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Anomalies in Maturity Gap: Evidence from Scheduled Commercial Banks in India

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Abstract

Sound ALM practices ensure the stability and liquidity of banks, thus enhancing the profitability. ALM is a mechanism to address the risk faced by banks due to mismatch in assets and liabilities. In the context of India, banking industry is closely monitored and supervised by Reserve Bank of India (RBI). As a part of many norms to ensure the sound banking system, RBI also has come out with the comprehensive framework on ALM that the banks in India has to follow. It includes measures such as earnings and economic value approach, traditional gap analysis, earnings-at-risk method, duration gap analysis, simulation method and funds transfer pricing. The scheduled commercial banks (SCBs) in India are divided into five categories based on bank group by RBI. They are, State Bank of India (SBI) and Associates, Nationalised Banks, Old Private Sector Banks, New Private Sector Banks and Foreign Banks. There could be differences between the banks based on bank groups in ALM. Therefore this study attempts to find out the differences in ALM of Indian banks based on bank groups. The empirical result suggests that there is a significant difference in the gap ratio amongst the bank groups. The null hypothesis can be rejected.

Keywords: Asset Liability Manageme; maturity gap analysis; maturity gap ratio; bank group; rate sensitive assets; rate sensitive liabilities

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Contribution to the Body of Knowledge:

The present study is on the less explored asset liability management and its techniques. This study identifies the asset liability management strategies followed by banks in India. Maturity gap analysis technique is used in the study. The study hypothesizes that bank group could have a significant effect on the asset liability management strategies and hence attempts to find out if there are any differences between the bank groups. There are very few studies done in this area. The outcome of the study is significant for both practitioners and academicians.

1. Introduction

In the changed banking scenario, one of the important areas that the banks are concentrating is Asset-Liability Management (ALM). The recent global financial turmoil can be largely attributed to mismanagement of assets and liabilities by large financial institutions. In this context, banks are now taking ALM more serious than ever. Sound ALM practices ensure the stability and liquidity of banks, thus enhancing the profitability. ALM is a mechanism to address the risk faced by banks due to mismatch in assets and liabilities. The mismatch may be because of maturity profile or due to interest rate structures. Any such mismatch in will lead banks into trouble. For instance, if assets are bearing fixed interest rate and liabilities are bearing floating interest rates, any rise in interest rate would axe the net interest margin of the banks. Similarly if the maturity of the assets is longer than that of liability, bank may face liquidity crisis. ALM unifies the liquidity and profitability of the banks. Therefore it is imperative to monitor the status of assets and liabilities constantly. The goal of ALM is not eliminating the risk but to manage the risk amicably between risk, liquidity and profitability (Bruce, 2004). Having faced with increasing volatility in interest rates and severe competition in fund formation, the banks are now paying more attention to fund formation and monitoring of deposit value and its structure, as well as the state of non-deposit liabilities (Lileikiene, 2008). Alongside, with the increased use of technology and computing power in the banks, ALM could find with a new and broader function to perform (Black, Brown, & Moloney, 2003). To attract globally competent talents to do this job, banks are paying a very high remuneration for the talents performing this job (Walters, 2003). This reiterates the importance of ALM. In the post liberlisation era, with large deregulation in banking sector and due to intense competition, efficient management of assets and liabilities became imperative for survival of banks.

2. Asset Liability Management Process and Techniques

In the context of India, banking industry is closely monitored and supervised by Reserve Bank of India (RBI). As a part of many norms to ensure the sound banking system, RBI also has come out with the comprehensive framework on ALM that the banks in India has to follow. It includes measures such as earnings and economic value approach, traditional gap analysis, earnings-at-risk method, duration gap analysis, simulation method and funds transfer pricing. Besides, there are many research studies on application of various techniques in ALM. Goal programming model with simulation analysis technique in ALM was found effective in solving conflicting goals such as returns,