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ASSESSMENT OF LIQUIDITY RISK IN ERIKUM MULTI-PURPOSE FARMER'S COOPERATIVES, DESSIE, AMHARA REGION, ETHIOPIA

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Abstract
This study is aimed to assess financial risk of Erikum Multi-Purpose Farmers' Cooperative Union Dessie, Ethiopia for the period 2013-14 to 2017-18 based on relevant review of literature. Under the Credit Risk Assessment (CRA) system, the factors which need to be taken into account for appraising credit risk may group under the three (3) categories are Financial Risks, Business/Industry Risks and Management Risks, the Financial Risk Assessment of financial risks involves both quantitative and qualitative aspects. The parameters for quantitative assessment of financial strength are Liquidity Ratios, Profitability Ratios, Turnover Ratios, Return on Capital Employed. The researcher purposively selected for the study with the objective to analyze the liquidity risk of the union. The study used secondary data. The secondary data were obtained from annual report of the union After collecting the necessary data, the result discussed through appropriate financial ratios, percentage, average, chart and descriptive statistical techniques were employed Accordingly, the financial ratios result displayed that particularly, the liquidity risk of the current ratio, and loans to asset result reveals that the union had kept more liquidity risk or not satisfactory Finally, the Erikum Multi-Purpose Farmers' Cooperative Union recommended that have to more in profit earning and efficiently managing its assets for generating revenue, need for improving of much dependence on outside financing, improving in their risk management and increase its current asset and internal owner equity.

Keywords: Risk Assessment, Liquidity Risk Ratios, Current Asset to Current Liability, Networking Capital, Loans to Total Assets.

1. Background

Credit risk assessment or assessment of credit worthiness of borrowers is an integral and most important part of credit appraisal exercise. It is needless to emphasize that a lending banker has to evaluate the risks associated with the credit proposal before taking a decision on its sanction or rejection. Since the early 1990s, a few commercial banks introduced Credit Rating System (CRS) to assess the credit worthiness of borrowers or risk associated with the credit proposal on the basis of certain financial parameters and past conduct of the borrowers ***(Credit Management in Urban Cooperative Banks, 2006)***. Under the Credit Risk Assessment System (CRAS), the factors which need to be taken into account for appraising credit risk may group under the three (3) categories are Financial Risks, Business/Industry Risks and Management Risks, the Financial Risk Assessment of financial risks involves both quantitative and qualitative aspects. The parameters for quantitative assessment of financial strength are Liquidity Ratios, Profitability Ratios, Turnover Ratios, Return on Capital Employed Further, while analyzing the ratio, both inter-firm and intra-firm comparison of performance of business organization for the current year as compared to 3 to 5 years or inter-firm performance of other business organizations in the same line of business should be taken into account. Qualitative Aspects is equally important to assess the qualitative aspects of business organization financial strength from the following: Accounting policies, Policy towards provision for bad debts and depreciation c. Contingent liabilities and claims against business organization d. Auditors observations in the annual reports. Industrial or Business Risk Assessment attached to the borrow account on account of industry in which the business organization is operating should be factored into the rating assessment. The risks arise from the following are Competition and markets, Industry cyclicality, Regulatory risks, Credit Risk Assessment and Risk Rating of Borrowers Technology and obsolescence risks Availability of raw material and other inputs as also their pricing, Product substitution. The Management Risk parameters for judging management risks are Integrity, Track record Organizational structure and system Expertise, competence and commitment in the organization Capital market perception.

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According to the Federal Cooperative Agency (FCA); there are 85,496 primary cooperatives with 19,502,786 members. In addition to these, 388 secondary cooperatives (unions) which have 15,813 primary cooperatives and 3 cooperative federations with 146 members are registered. Besides new types of cooperatives are being introduced to meet members special needs **(*FCA, 2018*).**

Specially, the multi-purpose cooperatives, primary and secondary (union), are organized in the rural agricultural areas. They are owned by farmer-members who their major occupation is agriculture. Thus, their major function is to supply farm inputs; fertilizer, pure seeds, pesticide, farm equipments, and new technologies... on cash and credit bases and searching for market outlets for farmer-members produce. Besides they deliver basic consumer goods and house furniture at reasonable price to member-owners and their community. From this it is possible to understand that their contribution to increase members income by improving productivity and production of members. Thus, they are playing vital role in the food sufficiency and security program as well as in attaining the Millennium development Goals in the rural areas.

2. Statement of the Problem

In view of growing complexity of business, unsatisfactory financial performance and the dynamic operating environment the financial risk management has become very significant. A study of business failures in cooperatives would reveal that majority of such failures resulted from the lack of proper financial management. Inefficient functioning of cooperatives is due to bad debts, excessive overdue or failure of financial risk management. In the process of providing financial services, they assume various kinds of financial risks , Without a doubt, in the present-day's unpredictable and explosive atmosphere all business are in front of financial risks like solvency risk, liquidity risk, credit risk and interest rate risk, along with others risks, which may possibly intimidate the survival and success of the business's. **(*Santomero,1997*).**

The cooperative that failed to manage their financial health with unable to meet financial obligation became financial deterioration while; those ones that managed them properly have had perform their good financial health **(*Herero, 2003*).**

Cooperatives should now have a keen awareness of the need to identify measure, monitor and control financial risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred **(*Basel Committee, 2010).***

Bearing in mind the above points; liquidity the level of cooperative performance analysis focusing on their liquidity conditions and identifying those factors influencing the effectiveness of liquidity risk and efficiency of ERMPFCU. Therefore the researcher needed to assess the liquidity risk situation of the cooperative to evaluate the liquidity risk, efficiency and effectiveness of the union, in order to examine the presiding year financial risk of the union and the existing time and to recommend suggestion in the activities of ERMPFCU.

3. Literature Reviews

3.1 Tefera, (2011) in his literature, all business is connected with risks resulting from the fact that future states of the world and outcomes of decisions can only be predicted. As business activities are uncertain regarding their outcome and this uncertainty implies risks to the profit of the firm. These risk factors can be of different origin; these can result from changes in the markets, legal aspects, firm intern aspects or financial factors.

3.2 M khan. P k Jain, (2007) in their study, financial risk needs to be managed directly depends on a mismatch between the assets and their financing. The firm should therefore try to match the two durations in order to avoid problems with and high costs of follow-up loans. Furthermore this reduces the risk of having more debt than needed after the asset's lifetime and by that it saves interest costs.

3.3 James, (2013) assessed, the amount of liquidity held by banks is heavily influenced by loan demand that is the base for loan growth. If demand for loans is weak, then the bank tends to hold more liquid assets (i.e. short

term assets), whereas if demand for loans is high they tend to hold less liquid assets since long term loans are generally more profitable. Therefore, a growth in loans and advances has negative impact on banks liquidity.

3.4 Barrickman, (1990) in his study, loan as major asset, income source for banks, and risky area of the bank. Therefore, managing loan in a proper way not only has positive effect on the banks profitability but also on the borrower firms and a country as a whole. The heart of any successful commercial lending function is credit discipline written in loan policy.

4. Objectives of the Study

The specific objectives of the present study are:

1. To analyze the liquidity risk of the Erikum Multi Purpose Farmers Cooperative Union, and
2. To offer suitable suggestions for the development of the EMPFCU.

5. Data Source and Collection and Analysis Methods

5.1 Source of Data and Collection Method

Secondary data was used for the study. The secondary data was used for analysis mainly obtained from the audited financial statement of the ERMPFC which gathered from balance sheet and profit and loss account of the union at district office level for five consecutive years (2013-14 to 2017-18 G.C.) .

5.2 Method of Data Analysis

In this particular study, the collected data were analyzed by employing financial risk ratio analysis and descriptive statistics analysis through descriptive to represent and interpret the results and findings of the study. Since the data collected quantitative in nature, this research quantitative analysis: For the matter of simplicity data analysis methodology was categorized objective wise as follows;

To analyze the liquidity risk of the study unit, data were analyzed through ratios, percent, average and result presented by using tables for data collected from audited financial statements and data were analyzed through descriptive statistics frequencies table for the data collected through key informant interview from the employees of the study unit.

6. Sampling

A research design is the arrangement of conditions of collections and analysis of data in a manner that aims to combine relevant data to the research purpose with economy in procedures. The researcher used a case of ERMPFC is selected purposely.

7. Results and Discussion of Financial Risk of ERMPFC through Financial Ratios

7.1 Liquidity Risk Assessment

Liquidity means the ability of the union to maintain sufficient fund to pay for its maturing obligation. This implies risk results from the inability of the union to repay liabilities and obligations due on their maturity dates.

7.1.1 Current Asset to Current Liability Ratio

These ratios measure ability of the union to meet its short-term obligations, maintain cash position, and collect receivables. The higher current ratio mean union has larger margin of safety and ability to cover its short-term obligations and thus low risk and vice versa. As the standard of current ratio, 2:1 is considered as normal (for every one birr of current liability there is two birr of current assets).

Table 1.1: Current Asset to Current Liability Ratio

Year	Current Asset (ETB)	Current liability (ETB)	Ratio
2013-2014	150707565.08	131918394.4	1.14
2014-2015	119688989.76	104979939.1	1.14
2015-2016	86655742.74	74134767.81	1.16
2016-2017	114593057.85	98438452.86	1.16
2017-2018	71501063.21	55386841.4	1.29
Average	**538390697.88**	**464858395.57**	**1.17**

Source: computed from annual audited financial statement of the ERMFCU.

It was clear from the above table; the current ratio was between 1.10:1 and 1.29:1 during the study period of 2013-14 to 2017-18increased. A relatively high level of current ratio is considered as an indication of the comfortable liquidity position of multi-purpose farmers cooperative union and its ability to meet its obligation to creditors. On the other hand, if the current ratio is relatively, low the multi-purpose farmers' cooperative union may have difficulty in paying its shot-term creditors. An ideal current ratio is 2:1. However, the multi-purpose farmers' cooperative union 1.17:1 as benchmark ratio for financing working capital requirements of the multi-purpose farmers' cooperative union. Therefore, the current status of the financial ability to meet short term financial obligation of the selected multi-purpose farmers' cooperative union depicts ratios compared to current ratio standard which reflect the union small liquidity risk during the study period.

7.1.2 Net Working Capital Ratio

Net working capital is the difference between current assets and current liabilities. It evaluates the extent of the union's financial ability to meet its short term obligation.

Table 1.2: Net Working Capital (NWC) Ratio

Year	Current Asset (ETB)	Current liability (ETB)	NWC
2013-2014	145951844.32	131918394.40	14033449.90
2014-2015	119688989.76	104979939.10	14709050.60
2015-2016	86655742.74	74134767.81	1252097.43
2016-2017	114593057.85	98438452.86	16154604.94
2017-2018	71501063.21	55386841.40	16114221.81
Average	**538390697.88**	**464858395.57**	**73532302.30**

Source*: computed from Audited financial statements of ERMFCU*

It could be observed from the above table that, the net working capital position of the multi-purpose farmers' cooperative union were positive in the study years of 2013-14 to 2017-18 amount of 14033449.90 to 16114221.81 respectively which were significant amount of current asset exceed current liability. These significant of current asset to current liability and positive networking capital result of the union reveals adequacy of financial ability.

7.1.3 Loans to Total Assets Ratio

This ratio measures the percentage of assets that is tied up in loans. The higher the ratio, the less liquid the union is. The lower this ratio signifies a union is more liquid.

Table 1.3: Loans to Total Assets

Year	Total Loans (ETB)	Total Asset (ETB)	Ratio
2013-2014	112974572.39	150707565.08	74.96
2014-2015	96232298.98	125827253.77	76.48
2015-2016	71739492.21	92992121.69	77.14
2016-2017	89735178.13	120558321.1	74.43
2017-2018	54703569.32	77134983.04	70.92
Average	**425385111.03**	**567220244.68**	74.78

Source: *computed from annual audited financial statement of the ERMPFCU.*

The loans to total asset ratio was used to measure the total loans as a percentage of total assets. The lower this ratio signifies a union is more liquid. So, the lesser the ratio means the less risky a union to higher defaults. The ratio trend of Erikum Multi-Purpose Farmers' Cooperative Union from 2013-14 to 2017-18 was a mix of ups and downs drift of the ratio implied that the union was not in a stable financial position. It is clear that the ratio ranges between 74.96 percent and 70.92 percent during the study period. Furthermore, in most study period except the study year of 2017-18 the result shows a higher ratio that means more liquid risk because relatively the higher loans to total asset.

8. Major Findings

The major findings of the longitudinal study of the ERMPFC started through financial highlight were discussed from secondary and primary data analyzes are presented as follows:

8.1 Current Asset to Current Liability Ratio

The current ratio of the ERMPFC resulted that in average 1.17:1 which evident that the current status of the financial ability to meet short term financial obligation was inadequate or low liquidity risk.

8.2 Net Working Capital Ratio

The net working capital results the 2013-14 to 2017-18 study period the current asset exceed current liability. The current asset exceed of current liability that leads positive net working capital which of the union adequacy of financial ability to meet short-term financial obligation. The union could pay its all bills and thus has lower liquidity risk.

8.3 Loans to Total Assets Ratio

The loans to asset ratio trend of Erikum Multi Purpose Farmers' Cooperative Union from 2013-14 to 2017-18a mix of ups and downs drift of the ratio implied that the union was not in a stable financial position. The ratio ranges between 74.96 percent and 70.92 percent during the study period this result shows a higher ratio that means more liquid risk.

Table 1.4
Result of Liquidity Risk Ratio Assessment Approach

S. No	Name of the Ratios	Ratios Result	
		S	NS
Liquidity Ratios			
1.	Current Asset to Current Liability	-	**NS**
2.	Net Working Capital	**S**	-
3.	Loans to Total Assets	-	**NS**
Total		**1**	**2**

S: Satisfactory; NS: Not Satisfactory

9. Conclusions

The liquidity risk assessed through current ratio, net working capital and loans to total asset of the union. In these ratio results, except net working capital the financial ability to meet short term financial obligation of the ERMPFCU depicts inadequate and thus has more liquidity risk.

10. Suggestions

1. The adequacy of working capital may be maintains full confidence of members on the union. Therefore, the union should better to keep more than this to increase its liquidity position.
2. For timely and adequate dispensation of production credit, there must be coordination even from the time of credit planning.
3. Recovery officers should not be politically pressurized so that they can recover loans properly.

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