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"Innovations in the Indian Financial Sector Towards Economic Growth"

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Abstract

Asset liability management in Regional Rural Banks – A Case study of Karnataka Vikas Grameena Bank, Dharwad of Karnataka State.

Asset Liability Management represents the core of sound bank planning of financial management. It is the process of adjusting bank liabilities to meet loan demands, liquidity needs and safety requirements. ALM has been defines as “The Management of a Bank’s entire balance sheet to achieve desired risk return objectives and to maximize the market value of stock holders”. ALM is the process of adjusting bank liabilities to meet loan demands, liquidity needs and safety requirements. ALM is philosophy under which banks can target asset growth by adjusting liabilities to suit their needs. The focus of ALM should be the bank profitability and long term operating viability the practice of ALM over time permits creation of large volume of interest sensitive short term assets and liabilities. A significant shift has ensured in recent years from core-deposit banking into banking based on purchased funds. Disintermediation deregulation and depositor preferences have led banks to devise appropriate strategies for managing bank funds. “ALM is the ongoing process of formulating implementing, monitoring, revising strategies related to assets and liabilities in an attempt to achieve financial objectives for a given set of risk tolerance and constraints.” The key objective of ALM is that of sustaining profitability in such a manner as to argument capital resources. It calls for an integrated approach towards simultaneous decision making with regard to type and size of financial assets and liability.

Introduction:

Agriculture and rural sectors play an important role in India's overall development generation and poverty alleviation. Great significance has therefore, been accorded to developing appropriate institutions and mechanisms for catering to the credit requirements of these sectors. A safe and sound financial sector is a pre-requisite for sustained growth of any economy. This is more particularly true in respect of developing economies like those of India and many others, as the process of growth generally involves more intense challenges than those of developed economies.

A sound and stable banking system, in turn, is the foundation thereof 'Banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable an demand otherwise and withdraw able by cheque, draft, order or otherwise banks are special type of institutions and are unlike many other business forms, because of their own special-characteristic reasons.

Bank asset liability management (ALM) may be defined as the planning of all asset and liability positions on the bank's under consideration of the different bank management, managerial and market constraints, for the purpose frrarv-nu the value of the bank, providing liquidity, and mitigating risk {Gup and Books, 1993). An efficient asset-liability manage the volume, mix, maturity, rate sensitivity, quality and liquidity of the assets and liability as a whole, so as to earn a predetermined, acceptable risk/reward ratio.

Need for the Present Research Study:

As seen, there have not been investigative researches made with regard to all aspects of Asset-liability management practice of banks. This is quite natural, as the practice of Asset-liability management itself is fairly new and even the banks in the developed countries started asset-liabilities management practices, seriously only during 1990's, in India it came into practice much later, from April, 1999 and in RRB's it was implemented as per the RBI/NABARD directions with effect from 1st April, 2007. Implementation of asset-liability

marginal practices requires a sound and effective information (data) collection system and many banks in India have had necessary computerization completed in all respects only around that time. Hence, no efforts have been made by the researchers in India more particularly in Karnataka in relation to KVG Bank, Dharwad. So, at this stage there is a need to analyse the ALM in KVG Bank, Dharwad becomes very relevant and appropriate.

Review of Literature:

A brief summaries of reviews of literature conducted in connection with this research are highlighted below:

1. **Ila Patnaik** (NCAER, New Delhi) and Ajay Shah (Ministry of Finance, New Delhi), (Jan, **2003)** in this paper on "Interest-rate risk in the Indian banking system" have studied the impart of rise in interest rates upon equity capital and on stock prices of a sample of **42** Indian banks. They have empirically evaluated and demonstrated that two thirds of the sample gained or lost over **25%** of equity capital upon a **320** basis points more in interest rates. They further find that stock prices of nearly one third of the banks in the sample have significant sensitivities over movement of interest rates.
2. **Mr. A Venkateshwara Rao (2004),** an officer of Andhra Bank, Head Office, Hyderabad has made an exclusive study of the Asset-liability management practices of **24** banks from the public sector, the private sector and one foreign bank, with a view to study how Asset-liability management system can be used for the purpose of pricing the banking products. He stipulates the necessity of implementations of advanced technology for the purpose or getting Iruormation rroin uie urancn neiwuxf. iu neip and decide costs of deposits and operations. He concludes that the asset-liability management system can help banks to decide the bench mark prime lending rate and this would help banks from under-selling their products. This study has an exclusive pricing perspective and all other issues relating to credit, operations, liquidity and currency risks have been kept outside the purview of the study.
3. **Mr. Abhiman Das** (1996), in his paper 'Structural Changes and Asset-Liability Mismatch of Scheduled Commercial Banks in India' has identified and explored the relationships and structural changes between assets and liabilities of a cross section of scheduled commercial oariKS m inaia. mr. uas ei±ipjun_a±i_y to a conclusion that large banks in India do not necessarily show hedging pattern in their assets and liabilities compared to small size banks, despite the large size of greater access of the

former to the money market. He further observes that small size foreign banks have fared better than relatively large size Indian Public Sector Banks.

4. **Vaidya and Shahi** (2001) studied asset-liability management in Indian banks. They suggested in particular that interest rate risk and liquidity risk are two key inputs in business planning process of banks.

Statement of the Problem:

India a large country of diversities diverse groups diverse culture diverse capabilities diverse income levels diverse manifesto diverse philosophy of people in power and hence a land of diverse and difficult challenges for the banking sector. A large number of regional and small banks came up reacting to the need and scope for banking business. Some banks with larger perspective also came up in the beginning of the 20th century. The banking sector also went through serious crises at the first half of the 19th century.

The following as the major reasons for bank failures in India -

1. Poor liquidity of assets,
2. Insufficient capital,
3. Creation of long-term loans on the basis of short term deposits,
4. Irrational credit policy leading to reckless and injudicious loans and advances,
5. Combination of non-banking activities with banking and indulgence in speculative investments,
6. Lack of suitable banking legislation for regulation of banks,
7. Absence of a Central Bank for over all supervisions and control.

In 20th century, the new generation bank and adoption of high technology by most scheduled banks and deregulation of interest rates have intensified competition amongst banks. As a result, there is a tendency among competitors to have short cut to success and glory, which force compromises on quality of assets. The collapse of Global Trust Bank (GTB) and the bank of Karad shown us there is a management failure and therefore ALM stand in strong demand of a study of this kind and hence, the statement of the problem is "Asset- Liability Management in KVG Bank, Dharwad/

Objectives:

The main objectives of the study are as follows:

1. To study the origin and growth of RRBs
2. To study the origin and growth of the KVG Bank
3. To analyze the Spread and Return On Investment (ROI)
4. To analyze the Liquidity Risk
5. To analyze the Interest Rate Risk
6. To analyze the Currency Risk
7. To analyze the Credit Risk
8. To offer suggestions in the light of findings of the study

Research Methodology:

This investigative study is based on the secondary data. The issue of perception of banking risks, their measurement and quantification, the preparedness and willingness to implement the complex regulatory requirements and such similar efficiency and intellectual imports are studied and evaluated based on the personal interviews with very senior officers who were either numbers or conveners of the high level committee responsible for implementation and review of asset-liability management of the banks. Officers of the cadre of Treasurer (of the bank), general managers, deputy general managers were met in their respective head office in Dharwad.

The practicability of implementation of regulatory requirements, the risk management techniques designed and adopted for implementation, the inter-relationship (if any) amongst different kinds of banking risks, etc., have been studied based on secondary data obtained from both published annual reports and internal control reports prepared for management information system (review committees) of the various banks. Annual reports have been collected and studied for a period five years.

Plan of the Analysis:

Such data have been classified, tabulated and extensively analyzed using various suitable statistical techniques. Tables, charts, graphs have been provided wherever necessary. Statistical tools are selected based on the above mentioned objectives and hypothesis.

Limitations of the study:

Although the sample is a representative part of the banking, the -^search is completely based on the secondary data collected from different sources. Apart from these data, the researcher has interacted with senior officers in the concerned banking sector; the study has the following limitations:

The replies to the interview schedule depend on the eagerness of the interviewee to furnish data to the most accurate level. Normally, there used to be a team of officers led by a senior officer, which used to respond to the interview schedule as it involved information from different departments for the study. It is difficult to expect some level of high commitment while gathering related information.

The study of liquidity risk and interest rate risk is heavily dependent on the data furnished. It may not be possible to collect all the necessary information as many of the respondents did not furnish the required details.

Most importantly, data relating to some very confidential issues in liquidity risk and interest rate risk were not disclosed by a majority of the banking sectors. The conclusions and generalizations on these aspects, therefore, are quite likely to be influenced accordingly.

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