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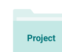
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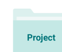
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EFFECT OF LIQUIDITY MANAGEMENT ON FINANCIAL PERFOMANCE OF COMMERCIAL BANKS IN MOGADISHU, SOMALIA

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ABSTRACT: *The purpose of the study was to conduct a survey of Liquidity management factors affecting in financial performance of the commercial banks in Mogadishu, Somalia. The study design was used is descriptive survey, the target population of the study was 112 employees of commercial banks in Mogadishu. A sample size of 87 respondents was selected using Slog van's formula. Data collection methods used included questionnaire. The selection sample technique was purposive or judgmental approach. Data was analyzed using SPSS version. The key findings were that liquidity management drivers individually had a positive influence on the financial performance of commercial banks in Mogadishu-Somalia. The overall results indicated that there was a significant linear relationship between account receivable management, account payable and cash management on financial performance of commercial banks in Mogadishu. The conclusions were based on the objectives of the study that liquidity management drivers had a significant influence on financial performance of commercial banks. The results established that liquidity management drivers were found to significantly and positively influence financial performance of commercial banks in Mogadishu, Somalia. The study results support the view that liquidity management drivers have a significant effect on financial performance. It is recommended that managers should study and select the driver that best suits their banks in order to achieve maximum performance.*

Keywords: Liquidity Management, Account receivable, Account payable, Cash Management and Financial performance

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INTRODUCTION

Background of the Study

The study sought to assess effects of liquidity management on financial performance of commercial banks in Mogadishu, Somalia. Bank is very old institution that is contributing toward the development of any economy and it's treated as an important service industry in modern world. Nowadays the function of bank is not limited to with the same geographical limit of any country. It is an important source of financing for most businesses. The common assumption, which underpins much of the financial performance research and discussions, is that increasing financial performance will lead to improved functions and activities of the organization (Liargovas & et al, 2008). The financial performance of companies are globally as subject that have attracted a lot of attention, comments and interests from both financial experts, researchers, the generally including public and the private management of banks entities. The Financial performance of a firm can be analyzed in terms of profitability, dividend growth, sales turnover, and return on investments among others. However, there is still debate among several disciplines regarding how the performance of firms should be measured and the factors that affect financial performance of companies (Liargovas & et al, 2008). Liquidity is very closely related to working capital which is the money needed to finance the daily revenue generating activities of the firm. According to Vahid and et al, (2012) working capital management plays a significant role in determining success or failure of firm in business performance due to its effect on firm's profitability. Business success depends heavily on the ability of financial managers to effectively manage the components of working capital (Filbeck & et al, 2005).

A firm may adopt an aggressive or a conservative working capital management policy to achieve this goal. According to Begg, and et al, (1991) liquidity refers to the speed and certainty with

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which an asset can be converted back into money (cash, income) whenever the asset holder desires. Cash is the most liquid asset of all. In terms of accounting, liquidity can be defined as the ability of current assets to meet current liabilities (working capital). In terms of investment, it is the ability to quickly convert an investment portfolio to cash with little or no loss in value. A liquid company is one that stores enough liquid assets and cash together with the ability to raise funds quickly from other source to enable it meet its payment obligation and financial commitment in a timely manner. Various ratios are used to measure liquidity. These include: the current ratio, which is the simplest measure and is calculated by dividing total current assets by total current liabilities; and the quick ratio, calculated by deducting inventories from current assets and then dividing by current liabilities. Although the two ratios are similar, the quick ratio provides a more accurate assessment of a business's ability to pay its current liabilities. The quick ratio cuts out all but the most liquid of current assets. Inventory is the most notable omission, because it is not as speedily convertible to cash. The quick ratio is a reasonable marker of a business's short term liquidity. The higher quick ratio is the better the position of the business Begg, and et al, (1991).

Statement of the Problem

Liquidity management has a significant positive effect on financial performance. Bank companies under going to achieve their goals have to consider to the liquidity management. Liquidity is the ability of the business to meet its cash obligations within a specific period. For instant liquidity is best measured with cash flow statements or budgets.

Liquidity management plays a significant role in determining success or failure of firm in business performance due to its effect on firm's financial profitability (Eljelly, 2004).

In Somalia, the commercial banks are faced challenges of financial performance. This is seen in the fact that the firms have problems with financial performance they may defer their payments to creditors which is a harmful for companies and can result in several consequences such as worse credit terms in the future. This in the long run adversely affects profitability. When working capital is the money needed to finance the daily revenue generating activities of the firm. So, if this continues will cause the a number of problems to not only the firm who depend so much on this liquidity management, but also the various stakeholders in the banking industry. It was evident that research in the area of Liquidity management has not been done in a more comprehensive approach. The study research gap is demonstrated by the scarcity of empirical studies on determinants of liquidity management. Empirical studies (Nwakaego, 2014), and (Lawrence, 2013)zir and Afza (2009)), were inadequate as they concentrated on liquidity management other industries in Small and Medium Enterprise. Banks to remain competitive emphasis should be made on liquidity management and profitability with regards to how their ability to manage financial performance and should be provided to the organizational achievement. This study will focus on the Effect liquidity management on financial performance of Commercial Banks in Mogadishu, Somalia.

Specific Objectives of the Study

i. To find out the effects of Account receivable on financial performance of Commercial banks in Mogadishu, Somalia.

ii. To establish the effects of Account payable on financial performance of Commercial banks in Mogadishu, Somalia.

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iii. To determine the effects of Cash management on financial performance of Commercial banks in Mogadishu, Somalia.

Conceptual Framework

Conceptual framework is a scheme of variables which the study operationalizes in order to achieve the set objectives. A variable being the measurable characteristic that assumes different values among the subjects, independent variables are the ones that the study manipulates in order to determine their effects on another variable. The dependent variable attempts to indicate the total influence arising from the effects of the independent variables. It therefore varies as a function of the independent variables (Mugenda & Mugenda, 2003)

Independent variable, according to Nachmias & Nachmias (2009) is the presumed cause of changes in the values of the dependent variable; the dependent variable is expected to be influenced by the independent variable. This is illustrated in figure 2.1 below. The independent variables in this study are account receivable , account payable, and cash management how they affect financial performance of commercial banks in Somalia.

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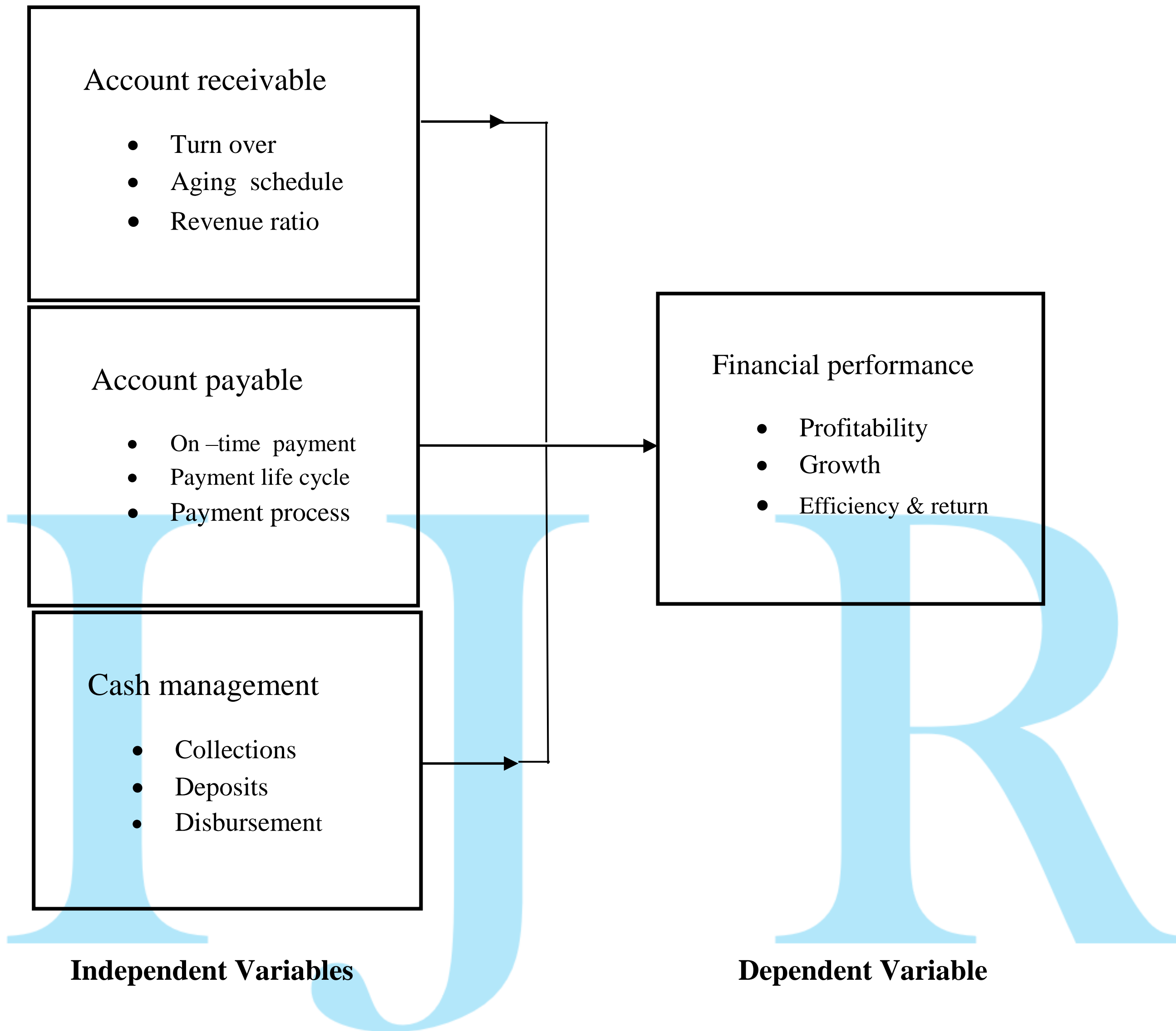

Figure 2.1: Conceptual Framework

Account Receivable Management

According to Robert (2001), accounts receivables are amounts owed to the business enterprise, usually by its customers. Managing accounts receivables involves five steps: determining to whom to extend credit, establishing a payment period, monitoring collections, evaluating the liquidity of receivables accelerating, and eventually cash receipts from accounts receivables

holders. A critical part of managing accounts receivables is determining to whom credit should be extended and to whom it should not. Many companies increase sales by being generous with their credit policy, but they may end up extending credit to risky customers who do not pay.

If the credit policy is too tight, sales will be lost. Particularly risky customers might be required to pay cash on delivery. In addition, companies should ask potential customers for references from banks and suppliers, to determine their payment history. It is important to check these references on potential new customers as well as periodically check the financial health of continuing customers (McKesson, 2011).Account receivable represents the average days that firm takes to collect payment from its customers (falope and Ayilore, 2009 and shams and Kumar, 2011). Excessive level of current assets and low level of current assets may lead to negative effect on a firm's profitability and difficulties in mediating smooth operation (Van horne and Wachowtics, 2004). Study is deemed necessary because of the frequency of corporate failure in recent times owing to improper management of accounts receivables and as a result of the dearth of literature in this area.

Account Payable Management

Needles, (2011), state that Accounts payable is money owed by a business to its suppliers shown as a liability on a company's balance sheet. It is distinct from notes_payable liabilities, which are debts created by formal legal instrument documents. An accounts payable is recorded in the Account Payable sub-ledger at the time an invoice is vouched for payment. Voucher, or vouched, means that an invoice is approved for payment and has been recorded in the General Ledger or AP sub ledger as an outstanding, or open, liability because it has not been paid. Payables are often categorized as Trade Payables, payables for the purchase of physical goods that are recorded in Inventory, and Expense Payables, payables for the purchase of goods or services that

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are expensed. Common examples of Expense Payables are advertising, travel, entertainment, office supplies and utilities. *A/P* is a form of credit that suppliers offer to their customers by allowing them to pay for a product or service after it has already been received. Suppliers offer various payment terms for an invoice. Payment terms may include the offer of a cash discount for paying an invoice within a defined number of days. For example, 2%, Net 30 terms mean that the payer will deduct 2% from the invoice if payment is made within 30 days.

If the payment is made on Day 31 then the full amount is paid. In households, accounts payable are ordinarily bills from the electric company, telephone company, cable television or satellite dish service, newspaper subscription, and other such regular services. Householders usually track and pay on a monthly basis by hand using cheques, credit cards or internet banking. In a business, there is usually a much broader range of services in the A/P file, and accountants or bookkeepers usually use accounting software to track the flow of money into this liability account when they receive invoices and out of it when they make payments(Mar ,2007). Increasingly, large firms are using specialized Accounts Payable automation solutions (commonly called e-Payables) to automate the paper and manual elements of processing an organization's invoices. Commonly, a supplier will ship a product, issue an invoice, and collect payment later, which describes a cash conversion cycle, a period of time during which the supplier has already paid for raw materials but hasn't been paid in return by the final customer (Mar ,2007). When the invoice is received by the purchaser, it is matched to the packing slip and purchase order, and if all is in order, the invoice is paid. This is referred to as the three-way match. The three-way match can slow down the payment process, so the method may be modified. For example, three-way matching may be limited solely to large-value invoices, or the

matching is automatically approved if the received quantity is within a certain percentage of the amount authorized in the purchase order (Christopher, 2011).

Cash Management

Abel (2008) argues cash is crucial in every business in terms of enhancing its survival and prosperity. The term cash refers to the most liquid of assets, including demand deposits, money market accounts and currency holdings. The key elements of cash management are cash forecasting, balances management, administration of cash receipts and disbursements, and internal control (i.e. bank reconciliation) (Gitman, 2009). Good cash management can have a major impact on overall working capital management. It is objectively used to manage and determine the optimal level of cash required for the business operation and invested in marketable securities, which is suitable for the nature of the business operation cycle (Gitman, 2009), Zietlow et al., (2007). Gitman (2009) explain that "cash management" involves planning for cash inflows and outflows, and determining the optimal balances of cash and near-cash accounts such as marketable securities. Marketable securities are short-term interest-earning financial claims that can be quickly converted to cash without any significant loss of value. Birt et al., (2011) explain the preparation of the cash budget in a given business requires a detailed forecast of cash receipts and cash disbursements. It firstly starts from obtaining the monthly forecast of sales revenues, which may normally come out from the assistance of the sales and marketing department of a given business. This forecast gives the relevant information on the collection aspects for all credit sales transactions, and monthly cash receipts from sales can be predicted. The other cash receipts transactions to the business are then added to cash receipts from sales revenues to articulate the total cash receipts. Cash disbursements transactions must then be forecast and summed up for operating, financing and investment needs. In addition the

"Net cash flow" is then calculated as total cash receipts deduct total cash disbursements. The opening cash balance is next added to net cash flow in order to arrive at the closing cash balance. Conventionally, if the closing cash balance is positive, then excess cash may be invested in marketable securities. If the closing cash balance is negative, then additional financing may be required (Oliver & English, 2007).

Financial Performance

The financial performance is often measured using traditional accounting Key Performance Indicators such as Return on Assets, Operating profit margin, Earnings before Interest and Tax, Economic Value Added or Sales growth (DeBusk, 2008). The advantage of these measurements is their general availability, since every profit oriented organization produces these figures for the yearly financial reporting (Smith, 2007). However, balance sheet manipulations and choices of accounting methods may also lead to values that allow only limited comparability of the financial strength of companies. Ratios are best used when compared or benchmarked against another reference, such as an industry standard or "best in class" within the industry. This type of comparison helps to establish financial goals and identify problem areas. Vertical and horizontal analysis can also be used for easy identification of changes within financial balances. The size of the firm affects its financial performance in many ways. Large firms can exploit economies of scale and scope and thus being more efficient compared to small firms. In addition, small firms may have less power than large firms; hence they may find it difficult to compete with the large firms particularly in highly competitive markets. On the other hand, as firms become larger, they might suffer from inefficiencies, leading to inferior financial performance. Theory, therefore, is equivocal on the precise relationship between size and performance (Majumdar, 1997).

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Empirical Literature Review

(Nwakaego, 2014) Account receivable management is an important fact of financial management. Their accurate monitoring and proper management are also important dimensions in organization. This study examines the impact of Account receivables management on profitability of food and beverages manufacturing companies in Nigeria. The variables include, accounts receivable, debt and sales growth. Secondary sources of data were used for the period 2000-2011. The hypotheses were analyzed using the multiple regression analytical tools. The findings show that accounts receivable had negative and non-significant relationship with profitability, while debt had positive but non-significant relationship with profitability of food and beverages manufacturing companies in Nigeria. Finally, sales growth also had positive and non-significant relationship with profitability.

(Lawrence, 2013) study focuses on the effect of Account payable management on performance of Nigerian banks. Relevant data were collected from financial report. The data was obtained from a survey of some selected banks in Nigeria. The data collected were analyzed by the use of regression. Some performance indicators such as profit after tax, earnings per share and dividend were used to measure the performance of the selected banks. The analyses reveal that loan is predominate source of revenue, and effective management of loan portfolio and credit function is fundamental to banks safety and soundness. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, such as those associated with the banking sector, has made it clear that portfolio managers should do more. There is also the failure of bank management to establish sound lending policies and adequate credit administration procedure Banks, as custodians of depositors' fund therefore, are obliged to exercise due care and prudence on their lending operations. While the test reveals that there is no

significant relationship between effective account payable management and the performance of banks. The work concludes that Account payable management has not affected the performance of Nigerian banks. Finally the research recommend that effective management of payable and credit risk be strictly adhere to, and critical evaluation must be made and they should be continuously checked for proper management.

Research gaps

From the foregoing review of relevant literature, it is evident that research in the area of Liquidity management has not been done in a more comprehensive approach. The study research gap is demonstrated by the scarcity of empirical studies on determinants of liquidity management. Empirical studies (Nwakaego, 2014), and (Lawrence, 2013)zir and Afza (2009)), were inadequate as they concentrated on liquidity management other industries in Small and Medium Enterprise. None of these studies focused on developing banks. From the survey of relevant literature, it has been found that there are no studies specific to Somalia on the link of Liquidity management and financial performance of the commercial banks in Mogadishu Somalia. This study therefore intends to fill these pertinent gaps in literature by studying the determinants of liquidity management in the bank industry in Mogadishu, Somalia.

Methodology

A descriptive survey focuses on the research design and is concerned with addressing the particular characteristics of a specific population of subjects, either at a fixed point in time or at varying times for comparative purposes. This is to ensure that any subsequent assessments of the attributes of that population are accurate and the findings are generalizable in other words, they have population validity (John & et al, 2002). According to Lavrakas (2008), a research design is

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a general plan or strategy for conducting a research study to examine specific testable research questions of interest.

The target population of this study was conducted employee of three commercial bank companies in Mogadishu which are Dahabshill bank, IBS bank, and Premier bank because we are more dependent on banks and they are a good source of information to analyze the topic. Burns & Grove (2003) states that population includes all elements that meet certain criteria for inclusion in a study. So the target populations of this study consist of 112 employees of the three banks which were mentioned above.

Sampling is the process of selecting a number of individuals for a study. A sampling design is a defined plan determined before any data is collected for obtaining a sample from a given population. The selected number of individuals will be as a representative of the whole population under study. The formula which was used this study was Slog van's formula which states the sample size of employee in three commercial banks in Mogadishu. The main objective of using this sample was to obtain accurate and reliable information within minimum cost, time and energy.

$n = N \div [1+N(e^2)]$

Where: n= sample size, N= target population, e =marginal error (femandes, 2009)

The sample consists of 87 employees of commercial banks in Mogadishu according the slog van's formula.

Non-probability sampling (or non-random sampling) provides a range of alternative techniques to select samples based on your subjective judgment (Saunders, &et al, 2009). The researchers will use judgmental sampling techniques of non-probability sampling because the researchers cannot obtain the list commercial bank companies' employee. Therefore, data will be collected

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from those people who are conveniently available and willing to co-operate. Purposive sampling was also convenient because the sample selected will be small and the ideas of the population were needed in a shorter period.

Data collection methods used included questionnaire**.** Data will be analyzed quantitatively and presented descriptively and illustrated by using of tables and charts. The selection of these tools have been guided by the nature of data to be collected, the time available as well as by the objectives of the study. Kothari (2004) defines a questionnaire as a document that consists of a number of questions printed or typed in a definite order on a form or set of forms. And according to Dawson (2002), there are two basic types of questionnaires; closed ended, open-ended. Closed ended questionnaires are used to generate statistics in quantitative research while open-ended questionnaires are used in qualitative research, although some researchers quantify the answers during the analysis stage.

DATA ANALAYSIS AND PRSENTATION RESULT

Data analysis is a process of analyzing all the information and evaluating the relevant information that can be helpful in better decision making, Silvia and Skilling (2006). The data collected was analyzed using the software called Statistical Package for the Social Sciences (SPSS) and results shown in terms of frequency distribution and percentages. The data was tabulated and classified according to their common characteristics.

Table 4.1 Response Rate

Response	Total	Percent
Non Responses	02	02
Responses	85	98
Total	**87**	**100**

The number of questionnaires, administered to all the respondents, was 87. A total of 85 questionnaires were properly filled and returned from the Commercial bank employees. This represented an overall successful response rate of 98%. According to Mugenda and Mugenda (2003), a response rate of 50% or more is adequate. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good.

Table 4.2 Reliability Results

Variables	Cronbach's Alpha	Comments
Account receivable mgt	0.800	Accepted
Account payable mgt	0.763	Accepted
Cash management	0.721	Accepted

Reliability was measured using Cronbach's Alpha coefficient which was used to measure the internal consistency of the study measures. The Cronbach's alpha coefficient ranges between 0 and 1 and alpha coefficients of a minimum of 0.70 are considered appropriate. The overall Cronbach's alpha coefficients for all the constructs in the study were 0.830. The study measures were found to be highly reliable in that they all had alpha coefficient greater than the minimum accepted Cronbach's alpha coefficient of 0.70 (Hair *et al.,* 2010). Account receivable management had Cronbach's alpha coefficient of 0.800 while account payable management had 0.763. Cash management had 0.721.

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Regression Analysis

In this study, a multiple regression analysis was conducted to test the effect of liquidity on the financial performance on commercial banks in Mogadishu, Somalia. The research used statistical package for social sciences (SPSS V 22) to code, enter and compute the measurements of the multiple regressions.

Table: 4.12 Models Summery

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.715[a]	0.511	0.493	.54891

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variables due to change in the independent variables. From the findings in the above table the value of adjusted R squared is 0.493 and indicates that there was variation of 49.3% on financial performance of commercial banks in Mogadishu due to changes in account receivable management, account payable management and cash management at 95% confidence interval. This shows the significant that 49.3% of the variations in the financial performance of commercial banks in Mogadishu are accounted for by the variations in the independent variables and the remaining 50.9% are accounted by other factors contained in the standard error.

R is the correlation coefficient which shows the relationship between the study variables. From the findings shown in the table above there was a strongly positive relationship between the study variables as shown by 0.715.

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Analysis of Variations

Table: 4.13 ANOVA

Model		Sum Squares	df	Mean Square	F	Sig.
1	Regression	25.547	3	8.516	28.263	.000[a]
	Residual	24.406	81	.301		
	Total	49.953	84			

From the ANOVA statistics shown in table, the processed data, which is the population parameters, had a significance level of 0.5% which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance (p-value) is less than 5%. The F critical at 5% level of significance was 2.72. Since F calculated (28.263) is greater than the F critical (2.72), this shows that the overall model was significant and that account receivable, account payable and cash management significantly affect the financial performance of commercial banks in Mogadishu- Somalia.

Table: 4.14 Coefficients

	Un standardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	T	Sig.
1. (Constant)	.801	.364		2.198	.031
Account receivable	.227	.106	.213	2 .146	.035
Account payable	.414	.093	.443	4.462	.000
Cash Management	.184	.073	.216	2.508	.014

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From the data in the above table the established regression equation was; $Y = 0.801 + 0.227X_1 + 0.414X_2 + 0.184X_3$

From the above regression equation it was revealed that holding account receivable, account payable and cash management to a constant zero, financial performance of commercial banks in Mogadishu would be at 0.801. A unit increases in account receivable would lead to increase in the financial performance of commercial banks in Mogadishu by a factor of 0.227. A unit increases in account payable would lead to increase in the financial performance of commercial banks in Mogadishu by a factor of 0.414 and a unit change in cash management would lead to increase in the financial performance of commercial banks in Mogadishu by a factor of 0.184.

The regression results presented in above table indicate that account receivable, account payable and cash management were significant at 5 percent level. The coefficient of account receivable showed 0.277 with a p-value 0.035, which is less than 5%, the coefficient of account payable was 0.414 which is less than 0.05, with a p-value of 0.000. And the coefficient of the cash management was 0.184, with a p-value of 0.014 which is less than 0.05 so that indicates there was statistically strong positive relationship between account receivable, account payable and cash management and financial performance of commercial banks in Mogadishu. Hence, the most significant factor is account payable. Overall, account payable had the greatest effect on the financial performance of commercial banks in Mogadishu, followed by cash management and account receivable. All of the variables were found to be significantly affect financial performance of commercial banks because they less than ($p<0.05$).

Conclusions

The conclusions were based on the objectives of the study that liquidity management drivers had a significant influence on financial performance of commercial banks. The results established that liquidity management drivers were found to significantly and positively influence financial performance. When all the stated variables were tested in the regression model they were found to have a significant relationship between themselves and financial performance of commercial banks. Account payable management was the driver which had the highest effect on financial performance of commercial banks followed by account receivable and cash management. The findings of the study established that commercial banks were operating under a highly competitive environment between them. However, this moderate result revealed that there were all variables which were influencing the financial performance of commercial banks in Mogadishu- Somalia.

Recommendations

1. It was found that management policies influenced accounts receivables management. It is recommended to the commercial banks management to ensure that the banks have put in place policies and procedures to be adhered to during trade credit.

2. There is need for the commercial banks in Mogadishu to increase their debt to current liability as it was founded that account payable positively affects the financial performance of commercial banks in Mogadishu.

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