Determinants of Banks’ Liquidity and their Impact on Financial Performance in Nepalese Commercial Banks*

Sushil Subedi¹ and Bivab Neupane²

Abstract

This paper aims to study the relationship between liquidity of selected Nepalese commercial banks and their impact on financial. In order to collect primary data, structured questionnaire were distributed whereas quarterly publication of banks were used as secondary sources and analyzed through different statistical tools such as descriptive statistics, correlation, and multiple regressions with variance inflation factor. Multivariate linear regression model is used to include Liquid Assets to Total Assets Ratio, Loan to Deposit & Short Term Financing and Return on Assets for the data of six commercial banks in the sample covering the period from 2002/03 to 2011/12. Based on quantitative methods, hypothesis were tested and reached into the conclusion.

The results of regression analysis showed that capital adequacy, share of non-performing loans in the total volume of loans had negative and statistically significant impact on banks liquidity whereas loan growth, growth rate of gross domestic product on the basis price level, liquidity premium paid by borrowers and short term interest rate had negative and statistically insignificant impact on banks liquidity. Bank size had positive and significant impact and inflation rate had positive and insignificant impact on banks liquidity. Similarly, it showed that capital adequacy, bank size, share of non-performing loans in the total volume of loans and liquidity premium paid by borrowers had negative and statistically significant impact on banks liquidity. Bank size had positive and significant impact and inflation rate had positive and significant impact on banks liquidity. Growth rate of gross domestic product on the basis price level (2000-2001), short term interest rate and inflation rate had negative and statistically insignificant impact on banks liquidity. And, loan growth rate had positive and statistically insignificant impact on banks liquidity. Among the statistically significant factors affecting banks liquidity capital adequacy, bank size and growth rate of gross domestic product on the basis price level had negative impact on financial performance whereas, liquidity premium paid by borrowers had positive impact on financial performance. Therefore, the impact of bank liquidity on financial performance was non-linear.

Adjusting the liquidity position with better strategy for managing credit risk has negative impact on financial performance. The study suggest that commercial banks in Nepal should adopt other ways of managing credit risk as minimizing adverse selection during the time of credit approval, improving credit administration, debt recovery and strict follow up of borrowers to minimize the problem of moral hazards after the provision of credit. Since commercial banks focuses mainly on interest spread, NRB should come out with strict rules and regulations for control mechanism of firm specific factors.

Keywords: bank’s liquidity, commercial banks, financial performance, multivariate linear regression,

---

* This paper is the modified version of an unpublished MBA thesis submitted to Ace Institute of Management, Pokhara University in spring, 2013.
¹ Mr. Subedi is a graduate student at Ace Institute of Management, Email: 
² Mr. Neupane is a visiting faculty at Ace Institute of Management, Email: