LIQUIDITY AND GROWTH: THE CASE OF A LOCAL BANK

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A commercial bank has two major considerations — liquidity and growth. To maintain liquidity is a defensive posture; a bank keeps sufficient cash, reserves and liquid assets to meet eventualities and to safeguard the interest of depositors and shareholders. It should aim at a high rate of growth, so that it can be developed progressively as a financial intermediary between investors and savers. It has the social responsibility of playing an important role in financing economic development. To maintain excess liquidity would hinder the growth of a bank. To aim only at growth without due regard to liquidity may endanger a bank in the event of depression or unexpected economic changes. To strike a balance between the two considerations is a difficult task.

The historical development of the Oversea-Chinese Banking Corporation illustrates a local bank faced with the considerations of liquidity and growth. Generally speaking, before World War II liquidity was their main concern, while after the War the growth aspect was predominant. The pre-war emphasis on liquidity was due to the following factors:

1. the unstable economic conditions, as the export earnings of Malaya and Singapore depended much upon the world demand of rubber, tin, timber and palm oil (later stage) and hence the economies were much affected by cyclical fluctuation.
2. the high bankruptcy rate of the small Chinese business concerns, which were the customers of banks.
3. consequently, the high banking risk in the late 19th and early 20th Century, as evidenced by many bank failures and bank runs.

Before the establishment of the Central Bank of Malaya in 1959, there was no statutory liquidity requirements, nor any traditional banking practice for liquidity ratio. Banks maintained their liquidity ratio by prudence. In view of the unstable economic conditions, banks had to maintain a particularly high liquidity ratio.

The problem of local liquidity and foreign liquidity has often been discussed in recent years. In the colonial time, foreign banks, particularly the British exchange banks, main-

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2. For example, the Asiatic Banking Corporation and Commercial Bank of India failed in 1866; Oriental Banking Corporation, in 1884; and Kwong Yik Bank, Singapore in 1913. There were "runs" on Sze Hai Tong Bank and on the Chinese Commercial Bank when the World War I broke out in 1914. The post-war recession 1920/21 caused the Bank of Communication, China to close its branch office in Singapore.

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Graph 1
CAPITAL FUNDS, DEPOSITS, LOANS AND AGGREGATE ASSETS OF THE CHINESE COMMERCIAL BANK LTD. Dec. 1914 - June 1932

SOURCE: Appendix 1