The Impact Of Liquidity And Market Risks On The Performance Of Iraqi Banks

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ARTICLE INFO	ABSTRACT
	The study investigates the correlation and impact between Iraqi banks' risk management, liquidity risks, market risks, and the performance of Iraqi banks after the introducing of the Basel System. A sample of employees in Iraqi banks, numbering (22) banks, was chosen (general manager of a bank - executive, assistant general manager of a bank, head of a department, head of a division, and others). The results were based on this sample. After delving into the theoretical and practical aspects of the study, it was concluded that there is a statistically significant correlation between liquidity risk management and market risk on the performance of Iraqi banks. **Keywords:** Liquidity, Market Risks, Performance, Iraqi Banks.

Introduction

Risk management is classified as the process of identifying, monitoring and managing risks with the aim of reporting, controlling and reducing their negative effects, (Khalaf, Ali, 2018: 63). Risk management aims to identify losses from potential risks such as (how losses occur, how certain events are sequenced to risk generating losses) and methods of risk management through (avoiding risks or reducing them) or reducing risk, risk retention, risk transfer, and risk apportionment). The stages of the risk management process may consist of (identifying risks, setting the goal, identifying risks, assessing or measuring risks, studying alternatives, and choosing a method for dealing with risks. (2013: 2 Mark). The bank must have a risk management strategy that monitor and review risks approved by the Board of Directors, that demonstrates an appropriate risk tolerance to determine the level of risk that can be tolerated (Central Bank of Iraq, 2019: 4). Banks are considered one of the most important financial operations in every country because they contribute significantly to social and economic progress. They identify the sector's ability to adapt to new and changing events, as well as improve continuously their capabilities, resources, and level of service, and determines their success and effectiveness. Banking activities benefit the local economy by managing the processes of developing financial savings and investments, including the formation of the necessary banking, commercial and financial projects and operations. Risks, especially liquidity, capital adequacy and financial performance indicators, are among the main concerns that affect all types of banking units, especially Private commercial banks, which require immediate attention and adoption of modern development and management topics in order to achieve a certain level of success. Banks are at the heart of any country's economic life because of the crucial duties and roles they perform in the economy. It is believed that the development of a country's banking system is a benchmark for its economic development because banks are the most important financial institutions in the economy and have a greater influence on the economy than any other financial institution.

Banks play an essential role in providing modern financial services and making them accessible to the general public. In doing so, they contribute to the survival of banks and to increasing their business and progress in light of the rapid technological developments and strong competition witnessed in the banking arena today. From this standpoint, banks must pay attention to financial technology, which is technology and innovations that seek to compete with traditional financial methods when providing their financial services using mobile phone services and encrypted digital currencies (Iskandar, 2020: 93). Comparing the rapid developments with Iraq, the banking sector suffers from a series of operational and marketing challenges. According to the Central Bank of Iraq report for the year (2014), the low performance of the Iraqi banking system necessitates redesigning the process structure in order to improve banking performance. Therefore,

this study decided to test the relationship between liquidity and market risks on the performance of Iraqi banks.

Previous studies and hypotheses

1. Liquidity risk

The term liquidity refers to the amount of capital available for investment and spending, while for banks, the term refers to the ability to meet the demanding needs for credit and debt that lead to a lack of liquidity. As for liquidity risk, it is the lack of liquidity that banks need to fulfil their obligations to the beneficiaries of their clients (Ingkara, Cetinkaya, 2019: 1). Liquidity risk is considered one of the most important financial market risks and is defined as the situation that leads to the lack of sufficient liquidity in the bank to meet its financial obligations. Liquidity risk becomes a threat when a bank cannot predict demand for new loans or deposit withdrawals (Mattis, 2019: 1189). Financing liquidity risk refers to the inability to meet cash flow obligations, and is also known as cash flow risk (Jurion, 2007). Banks should establish a robust liquidity risk management framework that ensures maintaining adequate liquidity, including the ability to withstand a range of stress events.

So, when banks finance long-term assets with short-term liabilities, they risk rolling over or refinancing the liabilities. Liquidity risk is usually personal, although it can jeopardize the liquidity of the financial system in certain circumstances. Liquidity relates to a bank's ability to absorb deposits and liabilities, support loan growth, and possibly finance off-balance sheet requests efficiently (Al-Zoubi, 2020: 257).

The most important theories of bank liquidity can be presented as follows: (Al-Mamouri, 2016: 293) Commercial loan theory. This theory is based on the fact that commercial bank liquidity is achieved automatically through the self-liquidation of its loans, which must be for short periods or for working capital financing purposes, where borrowers return the money. They borrowed after the successful completion of their business cycle, and on the theory that banks do not lend for such purposes to real estate, consumer goods or investment in stocks and bonds because of the long period of recovery expected in these areas. This liquidity theory is suitable for trading communities, where the vast majority of a bank's clients are traders who need financing for specific trades for short periods.

The study (Dheyaa Mohammed Abed Radii, Ali Ahmed Fares Kaabi, 2020) dealt with measuring and analyzing bank performance indicators for a sample of commercial banks listed on the Iraq Stock Exchange and comparing them with a sample of Arab banks located in Doha, Qatar, and Dubai in the United Arab Emirates to support the Basel Resolution. This study found that there are different correlations: positive and negative, with regard to their strength and direction. For the most important recommendations, banks must comply with them by maintaining capital adequacy ratios higher than those stipulated by the Basel Committee, maintaining acceptable liquidity rates, and facing the risks of exposure to increasing withdrawals and the resulting financial crises. The study (Mohd Fazli Mohd Sam, Ayad Zuhair Khudhair 2019) seeks to investigate how risk management activities in Iraqi commercial banks can help these banks improve their performance. The study revealed that risk management is the main variable in evaluating the performance of commercial banks. The study also showed that risk management has a significant impact on the financial performance of commercial banks when counterparties fail to fulfil their obligations.

As for the study (Jamal Hadash Mohammed, Fatima Mohammed Saleh, 2022), it aimed to shed light on the analyses and measurements that were conducted on the decisions of Basel III, which greatly affected the volume of deposits to banks, as well as to identify and know the factors that affected the implementation of the decisions of Basel III. The study found that there is a significant impact of Basel III decisions on the deposit coverage rate and recommended the necessity of forming committees in bank departments to implement the recommendations of Basel III decisions.

Therefore, liquidity risk management occupies the utmost importance in the Iraqi banking sector, so it was obligatory to work on its management in accordance with the legal frameworks and instructions issued by the Central Bank of Iraq, the applicable instructions and relevant laws. Since risk management improves banking performance, the study will suggest the extent of the impact of liquidity risk management in improving the performance of banks, and as a result, the first hypothesis was proposed.

> **The first hypothesis**
> **There is a positive relationship between liquidity risk management and bank performance.**

2. Market risks

The Basel Accord defines market risk as "the risk of loss on budget and off-balance sheet items due to changes in market prices" (Basel Committee on Banking Supervision, 2005). The most important elements that can lead to the emergence of market risks are stock prices, interest rates, foreign exchange rates, and commodity risks. Equity risk is defined as the risk of changes in stock prices having an impact on a bank's balance sheet and off-balance sheet items. General price risk, which is associated with changes in the entire stock market, and specific price risk, which is associated with changes in individual stocks, are two types of equity risk. Market risk can be defined as the risk of negative deviations in the value of monitoring market movements of the trading portfolio during the period required to liquidate transactions, or it is the risk of

bank losses arising from market price movements as a result of changes in interest rates, foreign exchange rates, and stock and commodity prices, or it is the loss that could result as a result of unexpected changes in the market value of financial instruments; It includes interest rate risks, exchange rate risks, risks of stock price changes, in addition to the risks associated with raw material prices. Market risk is the uncertainty about the company's value or cash flow associated with movements in a basic source of risk (Saghir, 2020: 71). For example, a company may be concerned about movements in interest rates, foreign exchange rates, stock prices, or commodity prices (Tchance, 2010: 524). A group of researchers defined market risk as the risks to which profits or capital are exposed as a result of changes in the total market value of securities held by the bank. Market risk is also known as the possibility of a change in market prices or the state of uncertainty that affects bank revenues as a result of market changes whose source is economic and financial conditions, including changes in asset prices, interest rates, market indicators and liquidity (Jassem, Muhammad, 2018: 76). It is an important risk in the banking system, with countless products, market risk occurs when the net asset value changes due to changes in stocks, commodity prices, and exchange rates (Zulkefly, Janor, 2015: 1). Market risk is the risk of loss resulting from a decline in market prices due to market factors and the possibility of harming the bank's portfolio position. It is defined as the risk to which the financial portfolio is exposed to market price movements that banks cannot control, such as the interest rate, exchange rate, stock price, and commodity price (Jospin, 2022: 705).

A study (Taya, Birah, 2022) referred to an analytical study of a number of Iraqi private commercial banks in banking risk management in light of the Covid-19 crisis. The study concluded that there is no special support for banking risk management by higher authorities, as its presence is limited to the general administrations of banks and is not its effective presence in the branches, which increases the risks faced by banks and generated from the branches as a result of the branches' inefficiency in conducting banking transactions. The researcher also reached recommendations, the most important of which was the importance of increasing support for banking risk management in banks by higher authorities, and opening risk management departments. Banking in branches, provided that it is linked to banking risk management in public administrations and possesses a degree of efficiency to conduct banking transactions. As for the study (Ayodeji Michael Obadire, Vusani Moyo, Ntungufhadzeni Freddy Munzhelele 2019) it focuses on analyzing the efficiency of African banks. The results reveal that capital buffers have a positive impact on operational efficiency and investment efficiency in African banks. This relationship suggests that capital buffers not only protect capital from financial, market and economic shocks, but also improve banks' efficiency by influencing bank decision-making and perceptions of cost containment strategies.

After presenting the previous studies above and the theories supporting these hypotheses, we conclude that market risk management is important in the banking sector and has a significant impact on banking performance. Therefore, it is obligatory to work on its management in accordance with the legal frameworks and instructions issued by the Central Bank of Iraq and the applicable instructions and relevant laws and a statement and its impact, as a result, the second hypothesis was proposed.

> **The second hypothesis**
> **There is a positive relationship between market risk management and bank performance.**

Results of the study
The structural structure of the measuring instrument
In order to determine the validity of the scale and the reliability of the questionnaire for the current variables, the researcher relied on the Cronbach Alpha test, as it was found that the coefficient values for the main study variables and their sub-dimensions ranged between (0.823 - 0.783). These values are acceptable in descriptive studies as they are high values compared to the standard Cronbach alpha values of (0.7). It was also shown that the values of the structural validity coefficient were high and feasible for the approved standards. Thus, the study tool became valid for final application as it is characterized by accuracy, reliability and high reliability. Table (4) shows the reliability and validity coefficients for the measurement tool adopted in the current study.

Table No. (1): Reliability and validity coefficients at the level of the main variables and their sub-dimensions

Main variables and its sub-dimensions		Cronbach alpha value	The value of the structural validity coefficient	
Banking risk management	Liquidity risk management	0.793	0.783	
	Market risk management	0.782	0.791	
Performance of Iraqi banks		0.816	0.794	

Source: Prepared by the researcher based on the program outputs (SPSS. V.27)

The results of Table (1) indicate that the Cronbach's alpha coefficients for the variables included in the analysis were higher than (0.75), which indicates that the measurement tool is characterized by high relative stability.

The first axis: banking risk management
1- Liquidity risk management
Table No. (2) Internal consistency of the liquidity risk management axis statements

Code	Liquidity risk management	Pearson Correlation	Sig.
LRM1	The Bank has an effective risk management framework (infrastructure, processes and policies) to manage liquidity risk.	.799	0.000
LRM2	There is an appropriate set of rules and guidelines for liquidity risk management available in the bank.	.714	0.000
LRM3	Does increased liquidity risk negatively affect bank performance?	.874	0.000
LRM4	To what extent do you believe that a higher level of liquidity risk is associated with a lower bank performance?	.845	0.000
LRM5	To what degree do you see a positive relationship between liquidity risk and bank performance?	.895	0.000
LRM6	To what extent do you agree or disagree with the following statement: "Liquidity risk has a significant impact on bank performance."	.784	0.000
LRM7	How likely do you think it is that increased liquidity risk will degrade the overall performance of the bank?	.895	0.000

Through the data of the table above, it is clear to us that all paragraphs are linked to the first axis (liquidity risk management), which means that all paragraphs are statistically significant. We also find that the correlation coefficient in all paragraphs of this axis is significant, meaning that there is a moral correlation, and therefore, the items in this axis are considered honest and have internal consistency for what they were designed to measure.

2- Market risk management
Table No. (3) Internal consistency of market risk management axis statements

Code	Market risk management	Pearson Correlation	Sig.
MRM1	The bank adopts multiple risk measurement methodologies to identify market risks in various business activities.	.882	0.000
MRM2	Please rate the extent to which you agree with the following statement: "Increasing market risks negatively affect bank performance.	.901	0.000
MRM3	To what extent do you believe that a higher level of market risk is associated with a lower bank performance?	.795	0.000
MRM4	To what degree do you see a positive relationship between market risk and bank performance?	.784	0.000
MRM5	Please indicate the extent to which you agree or disagree with the following statement: "Market risk has a significant impact on bank performance."	.763	0.000
MRM6	How likely do you think it is that an increase in market risk will reduce the overall performance of the bank?	.774	0.000

Source: Prepared by the researcher based on the program outputs (SPSS. V.27)
Through the data of the table above, it is clear to us that all paragraphs are linked to the first axis (market risk management), which means that all paragraphs are statistically significant. We also find that the correlation coefficient in all paragraphs of this axis is significant, meaning that there is a moral correlation, and therefore items in this axis are considered honest and have internal consistency for what they were designed to measure.
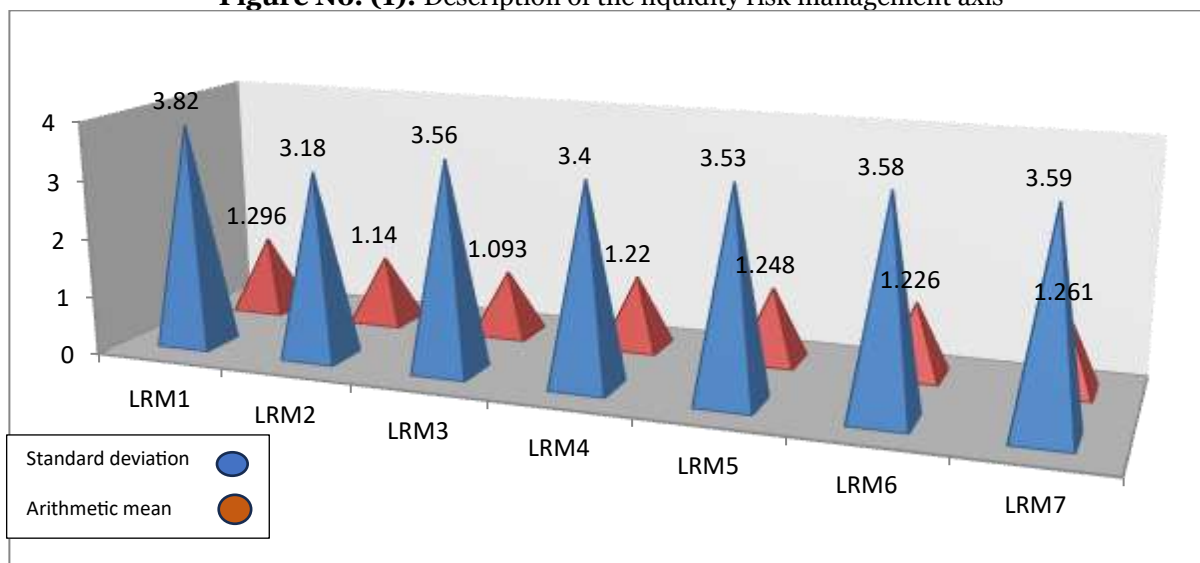
Liquidity risk management
The results of table (4) show that the general arithmetic mean of the liquidity risk management axis is trending towards neutral, with a moderate response level of (3.522) and a standard deviation of (.808), which means that workers in Iraqi banks are aware of the importance of managing liquidity risks, which increases the interest of workers in Iraqi banks in liquidity risks with the aim of developing the banks in which they work.

Table No. (4) Description of the axis of liquidity risk management

Paragraphs	I totally disagree	I do not agree	neutral	Agree	Totally agree	Arithmetic mean	standard deviation	Order of importance
	Fi	Fi	Fi	Fi	Fi			
LRM1	22	30	85	133	137	3.82	1.296	1
LRM2	53	73	106	96	79	3.18	1.140	7
LRM3	20	49	109	143	86	3.56	1.093	4
LRM4	30	69	114	99	95	3.40	1.220	6
LRM5	24	74	92	98	119	3.53	1.248	5
LRM6	21	67	99	95	125	3.58	1.226	3
LRM7	26	65	88	98	130	3.59	1.261	2
The overall rate of the liquidity risk management axis						3.522	.808	

Figure No. (1): Description of the liquidity risk management axis
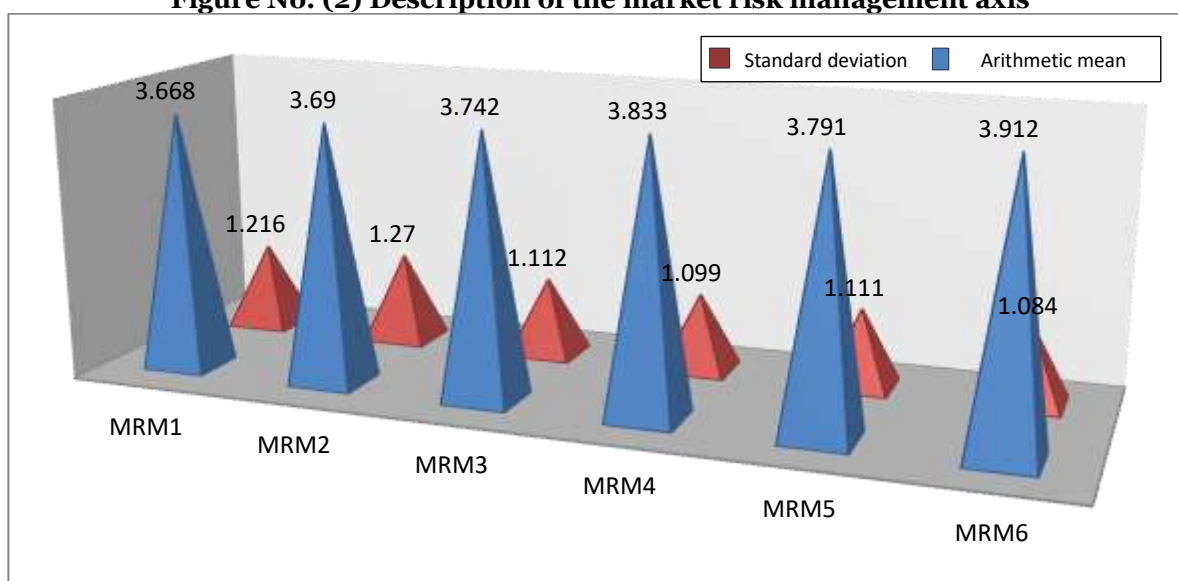

Market risk management

The results of table (5) show that the general arithmetic mean for the market risk management axis is trending towards neutral, with a moderate response level of (3.773) and a standard deviation of (0.792), which means that workers in Iraqi banks are aware of the importance of managing market risks, which increases the interest of workers in banks. Iraqis in market risk management with the aim of developing the banks in which they work.

Table No. (5) Description of the market risk management axis

Paragraphs	I totally disagree	I do not agree	neutral	Agree	Totally agree	Arithmetic mean	standard deviation	Order of importance
	Fi	*Fi*	*Fi*	*Fi*	*Fi*			
MRM1	31	40	84	130	122	3.668	1.216	6
MRM2	35	40	80	113	139	3.690	1.270	5
MRM3	19	35	98	135	120	3.742	1.112	4
MRM4	18	26	99	127	137	3.833	1.099	2
MRM5	8	56	86	120	137	3.791	1.111	3
MRM6	10	40	78	127	152	3.912	1.084	1
The overall rate of the liquidity risk management axis						3.773	.792	

Figure No. (2) Description of the market risk management axis

Risk management is classified as the process of identifying, monitoring and managing risks with the aim of reporting and controlling them and reducing their negative effects (Khalaf, Ali, 2018: 63). Risk management aims to identify losses from potential risks such as (how losses occur, how certain risk events are sequenced to generate losses) and methods of risk management through (avoiding or avoiding risks, reducing risks) or

reducing risks, retaining risks, transferring risks, and dividing Risks). The stages of the risk management process may consist of (identifying risks, setting the goal, identifying risks, assessing or measuring risks, studying alternatives, choosing a method for dealing with risks, monitoring and reviewing (Mark, 2013: 2). The bank must have a risk management strategy that is approved by the Board of Directors and demonstrates an appropriate risk tolerance to determine the level of risks that can be tolerated (Central Bank of Iraq, 2019: 4). Banks are considered one of the most important financial operations in every country because they contribute significantly to social economic progress. They determine the sector's ability to adapt to new and changing events, as well as the continuous improvement of its capabilities, resources, and level of service, its success and effectiveness. Banking activities benefit the local economy by managing the processes of developing financial savings and investments, including the formation of the necessary banking, commercial, and financial projects and operations. Risks, especially liquidity, capital adequacy, and financial performance indicators, are among. Among the main concerns affecting all types of banking units, especially private commercial banks, which require immediate attention and the adoption of modern development and management topics in order to achieve a certain level of success. Banks are at the heart of any country's economic life because of the crucial duties and roles they perform in the economy. It is believed that the development of a country's banking system is a benchmark for its economic development because banks are the most important financial institutions in the economy and have a greater influence on the economy than any other financial institution.

Study conclusions and recommendations
Conclusions:
1. The weakness of internal control procedures in monitoring and identifying credit risks in some banks in identifying risks and ways to reduce them, by not performing sufficient auditing procedures to ensure the accuracy and validity of the balance of customers' deposits, as in the Commercial Bank of Iraq.

2. The results showed that liquidity risk management contributed to explaining the differences in the performance of Iraqi banks, while the remaining value represents factors not included in the scope of the study.
3. The results indicate that there is a statistically significant correlation between liquidity risk management and the performance of Iraqi banks, which is characterized by being moderate.
4. The results showed that market risk management contributed to explaining the differences in the performance of Iraqi banks, while the remaining value represents factors not included in the scope of the study.
 5. The results indicate that there is a statistically significant correlation between market risk management and the performance of Iraqi banks, which is characterized by being moderate and valuable.

Recommendations:

- Commercial banks operating in the Iraqi banking sector must maintain a capital adequacy ratio of no less than (10%) before forming the precautionary pillar and no less than (12.5%) after forming the precautionary pillar. This ratio represents the relationship between the capital base and (simplifying the ratio) and assets weighted with risk weights specified to meet market risks and operational risks.
- Banks should have the ability to diagnose risks early, measure them, and treat them. This is achieved through the presence of an information system that enables management to achieve its goal, which is to measure credit risks, as well as the availability of procedures for monitoring the financial performance of customers.
- It requires calculating the capital adequacy ratio for both the bank and its branches inside and outside Iraq and the affiliated banks and financial institutions (except insurance companies) in which it owns
- Performing a set-off between long positions and short positions that are identical in all aspects in terms of the nature of the financial instrument, the source of this instrument, the interest rate on it, its maturity date, and the financial instrument that is the subject of the contract in the event that it is a financial derivative related to interest rates.
- A special committee for banking risks should be formed within its organizational structure and it should be independent. There should also be an exchange of information and results achieved with the Credit Facilities Division for the purpose of reducing bank credit risks to the lowest possible extent.
- Performing a clearing between the net long and short positions for types of financial instruments that are identical in all aspects to arrive at the mismatched position, which represents the remaining value of the clearing process and is classified as a long position or short position according to its greater value.
- Follow a policy by Iraqi banks and under the guidance of the Central Bank of Iraq, as it is the supervisory and controlling body over banks with regard to useful information, the lack of which leads to misleading the user, which is reflected in inappropriate decision-making. Therefore, it is required to oblige private commercial banks to the principles of transparency and disclosure in order to build a balanced and clear banking system that guarantees the rights of its customers and increases their confidence in the banking system.

- It is necessary for Iraqi banks to build a huge and advanced base that documents the banking scams they have been exposed to and work to form committees specialized in managing them and facilitating overall performance in banks.

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