

1 A Study of Relationship between Liquidity and Profitability of  
2 Standard Charterd Bank Pakistan: Analysis of Financial  
3 Statement Approach

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8 **Abstract**

9 The purpose of this research paper is to know the relationship between two ratios of the  
10 financial statements i.e. profitability and liquidity. The study is focused on the banking  
11 sector. The relation is measured by current ratio, quick ratio, and net-working capital. The  
12 bank under study is standard chartered bank Pakistan. From the findings of this study we  
13 came to conclusion that there is weak positive relation between liquidity and profitability.  
14 Quantitative research design is used as tool for the study. To find the relation and strength of  
15 the relation correlation and regression are used. So companies need to focus on liquidity  
16 management which has a positive relation with the company's profitability.

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18 **Index terms**— profitability, liquidity, liquidity management.

19 **1 Introduction**

20 Profitability and liquidity are two important variables which give information about the performance of any business  
21 entity. For long-term survival and healthy growth both profitability and liquidity should go parallel to each other  
22 .Profitability is one of the major goals of any business. Without being profitable it is not possible for a business to  
23 survive and the business growth is difficult. To generate profit a business need short-term funds to fulfill its day  
24 to day needs in operations and other requirements. Business will be more profitable when this short-term need  
25 of funds is generated by business operation not through external debts. So the liquidity tells about the business  
26 capability to meet short-terms need of funds by the business and profitability tells about the profit generated  
27 from the operations of business.

28 The reason to choose this title is that many studied have been conducted in past to find the tradeoff between  
29 profitability and liquidity and there is a huge variation in the results. As Pakistan's economy is different from  
30 other economies this study will put light on relation of these two variables in context of banking sector in Pakistan.  
31 Pakistan economy is different from other economies due to some its unique natures.

32 For the study banking sector is selected and standard chartered bank Pakistan is the main focus of the study.  
33 The reason to choose standard chartered bank is that it is the largest and oldest international bank in Pakistan.  
34 It is first international bank to get the license

35 **2 Literature Review**

36 Profitability helps in taking decisions and constructing policies according to ??siegbu and Nwakanma (2008).  
37 Liquidity tells about the firm's ability to meet short-term need of funds says Ibenta ??2005). Performance of any  
38 business entity is judged by its liquidity management (Bardia 2007). Efficient liquidity management has a great  
39 significance for a business to run smoothly ??Valrshney, 2008).According to Samilogu and Dermirgunes (2008)  
40 the relationship of working capital management to profitability is negative. Decisions related to liquidity have  
41 no impact on profitability but the use of forecasting of liquidity and short-term financing during crisis effects

42 profitability positively ??ambery and Valming (2009). According to Amit et al ??2005) there is no any relation  
43 between profitability and liquidity. ??arware (2004) in his study on NFL concluded that; there is both negative  
44 and positive relationship between profitability and liquidity. According to ??ur et al (2001), ??ardia (2007),  
45 ??ardia (2004) and ??ur and Ganguly (2001) the relationship between profitability and liquidity is positive. As  
46 liquidity has a close relation with day to day activities so the study of liquidity is important for the internal  
47 analysts as well as external analysis in their study ??Bhunia, 2010).

48 By taking Current ratio as tool to find the relation between profitability and liquidity found that there is  
49 negative relation between the business's liquidity and its profitability Abuzarand ??ljelly (2004).Working capital  
50 management is important due to its direct relation with the firm's profitability and liquidity ??ingh and Pandey  
51 (2008). According to Walt (2009) Profitability can be turned into liquid asset that's why it is more important but  
52 this never means that company is profitable if its liquidity is high. Liquidity is more important than profitability  
53 because it has impact on the survival of the company Don ??2009).According to Dong (2010) Working capital  
54 management affects the liquidity and profitability of any firm. Fixed and current assets are important for the  
55 successful running of any business and these both have direct impact on liquidity and profitability Saswata  
56 Chatterjee (2010) .According to ??eloof (2003) and ??ang (2002) the working capital management increases  
57 profitability by reducing average collection period and inventories. According to Afza and Nazir (2007) there is a  
58 negative relation between the profitability and business's working capital investment and the financing policies.

59 Mahmood and Qayyum, (2010) argue that the liquidity and profitability are important to achieve two main  
60 objectives profitability is related to the wealth maximization goal of the shareholders and liquidity is important for  
61 the continuity of business. Correlation and regression study of ??ljelly (2004) founded that Current ratio is more  
62 important to measure profitability and cash conversion cycle is more important to measure liquidity. According  
63 to ??him and Siegel (2000) Liquidity is business capacity to pay short-term debts means their maturity is less  
64 than one year. Economic success achieved by any business by investing capital in it is said to be its profitability  
65 and it is determined by the net profit margin ??Pimentel et al, 2005). High financial cost and business's inability  
66 to pay its obligations are the results of low liquidity ??Maness & Zietlow 2005).Liquidity tells about the firm's  
67 degree of independence against the creditors and it also tells about the difficulties and crises face by the company  
68 Matarazzo ??2003). Financial strength of a business is measure of it liquidity Chandra (2001). Profitability will  
69 be lower the more funds are invested in current assets Assaf Neto ??2003).The relation of profitability to liquidity  
70 is inverse according to ??arques and Braga (1995) and Renato Schwambach Vieira (2010).Liquidity is commonly  
71 measured by current ratio and profitability is commonly measured by ROI ??ishnani and Shah (2007).

### 72 3 III.

### 73 4 Measurement a) Operational definitions

74 i. Accounting Liquidity It measures the company's ability to meet its short-term obligations using its most liquid  
75 assets. That is, accounting liquidity is the ease with which a company can pay its bills and liabilities over the  
76 next year, especially if it must convert its assets into cash in order to do so. Two common ways to measure  
77 accounting liquidity are the current ratio and the quick ratio. ??financial-dictionary.thefreedictionary.com, 2010)  
78 ii. Profitability Ratios A class of financial metrics that are used to assess a business's ability to generate earnings  
79 as compared to its expenses and other relevant costs incurred during a specific period of time. For most of these  
80 ratios, having a higher value relative to a competitor's ratio or the same ratio from a previous period is indicative  
81 that the company is doing well. (www.investopedia.com, 2010).

82 IV.

### 83 5 Hypothesis

84 For the study seven hypotheses have been constructed: Ho: No relation exists between the liquidity and  
85 profitability. H1: There is significant relationship between liquidity and profitability H2: There is a positive  
86 relation between current ratio and profitability. H3: There is a negative relation between current ratio and  
87 profitability. H4: There is a positive relation between quick ratio and profitability. H5: There is a negative  
88 relation between quick ratio and profitability. H6: There is a positive relation between Net-working capital and  
89 profitability. H7: There is a negative relation between Net-working capital and profitability

### 90 6 Conceptual Framework

91 VI.

### 92 7 Methodology a) Research Design

93 The purpose of this research paper is to know the relationship between two important ratios of the financial  
94 statements the profitability and liquidity. The study is conducted on the basis of actual data available in the  
95 financial statements of the standard chartered bank, so our interference in this study is low. The study is done  
96 on a real business scenario so this study is noncontrived study. No artificial data is used actual data is used for  
97 the study purpose. The unit of analysis for this study is organization that is standard chartered bank Pakistan.  
98 Standard chartered bank Pakistan is largest international bank in Pakistan with 116 branches. The study is

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99 conducted on the basis of the financial statements of standard chartered bank from 2004 to 2013. The data of  
100 last ten years of standard chartered bank is taken as a sample for the study. The data to find the relation is not  
101 collected of just one specific point but it is collected at ten different points from the year 2004 to 2013. So the  
102 study is longitudinal. For this study the secondary data collection method is used. The data is collected from  
103 the annual reports of standard chartered bank Pakistan.

104 **8 VII.**

105 **9 Findings and Results**

106 **10 a) Descriptive statistics Table 1.1 : Descriptive Statistics**

107 From the descriptive statistic table 1.1 its can be concluded that the mean of liquidity is negative that is mainly  
108 due to the large negative figure of net-working capital .The negative figure of net-working capital is due to access  
109 of current liabilities to the current assets. The mean of profitability is positive because all the four ratios are  
110 positive. The standard deviation of profitability is low that is due less variation in the ratios. The standard  
111 deviation of liquidity is high due to the large variation in the figures of the liquidity ratio.

112 **11 Conclusion**

113 From the findings and results of the study we can conclude that there a positive relation between profitability  
114 and liquidity .So the null hypothesis is rejected and alternate hypothesis 1 is accepted. There is negative relation  
115 between current ratio and profitability so the alternate hypothesis 2 is rejected and alternate hypothesis 3  
116 is accepted. There is positive relationship between quick ratio so the alternate hypothesis 4 is accepted and  
117 alternate hypothesis 5 is rejected. There is positive relation between net-working capital and profitability so  
118 alternate hypothesis 6 is accepted and alternate hypothesis 7 is rejected.

119 IX.

120 **12 Limitations**

121 The study is concentrated to only banking sector. The results and findings of this study is based on the financial  
122 statement of standard chartered bank Pakistan. Only past ten years data is taken under consideration for the  
123 study. Considering other countries will result in more reliable and accurate results, findings and relation between  
124 the variables.



Figure 1:

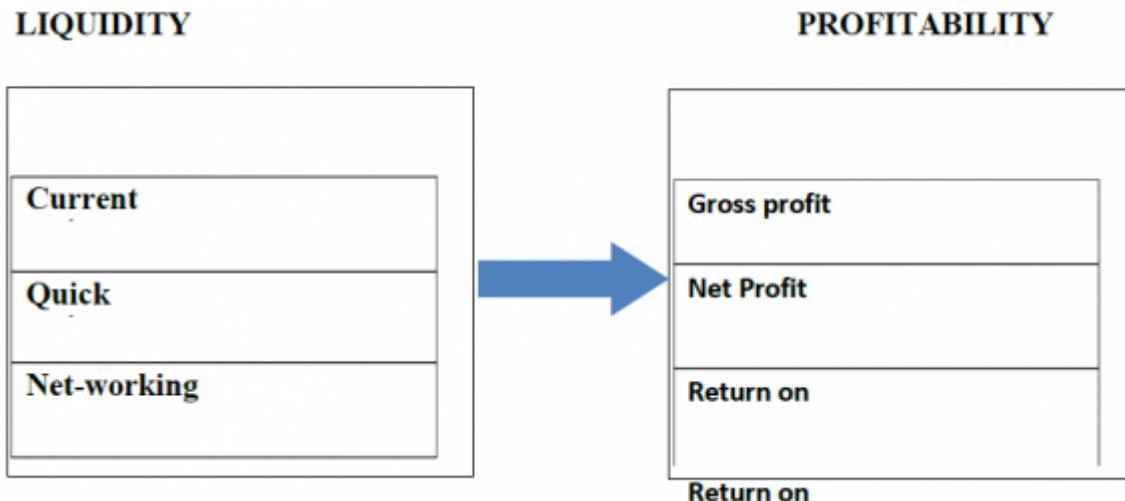


Figure 2: CA

	Mean	Std. Deviation	N
Liquidity	-2.1217	7.36167	10
Profitability	1.0480	.39384	10

Figure 3: A

		Profitability	Current ratio	Quick Ratio	NWC
Pearson Correlation	Profitability	1.000	-.207	.423	.094
	Current ratio	-.207	1.000	.176	.815
	Quick Ratio	.423	.176	1.000	.657
Sig. (1-tailed)	Profitability	.094	.815	.657	1.000
	Current ratio	.283	.283	.112	.398
	Quick Ratio	.398	.314	.314	.002
N	Profitability	10	10	10	10
	Current ratio	10	10	10	10
	Quick Ratio	10	10	10	10

Figure 4: A

		profitability	Liquidity
Pearson Correlation	profitability	1.000	.094
	Liquidity	.094	1.000
Sig. (1-tailed)	profitability	-	.398
	Liquidity	.398	-
N	Profitability	10	10
	Liquidity	10	10

Figure 5: A

Mod	Unstandardized		Standardiz	T	Sig
	B	Std.	Coefficie		
1 (Constan	1.34	1.84	-	.73	.49
Current ratio	-	1.17	-	-	.64
Quick	1.15	3.02	.31	.38	.71
NW	1.626-	.00	.30	.21	.83

Figure 6: ?

12

Figure 7: Table 1 . 2 :

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Figure 8: Table 1 . 3 :

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[Note: 4 : Coefficients a. Dependent Variable: profitability]

Figure 9: Table 1 .

## **12 LIMITATIONS**

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