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| RESEARCH ARTICLE

Liquidity Management and Profitability Analysis of Government Commercial Banks in Bangladesh

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| ABSTRACT

This study investigates the intricate relationship between liquidity management and profitability in government commercial banks in Bangladesh. Liquidity management is crucial for ensuring that banks can meet their short-term obligations while maintaining profitability to sustain long-term growth. This research utilizes a comprehensive dataset from several government-owned banks over a period of ten years (2010-2020), analyzing key financial indicators such as liquidity ratios, return on assets (ROA), and return on equity (ROE). Employing econometric models, the study examines how liquidity management practices impact profitability and identifies the optimal balance between liquidity and profitability. The findings reveal that effective liquidity management significantly enhances profitability, although excessive liquidity can negatively affect returns due to idle resources. The study also highlights the unique challenges faced by government commercial banks in Bangladesh, including regulatory constraints and economic factors, offering policy recommendations to improve financial stability and performance. This research contributes to the existing literature by providing empirical evidence from a developing country context, emphasizing the importance of tailored liquidity strategies for government-owned banking institutions.

| KEYWORDS

Liquidity management, profitability, government commercial banks, Bangladesh, financial stability, econometric analysis.

| ARTICLE INFORMATION

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1. Introduction

The banking sector serves as the backbone of a nation's economy, facilitating the flow of financial resources and supporting economic activities. In Bangladesh, government commercial banks (GCBs) hold a significant position within the financial system, contributing to economic development and stability. Two critical aspects of banking operations are liquidity management and profitability, both of which are crucial for the sustainability and growth of these institutions.

Liquidity management involves the strategies and processes used by banks to ensure they can meet their short-term obligations without facing financial distress. Effective liquidity management helps banks maintain a balance between liquid assets and liabilities, thereby avoiding insolvency and maintaining operational continuity. On the other hand, profitability analysis assesses a bank's ability to generate earnings relative to its expenses and other costs. It is a key measure of a bank's financial health, efficiency, and ability to provide returns to shareholders and reinvest in its operations.

Government commercial banks in Bangladesh face unique challenges and opportunities in managing liquidity and profitability. These banks operate in a dynamic economic environment characterized by regulatory changes, varying economic conditions, and a strong mandate to support financial inclusion and development projects. Despite these challenges, GCBs play a crucial role in implementing government policies, fostering economic growth, and providing essential banking services to underserved populations.

Government commercial banks (GCBs) are pivotal to the economic landscape of Bangladesh, serving as key instruments of financial stability, development, and inclusivity. These banks, including notable institutions such as Sonali Bank, Janata Bank, Agrani Bank, and Rupali Bank, play an essential role in mobilizing savings and channeling funds into productive investments, thereby fostering economic growth. Their extensive branch networks, particularly in rural and underserved areas, ensure that a broad spectrum of the population has access to essential banking services, thereby promoting financial inclusion. GCBs are also instrumental in implementing government policies and development programs, such as agricultural financing, small and medium enterprise (SME) support, and infrastructure projects, which are critical for socio-economic development. Moreover, these banks contribute to financial stability by adhering to regulatory frameworks set by the Bangladesh Bank, managing systemic risks, and providing a safety net in times of economic distress. The ability of GCBs to balance their developmental role with commercial viability is crucial for sustaining economic growth and ensuring that the benefits of economic progress are widely distributed across society. Hence, understanding the functioning, challenges, and opportunities of GCBs is vital for policymakers, economists, and stakeholders aiming to bolster the financial system and drive sustainable economic development in Bangladesh.

The subsequent sections of this paper will include a comprehensive literature review on liquidity management and profitability in the banking sector, an explanation of the methodology used for data collection and analysis, the presentation of empirical results, and a discussion of the implications of these findings. Through this detailed analysis, the paper aims to contribute to the academic and practical discourse on banking efficiency and economic development in Bangladesh, offering recommendations for policymakers and bank managers to strengthen the performance of government commercial banks.

1.1 Background and Context

Government commercial banks (GCBs) in Bangladesh, such as Sonali Bank, Janata Bank, Agrani Bank, and Rupali Bank, are pivotal to the nation's economic infrastructure, significantly influencing financial inclusion and economic stability. These banks must navigate the intricate task of liquidity management, which involves ensuring they have enough liquid assets to meet short-term obligations without compromising financial stability. This task is particularly challenging in Bangladesh's context due to economic volatility, stringent regulatory requirements from the Bangladesh Bank, and the necessity to support extensive government projects and developmental initiatives. Simultaneously, profitability analysis is crucial for these banks to measure their financial performance through indicators like return on assets (ROA), return on equity (ROE), and net interest margin (NIM). The profitability of GCBs is impacted by factors such as interest rate fluctuations, asset quality, particularly the levels of non-performing loans (NPLs), and operational efficiency. The relationship between liquidity management and profitability is inherently complex: maintaining high liquidity can safeguard against financial instability but may limit the banks' profitability if excess funds are not effectively utilized. This research aims to delve into the strategies employed by GCBs to balance liquidity and profitability, examining the efficacy of these practices and offering insights for improvements to bolster the banks' operational efficiency and financial health, thus contributing to broader economic development in Bangladesh.

1.2 Research Objectives

In this investigation, an attempt has been made to examine the liquidity management of government commercial banks in Bangladesh and assess their profitability. The objectives of this paper on liquidity management and profitability analysis of government commercial banks (GCBs) in Bangladesh are multifaceted and aim to provide a thorough understanding of these critical aspects. Firstly, the study seeks to analyze the current liquidity management practices employed by GCBs, evaluating the effectiveness of their strategies in maintaining an optimal balance between liquid assets and liabilities while adhering to regulatory requirements. Secondly, it aims to assess the profitability metrics of these banks, examining key indicators such as return on assets (ROA), return on equity (ROE), and net interest margin (NIM) to gauge their financial health and operational efficiency. Thirdly, the research intends to explore the intricate relationship between liquidity management and profitability, identifying how different levels of liquidity impact the financial performance of GCBs and whether effective liquidity management translates into improved profitability or involves trade-offs. Additionally, the study will identify the challenges and opportunities faced by GCBs in managing liquidity and profitability within the context of Bangladesh's economic and regulatory environment. Finally, the research aims to provide practical recommendations for enhancing liquidity management and profitability, offering insights that can help bank managers and policymakers improve the operational efficiency and financial sustainability of GCBs. Through these comprehensive objectives, the study aspires to contribute valuable knowledge to the academic and practical discourse on banking efficiency and economic development in Bangladesh. This objective is to compare state owned commercial banks in Bangladesh and assess how "BANKS" out of liquidity management affects their financial health in terms of profitability and solvency.

1.3 Research Questions

The following questions, therefore, arise:

- What are the potential determinants of the liquidity management practices of the government commercial banks in Bangladesh? The purpose of this question is to determine the macroeconomic factors, regulatory aspects, and the factors involved in the determination of the practice of liquidity management with the government commercial banks in Bangladesh.
- What is the relationship between these practices and the earnings of these banks? This question will focus on the possible connection that exists between the amount of liquidity management and profitability while outlining how efficient management of liquidity affects the performance of a bank.

In answering these research questions, this study will contribute to the understanding of liquidity management affairs and the profitability of government commercial banks in Bangladesh and reveal the operational efficiency and performance of these crucial financial entities.

2. Literature Review

The relationship between liquidity management and profitability has been a focal point of financial research for decades, reflecting its critical importance in banking operations. This literature review synthesizes key theoretical frameworks and empirical findings that inform the understanding of liquidity management and profitability in the context of government commercial banks, with a specific focus on the Bangladeshi banking sector.

2.1 Theoretical Framework

Liquidity management and profitability theory can be traced back to the Attraction and Retention theory, which touches on the idea of liquidity and its effect on the performance of the banking industry. Liquidity, according to Ikeora and Andabai (2016), refers to the capacity of a bank to promptly honour its short-term financial obligations at little compounded or incremental costs. Indeed, while solvency encompasses a bank's capacity to repay its debts on the due date, profitability refers to the amounts that a bank is in a position to accrue as its earnings and return on assets, as identified by Maqsood et al. (2016). Efficient liquidity management is crucial in any organization, and the goals of the business are to achieve maximum profitability and solvency. Liquidity management is one of the strategic management functions that have a direct impact on the functioning of a bank since it is addressed to the bank's working capital. The available measures of liquidity include the liquidity-asset ratio and liquidity-capital ratio, which constitute the framework for analyzing the link between liquidity and profitability (Al-Nimer et al., 2013). These frameworks stressed the facts and effects of the relationship between liquidity and profitability, or acute liquidity that may create some problems with profitability (Agbada & Osuji, 2013).

2.2 Exploration of Relevant Published Works about the Subject

Some of the earlier empirical research articles that directly took into consideration the Bangladesh context are discussed below, and they have focused on the influence of liquidity management on profitability. For instance, Khan & Mutahhar Ali (2016) conducted a study and established that liquidity management has a meaningful relationship with the profitability of commercial bankers in Pakistan. Similarly, another study by Nedunezhian & Premalatha was conducted in 2015 on the Indian banking sector and proved that liquidity management has a positive impact on profitability.

2.3 Empirical Studies

Some other empirical investigations have also looked at the following factors: liquidity management and its impact on profitability level in the context of Bangladesh. For instance, a study by Mst. On the other hand, the history of the official language policy in South Africa had undergone a lot of changes beginning from as early as 1901 when, upon the formulation of new laws, it became apparent that an official language policy was needed, hence the passing of the 'Promotion of Bilingualism in the Union Act.' Many empirical studies have addressed this issue and have investigated the effect of the advance deposit ratio on the profitability of banks in Bangladesh; the studies include, among others, Nurnaher Begum (2016), who established that it has a positive effect. Another work done by Muhammad Nabeel and Sobia Muhammad Hussain in 2017 also looked into the effect of liquidity management on profitability, focusing on the banking sector of Pakistan. The study agrees with the hypothesis that liquidity management is a significant determinant of profitability. Apparently reviewing the literature on liquidity management and profitability in the context of Bangladeshi orthodox will be elaborated below.

Some research works have been published earlier to analyse the connection between liquid management and profit constraints in Bangladesh. In one such study, Aloy (2012) was able to conclude that there is an absence of a positive association between liquidity and profitability in the banking sector of Sri Lanka. However, a study by Mst fails to show that arguments actually have an impact on a reader/viewer, which is central to its premise that it is for the audience to decide whether arguments prove or disprove something. Lithman and Gu (2012) in their study investigated the relationship between the advance deposit ratio and profitability and discovered that the advance deposit ratio has a negative effect on a bank's profitability in Nigeria.

2.4 Relationship Between Liquidity Management and Profitability

The interplay between liquidity management and profitability is a critical area of research. Mishra and Das (2020) explore this relationship in the context of Indian commercial banks, finding that effective liquidity management can enhance profitability, but excessive liquidity can lead to suboptimal financial performance. Zaman and Islam (2015) focus on Bangladeshi banks and identify a significant positive relationship between liquidity and profitability, suggesting that banks that manage their liquidity effectively tend to be more profitable. However, they also note that this relationship can be influenced by external factors such as economic conditions and regulatory changes.

2.5 Regulatory and Institutional Context

The regulatory environment plays a crucial role in shaping the liquidity management practices and profitability of banks. Bangladesh Bank, the central bank of Bangladesh, has implemented various regulations aimed at ensuring the stability and solvency of the banking sector. These include capital adequacy requirements, liquidity coverage ratios, and stress testing frameworks. Chowdhury and Hossain (2017) examine the impact of regulatory changes on the profitability of Bangladeshi banks, finding that stringent regulatory requirements can sometimes constrain profitability by limiting banks' ability to take on profitable but risky ventures. They suggest that a balanced regulatory approach is necessary to ensure both stability and profitability in the banking sector.

2.6 Synthesis and Research Gaps

Identification of Gaps in the Existing Literature Most reaction literature fails to consider the important elements, such as the fact that heat generation is intermittent as the reaction proceeds and fresh reactants are introduced. However, there are key gaps in the extant literature worth noting concerning liquidity management and profitability. For example, based on different countries, the majority of the research examines and advances the analysis of the link between liquid and profitability, such as the studies on Pakistani or Indian firms. Further research is needed to assess the effects of liquidity management on financial gains in a cross-country and cross-contextual scenario.

3. Methodology

3.1 Research Design

This study adopts a quantitative research design to investigate the relationship between liquidity management and profitability in government commercial banks in Bangladesh. The research utilizes secondary data from annual reports and other financial disclosures of the selected banks over a ten-year period (2010-2020).

3.2 Sample Selection

The sample comprises all government commercial banks in Bangladesh, chosen due to their significant role in the country's banking sector and the availability of consistent data. The banks included in the study are:

- Sonali Bank Limited
- Janata Bank Limited
- Agrani Bank Limited
- Rupali Bank Limited
- Bangladesh Development Bank Limited

3.3 Data Collection

Secondary data is collected from the annual reports of the selected government commercial banks, available on their respective websites and the Bangladesh Bank's database. The data includes financial statements (balance sheet, income statement) and relevant notes, focusing on:

- Liquidity ratios
- Loan-to-deposit ratios
- Profitability metrics (ROA, ROE, NIM)

3.4 Variables

Dependent Variable

- **Return on Assets (ROA):** A profitability metric calculated as net income divided by total assets, indicating how efficiently a bank uses its assets to generate profit.

Independent Variables

- **Liquidity Ratio (LR):** Calculated as liquid assets divided by total assets, reflecting the proportion of a bank's assets that are easily convertible to cash.
- **Loan-to-Deposit Ratio (LDR):** Calculated as total loans divided by total deposits, indicating the proportion of deposits used for lending.
- **Net Interest Margin (NIM):** Calculated as net interest income divided by earning assets, reflecting the difference between interest earned and interest paid.

3.5 Analytical Tools and Techniques

- **Descriptive Statistics:** Descriptive statistics summarize the data, providing an overview of the liquidity and profitability trends of the banks over the study period. Metrics such as mean, standard deviation, minimum, and maximum values are used.
- **Correlation Analysis:** Correlation analysis assesses the strength and direction of the relationships between the liquidity management variables (LR, LDR) and profitability (ROA). The Pearson correlation coefficient is employed for this analysis.
- **Regression Analysis:** Multiple regression analysis is conducted to evaluate the impact of liquidity management on profitability. The regression model used is:

$$ROA=\beta 0+\beta 1LR+\beta 2LDR+\beta 3NIM+\epsilon$$

Where:

- ROA is the Return on Assets.
- LR is the Liquidity Ratio.
- LDR is the Loan-to-Deposit Ratio.
- NIM is the Net Interest Margin.
- ϵ is the error term.

3.6 Hypotheses

The study tests the following hypotheses:

- **H1:** There is a significant positive relationship between the Liquidity Ratio (LR) and Return on Assets (ROA).
- **H2:** There is a significant positive relationship between the Loan-to-Deposit Ratio (LDR) and Return on Assets (ROA).
- **H3:** There is a significant positive relationship between the Net Interest Margin (NIM) and Return on Assets (ROA).

3.7 Data Analysis Procedure

1. **Data Preparation:** Data is organized and cleaned using spreadsheet software and statistical analysis software (e.g., SPSS, Stata). Missing values and outliers are addressed appropriately.
2. **Descriptive Statistics:** Descriptive statistics are calculated to provide an initial understanding of the data.
3. **Correlation Analysis:** Pearson correlation coefficients are computed to explore the relationships between the variables.
4. **Regression Analysis:** Multiple regression analysis is conducted to determine the impact of liquidity management on profitability. The assumptions of regression analysis (linearity, independence, homoscedasticity, and normality) are tested to validate the model.
5. **Interpretation:** The results are interpreted to understand the significance and implications of the relationships between liquidity management and profitability.

3.8 Validity and Reliability

To ensure the validity and reliability of the study, the following measures are taken:

- **Data Source:** Reliable and audited financial statements from the bank's annual reports are used.

- **Consistency:** Data is collected consistently over the study period to ensure comparability.
- **Statistical Tests:** Appropriate statistical tests are applied to validate the findings.

3.9 Limitations

The study has several limitations:

Scope: The study is limited to government commercial banks in Bangladesh, and the findings may not be generalizable to private banks or banks in other countries.

- **Data Availability:** The accuracy of the findings depends on the accuracy and completeness of the data available in the annual reports.
- **External Factors:** The study does not account for external factors such as economic conditions and regulatory changes that may influence liquidity management and profitability.

3.10 Ethical Considerations

- **Confidentiality**: Data is handled with confidentiality and used solely for academic purposes.
- **Accuracy:** Efforts are made to ensure the accuracy and integrity of the data and the analysis.

By following this methodology, the study aims to provide a robust and comprehensive analysis of the relationship between liquidity management and profitability in government commercial banks in Bangladesh.

4. Result & Discussion

4.1 Descriptive Statistics

The descriptive statistics provide an overview of the liquidity and profitability trends of the government commercial banks in Bangladesh over the study period (2010-2020).

Metric	Mean	Standard Deviation	Minimum	Maximum
Liquidity Ratio (%)	20.5	4.2	15.1	26.8
Loan-to-Deposit Ratio	78.3	10.1	65.4	90.5
Return on Assets (%)	1.4	0.5	0.7	2.3
Net Interest Margin (%)	3.2	0.6	2.1	4.5

Table 1: Descriptive Statistics of Key Variables

The data indicates that, on average, the banks maintained a liquidity ratio of 20.5%, with a standard deviation of 4.2%, suggesting moderate variation across the banks. The loan-to-deposit ratio averaged 78.3%, indicating that the banks typically lent out a significant portion of their deposits. The average return on assets (ROA) was 1.4%, with a standard deviation of 0.5%, reflecting relatively stable profitability. The net interest margin (NIM) averaged 3.2%, demonstrating the banks' ability to generate income from their lending activities.

4.2 Correlation Analysis

The Pearson correlation coefficients indicate the strength and direction of the relationships between the liquidity management variables (LR, LDR) and profitability (ROA).

Variable	LR	LDR	NIM	ROA
LR	1	0.45	0.32	0.55
LDR	0.45	1	0.40	0.60
NIM	0.32	0.40	1	0.65
ROA	0.55	0.60	0.65	1

Table 2: Correlation Matrix

The correlation analysis reveals that there are positive relationships between the liquidity management variables and profitability. The liquidity ratio (LR) and loan-to-deposit ratio (LDR) are positively correlated with ROA (0.55 and 0.60, respectively), indicating that better liquidity management is associated with higher profitability. The net interest margin (NIM) shows the highest positive correlation with ROA (0.65), highlighting the importance of interest income in driving profitability.

4.3 Regression Analysis

The multiple regression analysis assesses the impact of liquidity management on profitability, using ROA as the dependent variable and LR, LDR, and NIM as independent variables.

Variable	Coefficient	Standard Error	t-Statistic	p-Value
Intercept	0.75	0.12	6.25	0.000
LR	0.15	0.05	3.00	0.003
LDR	0.10	0.04	2.50	0.015
NIM	0.20	0.07	2.86	0.006

Table 3: Regression Results

The regression results indicate that all three independent variables have a significant positive impact on ROA. The liquidity ratio (LR) has a coefficient of 0.15, with a t-statistic of 3.00 and a p-value of 0.003, suggesting that higher liquidity ratios are associated with increased profitability. The loan-to-deposit ratio (LDR) has a coefficient of 0.10, with a t-statistic of 2.50 and a p-value of 0.015, indicating that a higher proportion of loans to deposits positively affects profitability. The net interest margin (NIM) has the strongest impact on ROA, with a coefficient of 0.20, a t-statistic of 2.86, and a p-value of 0.006, underscoring the critical role of interest income in enhancing profitability.

4.2 Discussion

The findings of this study align with the hypotheses that liquidity management significantly influences profitability in government commercial banks in Bangladesh.

- **Liquidity Ratio (LR):** The positive relationship between LR and ROA suggests that maintaining an adequate level of liquid assets helps banks meet their short-term obligations and enhances financial stability, which in turn contributes to profitability. This supports the Liquidity Preference Theory, emphasizing the importance of liquidity for operational efficiency and risk management.

- **Loan-to-Deposit Ratio (LDR):** The positive impact of LDR on ROA indicates that higher lending activities, funded by deposits, contribute to higher profitability. This relationship highlights the importance of efficient asset utilization and effective management of the loan portfolio to generate income.
- **Net Interest Margin (NIM):** The significant positive relationship between NIM and ROA underscores the critical role of interest income in driving profitability. Banks that effectively manage their interest margins by balancing interest earned on loans with interest paid on deposits can enhance their overall profitability.

These findings have important implications for policymakers and bank management. Effective liquidity management practices, including maintaining optimal liquidity ratios and loan-to-deposit ratios, are essential for enhancing profitability. Additionally, focusing on improving net interest margins through strategic lending and deposit pricing can further boost financial.

4.3 Limitation

Despite the comprehensive methodology outlined for examining liquidity management and profitability in government commercial banks in Bangladesh, several limitations exist that may impact the validity and generalizability of the findings:

- **Data Availability and Quality:** Reliance on secondary sources such as annual reports and financial statements may introduce limitations related to data availability and quality. Incomplete or inconsistent reporting practices across banks could compromise the accuracy and reliability of the dataset, potentially skewing the results.
- **Sample Selection Bias:** While efforts are made to include all government commercial banks with publicly available data, the exclusion of banks with incomplete or discontinuous data may introduce sample selection bias. This could limit the representativeness of the sample and affect the generalizability of findings to the entire population of government-owned banks.
- **Indigeneity Concerns:** Despite employing panel data regression models to control for individual bank effects and time-varying factors, indigeneity remains a concern. Factors such as unobserved heterogeneity or simultaneous causality between liquidity management and profitability may confound the estimated relationships, potentially biasing the results.
- **External Validity:** The study focuses specifically on government commercial banks in Bangladesh, which may limit its external validity beyond this context. Banking dynamics, regulatory frameworks, and economic conditions vary across countries, necessitating caution in extrapolating findings to other contexts or banking systems.
- **Complexity of Banking Dynamics:** The multifaceted nature of banking operations, including interactions between regulatory, economic, and institutional factors, introduces complexity that may not be fully captured within the confines of the study. Certain nuances or dynamics within the banking sector may remain unexplored, potentially limiting the depth of analysis.
- **Temporal Constraints:** The study's reliance on data from a specific time period (2013-2023) may restrict the temporal scope of analysis and overlook long-term trends or structural changes within the banking sector. Future research incorporating data from a broader temporal range could provide a more comprehensive understanding of liquidity management and profitability dynamics over time.

Addressing these limitations requires careful consideration and methodological refinements to enhance the robustness and reliability of research findings. By acknowledging and mitigating these constraints, researchers can contribute to a more nuanced understanding of liquidity management and profitability in government commercial banks, thereby informing more effective policy and managerial decisions within the banking sector.

4.4 Future research direction

As for the directions for further research, the given study indicates that more investigation should be conducted on the effect of liquidity management on profitability in other segments of the banking industry in Bangladesh.

Further, similar secondary research studies for comparisons of such indices and cross-sectional analysis of the LM-Profits relationship in other countries might be useful. Thus, the inclusion of the rewritten conclusion and implications section would help make a conclusion more distinct in the article and would also list guidelines for the next steps in research and the policies that might be crucial in that process.

5. Conclusion

In conclusion, the exploration of liquidity management and profitability in government commercial banks in Bangladesh illuminates intricate relationships, confronts formidable challenges, and underscores methodological considerations essential for scholarly inquiry and policy formulation. Through rigorous analysis, it becomes evident that while liquidity is crucial for operational stability and financial resilience, an optimal balance must be struck to avoid diminishing returns. Moreover, the unique challenges faced by government commercial banks, including regulatory constraints, economic volatility, and political influences, underscore the imperative for strategic reforms and governance fortifications. Despite methodological rigor, challenges such as data availability, indigeneity concerns, and external validity necessitate caution in interpretation. Nevertheless, by navigating these challenges with transparency and innovation, researchers can chart pathways toward transformative outcomes within the banking landscape, enriching scholarly discourse and informing policy deliberations.

5.1 Recommendations

Recommendations stemming from the study on liquidity management and profitability in government commercial banks in Bangladesh are multifaceted and aimed at enhancing operational resilience and strategic agility within the banking sector. Firstly, policymakers should prioritize regulatory reforms aimed at fostering a more accommodative regulatory environment, striking a balance between prudential imperatives and operational flexibility to empower banks in optimizing liquidity management strategies. Secondly, there is a pressing need for strengthening risk management frameworks, encompassing robust credit assessment methodologies, proactive loan recovery mechanisms, and stringent provisioning practices to mitigate credit risk and fortify asset quality. Additionally, government commercial banks should embrace technological innovation and operational efficiency initiatives to enhance competitiveness and adaptability in the face of dynamic market conditions. By implementing these recommendations, stakeholders can fortify the resilience and vitality of government commercial banks, thereby fostering a conducive ecosystem for sustainable growth and economic development.

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