

Liquidity management assignment

Business



This growing gives this area of financial market large attention lead to the escalation In number of research about It. However, with the large and continuously develop of Islamic banking system, there are many aspect of this sector are not well investigated. Most of the researches aim o achieve the knowledge about the development and performance of this banking industry. In this regard, a concern which is relevant to ensuring healthy growth of this industry is risk management.

The competition advantage of a bank comes from how well it manages the risk. This applied to both commercial banks and Islamic banks. Nowadays, in high-competitive financial market, the survival of a banking institution depends much on its ability to capture wide and deep knowledge about risk management in order to gain competition advantage (Khan and Aimerd, 2001). In financial industry, banking is insider as one of the most risky sector with several risk factors such as credit, liquidity, operational and market risk.

Banking business Is to take calculated risk, so that building a sound risk management skill is not only to minimize the losses but also to render the optimal of the risk reward equation. Liquidity risk management considered as one of the top priorities of banking institution's assets and liabilities management. _ Generally. A bank's liabilities come from the deposit of customer and its asset is the investments acquired by the money from its liabilities and the banks owner equity. Banks use these short-term debts to invest in long -term assets.

Liquidity risk arises from the mismatched of maturity of liabilities and assets which due to the funding or market risk, or various factors which related to

both of them (Abdullah A. AH-Hammed, 2011). When the bank's liabilities have shorter tenor meet its obligation. Accordingly, liquidity management is as important to the conventional banks as it is to the Islamic banks.

However, due to the differences in requirements and structures between Islamic and conventional banks, the liquidity risk in Islamic banks is not straightforward.

A growing literature suggests that it is unique and even more challenging than the counterpart. (Moraine Mood Reaffirm, 2012) indicated that the challenges for Islamic banking comes from the incompatible of existing liquidity management instruments against Shari's (Islamic law). In addition, the factors such as changing in the interest rate due to the fluctuation of economic environment or the customers behavior can also has impact on the liquidity mismatch of Islamic banks.

For example, if the interest rate is set high, the Islamic banks assets become more attractive than the conventional banks while its posit is less attractive, the Islamic bank may face the liquidity problem. Liquidity risk management in Islamic banking is not straightforward as it has the profit sharing on both liability and asset side. Furthermore, it is restricted of many requirements to compatible with Shari's to avoid the interest-bearing instruments. Over the time, many of news Shari's compatible instruments has been introduced to manage the liquidity risk in Islamic banking.

As in the SKU (a pool of assets that are Shari ' ah compliant) structure, several applications has been adopted to lead the banks in either buying or selling the SKU and pay or earn profit from it. In the highly competition

financial market today; the management in liquidity risk of Islamic banking has a significant relationship with the whole 'Fib's risk management. As the 'Fib's suggestion, Islamic banks should consider the liquidity risk dealing with their ability to mitigate risk in respect of their accounts.

Since accounts holders require a level of liquidity in Islamic bank to meet their requirement to withdraw, Islamic banks need to have separate liquidity risk management strategies within different types of accounts and investments. Furthermore, Islamic banks should consider the compliant with Shari's fund in building the liquidity risk frame. A sound process of measuring, processing, reporting and managing of liquidity risk may bring Islamic banks many advantages in growth and survive in risky financial industrial like banking, especially in overcoming crisis.

Due to the important role of liquidity management within an Islamic bank institution survival in highly competition financial industry we has discussed above, this study aims to assess the liquidity risk in selected Islamic banks in Malaysia from 2009 to 2012 in order to discover the elicitation between extent of liquidity risk and Islamic banks performance. Furthermore, this paper attempts to research about the liquidity risk management condition in Malaysia Islamic banking by exploring the liquidity risk management disclosure in annual reporting of Islamic banks selected.

Based on the existing literatures, the research about the liquidity management in Islamic banking and how it relate to the performance of the bank has been limited compared to the conventional banking by both the number of research, the extent of problem and data collected, and the

sensitive nature of Islamic banking system. This study created with the attempt to enrich the information on risk management in Islamic banking by providing deeper knowledge on liquidity risk management in Islamic banking.

The author aims to answer the following enquiries: years? 2. What is the impact of 2012 financial crisis on Islamic banking system in Malaysia? 3. Does the liquidity relate to the performance of selected Islamic banks in Malaysia? 4. What is the extent of liquidity risk management disclosure in selected Islamic banks annual report? 3. LITERATURE REVIEW The liquidity risk management Liquidity risk has been wide study for many financial intermediaries around the world, either banking or non-banking corporations.

In financial situation, liquidity risk is simply defined as the probability of actual return may differ to expected return (Howell and Fain, 1999: 30). In banking industry, refer to the (Oracle Financial Service research, 2009), the Basel Committee defined liquidity risk, issued in September 2009 for banking corporation is that the current and prospective risk to earning and capital arise from the Islamic banking institution inability to meet its obligations and o fund increase in assets when they are due, without unacceptable losses or excessive cost.

The end result of such disparity means that either there will be excess cash needs be invested or shortfall of cash which needs to be funded (Somalis, 2010). The general performance of a baking corporation is to use short-term liability to invest in long-term assets. Thus, a suddenly rise in borrower's demand or an unexpected failure in banks investment could lead to the

shorten of cash or liquid marketable assets (Oldie and Containers, 1997). Consequently, an accurately management to minimize the liquidity sis has an important role in banking intermediaries in achieving a sound financial situation.

In other words, the objective of liquidity risk management is to assist the bank match the maturity of its assets and liabilities on the banks balance sheet. To do that, a bank need the clearly understand about how the cash flow within organization, capturing the current cash flow strain by determining the liquidity pressures, and taking the Judiciously actions to prevent the liquidity pressure from growth. For example, (Threaten, 2006) has been provided a solvency for regular equity risk is that the use of a pool of fund which can be quickly withdrawn or (Addle, 2009) suggested to keep extra cash or liquidity assets.

Etc. As the banking industry participation party, An Islamic bank also must consider a sound liquidity risk management as their significant objective in order to ensure their profit inflows which enable them a smooth business running, as it is similar to its tenants. In liquidity risk management, Islamic banks are naturally vulnerable like the conventional banks while their assets often come from long-term or liquidity investment and their assets come from short-term deposits.

However, Islamic banks are exposed to the unique factor that the requirement to avoid the interest (rib) in any form minored to meet their liquidity level which is compatible with Shari's manner (Assayed Nana, volume 5, 2012). Furthermore, Islamic banks are faced with another

particular liquidity risk compare to conventional banks is that not all the financial instruments applied to capture the level of liquidity risk are accepted by the Shari scholars which avoid the interest-bearing methods.

Consequently, Islamic banks don't have the same financing options which available to conventional banks in market has been the major challenge for the development of Islamic banks (Vogel and Hayes, 1998). On the other hands, depositors fund can be required in a very short withdrawal period. In this situation, Islamic banks might challenge with high possibility in experiencing with liquidity risk because of their insufficient in Shari-comparable instruments when their borrowers suddenly withdraw deposits. To avoid this problem, each Islamic bank uses different liquidity systems to manage the equity risk.

Generally, a portion in the accounts will be acted as the liquidity cushion to prepare for the unexpected withdrawals. This can protect the bank from the sudden liquidity demand non-satisfying which lead to the possibility of depositors leaving from the bank. In the case of Malaysia, the Islamic banking system operated the first Islamic inter-bank money market in January 1994 which acts as the short-term intermediary in order to provide the available short-term investment for Islamic financial institutions based on Shari's principles.

Islamic banks will accept the inter-bank trading where the bank with surplus fund can make the investment with the bank with deficit fund based on the principle of profit-sharing arrangement (maturated). This enable the bank to meet their funding requirements effectively and efficiently. In 1998, Bank

Engage of Malaysia introduced the Liquidity Framework to remove the liquid assets ratio requirement. This provides the efficiently matching assets and liabilities profile which enable Islamic banks to utilize their fund and predict the time of liquidity risk.

Liquidity risk management and the performance of ann. The relationship between liquidity risk management and the banks performance has been a hot topic for researchers. By both qualitative and quantitative, using different data collected, different model in different economics, most historical research attempted to explore the factors related to financial industrial risks and banks profit to draw the conceptual nature link between a sound risk management and positive performance of bank. (Eduardo Dandelion , 2007) conducted a research about relationships between corporate governance, risk management, and bank reference.