ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

ASSESSMENT OF LIQUIDITY RISK MANAGEMENT PRACTICE THE CASE STUDY OF LION INTERNATIONAL BANK SHARE COMPANY

BY

MILLION GIRMA

SGS/0085/2010B

MAY, 2020

ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

MAY, 2020.

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DECLARATION

I,Million Girma, the undersigned, here by to declare that the thesis entitled "LIQUIDITY RISK MANAGEMENT PRACTICE THE CASE STUDY OF LION INTERNATIONAL BANK SHARE COMPANY" and submitted in partial fulfillment of the requirements for the degree of Master of art in Accounting and Finance, declare that this thesis is my original work, comply with the Regulations of the University. All source of materials used for the thesis have been duly acknowledged. I further that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning degree.

Million Girma   _____

Name   Signature

St. Mary's University, Addis Ababa   May, 2020

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate studies with my approval as a university advisor.

Dejene Mamo (PHD)   _____

Advisor   Signature

Table of Contents

Acknowledgement

First, I thank God for giving me the strength to get through my studies and the challenges that come with it from beginning to end. I thank my wife for being there for me and supporting me all the way. I also would like to thank my fellow students and friends for making the journey much easier by standing together and overcoming many challenges with me. I want to extend my gratitude to LIB credit, finance, treasury and risk and compliance department staff who gave me valuable information. Finally, I want to thank my advisor Dejene Mamo(PHD) for his continued intellectual guidance and support in the entire process of preparing this thesis.

Thank you all very much and God bless you.

List of Tables

List of Graphs

List of Abbreviations and Acronyms

ALCO: Asset and Liability Committee

LIB: Lion International Bank

MBA: Master of Business administration

MIS: Management Information Services

NBE: National Bank of Ethiopia

SD: Standard Deviation

Abstract

The main purpose of this study is to assess the liquidity risk management practice of Lion international bank Share Company from the year 2016 to 2019 there are four fundamental research question were formulated that existence of standardize liquidity risk management strategy, the loan portfolio management practice, examine the source of the liquidity risk and the involvement NBE on the performance of LIB.

To conduct the study descriptive design method was employed. Purposive sampling technique was used in the selection of department in LIB Share Company. Thus, risk and compliance, credit, treasure and finance department employee who are directly related to the subject matter selected, the total number of 47 respondent participate to the sources of primary data for the study.

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. 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 Lion international banks 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 (Berehanu 2015).

1.3 Research question

So as to evaluate the liquidity risk management practice of Lion international bank Share Company the following research questions are formulated in order to conduct the study.

- ➢ Is there a uniform (standardized) liquidity risk management strategy practice for Lion international bank S.C?
- ➢ How does Lion international bank Share Company managing its loan portfolios?
- ➢ How could Lion international bank Share Company identify the source of liquidity risk?
- ➢ How could Lion international bank Share Company comply with NBE directive?

1.4 Objective of the study

1.4.1 General objective
- ➢ Analyze the liquidity risk management practice of Lion international bank Share Company.

1.4.2 Specific objective
- ➢ To evaluate the liquidity risk contingency plan and strategies of the bank.
- ➢ To examine Lion international bank Share Company loan portfolio management practice.
- ➢ To investigate the sources of liquidity risk in Lion international bank Share Company.

> ➤ To investigate Lion international banks Share Company comply with NBE directive.

1.5 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 stake holders.
>
> ➤ It might help the Lion international Share Company to know how effective they are liquidity risk management practice.

1.6 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 Lion international bank share company be analyzed and evaluate. The needs to focus on one company alone arise from the fact that Lion international Share Company has to work in competition environment.

1.7 Limitation of the study

Some of the challenges that will expect 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.

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

1.8 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 the statement of the problems and objective 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 on the basis of the research outcomes.

CHAPTER TWO

LITERARURE REVIEW

2.1 Introduction

This chapter reviews theoretical and empirical literature on liquidity risk management practice. Specifically it covered the theoretical review and empirical review in relation to the study variables. It addressed the research gap and conceptual framework. A summary of the literature review is also provided.

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 Venezuela (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 met 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 are 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.

Contagious bank failures can result from information externalities or explicit credit linkages between banks. Credit linkages between banks can arise from interbank risk sharing or from banks' participation in payment and settlement systems, and they cause banks' performances to be correlated even when "fundamentals" are independent across banks. Information contagion occurs when depositors perceive the

performance (fundamentals) of banks to be correlated with each other. Liquidity problems at one bank may also be transmitted to other banks through the market for bank assets. When a run occurs on a bank, the bank generally must sell its assets quickly, possibly at fair –sale prices, and/or borrow funds, possibly at higher interest rates. This can turn a liquidity problem into a solvency problem. The reduction in bank asset prices can adversely affect the value of other banks' assets to an extent that it creates liquidity problems for them. When banks hold claims on other banks, a run on one bank is likely to affect other banks directly as the affected bank with draws its interbank funding (Alexandra, 2002).

Diamond and Dybvig (1983) demonstrated that the characteristics of demand deposit contracts, combined with the maturity mismatch (in which a bank's potential repayment obligations exceed the value of its liquid assets) in banks' portfolios, create pay off externalities that are at the heart of the banking system's fragility.

Diamond and Rajan (2000, 2001) developed a theory of banking crisis based on non-commitment and liquidity creation that provides a useful role for the coordination failure that arises from deposit contracts. Their paper suggests that while deposit contracts can cause problems for the banking system in some states of the world, they exist to overcome another problem, that of limited commitment.

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:-

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 can 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 is influenced by numerous factors, including sales volume, unit-price, 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 hazard-based (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 non-performance 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 time 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 it's 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 real 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 time period, the bank will become unable to settle obligations with immediacy (Halling and Hayden, 2006). The vulnerability of banks to liquidity risk is determined by the funding risk and the market risk (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 study made on bank specific determinants of liquidity on English banks studied (Halling and Hayden, 2006), and assumed that, the liquidity ratio as a measure of the liquidity should be dependent on the following factors: bank profitability and loan growth had negatively correlated with liquidity while size of the bank is ambiguous. Liquidity created by Germany's state-owned savings banks and its determinants has been analyzed by (Hassan, et, al 2009). In the first step they attempted to measure the liquidity creation of all 457 state owned savings banks in Germany over the period 1997 to 2006 and they analyzed the influence of monetary policy on bank liquidity creation. To measure the monetary policy influence, the study developed a dynamic panel regression model. According to this study, the following factors determine bank liquidity: monetary policy interest rate, where tightening monetary policy expected to reduces bank liquidity, level of unemployment, which is connected with demand for loans having negative impact on liquidity, savings quota affect banks liquidity positively, size of the bank measured by total number of bank customers have negative impact, and bank profitability expected to reduce banks liquidity.

Naser, Mohammed and Ma'Someh(2013) aimed to examine the effect of liquidity risk on the profitability of commercial banks using of panel data related to commercial

banks of Iran during the years 2003 to 2010. In the estimated research model, two groups of bank-specific variables and macro-economic variables are used. The results of research show that the variables of bank's size, bank's asset, gross domestic product and inflation will cause to improve the profitability of banks while credit risk and liquidity risk will cause to weaken the performance of bank.

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.

Bank-specific and macroeconomic determinants of liquidity of English banks were studied by (Aspachs et al. 2005). The researchers used unconsolidated balance sheet

and profit and loss data, for a panel of 57 UK-resident banks, on a quarterly basis, over the period 1985Q1 to 2003Q4. They assumed that the liquidity ratio as a measure of the liquidity should be dependent on following factors: Probability of obtaining the support from LOLR, which should lower the incentive for holding liquid assets, interest margin as a measure of opportunity costs of holding liquid assets expected to have negative impact, bank profitability, which is according to finance theory negatively correlated with liquidity, loan growth, where higher loan growth signals increase in illiquid assets, size of the bank expected to have positive or negative impact, gross domestic product growth as an indicator of business cycle negatively correlated with bank liquidity, and short term interest rate, which should capture the monetary policy effect with expected negative impact on liquidity. The output of the regression analysis showed that probability of getting support from LOLR, interest margin, and loan growth have negative and significant effect on banks liquidity whereas, profitability and bank size had statistically insignificant impact on liquidity. Using a measure of support expectations based on the Fitch support rating, the researchers also found strong evidence of the existence of such an effect, which may point to a rationale for regulatory liquidity requirements as a quid pro quo for LOLR support.

In another study from Pakistan,Akter and Mahmud (2014) examines bank specific and macroeconomic determinants of commercial bank liquidity in Pakistan. Their study period covers from 2007 to 2011. They have used two models of liquidity. The first model L1 is based on cash and cash equivalents to total assets. The second model L2 is based on advances net of provisions to total assets. Their results suggest that, Non-Performing Loan (NPL) and Return on Equity (ROE) have a negative and significant effect with L1. Capital adequacy (CAP) and inflation (INF) are negatively and significantly correlated with L2, Additionally there is a significant and positive impact of financial crisis on the liquidity of commercial banks. The central bank regulations greatly affect the liquidity of commercial banks which means tight monetary policy can regulate the undesirable effect of inflation on liquidity.Abera, (2012) studied Factors Affecting Profitability on Ethiopian Banking Industry. This study examined

the bank-specific, industry-specific and macro-economic factors affecting bank profitability for a total of eight commercial banks in Ethiopia, covering the period of 2000-2011 using a mixed methods research approach by combining documentary analysis and in-depth interviews.

The result of the interview revealed that the liquidity of banks was one of the major determinants of Ethiopian banks profitability. But, the output of the regression analysis and the interview were in agreement in relation to the direction of the effect of liquidity as far as both of them proved the existence of negative or inverse relationship between liquidity 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 of Lion international bank Share Company. 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) and also Tseganesh (2012) focused on the impact of bank liquidity on financial performance through the significant factors

affecting liquidity using the traditional measurement of ROA and ROE. 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 also indicates future profitability. But the study still didn't focuses in identifying specifically the determinants of liquidity risk relating with several factors.

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 frame work based on taxonomy of liquidity risk model.

The models 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 may 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). This definition of liquidity risk illustrates its two basic types, which are funding risk and market liquidity risk.

Fig 2.1 Conceptual Framework of the study

Internal	•Bank liquidity risk management strategy •Loan portifolio management •Bank size •None performing loan

External	•Interest rate •Monetary policy of the country •NBE directive •Fisical policy of the country •Deposit
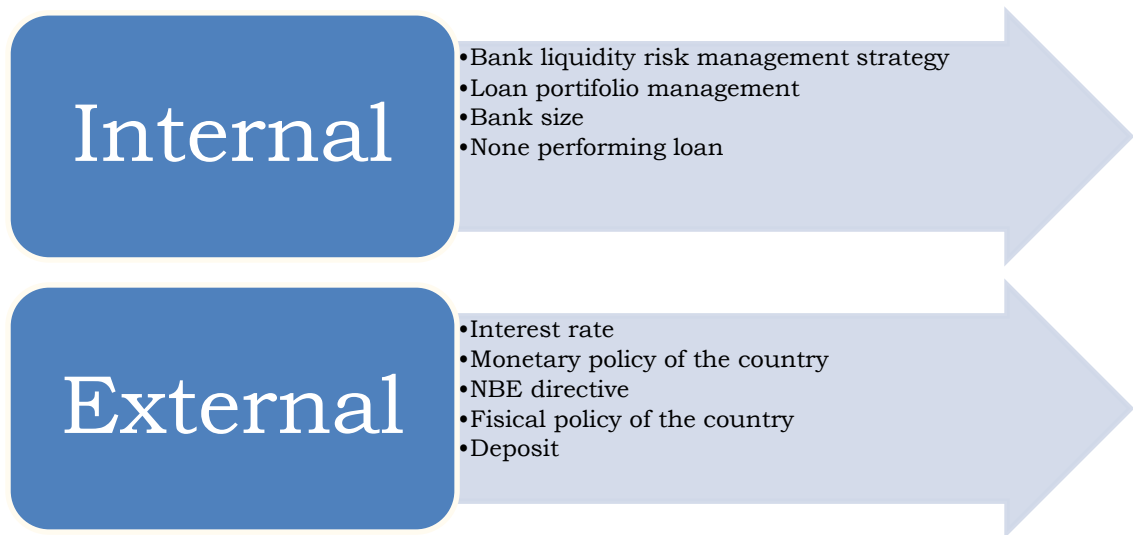
CHAPTER THREE

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). Various authors recommended the use of descriptive design (Orodho, 2004).This involved collection of information by administering questionnaires and interviewing a sample of individuals. Accordingly, the researcher adopted the descriptive research design aiming to receive in depth information in order to assess liquidity risk management practice of Lion international bank Share Company. 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

Lion international bank Share Company is a private owned Share Company, established on October 02, 2006 in according with proclamation 84/924 and the commercial code of Ethiopia. The bank commenced operation on January 6, 2007 with 3 (three) branches.

3.4Population, sample size and sampling technique

The total population of the study used 349 head office employees working in Lion international bank Share Company. 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 use judgmental

(purposive) sampling technique for the study. Because, it will 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. Thus, the sample size will be 67 of total population selected by non-probability judgmental sampling method (Bartlett,Kotrlik,&Higgins2001).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 finance and other concerned department 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, interview, and focus group discussion.

3.5.2 Secondary Data

Secondary data are those collected by someone else and have already been passed through the statistical process for this study the secondary data were also obtained from various departments on liquidity risk management practice of Lion international bank Share Company. 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. Both qualitative and quantitative dada analysis techniques were employed in this study. To analyze and interpret the data gained from questionnaires, a quantitative technique involving percentages was used. Moreover, the data obtained from annual reports of the company considered in this study was analyzed using percentages, ratios, graphs and interpreted quantitatively. 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 LIB that directly related to the study i.e. Treasury department, finance department, credit and risk and compliance management department.

4.2 General Characteristics of Respondents

From those departments selected 67questioners distributed according to the number of employees related to the study. Out of 67 questioners 47 returned. So, the analysis is presented according to the data gathered from the employee of LIB which they are working in different level of management and expert level.

Table 1: personal profile

NO	Question	Frequency	Percentage
1	Gender		
	Male	40	85.1
	Female	7	14.9
	Total	47	100
2	Education Background		
	Diploma	1	2.13
	First degree	26	55.32
	First degree and professional qualification such as ACCA		
	Second degree in finance or related field		
	Second degree in Non-finance field	20	42.55
	Total	47	100

The personal profile of the respondents indicated from the above table 85.1% of the respondent are male and the rest 14.9% are female. Furthermore 2.13% are diploma holder 55.32% are holder of first degree and 42.55 have second degree in finance and related field. From this, most of the respondents are male and more than 97% of the respondents are first and second degree holder in finance and related fields.

4.3 The Results for the Secondary Data

The secondary data was 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.

This summary incorporates data on liquid assets, current liability and liquidity requirement. The results are summarized in the following chart.
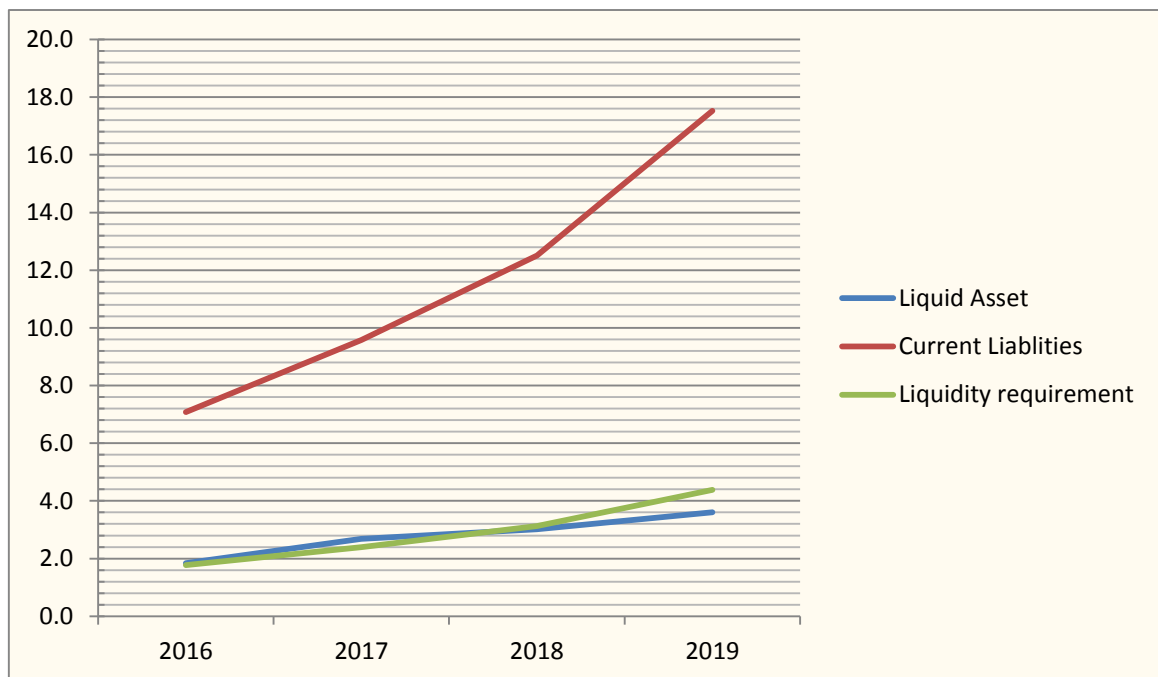
Note. Amount in Billion

The liquidity requirement set by the National Bank of Ethiopia dictated that all banks should maintain a bucket of liquid assets equivalent to at least 25% of their current

liabilities. In the above figure the liquidity requirement graph shows the 25% of the total current liabilities of LIB at a given point of time, hence, the minimum required amount of liquid assets. For the period under consideration LIB maintains enough liquid assets for the 2016 and 2017 years and meet liquidity requirement of the supervisory organ however, the last two years in 2018 and 2019 fiscal year LIB fail to meet the required level.

The trend of the movement of the two important variables is similar throughout the period under review. The stock of liquid assets in each period is barely above the required level and it shows that it is vulnerable for huge shocks. The period 2018 and 2019 was the real low points where the levels of liquid assets fall below the required liquidity level.

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.

4.4.1To assess the liquidity risk management strategy practice of Lion international bank S.C

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 LIB. 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 practice.

Table 2: Liquidity risk management strategy, policy, procedure and framework of the bank

No	Item	N	Mean	Standard Deviation
1	The risk and compliance management subcommittee of the board of director oversee the implementation of risk management policy.	349	3.68	0.74
2	The company boards of director properly understand the nature of the bank liquidity and assigning responsibility to different level for managing liquidity risk.	349	3.45	0.86
3	The senior management of the company Evaluating the design and implementation of an appropriate liquidity risk management system and standards, liquidity risk reporting and monitoring process.	349	3.53	0.82
4	The Asset and Liabilities committee (ALCO) properly Facilitating, coordinating, communicating and controlling balance sheet plan regarding risks inherent in managing liquidity.	349	3.68	0.8
5	The bank constantly improves its risk management framework.	349	3.64	0.9
Average			3.6	0.82

In response for question one which states that the risk and compliance management subcommittee of the board of director oversee the implementation of risk management policy, a mean score of 3.68 and small variation between the respondent which is a standard deviation of 0.74.The scale of 1 to 5 1 being the scale for strong disagreement and 5 for strong agreement. This shows that on average the respondents fairly agree the risk and compliance subcommittee oversee the implementation of risk management policy. In response for question two towards the BOD properly understand the nature of risk, the result shows that a mean score of 3.45 and standard

deviation of 0.86 which means most of the respondent are neutral the BOD properly understand the nature of risk.

The third question is LIB has a formal contingency funding plan that clearly sets out strategy for addressing liquidity shortfall in emergency situation. And the result 21.3% strongly agree, 44.7% agree, 23.4% natural 8.5% disagree and 2.1% strongly disagree with the statement. More than 65% of the respondent agreed that LIB has a strategy for addressing liquidity shortfall in emergency situation a mean score and standard deviation of 3.53 and 0.82 respectively.

The 4th question The Asset and Liabilities committee (ALCO) properly Facilitating, coordinating, communicating and controlling balance sheet plan regarding risks inherent in managing liquidity, 19.1% strongly agree, 46.8 % agree, 21.3% neutral, 8.5 disagree and 4.3 strongly disagree in addition a mean and standard deviation score of 3.68 and 0.8 respectively.

As shown in the above table, question no 5 says, LIB has established a robust liquidity risk management framework that insures sufficient liquidity. With this statement the mean score of 3.64 and 0.9 standard deviation which shows relatively a significant variation between the respondent abut LIB has established a robust liquidity risk management framework that insures sufficient liquidity.

The overall result for liquidity management strategy, policy, procedure and frame work LIB an average mean square of 3.6 which is approximate to (4), thus implies the respondent agree that the bank formulates strategy to manage liquidity risk.

4.4.2 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 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.

Table3: Information about loan approval and portfolios management practice of Lion international bank Share Company.

No	Item	N	Mean	Standard Deviation
1	The loan portfolio of the bank is distributed across all sector of the economy.	349	3.34	0.94
2	The bank identify with due care and diligent the payment capacity of the newly credit applicant customer before loan approval.	349	3.34	0.93
3	The bank adjusts the loan interest rate parallel to its cost of capital.	349	3.34	0.94
4	The loan recovery management of the company is to prevent the bank from possible loan loss when the loan repayment of business performance of the company deteriorated.	349	3.43	0.84
5	Does the overall investment portfolio management practice of Lion international bank Share Company are economical, efficient and effective.	349	3.29	0.89
Average			3.35	0.89

In response for question one which states that the loan portfolio of the bank is distributed across all sector of the economy, a mean score of 3.34 and SD 0.94 relatively a significant variation between the respondent. This shows that the respondent approximate to (3) which means neutral 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, a mean score of 3.34 and SD 0.93 which is approximate to the (3) neutral. 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 a mean and standard deviation of 3.34 and 0.94respectively. This shows that the respondent approximate to (3) which means neutral about the loan interest rate and other bank charge.

The 4th question The loan recovery management of the company is to prevent the bank from possible loan loss when the loan repayment of business performance of the company deteriorated, 10.6 % strongly agree, 47.7 % agree, 29.8% neutral, 6.4 disagree and 8.5 strongly disagree in addition a mean and standard deviation score of 3.43 and 0.84 respectively.

As shown in the above table, question no 5 says, overall investment portfolio management practice of Lion international bank Share Company are economical, efficient and effective. With this statement the mean score and standard deviation are 3.35 and 0.89 respectively. It shows approximately (3) which means the respondent neutral about investment portfolio management practice of Lion international bank Share Company are economical, efficient and effective.

The overall result for loan approval and portfolio management of LIB is an average mean square 3.35 which is approximate to (3), thus implies that deteriorates the quality asset of the bank and easily affected by stand-alone risk because around 60% of the loan portfolio concentrated import and export sector.

4.4.3 Information about liquidity risk management process of Lion international bank Share Company.

In the process of providing financial services, commercial banks assume different kinds of risks. Hence, cash flow forecasting is performed by the bank concerned department monitor rolling forecast of liquidity requirement to insure it has sufficient

cash to meet regulatory and operation needs. The bank has incurred indebtedness in the form of borrowing. The bank evaluates its ability to meet its obligation on ongoing basis. Based on this evaluation, the bank devises strategy to manage its liquidity risk.

Prudent liquidity risk management implies that sufficient cash is maintain and that sufficient fund is available to meet its liabilities when due, under both normal and stressed condition, without incurring unacceptable losses or risk.

Table 4: *Liquidity risk management process of Lion international bank Share Company.*

No	Item	N	Mean	Standard Deviation
1	The policy clearly establishes the purpose, objectives and goals of liquidity management.	349	3.79	0.78
2	A bank has a sound process for identifying, measuring, monitoring &Controlling liquidity risk.	349	3.78	0.69
3	*Does the bank measure liquidity position by considering* Loan/deposit ratio, Liquid asset/deposit ratio, Liquid asset/total asset ratio and Depositor concentration ratios.	349	3.93	0.61
4	The bank identifies liquidity risk by maturity mismatch analysis of assets and liabilities, cash flow projection and use of liquidity indicator.	349	3.53	0.86
5	The bank monitors the liquidity risk by having adequate internal control and use of suitable management information system (MIS).	349	3.46	0.87
6	The bank control liquidity risk by audit check and internal control mechanism.	349	3.44	0.69
7	The bank set limits to control its liquidity risk	349	3.64	0.75

	exposure and vulnerabilities.			
8	Funding concentrated in Relatively few sources.	349	3.74	0.88
9	There are adequate alternative plans for emergency occur in shortage of liquidity and efficiently and effectively utilize when excess liquidity occur.	349	3.63	0.78
10	The bank has experienced professionals and good interbank relationship to control liquidity risk.	349	3.68	0.72
11	LIB has the potential to recover in a short period of time if faced with liquidity shortage.	349	3.51	0.83
Average			3.65	0.77

The above table shows that question asked to assess liquidity risk management process of Lion international bank Share Company. The first question says the policy clearly establishes the purpose, objectives and goals of liquidity risk management*, the result shows 23.4% strongly agree,48.9% agree, 14.9% natural, 8.5% disagree and 4.3 strongly disagree and 3.65 mean with 0.78 standard deviation. From this we can conclude that the bank policy* clearly establishes the purpose, objectives and goals of liquidity risk management.

The second question is the bank has a sound process for identifying, measuring, monitoring & controlling liquidity. Although more than half of the respondents agreed that there a sound process for identifying, measuring, monitoring & controlling liquidity, there are many who have their doubts. While 8.6% of them disagreed with the statement the other 19.1% gave a neutral response to it.

The third question *does the bank measure liquidity position by considering* Loan/deposit ratio, Liquid asset/deposit ratio, Liquid asset/total asset ratio and depositor concentration ratio. Although more than half of the respondents agreed that

the bank measure liquidity position by considering the indicator, there are many who have their doubts. While 6.3% of them disagreed with the statement the other 12.7% gave a neutral response to it.

The fourth question focuses on LIB regularly measures its capacity to raise funds quickly from each source and it identifies the main factor that affect its ability to raise funds and monitors them closely. The results for this statement show that more than half of the respondents agreed that the bank rise funds quickly from each source funds, there are many who have their doubts. While 17% of them disagreed with the statement the other 23.4% gave a neutral response to it.

The fifth question the bank monitors the liquidity risk by having adequate internal control and use of suitable management information system (MIS); the result shows that a mean and standard deviation of 3.46 and 0.86 respectively. This shows that the respondent approximate to (3) which means neutral about banks monitor liquidity risk by using technological product.

The seven question focus on the bank set limits to control its liquidity risk exposure and vulnerabilities. The results for this statement show that more than half of the respondents agreed that the bank rise funds quickly from each source funds, there are many who have their doubts. While 10.6 % of them disagreed with the statement the other 25.5% gave a neutral response to it.

The question number eight focus on LIB conducts stress test on a regular basis to identify source of potential liquidity strain. In this context 60% agreed that LIB regularly undertakes stress tests. By conducting regular stress tests LIB can decrease the threat of liquidity risks by identifying the potential sources of this problem. *When we look to the tenth question, the* bank has experienced professionals and good interbank relationship to control liquidity risk, the result shows that a mean and standard deviation of 3.68 and 0.72 respectively. This shows that the respondent approximate to (4) which means the respondent agree about the bank has professionals and good interbank relationship to control liquidity risk.

The final question focus on the bank has a potential to recover in a short period of time if faced with liquidity shortage, 12.8% strongly agree, 46.8 % agree, 23.4% neutral, 12.8 disagree and 4.2 strongly disagree in addition a mean and standard deviation score of 3.51 and 0.83 respectively.

The overall result for *liquidity risk management process of Lion international bank Share Company* is an average mean square 3.65 which is approximate to (4), thus implies that respondent agree with risk management process of the LIB.

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. But the extent to which Lion international banks extend credits is restricted by the directives issued by the NBE on liquidity, and reserve requirement.

Table 5: the involvement of national bank of Ethiopia

No	Item	N	Mean	Standard Deviation
1	*As a regulatory the NBE decision like monetary, fiscal and exchange rate policies positively support the performance Lion international bank Share Company.*	349	3.71	0.73
2	The current status of the bank meet the requirement of NBE regarding liquidity is as expected.	349	3.5	0.86
3	The NBE support banks when their operation is tight liquidity environment.	349	3.75	0.76

4	The current status of the bank meet the requirement of NBE regarding liquidity is as expected.	349	3.68	0.74
5	The overall intervention of NBE is adequate and supportive.	349	3.68	0.85
Average			3.66	0.79

In response for question one which states that *as a regulatory the NBE decision like monetary and exchange rate policies positively support the performance Lion international bank Share Company*. The result shows a mean score of 3.71. This shows that more than the average respondents fairly agree that *the NBE decision like monetary and exchange rate policies positively support the performance Lion international bank Share Company*.

The response for question number two towards the current status of the bank meet the requirement of NBE regarding liquidity is as expected. Although more than half of the respondents agreed that the bank meet the requirement of NBE regarding liquidity is as expected. While 12.7% of them disagreed with the statement the other 31.9 % gave a neutral response to it.

NBE support banks when their operation is a tight liquidity environment third question. According to the result of this statement all employees with 66% of the respondents giving it a score of 4 and 5, where 44.7 % of them agreeing and 21.3 % of them agreeing strongly.

As for question four towards the current status of the bank meet the requirement of NBE regarding liquidity is as expected, the result shows that there is an above average score. Although more than half of the respondents agreed that the bank meet the requirement of NBE, there are many who have their doubts. While 10.8% of them disagreed with the statement the other 21.2% gave a neutral response to it

In response for question five which states that the overall intervention of NBE adequate and supportive, a mean score of 3.68. This shows that more than average the respondents fairly agree that the overall intervention of NBE adequate and supportive.

The overall result for the risk the involvement of NBE mean score of 3.66 which is approximated to an agreeable level (4). This implies that the involvement of the supervisory bank is adequate and excessive.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter presents the summarized form of the findings of this research and based on that conclusion and recommendations are presented. The conclusions are based on the research questions that were stated in the first chapter. These conclusions have led the researcher to present his recommendations in order to have a sound liquidity risk management.

5.2 Summary of Findings and Conclusions

To begin with, the general objectives this research paper started to accomplish were to show the Analyze the liquidity risk management practice of Lion international bank Share Company and to check whether these practices were in accordance with international principles for liquidity risk management and the supervisory organ.

The specific objective of this paper intended to answer are:

➢ To evaluate the liquidity risk contingency plan and strategies of the bank.

➢ To examine Lion international bank Share Company loan portfolio management practice.

➢ To investigate the sources of liquidity risk in Lion international bank Share Company.

➢ To investigate Lion international banks Share Company comply with NBE directive.

In this research it is found that the liquidity risks that LIB is facing are increasing over time. This is the result of increasing expansion and growth of the bank. The year under review is characterized by declining the liquidity position of the bank as a measured by liquidity ratio. It was computed 20.6% in 2019 and 24.1% in 2018 which is below the preceding year 2017, and 2016 28% and 25.9 respectively and the requirement level of the supervisory organ 25%.

The board of the director of the company has the overall responsibility for the development of the risk management strategy and implementation principle, frameworks, policies and limit. It is also responsible for managing risk decisions and monitoring risk levels. The board of director risk management subcommittee to insure that the procedures are compliant with the overall framework and periodically reviews the internal audit and risk management reports and regularly oversees senior managements action to insure the policies , procedures and system are functioning effectively at all decision level.

The bank treasury department is responsible for managing the bank financial asset, financial liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risk of the bank.

Regarding the loan portfolio management of Lion international bank Share Company, the overall study indicate that the bank lending composition 40.1% the loan avail for export, 18.8 for import trade and the rest avail for DTS, building and construction, manufacturing and production, hotel and tourism , consumer loan, transportation and agriculture. The export and import took the largest share 60% of loan and advance of the total loan portfolio, which is labeled as high risk categories.

The study also indicate that the bank refrain to adjust its interest rate parallel to the bank cost of capital specially when the average cost of capital of the bank reduce, which is affect the repayment capacity of the borrower. The overall LIB loan approval focuses on the collateral value of the borrower instead of know your customer principle and ensure full repayment capacity of the borrower.

The overall risk management process LIB prepared monthly risk assessment report to the board risk and compliance management subcommittee of the board of the director. The report includes the liquidity position of the bank, the expansion on credit exposure, stress test on liquidity risk, interest rate risk and foreign exchange. Lion international bank Share Company face different problem to manage liquidity risk. These are absence of organized money market and well developed interbank borrowing system in the banking industry and management information system.

The National bank of Ethiopia is the central bank of the country issue directive regarding liquidity and reserve requirement. NBE control commercial banks operating in Ethiopia using its directive and other special message sent to the bank. To manage inflation and reduce the amounts of money circulate in the economy. The NBE orders the banks not give credit which may affect the bank performance. The interface of NBE through directive and message is important for smooth functioning of each bank and industry at a large. Even through some directive of NBE is adversely affect the private investment; escalation the average costs of capital of the private banks and the overall lending interest rate which is affect the repayment capacity of the borrower and the liquidity position of the bank.

In the process of managing the present and future liquidity risks there are some challenges that the bank is likely to face. The most prominent and serious challenge is the inability to fund its increasing asset and deterioration of asset quality. This is the result of the above mentioned excessive growth and ever increasing commitments. On top of this, the increasing competition in the deposit market leads to exhaustion of funding sources that would enable LIB meet its huge commitments. If this continues, the bank will not be able to match the ever increasing demand of the customers for credit and other resources.

The boards of the director of the bank approve the risk management framework, policies, procedure and the board established risk and compliance management subcommittee, even though the board still not properly understand the nature of the risk due to unorganized management information system and internal controlling mechanism.

5.3 Recommendations

Based on the findings and conclusion of this research, the following recommendations are forwarded by the researcher in order for LIB to practice a robust, resilient and sound liquidity risk management system. These recommendations are provided based on the information that was availed to the researcher and the results found by analyzing those data.

- The bank should maintain consistent buffer liquidity well above the minimum required liquidity to be able to absorb and withstand market shocks better by designing good strategy to mobilize sustainable deposit, properly collect the loan disbursement as per payment schedule and invest its excess in money market instrument like treasury bill.

- Banks invest its short term source of finance into long term asset. However, 60% LIB loan portfolio avail for export and import. Hence 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. Diversification of the uses of funds is also an important issue in the banking industry.

- The bank should be continuously adjust 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.

- Absence of management information system and internal controlling mechanism is the other problem in the LIB 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 LIB to determine the day-to-day liquidity position of the bank and to check the compliance with the bank's established policies, procedures and limits and the requirements of NBE.

- To be resolve the current liquidity crunch and availability of loan for borrower the central bank should be pay back the 27% of the loan disbursement sold bond for the private bank. The central bank also established a federal fund in order to banks borrow each other to fulfilled the reserve requirement and interbank transaction settlement.

➢ 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.

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Annex

ST. MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIESMBA IN ACCOUNTING AND FINANCE

Dear Respondent:

This is an endeavor to collect information about the liquidity risk management practice of Lion international bank Share Company. I intend to look into liquidity risk management practice of Lion international bank Share Company. Such exercise is believed to have a positive contribution to both academic delivery and the practical for the company. 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 cooperation to fill in andcomplete the questionnaire.

Million Girma , MBA Candidate (ST Mary 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-please

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 policy, procedure, framework and liquidity risk management structure.

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

No	Item	1	2	3	4	5
1	The risk and compliance management subcommittee of the board of director oversee the implementation of risk management policy.					
2	The company boards of director properly understand the nature of the bank liquidity and assigning responsibility to different level for managing liquidity risk.					
3	The senior management of the company Evaluating the design and implementation of an appropriate liquidity risk management system and standards, liquidity risk reporting and monitoring process.					
4	The Asset and Liabilities committee (ALCO) properly Facilitating, coordinating, communicating and controlling balance sheet plan regarding risks inherent in managing liquidity.					
5	The bank constantly improves its risk management framework.					

Section III: Information about loan approval and portfolios management practice of Lion international bank Share Company.

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	The loan recovery management of the company is to prevent the bank from possible loan loss when the loan repayment of business performance of the company deteriorated.					
5	Does the overall investment portfolio management practice of Lion international bank Share Company are economical, efficient and effective.					

Section IV: Information about liquidity risk management process of Lion international bankShare Company.

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

No	Item	1	2	3	4	5
1	The policy clearly establishes the purpose, objectives and goals of liquidity management.					
2	A bank has a sound process for identifying, measuring, monitoring &Controlling liquidity risk.					
3	*Does the bank measure liquidity position by considering* Loan/deposit ratio, Liquid asset/deposit ratio, Liquid asset/total asset ratio and Depositor concentration ratios.					
4	The bank identifies liquidity risk by maturity mismatch analysis of assets and liabilities, cash flow projection and use of liquidity indicator.					

No	Item	1	2	3	4	5
5	The bank monitors the liquidity risk by having adequate internal control and use of suitable management information system (MIS).					
6	The bank control liquidity risk by audit check and internal control mechanism.					
7	The bank set limits to control its liquidity risk exposure and vulnerabilities.					
8	Funding concentrated in Relatively few sources					
9	There are adequate alternative plans for emergency occur in shortage of liquidity and efficiently and effectively utilize when excess liquidity occur.					
10	The bank has experienced professionals and good interbank relationship to control liquidity risk.					
11	LIB has the potential to recover in a short period of time if faced with liquidity shortage.					

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 Lion international bank Share Company.*					
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 current status of the bank meet the requirement of NBE regarding liquidity is as expected.					
5	The overall intervention of NBE is adequate and supportive.					

If you have any additional comment, please write

_____

Thank you