

**TREND ANALYSIS OF LIQUIDITY IN OMO MICROFINANCE
INSTITUTION**



**COLLEGE OF BUSINESS AND ECONOMICS
DEPARTEMENT OF ACCOUNTING AND FINANACE**

**RESEARCH PAPER SUBMITTED IN PARTIAL FULFILLMENT OF THE
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PREPERD BY, SULTAN SHUKRE

ADIVAISER: DELELEGN E. (MP Acc)

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ETHIOPIA

Abstract

Liquidity analysis is one of the most important contents in institutions financial analysis. Many institutions worldwide lack a formal and suitable financial policy on the administration and management of liquidity. For financial institutions experiencing fast paced growth like OMO microfinance institution, the establishment of norms and policies to administer liquidity is nonetheless crucial for the institutional viability as much in the short term as in the long term. Liquidity position is commonly measured by financial ratios that are conventional ratios (based on balance sheet and income statement) and cash flow ratios. The management and formulation of policies in liquidity becomes relevant. Data for the study will from secondary sources and various ratios and indicators will be used to measure the liquidity performance of the OMO MFIs. Nine years data from 2006 to 2014 would used to see the trend analysis of liquidity. In connection with liquidity, OMO MFIs lack strong position to effect immediate obligations. In this study, an attempt has been made to fill in the existing knowledge gap by trend analysis of liquidity in OMO micro finance institution.

Key words: Liquidity, OMO, MFIs.

LIST OF ACRONYMS

OMO: Open market operations

MFIs: Micro finance institution

AEMFIs: Association of Ethiopian micro finance institution

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CHAPTER ONE

1. Introduction

1.1. Back Ground of The study

The microfinance constitutes a diverse range of practitioners, practices and body of knowledge. From this perspective the commonly accepted definition of microfinance as “the means of providing a variety of financial services to the poor based on market-driven and commercial approaches (Christen, 1997). Microfinance is the provision of convenient financial services and products to the poor, low-income households and micro and small enterprises (Central Bank of Kenya, 2007). Management of working capital has profitability and liquidity implications.

Hence, working capital proposes a familiar front for profitability and liquidity management. Microfinance institutions consciously take risk survival and sustainability. Rather than focusing on current or historical financial and operational performance management and regulators now focus on an organization’s ability to identify and manage future risks as best predictor of long term success of financial institutions.

Liquidity is the ability of an institution to generate sufficient cash or its equivalent in a timely manner at a reasonable price to meet its commitments as they fall due. These commitments can be met either by drawing from a stock of cash holdings, by using current cash inflows, by borrowing cash or by converting liquid assets into cash. Liquidity is the probability that an asset can be converted into an expected amount of value within an expected amount of time. Cash and cash equivalents are the most liquid assets within the asset portion of a firm’s balance sheet. The level of liquidity can be an indicator of the success or the failure of the firm (Mainelli, 2007).

Liquid assets are important to have in times of crisis or emergency because they can be readily converted into cash. Without liquidity, money can become tied up in systems that are difficult to cash out of and even more difficult to assess for actual cash value (Chaplin, Emboli and Michael, 2000). During times of emergency, large financial institutions shut down, making it difficult for people to access the cash they need to buy essentials like food, gasoline and other emergency supplies.

Maintaining an adequate degree of liquidity in the whole banking system is extremely important, because the registration of a liquidity crisis at a single bank can have negative repercussions over the whole banking system thanks to the risk of contagion through interbank settlements (Greunin & brattanovic,2004).The optimal amount of liquidity is determined by a tradeoff between the low return earned on liquid assets and the benefit of minimizing the need for costly external financing (Bhunia, 2003). Objective of the present paper is to conduct a study on the overall efficiency of the management of micro finances with special reference to short-term liquidity. Liquidity plays a significant role in the successful functioning of a business. A firm should ensure that it does not suffer from lack of or excess liquidity to meet its short-term compulsions. Shortfall in liquidity results in bad credit ratings, and finally it may result in the closure of the company. At the same time a very high degree of liquidity is also bad, as idle assets earn nothing.

After some investigation, micro finances have been singled out for research in the present study. This is definitely the backbone of economic growth in any micro finance institution. A thick relationship has been found between the level of economic growth and liquidity position on developed as well as developing countries.

Thus, more studies are still required to understand liquidity of microfinance institution. Therefore, to address the current gap in the literature this study focused on the trend analysis of liquidity in OMO microfinance institution.

1.2.Statement of the Problem

Liquidity is very important for any micro finance institution to pay its short term dept. Firms that exhibit a proper balance of their liquidity are able to channel their finances into profitable investments. The micro finance and the regulatory authorities are becoming increasingly vigilant to the liquidity positions held by financial institutions (Muranaga and Ohsawa, 2002).

Proper liquidity management would have enable a financial institution meet their financial obligations and take advantage of profitable investments that are likely to yield higher returns in future. The optimal amount of liquidity is determined by the credit management practices implemented by a financial institution in order to mitigate exposure to credit risk (Myers and

Majluf, 2004). The financial institutions may face serious consequences if it is not properly managed. Most of the micro finance institution are run through deposits. If the depositors start withdrawing their deposits from the institution, it will create a liquidity trap for the micro finance institution forcing the institution to borrow funds from the central bank or the interbank market at higher costs (Plochan, 2007). The major cause of liquidity risk is the maturity mismatch between assets and liabilities. The majority of the assets are funded by deposits most of which are current with a possibility to be called at any time. This situation is known as the mismatch between assets and liabilities. This mismatch can be measured with the help of the maturity gap between assets and liabilities. This is also called liquidity gap. Higher liquidity gap might create liquidity risk to most microfinance institutions. Trend analysis of ratios indicates the direction of change. The term trend is very commonly used in day to day conversation. Trend is the basic tendency of production, sales, income, current assets, and current liabilities etc., to grow or decline over a given period of time. In accounting, trend is generally computed trend ratios or by trend percentages. Trend ratios are the basic tool for trend analysis of an enterprise.

The analysis of a series of trend ratios provides only a view regarding increase and decrease or rate of increase and decrease. It does not depict that increase or decrease is favorable or adverse. To make a view that a trend of liquidity is satisfactory or not it is better to compare it with trend values. Analysis of trend should be made after study of trend ratios and trend values as base. Thus a very limited research has been conducted on the trend analysis of liquidity in microfinance institutions. Thus the researcher attempts to fill this gap and contributes to the literature on the microfinance institutions. Therefore this study will assesses the trend analysis of liquidity in OMO micro finance institution.

1.3. Objective of the Study

1.3.1. General objective

- The main objective of this study is trend analysis of liquidity in OMO micro finance institution

1.3.2. Specific objective

- To assess analysis of liquidity in terms of portfolio at risk >30 days of OMOMFIs.
- To examine trends of liquidity in terms of write of ratio.

- To assess the trend of loan loss ratio.
- To observe the trend of liquidity for non- earning liquid asset.

1.3.3. Research question

- What shows the trend of portfolio at risk>30days?
- What shows the trends of write off ratio?
- What shows the trends of loan loss ratio?
- What shows the trend of non- earning liquid asset?

1.4. Significance of the Study

The study would show the trend analysis of liquidity in OMO micro finance institution. It would be significant for researchers to understand the trend of liquidity.

This study would benefit a number of groups among them managers of MFIs who would use the study to gain an insight on the trend analysis of liquidity management on the revenue growth of their institutions. Identification of liquidity levels that maximize Profits enables managers to revise and adopt relevant strategies. As the regulator devises standards establishing appropriate level of liquidity for MFIs, helping to ensure adequate stability for the overall financial system, they should bear in mind the trade-off between resilience to liquidity shocks and the cost of holding lower-yielding liquid assets. Academicians will benefit from the information of the study as well as it will contribute to existing body of knowledge. The study will further provide the background information to research organizations and scholars and identify gaps in the current research for further research.

1.5. Scope of the study

The scope of the study is limited to OMO micro finance and also this study conceptually trend analysis of liquidity in OMO micro finance institution. The researcher relies only on which is associated mainly with study area of liquidity trends and open market operation (OMO) micro finance institution.

1.6.Organization of the paper

This proposal paper organized into five chapters. Chapter one which tells about introduction part including back ground of the study, statement of the problem, back ground of the organization of paper, objective of the study, scope of the study and significance of the study. Chapter two deals with review of literature which used as the theoretical frame work of the research. The last chapter deals with methodology of the study. Chapter four deals about data presentation and analysis. Chapter five deals with conclusion and recommendation.

CHAPTER TWO

2. Literature Review

This section summarizes the literature that is available regarding to liquidity analysis. It starts from the theoretical foundation of the study. Then it is followed by theoretical meaning and the emergence of MFIs, detail description of MFIs in Ethiopia, financial performance analysis, areas of financial analysis, liquidity analysis, significance of liquidity analysis, techniques of liquidity analysis will be presented respectively. Second, empirical review evidence investigated by different researchers and finally summary of empirical review is presented.

2.1. Theoretical Literature

Micro finance refers to the means by which poor people convert small sums of money into large lump sums (Rutherford 1999). Micro finance institutions are existed to perform a number of functions primarily for granting a credit for those productive poor which are a credit worthy borrowers. micro finance provide financial service to those who are excluded from formal financial institution likes banks and financial companies provides micro finance service to marginal clients, therefore, MFI hare to create mechanism to bridge the gap created by poverty level, illiteracy, gender and remoteness of the society, because ordinary financial institutions are not really enough to help and participate low income group of the population.

There are two broad categories of products and services that are provided to micro finance clients, by MFI, financial and non-financial services. (Rob Gnomon 2001)

The primary role of MFIs is to provide financial intermediation of funds at a particular time to those who have deficit at the same time. (Otero, 1999) Microfinance services may be seen in terms of four main mechanisms:

Loans: which allow a lump sum to be enjoyed now in exchange for a series of savings to be made in the future in the form of repayment instalments.

Savings: which allow a lump sum to be enjoyed in future in exchange for a series of savings made now.

Insurance: which allows a lump sum to be received at some unspecified future time if needed in exchange for a series of savings made both now and in the future. Insurance also involves income pooling in order to spread risk between individuals on the assumption that not all those who contribute will necessarily receive the equivalent of their contribution.

Pensions: which allow a lump sum to be enjoyed as a specified and generally distant date in future in exchange for a series of savings made now.

In the literature the terms micro credit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Sinha (1998) states "micro credit refers to small loans whereas microfinance is appropriate where NGOs and MFIs supplement the loans with other financial services (savings, insurance, etc.). Therefore micro credit is a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional non-credit financial services such as savings, insurance, pensions and payment services (Kio credit, 2005).

2.1.1. Emergence of Microfinance

Traditional banking sector cannot reach millions of poor for whom small loans could make huge differences. There are several reasons for this. Most of the poor are rural, and they are much dispersed. They have low education levels, if at all. As a result, administrative cost of supplying loans to the poor population is extremely high. Another issue that makes it difficult to serve these customers through traditional banking is that the poor does not have any assets to use as collateral. As a result, the poor had access to loans only through local money lenders at exorbitantly high interest rates.

Micro-credit financing starts with the assumption that the poor is willing to pay high interest rates to have access to finance. In general, the system uses the social trust as the collateral. Although there are different micro-credit financing models, the borrowers in the pioneering models are usually members of small groups. Loans are given to individuals, but an entire group is responsible for the repayment. Hence, the borrower who does not fulfill his commitment to repay back will lose his/her social capital. Micro-credit institutions report that their repayment rates are above the commercial repayment rates, sometimes as high as 97%. Today, there are

millions of poor people around the world who turn to be entrepreneurs through the micro-credit sector.

Micro credit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmers. These often resulted in high loan defaults, high loss and an inability to reach poor rural households (Robinson, 2001). Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “micro credit” came to prominence in development (MIX3, 2005). The difference between micro credit and the subsidized rural credit programmers of the 1950s and 1960s was that micro credit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that micro credit could provide large-scale outreach profitably. The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in micro credit institutions, attention changed from just the provision of credit to the poor (micro credit), to the provision of other financial services such as savings and pensions. (Microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

2.1.2. Evolution of the MFIs Institution in Ethiopia

Initially, micro credit started as a government and non-government organizations motivated scheme. Following the 1984/85 severe drought and famine, many NGOs started to provide micro credit along with their relief activities although this was on a limited scale and not in a sustained manner (IFAD 2001). The Government also sporadically provided loans largely for the purchase of oxen through its Rural finance Department of the Ministry of Agriculture and

cooperatives. But these loans were not based on proper needs assessment and no mechanism was in place to monitor their effectiveness. In many cases, these loans were not to be repaid and might have fostered a culture of not repaying loans. (Getachew Teaka Yishak Mengesha 2005). During the command economic system (1974-91), the Development Bank of Ethiopia (DBE) and the commercial Bank of Ethiopia (CBE) were also involved in extending loans to cooperatives largely in response to the government's pressure. A massive default by the cooperatives following the demise of the command economy along with its extensive control systems, however, forced the CBE has continued to provide loans for the purchase of fertilizers and improved seeds on the basis of regional government guarantees. The DBE has also been providing loans to micro and small-scale operators in some selected towns. This scheme was, however, based on donors fund designed in the form of revolving fund, and essentially based on a limited scale in terms of the number of clients covered. Funds were simple been given from the DBE to clients identified and screened by the Trade and Industry Breaux of regional Gove rally led to a low loan recovery rate (DBE 1999). In line with this, the early formal microfinance activity is the DBE (Development Bank of Ethiopia) Place, Pilot Credit Scheme, initiated in 1990 under the Market Towns Development Project [1], implemented in 1994. While many NGOs Programmers that emphasizes both credit and savings began in early 1990s. For example, the REST Credit Scheme of Tigray (RCST) (own Dedebit Credit and Savings Institution, DECSI) was launched in 1993; Sidama Saving and Credit scheme (now Sidama Microfinance Institution) was established in 1994; Oromia Credit and Saving Scheme (Now Oromia Credit and Saving S.C.) Started in 1996 (Gerehiwot Ageba). The formulization of the Micro finance institutions, micro credit used to be provided in a fragmented and unplanned manner even during the early 1990s. The micro credit scheme was donor driven rather than an outcome stemming from a clear policy direction and development strategy. Their outreach and impact also remained Limited (IFAD 2001). Another feature of these credit schemes is that all was trying to address the credit delivery service alone. The provision of savings facilities, which is essential for a sustained credit service delivery, was completely ignored. The failure of the formal banks to provide banking facilities, on the one hand, led the unsustainability of the NGOs credit scheme on the other hand, led the government to issue out a legal framework for the establishment and operation of micro finance institutions. Currently there are 27 microfinance institutions in

Ethiopia, licensed and registered by NBE, following the issuance of proclamation No. 40/1994. Aggregation. (WWW.Shodhganaginlibnet.ac).

2.1.3. Financial Performance Analysis

In short, the firm itself as well as various interested groups such as managers, shareholders, creditors, tax authorities, and others seeks answers to the following important questions:

1. What is the financial position of the firm at a given point of time?
2. How is the Financial Performance of the firm over a given period of time?

These questions can be answered with the help of financial analysis of a firm. Financial analysis involves the use of financial statements. A financial statement is an organized collection of data according to logical and consistent accounting procedures. Its purpose is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment of time as in the case of a Balance Sheet, or may reveal a series of activities over a given period of time, as in the case of an Income Statement.

Thus, the term financial statement general refers to two basic statements: the Balance Sheet and the Income Statement. (Www.Shodhganaginlibnet.ac)

The Balance Sheet shows the financial position (condition) of the firm at a given point of time. It provides a snapshot and may be regarded as a static picture. Balance sheet is a summary of a firms financial position on a given date that shows $\text{Total assets} = \text{Total liabilities} + \text{Owners equity}$.

The income statement (referred as the profit and loss statement) reflects the performance of the firm over a period of time. Income statement is a summary of a firm's revenues and expenses over a specified period, ending with net income or loss for the period. However, financial statements do not reveal all the information related to the financial operations of a firm, but they furnish some extremely useful information, which highlights two important factors profitability and financial Soundness. Thus analysis of financial statements is an important aid to financial performance analysis.

The analysis of financial statements is a process of evaluating the performance analysis includes analysis and interpretation of financial statements in such a way that it undertakes full diagnosis of the profitability and financial soundness of the business. Relationship between component parts of financial statements to obtain a better understanding of the firm's position and performance.

The financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account. The first task is to select the information relevant to the decision under to consideration from the total information contained in the financial statements. The second is arranging the information in a way to highlight significant relationships. The final is interpretation and drawing of inferences and conclusions.

2.1.4. Liquidity analysis

Liquidity analysis is a domineering subject in corporate finance in recent decades because of their meaning. Solvency is represented by the capacity of the company to cover all its obligations either in the short term or long term. Liquidity is the ability of a company to meet the short term commitments (12 months or one normal operating year). It is the ability of the company to convert its assets into cash. Liquidity management is a concept that attracts considerable attention of many companies throughout the world, especially with the current financial situations and the state of the world economy. The main concern for management is to balance between profitability, which helps increase shareholder's wealth, and liquidity, which assures smooth operations and maintains their remunerations. An organization having a proper set of liquidity management policies and procedures will enhance profits, reduce the risk of corporate failure and significantly improve its chances of survival. Liquidity plays an important role in maintaining smooth operations for firms. There is a significant impact of current ratio, quick ratio and debt to total assets ratio on return on assets and a relationship between liquidity management and profitability exists. Failed entities, which face financial distress, have lower cash flows than healthy entities and smaller reserves of liquid assets.

2.1.5. Significance of Liquidity Analysis

Interest of various related groups is affected by liquidity performance of a firm. Therefore, these groups analyze liquidity of the firm. The type of analysis varies according to the specific interest of the party involved.

Trade creditors: interested in the liquidity of the firm (appraisal of firms liquidity)

Bond holders: interested in the cash-flow ability of the firm (appraisal of firms capital structure, the major sources and uses of funds, profitability over time, and projection of future profitability)

Investors: interested in present and expected future earnings as well as stability of these earnings (appraisal of firms profitability and financial condition)

Management: interested in internal control, better financial condition and better performance (appraisal of firms present financial condition, evaluation of opportunities in relation to this current position, return on investment provided by various assets of the company, etc.)(Pamela P, 2010).

2.1.6. Techniques /Tools Of Liquidity Analysis

An analysis of liquidity performance can be possible through the use of one or more tools / techniques of liquidity analysis. One of the most common techniques is accounting techniques. It is also known as financial techniques. Various accounting techniques such as Ratio Analysis and trend analysis may be used for the purpose of liquidity Analysis.(Modern corporate finance, 1994)

2.1.6.1. Ratio Analysis

In order to evaluate liquidity condition and performance of a firm, the financial analyst needs certain tools to be applied on various financial aspects. One of the widely used and powerful tools is ratio or index. Ratios express the numerical relationship between two or more things. This relationship can be expressed as percentages (25% of revenue), fraction (one-fourth of revenue), or proportion of numbers (1:4). Accounting ratios are used to describe significant relationships, which exist between figures shown on a balance sheet, in a profit and loss account, in a budgetary control system or in any other part of the accounting organization. Ratio analysis

plays an important role in determining the financial strengths and weaknesses of a company relative to that of other companies in the same industry. The analysis also reveals whether the company's liquidity position has been improving or deteriorating over time.

I. Liquidity Ratio

Liquidity ratios provide information about a firm's ability to meet its short-term financial obligations. These ratios are calculated to comment up on the short-term paying capacity of a concern or the firm's ability to meet its current obligations. Two frequently used liquidity ratios are the current ratio (or working capital ratio) and the quick ratio cash ratio is the most conservative liquidity ratio.

A. Current Ratio

Current ratio may be defined as the relationship between current assets and current liabilities. This ratio is also known as working capital ratio. It is a measure of general liquidity and is most widely used to make the analysis for short term financial position or liquidity of a firm. It is calculated by dividing the total of the current assets by total of the current liabilities. A relatively high current ratio is an indication that the firm is liquid and has the ability to pay its current obligations in time and when they become due. On the other hand, a relatively low current ratio represents that the liquidity position of the firm is not good and the firm shall not be able to pay its current liabilities in time without facing difficulties. An increase in the current ratio represents improvement in the liquidity position of the firm while a decrease in the current ratio represents that there has been deterioration in the liquidity position of the firm. A ratio equal to or near 2:1 is considered as a standard or normal or satisfactory. The idea of having doubled the current assets as compared to current liabilities is to provide for the delays and losses in the realization of current assets.

B. Quick Ratio (Acid Test)

It is an instrument to measure the liquidity position of the company. This ratio is the same as the current ratio except that not include inventory account and prepaid expenses. The two components of quick ratio are liquid assets and liquid liabilities. Liquid asset includes all current asset except inventory and prepaid expenses. Inventories can't be termed as liquid assets because it can't be converted in to cash immediately without a loss of value. In the same manner, prepaid

expenses are also excluded from the list of liquid assets because they are not expected to be converted in to cash similarly, liquid liabilities mean current liabilities.

Formula: Quick Ratio = Liquid Asset Divided to current liability

C. Cash flow Ratio

The cash ratio is the most conservative liquidity ratio. It excludes all current assets except the most liquid cash and cash equivalents. Along with conventional ratios, cash flow-based ratios are getting more and more popular to financial analysts, managers and other users of financial information. Gradually, they are believed to reflect a better picture of a firms health, especially liquidity position. Cash flow statement (CFS) reflects changes in cash and cash equivalents during a period. Cash and cash equivalents comprise of cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash and which are subject to an insignificant risk of changes in value Since CFS provides information on cash inflows and outflows of a business within a given period of time, it becomes an essential tool in measuring liquidity In fact, CFS is used in financial analysis of a firm with regards to solvency, liquidity, productivity, efficiency and sufficiency . Cash flow ratios as a liquidity measure is brought about and used by many researchers like Beaver (1966), Kirkham (2012) Atieh (2014) and Barua.

II. Trend Analysis

Trend analysis indicates changes in an item or a group of items over a period of time and helps to draw the conclusion regarding the changes in data. In this technique, a base year is chosen and the amount of item for that year is taken as one hundred for that year. On the basis of that the index numbers for other years are calculated. It shows the direction in which concern is going.

2.2. Empirical literature review

The empirical result is listed below in chronological order to provide readers with the development of liquidity analysis over the years.

Loo (2007) conducted a survey of liquidity management approaches and their effect of profitability of commercial banks in Kenya. The survey was conducted on all commercial banks

operating in Kenya between the periods 1997 to 2004 and used questionnaires to top finance management staff to identify liquidity management approaches. The study found that profitability was one of the factors that affected a firm's liquidity management policy. From the study there was a positive correlation between liquidity and profit levels in the banks.

Bordeleau, Crawford and Graham (2009) reviewed the impact of liquidity on bank profitability for 55 United States banks and 10 Canadian banks between the period of 1997 and 2009. The study employed quantitative measures to assess the impact of liquidity on bank profitability. Results from the study suggested that a nonlinear relationship exists, whereby profitability is improved for banks that hold some liquid assets, however, there is a point beyond which holding further liquid assets diminishes banks profitability, all else equal. Conceptually, this result is consistent with the idea that funding markets reward a bank, to some extent, for holding liquid assets, thereby reducing its liquidity.

Ismal, Rifki, (2010) carried out a research, analyzing the practices of managing liquidity in Islamic banks and gaining real information about the perception of banking depositors and Islamic bankers. The research used a quantitative research methodology to analyze and gather all relevant information on liquidity risk management and to construct the main output of the research. It analyzed primary data from direct surveys to depositors and Islamic banks and employed secondary data to make econometric models and analyze the performance of the industry. The Survey questionnaire to both Islamic bankers and depositors were done through an online system. The study found out that conventional banks, Islamic banks face a number of risk areas, which affect their performance and operations. One of such risk areas was liquidity risk, which showed additional features in the case of Islamic banks. Both the international banking standards and the Sharia guidance suggested that banks should have: robust liquidity risk management policies, a responsive asset and liability committee, effective information and internal control systems and, methods for managing deposits to reduce on-demand liquidity, to manage liquidity risk.

The study concluded that in their operations, banks might face liquidity risk as a result of asset-liability imbalance and maturity mismatch risks. In order to manage liquidity risk, the banks should conduct liquidity management processes which consist of determining liquidity

management policies, establishing asset liability committees (ALCOs), having an effective information system and internal control, and preparing techniques to mitigate liquidity risk. The study recommended that banking regulators, Islamic banks, depositors, business.

Owolabi, Obiakor and Okwu (2011) conducted a study that investigated the relationship between liquidity and profitability in 15 selected quoted companies in Nigeria. The central objective was to examine the nature and extent of the relationship between liquidity and profitability in profit-driven quoted companies and also to determine whether any cause and effect relationship existed between the two performance measures. Liquidity measure considered was current assets-liabilities ratio while profitability measure was operating profit-turnover ratio. Investigative and quantitative analysis methods were used for the study.

Obawale and Oladunjoye (2013), examined for the study of risk management issues in the banking sector do not only have greater impact on bank performance but also on national economic growth and general business development. The bank's motivation for risk management comes from those risks which can lead to underperformance. This study focuses on the association of risk management practices and bank financial performance in Nigeria. Data sourced was based on a 4 year progressive annual reports and financial statements of 10 banks and a panel data estimation technique adopted. The result implies an inverse relationship between financial performance of banks and doubt loans, and capital asset ratio was found to be positive and significant. Similarly, it suggests the higher the managed funds by banks the higher the performance. The study concludes a significant relationship between banks performance and risk management. Hence, the need for banks to practice prudent risks management in order to protect the interest of investors the finding showed that liquidity position of investigated.

In particular, current ratio was manipulated, as compared to cash flow ratio, by more than 78%, while quick ratio is overestimated by more than 50% as compared to critical needs coverage ratio. The authors recommended the use of traditional ratio in conjunction with cash flow-based ratio to get a better indication of the financial health of an entity. The research of McGowan, Billah & Jakob named Liquidity Analysis of selected public-listed companies in Malaysia performed in the same year also proved significant statistical differences between the two types of ratios and suggested the use of both for a better decision-making process.

2.3. Summary of Literature Review

From the literature review, liquidity might expose the firm into financial losses when the firm fails to maintain a proper match between assets and liabilities. It is therefore important for firms to balance between liquidity through implementing proper financial management practices in investing and risk management. The empirical evidence has demonstrated that a direct relationship exists between liquidity risk and financial performance of firms: Hence, the need for banks to practice prudent risks management in order to protect the interests of investors. There was also observed varying results depending on the industry in which the research was conducted.

Holding of liquid assets in the financial sector was beneficial up to a certain extent beyond which an increase in holding liquid assets can eventually be outweighed by the opportunity cost of holding such comparatively low yielding liquid assets on the balance sheet.

Little focus has been laid on trend analysis of liquidity in OMO micro finance institution. This study is therefore deals about trend analysis of liquidity in OMO micro finance institution.

CHAPTER THREE

3. Research Methodology

3.1.Introduction

This chapter covers the research methodology that would be used by the researcher in achieving the objective of this study.

3.2.Research Approach

The researcher would use one approach method in which the researcher to conduct analyses and interpret data by using quantitative approach. Because Quantitative research is, as the term suggests, concerned with the collection and analysis of data in numeric form. It tends to emphasize relatively large-scale and representative sets of data.

3.3.Research Design

To achieve stated objective of the study the researcher would use descriptive type of research. Because the descriptive design aimed at describing situation at set of circumstance by observing (scientific observation) to scientific description.

3.4. Data Collection Method

The study is based on the secondary data obtained from the audited balance sheets and profit & loss accounts and also the annual reports of respected financial institutions. The study also used financial statements which were obtained from association of micro-finance institutions. The study used secondary data sources for a period of nine years(2006to 2014).

3.5.Method OF Data Analysis

After the relevant data collected from the company financial statement, in order to describe the real financial performance of the company the researcher would use different accounting tools such as ratio analysis including liquidity ratio, debt ratio, profitability ratio and asset management ratio, quick ratio, acid ratio to measure the liquidity of OMO micro finance institution. Finally, the analysis would be present in the form of percentages and graphs in order to compare the liquidity performance of the institution in different year.

CHAPTER FOUR

4. DATA PRESENTATION AND ANALYSIS

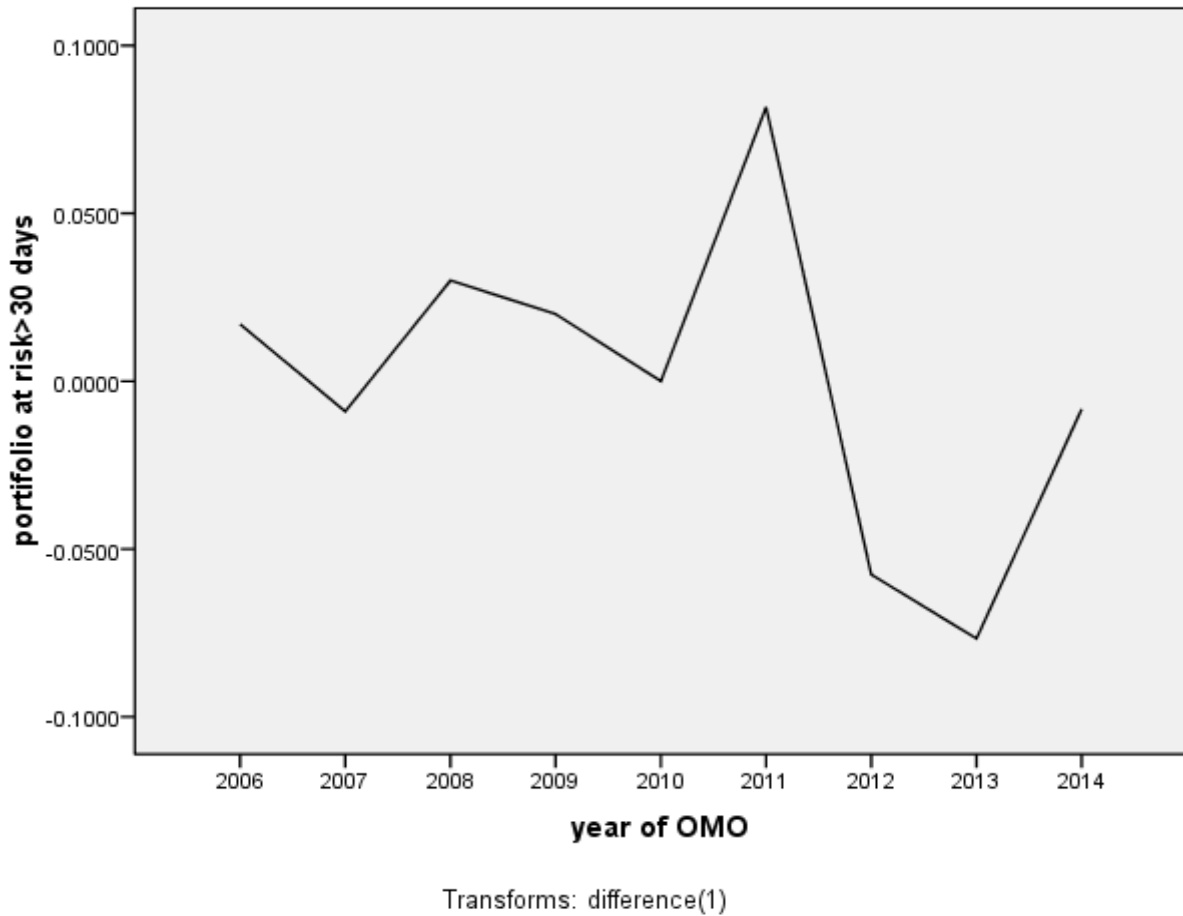
In the previous chapter the research methodology containing sub topics such as research approach, research design, methods of data collection and analysis used in the study was presented. In this chapter the results and analysis of the data collected through secondary data and the results are presented in the form of sequence charts.

4.1. Trend analysis of liquidity in OMO MFIs.

Trend analysis of liquidity is the examination of institutions and indicators over time to determine how action affects results. Since liquidity for a single period do not reveal much about the institutions trend analysis covering Nine years period from 2006 to 2014 were used to show their liquidity.

4.1.1. Trend analysis of liquidity in terms of portfolio at risk >30 days in OMO MFIs

Portfolio at Risk (PAR) is the percentage of total loan portfolio that is at risk. So, PAR 30 is the principal amount (net after repayments) of open loans overdue by 30 days or open loans where no repayment has been made for 30 days.



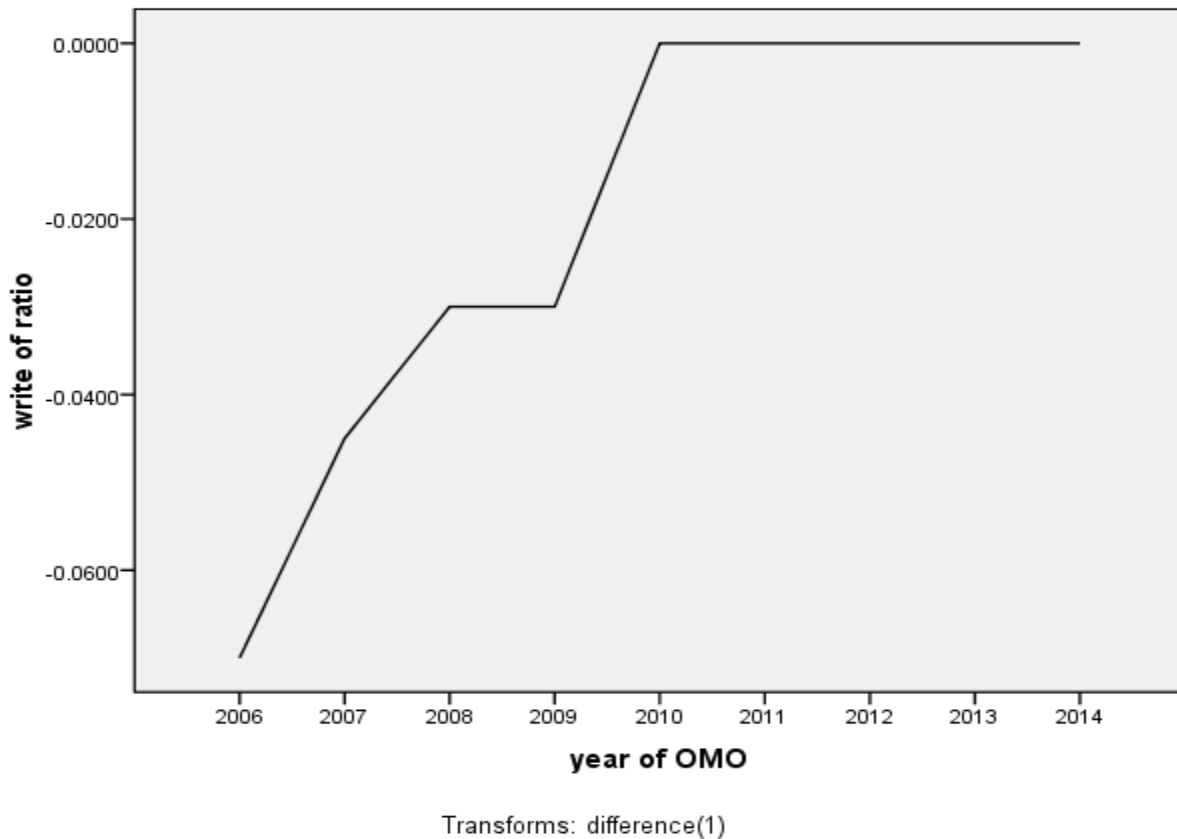
Source: association of Ethiopian micro finance institution: year (2006-2014)

The above graph showed that trend analysis of liquidity in terms of portfolio at risk greater than 30 days for OMO MFIs. The graph showed that decreased 0.02 to -0.01 in (2006- 2007), increase 0.01 to 0.03 in (2007- 2008), decrease 0.03 to 0.015 in (2008 to 2009), decrease 0.015 to -0.01 in (2009 - 2010), increase (-0.01 to 0.085), in (2010 -2011) decrease ,0.085 to -0.075 in (2011 – 2012) decrease, -0.075 to -0.083 in (2012 to 2013), and increase -0.083 to -0.017 in (2013 -2014) from the above it can be concluded that OMO MFIs in portfolio at risk greater than 30 days were decrease ,increase and decrease in the first three years (2006-2009) respectively and the next three years (2009_2012) decrease, increase in increasing rate and decrease at increasing rate respectively and the remaining years (2012-2014) decrease and increase. Therefore the above graph

showed that liquidity in portfolio were very risky in (2011) compared to previous and last years but in recent years almost a good position.

4.1.2. Trend analysis of liquidity in terms of write-off ratio in OMO MFIs

Write-Off Ratio means, for any Settlement Date, the percentage equivalent of a fraction, the numerator of which shall be (a) the Outstanding Balance of Purchased Receivables that first became Written-Off Receivables during the immediately preceding Collection Period, and the denominator of which shall be (b) the Settlement Date Receivables Balance as of the immediately preceding Settlement Date (which, for purposes of the first Settlement Date, shall



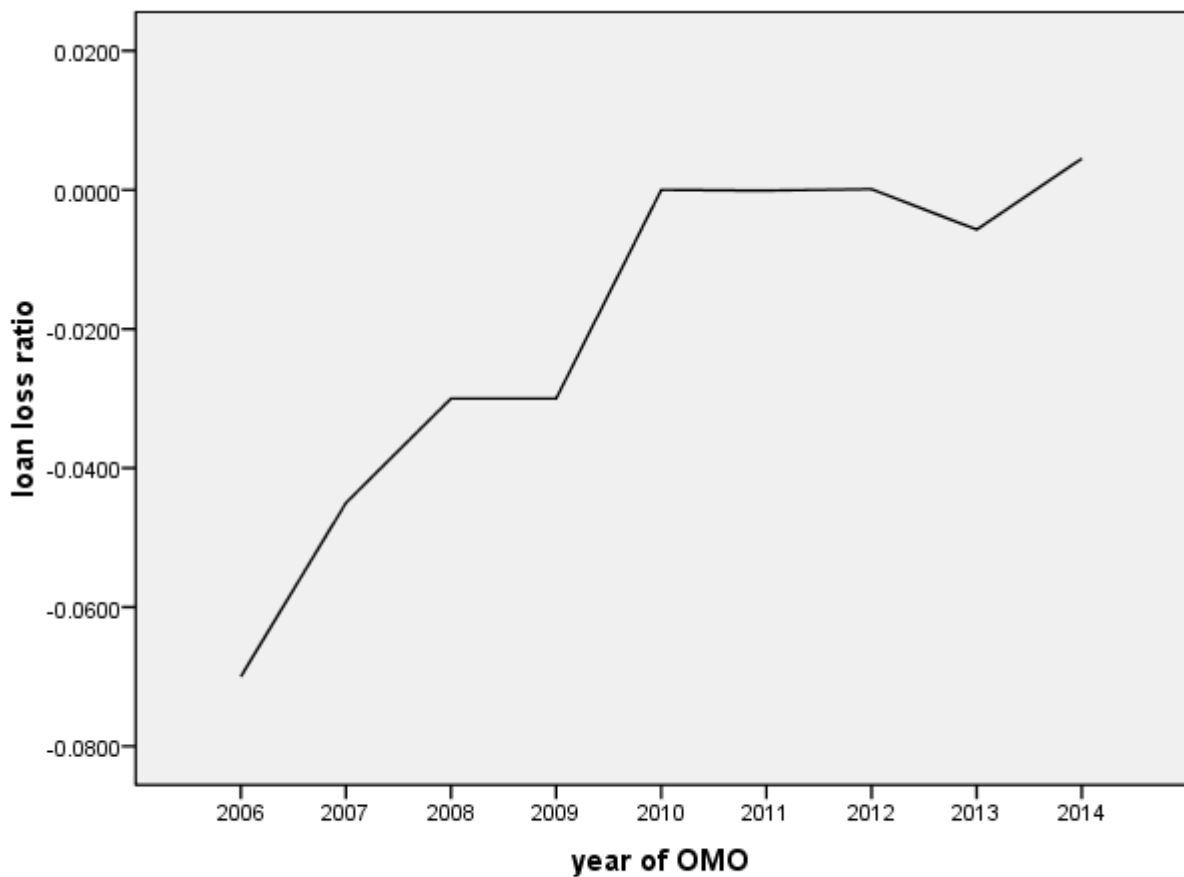
Source: association of Ethiopian micro finance institution year: year (2006-2014)

From The above graph it can be observed that the trend analysis of liquidity in terms of write off ratio, the trend shows increase in Liquidity .these institutions were better liquidity position in terms of write off ratio in recent years than later years.

4.1.3. Trend analysis of liquidity in terms of loan loss ratio in OMO MFIs

A loan loss provision is an expense that is reserved for defaulted loans or credits. It is an amount set aside in the event that the loan defaults.

A loan loss provision is an expense set aside as an allowance for uncollected loans and loan payments. This provision is used to cover a number of factors associated with potential loan losses, including bad loans, customer defaults, and re negotiated terms of a loan that incur lower than previously estimated payments.



Transforms: difference(1)

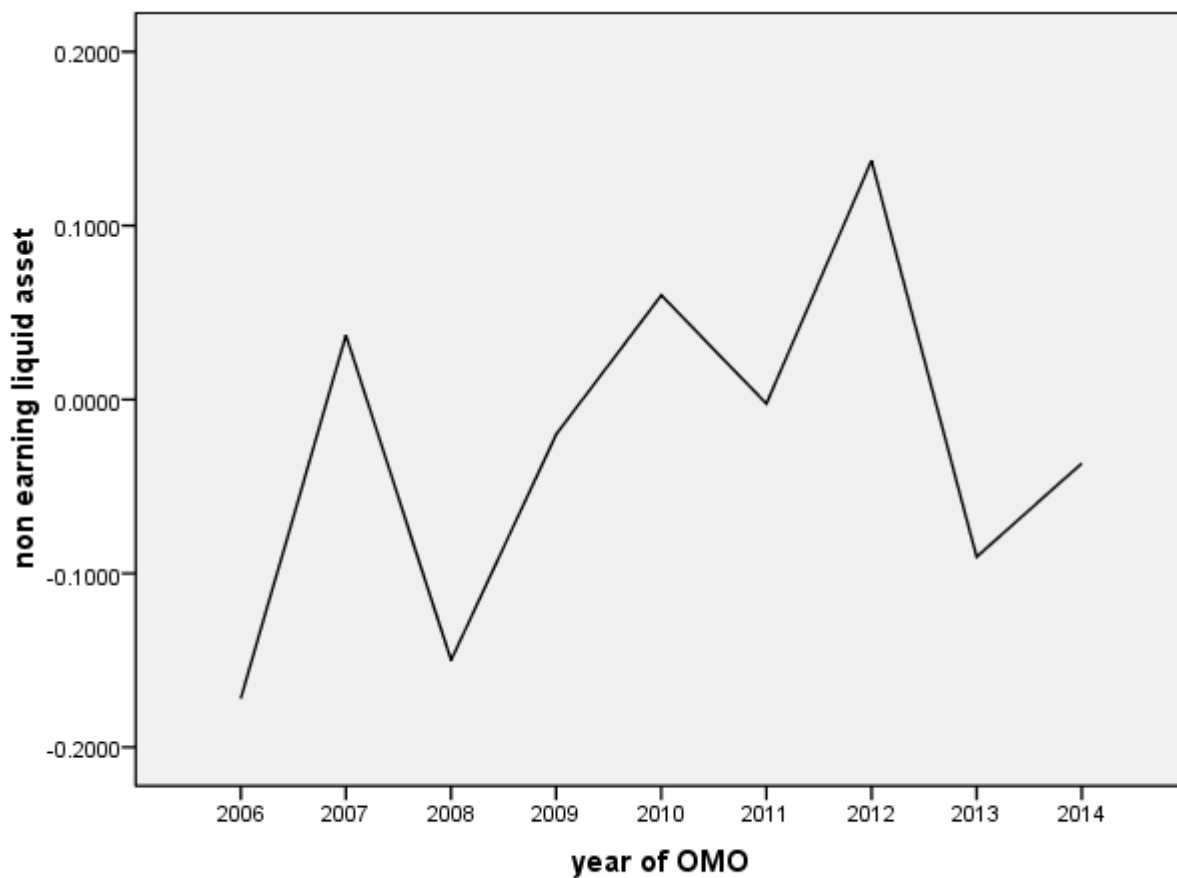
Source: association of Ethiopian micro finance institution year (2006-2014)

From The above graph it can be observed that tshe trend of liquidity in OMO MFIs in terms of loan las ratio, the trend shows increase in loan loass from -

0.08 to 0(2006_2010),steady or 0 from(2010_2012) ,decrease 0 to -0.01 in (2012_2013) and increase -0.01 to 0.005 in (2013 to 2014).These institutions were better in 2011 to 2012 because the institution loan loss is decreased in some amount than later but bad in (2013) , and the remaining year (2014) were agood liquidity position.

4.1.4. Trend analysis of liquidity in terms of non-earning liquid asset in OMO MFIs

Non-liquid assets are assets that can be difficult to liquidate quickly. Land and real estate investments are considered non-liquid assets because it can take months for a person or company to receive cash from the sale. In this case, trying to liquidate a real estate investment can have a high impact on its value.



Transforms: difference(1)

Source: associations of Ethiopian micro finance institutions (AEMFIs) year (2006-2014)

From the above graph it can be observed that non-earning liquid asset has increased the years from -0.1800 in the year 2006 to 0.04 in the year 2007, decrease 0.04 to -0.17 in (2007-2008), increase -0.17 to -0.002 in (2008-2009), increase -0.002 to 0.07 in (2009-2010), decrease 0.07 to -0.01 in (2010-2011), increase -0.01 to 0.14 in (2011-2012), decrease 0.14 to -0.11 in (2012-2013), increase -0.11 to -0.08 in (2013-2014). The graph showed a continues increase, decrease and increase in those years of 2006 to 2014 respectively so the institutions are a good position in only the year 2012 from non-earning liquid asset.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1. Conclusion

Based on the analysis made in Chapter four the following conclusions are made on the trend analysis of liquidity in OMO microfinance institutions.

Microfinance institutions, regardless of their social mission, are financial intermediaries. Therefore, it should be financially viable and sound to achieve its mission.

The trend of liquidity in terms of portfolio at risk >30 days were minimum up to some years but the liquidity risk are very high in the last three years those showed that the liquidity were very weak in recent years than the early years.

The trend of liquidity in the angle of write of ratio showed an increase from early to recent years by increasing rate and steady in the last five years those indicated that a good position in recent years than early years.

The trend in liquidity related to loan loss ratio showed there was an increase in the early four years, steady in the next three years and decrease and increase in the remaining years. Therefore we conclude that the OMO micro finance institution almost a well in the recent year than in the early years.

The trend of liquidity in terms of non-earning liquid asset increased in increasing rate ,decreased at increasing rate in the early two years and the next four years showed that increased and decreased respectively and in (2012-2013) indicated decreased at increasing rate and the last years(2013-2014) showed increased at decreasing rate. Generally the graph showed that non-earning liquid asset was not properly managed all over the year.

5.2. Recommendations

Based on the findings of the study the following recommendations are made by the researcher.

Even though the OMO MFIs liquidity were doing well in terms of write of ratio and loan loss ratio the institution should exert maximum effort to decrease threshold level in connection with operational and financial self-sufficiency to cover their costs, grow and sustain by their own.

Since liquidity in terms of loan loss ratio and write of ratio of the institution is almost negative, these institutions should work on it and move towards positive because this is the means to assure their survival in the market by their own, without the immense support of government and donors.

OMO MFIs should devise a means to obtain funds from diversified sources in order to minimize the risks associated with obtaining funds from few sources.

To provide repeat loans to clients, which is a major incentive to repay loans; to repay client deposits on time OMO microfinance institutions should maintain at least more than 50% liquidity ratio. Any financial institution that fails to repay client deposits on time is likely to lose client confidence and access to future funding. Hence, OMO micro finance institution should upgrade their liquidity level to win and get trust of customers to the desired level possibly by increasing their current assets.

Open market operation (OMO) micro finance institution should decrease their operating expenses in order to become more efficient through experience sharing with the most efficient counterparts and benchmarking themselves against best performers in the industry. OMO MFIs should reappraise themselves to ascertain whether they are reaching the poorer section of the society or not and act accordingly.

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