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An Analysis of Liquidity and Solvency Position with Reference to Axis Bank

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ABSTRACT

Banking industry in India has achieved a new height with the changing times. The use of technology has brought a revolution in the working style of the banks. India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process. Indian Banks are moving towards the concept of financial supermarkets, where the customer can get the full range of financial services.

Keywords: Banking industry, Private banks, Assets, Liquidity, Income, Expenditure.

INTRODUCTION

Banking industry is a major sector of the economy that has achieved renewed focus after financial sector reforms and the entry of private sector banks. Banking industry in India has achieved a new height with the changing times. The use of technology has brought a revolution in the working style of the banks. India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process. Indian Banks are moving towards the concept of financial supermarkets, where the customer can get the full range of financial services. The Indian banking system classifies banks into scheduled and non-scheduled banks, public sector and private sector banks, Indian banks and foreign banks, and commercial and co-operative banks. Scheduled banks, the banks which are listed in the 2nd schedule of the Reserve Bank of India Act, satisfy the prescribed rules by Reserve Bank of India. Reserve Bank of India regulates the banking sector. Public sector banks are owned (over 51%) by the Central Government / the Reserve Bank of India or other public authorities and comprise three groups – Nationalised Banks, State Bank of India group of banks, Regional Rural Banks (RRBs). Private Sector Banks are owned by private entities and are either Indian Banks or foreign banks. Indian private sector banks are further classified into two sub-groups-old generation (established prior to 1993) and new generation private sector banks (established after 1993). Co-operative Banks are small size banks operating mainly for agriculture and allied activities in rural areas and small and tiny business in urban. Commercial Banks generally concentrate on industry, trade, commerce in the urban centres and they also lend to agricultural and small business in the rural areas.

The broad objective of the banking sector reforms in India has been to increase efficiency and profitability of the banks. For this purpose, the banking sector has been opened for new private sector banks. As a result, various new private sector banks have started their banking business in India.

STATEMENT OF THE PROBLEM

The financial performance of banking sector always puts an impact on the performance of the economy. The performance analysis of banking sector is very important to meet the global benchmark and useful to investors, customers, bankers, policymakers and economy in general. Two decade has elapsed since the initiation of banking sector reforms in India. Over this period the India banking sector has experienced a paradigm shift. At this juncture it is imperative to make the performance appraisal of this sector. Axis bank is the third largest Private Sector bank in india offering a wide range of products and services to corporate and retail customers though a variety of delivery channels. As against this background an attempt is made here by the researcher to evaluate the financial performance of Axis bank. The researcher is of opinion that the study would highlight the operational efficiency of the bank that helps for further growth.

OBJECTIVES OF THE STUDY

1. To examine the liquidity and solvency position of the bank
2. To analyze the financial performance of the bank

LIMITATION OF THE STUDY

The present study is restricted to evaluate the financial performance of Axis Bank and to suggest remedial measures for its success. The present study concentrates only on the financial performance of the bank. It excludes the perception of the customers of the bank.The study is undertaken only on the basis of secondary data (Annual Reports of the Bank). It excludes the non-performing assets management.

RESEARCH DESIGN AND METHODOLOGY

The present research is a case study. Axis Bank has become the case unit. In view of considerable data, especially form the sources collected and presented in this research report, descriptive is considered to be most appropriate to the present study. The study is based on the primary sources of secondary data which have been collected from annual reports of the bank, published and unpublished financial reports, journals, magazines and related websites.

DATA PROCESSING

The data collected were edited to ensure its correctness and completeness. The collected data were presented by preparing classification tables for further analysis. For further processing the data were computerized.

ANALYSIS AND STATISTICAL TOOLS EMPLOYED

The financial performance of Axis Bank is analysed in terms of liquidity, earnings quality and profitability (in terms of returns). To measure these, various statistical tools such as arithmetic average, growth rate, percentage analysis and accounting ratios are used.

DATA ANALYSIS AND INTREPRETATION

The financial statement analysis is simply a process of evaluating the relationship between component parts of a financial statement to obtain a better understanding of a firm's position and performance. Ratio analysis is a widely used tool of financial analysis. It is defined as the systematic use of ratio to interpret the financial statement so that the strengths and weaknesses of a firm, as well as its historical performance and current financial condition, can be determined.

In this chapter the researcher analyses the financial performance of Axis Bank in terms of Liquidity ratios, Earnings Quality ratios and Profitability ratios.

Current Ratio is the most commonly used measure of short term solvency, since it indicates the extent to which the claims of short term creditors are covered by assets that are expected to be converted into cash in a period of roughly corresponding to the maturity of the claims. It brings relationship between the total current assets and total current liabilities. This is the indication of general measure of liquidity and state of trading.

Current asset include cash and those assets which can be converted into cash within a year and all liabilities maturing within a year are included in current liabilities. Items which are included in the current assets of the Bank are Cash and Balances with RBI, Balances with Banks and Money at Call and Short Notice, Investments and Advances. The components of current liabilities are Deposits, Borrowings and Other liabilities and provisions.

"A Current Ratio of 2:1 is considered ideal as rule of thumb. But in actual practice 1:1 is found more suitable than 2:1"[1]. "It is important to note that a very high ratio of current assets to current liabilities may be indicative of slack management practices, as it might signal excessive inventories for the current requirements and poor management in terms of over extended accounts receivables. At the same time, the firm may not be making full use of its current borrowing capacity".

"A low current ratio also indicates a weak liquidity position. It means that the firm may experience difficulty in meeting its maturing obligations. Poor ratio may be due to heavy losses, excessive financing on a short term basis and the practice of using current funds to finance fixed assets".

The significance of the Current Ratio is that it is not only a measure of solvency but it is an index of the working Capital available to the enterprise.

The current ratio is computed as follows

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

On an average, the current ratio was recorded as 1.07 times. If we see the current ratios of the bank, it is clear that the bank is not enjoying a satisfactory level of liquidity and solvency position.

LIQUID RATIO

Liquid Ratio is also known as Quick Ratio or Acid Test Ratio or Near Money Ratio. It is the ratio between Liquid Assets and Current Liabilities. It is a more refined tool to measure the liquidly of an organization. A Liquid Ratio of 1:1 is usually considered as satisfactory, it is again a rule of thumb only.

"A Company with a high value of Quick Ratio can suffer from the shortage of funds if it has slow paying, doubtful and long duration outstanding debtors. On the other hand, a company with a low value of Quick Ratio may really be prospering and paying, its current obligation in time if it has been turning over its inventories efficiently".[4]

The Liquid Assets of the bank include the cash and balances with RBI, balances with banks and money at call and short notice, and Advances and the current liabilities include the items already mentioned.

This ratio is expressed as

$$\text{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$$

The liquid ratio of the study unit reveals a constant trend. On an average the liquid ratio of the study unit was reported 0.72 times.

CURRENT ASSETS TO TOTAL ASSETS RATIO

This ratio explains the relationship between current assets and total investments in assets. A business enterprise should use its current assets effectively and economically because it is out of the management of these assets that profits accrue. A business will end up in losses if there is any lacuna in managing the assets to the advantage of business. Investment in fixed assets being inelastic in nature, there is no elbow room to make amends in this sphere and its impact on profitability remains minimal.

Total assets of the bank include: Cash and balances with RBI, balances with banks and money at call and short notice, investments, advances, fixed assets and other assets appearing in the asset side of the balance sheet.

The current assets to total assets ratio is calculated as follows:

$$\text{Current Assets to Total Assets Ratio} = \frac{\text{Current Assets}}{\text{Total Assets}} \times 100$$

On an average current assets constitute 97.10 per cent of the total assets.

LIQUID ASSETS TO TOTAL ASSETS RATIO

Liquid Assets as a percent of total assets show the percentage of liquid assets in the asset structure of the bank. Higher the proportion of liquid assets in the total assets, higher liquidity of the bank

This ratio is calculated as follows:

$$\text{Liquid Assets to Total Assets Ratio} = \frac{\text{Liquid Assets}}{\text{Total Assets}} \times 100$$

On an average this ratio was registered 65.85 percent. It is worthwhile to note that the amount of liquid assets of the bank is increasing from Rs 119550 crore to Rs 258305 crore during the period under study which is welcoming feature.

CURRENT LIABILITIES TO TOTAL ASSETS RATIO

The ratio of current liabilities to total assets is used to measure current liability strategy. Larger values of this ratio indicate increasingly aggressive current liability strategies.

"An Aggressive current liability strategy is designed to maximize the amount of short term debt that is used to finance current assets".

The ratio is calculated as follows:

$$\text{Current Liabilities to Total Assets Ratio} = \frac{\text{Current Liabilities}}{\text{Total Assets}} \times 100$$

On an average it is 91.16 per cent. The hallmark of the study is that the bank has larger ratio of current liabilities to total assets and it is proved that the bank is adopting aggressive current liability strategy.

DEBT EQUITY RATIO

Debt – Equity Ratio is used to determine the soundness of the long term financial policies of the company. It is also known as "External – Internal" Equity Ratio. The purpose of calculating Debt – Equity ratio is, to have an idea of the amount of capital supplied to the bank by the members and the amount available to creditors in the event of liquidation.

The following formula is used to calculate Debt – Equity Ratio

$$\text{Debt – Equity Ratio} = \frac{\text{Debt}}{\text{Equity}}$$

The results highlights that the debt equity ratio of the study unit varies between 8.67 times and 11.34 times. On an average this ratio reaches 10.02 times during the study period and it reveals that the study unit depends on higher debt.

EARNINGS QUALITY RATIOS

This section, assesses the quality of earnings in terms of income generated by core activity that is income from lending operations. The researcher discussed this segment under the following heads.

1. Interest rate spread
2. Net profit / loss and spread amount of the bank
3. Expenditure
4. Income
5. Expenditure to income ratio
6. Total expenditure to total assets
7. Total income to total assets

INTEREST RATE SPREAD

Interest Rate Spread is the difference between the interest income and interest expenses. It provides contribution to a bank's profit, after providing for loan losses. A bank having larger spread would be able to earn more profit. The spread would be large if the bank has quality loans and investments to earn income and it raises funds at low cost. The following table shows the interest rate spread of the study unit.

During the study period the spread amount was increasing from Rs 5004 crore to Rs 11951 crore.

NET PROFIT / LOSS AND SPREAD AMOUNT OF THE BANK

Profit is a financial measure of a firms operations during a period. It is the difference between the income earned and the expenditure incurred to earn the said income during the period. It is therefore, called the 'net result'. It is an accounting entity where profit= income – expenditure. The net profit is the net result of the firm during a particular period. It is computed after payment of business expenses, including tax.

The spread amount varies between Rs. 5004 crore and Rs.11951 crore during the period under review.

EXPENDITURE

The expenditure of the bank mainly consists of interest paid by the bank on borrowings and deposits. Apart from interest paid it has operating expenses which includes payments to and provisions for employees, rent, taxes and lighting, printing and stationery, advertisement and publicity, depreciation of bank property, directors' fees, auditors' fees, repairs and maintenance, insurance and so on.

The total expenditure of the bank varies between Rs.10344 crore and Rs.26591 crore during the study period.

INCOME

The income of the bank mainly consists of interest earned on the loans and advances issued by the bank. Apart from interest received, it has other incomes as commission, exchange and brokerage, profit on sale of investment, dividends from subsidiaries and so on.

The total income of the study unit were registered Rs.33734 crore in the study period and Rs.38046 crore in the study period.

EXPENDITURE TO INCOME RATIO

The Expenditure to income ratio shows about the percentage of expenditure to income. The ratio below 100 percent shows a surplus of income over expenditure. If the ratio is above 100 percent it shows a deficit in income to total expenditure. The expenditure to income ratio is computed as follows.

$$\text{Expenditure to Income Ratio} = \frac{\text{Expenditure}}{\text{Income}} \times 100$$

During the whole study period, the ratio shows the position of surplus of income over expenditure.

TOTAL EXPENDITURE TO TOTAL ASSETS

The expenditure to total assets ratio shows about percentage of total expenditure to total assets. The following table highlights the Total expenditure to Total assets ratio.

The total expenditure to total assets ratio varies between 5.51 per cent and 7.17 per cent during the period of study.

TOTAL INCOME TO TOTAL ASSETS RATIO

This ratio explains the relationship between total income and total assets of the study unit.

The ratio of total income to total assets has registered a maximum of 9.93per cent in the study period and minimum of 8.15 per cent in the study period. On an average it was recorded 9.24 per cent.

SUMMARY OF FINDINGS

Financial Performance of the Bank

The financial performance of Axis Bank, was analysed with the help of liquidity ratios, Earnings Quality ratios and Profitability ratios.

Liquidity Ratios

Liquidity ratios consist of Current Ratio, Liquid Ratio, Current Assets to Total Assets Ratio, Liquid Assets to Total Assets Ratio, Current Liabilities to Total Assets Ratio and Debt Equity Ratio.

Current Ratio

The bank is having insufficient current assets in all the years to meet its current obligations. On an average, the current ratio was recorded as 1.07 times.

Liquid Ratio

Liquid ratio of the bank is lower than the standard norm. On an average, liquid ratio of study unit was registered 0.72 times.

Current Assets to Total Assets Ratio

The ratio of current assets to total assets almost has a fixed trend from study period. On an average current assets constitute 97.10 per cent of the total assets.

Liquid Assets to Total Assets Ratio

On an average liquid assets to total assets ratio was registered 65.85 per cent. The amount of liquid assets of the bank is increasing from Rs.119550 crore to Rs.258305 crore during the period under study .

Current Liabilities to Total Assets Ratio

The current liabilities to total assets ratio varies between 90.02 per cent and 92.38 per cent. On an average it is 91.16 per cent. The hallmark of the study is that the bank has larger ratio of current liabilities to total assets

Debt Equity Ratio

On an average debt equity ratio reaches 10.02 times during the study period and it reveals that the study unit depends on higher debt.

Earnings Quality Ratios

Earnings quality ratios consist of Interest rate spread, Net profit / loss and spread amount of the bank, Expenditure, Income, Expenditure to income ratio, Total expenditure to total assets and Total income to total assets.

Interest rate spread

During the study period the spread amount was increasing from Rs 5004 crore to Rs 11951 crore.

Net profit / loss and spread amount of the bank

The profit amount varies between Rs.2515 crore and Rs.6218 crore during the period of study. The spread amount varies between Rs. 5004 crore and Rs.11951 crore during the period under review.

Expenditure

The total expenditure of the bank shows an increasing trend from study period. The total expenditure of the bank varies between Rs.10344 crore and Rs. 26591 crore during the study period.

Income

The total income of the bank shows an increasing trend from Rs 15584 crore to Rs 38046 crore during the period under study.

Expenditure to income ratio

In all the years the ratio is less than 100 per cent. During the whole study period, the expenditure to income ratio shows the position of surplus of income over expenditure.

Total Expenditure to Total Assets

The ratio of the total expenditure to total assets varies between 5.51 per cent and 7.17 per cent during the period of study. On an average this ratio was recorded 6.47 per cent during the period under review.

SUGGESTIONS

- Though the ratio of total income to total assets is satisfactory, the study unit must take steps to improve this position by efficient management of the assets.
- The liquidity position of the bank is not healthy. It is suggested that necessary steps to be taken by the bank to improve its liquidity position.
- It is suggested that the study unit should give training to the staff especially in the field of bank marketing.

CONCLUSION

The results of the Research show that the performance of the study unit is better in terms of deposits, advances, interest spread, expenditure to income, net profit and in terms of earning per share and dividend per share during the study period. But on liquidity front, the liquidity position of the bank is not healthy and therefore the bank should earnestly endeavour to strengthen its liquidity position.

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