ABSTRACTS OF THE THESIS

This thesis examines the role of Asset-Liability Management and Risk Management in Pricing of Products in Urban Co-operative Banks (UCBs). 16 UCBs in the district of Pune in the state of Maharashtra have been selected for the purpose of this research study. While selecting UCBs due care has been taken to cover four UCBs from each grade i.e. I, II, III and IV as allocated by the Reserve Bank of India as on 31.03.2007 on the basis of CAMELS rating system. Number of UCBs selected for the purpose of study stands at 25% of the total UCBs in Pune district. However, in terms of business it covers deposits of 51.65%, advances of 49.64% and investments of 55.28%, for making the study broad based and more meaningful as well as fair representative.

The main objective of this research is to find out ways and means to ensure the existence of these UCBs as they are much needed by the society. It aims at the attitude of Board of Directors to face the basic problem with regards to Net Interest Margin (NIM), Asset-Liability Management (ALM) and Risk Management (RM) and to evaluate the present system of fixing prices of various products of the bank and to ensure its capability of maintaining required NIM. It also aims at whether the present system of managing Liquidity Risk and Interest Rate Risk with its capabilities and inaccuracy in pricing of products, is the main cause of sickness? Further, whether non implementation of ALM and RM is cause of sickness?

For the purpose of study, primary data has been sourced with the help of a well designed questionnaire. Replies to the questionnaire have been obtained from Chairman, two directors and Chief Executive Officer of each selected UCBs through personal interviews. In deregulated interest rate scenario, these officials are now empowered to take decision on pricing of products. Secondary data have been sourced
from comprehensive study of annual reports, magazines, journals, newspapers, periodicals, articles, websites etc.

In all 80 Profit and Loss accounts and 80 Balance Sheets are analyzed. The Profit and Loss account indicates revenue position of the bank. The data of Income side has been further classified on the parameters of Interest Received on Advances, Interest Received on Investments and Non Interest Income whereas the data of Expenses side has been further classified on the parameters of Interest Expenses, Administrative Expenses, Depreciation (Being book entry only), Provision for N.P.A., Provision for Depreciation in Investments, Other Provisions and Staff cost. The Balance Sheet indicates the financial position of the bank. The data of Liability side has been further classified on the parameters of Share Capital, CASA Deposits, Term Deposits, External Borrowings, Contras, Other Liabilities and Profit whereas the Asset side has been further classified on the parameters of Cash, Bank Balances, Investments, Advances, Fixed Assets, Contras, Other Assets and Loss.

Analyzed information have been subsequently used for assessing the performance of each bank for five years on various parameters. The results of analyzed information have been tested by using paired t-test and regression analysis for proving the hypotheses.

The important findings of the study are as under:

1. It is revealed from the ‘VISION DOCUMENT’ published by the Reserve Bank of India in the year 2004 that the UCBs have made good progress during about 15 years of reforms. The number of UCBs increased from 1307 to 2105 registering rise of 61.06%, Deposits of the UCBs increased from Rs. 8,600
crores to Rs. 1,10,000 crores recording growth of 1179% and advances of the UCBs increased from Rs. 7,800 crores to Rs. 65,000 crores recording growth of 733.33%. The contribution of state of Maharashtra in this growth process has been almost 60%. However, the UCBs that were performing well during the earlier period, all of a sudden found it very difficult to get adjusted in deregulated interest rate scenario and are exposed to ‘Interest Rate Risk’ (IRR) in the dramatically changed competitive banking environment. It is observed that 46 UCBs have failed in short period of 30 months during the period of this study.

2. All 16 selected UCBs failed to control the inflow of funds by reducing the pricing of deposit products when the profitable deployment opportunities were not available. As a result, these UCBs held the surplus funds either in form of excess C.R.R. or excess S.L.R. investments at lesser yields. Except the Janata Bank, all other UCBs suffered loss due to holding of excess cash. The minimum negative impact has been seen to the extent of 0.05 per cent of W/C in case of Vidya Bank and Cantonment Bank and maximum of 4.25 per cent of the W/C in case of Sambhaji Bank. Similarly, except Janata Bank all other UCBs have suffered loss due to excess investments in S.L.R. securities. Minimum adverse impact to the extent of 0.10 has been seen in case of Sambhaji Bank and maximum of 1.93 per cent of W/C in case of Ganesh Bank. This reveals that the UCBs have failed to price the products accurately, manage liabilities efficiently and have been victim of Interest Rate Risk on the Liability side of Balance Sheet.

3. On the Asset side of the Balance Sheet the UCBs have been exposed to Credit Risk and Investment Risk in a big way. All 16 UCBs have suffered set back due to N.P.A. provisioning. The negative impact of N.P.A. provisioning
worked out to be minimum of 0.04 per cent of W/C in case of Sambhaji Bank and maximum of 1.94 per cent of W/C in case of Anand Bank. The adverse impact in case of grade – III and grade – IV UCBs is so severe that except Siddharth Bank and Janata Bank all other 6 UCBs have sustained loss. Out of 16 selected UCBs, adverse impact of M to M depreciation provisioning, i.e. Investment Risk has been seen in case of 9 UCBs. The negative impact of these 9 UCBs worked out to be minimum of 0.04 per cent of W/C in case of Sambhaji Bank and maximum of 0.29 per cent of W/C in case of Laxmi Bank. Severe adverse impact of Investment Risk has been seen in case of grade – III and grade – IV banks. Vidya Bank went in to loss whereas Sanmitra, Cantonment and Laxmi Bank extended their losses. This reveals that the UCBs have failed to manage both Credit and Investment Risks on the Asset side of the Balance Sheet. It also reveals that had the Risk Cost properly accounted been for during the pricing process, these UCBs would not have suffered losses.

4. It is further revealed that failure to manage Assets and Liabilities in efficient manner, pricing of products and managing various risks has put lot of pressure on the profitability of all 16 selected UCBs. Losses suffered by these UCBs have reduced their own funds in a big way. It has been observed that out of 16 selected UCBs only 4 UCBs i.e. Cosmos Bank, Mahesh Bank, Bhavani Bank and Cantonment Bank have own funds of more than 10 per cent of W/C. This indicates that the remaining UCBs are more risk prone.

5. It is also revealed that out of 16 selected UCBs none of the UCB has priced the ‘Risk Cost’ while pricing its products. As a result, NM of all UCBs have been affected to the extent of Risk Cost.
6. Out of 16 selected UCBs only two UCBs i.e. Cosmos Bank and Siddharth Bank could report NIM of above 2 per cent because of low risk cost and good existing NIM. Four UCBs i.e. Mahesh Bank, Seva Vikas Bank, Ganesh Bank and Janata Bank which reported the NIM of above 1 per cent but less than 2 per cent of W/C are borderline cases. In case of five UCBs i.e. Pimp. Chd. Bank, Sambhaji Bank, Vidya Bank, Sanmitra Bank and Gajanan Bank which formed 31.25 per cent of selected UCBs, the NM is below 1 per cent of W/C. The UCBs cannot afford to function at such low NM in competitive business environment. Unfortunately, Five UCBs i.e. Prerana Bank, Bhavani Bank, Cantonment Bank, Laxmi Bank and Anand Bank which formed 31.25 per cent of selected UCBs, have incurred loss due to improper pricing of product. The net margin (NM) has turned negative after adjusting risk cost indicating that the Managements of these UCBs have run these banks in loss.

7. Interestingly, if the risk cost is not added then the 4 UCBs out of 5 UCBs which incurred loss will show positive NM. These banks are Prerana Bank, Bhavani Bank, Cantonment Bank, and Laxmi Bank. This indicates that these banks have totally failed in pricing their products.

8. Thus, 10 UCBs (i.e. 62.50 per cent) have not understood the concept and importance of NIM. Without considering the ‘Risk Cost’ at the time of pricing of products has affected these UCBs very seriously.

9. It has been observed from the replies to the questionnaire during the field study that the decision to change the interest rate structure has not been taken by the Asset-Liability Committee of the bank in majority of the cases. Most of the UCBs follow other bank’s interest rate structure while pricing the products in
their bank. UCBs do calculate neither product wise profitability nor breakeven point of the products offered. Many UCBs do not have any system to monitor the NIM in their bank. Most of the UCBs do not have credit rating system for the borrowers. UCBs are neither aware of the concept of interest rate sensitivity of the Balance Sheet nor they have any computerized system to calculate the interest rate sensitivity of balance sheet. Many UCBs have accepted that they neither give importance to gap analysis nor read the same. Similarly, they do not have any contingency plan in their bank. It is also observed that UCBs do not have adequately skilled personnel who understand the concept of Asset Liability Management and Risk Management.

Some of the important recommendations of the study are under:

1. Asset-Liability Management and Risk Management plays very important role in competitive banking environment. Co-operative banking being integral part of the Indian banking system cannot be left outside of the preview of these concepts. Fortunately, the Reserve Bank of India has now extended the scope of ALM and RM to all the UCBs in India w.e.f. 2009-10.

2. Pricing of the products is very important and independent function. Copying the interest rate structure of other UCBs operating in their area needs to be discontinued immediately. Pricing of Products needs to be done in more scientific way.

3. Calculation of NII, W/C, NIM, Risk Cost, Non. Int. Inc., T/C etc. have now become easy with increased use of computer by UCBs. The Management
needs to follow the formula suggested and base the decision of pricing of products on it.

4. UCBs need to be educated that the pricing of product will differ from bank to bank as the Risk Cost of each bank will differ. While pricing the products the UCBs need to fully factor their Risk Cost. This will help the UCBs to ensure that the projected NM is achieved.

5. Mindset of the Board of Directors, for maintaining NIM, has to make simultaneous change in the interest rates on deposits and advances have to be changed through training. Depending upon the interest rate sensitivity of the Balance Sheet the expected result of maintaining NIM can be achieved by making change either on asset side or on liability side or by using mix of both.

6. Monitoring of NM needs to be done on an ongoing basis, preferably on every quarter. Similarly, required provisioning of N.P.A. and depreciation in the value of Investment based on ‘M to M’ basis also needs to be worked out on quarterly basis. This will no doubt help the UCBs to calculate the probable Risk Cost. Based on this data the UCBs need to change the pricing of products to absorb the variations in Risk Cost. This will facilitate the management in understanding the position of profitability for the current year well in advance and will act as pre warning signals.

7. UCBs should use software for transforming the Balance Sheet on the basis of residual maturity and on the basis of sensitivity to get more accurate results.
8. Mindset of the Board for spending money on technology, on skilled personnel and on training needs to be changed as these aspects have become necessity of the present banking environment. Technology will ensure instant availability of required information which will be accurately analyzed by skilled personnel with recommendations of corrective measures. Training will always ensure that the level of knowledge of the Directors, senior management and other staff members is kept updated.

9. The Management needs to consider GAP ANALYSIS very seriously. This is required to counter ‘Liquidity Risk’ and ‘Interest Rate Risk’. It needs to be understood and used in proper way. The mindset to use it as reporting format to regulator needs to be changed. Pre warning signals given by Gap Analysis needs to be attended immediately by taking corrective actions.

10. Educating the Directors, senior management and staff members on the use of these techniques needs to be done more aggressively. It has been revealed from the study that the UCBs are failing because of improper pricing of their products. This can only be done through effective training.