COMPARATIVE LIQUIDITY RISK ANALYSIS IN AWASH INTERNATIONAL AND WEGAGEN BANKS

COLLGE OF BUSINESS AND ECONOMICS

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ACRONYMS

GDP_ Gross domestic product

GNP_ Gross national product

GTP_ Gross and transformation plan

AIB_ Awash International Bank

NBE_ National Bank of Ethiopia

NPL_ Non-performing loan

ROE_ Return on equity

CAP_ Capital adequacy

INF_ Inflation

WB_ Wegagen Bank

Abstract

Comparative Liquidity Risk Analysis in Awash International and Wegagen Bank The Comparative Liquidity Risk Analysis in Awash International and Wegagen Banks. The main objective of the study was to assess the Comparative Liquidity Risk Analysis in Awash International and Wegagen Banks. The specific objectives were to assess *the main sources of liquidity risk in these two banks, to asses systems they make to control liquidity risk, to compare which banks affected more by liquidity risk. The study was considered the effect on comparative liquidity risk analysis of capital adequacy, Gross domestic product, loan growth, size and inflation. In order to meet the objectives of the study, both primary and secondary data was used. The primary data was collected through questionnaires by using by using judgmental sampling techniques and the secondary data also was taken from books, internets, annual report of Woreda, and others. The study was benefited to develop intervention mechanisms those are tailored to the specific need of the study area, it helps concerned bodies in their effort to formulate policies, and it was used as a source material for further studies. And the research was employed descriptive statistics like percentages, charts and frequencies to analyze the collected data.The researcher used both quantitative and qualitative data. Quantitative data is used through closed ended questions in the questionnaires. Qualitative data collected through interview and open-ended questions in the questionnaires. The quantitative data that is collected through questionnaires is analyzed through descriptive data analysis techniques.The bank faces different problems to manage liquidity risk. These are no well-developed payment system and management information system (MIS) and there is no interdependence and flow of information in different department. Therefore, the researcher recommended that, all departments should clear knowledge and information to minimize the bank liquidity problem and work as synergy. Diversification of the uses and sources of funds is also an important issue in the banking industry.*

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Chapter One

Introduction

1.1. Background of the Study

The role of banking sector is very important in the economic and financial development of the country as these sectors contribute one of the most fundamental of the country economy. Now a day there is many changes in the banking sectors of the country and develops more branch solidity and fast technological alternation and enlarged competition has added stress on bank to increase its performance. Bank plays an important role in an economy of the nation. According to Sergeant (2001), bank contributes to investments, employment creation and the process of economic growth and development.

They are the corner stone of an economy of a given nation (Omankhanlen, 2012). The economies of all nations depend on the efficient operation of complex and delicately balance system of money and credit. Bank provides the bulk of money supply and the primary means of facilitating the flow of credit (Omankhanlen, 2012). Given this fact, over the period of 2011-2015, the government of Ethiopia prepared a growth and transformation plan (GTP) directed towards achieving Ethiopia's long- term vision and sustained the rapid and broad- based economic growth performance. For this purpose, banks are give the role of rendering efficient and effective loan service for those investors engaged in industrial development field and to mobilize resource needed for implementing the plan. According to Keating (2014), the development of private banking system is considered important in Ethiopia's economic progress and a key to the success of the country's GTP. Bank for International Settlements defines liquidity as the ability of bank to found increases in assets and meet obligations as they come due, without incurring unacceptable losses. Liquidity level refers to the ability to have enough funds to meet the long –term and short term obligations. Liquidity risk arises from the fundamental role of banks in the maturity transformation of short term deposits in to long-term loans. Banks have always been prone to liquidity risk because one of their principle social purposes is to perform maturity transformation, also known as time intermediation.

In other word they take demand deposits and other short –term funds and lend them back out at longer maturities. Therefore, banks can lend out the for longer periods with affair degree of assurance that the deposit will remain available or that equivalent, deposits can be obtained from others as needed, perhaps with a modest boost in deposit rates (Tsignesh, 2012). In Finance, liquidity risk may not be seen as isolated since all financial risk are not mutually exclusive and liquidity risk often caused by other financial risks such as credit risk, market risk, etc. For instance, a bank increases its credit risk through asset may increase its liquidity risk as well. Similarly, a large loan default can adversely impact a banks liquidity position. Market liquidity risk is the risk that a bank cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption (Vodova, 2011). According to Bank Risk Management Guidelines of NBE (2010), liquidity risk as one of the major risk from bank, it arises if the cushion provided by the liquidity asset is not sufficient to cover its obligation.

1.2. Statement of the Problem

National Bank of Ethiopia (NBE) has put a lending cap on commercial banks and this hindered them from giving more loans and reduced their level of profitability for a whole, but recently the cap has been lifted and private commercial banks are able to lend, but only recently this lending cap was lifted, (Simeneh, 2013), Relatively speaking private commercial banks are a new phenomenon in the Ethiopian economy. They used to operate before the 1974 revolution but after that they were nationalized and amalgamated with the government owned banks and they start to operate after the demise of the Dergue regime's banks dominate the financial sector in the Ethiopia, the process of financial intermediation in the country dependents heavily on banks. Hence, keeping their optimal liquidity for banks in the Ethiopia is very important to meet the demand by their present and potential customers.

Furthermore, the National Bank of Ethiopia has required banks to have their liquidity police (Bank Risk management Guide line, 2010) which enforce banks to monitor their funding structure and their ability to handle short term liquidity problems and provide them with a better means of assessing the present and future liquidity risk associated with their future liquidity potion. Liquidity risk arises from the inability of a Bank to accommodate decreases in

the liabilities or to fund increase in assets. An illiquidity bank means that it cannot obtain sufficient funds, either by increasing liabilities or by converting assets promptly, at a reasonable cost. In periods the banks don't enjoy liquidity, they cannot satisfy the require resources from debt without conversion the asset in to liquidity by reasonable cost. Under critical conditions, lack of enough liquidity even results in bank's bankruptcy.

A reduction in funding liquidity then caused significant distress (Berehanu 2015). Liquidity risk is the possibility that over a specific time period, the bank will become unable to settle obligations with immediacy. It is a risk rising from a banks inability to meet its obligations when they come due without incurring unacceptable losses. This risk can adversely affect both banks earnings and the capital and therefore, it becomes the top priority of a bank's management to ensure the availability of sufficient funds to meet demands of providers and borrowers, at reasonable costs.

There are internal and external sources of liquidity risk. Accordingly, banks specific (internal factors) such as, bank size, capital adequacy, non-performing loan and banks external (macroeconomic factors) factors such as GDP, financial police of the country, inflation, and financial crisis. Liquidity risk needs to be monitored as part of the enterprise-wide risk management process, taking into account market risk and credit risk to ensure stability in the balance sheet and dynamic management of liquidity risk.

A bank should only attempt this if it makes good business sense, not use it as a means to keep afloat. Liquidity risk not only affects the performance of a bank but also its reputation. A bank may lose the confidence of its depositors if funds are not timely provided to them. The banks reputation may become at stake in this situation. AIB and Wegagen Bank reported a decline in cash balances of 18.63 pc and 15.46pc, respectively. Average cash holdings for a branch, across banks, must have considerably declined. In this study the research try to compare the liquidity risk analysis between awash internal and Wegagen Bank some of the hindrance factors to accomplish their goal.

1.3 Basic research questions

1. What are the main sources of liquidity risk in these two banks?
2. What are systems they make to control liquidity risk?
3. Which banks affected more by liquidity risk than the other?

1.4. Objectives of the Study

1.4.1. General Objective of the Study

The main objective of the Studyis to assess the liquidity risk between Awash International Bank and Wegagen Banks in Ethiopia

1.4.2. Specific objective of the study

1. To assess the main sources of liquidity risk in these two banks.
2. To asses systems they make to control liquidity risk.
3. To compare which banks affected more by liquidity risk.

1.5 Limitation of the Study

One of the basic limitations that the researchers faced is the reckless of liquidity managers in responding to the question in the questionnaire is the main problem. The other limitation is respondent perception about the research project they consider it as the researchers would have conducted for some other reason behind the main objective of the research.In addition, the limitation of this study can be the fact that findings cannot be generalize because the study would be focused on selected Awash International and Wegagen Bank and only include liquidity risk. The other problems would there were no adequate empirical literatures assessed in Ethiopia on related area.

1.6. Significance of the research

The study has great contribution to the existing knowledge in the area of Factors determining commercial banks liquidity and their impact on Profitability in the context of Ethiopia. Furthermore, this help to study other commercial banks in Ethiopia to evaluate liquidity

management practice and related to their performance. Because there is lack of research in this area. This also helps the management level to give a proactive measure towards risk of liquidity and to analyze the trends of the bank for effective decision making. In the other hand, it can also help other researcher for further study and explanation. And also contributes to the wellbeing of the financial sector of the economy and the society as a whole.

1.7 Structure of the Study

The research was to be organized in five chapters. The first chapter presents background information, statement of the problem, and objective of the study, scope and limitations of the study and organization of the study. Chapter two contains review of related literature. The third chapter present methodology of the study (which constitutes research approach of study, population, sample size and sampling design, types and sources of data, variables under consideration and methods of data collection and presentation). Then, chapter four will contain presentation of data and analysis; while chapter five will present summary of major findings and recommendations.

Chapter Two

2. Review of Literature

In this chapter different theoretical aspects of risk like its definition, management and others as well as empirical issues and works as to the risk management practice in the banking industry discuses.

2.1 Theoretical Literature Reviews

A risk can be defined as an unplanned event with financial consequences resulting in loss or reduced earnings (VodovaPavl 2010). An activity, which may give profits or result in loss, may be called a risky proposition due to uncertainty or unpredictability of the activity of trade in future. In other words, it can be de

fined as the uncertainty of the outcome. Risk refers to a condition where there is a possibility of undesirable occurrence of a particular result, which is known or best quantifiable and therefore insurable, ‟ (Periasamy, 2008). Risk may mean that there is a possibility of loss or damage, which, may or may not happen. Risks may be defined as uncertainties resulting in adverse outcome, adverse in relation to planned objective or expectations (VodovaPavl.2010).

In the simplest words, risk may be defined as possibility of loss. It may be financial loss or loss to the reputation/ image (Sharma, 2003). Although the terms risk and uncertainty are often used synonymously, there is difference between the two (Sharma, 2003). Uncertainty

is the case when the decision-maker knows all the possible outcomes of a particular act, but does not have an idea of the probabilities of the outcomes. On the contrary, risk is related to a situation in which the decision-maker knows the probabilities of the various outcomes. In short, risk is a quantifiable uncertainty. In general risk is all about uncertainty. That is inability to precisely determine what will occur in the future, as future is full of uncertain.

The types and the degree of effect of risk defers among business organizations, even within industry level as they might differ in their size, complexity of task, types of service or product being offered or organizational structure.

Thus, risks that business organizations face are inherent to their operations or endeavors.

As to the classification of risk Jorion and Khoury (1996) argument has cited by Khan and Ahmed (2001) discusses that, there are different ways in which risks are classified. One way is to distinguish between business risk and financial risks. Business risk arises from the nature of affirm‟ s business. It relates to factors affecting the product market. Financial risk arises from possible losses in financial markets due to movements in financial variables (Jorion and Khoury1996). It is usually associated with leverage with the risk that obligations and liabilities cannot be met with current assets. Another way of decomposing risk is between systematic and unsystematic components. While systematic risk is associated with the overall market or the economy, unsystematic risk is linked to a specific asset or firm. While the asset-specific unsystematic risk can be mitigated in a large diversified portfolio, the systematic risk is non-diversifiable. Parts of systematic risk, however, can be reduced through the risk mitigation and transferring techniques.

2.1.1. Liquidity Risk

Gup and Kolari (2005) define liquidity risk as the risk to earnings or capital related to a bank's ability to meet its obligations to depositors and the needs of borrowers by turning assets into cash quickly with minimal loss, being able to borrow funds when needed, and having funds available to execute profitable securities trading activities. Liquidity risk is a major risk for the bank portfolio, in that, in extreme cases it could result in bankruptcy. The Basel Committee on Bank Supervision, in its June 2008 consultative paper, defined liquidity as the ability of a bank to fund increases in assets and meet obligations as they

become due, without incurring unacceptable losses. Bessis (2010) however considers liquidity risk from three distinct situations.

The first angle is where the bank has difficulties in raising funds at a reasonable cost due to conditions relating to transaction volumes, level of interest rates and their fluctuations and the difficulties in funding counterparty. The second angle looks at liquidity as a safety cushion, which helps to gain time under difficult situations. In this case, liquidity risk is defined as a situation where short-term asset values are not sufficient to match short-term liabilities or unexpected outflows.

The final angle from where liquidity risk is considered as the extreme situation. Such a situation can arise from instances of large losses, which creates liquidity issues and doubts on the future of the bank. Such doubts can result in massive withdrawal of funds or closing of credit lines by other institutions that try to protect themselves against a possible default. Both can generate a brutal Liquidity crisis, which possibly ends in bankruptcy. There are many factors that affect banks own liquidity and in turn affect the amount of liquidity they can create. These factors have a varying degree of influence on the balance between liquidity risk and liquidity creation, or a bank's liquidity management. A bank's assets and liabilities play a central role in their balancing of liquidity risk and creation.

A bank's liabilities include all the banks sources of funds. Banks have three main sources of funds: deposit accounts, borrowed funds, and long-term funds. The amounts and sources of funds clearly affect how much liquidity risk a bank has and how much liquidity it can create. The easier a bank can access funds the less risk it has and the higher amount of funds it holds the more liquidity it can create. Liquidity is necessary for banks to compensate for expected and unexpected balance sheet fluctuations and to provide funds for growth (Greuning and Bratanovic, 2009). Bessis (2010), however, suggests that while some would include the need to plan for growth and unexpected expansion of credit, the risk here should be seen more correctly as the potential for funding criteria Such a situation would inevitably be associated with an unexpected event, such as a large charge off, loss of confidence, or a crisis of national proportion such as a currency crisis. Effective liquidity risk management therefore helps ensure a bank's ability to meet cash flow obligations, which are uncertain as they are affected by external events and other agents' behavior.

2.1.2. Determinants of Bank Liquidity

In most of the literature, there are two ways of classifying the determinants of bank Liquidity. Moore (2009), for instance, bank specific (internal) and macroeconomic (external) variables. The internal factors are individual bank characteristics which affect the bank's performance. These factors are basically influenced by the internal decisions of management and board.

The external factors are sector wide or country wide factors which are beyond the control of the company and affect the liquidity of banks. Other studies, Kiyotaki, and Moore,(2008), attempted to integrate sector specific factors like bank ownership, bank size and concentration as a specific determinant of bank Liquidity. This approach seems to segregate the external factor determinants in to sector specific and macroeconomic variable. However, some authors, (Chantapong, 2005; Olweny and Shipho, 2011) focused on sector specific variables with total neglecting of the macroeconomic variables like GDP and inflation. In general, the two approaches seem similar in context and wide variation is not observed in classifying the determinants of bank liquidity and most of the researchers used both internal and external variables in their studies as follow.

A. Capital Adequacy and Bank Liquidity

Capital can be defined as common stock plus surplus fund plus undivided profits plus reserves for contingencies and other capital reserves. Besides, a bank’s loan loss reserves which serve as a buffer for absorbing losses can be included as bank’s capital (Basel, 2011). The primary reason why banks hold capital is to absorb risk including the risk of liquidity crunches, protection against bank runs, and various other risks. According to Ezirim(2005) bank’s capital plays a very important role in maintaining safety and solidarity of banks and the security of banking systems in general as it represents the buffer gate that prevents any unexpected loss that banks might face, which might reach depositors funds given that banks operate in a highly uncertain environment that might lead to their exposure to various risks and losses that might result from risks facing banks.

The recent theories suggest that, bank capital may also affect banks‟ ability to create liquidity. These theories produce opposing predictions on the relationship between capital and liquidity creation. The theoretical literature provides two opposite views on the

relationship between bank capital and liquidity creation. Under the first view, bank capital tends to impede liquidity creation through two distinct effects: the financial fragility structure and the crowding-out of deposits hypothesis. Indeed, financial fragility structure, characterized by lower capital, tends to favor liquidity creation (Diamond and Rajan, 2000, 2001), while higher capital ratios may crowd out deposits and thereby reduce liquidity creation.

Roughly described, the financial fragility structure effect is the outcome of the following process. The bank collects funds from depositors and lends them to borrowers. By monitoring borrowers, the bank Obtains private information that gives it an advantage in assessing the profitability of its borrowers. However, this informational advantage creates an agency problem and the bank may extort rents from its depositors by requiring a greater share of the loan income. If depositors refuse to pay the higher cost, the bank withholds monitoring efforts or loan collecting efforts. As depositors know that the bank may abuse their trust, they become reluctant to put their money in the bank. Consequently, the bank has to win depositors‟ confidence by adopting a fragile financial structure with a large share of liquid deposits. A contract with depositors mitigates the bank's hold-up problem because depositors can run on the bank if the bank threatens to withhold efforts. Consequently, financial fragility favors liquidity creation since it allows the bank to collect more deposits and grant more loans. By contrast, higher capital tends to mitigate the financial fragility and enhances the bargaining power of the bank that leads to hamper the credibility of its commitment to depositors. Thus, higher capital tends to decrease liquidity creation.

Besides, Gorton and Winton (2000) show that a higher capital ratio may reduce liquidity creation through another effect: the crowding out of deposits. They consider that deposits are more effective liquidity hedges for agents than investments in bank equity. Indeed, deposits are totally or partially insured and withdraw able at par value. By contrast, bank capital is not eligible and with a stochastic value that depends on the state of bank fundamentals and on the liquidity of the stock exchange. Consequently, higher capital ratios shift investors‟ funds from relatively liquid deposits to relatively illiquid bank capital. Thus the higher is the bank's capital ratio; the lower is its liquidity creation.

Under the alternative "risk absorption" hypothesis, which is directly linked to the risk-transformation role of banks, higher capital enhances the ability of banks to create liquidity. Liquidity creation increases the bank's exposure to risk as its losses increase with the level of illiquid assets to satisfy the liquidity demands of customers (Allen and Gale 2004). The more liquidity that is created, the greater is the likelihood and severity of losses associated with having to dispose of illiquid assets to meet the liquidity demands of customers.

Bank capital allows the bank to absorb greater risk (Greuning and Bratanovic, 2009). Thus, under the second view, the higher is the bank's capital ratio, the higher is its liquidity creation.

B. Non-performing Loans

Non-performing loans are loans that are outstanding in both principal and interest for a long time contrary to the terms and conditions contained in the loan contract (Kiyotaki, and Moore (2008). It follows that any loan facility that is not up to date in terms of payment of both principal and interest contrary to the terms of the loan agreement, is non-performing. Therefore, the amount of non-performing loan measures the quality of bank assets (Basel, 2011). Bank nonperforming loans to total gross loans are the value of nonperforming loans divided by the total value of the loan portfolio (including nonperforming loans before the deduction of specific loan-loss provisions).

The loan amount recorded as nonperforming should be the gross value of the loan as recorded on the balance sheet, not just the amount that is overdue. Non-performing Loans is measured by ratio of nonperforming loans over the Total Loan (Moore, 2005). Non-performing loans can lead to efficiency problem for banking sector. It is found by a number of economists that failing banks tend to be located far from the most-efficient frontier because banks do not optimize their portfolio decisions by lending less than demanded (Barr 1994). According to Bloem and Gorter (2001), though issues relating to non-performing loans may affect all sectors, the most serious impact is on financial institutions such as commercial banks and mortgage financing institutions which tend to have large loan portfolios. Besides, the large bad loans portfolios will affect the ability of banks to provide credit. Huge non-performing loans could result in loss of confidence on the part of

depositors and foreign investors who may start a run on banks, leading to liquidity problems.

C. Bank Size and Bank Liquidity

Performing loans has a negative impact on banks liquidity. Bank size is defined broadly as the banks net total asset. It measures its general capacity to undertake its intermediary function. This variable is included to capture the economies or dis economies of scale. There is consensus in academic literature that economies of scale and synergies arise up to a certain level of size. Beyond that level, financial organizations become too complex to manage and dis economies of scale arise (Ezirm, 2005).

When bank size grows it will help them to overcome the risk but it should be noted that it may leads also to failure. According to the "too big to fail" argument, large banks would benefit from an implicit guarantee, thus decrease their cost of funding and allows them to invest in riskier assets (Moore 2005). If big banks are seeing themselves as "too big to fail", their motivation to hold liquid assets is limited. In case of a liquidity shortage, they rely on a liquidity assistance of Lender of Last Resort (Ezirim, 2005). Thus, large banks are likely to perform higher levels of liquidity creation that exposes them to losses associated with having to sale illiquid assets to satisfy the liquidity demands of customers (Kiyotaki and Moore, 2008). Therefore, "too big to fail" status of large banks could lead to moral hazard behavior and excessive risk exposure and thus there can be negative relationship between bank size and liquidity.

D. Loan Growth:

The loan portfolio is typically the largest asset and the predominate source of revenue. Diamond &Rajan (2002) stated that lending is the principal business activity for most commercial banks. As such, loan is one of the greatest sources of risk to a banks safety and soundness (Kiyotaki and Moore, 2008). Since loans are illiquid assets, increase in the amount of loans means increase in illiquid assets in the asset portfolio of a bank. According to Eakins (2008), in practice the amount of liquidity held by banks is heavily influenced by loan demand that is the base for loan growth. If demand for loans is weak, then the bank tends to hold more liquid assets (short term assets), whereas if demand for loans is high they tend to hold less liquid assets since long term loans are generally more profitable.

Therefore, a growth in loans and advances has negative impact on banks liquidity (Weisel, Harm, & Bradley, 2003). Loan Growth will be measured by the Current year total loans less previous year total loans over the previous year total loans. Loan Growth and Bank Liquidity the loans & advances portfolio is the largest asset and the predominate source of revenue of banks.

According to Muranaga, and Ohsawa, (2002), lending is the principal business activity for banks. Since loans are illiquid assets, increase in the amount of loans means increase in illiquid assets in the asset portfolio of a bank. The amount of liquidity held by banks is heavily influenced by loan demand and it is the base for loan growth (Basel, 2011). If demand for loans is weak, then the bank tends to hold more liquid assets whereas, if demand for loans is high they tend to hold less liquid assets since long term loans are generally more profitable. Therefore, loan growth has negative relationship with bank liquidity.

According to the "too big to fail" argument, large banks would benefit from an implicit guarantee, thus decrease their cost of funding and allows them to invest in riskier assets (Iannotta 2007). Therefore, "too big to fail" status of large banks could lead to moral hazard behavior and excessive risk exposure.

If big banks are seeing themselves as "too big to fail", their motivation to hold liquid assets is limited. In case of a liquidity shortage, they rely on a liquidity assistance of Lender of Last Resort. Thus, large banks are likely to perform higher levels of liquidity creation that exposes them to losses associated with having to sale illiquid assets to satisfy the liquidity demands of customers. Hence, there can be positive relationship between bank size and obliquity. However, since small banks are likely to be focus on traditional inter mediation activities and transformation activities (Rauch 2008; Berger and Bouwman 2009) they do have small amount of liquidity. Hence, there can be negative relationship between bank size and illiquidity.

E. Gross Domestic Product (GDP):

The economy health of a nation is measured by its growth rate in national income. The economic growth is measured as percentage change in Gross Domestic Product (GDP) or Gross National Product (GNP). The GNP is broader than GDP, although both proxies are

used to measure economic growth. GDP is a macroeconomic factor that affects bank liquidity. For which, a major recession or crises in business operations reduces borrowers' capability to service obligations which increases banks' NPLs and eventually banks insolvency (Gavin &Hausmann, 1998). In reference to Painceira (2010), research on liquidity preference during different business cycle states that banks liquidity fondness is low in the course of economic boom. Where, banks confidently expect to profit by expanding loan able funds to sustain economic boom, while restrict loan able funds during economic down turn to prioritize liquidity.

To sum up, banks prefer high liquidity due to lower confidence in reaping profits during economic downturn. Macroeconomic context is likely to affect bank activities and investment decisions as the profile of bank liquidity (Pana. 2009 and Shen. 2010). For example, the demand for differentiated financial products is higher during economic boom and may improve bank ability to expand its loan and securities portfolios at a higher rate. Similarly, economic downturns are exacerbated by the reduction in bank credit supply. Based on these arguments, we can expect banks to increase their transformation activities and their illiquidity during economic booms. According to the theory of bank liquidity and financial fragility, the relationship between banks‟ liquidity preference and the business cycle is fundamental to explain the inherent instability of the capitalist system as an endogenous market process. In periods of economic expansion, which are characterized by high degree of confidence of the economic units about their profitability, there is a rise in the level of investment.

During this expansion, economic units decrease their liquidity preference, preferring more risky capital assets with higher return. In this environment, economic units are more likely to hold less liquid capital assets and to incur short-term debt with higher interest rates.

As in Bessis (2010) in line with the above argument the "loan able fund theory of interest" states that the supply for loan (i.e. illiquid assets for banks) increases when the economy is at boom or going out of recession.

Bordo (2001) suggest two explanations on the cause of liquidity runs on deposit money banks. They explained that runs on banks are a function of mass psychology or panic, such that if there is an expectation of financial crisis and people take panic actions in anticipation

of the crisis, the financial crisis becomes inevitable. Bordo. (2001) also "asserts that crises are an intrinsic part of the business cycle and result from shocks to economic fundamentals. When the economy goes into a recession or depression, asset returns are expected to fall. Borrowers will have difficulty repaying loans and depositors, anticipating an increase in defaults or non-performing loans, will try to protect their wealth by withdrawing bank deposits. Banks are caught between the illiquidity of their assets (loans) and the liquidity of their liabilities (deposits) and may become insolvent."

F. Liquidity and Inflation in Commercial Banks:

Inflation reflects a situation where the demand for goods and services exceeds their supply in the economy. Inflation causes many distortions in the economy. It hurts people who are retired and living on a fixed income. When overall prices rise these consumers cannot buy as much as they could previously. It also affects the repayment of loans and discourages savings due to the fact that the money is worth more presently than in the future and inflation therefore affects the liquidity of the Commercial Banks. In any economy inflation is undesirable. This is because of the specific economic costs associated with inflation. First, when inflation is high, currency and non-interest-bearing checking accounts are undesirable because they are constantly declining in purchasing power.

Secondly, there are tax distortions, for example, when inflation rages, the actual value of these deductions are much less than it should actually be (Ludi and Ground, 2006). A growing theoretical literature describes mechanisms whereby even predictable increases in the rate of inflation interfere with the ability of the financial sector to allocate resources effectively.

More specifically, recent theories emphasize the importance of informational asymmetries in credit markets and demonstrate how increases in the rate of inflation adversely affect credit market frictions with negative repercussions for financial sector (both banks and equity market) performance and therefore long-run real activity.

The common feature of these theories is that there is an informational friction whose severity is endogenous. Given this feature, an increase in the rate of inflation drives down the real rate of return not just on money, but on assets in general. The implied reduction in real returns exacerbates credit market frictions. Since these market frictions lead to the

rationing of credit, credit rationing becomes more severe as inflation rises. As a result, the financial sector makes fewer loans, resource allocation is less efficient, and intermediary activity diminishes with adverse implications for capital/long term investment. In turn, the amount of liquid or short term assets held by economic agents including banks will rise with the rise in inflation. Hence, there is positive relationship between increase in inflation rate and banks liquidity.

2.1.3 Managing Liquidity Risk

Liquidity risk management is an essential component of the overall risk management framework of the financial services industry, concerning all financial institutions (Guglielmo, 2008). Ideally, a well-managed bank should have a well-defined mechanism for the identification, measurement, monitoring and mitigation of liquidity risk. A well-established system helps the banks in timely recognition of the sources of liquidity risk to avoid losses. The balance sheets of banks are growing in complexity and dependence upon the capital markets has made the liquidity risk management more challenging

(Goodhart, 2008). Moore (2005) further argues that the banks having enhanced exposure in the capital markets must have a deep understanding of the risks involved. The said banks should develop the mechanism required for proper risk measurement and management. A bank should have continuous awareness about the breakdown of its various funding sources in terms of individual strata of clientele' financial markets and instruments (Falconer, 2001).

According to Gatev and Strahan (2003), the deposits provide a natural hedge to banks against the liquidity risk. Under the stressed market conditions, the banks are perceived as a haven for investors who do not intend to issue funds against their loan commitments. The cash flows in any bank complement each other. The inflows of funds give a natural hedge to banks for outflows due to loan advancements. Therefore, banks use deposits to hedge the liquidity risk. This argument also finds support from the work of Guiliemo (2008) who provided a rationale of risk management to define the features of a commercial bank, commonly labeled as "financial intermediary" combining demand deposits with loan commitments.

One possible counter measure to reduce liquidity pressure is the transformation of illiquid assets in to cash. In times of immense funding pressure, securitization techniques are usually employed by the banking system for liquidation of assets like mortgages. A bank should respond to funding shortfall by acting on the assets side of the balance sheet if it is facing restrictions on raising liquidity. It will be forced to squeeze the advancement of loans to its customers to reduce funding requirements. Despite its features to support funding and increase liquidity, Basel (2011) has narrated two main drawbacks of the above stated policy. First, this strategy needs a bit longer period to be matured. Many of the lending decisions are taken in advance and hard to be reversed instantly, thereby not generating liquidity drainage quickly. Second, reduced lending affects a large part of the economy. In the non-availability of funds to companies and households, it becomes difficult to support long-term investment and consumption in the economy.

2.2. Empirical Literature Review

Liquidity risk is the possibility that over a specific time period, the bank will become unable to settle obligations with immediacy (Halling and Hayden, 2006). The vulnerability of banks to liquidity risk is determined by the funding risk and the market risk. The funding liquidity risk is caused by the maturity mismatch between inflows and outflows and/or the sudden and unexpected liquidity needs due to contingency conditions. The market liquidity risk refers to the inability to sell assets at or near the fair value, and in the case of a relevant sale in a small market; it can emerge as a price slump (Hassan, 2009).

The study made on bank specific determinants of liquidity on English banks studied (Halling and Hayden, 2006), and assumed that, the liquidity ratio as a measure of the liquidity should be dependent on the following factors: bank profitability and loan growth had negatively correlated with liquidity while size of the bank is ambiguous. Liquidity created by Germany's state-owned savings banks and its determinants has been analyzed by (Hassan, 2009). In the first step they attempted to measure the liquidity creation of all 457 state owned savings banks in Germany over the period 1997 to 2006 and they analyzed the influence of monetary policy on bank liquidity creation. To measure the monetary policy influence, the study developed a dynamic panel regression model. According to this study, the following factors determine bank liquidity: monetary policy interest rate, where

tightening monetary policy expected to reduces bank liquidity, level of unemployment, which is connected with demand for loans having negative impact on liquidity, savings quota affect banks liquidity positively, size of the bank measured by total number of bank customers have negative impact, and bank profitability expected to reduce banks liquidity

Naser, Mohammed and Ma'Someh(2013) aimed to examine the effect of liquidity risk on the profitability of commercial banks using of panel data related to commercial banks of Iran during the years 2003 to 2010. In the estimated research model, two groups of bank-specific variables and macro-economic variables are used. The results of research show that the variables of bank's size, bank's asset, gross domestic product and inflation will cause to improve the profitability of banks while credit risk and liquidity risk will cause to weaken the performance of bank.

They have used two models of liquidity. The first model L1 is Vodova (2011) aimed to identify important factors affecting commercial banks liquidity of Czech Republic. In order to meet its objective the researcher considered bank specific and macroeconomic data over the period from 2001 to 2009 and analyzed them with panel data regression analysis by using EViews 7 software package. The study considered four firm specific and eight macroeconomic independent variables which affect banks liquidity.

The expected impact of the independent variables on bank liquidity were: capital adequacy, inflation rate and interest rate on interbank transaction/money market interest rate were positive and for the share of non-performing loans on total volume of loans, bank profitability, GDP growth, interest rate on loans, interest rate margin, monetary policy interest rate/repo rate, unemployment rate and dummy variable of financial crisis for the year 2009 were negative whereas, the expected sign for bank size was ambiguous (+/-). The dependent variable (i.e. liquidity of commercial banks) was measured by using four liquidity ratios such as liquid asset to total liquid assets to total deposits and borrowings, loan to total assets and loan to deposits and short term financing.

The study by Vodova (2011) revealed that bank liquidity was positively related to capital adequacy, interest rates on loans, share of non-performing loans and interest rate on interbank transaction. In contrast, financial crisis, higher inflation rate and growth rate of gross domestic product have negative impact on bank liquidity. The relation between the

size of the bank and its liquidity was ambiguous as it was expected. The study also found that unemployment, interest margin, bank profitability and monetary policy interest rate/repo rate have no statistically significant effect on the liquidity of Czech commercial banks.

Bank-specific and macroeconomic determinants of liquidity of English banks were studied by (Aspachs. 2005). The researchers used unconsolidated balance sheet and profit and loss data, for a panel of 57 UK-resident banks, on a quarterly basis, over the period 1985Q1 to 2003Q4. They assumed that the liquidity ratio as a measure of the liquidity should be dependent on following factors: Probability of obtaining the support from LOLR, which should lower the incentive for holding liquid assets, interest margin as a measure of opportunity costs of holding liquid assets expected to have negative impact, bank profitability, which is according to finance theory negatively correlated with liquidity, loan growth, where higher loan growth signals increase in illiquid assets, size of the bank expected to have positive or negative impact, gross domestic product growth as an indicator of business cycle negatively correlated with bank liquidity, and short term interest rate, which should capture the monetary policy effect with expected negative impact on liquidity.

The output of the regression analysis showed that probability of getting support from LOLR, interest margin, and loan growth have negative and significant effect on banks liquidity whereas, profitability and bank size had statistically insignificant impact on liquidity. Using a measure of support expectations based on the Fitch support rating, the researchers also found strong evidence of the existence of such an effect, which may point to a rationale for regulatory liquidity requirements as a quid pro quo for LOLR support.

In another study from Pakistan, Akter and Mahmud (2014) examines bank specific and macroeconomic determinants of commercial bank liquidity in Pakistan. Their study based on cash and cash equivalents to total. The second model L2 is based on advances net of provisions to total assets. Their results suggest that, Non-Performing Loan (NPL) and Return on Equity (ROE) have a negative and significant effect with L1. Capital adequacy (CAP) and inflation (INF) are negatively and significantly correlated with L2, Additionally there is a significant and positive impact of financial crisis on the liquidity of commercial

banks. The central bank regulations greatly affect the liquidity of commercial banks which means tight monetary policy can regulate the undesirable effect of inflation on liquidity.

Abera, (2012) studied Factors Affecting Profitability on Ethiopian Banking Industry. This study examined the bank-specific, industry-specific and macro-economic factors affecting bank profitability for a total of eight commercial banks in Ethiopia, covering the period of 2000-2011 using a mixed methods research approach by combining documentary analysis and in-depth interviews. The result of the interview revealed that the liquidity of banks was one of the major determinants of Ethiopian banks profitability. But, the output of the regression analysis and the interview were in agreement in relation to the direction of the effect of liquidity as far as both of them proved the existence of negative or inverse relationship between liquidity and profitability of Ethiopian banks. The study concluded that the impact of Ethiopian banks' liquidity on their performance remains ambiguous and further research is required.

2.3. Conclusion and Knowledge Gap

Most of the empirical study will been shown the vulnerability of banks to liquidity risk is determined by the funding risk and the market risk , the liquidity ratio as a measure of the liquidity should be dependent on the following factors: bank profitability and loan growth had negatively correlated with liquidity while size of the bank is ambiguous and factors determine bank liquidity: monetary policy interest rate, where tightening monetary policy expected to reduces bank liquidity, level of unemployment, which is connected with demand for loans having negative impact on liquidity, savings quota affect banks liquidity positively, size of the bank measured by total number of bank customers have negative impact, and bank profitability expected to reduce banks liquidity.

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All the research stated used quantitative technique to study and some of them use both quantitative and qualitative technique in the study. But this study try to fill the gap that to show the practice of the bank by using qualitative technique and give explanation about the liquidity risk management of the bank comparing with the international standard of liquidity risk management principle.

In addition to this Vodova (2011) the study, showed that bank liquidity was positively related to capital adequacy, interest rates on loans, share of non-performing loans and interest rate on interbank transaction. In contrast, financial crisis, higher inflation rate and growth rate of gross domestic product have negative impact on bank liquidity. The relation between the size of the bank and its liquidity was ambiguous as it was expected.

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But the study still didn't focuses in identifying specifically the comparative liquidity risk analysis in Awash International and Wegegan Banks relating with several factors. Therefore, this study aimed to fill this knowledge gap, specifically, assessing the main sources of liquidity risk, evaluate the system that control liquidity risk and compare which Banks affected more by liquidity risk than the others. This will help each and every bank should assess the liquidity management practice towards monitoring and maintain adequate level liquidity by avoiding the risk of excess or deficiency of the bank.

Chapter Three

3. Research Design and Methodology

This section describes the research design, research approaches, target population, sampling techniques, sources of data and method of data collection. It also deals with the methods of data analysis used in carrying out the research project.

3.1 Research Design

The study attempted to comparative liquidity risk analysis of awash international and wegagen banks**.** Descriptive study is choosen as it enabled the researcher to describe the main source of current liquidity risk, management practice liquidity risk and affect of liquidity risk between the bank considered in this study.

3.2 Research Approaches

The researcher used both quantitative and qualitative data. Quantitative data is used through closed ended questions in the questionnaires. Qualitative data collected through interview and open-ended questions in the questionnaires. The quantitative data that is collected through questionnaires is analyzed through descriptive data analysis techniques. The data summarized through tabulation and percentage. The response is obtained through interview and open-ended questions in the questionnaires were narrated

3.3 Target Population

To gather appropriate information that is relevant to the study the researcher took the employee of awash and wagagen bank as population. From the total population 20 employee selected to the sample size.

3.4 Sampling and Sampling Technique

The sample used in this study was 20 which were selected using purposive sampling technique. Respondents were selected from the departments considered as better sources of data for the topic under study with the assumption that they could have better information and experience. By using judgmental sampling techniques the researcher took three departments that are directly related to the subject matter. From the risk and compliance department, all the expert working in that department is 7, from the finance department, cheque clearance officers, which are the total number working there is 6 and the rest 7 experts working in treasury department selected purposively. Therefore, the total 20 employee selected to the sample size. In addition to this, risk and compliant department director and finance manager is conducted through interview.

3.5 Sources of Data

Primary and secondary source of data were used and both close ended and open ended questions were prepared. The interview will prepared for the manager of risk department and treasury department manager. the finance /treasury/, risk and compliant management departments of the awash and Wegagen banks and the banking supervision department of NBE. Moreover, annual reports of the commercial banks and directives issued by the NBE were used

3.6 Method of Data Collection

To accomplish the objectives of this study, the researcher collected data from both primary and secondary sources. In order to collect data from primary sources through questionnaires, both close ended and open ended questions were prepared and used in English. The questionnaires for the respective respondents were administered by the researcher, assuming that they can get more assistance by the time they fill the questionnaire in case they needed.

The questionnaires distributed to commercial bank had two sections. The first part of the questionnaire is intended to gather background information of the respondents. The second part consists of questions that were designed to examine the liquidity risk management policy and Procedure framework. Personal interview was conducted on some issues (points) that need more clarification and which are difficult to be collected through questionnaires

The researcher adopted three main steps in collecting data for the study. First, relevant literature was reviewed to get adequate information and ideas on the topic. Second objectives and research questions were formulated to show the direction of the study. Third, on the basis of the objectives of the study, the researcher designed the instruments to collect the relevant data. The data gathered through the various instruments were organized, analyzed, interpreted and discussed.

3.7. Data Analysis

After collecting the relevant data through the data gathering methods used in this study, the researcher categorized the data appropriately for interpretation. Both qualitative and quantitative data analysis techniques were employed in this study. To analyze and interpret the data gained from questionnaires, a quantitative technique involving percentages was used. The data obtained from interview was analyzed descriptively. Moreover, the data obtained from annual reports of the bank considered in this study was analyzed using percentages, ratios, graphs and interpreted quantitatively. Finally, based on the findings of the study, conclusions and recommendations were made.

Chapter Four

4. Data Presentation, Analysis, and interpretation

The preceding two chapters deal with literatures related to the topic and research methodology. In this chapter, detail analyses about the descriptive statistics result have been made. The analysis is presented based on the response gathered from employee of the bank of Awash international and Wegagen banks that directly related to the study i.e. Treasury department, finance department and risk and compliance department. In addition to this, the researcher interviewed the manager of risk and compliant department director and finance department manager. The researcher couldn't get manager of treasury department because of annual leave.

From those department selected 20 questioner distributed according to the number of employees related to the study. Out of 20 questioners 18 are filed and returned. So, the analysis is presented according to the data gathered from the employee of bank of Awash and wogagen banks which they are working in different level of management and expert level.

The row data find from the questioner is computed in percentage, and presented in a tabularized form followed by detailed explanation, and critical interpretations of the data that was made to show implication of the major findings. Also open ended question and interview question is narrated.

4.1 General Characteristics of Respondents Table below describes the general personal profile of respondent

Table 4.1.1 personal profile

No Question Frequency Percentage (%)

No	Question	Frequency	Percentage (%)
	Gender		
1	Male	14	78
2	Female	4	22
	Total	18	100

The personal profile of the respondents indicated from the above table 78% of the respondent are male and the rest 22% are female. Furthermore, 72% are holder of first degree, 11% are first degree and professional qualification such as ACCA and 17% have second degree in finance and related field. From this, most of the respondents are male and more than half of the respondent are degree holders and remain are second degree and other professional qualification

4.2. Analysis of the Major Findings

The following emphasizes on the responses obtained from the customers and international banking department director. The questions are essential for the analysis of the stated problems in order to articulate their respective interpretation.

4.2.1. To assess the main sources of liquidity risk in these two banks.

Table 4.2.1. To assess the main sources of liquidity risk in these two banks.

Item no	Question		Frequency	Percentage (%)
			YES	NO
1	Is there any liquidity risk problem in the bank?		13	72
	If your answer is yes for the above question what are the causes for the liquidity problem?			
	1	Lack of professional - weak inter bank system	3	23
	2	inadequate assistance from NBE	2	15
	3	information gap between the management and regulatory body	4	32
	4	both weak payment system and inter bank system	2	15
	5	other	2	15
		Total	13	100
3	Funding concentrated in relatively few sources			
	strongly agree		1	6
	Agree		13	72
	Neutral		2	11

	Disagree	2	11
	Strongly disagree	-	-
	Total	16	100
4	The bank experience significant seasonal fluctuation in its funding source		
	strongly agree	2	11
	Agree	6	45
	Neutral	4	22
	Disagree	4	22
	Strongly disagree	-	-
	Total	18	100

In the basic research question the first question is there any liquidity risk problem in bank of awash and wegagen. From the total respondent,72% of the respondent said that there is liquidity risk problem and the rest 28% said that there is no such risk in this bank. From the respondent which says there is liquidity problem in the bank ,23% of the respondent said that it is because of weak interbank system, 15% are inadequate assistance from national bank of Ethiopia, 32% respond that information gap between the management and regulatory body and 15% believed that it is because both weak interbank system and weak payment system.

The rest 15% of respondent state different cause of the liquidity risk faced by the bank are National bank of Ethiopia enforce all commercial bank to purchase 27% of loan disbursement for purchasing of NBE bill in every month with 3% annual interest rate and There is also unexpected withdrawal of depositor because of unable to satisfy the demand of foreign currency demand for customer. Commercial bank of Ethiopia give foreign currency highly compare to other private banks so customer withdraw their money demanding foreign currency.

From the data result presented in the above, we can generalize that the banks have some liquidity problem. The reason for this is, High loan demand for customer and management granted credit in order to maximize profit affect the liquidity performance of the bank. With related to this,

information gap between the management body who grant loan and risk and other regulatory department create excess loan grant to customer and unable to meet current obligation which will result dalliance of payment settlement. Also unexpected withdrawal of the depositor to get foreign currency from commercial bank of Ethiopia is the other reason. In addition, the commitment to all private banks to purchase NBE bill monthly add pressure to meet liquidity demand of the customers.

From table 4.2.1 question no 3, Funding concentrated in relatively few sources, 6% strongly agree with the statement,72% agree ,11% neutral and 11% disagree with the statement. Therefore more than 50% of the respondent believed that the bank concentrate its funding in few sources. so, the bank should diversified the concentration of funding.

The next question is the bank experience significant seasonal fluctuation in its funding source, 11% is strongly agrees, 45% agree, 22% neutral and 22% disagree with the above statement. From the result more than half of the respondents agree that Awash and wegagen bank experience significant seasonal fluctuation in its funding sources. Therefore, it needs proper assessment of this risk and gives remedy for the problem.

From the result stated above, in Awash and wegagen bank of funding are concentrated in relatively few sources. Also the bank experience significant fluctuation in its funding sources. According to Madura (2007) , The amounts and sources of funds clearly affect how much liquidity risk a bank has and how much liquidity it can create. The easier a bank can access funds the less risk it has and the higher amount of funds it holds the more liquidity it can create, if willing to do so. Deposit accounts are made up of transaction deposits, also known as demand deposits, savings deposits, time deposits, and money market deposit accounts. The borrowed funds of a bank come from loans from other banks via the Federal Funds market, loans from the Federal Reserve Bank, repurchase agreements, and Eurodollar borrowings. Therefore, the bank should diversify the sources of funds and work to increase the amount of funds to sustain seasonal fluctuation in its funding source.

Interview- How liquidity risk identified in the bank and what are the major sources?

From risk and compliance department says bank of Awash and wegagen periodically identifies its liquidity risk in a continuous manner using different acceptable techniques. In order to keep optimal asset liability structure, we adhere to regulation of the land; the bank adopts liquidity risk management system that is governed by adequate oversight, early warning system and proper implementation of risk management process.

The process include the use of liquidity risk measurement tools, setting limits, establish strong management information system and controlling mechanisms that ensures adherence to documental requirements. There are some early warning indicators that may not necessarily always lead to liquidity problem to the bank but have the potential to ignite such a problem. They are, Negative trend in significantly increased risk in any area or product Concentration on either assets or liability such as Deterioration in quality of credit portfolio, A decline in earnings performance or projection, Rapid asset growth funded by volatile large deposit, A large size of off balance sheet exposure and Customs trend of withdrawal and a manner of account operation.

The manager of finance department also says that liquidity risk in the general funding activities of the bank and the management of positions. It includes the risk of being unable to fund assets at appropriate maturities and the risk of being unable to liquidate an asset at a reasonable price and in appropriate time frame. Funds are mainly raised from customer deposit.

From the interview we can see that in addition to diversify and increasing the sources of funds the bank should also review the quality of credit portfolio and carefully analysis method. Since, funds mainly rose from customer deposit the bank should attract potential depositor and maintain the existing customer.

4.2.2. To asses systems they make to control liquidity risk.

Table 4.2.2. To asses systems they make to control liquidity risk.

No	Item	Frequency	Percentage
1	A bank has a sound process for identifying, measuring, monitoring and controlling liquidity risk		

	Strong agree	6	33
	Agree	9	50
	Neutral	2	11
	Disagree	1	6
	Strong disagree	-	-
	Total	18	100
2	Bank cash inflows against its outflow and the liquidity value of its asset to identify the potential for future net funding shortfalls		
	Strongly agree	6	33
	Agree	9	50
	Neutral	2	11
	Disagree	1	6
	Strong disagree	-	-
	Total	18	100
63	A bank liquidity measurement is adequate		
	Strong agree	7	39
	Agree	8	44
	Neutral	2	11
	Disagree	1	6
	Strong disagree	-	-
	Total	18	10
4	Policy clearly establish the methodology for measuring liquidity appropriate risk limit been established		
	Strong agree	7	39
	Agree	8	44
	Neutral	2	11
	Disagree	1	6
	Strong disagree	-	-

	Total	18	100
5	There is appropriate level of risk tolerance in the bank		
	Strong agree	7	39
	Agree	8	44
	Neutral	2	11
	Disagree	1	6
	Strong disagree	-	-
	Total	18	100
6	The bank set limit to control its liquidity risk exposure and vulnerabilities		
	Strong agree	5	28
	Agree	10	56
	Neutral	3	18
	Disagree	-	-
	Strong disagree	-	-
	Total	18	100

The above table shows that question asked to assess the liquidity level or position of the bank. The first question says a bank has a sound process for identifying, measuring, monitoring and controlling liquidity risk, 33% strongly agree, 50% agree, 11% natural and 6% disagree with the statement. From this we can conclude that the bank has sound process of identifying, measuring, and monitoring liquidity risk.

The second question is the bank cash inflows against its outflow and the liquidity value of its asset to identify the potential for future net funding shortfalls. And the result 33% strongly agree, 50% agree, 11% natural and 6% disagree with the statement. More than 50% of the respondent agreed so; the bank should keep it up and continuously improved it. When we look to the next question, a bank liquidity measurement is adequate, 39% strongly agree, 44% agree, 11% is neutral and 6 % disagree. With this result we can conclude that the bank liquidity measurement tools are adequate. From the above table the 4th question the statement that Policy clearly

establish the methodology for measuring liquidity appropriate risk limit been established, 39% strongly agree, 44% agree, 11% neutral and 6% disagree. Therefore, the bank of Awash and wegagen Policy clearly establish the methodology for measuring liquidity appropriate risk limit been established As shown in the above table, question no 5 says, There is appropriate level of risk tolerance in the bank. With this statement 28% strongly agree, 56% agree and 18% neutral. So, the bank is good in maintaining the appropriate risk tolerance .

Similar question asked in question no 6 that says The bank set limit to control its liquidity risk exposure and vulnerabilities. By this statement 28% strongly agree, 60% agree, 6% neutral and 6% is disagreeing with the statement. As a result, we can conclude that the bank set limit to control this risk.

The risk and compliant manager said that, liquidity measurement of the bank will be conducted through programmed review of liquidity status to ensure the presence of acceptable procedure by the concerned risk management and compliance department/ ALCO. The indicator that a bank should utilize at a minimum, to measure its liquidity position.

Interview what is the role of asset and liability committee (ALCO) in liquidity risk management? The finance department manager said that ALCO responsibility is as follows:- Assess the current balance sheet position of the bank, Develop asset and liability management strategies, Assess the financial indicators, like return on equity(ROE) and return on asset (ROA), Analyze off balance sheet commitments, Review the appropriateness of the existing strategies, Review the profit performance etc In addition to this, the risk and compliance department manager said that ALCO responsible for Review the liquidity and market risk strategies of the bank and submit to the executive management for approval and Provide management oversight for the implementation of policies related to liquidity, foreign currency and interest rate risk.

Interview is there any liquidity controlling mechanism for liquidity risk in the bank? What are they? The finance department manager said that there are different mechanism for controlling liquidity risk in the bank. Such as, ratios and scenarios , continuously reviewing the maturity of asset and liability and mobilizing deposit the risk and compliance department manager also said that contingency funding planning is used for controlling liquidity risk in the bank during

liquidity crisis to enable the bank to survive. A contingency funding plan is a plan for a fund of money that kept in reserve for use in times when other funding sources run out.

Generally, bank of Awash and wegagen measure and set limit to control liquidity risk. According Basil committee on bank supervision (2008), A bank should have a sound process for identifying, measuring, monitoring and controlling liquidity risk. This process should include a robust framework for comprehensively projecting cash flows arising from assets, liabilities and of balance sheet items over an appropriate set of time horizons. Furthermore, A bank should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions and those contribute to the smooth functioning of payment and settlement systems. From the result found from interview and questionnaire the bank continuously measure the liquidity position and there is asset liability committee for maintaining liquidity and other related risk.

4.2.3 To compare which banks affected more by liquidity risk.

Table 4.3.3.1 To compare which banks affected more by liquidity risk.

No	Item	Frequency	Persantage
1	1. Does the bank have liquidity risk management policy and procedure? Yes 18 100 No - Total 18 100		
	Yes	18	100
	No	-	-
	Total	18	100
2	2. If yes your answer for the above questions how often the strategy revised		
	6 month	1	6
	1 year	6	33
	2 year	2	11
	4-5 year	3	16
	Other Never	1	6

	When it is needed	5	28
	Total	18	100
3	3. Which body involved in the liquidity risk management of the bank		
	BOD - - Senior management	4	22
	Risk and control department	4	22
	In all management level	5	28
	Other both BOD, senior management and risk and control department	3	16
	Both senior management and risk and control department 2 12	2	12
	Total	18	100
4	4. What does the strategy cover ?		
	Normal course of action	2	11
	Crises situation	-	-
	Both situation	16	89
	Total	18	100
5	5. Does the strategy include regular liquidity monitoring and management?		
	Yes	17	94
	No	1	6
	Total	18	100
6	6. If yes state the periodicity of monitoring and reporting		
	Daily	7	41
	Weekly	8	41
	Monthly	2	12
	Other	1	6

	Total	18	100
7	7. Does your bank use stress tests on liquidity?		
	Yes	11	61
	No	7	39
	Total	18	100
8	8. If yes what type of scenarios are used?		
9	9. Has your bank set warning signal for possible liquidity crisis		
	Yes	7	39
	No	11	61
	Total	18	100
10	What are the event you consider as warning of such crisis and their contingency plan?		
11	The policy clearly established the purpose objective and goal of liquidity management are action to control liquidity in a timely manner		
	Strongly agree	8	44
	Agree	8	44
	Natural	2	12
	Disagree	-	-
	Strongly disagree	-	-
	Total	18	100
12	12. The risk tolerance should be articulated in such a way that all level of management clearly understand the trade off between risk and profit		
	Strongly agree	2	11
	Agree	6	34
	Natural	2	11

	Disagree	8	44
	Strongly disagree	-	-
	Total	18	100

To compare which banks affected more by liquidity risk, the first question is does the bank have liquidity risk management policy and procedure? All the respondents said yes. Therefore, the bank has liquidity risk management policy and procedure. In addition to this, the strategy revised within 6 month is 6%, 1year 33%, 2 year 11%,4-5 years 16%, never 6% and it revised when it is necessary is 28%. With this result the bank liquidity policy and strategy 4-5 years and revised when it is necessary. So, we can generalize that there is no specific period to revise it according to the current situation. As shown in the above table, the third question says which body involved in the liquidity risk management of the bank. 16% senior management, 22% risk and control management ,22% BOD, senior and risk management,12% senior management and risk department manager. Related to this question, the next question says what the strategy covers. 11% says it cover only normal course action and 86% respond it cover both normal course of action and crisis situation.

From question no 5, 94% of the respondent says the strategy include regular liquidity monitoring and management and 6% disagree. The next question state the periodicity of monitoring and reporting, 41% report daily, 47 weekly and 12% monthly. Generally, the bank has timely reporting and monitoring of liquidity risk. The question asked that does your bank use stress tests on liquidity. 39% say yes and 39% no and among the type of scenarios are used, here are some From question 10, what are the event you consider as warning of such crisis and their contingency plan? The respondent mention the When high cash outflow than inflow The statement stated in 11 questions that The policy clearly established the purpose objective and goal of liquidity management are action to control liquidity in a timely manner, 44% strongly agree and agreed and 12% is neutral. so, it is not vague to apply in daily operation.

In the other hand, The risk tolerance should be articulated in such a way that all level of management clearly understand the tradeoff between risk and profit is 11% strongly agree, 34% agree, 11% neutral and 44% disagree. From this we can concluded that all management did not

understand the tradeoff between risk and profit. So, it can have a great potential to expose liquidity risk to the bank.

The last question states that thereis an adequate alternative plan for emergency occur in shortage of liquidity, 22% strongly agree, agree 50%, 17% neutral and 11% disagree. This shows that there is an alternative plan when uncertainty occurs.

Interview Is there any contingency plan when uncertainty or crisis occur? What are they?

When false transaction is occurred Cash in vault, due from other local banks, due from NBE held from trading (HFT) government securities t- bill. Secondary sources are interbank call loan, negotiated certificate of deposit and borrowing from the central bank as a last resort.

Therefore, the bank has its own liquidity risk management policy and procedure. It is essential for supervisors to address liquidity risk as thoroughly as other major risks. From the data obtained the bank has timely reporting and monitoring of liquidity risk. Furthermore, the strategy cover both normal course action and crisis situation. The aim of liquidity supervision and regulation is to reduce the frequency and severity of banks' liquidity problems, in order to lower their potential impact on the financial system. But, there is no specific period to revised it according to the current situation. though there is policy and procedure to monitor the liquidity risk the bank should timely and periodically review in order to be competitive with the current situation.

The open ended question in the questionnaire, respondents mention the strength of the two bank liquidity risk management practice strong in The quality of the liquidity risk management evaluated in terms of the developed framework and periodically manage liquidity risk exposure e.g ALCO engagement. The bank has also good policy and strategy towards managing liquidity.

The weakness that the bank should work on it is, The total deposit of the bank relatively concentrated in few depositors and fund sources. Also there is weak Interdependent and coordination between department that create information gap and lack of synergy. This lead to excess grant of loan to the customer and unable to meet the obligation.

Chapter Five

Conclusion and Recommendation

5.1 Conclusions

In this session, the researcher summarized, conclude and recommend the major findings obtained from the questioner employees working in risk and compliant department, finance and treasury department and interview made from finance manager and risk and compliant department director.

Bank of awash and wegagen experience liquidity problem because of different reason, unexpected withdrawal of depositor because of unable to satisfy the demand of foreign currency demand for customer. commercial bank of Ethiopia give foreign currency highly compare to other private banks so customer withdraw their money demanding foreign currency, High loan demand for customer and management granted credit in order to maximize profit affect the liquidity performance of the bank.

Awash and wagegan bank experience significant seasonal fluctuation in its funding sources. Therefore, it needs proper assessment of this risk and gives remedy for the problem.

There is strategy and procedure towards managing and measuring the liquidity risk of the bank. But the periodicity and revision is not within a specific period. So, there should be periodically revised and upgrade with the current situation. There is also contingency plan when there is unexpected situation happens and also have stress test assuming different scenarios.

Policy and procedure which is approved by the Board of Directors of each bank. Other bodies (units) are also involved in executing the liquidity risk management policy and procedure which include senior (top) management, Asset and Liability committee (ALCO) or Resource Mobilization committee risk management unit (department) and risk control department. These bodies do have their own responsibilities in the liquidity risk management process.

5.2 Recommendations

The bank faces different problems to manage liquidity risk. These are no well-developed payment system and management information system (MIS) and there is no interdependence and flow of information in different department. Therefore, all departments should clear knowledge and information to minimize the bank liquidity problem and work as synergy.

Diversification of the uses and sources of funds is also an important issue in the banking industry. Banks have limited types of fund sources, mainly deposits and there is no market for raising fund. Therefore the NBE has to facilitate the establishment of secondary markets. Absence of management information system is the other problem in the bank using which appropriate personnel can be provided with timely information on the liquidity position of the bank. Thus appropriate management information system should be designed by bank to determine the day-to-day liquidity position of the bank and to check the compliance with the bank's established policies, procedures and limits and the requirements of NBE.

The NBE should also revise its liquidity risk management parameters, strengthen its staff capacity and introduce modern day supervisory tools such as risk-based supervisory approach. Concepts of financial management and familiarity of best practices do not exist. So bank officials should open their mind and give due consideration towards the understanding of banking business as the business is vulnerable to liquidity risk.

Due to limited studies done in Ethiopia, more researchers are encouraged to conduct research on liquidity issues faced by banks. This would actually benefit both the bank and the policy makers to setup a better and new workable policy.

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Appendix

Questionnaire

Wolkite University

Graduate Studies

Department Of Accounting and Finance

Dear respondents,

I'm a graduate student at Wolkite University in Department of Accounting and finance Currently, I'm conducting a research entitled **'comparative liquidity risk analysis in Awash International Banks and Wagegan Banks'** as a partial fulfillment of the requirements for the Degree of Bachelor of Art

The purpose of this questionnaire is to gather data for the proposed study, and hence you are kindly requested to assist the successful completion of the study by providing the necessary information. Your participation is entirely voluntary and the questionnaire is completely anonymous. I confirm you that the information you share will stay confidential and only used for the aforementioned academic purpose. So, your genuine, frank and timely response is vital for the success of the study.

Sincerely,

Part I Please use a thick mark (□) to show your choice (response) in the corresponding box Personal profile

1. Sex Male □ Female □

Education/professional qualification

First degree □

First degree and professional qualification such as ACCA □

Second degree in finance or related field □

Second degree in Non-finance field □

Other advanced education or professional qualification-please specify_____

Basic research question

1. Is there any liquidity risk problem in the bank? Yes □ No □

2. If your answer for question no.2 is yes, what were the causes for the liquidity problem?

A. Lack of professionals

B. Weak interbank system

C. Inadequate assistance from NBE

D. Information gap between the management and regulatory body

E. Weak payment system

3. Does the bank have liquidity risk management policy and procedure?

Yes □ No □

4. If yes, is this strategy revised?

Yes □ No □

5. If yes, how often do you revise it? Please tick in the respective box.

A. 6 months B. 1 year C. 2 years D. Other (please specify)

6. Which bodies are involved in the liquidity risk management of the bank?

A. Board of directors B. Senior management C. Risk control department D. In all management level

E. Others please specify _____

_____

_____

7. What does the strategy cover? A. Normal course of business B. Crisis situations C. both situation

6. Does the strategy include regular liquidity monitoring and management

Yes □ No □

8. If yes, please state the periodicity of monitoring and reporting

A. Daily B. Weekly C. Monthly D. Other (please specify)

9. Does your bank use stress tests on liquidity? Please tick in the respective box.

Yes No

10. If yes, what types of scenarios are in use? Please list below

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11. Has your bank set warning signals for possible liquidity crises?

Yes No

12. What are the events you consider as warning of such crises and their contingency plan?

13. What are the strength and weakness of the bank towards managing liquidity risk?

14. What is the current status of the bank in meeting the requirements of NBE regarding liquidity? A. As expected B. Over liquid C. Deficient D. Others, please specify

15. Any comment and suggestion in the management of liquidity risk management of the bank

Part II Please respond to the following statement indicating your agreement/disagreement by using a thick mark (□) with each statement listed below by checking the appropriate box to the right of the corresponding statement.

1 STRONGLY DISAGREE

2 DISAGREE

3 NATURAL

5 AGREE

6 STRONGLY AGREE

1. The board established Liquidity policies

2. The policy clearly establish the purpose, objectives and goals of Liquidity management

3.Are actions to control liquidity Made in a timely manner

4. The risk tolerance should be articulated in such a way that all Levels of management clearly understand the trade-off between risks and profits

5. A bank has a sound process for identifying, measuring, monitoring &Controlling liquidity risk.

6. A bank liquidity measurement is Adequate

7. Bank's cash inflows against its outflows and the liquidity value of its assets to identify the potential for future net funding shortfalls

8. Policy clearly establish the methodology for measuring Liquidity

9. Appropriate risk limits been Established

10. Funding concentrated in relatively few sources

11. BOA experience significant seasonal fluctuation in its Funding sources

12. There is appropriate level of risk tolerance in the bank

13 The risk tolerance is articulated in such a way that all Levels of management clearly understand the trade-off between risks and profits

14. The bank set limits to control its liquidity risk exposure and vulnerabilities.

15. There is adequate alternative plans for emergency occur in shortage of liquidity

Interview

1. How is liquidity risk identified in the bank and what are the major sources?

2. Which department (unit) is responsible for implementing the liquidity risk management policy and procedure?

3. What are the tools used by the bank to measure liquidity position?

4. What is the role of Asset and Liabilities committee (ALCO) in liquidity risk management?

5. Is there a controlling mechanism for liquidity risk in the bank? What are they?

6. Is there any contingency plan when uncertainty or crisis occurs? What are they?

7. What are the strength and weakness of the bank towards managing liquidity risk?

8. If there is any comment and suggestion forward please