Excess SLR And Its Impact On Profitability Of State-Owned Commercial Bank: Bangladesh Perspective

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Abstract: The purpose of the study is to review the amount SLR and to find out the amount of loss incurred due to maintaining excess SLR. The study found that excess SLR of State-owned Commercial Banks (SOCB) was gradually increased in 2015 and 2016 with some exceptions. On the other hand, although COF (Cost of Fund) was gradually increased in the period of 2014 to 2016 but WAIR (Weighted Average Interest Rate) of investment was drastically fall in 2015 and 2016. As a result, in 2015 Sonali, Janata, Agrani, Rupali & Basic bank incurred loss of Tk. 557.41, 255.26, 391.33, 52.23 & 102.99 crore and in 2016, it was Tk. 307.57, 352.14, 468.23, 62.60 & 56.54 crore respectively. The implication of the study is that SOCBs can use the findings to take necessary actions regarding excess SLR. Moreover, this study is a unique one in Bangladesh perspective, because a number research conducted on the investment in govt. securities or security market related topic but "Excess SLR and its impact on Profitability of State-owned Commercial Bank: Bangladesh Perspective" is new and unique.

Key words: SLR; State-owned commercial Banks; Profit; Loss

Introduction

Statutory liquidity ratio is the percentage of funds banks need to maintain in the form of liquid assets at any point in time. But, banks need to maintain these funds in the form of government securities, bonds or precious metals, and not in the form of cash (Reddy & Chandraiah, 2018). According to DOS Circular No.-01, dated 19/01/2014 every scheduled bank has to maintain assets in cash or gold or in the form of un-encumbered approved securities the market value of which shall not be less than such portion of its total demand and time liabilities as prescribed by BB from time to time. BB may also prescribe the procedure of determination of assets and liabilities and percentages of maintainable assets in different classes. At present, the required SLR is 13% daily for conventional banks and 5.5% daily for Islamic Shari'ah based banks and Islamic Shari'ah based banking of conventional banks of their average total demand and time liabilities. The Statutory Liquidity Requirement (SLR) is one of the quantitative and powerful tools of monetary control of the central banks. Changes in SLR can have a marked effect on money and credit situation of a country. If the central bank raises average reserve requirement of the commercial banks, this would create a reserve deficiency or decrease in available reserve of depository institutions (Younus & Akhtar, 1990).

Methodology

The topic for the research is "Excess SLR and its impact on profitability of State-owned Commercial Bank: Bangladesh Perspective" and the nature of the topic is theoretical and descriptive. So, to conduct the research the type of research suitable is Descriptive research and the study is conducted based on only secondary data. Secondary data have been collected various publications of Bangladesh Bank, Annual Reports of commercial banks and published research journals, published books, websites, etc. Besides, treasury manuals of different banks have been consulted for preparing the report.

Justification of the Study

All banks including State-owned Commercial Banks, have to maintain 6.50% CRR (from June, 2018 it is 5.50%) and 13.00% SLR as a regulatory requirement. This SLR is calculated on the basis of their two months earlier total demand and time liabilities. To fulfill SLR requirement, banks invest their funds to the Government Securities. A Government Security (G-Sec) is a tradable instrument issued by the Government either short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Govt. bonds or dated securities with original maturity of one year or more) basis. Although, G-Secs. carry practically no risk of default but there is a negative relationship between excess liquidity and profitability. Therefore, studying Excess SLR and its impact on profitability of State-owned Commercial Bank are very important. The financial system of Bangladesh is bank dependent. Though at present, a large number of non-banks financial institutions (NBFIs) are operating in the financial sector, yet their proportionate share is not significant (Choudhury, 2012). Moreover, banks invested in govt. securities to make

trade-off between liquidity and profitability. So, researcher used Excess SLR and its impact on profitability of State-owned Commercial Bank as research tropic because SOCBs are the most dominating element of financial system of Bangladesh and G-Secs. carry practically no risk of default. This topic is selected to present the real situation of investment in T-Bills & T-Bonds by State owned Commercial Banks as SLR in Bangladesh and the amount of loss incurred due to excess investment.

Literature Review

Although we did not found any research works on Excess SLR and its Impact on Profitability on State-owned Commercial Banks: Bangladesh perspective but there are several research works on liquidity and profitability management of the commercial banks internationally. Many studies have found that liquidity problem decreases the profitability. Other studies explained that available liquidity increases the profitability. At the literature review we will deliver the most important and appropriate theories of the several researchers where different researchers provide different explanations about this topic. Adebayo et al (2011), found that there is significant relationship between liquidity and profitability. That means profitability in commercial banks is significantly influenced by liquidity and vice versa. The study concluded that for the success of operations and survival, commercial banks should not compromise efficient and effective liquidity management and that both illiquidity and excess liquidity are "financial diseases" that can easily erode the profit base of a bank as they affect bank's attempt to attain high profitability-level. Larte et al (2013), in his study on **"**The Relationship between Liquidity and Profitability of Listed Banks in Ghana" found that there was a very weak positive relationship between the liquidity and the profitability of the listed banks in Ghana. Ibe (2013), in his study on "The Impact of Liquidity Management on the Profitability of Banks in Nigeria" found that for banks to resolve the liquidity/profitability trade-off, there is need for each bank to determine its optimal liquidity position and banks should engage competent and qualified personnel in order to ensure that right decisions are adopted especially with the optimal level of liquidity and still maximize profit. Sokefun (2014), in his study on "Liquidity Risk and Profitability: An Assessment of Nigerian Banks'' showed that there is a significant relationship between liquidity risk and profitability of both domestic and foreign banks in Nigeria. It was recommended that there is need to improve transparency of the financial system, which in turn would assist financial institutions to evaluate liquidity risk more effectively and to avoid problems associated with hazardous exposure. Alshatti (2014) also found a positive effect of the increase in the quick ratio and the investment ratio of the available funds on the profitability, while there is a negative effect of the capital ratio and the liquid assets ratio on the profitability of the Jordanian commercial banks. The researcher recommends that there is a need for an optimum utilization of the available liquidity in a various aspects of investment in order to increase the banks' profitability, and banks should adopt a general framework of liquidity management to assure sufficient liquidity for executing their operations efficiently, and they should initiate an analytical study of the evolution rates of liquidity and their ability to achieve a balance between sources and uses of funds. Bijoy et al (2015), in his research on "Liquidity Management and Profitability Analysis of Private Commercial Banks in Bangladesh'' found that excess liquidity reduces the profitability. Begum (2017), in her research on "Is There a Relationship between Liquidity and Profitability in the Banking Sector of Bangladesh: A Panel Data Analysis'' investigated the relationship between banks' liquidity and profitability by considering four types of banks (State-owned Commercial Banks, Private Commercial Banks, Foreign Commercial Banks and Development Financial Institutions) and using fixed effects model (FEM) for the period from 1997 to 2014. She opined that the expenditure-income ratio, non-performing loans (NPLs) negatively impact banks' profitability (ROA) while profitability is defined as return on asset (ROA). Finally concludes that profitability is more sensitive to NPLs and expenditure-income ratio than to liquidity. The negative relationship between NPLs and banks' profitability is an important concern for the policymakers.

Results and Discussion:

Investment Scenario of SOCBs:

All banks including State-owned Commercial Banks have to maintain 13.00% Statutory Liquidity Reserve (SLR) as a regulatory requirement. But they maintained huge excess amount of SLR in the year 2014, 2015 & 2016. In the year 2014, Sonali, Janata, Agrani, Rupali and Basic Bank Limited maintained excess SLR of Tk. 19886.59, 12263.26, 8249.11, 3670.42, & 1394.89 crore respectively. On the other hand, except Rupali Bank (which decreased by 2.54% in 2015 and 36.12% in 2016), it (amount of excess SLR) was increased by 49.09%, 15.00%, 50.00% & 83.21% in 2015 and 66.30%, 13.50%, 76.28% & 110.02% in 2016 respectively compared to the year 2014 (Table-1).

Table: 1: *Required SLR & Excess SLR*

(Figure in crore)

Bank	2014			2015			2016		
	Investment	Required SLR	Excess SLR	Investment	Required SLR	Excess SLR	Investment	Required SLR	Excess SLR
SBL	28547.13	8660.54	19886.59	39684.76	10035.49	29649.27	45184.38	12112.48	33071.90
JBL	18645.84	6382.58	12263.26	21052.66	6949.81	14102.85	21801.32	7882.94	13918.38
ABL	12706.43	4457.32	8249.11	17767.47	5344.19	12423.28	20654.21	6112.76	14541.45
RBL	6429.85	2759.43	3670.42	6869.36	3292.24	3577.12	6084.97	3740.33	2344.64
Basic	3094.84	1699.95	1394.89	4277.58	1722.05	2555.53	4782.59	1853.06	2929.53

(Source: Annual report of SOCBS 2014-2016)

Cost of Fund (COF), Weighted Average Interest Rate (WAIR) & Yield on Advance:

COF, WAIR & Yield on advance vary from bank to bank due to various reasons. In the year 2014, COF of state-owned commercial banks was between 8.09 to 11.87%, whereas it was between 7.34 to 10.24% in 2015 and 6.95 to 8.42% in the year 2016 (Table-2).

Table:- 2: *COF, WAIR & Yield on advance*

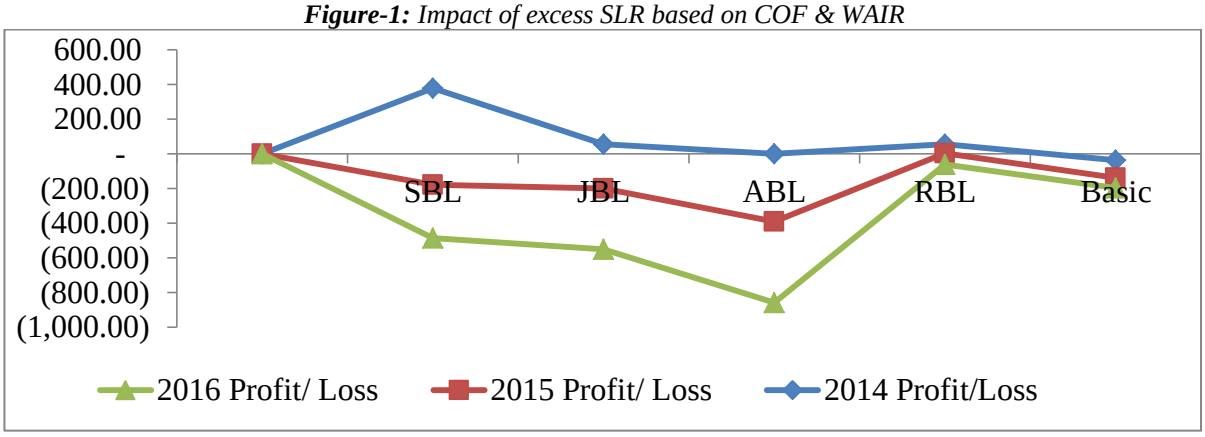
Bank	2014			2015			2016		
	COF	WAIR	Yield	COF	WAIR	Yield	COF	WAIR	Yield
SBL	8.09%	10.00%	7.88%	7.34%	5.46%	8.78%	6.95%	6.02%	8.70%
JBL	8.82%	9.27%	11.44%	7.94%	6.13%	9.35%	8.05%	5.52%	8.54%
ABL	9.58%	9.57%	12.17%	9.01%	5.86%	11.24%	8.42%	5.20%	10.02%
RBL	8.21%	9.68%	12.77%	8.02%	6.56%	12.52%	7.62%	4.95%	10.45%
Basic	11.87%	9.22%	13.50%	10.24%	6.21%	6.54%	8.31%	6.38%	6.01%

(Source: Annual report of SOCBs 2014-2016)

On the other hand, in the year 2014, weighted average interest rate received from govt. securities of state-owned commercial banks was between 9.22 to 10.00%, whereas it was between 5.46 to 6.56% and 4.95 to 6.38% in 2015 and 2016 respectively, that is, WAIR had drastically fall. Moreover, Yield on advance also had fall in the year 2016 compare to the year 2014.

Impact of excess SLR based on COF & WAIR:

Figure-1: *Impact of excess SLR based on COF & WAIR*

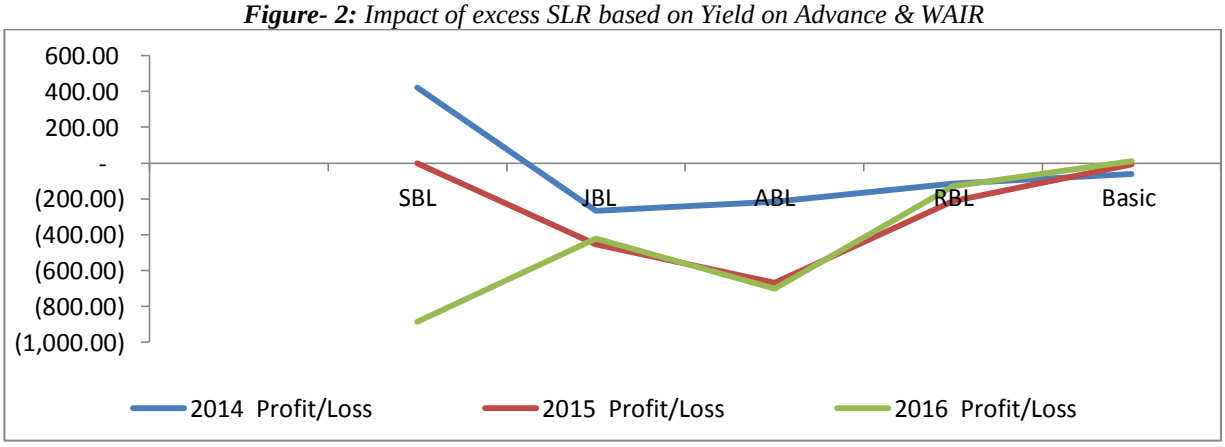


(Source: Annual report of SOCBS 2014-2016)

In 2014, except Agrani & Basic bank, all other SOCBs were profitable because their cost of fund was less than weighted average interest rate received from govt. securities. But in case of Agrani & Basic bank, cost of fund was higher than weighted average interest rate. However, in 2015 and 2016, cost of fund of SOCBs was higher than weighted average interest rate. As a result, in 2015 Sonali, Janata, Agrani, Rupali & Basic bank incurred loss of Tk. 557.41, 255.26, 391.33, 52.23 & 102.99 crore respectively due to maintaining excess amount SLR by those banks. Moreover, in 2016, the amount loss was Tk. 307.57, 352.14, 468.23, 62.60 & 56.54 crore respectively (Figure-1& Appendix-i).

Impact of excess SLR based on Yield on Advance & WAIR:

Figure- 2: *Impact of excess SLR based on Yield on Advance & WAIR*



(Source: Annual report of SOCBS 2014-2016)

***Profit/loss calculation shown in the appendix-I & ii**
Generally Yield on Advance is higher than cost of funds. Therefore, if SOCBs were able to invest their excess SLR in the conventional loan and advances then their operating income would raise tremendously. However, SOCBs were unable to do this and this scenario is depicted in the above Figure-2. In the year 2014, Sonali, Janata, Agrani, Rupali & Basic Bank Limited incurred loss of Tk. 421.60, 266.11, 214.48, 113.42 & 59.70 crores respectively due to maintaining excess amount SLR by those banks. On the other hand, except Basic Bank (which increased by 85.88%) the amount of loss incurred was increased by 133.46%, 70.65%, 211.62% & 87.97% in the year 2015 compared to 2014 due to decrease in WAIR, although in the year 2016, the amount of loss incurred was decreased compared to 2015 because of slightly increase in WAIR in the year 2016 (Figure-2 & Appendix-ii).

CONCLUTION

State-owned Commercial Banks have to maintain 5.50% Cash Reserve Requirement (CRR) and 13.00% Statutory Liquidity Reserve (SLR) as a regulatory requirement but these banks maintained an huge excess amount of SLR in the years 2014, 2015 & 2016 because of excess liquidity in the market, low private sector credit growth, unwillingness by the bank for disbursing loan and advances, etc. For instance, study found that Sonali, Janata, Agrani, Rupali and Basic bank maintained excess SLR of 35.49%, 22.95%, 30.92%, 8.15% and 20.55% in 2016 respectively against their regulatory requirement of 13% only. In addition, depending on the liquidity conditions in the money market, the weighted average interest (yield) rate of government securities of different maturities declined significantly in 2015 and 2016 with some exceptions. However, cost of funds of SOCBs was not reduced significantly. This pushed Sonali, Janata, Agrani, Rupali & Basic bank incurring loss of Tk. 557.41, 255.26, 391.33, 52.23 & 102.99 crore in 2015 and Tk. 307.57, 352.14, 468.23, 62.60 & 56.54 crore in 2016 respectively due to maintaining excess amount SLR by those banks. However, if SOBCs take into consideration yield on advance, then the amount of loss incurred by Sonali, Janata, Agrani & Rupali would be Tk. 886.33, 420.34, 700.90 and 128.96 crore in 2016. Therefore, SOCBs should try to maintain SLR as minimum as possible so that profitability as well as liquidity of that bank does not hampered.

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APPENDICES

Appendix-i: Profit/Loss Calculation Based on Cost of Fund

Bank	2014				2015				2016			
	COF (%)	WAIR (%)	Excess SLR	Profit/ Loss	COF (%)	WAIR (%)	Excess SLR	Profit/ Loss	COF (%)	WAIR (%)	Excess SLR	Profit/ Loss
SBL	8.09	10.00	19886.59	379.83	7.34	5.46	29649.27	(557.41)	6.95	6.02	33071.90	(307.57)
JBL	8.82	9.27	12263.26	55.18	7.94	6.13	14102.85	(255.26)	8.05	5.52	13918.38	(352.14)
ABL	9.58	9.57	8249.11	(0.82)	9.01	5.86	12423.28	(391.33)	8.42	5.20	14541.45	(468.23)
RBL	8.21	9.68	3670.42	53.96	8.02	6.56	3577.12	(52.23)	7.62	4.95	2344.64	(62.60)
Basic	11.87	9.22	1394.89	(36.96)	10.24	6.21	2555.53	(102.99)	8.31	6.38	2929.53	(56.54)

Profit/loss= (WAIR-COF) Excess SLR*100*

Appendix-ii: *Profit/Loss Calculation Based on Yield on Advance*

Bank	2014				2015				2016			
	Yield (%)	WAIR (%)	Excess SLR	Profit/ Loss	Yield (%)	WAIR (%)	Excess SLR	Profit/ Loss	Yield (%)	WAIR (%)	Excess SLR	Profit/Loss
SBL	7.88	10.00	19,886.59	421.60	8.78	5.46	29,649.27	984.36)	8.70	6.02	33,071.90	(886.33)
JBL	11.44	9.27	12,263.26	(266.11)	9.35	6.13	14,102.85	(454.11)	8.54	5.52	13,918.38	(420.34)
ABL	12.17	9.57	8,249.11	(214.48)	11.24	5.86	12,423.28	(668.37)	10.02	5.20	14,541.45	(700.90)
RBL	12.77	9.68	3,670.42	(113.42)	12.52	6.56	3,577.12	(213.20)	10.45	4.95	2,344.64	(128.96)
Basic	13.50	9.22	1,394.89	(59.70)	6.54	6.21	2,555.53	(8.43)	6.01	6.38	2,929.53	10.84

Profit/loss= (WAIR-Yield) Excess SLR*100* ***(Source: BB website & SOCBs Annual report-2014-2016)***

** WAIR- Researchers own calculation*