

# THE EFFECT OF ASSET LIABILITY MANAGEMENT ON THE LIQUIDITY RISK OF DOMESTIC LICENSED COMMERCIAL BANKS IN SRI LANKA

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## ABSTRACT

Commercial banks play a crucial role in the development of a country. A sound, progressive, and dynamic banking system is a major requirement for economic development. As an ultimate phase of the tertiary sector of an economy, commercial banks act as the backbone of economic growth and prosperity by acting as a catalyst within the process of development. They instruct the habit of saving and mobilize funds from several small households and business firms spread over a geographical region. Asset Liability Management (ALM) plays an important role in weaving together the various business lines in a financial institution. Managing liquidity and the financial positions are crucial to the existence of a financial institution and sustenance of its operations. It is also essential for seamless growth of the financial position. This study examined the effect of asset liability management on the liquidity risk of domestic licensed commercial banks in Sri Lanka. For this purpose, 10 domestic licensed commercial banks were selected. The data used for this study were collected from the bank's annual reports for the period 2009 -2016. It was analyzed using correlation and regression. The study established that liquidity risk can result into experiencing adverse operational and financial problems such as decline in investor confidence, panic withdrawals and daily operation problems. Hence, banks attempt to control asset liability management factors such as capital adequacy ratio, return on equity, return on assets, loans to deposits ratio and total assets of commercial banks by balancing cash inflows and outflows. According to the results of regression analysis capital adequacy ratio, return on equity, return on asset, loan to deposit ratio positively effect on liquidity risk at the same time size of the bank negatively effect on liquidity risk. There is a need for commercial banks to place greater emphasis on developing an integrated view of risk across all types of risks, and the banks operational areas while ensuring that the asset management committee introduces and implements tighter regulations and reporting requirements with tighter capital requirements and symmetrically greater liquidity creation

**Keywords:** Commercial banks, Asset liability management, Liquidity risk, Capital adequacy ratio, Return on equity