ICICI's weaker metrics in assets, debt-equity, and government securities. SBI excelled in Asset Quality, with ICICI lagging in total investments to total assets and Net NPAs to total assets. However, ICICI demonstrated better Management Efficiency, surpassing SBI in total advances to total deposits, business per employee, profit per employee, and return on equity ratios. In terms of Earning Quality, ICICI outperformed SBI, but in Liquidity, ICICI surpassed SBI due to the latter's weaker performance in various liquidity ratios. Despite differing ratio rankings, there was no statistically significant difference in their CAMEL ratios, suggesting that both banks' overall performance could be attributed to the adoption of modern technology.

Seema (Seema, 2021) conducted a study using CAMEL model to evaluate the performance of State Bank of India (SBI) and HDFC Bank across various parameters, including capital adequacy, asset quality, management efficiency, earnings, and liquidity. The findings reveal that HDFC Bank outperforms SBI in the areas of Capital Adequacy, Asset Quality, and Management. However, SBI surpasses HDFC Bank in terms of Liquidity. Both banks show similar performance in Earnings Quality.

The available literature shows a comparison of the financial performance of two banks in the past. Most of the analysis is done mainly using the CAMAL approach. Very few studies cover the liquidity aspects and how these banks manage their liquidity risk to ensure continued profitability. This study sheds light on how these banks manage their liquidity for the last five years and their resilience to liquidity risk.

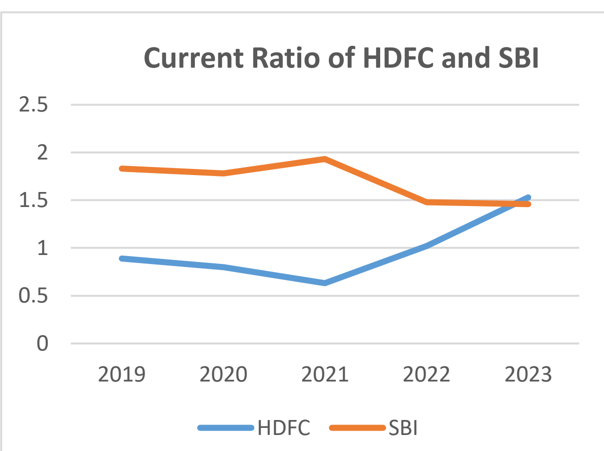
DATA AND METHODOLOGY

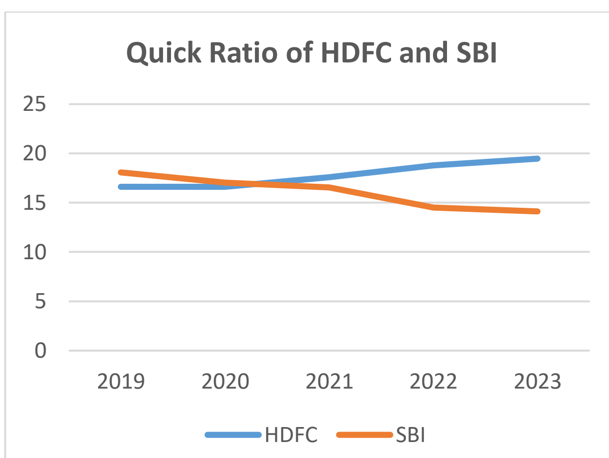
This study is based on secondary data collected from the financial statements of both the State Bank of India and HDFC banks. The data has been gathered from the balance sheets of both these banks for the period of 2019-2023. The current ratio and quick ratio are calculated based on the available data.

Liquidity ratios of HDFC bank and SBI bank

Current Ratio	**2023**	**2022**	**2021**	**2020**	**2019**
HDFC	1.53	1.02	0.63	0.8	0.89
SBI	1.46	1.48	1.93	1.78	1.83
Quick Ratios	**2023**	**2022**	**2021**	**2020**	**2019**
HDFC	19.48	18.77	17.58	16.62	16.61
SBI	14.11	14.49	16.56	17.05	18.06

Graph showing comparison of Current ratio and Quick ratio of HDFC and SBI Banks.





The increasing trend in the current ratio from 2019 to 2023 (0.89 to 1.53) suggests an improvement in HDFC Bank's ability to cover short-term liabilities with short-term assets. The rising current ratio signifies increased resilience to liquidity risk, as the bank has a larger buffer to meet its short-term obligations. HDFC banks quick ratio is exceptionally high, indicating a robust ability to cover short-term obligations. The quick ratio's significant increase from 2019 to 2023 (16.61 to 19.48) suggests that the bank holds a substantial amount of highly liquid assets, further enhancing its resilience to liquidity risk. A quick ratio well above 1 reflects a high level of financial flexibility and the ability to respond quickly to unexpected liquidity demands.

The current ratio for State Bank of India (SBI) has shown a fluctuating trend, declining from 1.83 in 2019 to 1.46 in 2023, indicating variations in SBI's ability to cover short-term liabilities with assets during this period. Although the current ratio has slightly decreased, it remains above 1 in 2023, suggesting that SBI still possesses more current assets than liabilities, although to a slightly lesser extent than in previous years.

Similarly, the quick ratio has decreased from 18.06 in 2019 to 14.11 in 2023, signaling a reduction in SBI's ability to cover short-term obligations. Despite this decrease, the quick ratio remains above 1 in 2023, indicating that SBI maintains sufficient highly liquid assets to meet short-term obligations. Overall, while SBI generally maintains a sound ability to meet short-term obligations, the declining trend in both ratios raises concerns about the bank's evolving liquidity position, warranting further analysis to understand the contributing factors. Contextual considerations, such as industry benchmarks and economic conditions, are crucial for a comprehensive understanding of SBI's relative liquidity performance.

Implications to liquidity risk resilience:- HDFC Bank's improving current and quick ratios over the years suggest a strengthening position regarding liquidity risk. The consistently high quick ratio implies a proactive approach to maintaining a robust liquidity position, potentially mitigating the impact of unforeseen liquidity challenges. The bank's ability to maintain healthy liquidity ratios is a positive indicator of its resilience to liquidity risk, showcasing a capacity to navigate short-term financial uncertainties. For SBI, the declining trend in both ratios raises concerns about SBI's evolving liquidity position. Early identification of these concerns allows the bank to initiate further analysis and implement strategic measures to enhance its liquidity risk resilience, such as adjusting the composition of assets or liabilities.

Conclusion:-

The increasing trend in HDFC Bank's current ratio from 2019 to 2023 (0.89 to 1.53) signifies an enhanced ability to cover short-term liabilities with assets, reflecting improved resilience to liquidity risk and a larger buffer for meeting obligations. The exceptionally high quick ratio, increasing from 16.61 to 19.48 during the same period, highlights HDFC Bank's robust capacity to cover short-term obligations, indicating a substantial holding of highly liquid assets and reinforcing its resilience to liquidity risk.

On the Other hand SBI's fluctuating current ratio, declining from 1.83 in 2019 to 1.46 in 2023, indicates variations in its ability to cover short-term liabilities. Although the current ratio remains above 1 in 2023, reflecting a positive liquidity position, the decreasing trend raises concerns about SBI's evolving liquidity position. The declining quick ratio from 18.06 to 14.11 over the same period signals a reduction in SBI's ability to cover short-term obligations, warranting further analysis and strategic measures to enhance liquidity risk resilience.

For HDFC Bank, the improving liquidity ratios suggest a strengthened position against liquidity risk, showcasing a proactive approach and the ability to navigate unforeseen challenges. In contrast, SBI's declining ratios underscore potential liquidity concerns, emphasizing the importance of early identification and strategic measures to enhance resilience in the face of evolving liquidity risks. Contextual considerations, such as industry benchmarks and economic conditions, play a crucial role in understanding each bank's relative liquidity performance

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