Barclays Bank Subsidiary Research

Posted on October 3, 2018

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Part I:

Liquidity risk is the type of risk in a bank in which a bank may be unable to meet its short-term payment obligations. It might be because they think they cannot manage to pay the funding taken from the market or because their securities cannot be sold rapidly to meet the market price of that security (Brown and Moles, 2014). The investor or any institution may not be able to convert their assets into cash without giving up on income or capital due to the lack of purchasers or any insufficient market (Brown and Moles, 2014). For example, a house worth $200,000 might not have any buyers when there is no real estate season. But, when the market goes up, the house may sell for more than the actual price. However, if the owner of the house needs to sell it quickly, he can even sell it for less than the actual price. Liquidity risk lets investors analyze whether they can cover their short-term debts and convert them into cash or not.

For this study, Barclays Bank was chosen to evaluate its liquidity risk performance over recent years, and USA's Barclays Bank PLC has been selected. The liquidity risk performance of the Barclays USA division will be compared with the parent company and will indicate the performance of the subsidiary in the USA.

Most banks measure their liquidity risk performances by taking account of their financial reports, i.e., Balance Sheet and Income statement (Mian and Santos, 2017). From these statements, banks usually analyze certain ratios, which help in understanding the liquidity performance of the banks. For this purpose, balance sheets and income statements of Barclays USA have been acquired, which will be attached in the appendices. From these statements, we will analyze the market situation of Barclays USA and Barclays itself in the context of their liquidity performance.

The liquidity performance of a company is measured by certain ratios, which help it understand its liquidity position in the market (Mian and Santos, 2017). These ratios include the current performance ratio, quick performance ratio, and cash performance ratio.

The current ratio tells about the ability of a company to manage its short-term debts and liabilities (Louzis, Vouldis and Metaxas, 2012). It is evaluated as the current ratio of current assets/current liabilities. A current ratio of 1:0 may be very bad for a company if it runs into a financial crisis. As for Barclays Bank PLC USA, the current assets are valued at $74,522,000 (for the year 2017), and the current liabilities are at $24,627,000. The current ratio of Barclays USA is 3.02, which means their

short-term obligations are fully met, and they are managing them effectively. As compared to parent Barclays, it has current assets valued at $94,719,200 and current liabilities at $79,202,900. Their current ratio is valued at 1.19 and is also good because a ratio of less than 1.0 shows a lack of management in their liquidity performance.

The quick ratio indicates whether the balance sheet is overleveraged or underleveraged (Louzis, Vouldis and Metaxas, 2012). It might tell the company that sales are decreasing or that the company is paying its bills more quickly than it should. It also tells about the cash conversion of a company's assets and how quickly it is receiving cash. It is calculated by (cash equivalents + market securities accounts receivable)/current liabilities. As of 2017, the US Barclays quick ratio is calculated as: ($40,107,000/$24,627,000). The quick ratio of Barclays US turns out to be 1.65, which is a great indicator that Barclays US is managing its liabilities skillfully. As of 2017, the Parent company, Barclays, has a quick ratio of $177,822,000/$79,202,900. It makes it 2.26 which tells that the parent company, Barclays, has greater strength in its liquidity management process.

The cash ratio is used to tell the investors when they need to convert their current liabilities into cash, and the cash ratio helps them identify a certain amount and time (Louzis, Vouldis and Metaxas, 2012). The cash ratio is formed as Cash + securities/Current Liabilities. As of 2017, Barclays US has its cash ratio calculated as $12,086,000/$24,627,000. It results in 0.49, which means the company has less capacity to cover its liabilities with cash, and it might turn bad for them in the long run, while the Barclays parent company, as of 2017, has a ratio of an estimated 2, which makes them more flexible in converting their liabilities into assets. It takes less time for the global Barclays company to convert its liabilities to cash.

Part II:

Based on the competition fragility view, used by many researchers in the past, the rise in the competition level also tends to have a decline in the loan and deposit rates (Mirzaei, Moore and Liu, 2013). It also reduces the profit margins of certain industries. Within the banking sector, it raises the risk-taking by the banks and may decrease the value of the banks globally. A firm-wide negative impact is opposed to the stability of the banking sector. In the USA context, the competition stability view says that the country, having a rising competition level, should reduce the interest rates charged by the US banks to give leverage for the investors to meet the market competition. In the US, the banking sector has competition that is growing day by day and has made the market more flexible in accepting risks (Mirzaei, Moore and Liu, 2013). It makes it easier to make repayments for the loans and improves the stability of the banks. Almost every bank in the US has acquired this strategy.

Credit risk is the type of risk where the lender may not be able to repay the debt taken from the bank. The debtor can be the one who took the loan, a debt-security issuer or it can be another bank lending money from the interbank market (Mirzaei, Moore and Liu 2013). In a general context, when a price is increased, banks apply a decrease in the borrowing rates, which is given to the borrowers by the

bank. This affects the credit and its risk and the finance structure in two ways. First, the decrease in borrowing rates makes it easier for credit borrowers to make repayments to the bank. These approaches are attained by the US banks, and their market competition remains very stable according to this approach. Secondly, a decline in the financing rates may also decrease the profit margins of the banking sector, which will decrease the overall worth of a bank. In this case, US banks make more short-term credits to a list of borrowers to increase their profit margins while having the risk of credit loss.

In the USA, the banking market changes widely every day, and the market situation is diverse according to the external factors involved in the competition. Competition is generally stiff. The franchise value of the banks in the country is mostly risk-taking, with and without the intervention of the government (Flamini, Schumacher and McDonald, 2009). The US banking market limits its risk-taking to protect the inter-monopoly. High competition would finish the banks and would impose high levels of risk-taking and instability of the finances. According to a study done by Marcus (1984) about the US market, he developed a one-period model that showed about the value decline of banks when they engage in riskier policies. Later researchers made amendments to these models and found that there was a negative relationship between credit risk and deposit power of the US market. Other studies have also told that in 1986, the US market was affected by the increased competition, which never gave any profit to the banks because there were no quality credit lenders. The decrease in the value of a bank also reduces the ability to hire potential buyers, and the overall profit of the credit decreases. Broecker (1990) showed, while studying the US market, that increased competition and increased quantity of banks in the USA also impose a negative impact on the money worth of the whole banking system. But it has now changed as the USA market is now different in the form of their banking system. The credit risk allows the banks to evaluate their worth as a credit taker and lender, and enhances overall market strength in terms of their liquidity performance. However, the USA, being the superpower, now has a market where their banking competition is really complex and hard to understand.

Part III:

Banking profitability is mostly expressed as a combination of external and internal factors. The internal factor is derived from the annual reports, i.e., income statement and balance sheet. These in-house factors can be termed as bank definite or micro determinants of banking profits (Almarzoqi, Naceur and Scopelliti, 2015). The external factors are the variables that do not relate to the bank itself but tell about the legal and economic culture that affects the enactment of a financial firm. Many researchers have aimed to analyze the profitability and its factors. Haslem (1968) and Bourke (1989) were among the researchers who focused on the factors of overlapping and single-based countries with the banking sector and analyzed their profitability (Flamini, Schumacher and McDonald, 2009). Another study by Bikker (2002) put emphasis on the bank’s profitability and the business cycle relationship.

The study here focuses on the bank-specific and macro environmental factors of Barclays in the USA and the effects on the profitability due to these factors.

Studies have shown that the internal factors include risk management, capital deployment, size and expense management to bring forward changes according to it. Size is mostly determining the accountancy of current economics or diseconomies in the overall market. Smirlock (1985) and Akhavein et al. (1997). found a positive relationship between bank profitability and size. Maksimovic (1998) says that various legal, financial and other (corruption, bankruptcy) factors are the determinants of the size of the banks. Size is also related to the capital capacity of a banking firm, where banks like Barclays give away less expensive capital and have higher profitability. In the USA, Barclays has the factor to consider the internal factors as discussed above, that size needs to be determined in the process to make sure that the allocation of capital is being deployed to accurate markets. Goddard et al. (2004) state that that all banks in the US region compare their banking size with the capital ratios, which is suggested to be positive in terms of size. It means that if the size increases in the small or medium banks, the profit also increases. Other studies also tell us that a small amount of money saving can be accomplished by growing the size of the banks. Large banks could face scale imbalances by increasing a large amount of size in the banking sectors.

The necessity of risk control in the banks is built into the theme of the banking industry. In context with the US, low levels of liquidity and poor asset quality are two important factors in the banking sector's failure. In the USA, when a bank is facing risk issues, they tend to diversify their cases and increase the liquidity performances to decrease the level of risks. Accordingly, risk is divided into credit and liquid risk. Thornton (1992) finds a negative relation between profitability and liquidity. Other studies show that there is an adverse relationship between credit risk and cost-effectiveness. This aspect has made it obvious that in a country like the USA, more loans are given and fewer are returned, which makes the risk factor very high. Subsidiaries of Barclays working in the US have to manage this aspect, as risk management can be vital if not controlled. As the study says, more loans are given and fewer returns will be received, so Barclays can minimize this factor in the US to create diversity in the bank.

Bank expenditure is also a very important aspect of banking profits, which is closely linked with the efficient management of resources (Boyd and De Nicolo, 2005). There have been debates about involving an expense-related factor in the costing procedure of the microeconomic profitability function. Thornton (1992) finds a positive relationship between quality management and profit. Talking about the external factors of banking profits in the US, we should consider the evaluation of macroeconomic factors like cyclical output, inflation, and interest rates (Boyd and De Nicolo, 2005).

An important issue is the ownership status of the banks in relation to their profitability. However, there is little research done on this issue, which is arising now in the US banking markets. Short (1979) provides evidence saying that there is a highly negative relation between profitability and ownership in banking. Ownership of government in the banks and their daily running has played a negative role in the bank's performance. That is why some banks in the US are not growing because

of bad ownership. In response, Thornton (1992) says that there is no relevant link between ownership and profitability. Profitability is determined by macroeconomic factors and has influenced the banking sectors as well. Inflation, the growth rate of money, and the interest rate are the key determinants of the macroeconomic factors. Revell (2013) made an analysis and found an issue between the relation of profit and inflation. He said that the effect of inflation on bank profits depends on the wages and operating expenses increasing even more than the inflation. The US economy has now stabilized inflation and its management by forecasting their industry-wise analysis and implementing them. US banking markets have controlled their overall costs and wages and controlled the inflation issue, which was rising previously and causing problems for the US economy. Perry (2002) says that the effect of inflation on bank profitability is determined by the way banking sector controls the inflation. It makes it vital for a bank to maintain its financial condition in such a state. If a bank can manage its inflation rate efficiently, then it can maintain its interest rates to increase its income more rapidly than the costs and is most likely to achieve higher profits (Tabak, Fazio and Cajueiro, 2012). Most studies have shown a positive relationship between inflation and profit of a banking sector.

According to the above-mentioned factors, Barclays has to consider these in entering the US as a well-reputed bank. Internal and external factors are in every aspect, but when looking at a financial institution, they need to be organized accordingly. It helps in understanding the positive and negative side of the topic and better evaluating future and current results (Athanasoglou, Brissimis and Delis, 2008). Launching or entering new subsidiaries in any country is vital and should be followed with proper analysis at first. The three factors listed above are to be considered by Barclays to be successful in US banking markets. The liquidity and credit risk performance of Barclays has shown that they do not lack any aspect of entering the global markets, but being the market giants, it is important for them to organize and structure proper techniques required in the field.

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