ASSESSMENT OF LIQUIDITY RISK MANAGEMENTPRACTICE (THE CASE STUDY OF ABYSSINIA BANK OF GUBRE BRANCH)

PREPARED BY: BAYISA ABEBE

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ADVISOR: BIRHANU YIRGA (MSC)

COLLEGE OF BUSINESS AND ECONOMICS
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ADVISORS' APPROVAL SHEET

This is to certify that the research paper entitled assessment of Liquidity risk management practices of Abyssinia Bank Gubre branch. Submitted in partial fulfillment of the requirements for the Degree of Bachelor of art in accounting and finance and has been carried out by Bayisa Abebe under our supervision. Therefore, I recommend that the student has fulfilled the requirements and hence hereby can submit the senior research to the department.

Name of major advisor: Mr. Birhanu Yirga Signature_____ Date ____

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Abstract

The main purpose of this study is to assess the Liquidity risk management practices of Abyssinia Bank from the year 2013 to 2016. There are four fundamental research question were formulated. The research examines the uniform (standardized) liquidity risk management strategy practice for Abyssinia Bank, examine how Abyssinia Bank managing its loan portfolios, examine the source of liquidity risk in the bank, and examine how Abyssinia Bank comply with NBE directive. To conduct the study descriptive design method was be employed. Purposive sampling technique used in the selection of department in Abyssinia Bank. Thus, 15the total number of respondents were selected. Data collected were both primary data and secondary data. The primary data collected through questioner and Secondary data like annual report were used. The data collected from primary source of data were organized table and percentage. The findings of the study revealed that the bank experience seasonal fluctuation in the source of funds which exposed to liquidity risk. The bank has strategies and contingency plan to meet emergencies. Therefore, the bank has strong side in preparing strategies and procedure. In addition, measurement and reporting system is a good practice. But, limited source of funds faces the bank to unable to meet its short-term obligation.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Banks are financial intermediaries in which they distribute surplus amount of money to the deficit part of the economy in terms of short- and long-term loan. Banks facilitate the saving and capital formation in the economy. Bank for international settlements BIS (2008) defines liquidity as the ability of bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. Hence, liquidity risk arises from the fundamental role of banks in the maturity transformation of short-term deposits into long-term loans. Therefore, banks have to hold optimal level of liquidity that can maximize their profit and enable them to meet their obligation (Alemayehu, 2016).

Liquidity risk is the potential inability of a bank to honor its obligations as and when they become due (Sunder, 2014). Basel Committee on Banking Supervision (BCBS) defines liquidity as the ability of a bank to fund increases in assets and meet obligations as they fall due, without incurring unacceptable losses. Liquidity risk arises from maturity mismatches where liabilities have a shorter tenure than assets.

Santomero (1997) has argued that banks are in the risk business. In the process of providing financial services, they assume various kinds of financial risks of which liquidity risk is one. Market participants seek the services of these financial institutions because of their ability to provide market knowledge, transaction efficiency and funding capability. The risks contained in the bank's principal activities i.e. those involving its own balance sheet and its basic business of lending and borrowing, are not all borne by the bank itself.

Banks need liquidity to pay creditors, meet unforeseen withdrawals, pursue other investment opportunities and accommodate unexpected changes in loan demand and loan commitments. Moreover, banks (as credit institutions) typically transform short

term liquid liabilities in to long-term illiquid assets. In doing so, banks provide away for consumers with liquidity needs to smooth consumption and investment but are exposed to liquidity risks too (Webb David C., 2000).

Liquidity risk management is part of the larger risk management framework of the financial services industry, which concerns all financial institutions. Studying liquidity risk management issues is a critical but complex subject. Failure to address the matter may lead to dire consequences, including banking collapse, and by extension, the stability of the financial system. In fact, most bank failures are due to *issues around managing liquidity risk. This is also the reason why regulators are very concerned with the liquidity position of financial institutions and many financial industry professionals believe that the current thinking of regulators appears to center around the strengthening of liquidity framework (Accenture, 2013).

Liquidity creation is the main concerns of commercial banks because it is crucial for its existence. It is known that the banking sector plays an important role in the economic growth of a country. This is made through matching surplus economic units with deficit economic units. However, this fundamental role of banks in the ‘maturity transformation’ of short term deposits into long term loans make banks inherently vulnerable to liquidity risk, both of an institution specific nature and that which affects markets as a whole (Kiyotaki and Moore,2008).

Liquidity risk is often an inevitable outcome of banking operations. Since a bank typically collects deposits which are short-term in nature and lends long-term, the gap between maturities leads to liquidity risk and a cost of liquidity. The bank’s liquidity situation can be captured by the time profile of the projected sources and uses of funds, and banks should manage liquidity gaps within acceptable ranges.

The rationale for liquidity risk management is because of the uncertainty about the timing and/or the amount of the cash outlays, a financial institution must be prepared with sufficient cash to satisfy its obligations.

1.2. Back ground of the Organization

On February 15, 1996, Bank of Abyssinia was officially established by Emperor Menelik the new Bank of Abyssinia (BOA), which shares nothing with the former one but its name, was established.

The new Bank of Abyssinia has established by its shareholders numbered only 131, its workforce 32 and had only one branch. Furthermore, its subscribed capital was only Birr 25 million, and its authorized capital Birr 50 million, whereas its paid-up capital was just Birr 18 million. Furthermore it had a subscribed capital of 25 million and authorized capital of 50 million, whereas it's paid up capital was just birr 17.8 million.

Nowadays the bank has shown growth progress in terms of shareholders, employees, customers, and branch expansion. Currently the bank has 2400 shareholders, 2,195 employees, and over 13 million customers with 928 branches expanding throughout the country. The bank provides different services to its customers some of these include; saving account, youth targeted saving program, gift saving accounts, on-site services safe deposit boxes, international money transfer etc. In addition to this, its subscribed capital has grown to ETB 20,419,148,034 birr and total capital of ETB 218,513,875,231 birr.

The vision of bank of Abyssinia is to the legacy of the pioneer bank of Ethiopia, through continuous innovation and provision of excellent banking systems. The mission of the bank is to provide a full fledged domestic and international banking service through qualified and motivated employees and utilization of modern technology. Specifically bank of Abyssinia Gubre branch was established November 18/2022. At that time Abyssinia Bank of Gubre Branch had 13 employees. Now it has 15 employees, that means, two additional permanent employees were added.

1.3. Statement of the problem

Accelerated and sustained economic growth is on the top of Ethiopian Government's policy agenda. An efficient and well-functioning financial sector is essential for the development of any economy and the achievement of high and sustainable economic growth (Ali I. Abdi).

Liquidity and solvency are the heavenly twins of banking, frequently indistinguishable. There are various ways of looking at liquidity. For instance, from a macroeconomic perspective, liquidity relates to monetary supply, official interest rates and the price of credit; from a financial market's perspective, liquidity relates to the ability to sell securities without triggering significant price changes and from a banking perspective liquidity relates to the ability to meet obligations at a reasonable cost when they come due.

Liquidity and liquidity risk are two concepts that are interrelated, so is unavoidable to study the liquidity risk without treating liquidity. Liquidity is an essential element of any trading and solvent entity that might be defines as the availability of financial and equivalent resources. The liquidity gives the banks the potential to meet their expected and unexpected liabilities in a timely manner so that their day-to-day activities can continue without interruption (Banks, 2005). Lack of sufficient monetary assets may risk the most important bank activities that boost the probability of facing severe financial situations (Banks, 2005).

Diamond and Rajan (2005) have argued that liquidity is one of the essential requirements for the effective functioning of the banking system. Without adequate liquidity, banks are not able to perform some of their core functions including settlement of their inter-bank obligations (transactions occurring between banks). There are banks with excess liquidity that result from conservative credit rating policy and not willing to extend loans to the customers. But there are many potential debtors who need to finance their feasible projects.

Effective management of liquidity in the banking system is therefore an important element in maintaining a well-functioning banking system and in complementing monetary policy.

The National Bank of Ethiopia is vested with powers, duties and responsibilities of monetary management, regulation and supervision of banks. The bank, (NBE) issues directives on liquidity management of banks operating in Ethiopia. Commercial banks have strong incentive to enhance profitability through credit extension. But, the extent to which Abyssinia bank extend credits is restricted by the directives issued by the NBE on liquidity, and reserve requirement.

The directives on liquidity requirement are issued by the National Bank of Ethiopia pursuant to the authority vested in it by Article 41 of the Monetary and Banking Proclamation No 83/1994 and by Article 16 of the Licensing and supervision of Banking Business proclamation No. 84/1994.

Thus the liquidity requirement directive affects the performance of all commercial banks (both private and public ones) in Ethiopia. In addition to this, any bank operating in Ethiopia shall at all times maintain 25% (Twenty five percent) of all birr and foreign currency deposit liabilities in the form of liquid asset.

Carletti, Hartmann and Spagnolo have argued that in the liquidity risk management activities, banks continually deal with either a liquidity deficit or a liquidity surplus situation both of which are not desirable for banks. Liquidity deficit can lead to unexpected cash shortages that must be covered at undue costs. On the other hand, excess liquidity results in low asset yields hence poor earnings. Excess liquidity build up may also entail a foregone income to a bank and a welfare loss to an economy. Banks also require trend liquidity needs. These are liquidity needs required by banks for liquidity demands that can be predicted over a long-time span. Santomero (1997) and Alexandra (2002) have argued that these long-term (trend) liquidity needs are generally related to the secular trends of the community or markets that a bank serves.

In rapidly expanding areas, loans often grow faster than deposits.

Achieving the optimum level of liquidity is very dependent on various things such as: size, characteristics, nature and level of complexity of activities of a bank. GreuningandBratonovic, (2004) explains that management of liquidity as the bank has to follow a decisional structure for managing liquidity risk; an appropriate strategy of funding, the exposure limits and a set of rules for arranging liquidities in case of need.

A bank has to try to reconcile the twin conflicting objectives by actually working on a good portfolio (Liquidity) management. This can be also done by analyzing the situation, studying the objectives and therefore choosing the diversified and balanced asset portfolio. But, the problem with the banks these days are that they are not taking these issues that seriously as seriously it should have been taken into consideration (Birhanu 2015).

1.4 Research question

So as to evaluate the liquidity risk management practice of Abyssinia Bank the following research questions are formulated in order to conduct the study.

- Is there a uniform (standardized) liquidity risk management strategy practice for Abyssinia Bank?
- How does Abyssinia Bank managing its loan portfolios?
- How could Abyssinia Bank identify the source of liquidity risk?
- How could Abyssinia Bank comply with NBE directive?

1.5 Objective of the study

1.5.1 General objective

- Analyze the liquidity risk management practices of Abyssinia Bank

1.5.2 Specific objective

- To evaluate the Liquidity risk contingency plan and strategies of the Abyssinia Bank.

- To examine Abyssinia Bank loan portfolio management practice.
- To investigate the sources of liquidity risk in Abyssinia Bank
- To investigate Abyssinia Bank comply with NBE directive.

1.6 Significance of the study

These days the banking industry is an important and key sector to achieve economic development of the country. For banks to discharge their responsibility, they should always be liquid. Accordingly, the outcome of this study is believed to be useful in the following aspects:

- It might help to provide relevant and valuable information to decision makers including managers, investors and other stakeholders.
- It might help the Abyssinia Bank to know how effective they are Liquidity risk management practices.

1.7 Scope of the study

In conducting this study, only one company is selected for the assessment. Since, it is a case study; the assessment of Liquidity risk management practice in Abyssinia Bank of Gubre branch would be analyzed and evaluated. The needs to focus on one company alone arise from the fact that Abyssinia Bank has to work in competition environment.

1.8 Limitation of the study

Some of the challenges thatexpected to be encountered while conducting the study were:

- Lack of cooperation from some of the subjects of the study
- Shortage of time and lack of the necessary materials written with respect to the topic under study.

- Lack of financial resources

Despite these limitations, the researcher has attempted to make the study as complete as possible using unreserved effort.

1.9 Organization of the study

This research paper is categorized into five chapters. The first chapter concentrates on introductory parts of the paper that mainly pinpoints background of the organization, statement of the problems, objective of the study, significance of the study, scope of the study and limitation of the study. The second chapter provides related literature review with specific emphasis to theoretical, methodological and empirical aspects. The third chapter also deals with research methodology and design. The fourth chapters include data presentation and analysis of the descriptive results. Finally, the fifth chapter has focused on conclusion and recommendations based on the research outcomes.

CHAPTER TWO

LITERARURE REVIEW

2.1 Introduction

This chapter reviews theoretical and empirical literature on Liquidity risk management practice. Bank liquidity, as defined by Jenkinson (2008), is the capacity of a financial institution to meet cash and collateral obligations without incurring unacceptable losses. It is essential for banks to manage liquidity effectively to mitigate risks associated with their inherent role in transforming short-term deposits into long-term loans. However, gaps remain in understanding how banks in emerging economies handle liquidity during periods of economic stress or financial crises. This chapter outlines the theoretical and empirical foundations relevant to liquidity risk management practices. It identifies critical gaps in current research and highlights the contribution of the proposed study to advancing understanding in this domain. The review examines theoretical frameworks, empirical studies, and the conceptual model to set the stage for the research.

2.2. Liquidity Shortages and Banking Crisis

Banks are often found at the center of systemic financial crises. A financial crisis can be initiated by the failure of one or several banks. The failure can result from a run on banks and imply a failure of markets for liquidity, to which banks turn to meet their short-term liquidity needs (Diamond and Rajan, 2005).

Alexandra (2002) has argued that by themselves, bank failures do not necessarily mean that a financial crisis is underway. In an uncertain world, firms and banks are subject to failure even when the economy is functioning smoothly, and failure need not imply a deviation from social optimality. Propagation of a financial crisis takes place through contagion, or a spreading of failures from one financial institution to another. Propagation can lead to collapse of the financial system and result in significant real costs for the economy. Contagion within banking markets is a

common feature of financial crisis. For instance, in the Swedish (1990) and Norwegian (1985) banking crisis, the problems first emerged in finance companies and then spread to banks, owing to the banks' involvement in the finance companies (Drees and Pazarbasioglu (1998). In Argentina (1995), depositor runs started at wholesale banks and spread to retail banks. Contagion in the banking sector was evident in Paraguay (1995) and Venezula (1994). A financial crisis can be initiated by a run on a bank as a result of coordination failure among the bank's depositors. Banks are characterized by balance sheets that exhibit "maturity mismatch", which means that banks' liabilities (predominantly composed of deposits) tend to be short-term, while their assets tend to be long-term and illiquid.

Diamond and Dybvig (1983) showed that a run on a bank occurs when the bank's demand for liquidity, owing to withdrawals by depositors, exceeds the short-term value of its assets.

Alexandra (2002) also pointed out that when a bank's need for short-term liquidity exceeds its reserve of liquid assets, it faces a potential liquidity crisis. This author argued that the bank can acquire liquidity by liquidating some of its long-term assets (usually at a loss), drawing on its deposits at other banks, or borrowing from other banks with excess liquidity. Hence, a necessary part of crisis initiation is that individual banks' liquidity needs are not meet by markets for liquidity. If markets for liquidity are efficient, a solvent bank should never be illiquid, since it will be able to sell its long-term assets or borrow against its long-term assets to tide over its liquidity problems. Banks with liquidity needs in excess of their liquid assets turn to market for liquidity, and banks with excess liquidity have an incentive to lend to illiquid banks. Markets for liquidity, however, can be inefficient because of market power or information asymmetries (Holod and Peek(2006)). In this case, liquidity problems at healthy banks can turn into solvency problems when the banks were forced to sell their long-term assets below their fair value, or when they are unable to borrow enough funds on the interbank lending market.

In a banking industry, a liquidity crunch can result from the liability side of banks' portfolios owing to runs on deposits, usually by wholesale depositors, or from the asset side owing to declines in banks' cash-asset ratios. Banking crises were generally accompanied by declines in bank deposits and bank lending, and increases in the interest rates on loans and deposits.

2.3. Measuring a Bank's Liquidity Needs

A bank's liquidity needs consist of immediate obligations, such as deposit withdrawals or legitimate loan demands that the bank must meet to continue its functions as a financial intermediary. Depositors and creditors must have confidence in the value of their bank's assets in order to trust the bank with their funds. Because it is difficult to know how much confidence quality-sensitive depositors and creditors have in a bank, it is difficult to measure bank's liquidity needs and ability to meet such needs. Liquidity needs and sources are dynamic in nature. A bank's liquidity needs are measured over time; then liquidity needs are matched with these changing needs (Hempel and Simonson, 1991).

Smith (1991) has also argued that bank management has an important task to measure and meet its liquidity needs dynamically. This author indicated that long-run profitability will suffer when banks hold too much in low-earning liquidity sources in relation to its needs for such liquidity. On the other hand, too little liquidity can lead to severe financial problems and even failure.

2.4. Determinants of Dynamic Liquidity Needs

Banks are guided by their past experience and knowledge of events likely to affect liquidity needs. Hempel and Simonson (1999) have argued that the short term or seasonal liquidity needs of a bank may arise from several sources. For example, seasonal factors, often affect deposit flows and loan demand. Since loans are generally to deposit customers, seasonal increases in loans tend to occur when deposits are at seasonal lows, and vice versa.

Large depositors and large borrowers may influence the short-term liquidity needs of an individual bank disproportionately. The extent of these customers' influence is in direct relationship to the bank's size. The short-term funding needs of important customers can strongly affect bank liquidity in the short-run.

These authors indicated that a bank should carefully evaluate its funding diversification, the probable loyalty of its major funding sources, and the risks the bank is taking in areas such as credit risk, interest rate risk and capital risk, which might blemish the bank's name.

Banks also require trend liquidity needs. These are liquidity needs required by banks for liquidity demands that can be predicted over a long-time span. Santomero (1997) and Alexandra (2002) have argued that these long-term (trend) liquidity needs are generally related to the secular trends of the community or markets that a bank serves. In rapidly expanding areas, loans often grow faster than deposits. A bank in such a situation needs sources of liquidity to provide funds for loan expansion.

In addition to the short-term and long-term liquidity needs, banks may also have contingent liquidity needs. The contingent liquidity needs are caused by unusual events that are difficult, if not impossible to predict. Smith (1991) pointed out that this contingent liquidity needs include an unexpected outflow of deposits caused by a rumor about the bank, on unusual increase in loan demand, or closing of an extensively used funding source. By their very nature, contingency liquidity needs are impossible to forecast accurately. At the same time, every bank should have a plan to remain liquid in case some contingency does occur.

2.5. Theory of bank liquidity

Providing for a bank's liquidity needs is often as complex as estimating those needs. Hempel and Simonson (1999) have indicated two possible sources that can be used to fill a bank's liquidity needs. These are:- Traditional Sources of Liquidity Theory and Emerging Sources of Liquidity Theory

2.5.1. Traditional Sources of Liquidity Theory

The primary traditional sources of liquidity fall into two basic categories. The first category consists of bank assets in which funds are temporarily invested with the assurance that they either will mature or be paid when liquidity is needed or will be readily saleable, without material loss, in advance of maturity. The second category includes the various methods by which banks can borrow or otherwise obtain funds.

2.5.2. Emerging Sources of Liquidity Theory

In addition to the traditional sources, banks use numerous other emerging methods to meet liquidity needs. One method applies underwriting of highly standardized loans, particularly home mortgages, for resale in well-organized secondary markets.

Another method is to purchase intermediate or long-term securities that have the option of being sold at a set price in the future. The option feature removes the price fluctuation risk and makes the long-term securities liquid. The last method is for the bank to use capital market obligations (such as preferred stock or capital notes) to finance its liquidity needs.

2.6. Risks in Providing Banking Services

In the process of providing financial services, commercial banks encounter various kinds of risks. The risks associated with the provision of banking services differ by the type of service rendered**.**

Santomero (1997) has pointed out that for the sector as a whole, the risks can be broken into six generic types: systematic or market risk, credit risk, counterparty risk, liquidity risk, operational risk and legal risks.

Systematic risk (market risk) is the risk of asset value change associated with systematic factors. By its nature, this risk can be hedged, but cannot be diversified completely away. For the banking sector, systematic risk comes mainly from variations in the general level of interest rates and the relative value of currencies (Saxegaard, 2006).

Credit risk is the risk of borrowers defaulting on their loans. This includes the failure to pay both or either of the principal or the interest of a loan disbursed by banks. A delay in repayment of loans is also considered as credit risk as it would entail a loss on the bank's side from that loan. This risk is primarily that of the lender's and include lost principal and interest, disruption to cash flows, and increased collection costs.

Credit risk can be further classified in to Transaction Risk and Portfolio concentration risk. Transaction risk is a risk associated with the credit transaction while concentration risk is associated with the concentration of loans in a certain sector or area. The higher the concentration ratio the higher will be the risk attached with it.

Inherent to banking, credit risk means that payments may be delayed or not made at all, which can cause cash flow problems and affect a bank's liquidity. Despite innovation in the financial services sector, more than 70 percent of a bank's balance sheet generally relates to this aspect of risk management. For this reason, credit risk is the principal cause of bank failures. (Greuning & Bratanovic, 2009)

Resti and Sironi (2007) on the other hand, forward three concepts that constitute credit risk. The first is default and migration risk in which default risk represents the mere insolvency of the borrower, whereas migration risk refers to the risk arising from the deterioration in the borrower's credit worthiness. The second concept they put forth is a risk occurring as an unexpected event. This risk as they put it is implicit in the first

one and what differentiates it from it is that this one occurs when the deterioration in the credit worthiness of the borrower is unexpected. The third concept is related to the concept of credit exposure in which what needs to be considered accruing in the loan portfolio is not just the classical form of credit but also operations such as guarantees, transactions in securities, foreign currencies and other pending settlements.

Greuning and Bratanovic (2009) state three kinds of policies related to credit risk management. The first set aims to limit or reduce credit risk, which include policies on concentration and large exposures, diversification, lending to connected parties, and overexposure. The second set aims at classifying assets by mandating periodic evaluation of the collectability of the portfolio of credit instruments. The third set of policies aims to make provision for loss or make allowances at a level adequate to absorb anticipated loss.

Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. (Board of Governors of the Federal Reserve, 2013) Although operational risk does not easily lend itself to quantitative measurement, it can result in substantial costs through error, fraud, or other performance problems. The growing dependence of banking organizations on information technology emphasizes one aspect of the need to identify and control this risk.

In Crouhy, Galai and Mark (2006) operational risk is defined as a risk incurred by an organization's internal activities. It refers to potential losses resulting from inadequate systems, management failure, faulty controls, fraud, and human error. From this we can identify four causes/ types of operational risk: people, systems, processes and external events. A risk from people refers to losses coming from human errors, frauds, violations of internal rules and processes, and the like. (Resti & Sironi, 2007) Legal and regulatory risk arises from failing to meet with regulation and laws of the land such that the failure would result on to a penalty that would be enforced by the law. The loss may not always come in the form of a penalty all the times but instead comes

as a big loss on the company from enforcing new regulations that have not been foreseen by the party affected. This is basically what is meant by legal and regulatory risk.

Legal risk, as defined by the Federal Reserve (US), is a risk arising from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations or condition of a banking organization.

Business risk refers to the classic risks of the world of business, such as uncertainty about the demand for products, the price that could be charged for those products, or the cost of producing and delivering products. It is the possibility that a company will have lower than anticipated profits, or that it will experience a loss rather than a profit. Business risk was influenced, by numerous factors, including sales volume, unitprice, input costs, competition, and overall economic climate and government regulations.

Business risks can be either internal or external to the business entity. They can also directly or indirectly affect a business's ability to operate. These risks can be hazardbased (e.g. chemical spills), uncertainty-based (e.g. natural disasters) or associated with opportunities (e.g. taking them up or ignoring them).

Counterparty risk comes from non-performance of a trading partner. The nonperformance may arise from counterparty's refusal to perform due to an adverse price movement caused by systematic factors or legal constraint.

Liquidity risk is the possibility that over a specific period, the bank will become unable to settle obligations with immediacy (Drehmann and Nikolaou, 2009). It is a risk arising from a bank's 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 future demands of providers and borrowers, at reasonable costs.

The vulnerability of banks to liquidity risk is determined by the funding risk and the market risk. 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 (Jenkinson, 2008). A bank may lose the confidence of its depositors if funds are not timely provided to them. The bank's reputation may become at stake in this situation. The maturity transformation of short-term deposits into long-term loans makes banks inherently Vulnerable to liquidity risk (Basel Committee on Banking Supervision, 2008). 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 (Drehmann and Nikolaou, 2009).

The behavior towards liquidity is affected by a firm's characteristics: a bank's liquidity position is affected by its size, status and product type. The size affects the attitude of the bank towards wholesale funding, including the access opportunity and the price of the Funds obtained (Kashyap, 2002). Bank size matters because of the economy of scope and Scale; concerning liquidity, a large bank might have better access to the interbank markets because it has a larger network of regular counterparties or a wider range of collateral. The Product type offered to the counterparties, on both the assets and liabilities sides, is able to affect the liquidity position; banks that take on demand deposits and offer loan commitments need to hold higher liquidity buffers that can be mitigated if an imperfect correlation holds (Kashyap, 2002).

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, 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. The longer-term sources of funds for banks are bonds that banks issue and bank capital. Therefore, these two liabilities are major factors of a bank's liquidity risk. Demand deposit accounts give banks a larger cash base and thus are a form of liquidity. Undrawn credit lines are a liquidity risk that is off the balance sheet; companies with established credit lines can borrow from banks when they need it and thus decrease a bank's liquidity (Madura, 2007).

The second is that the banks that face the most liquidity pressures and have more cash outflow than inflow will have to sell assets. In this situation, most other banks will be facing increased liquidity pressures and there will be only a few banks in the market to buy these assets. This lack of liquidity in the market can lead to fire sales of assets. This means the company looking to sell the assets will have to offer them at a large discount because it needs the cash now due to liquidity pressure. Therefore, in crisis periods banks holding more liquidity will be able to both grow in new business and take over business of other banks by buying their assets at low prices. By purchasing assets at fire sale prices banks that are the purchaser stand to make a great deal of profit (Acharya, Shin, &Yorulmazer, 2009).

2.7 Bank liquidity risk management

The importance of liquidity for sound banking practice is well established at both the theoretical and operational levels. Bank liquidity indicates the degree to which a financial institution is able to meet its obligations under normal business conditions. Dziobek, Hobbs and Marston (2000) have argued that bank liquidity is closely interlinked with confidence because its most generic function is to provide the bank and its customers with the reassurance that the bank's liability obligations can be

met as they become due without necessarily having to roll these over or postpone access to credit. For this reason, an important objective of liquidity risk management operations is to engage in confidence enhancing practices (Bundesbank 1982).

Liquidity risk is mainly due to a faulty balance sheet structure of the bank's assets and liabilities to provide cash to handle unexpected events. Excessive liquidity problems are therefore an indication of deeper-lying problems and are usually preceded by excessive risks taken by the bank i.e. interest rate risks (mismatching asset and liability maturities or duration) and credit risks (non-performing loans due to credit extended to risky borrowers).

Effective commercial bank liquidity management requires that sufficient liquid assets be held to meet normal business requirements (including reserve requirements) and that excess balance be minimized, (Dziobek, Hobbs and Marston, 2000).

These authors have also argued that asset liquidity and liability management are the core elements in liquidity risk management of commercial banks. They showed that asset liquidity can be obtained either by holding liquid paper, by managing the maturity distribution of non-liquid assets with a view toward the bank's liquidity needs, and/or by selling outright (or lending) collateralized claims on a repurchase basis.

Liability management aims at controlling liquidity risk by limiting volatility gaps between asset and liabilities, and by assuring access to funding markets. In broad term, techniques of limiting liquidity mismatches aim at extending the maturity of liabilities and increasing stable "core" deposits. A second group of techniques aims at assuring and improving funding market access. By diversifying funding sources by market segment, banks can reduce their vulnerability to market or counterparty disruptions and increase the probability that funding can be retained or replaced if there is a disruption. In managing funding relations, banks also establish contingency arrangements and often have bilateral and last-resort arrangements from which funds can be raised on a temporary basis (Dacey and Bazel-Horowitz, 1990).

The liquidity risk that does present a challenge is the need for funding when and if a sudden crisis arises. Under this condition, what is required is an analysis of funding demands under a series of "worst case" scenarios. These include the liquidity needs associated with a bank specific shock, such as a sever loss, and a crisis that is system wide. For managing liquidity risk in each case, the bank examines the extent to which it can be self-supporting in the event of a crisis, and tries to estimate the speed with which the shock will result in a funding crisis (Santomero, 1997).

2.8. Determinants of Excess Liquidity in Commercial Banks

Excess liquidity is typically equated to the quantity of reserves deposited with the central bank by deposit money banks plus cash in vaults in excess of the required or statutory level. Going beyond acknowledging the threat of increasing inflation, several authors have observed that this abundance of liquidity is likely to have adverse consequences for the ability of monetary policy to influence demand conditions and thus, to stabilize the economy. Agenor, Aizenman and Hoffmaister (2004), for example, have noted that if banks already hold liquidity in excess of requirements, attempts by the monetary authorities to increase liquidity to try to stimulate aggregate demand will prove largely ineffective. Similarly, Nissnake and Aryeetey (1998) have argued that in the presence of excess bank liquidity, it becomes difficult to regulate the money supply using the required reserve ratio and the money multiplier, so that the use of monetary policy for stabilization purpose is undermined. In other words, one would expect excess bank liquidity to weaken the monetary policy transmission mechanism.

Excess liquidity may simply reflect the holding of liquidity for precautionary purposes. In other words, the accumulation of non-remunerated (involuntary reserves that do not provide a convenience return which offsets the opportunity cost of holding them) reserves may be a result of commercial bank's optimizing behavior.

Agenor, Aizenman, and Hoffmaister (2004), for example, pointed out that the accumulation of reserves in excess of requirements in Thailand during the Asian crisis was a result of a contraction in the supply of credit by banks, and not due to a

reduction in the demand for credit. As a rationale for commercial banks' voluntary buildup of holdings of non- enumerated liquid assets during the East Asian crisis Agenor, Aizenman, and Hoffmaister (2004) showed, in particular, the role of increased uncertainty or risk of default. When free reserves are large, banks supposedly have surplus reserves and are eager to make loans and lower interest rates.

When free reserves are small, banks are supposedly under pressure to pay off their indebtedness and will consequently restrict credit and raise interest rates (Frost, 1971).

Mishkin (2001) explained that banks keep excess reserves as an insurance against the cost associated with deposit out flows. He argued that the higher the costs associated with deposits out flow, the more would be the excess reserves banks want to hold. Thus, literally, banks keep excess liquidity for a range of reasons. Among the widely cited reasons for accumulation of excess liquidity in banks are: susceptibility to required reserves deficiency penalty; market risks vulnerability; and liquidity deficiency costs, ranging from interest on borrowed funds to the possible bankruptcy ordinance action (Aikaeli, 2006).

Implications of precautionary and involuntary excess liquidity can be seen in terms of potential inflationary effects. In this regard, involuntary excess liquidity is likely to be rapidly lent out if demand conditions in the economy improve. Hence, the amount of liquidity in the economy may rapidly increase without a loosening of monetary policy at a time when liquidity conditions should be tightened. This in turn carries with it the risk of increased inflation. Precautionary excess liquidity, on the other hand, is likely to pose less of a risk in terms of inflation. Furthermore, if banks hold excess reserves only for precautionary purposes, then one would still expect monetary policy to be effective. A loosening of monetary policy, for example by lowering reserve the requirement would increase excess liquidity above the level demanded by commercial banks for precautionary purposes. Hence, one would expect banks to expand lending by lowering the cost of borrowing. Similarly, one would expect contractionary monetary policy would lead banks to contract lending to maintain their desired level of excess reserves (Saxegaard, 2006).

However, if the holdings of excess liquidity are involuntary in the sense that banks are unable to expand lending, then attempts by banks to boost credit demand by lowering the cost of borrowing to be largely ineffective. An expansionary monetary policy in that case would simply inflate the level of unwanted excess reserves in commercial banks and lead to an expansion of lending. Similarly, contractionary monetary policy will simply cause banks to reduce their unwanted reserves, and will only affect monetary policy if it reduces reserves to a level below that demanded by banks for precautionary purposes (O'Connell, 2005).

2.9 Empirical Studies

Liquidity risk is the possibility that over a specific 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 (Gorton and Winton, 2000,). 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 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.

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 assets, 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.

The result of the interview revealed that the liquidity of banks was one of the major determinants of Ethiopian banks profitability. However, the output of the regression analysis and the interview agreed 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 andprofitability of Ethiopian banks. The study concluded that the impact of Ethiopian banks' liquidity on their performance remains ambiguous and further research is required.

2.10 Research Gap Analysis

In Ethiopia, there were studies that took place related to liquidity risk and banks profitability determinates of profitability of commercials banks, bank liquid risk and their management practice, however, there were no timely studies that indicated the current situation of banks Liquidity risk management practice.

An important gap still exists in the empirical literature to indicate the overall liquidity management practice ofBank of Abyssinia. Studies cited on the empirical literature above suggest that identified such as a study doing by Belay (2010) factors that determine Commercial Bank profitability as an explanatory variable for bank profitability, which is traditional measured by ROA and ROE, and the result indicated that, liquidity risk is one of the major challenges of Commercial Banks. The study major focused was to identify any factors that might affect commercial banks profitability. In contrarily to this study the center of focus will be to identify determinates of liquidity risk rather than focusing other factors outside liquidity.

There was although the researches made by Semu (2012), focused on the impact of bank liquidity on financial performance). Therefore, the study examined some of bank specific and macroeconomic factors affecting banks liquidity and their impact on Profitability using Net interest margin, which shows how well the bank is earning income on its assets. High net interest Income and margin indicates a well-managed bank and indicates future profitability. However, the study still did notfocus in identifying specifically the determinants of liquidity risk relating with several factors.

- ✓ What Ethiopian banks, particularly the Bank of Abyssinia, manage liquidity during periods of economic stress.
- ✓ The effectiveness of liquidity risk management frameworks in aligning with international standards.
- ✓ Strategies for balancing liquidity and profitability in volatile market conditions.
- ✓ Limited studies on liquidity risk management practices in developing economies.
- ✓ Insufficient exploration of the impact of macroeconomic shocks on liquidity needs.
- ✓ Underdeveloped models integrating emerging risks, such as digital financial services, into liquidity frameworks.

2.11 Conceptual frame work

Most studies confirm that, banks liquidity risk determined by several factors. There are internal and external sources of liquidity risk. As examined above banks specific (internal factors) such as, bank size, capital adequacy, non-performing loan (NPL), loan portfolio management and banks external (macroeconomic factors) factors such as, monetary policy, fiscal policy of the country and financial crisis. Therefore, considering different types of models the study tried to develop conceptual framework based on taxonomy of liquidity risk model.

The model's analysis shows that the foundation for creating liquidity risk is the mismatch of cash flows that cause the liquidity gap. The mismatch gap is the result of the process of the adopted credit-deposit policy and the generation of the balance sheet structure. This gap would be broadened by not anticipating the customer's behavior and the improper process of assets and liabilities management. As a result, it can lead on one hand to the too low share of liquidity reserves, including assets classified as liquid, or to difficulties in selling them at a fair price, and on the other hand, to the improper diversification of funding sources or the low level of their stability as well as to the "freezing" of the market (Wójcik-Mazur, 2012).

Liquidity risk is therefore directly linked to the generation of loss, which results from the inability to sell assets, as well as to raise funds at an economic, moderate cost in order to cover expected and unexpected liabilities (Basel 2011).

CHAPTER THREE
RESEARCH METHODOLOGY

3.1Introduction

This chapter includes the Research Design; Study Area; Sample and Sample Size; Sampling Procedures; Data Collection Methods and Data Analysis Plan.

3.2 Research Design

Research design is a plan of collecting and analyzing data in an economic, efficient, and relevant manner. It is a plan of organizing framework for doing the study and collecting the necessary data. (C.R Kotari, 2004). Accordingly,the descriptive research design aiming to receive in depth information in order to assess liquidity risk management practices ofAbyssinia Bank. This study has implemented a descriptive research design strategy by consuming both qualitative and quantitative approaches to get anticipated outcomes of the study.

3.3 Description of the research area

Abyssinia Bank is a privately owned bank established on February 15, 1996 under Proclamation 84/924 and the commercial code of Ethiopia. The bank began operations on January 6, 2007. Specifically Abyssinia Bank of Gubre branchwas established on November 18/2022.

3.4Population, sample size and sampling technique

The total population of the study used 15 office employees at Abyssinia Bank Gubre branch. In order to conduct the study, the researcher used non-probability sampling and in such a way as to collect participants of the whole population. From the non-probability sampling, the researcher used judgmental (purposive) sampling technique for the study. Because, it would be effective to the availability of data and it enables the researcher to select respondents by consider that the respondents who can

provide the best information about the matter.Sample size of all (15) employees of Abyssinia bank of Gubre branch would be selected by non-probability judgmental sampling method. The sources of data where finance, treasury, credit, risk and compliance management department of the company.

3.5 Sources of data

Mugenda (2003) refer to target population as the entire group of individuals, events or objects having common observable characteristics to which the researcher wants to generalize the results of the study. The researcher used both primary and secondary sources of data. The primary sources of data were obtained from questionnaires the employees of staff. The secondary source of data obtained from different sources like annual reports and related.

3.5.1 Primary Data

Primary data are those which are collected a fresh and for the first time and thus happen to be original in character. These could be collected using observation, interviews, questionnaire and schedules (Kothari, 2009). The primary data were collected from distributed questionnaires.

3.5.2 Secondary Data

Secondary data are those collected by someone else and had already been passed through the statistical process for this study the secondary data were also obtained from various departments on Liquidity risk management practices of Abyssinia bank. For example, published and unpublished data. Published data include, research reports, books and annual report.

3.6 Procedures of Data Collection

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 Processing and Analysis

After collecting the relevant data through the data gathering methods used in this study, the researcher categorized the data appropriately for interpretation. Qualitative data analysis technique was employed in this study. To analyze and interpret the data gained from questionnaires, a qualitative technique involving was used. Finally, based on the findings of the study summary, conclusions and recommendations are prepared.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1 Introduction

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 Abyssinia bank.

4.2 General Characteristics of Respondents

From those departments selected 15 questioners distributed according to the number of employees related to the study. Out of 15 questioners 12 returned. So, the analysis was presented according to the data gathered from the employee of Abyssinia bank which they are working in different level of management and expert level.

Figure 1: personal profile

NO	Question	Frequency	Percentage
1	Gender		
	Male	9	75
	Female	3	25
	Total	12	100
2	Education Background		
	Diploma	5	41.67
	First degree	7	58.33
	First degree and professional qualification such as ACCA		

	Second degree in finance or related field		
	Second degree in non-finance field		
	Total	12	100

Source: Researchers surveys result from questionnaire.

The personal profile of the respondents indicated from the above table 75% of the respondent are male and the rest 25% are female. Furthermore 41.67% are diploma holder and 58.33% are holder of first degree.

4.3 The Results for the Secondary Data

The secondary data were collected from the annual report and monthly stress testing report prepared by risk and compliance management department of the bank. For analysis and convenience purpose the researcher had to summarize it in to a yearly report for the preceding four years. The result is the same with those of primarydata.

4.4 The Results for the Primary Data

The following emphasizes on the responses obtained from non-probability judgmental sampling method. The sources of data where finance, treasury, credit, risk and compliance management department of the company. The questions are essential in order to meet the research objective.

4.4.1. To assess the liquidity risk management strategy practice of Abyssinia Bank.

The first section of the questionnaire contains statements on Liquidity risk management strategy practice for which the respondents were asked to give their opinion on the process practiced in Abyssinia Bank. As stated in the literature review bank liquidity risk management has an important task to measure and meet its liquidity needs dynamically. In that order these issues were raised first in the

questionnaire and the first report of the results in this research begins with the risk management strategy practices.

Figure 2: Examine the liquidity risk management strategies of the bank

Item no	Question	Frequency	Percentage
1.	Does the bank have Liquidity risk management policy and procedure?		
	Yes	12	100
	No	-	-
	Total	12	100
2.	If yes your answer for the above questions how often the strategy revised		
	6 month	2	17
	1 year	3	25
	2 year	1	8
	other 4-5 year	1	8
	Never	-	-
	When it is needed	5	42
	Total	12	100
3.	The policy clearly established the purpose objective and goal of liquidity management are action to control liquidity in a timely manner		
	Strongly agree	4	33
	Agree	8	67
	Natural	-	-
	Disagree	-	-

	Strongly disagree	-	-
	Total	12	100
4	There is adequate alternative plans for emergency occur in shortage of liquidity		
	Strongly agree	3	25
	Agree	9	75
	Natural	-	-
	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100

Source: Researchers surveys result from questionnaire.

When assess the bank policy and strategy towards managing the liquidity, all the respondents said yes. Therefore, the bank has Liquidity risk management policy and procedure.

In addition to this, the strategy revised with in 6 month is 17%, 1year 25%, 2 year 8%,4-5 years 8%, and it revised when it is necessary is 42%. 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 be revised it according to the current situation.

The statement stated in No 3 question says that the policy clearly established the purpose objective and goal of liquidity management are action to control liquidity in a timely manner, 33% strongly agree and 67% agree with the statement. So, it is not vague to apply in daily operation.

The last question states that there is adequate alternative plan for emergency occur in shortage of liquidity, 25% strongly agree and 75% agree with the statement. This shows that there is an alternative plan when uncertainty occurs.

4.4.2. To investigate the sources of liquidity risk in the bankof Abyssinia

Figure 3: Assessments of source of liquidity risk in the Abyssinia bank.

Item no	Question	Frequency	Percentage (%)
1.	Is there any liquidity risk problem in the bank?		
	Yes	8	67
	no	4	33
	Total	12	100
2.	If your answer is yes for the above question what are the causes for the liquidity problem?		
	Lack of professional	-	-
	weak interbank system	2	25
	inadequate assistance from NBE	2	25
	information gap between the management and regulatory body	-	-
	both weak payment system and interbank system	2	25
	Other	2	25
	Total	8	100
3	Funding concentrated in relatively few sources		
	strongly agree	1	8
	Agree	9	75
	Natural	2	17
	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100
4.	The bank experience significant seasonal fluctuation in its funding source		
	strongly agree	3	25
	agree	6	50
	Natural	2	17

	Disagree	1	8
	strongly disagree	-	-
	Total	12	100

Source: Researchers surveys result from questionnaire.

In the basic research questions, the first question is there any liquidity risk problem in bank of Abyssinia. From the total respondent, 67% of the respondent said that there is liquidity risk problem and the rest 33% said that there is no such risk in this bank.

From the respondent which says there is liquidity problem in the bank, 25% of the respondent said that it is because of weak interbank system, 25% are inadequate assistance from national bank of Ethiopia, 25% respond believed that it is because both weak interbank system and weak payment system.

The rest 25% 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 gives 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 Bank had some liquidity problem. The reason for this was 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.

Question No 3, Funding concentrated in relatively few sources, 8% strongly agree with the statement, 75% agree and 17% neutral with the statement. Therefore more than 50% of the

respondent believed that the bank concentrate its' funding in few sources. So, the bank should diversify the concentration of funding.

The next question is the bank experience significant seasonal fluctuation in its funding source. 25% was strongly agrees, 50% agree, 17% neutral and 8% disagree with the above statement. From the results more than half of the respondents agree that Abyssinia bank experience significant seasonal fluctuation in its funding sources. Therefore, it needs proper assessment of this risk and giving remedy for the problem.

4.4.3. To assess the loan approval and portfolios management of the company

As stated in the literature review a financial crisis can be initiated by a run on a bank as a result of coordination failure among the bank's depositors. Banks characterized by balance sheets that exhibit "maturity mismatch", which means that banks' liabilities (predominantly composed of deposits) tend to be short-term, while their assets tend to be long-term and illiquid.

Figure 4: Information about loan approval and portfolios management practices of Abyssinia Bank

No	Item	**Frequency**	Percentage (%)
1	The loan portfolio of the bank was distributed across all sector of the economy.		
	Strongly agree	4	33
	Agree	6	50
	Neutral	2	17

	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100
2	The bank identify with due care and diligent the payment capacity of the newly credit applicant customer before loan approval.		
	Strongly agree	4	33
	Agree	5	42
	Neutral	2	17
	Disagree	1	8
	Strongly disagree	-	-
	Total	12	100
3	The bank adjusts the loan interest rate parallel to its cost of capital.		
	Strongly agree	5	42
	Agree	6	50
	Neutral	1	8
	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100

4	The overall investment portfolio management practices of Abyssinia bank are economical, efficient and effective.		
	Strongly agree	5	33
	Agree	6	50
	Neutral	2	17
	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100

Source: Researchers surveys result from questionnaire.

In response for question one, which states that was the loan portfolio of the bank distributed across all sector of the economy, 33% strongly agree, 50% agree and 17% of respondent were neutral. This shows that more than half of respondent agreed about the loan Portfolio and advances extended to all borrowers in any sectors, form of business ownership, and geographical location.

The second question is the bank identify with due care and diligent the payment capacity of the newly credit applicant customer before loan approval, 33% strongly agree, 42% agree, 17% of respondent were neutral and 8% were disagree with the statement. This shows that the respondents are not sure that the grant loan in a manner that ensure full repayment capacity of the borrower.

The third question towards the bank adjusts the loan interest rate parallel to its cost of capital; the result shows that 42% strongly agree, 50% agree and 8% of respondent were neutral.

As shown in the above table, question No 4 says, overall investment portfolio management practice of Abyssinia Bank are economical, efficient and effective. With this statement, 33% strongly agree, 50% agree and 17% of respondent were neutral with the statement. This shows that the overall investment portfolio management practice of Abyssinia Bank are economical, efficient and effective

4.4.4 Information about the involvement of national bank of Ethiopia

The National Bank of Ethiopia is vested with powers, duties and responsibilities of monetary management, regulation and supervision of banks. The bank, (NBE) issues directives on liquidity management of banks operating in Ethiopia. Commercial banks have strong incentive to enhance profitability through credit extension. The extent to which Abyssinia bank extending credit is restricted by the directives issued by the NBE on liquidity, and reserve requirement.

Figure 5: the involvement of national bank of Ethiopia

No	Item	**Frequency**	Percentage (%)
1	As a regulatory, the NBE decision like monetary, fiscal and exchange rate policies positively support the performance of Abyssinia Bank.		
	Strongly agree	3	25
	Agree	9	75
	Neutral	-	-
	Disagree	-	-

	Strongly disagree	-	-
	Total	12	100
2	The current status of the bank meets the requirement of NBE regarding liquidity is as expected.		
	Strongly agree	4	33
	Agree	7	59
	Neutral	1	8
	Disagree	-	-
	Strongly disagree	-	-
	Total	12	100
3	The NBE support banks when their operation is tight liquidity environment.		
	Strongly agree	4	33
	Agree	5	42
	Neutral	2	17
	Disagree	1	8
	Strongly disagree	-	-
	Total	12	100
4	The overall intervention of NBE is adequate and supportive.		

	Strongly agree	2	17
	Agree	6	50
	Neutral	3	25
	Disagree	1	8
	Strongly disagree	-	-
	Total	12	100

Source: Researchers surveys result from questionnaire.

In response for question one which states that as a regulatory the NBE decision like monetary and exchange rate policies positively support the performance of Abyssinia Bank. The result shows 25% strongly agree and 75% of respondent were agree with the statement. This shows that approximately all respondents fairly agree that the NBE decision like monetary and exchange rate policies positively support the performance of Abyssinia Bank.

The response for question number two towards the current status of the bank meet the requirement of NBE regarding liquidity is as expected. 33% strongly agree, 59% agree and 8% of respondent were neutral with the statement. About more than 92% of the respondents agreed that the bank meet the requirement of NBE regarding liquidity is as expected.

Question No 3 NBE support banks when their operation is a tight liquidity environment, According to the result of this statement 33% strongly agree, 42% agree, 17% neutral and 8% of respondent were disagree with the statement.

In response for question four which states that the overall intervention of NBE adequate and supportive, 17% strongly agree, 50% agree, 25% were neutral and8% of respondent were disagree with the statement. This shows that more than half of the respondents fairly agree that the overall intervention of NBE adequate and supportive.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Conclusions

In this session, the researcher summarized, conclude and recommend the major findings obtained from the questioner from Bank of Abyssinia 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 Abyssinia experience liquidity problem because of different reason, unexpected withdrawal of depositor, high loan demand for customer and management granted credit in order to maximize profit affect the liquidity performance of the bank.
- Abyssinia bank experience significant seasonal fluctuation in its funding sources.

  Therefore, it needs proper assessment of this risk and give 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

- All departments should clear knowledge and information to minimize the bank liquidity problem and work as synergy.

- The bank has scored higher on the role of supervisors in liquidity risk management and this should be maintained and strengthened more to have a well-prepared and capable supervisory team.
- 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 has 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 maker to setup a better and new workable policy.
- The bank should be continuously adjusting its loan interest rate parallel to the costs of capital of the bank to raise the profitability of the bank and set reasonable interest for the borrower in order to pay their commitment as per the schedule.

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APPENDIX: QUESTIONNAIRE

WOLKITE UNIVERSTY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

Dear Respondent:

The purpose of this questionnaire isto collect information about the Liquidity risk management practices, of Abyssinia Bank. I intend to look into Liquidity risk management practice of Abyssinia Bank of gubre branch.All information gathered from this questionnaire usedonly for academic delivery purpose. Hence, I kindly request you to share with me part of your valuable timely completing this questionnaire.

I would like to thank you in advance for your willingness andcomplete the questionnaire.

Bayisa Abebe (Wolkite University).

Section I: Respondent's Profile

1. Sex

□ Male □ Female

2. Marital status

□ Married □ Single

3. Education/professional qualification

□Diploma

□ 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,

specify_____

4. Present career in the company

□CEO

□VS President

□Director

□Division manager

□Department head

□Officer

Board Members

Other,

pleasespecify_____

Section II: Information about liquidity risk management strategies of the bank

N.B 1= Strongly Disagree 2=Disagree 3: Neutral4= Agree 5= Strongly Agree

1. Does the bank have Liquidity risk management policy and procedure?

Yes No

☐ ☐

2. If yes, how often the strategy been revised?

A. 6 months ☐

B. 1 year ☐

C. 2 years ☐

D. Other (please specify)____

N.B 1= Strongly Disagree 2=Disagree 3: Neutral4= Agree 5= Strongly Agree

NO	Item	1	2	3	4	5
1	The policy clearly established the purpose objective and goal of liquidity management are action to control liquidity in a timely manner					
2	There is adequate alternative plans for emergency occur in shortage of liquidity					

Section III, Information about sources of liquidity risk in the bank of Abyssinia

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 ☐

Others, please specify _____

N.B 1= Strongly Disagree 2=Disagree 3: Neutral4= Agree 5= Strongly Agree

NO	Item	1	2	3	4	5
1	Funding concentrated in relatively few sources					
2	The bank experience significant seasonal fluctuation in its funding source					

Section IV: Information about loan approval and portfolios management practice of Abyssinia Bank

N.B 1= Strongly Disagree 2=Disagree 3: Neutral4= Agree 5= Strongly Agree

No	Item	1	2	3	4	5
1	The loan portfolio of the bank is distributed across all sector of the economy.					
2	The bank identify with due care and diligent the payment capacity of the newly credit applicant customer before loan approval.					
3	The bank adjusts the loan interest rate parallel to its cost of capital.					
4	Does the overall investment portfolio management practice of Abyssinia bank are economical, efficient and effective.					

Section V: Information about the involvement of national bank of Ethiopia.

N.B 1= Strongly Disagree 2=Disagree 3: Neutral4= Agree 5= Strongly Agree

No	Item	1	2	3	4	5
1	As a regulatory, the NBE decision like monetary, fiscal and exchange rate policies positively support the performance of Abyssinia Bank					
2	The current status of the bank meet the requirement of NBE regarding liquidity is as expected.					

3	The NBE support banks when their operation is tight liquidity environment.					
4	The overall intervention of NBE is adequate and supportive.					

If you have any additional comment, please write

_____

Thank you