

ASSET LIABILITY MISMATCH AND ITS IMPACT ON NBFC STABILITY AT MUTHOOT FINANCE

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ABSTRACT: This PAPER concentrates on Muthoot Finance and investigates the influence of asset-liability mismatches on the stability of Non-Banking Financial Companies (NBFCs). It investigates the potential impact of different asset and liability maturity profiles on liquidity, profitability, and overall financial health. The investigation looks into how Muthoot Finance effectively addressed these discrepancies. It emphasizes the potential consequences of a downturn, as well as the risks associated with short-term financing for long-term assets. The investigation draws on both primary data from company reports and secondary data from trade journals. It assesses the extent to which regulatory guidelines reduce mismatch risks. Additionally, the investigation looks into the relationship between asset-liability management strategies and investor confidence.

Keywords: *Asset-Liability Gap, Liquidity Risk, Maturity Mismatch, Interest Rate Risk, Funding Risk, Cash Flow Imbalance*

I. INTRODUCTION

Financial institutions use asset and liability management (ALM) to reduce the financial risks associated with an asset-liability imbalance. Organizations frequently use ALM strategies, which combine financial planning and risk management, to mitigate potential long-term risks as circumstances change.

Asset and liability management covers a wide range of activities, including strategic asset allocation, risk reduction, and changes to capital and regulatory frameworks. Financial institutions have a surplus that can be actively managed to maximize investment returns and profitability when assets and liabilities are successfully aligned.

The Reserve Bank of India's (RBI) stringent regulations ensure the stability of NBFCs. These regulations include capital adequacy standards, risk management guidelines, the Scale-Based Regulation

(SBR) framework, which categorizes NBFCs based on risk, frequent inspections, and prudential standards. NBFCs' exposure to stressed industries such as infrastructure and power, as well as their connections to other financial markets, are risky, despite regulatory relief and improved liquidity conditions that contribute to stability. Strong corporate governance, ethical customer relations, and risk management are all necessary internal mechanisms for ensuring stability.

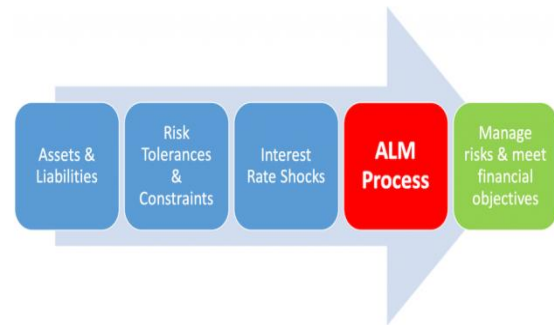
Asset-Liability Mismatch (ALM) is a source of concern for non-banking financial companies (NBFCs) because it has a direct impact on their liquidity, profitability, and financial stability. Timing gaps can lead to funding shortages when assets and liabilities have different maturities or cash flows. This is known as ALM. NBFCs are especially vulnerable to market disruptions and interest rate fluctuations because they rely heavily on

borrowed funds to fund their lending operations. This is due to the risk of mismatches between long-term loans and short-term borrowings.

NBFCs are more vulnerable to refinancing risks than traditional banks because they have limited access to low-cost funds via deposits. Persistent ALM issues can impede an NBFC's ability to meet commitments on time, increase reliance on expensive emergency funding, and eventually erode investor and stakeholder confidence. As a result, in a competitive and volatile financial environment, these institutions' operational and financial success is dependent on their understanding and ability to manage ALM. ALM has long-term implications for NBFC stability. Inconsistencies between the asset and liability structures can erode the balance sheet by increasing the risk of defaults, non-performing assets (NPAs), and credit losses. Furthermore, regulatory frameworks and rating agencies closely monitor an NBFC's ALM positions, which has a negative impact on its ability to raise funds and maintain its market reputation.

Inadequate management of asset liability management (ALM) can also stifle growth potential, as it may require enterprises to limit lending even during periods of high demand. As an alternative, non-bank financial companies (NBFCs) have the opportunity to strengthen their resilience to financial shocks, raise their profitability, and maintain constant cash flows by applying proactive asset life cycle management (ALM) techniques. These strategies include diversifying funding sources, optimizing asset and liability maturity profiles, and employing risk mitigation measures.

II. ASSET-LIABILITY MANAGEMENT (ALM) PROCESS



Assets & Liabilities

- Identify and classify all assets and liabilities.
- Understand the process of balancing financial assets such as deposits, loans, and investments.

Risk Tolerances & Constraints

- Determine acceptable operational and financial risk thresholds.
- Consider the internal, market, and regulatory constraints.

Interest Rate Shocks

- Changes in interest rates can have a significant impact on assets and liabilities.
- Determine how susceptible you are to market interest rate fluctuations.

ALM Process

- Create strategies for maintaining a balance between your assets and liabilities.
- Optimizing your portfolio reduces risk and helps you achieve financial stability.

Manage Risks & Meet Financial Objectives

- Ensure that the risk exposure is within acceptable limits.
- Ensure that financial decisions align with the company's objectives and goals.

III. METHODS FOR MANAGING ASSET-LIABILITY MISMATCH

- Methods for Analysis
- Methodology for balance sheets.
- Off-Balance Sheet Methods

ANALYTICAL METHODS

Gap Analysis: Gap analysis is a critical tool in asset lifecycle management (ALM) that assesses the differences between rate-sensitive assets (RSA), which are assets that fluctuate in response to interest rates, and rate-sensitive liabilities (RSL), which are liabilities that fluctuate in cost in response to interest rates over time. By computing these gaps, financial institutions can identify when they are vulnerable to interest rate fluctuations and take corrective action, such as changing the composition of their assets or liabilities.

Repricing Gap Analysis: Focuses primarily on the timing of interest rate changes. It compares asset and liability repricing dates to identify discrepancies that could expose the organization to gains or losses due to interest rate changes. For example, if liabilities reprice faster than assets, an increase in interest rates may reduce profitability by raising funding costs faster than asset returns.

Maturity Gap Analysis: This technique assesses liquidity risk by comparing the timing of cash inflows from assets to cash outflows from liabilities. It assists banks in determining when liquidity should be restricted. Liabilities maturing before assets or a negative maturity gap indicate a potential funding shortage, necessitating prudent liquidity management.

Duration Gap Analysis: This method assesses the sensitivity of a bank's assets and liabilities to interest rate fluctuations

by taking a comprehensive approach to interest rate risk. Duration is the weighted average time required for cash flows to be received or paid. By comparing asset and liability durations, management can assess the impact of rate fluctuations on net worth and adjust the balance sheet to mitigate risks. Even minor changes in interest rates can have a significant impact on the institution's equity, as evidenced by the substantial duration gap.

BALANCE SHEET METHODS

Diversification: Diversification reduces concentration risk by spreading investments across a wide range of industries, maturity levels, interest rate types, and geographic regions. To avoid the significant impact of negative changes in one area on overall profitability or liquidity, a well-diversified portfolio balances short- and long-term assets, fixed and floating-rate instruments, and multiple sectors.

Asset and Liability Adjustments: The balance sheet is reorganized strategically to reduce exposure to specific risks. To ensure that the timing and interest rate characteristics of their balance sheet items are consistent, banks may buy or sell specific assets or restructure liabilities. These changes stabilize net interest revenue while lowering the risk of mismatches.

Extending Liability Duration: During periods of rising interest rates, banks can reduce their exposure to rising short-term borrowing rates by issuing longer-term debt that has fixed funding costs. This strategy is especially useful when a bank's long-term assets are financed by short-term liabilities because it closes the maturity gap.

Shortening Asset Duration: In contrast, the current higher rates enable a more

rapid reinvestment as a result of the accumulation of a greater number of short-term securities. This is advantageous in an environment of rising interest rates because shorter-term assets mature earlier, reducing the bank's net interest margin exposure to rising rates.

Securitization: Securitization allows banks to remove illiquid assets from their balance sheets by converting them into securities and selling them to special purpose vehicles. Banks can better manage their funding and asset portfolios by focusing on more strategic investments, which reduces exposure to interest rate and liquidity risk and frees up capital.

OFF-BALANCE SHEET METHODS

Hedging with Derivatives: Swaps, futures, and options are examples of derivatives that can be used to mitigate specific risks while not affecting the overall balance sheet. The tools are useful for mitigating adverse fluctuations in interest rates, currencies, and credit spreads.

Interest Rate Swaps: A bank can match the interest rate characteristics of its assets and liabilities to its risk tolerance by exchanging fixed-rate obligations for floating-rate ones, or vice versa. For example, a swap could be used to stabilize cash flows for a bank with fixed-rate loans backed by floating-rate deposits.

Interest Rate Futures and Options: These contracts allow you to lock in interest rates or hedge against unfavorable fluctuations. They are adaptable instruments that help banks plan for a variety of interest rate scenarios and mitigate short-term risks.

Forward Rate Agreements (FRAs): FRAs are contracts that guarantee future interest rates for a set time. Participating in a FRA allows a bank to protect itself from

unforeseen interest rate increases or decreases while also ensuring more predictable funding costs or investment returns.

Dynamic Financial Modeling: Using sophisticated modeling techniques such as Monte Carlo simulations, banks can forecast cash flows in response to various economic scenarios. To reduce potential losses, banks can stress-test their balance sheets by simulating interest rate changes, deposit withdrawals, and loan defaults to identify weaknesses and proactively modify asset and liability strategies.

IV. LITERATURE SURVEY

Ankit Jain 2025 This PAPER looks into the potential of Asset Liability Management (ALM) to reduce liquidity risks for NBFCs by 2025. ALM is caused by an imbalance in asset inflows and outflows, which can lead to refinancing pressures and cash flow issues. Interest rate risk and default are more likely to hit NBFCs that use short-term liabilities to fund long-term loans. Strategic ALM techniques, such as duration matching, stress testing, maturity gap analysis, and hedging, are critical for maintaining financial stability and liquidity.

Asset Liability Mismatch (ALM) posed operational risks for Snehal Patil's 2024 Non-Banking Financial Companies. If the timing and volume of asset inflows do not correspond to liability obligations, ALM can cause financial stress and liquidity shortages. NBFCs that rely on short-term borrowings to fund long-term loans are especially vulnerable to interest rate volatility and refinancing risk. Maturity gap analysis, duration matching, stress testing, liability diversification, and maintaining a liquidity buffer are some of

the key ALM management techniques highlighted in the report. Real-time mismatch tracking and predictive analysis are made possible by technology-enabled risk monitoring. The regulatory emphasis on ALM ensures that NBFCs maintain appropriate risk exposure and capital.

Rakesh Kumar 2023 This paper examines the financial stability of NBFCs in 2023 in light of the risks associated with Asset Liability Mismatch (ALM). Cash inflows and asset maturities do not align with liability obligations, resulting in ALM. Mismanaged ALM increases the risk of operational stress, non-performing assets, and defaults. To mitigate these risks, NBFCs have implemented sophisticated risk management frameworks such as scenario analysis, stress testing, maturity profiling, and dynamic liquidity management. Technological tools help to implement timely interventions, which improves real-time asset-liability position monitoring.

Rahul Menon 2023 The investigation focuses on the financial health of NBFCs in 2023, a year marked by increased credit activity and economic recovery, as well as the impact of Asset Liability Mismatch (ALM). ALM occurs when liabilities mature faster than assets, creating liquidity gaps that may force NBFCs to use expensive short-term funding. Default, non-performing assets (NPAs), and capital adequacy stress are all exacerbated by ineffective asset lifecycle management (ALM). NBFCs use dynamic risk management strategies like liquidity buffer maintenance, stress testing, and gap analysis. Technology-driven ALM monitoring enables accurate and timely risk assessments. Regulatory oversight necessitates regular reporting of ALM positions to ensure stability.

Asset Liability Mismatch (ALM) had a significant impact on NBFC stability in 2022, owing to increased pressure from volatile interest rates and rising credit demand. ALM causes short-term liquidity stress and long-term solvency issues when asset cash flows do not match liability obligations. NBFCs are especially vulnerable to refinancing risk if they have large portfolios of long-term loans backed by short-term liabilities. Inadequate asset lifecycle management (ALM) leads to credit rating downgrades, declining asset quality, and higher funding costs. Duration matching, maturity profiling, and liquidity gap analysis are all effective asset lifecycle management methodologies for ensuring stability. Potential liquidity shortages can be predicted using scenario analysis and stress testing.

Arjun Verma 2021 This Paper investigates the impact of Asset Liability Mismatch (ALM) on NBFC liquidity management in 2021. When asset maturities and liabilities are not synchronized, ALM can cause short-term liquidity shortages and long-term solvency risks. NBFCs are more vulnerable to refinancing pressures and interest rate fluctuations due to their frequent use of short-term borrowings to fund long-term loans. The economic slowdown caused by the pandemic forced NBFCs to use emergency funding or more expensive borrowings, further straining their cash flows. To prevent defaults and maintain financial stability, effective ALM management is required, which includes scenario stress testing, liquidity buffers, and maturity gap analysis. Regular reporting and meticulous liquidity planning are now required due to increased regulatory oversight. ALM risks can be mitigated through a variety of funding options and strategic liability structuring.

V. DATA ANALYSIS

LIQUIDITY ANALYSIS OF MUTHOOT FINANCE

Liquidity Metric	Description	Impact of ALM Mismatch
Cash & Cash Equivalents	Short-term liquid assets available to meet obligations	Insufficient liquidity due to mismatch may force borrowing at higher rates
Short-Term Borrowings	Borrowings due within 1 year	Increased dependency on expensive short-term funds
Loan Disbursement vs. Collections	Difference between funds disbursed and collections received	Mismatch can create temporary cash deficits
Liquidity Coverage Ratio (LCR)	Ability to cover short-term obligations with high-quality liquid assets	Lower LCR indicates higher vulnerability to funding stress

THE IMPACT OF ASSET-LIABILITY MISMATCH (ALM) ON NBFC STABILITY AT MUTHOOT FINANCE

Aspect	Details / Impact	Implications for Stability
Business Model	Short-term gold-backed loans (3–12 months) funded by short-term & long-term borrowings	Alignment of asset and liability maturity reduces liquidity risk and strengthens financial stability
ALCO (Asset-Liability Committee)	Monitors maturity profiles, liquidity risk, and interest rate exposure	Effective risk oversight minimizes ALM impact and ensures disciplined fund management
Liquidity Risk	Proper matching of short-term assets with short-term liabilities	Reduces chance of cash crunch, ensuring smooth operations
Interest Rate Risk	Loans mostly have floating rates; borrowings include fixed & floating rates	Mismatch could affect margins; careful management stabilizes profits
Market Performance	Q1 2024: 11% net profit growth but impacted by rising finance costs (27%) & impairment charges (over 100%)	Shows ALM alone cannot fully insulate from external financial shocks
Regulatory Scrutiny	RBI flagged irregular gold loan practices in 2024	Regulatory actions can indirectly impact ALM management and liquidity planning
Overall Stability	Strong ALM practices through ALCO and asset-liability matching	Supports long-term financial stability despite external market and regulatory challenges

VI. CONCLUSION

Finally, asset-liability mismatch (ALM) has a significant impact on the stability of nonbank financial institutions. Liquidity and interest rate risks can impair NBFCs' ability to meet obligations when assets and liabilities mature at different times.

Effective ALM management lowers funding costs, increases market confidence, and ensures consistent cash flows. In contrast, persistent mismatches can increase financial vulnerabilities, defaults, and non-performing assets. Rigorous regulatory oversight and risk management are required to reduce ALM

risks. To increase market volatility resistance, asset and liability profiles are strategically aligned. NBFCs can achieve operational stability and long-term growth by implementing effective ALM strategies. It is critical to continuously monitor and modify funding and lending strategies. In general, NBFCs can maintain their long-term stability and reputation by implementing effective ALM management.

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