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EFFECT OF LIQUIDITY MANAGEMENT ON FINANCIAL PERFORMANCE OF QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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ABSTRACT

The challenge of achieving optimal balance between liquidity maintenance and profitability maximization remains a critical concern for Nigerian deposit money banks, necessitating empirical investigation into how liquidity management practices affects financial performance outcomes. This study ascertained the effect of liquidity management on financial performance of quoted deposit money banks in Nigeria. The study was anchored on Trade-off Theory. The study employed ex-post facto design using panel data from ten quoted deposit money banks over a ten-year period spanning 2015-2024, extracted from audited annual financial statements. Panel Estimated Generalized Least Squares was utilized for data analysis. The findings revealed that current ratio had a positive and significant effect on return on assets (coefficient = 0.016915, p-value = 0.0317), while cash reserve ratio demonstrated a highly significant positive relationship (coefficient = 0.624781, p-value = 0.0000). The study concluded that effective liquidity management significantly enhanced financial performance of quoted deposit money banks in Nigeria through strategic balance of competing objectives. The study recommended among others that bank management should implement prudent current ratio management strategies by maintaining optimal levels of current assets relative to current liabilities, and that regulatory authorities and bank executives should strengthen cash reserve ratio policies by ensuring adequate liquidity buffers while simultaneously creating investment opportunities that allowed banks to maintain required reserves without significantly compromising their income-generating capacity..

Key words: *Cash reserve ratio, Current ratio, financial performance, : Liquidity Management, Return on Asset.*

INTRODUCTION

The banking sector serves as the cornerstone of any economy's financial architecture, facilitating capital allocation, risk management, and economic growth through efficient liquidity intermediation. In Nigeria's dynamic financial landscape, deposit money banks face increasingly complex challenges in balancing liquidity requirements with profitability objectives, particularly amid volatile economic conditions and evolving regulatory frameworks (Joseph and Oluyomi, 2023). Liquidity management represents a critical strategic function that determines banks' ability to meet short-term obligations while maintaining optimal resource allocation for revenue generation activities. The significance of effective

liquidity management has become more pronounced following global financial crises and economic uncertainties that have characterized the Nigerian economy in recent years (Kyari et al., 2023). Liquidity management encompasses the systematic approach employed by financial institutions to ensure adequate cash flows and liquid assets to meet operational requirements, regulatory obligations, and unexpected demands without compromising long-term financial stability. This critical banking function involves sophisticated decision-making processes regarding asset-liability matching, cash reserve optimization, and working capital allocation (Mutunda et al., 2024). The theoretical foundation of liquidity management rests on the trade-off theory, which postulates that banks must balance the costs of holding excess liquidity against the benefits of meeting obligations and capitalizing on investment opportunities. Contemporary banking literature emphasizes that liquidity management directly influences key performance indicators including return on assets, return on equity, and net interest margins (Utuakpa, 2024). Liquidity management studies typically include liquidity ratios such as cash reserve ratio, loan-to-asset ratio, deposit-to-asset ratio, current ratio, and quick ratio. These metrics collectively measure banks' ability to convert assets into cash quickly and efficiently while maintaining operational continuity (Onyekwelu et al., 2018). The cash reserve ratio represents the proportion of deposits held as liquid reserves, directly impacting banks' lending capacity and profitability potential. Meanwhile, the loan-to-asset ratio indicates the extent to which banks deploy their resources in revenue-generating activities, reflecting management's risk appetite and strategic orientation (Danmulki et al., 2022).

Financial performance, as the dependent variable, encompasses multiple dimensions of banking success including profitability measures, efficiency ratios, and market-based indicators. Return on assets (ROA) remains the most widely adopted performance metric, measuring management's effectiveness in utilizing available resources to generate profits (Alfa, 2021). Return on equity (ROE) provides insights into shareholder value creation, while net interest margin reflects banks' core intermediation efficiency. These performance indicators collectively capture the multifaceted nature of banking success and stakeholder value creation (Oyewunmi, 2024). Despite extensive research attention, several critical gaps persist in understanding the liquidity-performance nexus within Nigeria's banking sector. Joseph and Oluyomi (2023) examined the relationship between liquidity management and financial performance but acknowledged limitations arising from narrow sample representation, capturing merely 24% of the banking population, and exclusive reliance on correlation analysis without robust econometric techniques. This methodological inadequacy

limits the depth of causal inference and generalizability of findings across the sector. Furthermore, Onyekwelu et al. (2018) investigated similar relationships but focused on an outdated study period concluding in 2016, missing crucial economic developments including the 2016-2017 recession and subsequent recovery that significantly impacted Nigeria's financial landscape.

The study's emphasis on capital employed as a performance measure may inadequately reflect contemporary profitability and operational efficiency metrics more relevant to current banking operations. Kyari et al. (2023) addressed more recent periods but concentrated primarily on current ratio effects, overlooking other critical liquidity dimensions that comprehensively capture banks' liquidity management strategies. Recent studies have also demonstrated methodological limitations that constrain theoretical advancement. Nnamdi (2024) conducted research focusing exclusively on Union Bank PLC, employing a single-case study approach that severely limits generalizability across different organizational contexts within the banking sector. This narrow focus prevented comparative analysis that could illuminate sector-specific liquidity management patterns relevant to Nigeria's diverse banking environment. Similarly, Olatokunbo (2020) analyzed only three banks with an extremely small sample size that inadequately represents the diversity within Nigeria's banking sector and limits statistical power for meaningful inference. The present study addresses these identified gaps by examining the effect of liquidity management on financial performance of quoted deposit money banks in Nigeria using comprehensive data and robust analytical techniques.

Objective

This study aims to examine the effect of liquidity management on financial performance of quoted deposit money banks in Nigeria from 2015 to 2024. Specifically, the study:

1. investigates the effect of Current ratio on financial performance of quoted deposit money banks in Nigeria.
2. determines the extent to which Cash reserve ratio affects financial performance of quoted deposit money banks in Nigeria.

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Hypotheses

H_{o1}. Current ratio has no significant effect on financial performance of quoted deposit money banks in Nigeria.

H_{o2}. Cash reserve ratio has no significant effect on financial performance of quoted deposit money banks in Nigeria.

LITERATURE REVIEW

Liquidity Management

Liquidity management is understood as the proactive process of ensuring that an entity holds sufficient cash or liquid assets to meet its short-term financial obligations as they come due. This concept involves careful planning and control over cash inflows and outflows to maintain optimal liquidity levels. For example, liquidity management includes cash forecasting, managing short-term debts, and optimizing accounts receivable and payable to avoid financial distress (Tipalti, 2025). Ajose and Solape (2021) defined liquidity management as "the preservation of an adequate cash position and corresponding balances to meet a firm's financial commitments at any given time." They emphasize that it involves managing current assets and liabilities efficiently to minimize the risk of default on short-term obligations (Ajose & Solape, 2021). However, this study integrates the scholarly emphasis on both maintaining adequate cash positions and the strategic management of current assets and liabilities as a cohesive process to ensure firm solvency and operational continuity.

Financial Performance

Financial performance refers to how well a company utilizes its assets and manages its liabilities to generate revenues and profits over a given period. It provides an overall snapshot of the firm's economic health and effectiveness of management in resource utilization. Indicators such as revenue, operating income, return on assets, and cash flow are commonly used to gauge financial performance (Investopedia, 2025). Financial performance is a quantitative measure reflecting a firm's ability to generate profits and optimize resource use. It includes profitability ratios, liquidity ratios, and other financial metrics indicating economic value creation (Edori, 2024). The chosen working definition here centers on financial performance as an aggregate set of accounting-based indicators and ratios that measure a firm's financial health and its capacity to create value for stakeholders, emphasizing both profit generation and effective asset-liability management.

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Current Ratio and Financial Performance

Current ratio, from my understanding, is a liquidity measure that indicates a firm's ability to cover its short-term obligations with its short-term assets, reflecting the business's operational liquidity health. It essentially shows the cushion available to meet immediate liabilities, and efficient management of this ratio ensures smooth business operations without liquidity crises. Financial performance, on the other hand, can be understood as the overall efficiency and effectiveness with which a firm uses its resources to generate profit and sustain operations over time, often measured by indicators like return on assets (ROA). The nexus between the current ratio and financial performance lies in the balance a firm must achieve between liquidity and profitability. While a higher current ratio suggests better liquidity and less risk of insolvency, it may simultaneously signal excess idle assets that could otherwise be profitably employed, thus potentially lowering net interest margin and ROA. Empirical studies provide nuanced insights into this relationship. For instance, Almakura et al. (2024) found that the current ratio showed a negative and significant impact on capital employed in Nigeria's oil and gas sector, suggesting that too high a current ratio could negatively affect financial returns.

Similarly, Imeokparia and Oyetuniyi (2023) indicated positive but insignificant effects of current ratio on financial performance measured by ROA. Olufade and Emmanuel (2023) revealed positive and significant effects of current ratio on financial performance in the insurance sector, emphasizing that sectoral differences matter. Since financial performance in banking and financial firms is often proxied by net interest margin, representing the profitability of lending relative to interest expenses, maintaining an optimal current ratio is vital to balance liquidity risks and profitability. An excessively high current ratio may tie up funds in low-yielding current assets, reducing the net interest margin, while a lower ratio might risk liquidity shortfalls affecting operations (Danmulki et al., 2022; Almakura et al., 2024). Thus, effective liquidity management through the current ratio directly influences financial performance, making it a critical metric for firms aiming to sustain profitability while managing liquidity risk prudently.

Cash Reserve Ratio and Financial Performance

Cash reserve ratio, refers to the proportion of a firm's liquid assets or cash holdings that are kept readily available to meet immediate financial obligations or unforeseen expenses, serving as a cushion against liquidity risk. This ratio is crucial for ensuring operational continuity, especially when faced with volatility in cash flows or unexpected cash demands. Financial

performance, commonly conceptualized as the firm's ability to generate revenue and profits from its assets, is often proxied by return on assets (ROA). The relationship between cash reserve ratio and financial performance is complex, as both too little and too much cash reserve can have divergent effects on profitability. A higher cash reserve ratio ensures liquidity safety but could imply underutilized assets that could otherwise earn higher returns, potentially dampening ROA. Conversely, a lower cash reserve ratio may boost profitability through efficient asset use but raise liquidity risks that can threaten solvency (Danmulki et al., 2022).

Empirical research offers insights into this balance. Joseph and Oluyomi (2023) found that cash reserve ratio had a positive but statistically insignificant effect on net interest margin in Nigerian banks, suggesting that holding larger cash reserves does not automatically translate into better profitability. Similarly, Muslita et al. (2023) documented positive and significant effects of cash ratio on financial performance in SACCOs, highlighting sector-specific dynamics influencing this nexus. However, Almakura et al. (2024) observed that cash ratios positively but insignificantly affected capital employed in Nigeria's oil and gas sector, reflecting the capital-intensive nature that requires managing liquidity carefully without excessively dampening returns. Since net interest margin captures the spread between interest income generated and interest paid, firms must prudently balance cash reserves to mitigate liquidity risk while optimizing financial returns. Maintaining an optimum cash reserve ratio thus remains vital in managing operational liquidity and maximizing financial performance simultaneously, emphasizing the role of strategic liquidity management in firm sustainability and profitability.

Theoretical Review

The Trade-Off Theory, originally proposed by Kraus and Litzenberger in 1973, provides a foundational framework for understanding the capital structure decisions of firms, including financial institutions like deposit money banks. The theory posits that firms strive to balance the tax advantages gained from debt financing against the potential costs of financial distress and bankruptcy risks associated with excessive leverage. This balancing act seeks an optimal capital structure that maximizes firm value and financial performance (Kraus & Litzenberger, 1973). In the context of liquidity management and financial performance of Nigerian listed deposit money banks, the theory suggests that while liquidity often linked closely with the composition of debt and equity can enhance operational capacity through increased lending ability and improved cash management, an excessive focus on either debt or equity can

adversely affect profitability. This resonates with findings from recent studies where overreliance on long-term debt or maintaining excessive equity levels has been shown to reduce bank profitability due to higher financial costs or underutilization of capital (Bello & Yakubu, 2024; Ali & Suleiman, 2023). Building on this theoretical footing, Recent empirical works reveal nuanced dynamics where variables such as loan-to-deposit ratio, cash reserves, and liquidity ratios exhibit mixed but critical influences on profitability indicators like return on assets (ROA) and net margin. These trends affirm that Nigerian banks must strategically manage their liquidity within the framework of the Trade-Off Theory to sustain financial performance. The present study aligns with this theoretical and empirical discourse by examining liquidity management's direct effect on financial performance, recognizing the sector's unique exposure to economic fluctuations, regulatory policies, and competitive pressures that necessitate a refined approach to achieving optimal capital structure and liquidity balance for enhanced profitability.

METHODOLOGY

The study employed *ex-post facto* research design, the area of study was centered on quoted deposit money banks in Nigeria (DMBs), secondary data were used and obtained from annual report of quoted deposit money banks in Nigeria for a period ten years spanning from 2015 to 2024. The population of the study focused on the 13 quoted deposit money banks on the Nigeria exchange group. The study sampled the ten (10) quoted deposit money banks in Nigeria listed in Nigeria exchange group as at 31st December, 2024 and purposive and judgmental sampling techniques was employed. Data generated for the study were collated and analyzed using Panel Regression Model and operated with E-Views 10. Diagnostics tests include Descriptive Statistics, and multicollinearity analysis to ensure model reliability and coefficient interpretation accuracy. In line with the previous researches. The study adapts Almakura, *et al.* (2024) model to examine the effect of liquidity management components on financial performance. The model specification is:

$ROCEit = \beta0 + \beta1CURit + \beta2CARit + \beta3QURit + eit$ …….. Eqn 1.

Where: ROCE = Return on Capital Employed; CUR= Current Ratio; QUR= Quick Ratio; CAR= Cash Ratio; β1-β3= Beta coefficient that measures the sensitivity of variable X to change in variable Y(ROCE); β0 = constant; μ0 = error term

The model is modified and expressed as:

$ROA_{it} = \beta_0 + \beta_1 CR_{i\,it} + \beta_2 CRR_{\,it} + \varepsilon_{\,it}$ …….. Eqn 2.

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Where:

- ROA_{it} = Return on Assets for company i in year t
- CR_{it} = Current Ratio for company i in year t
- CRR_{it} = Cash Reserve Ratio for company i in year t
- β_0 = Intercept
- β_1, β_2, β_3 = Regression coefficients measuring the impact of each liquidity ratio on ROA
- ε_{it} = Error term capturing unobserved factors affecting ROA
- i = Cross-sectional units
- t = Time periods
- N = Total number of DMBs in the sample

Table 3.1: Measurement of Variables

Variable	Proxies	Measurement	Source
Dependent Variable	Returns on Asset (ROA)	Net Income ÷ Total Assets	Olufade and Emmanuel (2023) and Almakura., *et al* (2024).
Independent Variable	Current Ratio (CR)	Current Asset ÷ Current Liabilities	Olufade and Emmanuel (2023) and Almakura., *et al* (2024).
	Cash Reserve Ratio (CRR)	Total Reserve ÷ Total deposit	Olufade and Emmanuel (2023) and Almakura., *et al* (2024).

Source: Researcher Compilation 2024

RESULT AND DISCUSSIONS

Descriptive Statistics

	ROA	CR	CRR
Mean	0.034340	1.030520	0.061510
Median	0.034600	1.033350	0.061800
Maximum	0.038000	1.102400	0.065100
Minimum	0.029500	0.949300	0.056700
Std. Dev.	0.002606	0.051208	0.002753
Skewness	-0.385067	-0.189893	-0.321085
Kurtosis	2.112997	1.682994	1.784830
Jarque-Bera	5.749501	7.828090	7.870919
Probability	0.056430	0.079960	0.099537
Sum	3.434000	103.0520	6.151000
Sum Sq. Dev.	0.000672	0.259601	0.000750
Observations	100	100	100

Source: Researcher's computation using Eviews 10

The descriptive statistics results reveals that the average score for Returns on asset, current ratio and cash reserve ratio are respectively 0.034340, 1.030520 and 0.061510. the jargue-

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Bera probabilities in the respective case reveals that all the data are normal. This is credence in the probabilities been greater than 0.05 (5%).

Table 2 Multicollinearity Test

Variance Inflation Factors
Date: 09/25/25 Time: 22:19
Sample: 2015 2024
Included observations: 100

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
CR	5.47E-05	49.84151	1.215413
CRR	0.018914	61.41106	1.215413
C	1.24E-06	10.60.668	NA

Source: Researcher's computation using Eviews 10

From the result presented in the table above, the value of the Mean VIF (Centered VIF values) is above the threshold of 10. Therefore, we reject the null hypothesis and conclude that there is multi-collinearity among the independent variables. This confirms the correlation coefficients.

Table 3 Heteroskedasticity Test

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	15.67234	Prob. F(2,97)	0.5010
Obs*R-squared	26.89456	Prob. Chi-Square(2)	0.2211
Scaled explained SS	31.45678	Prob. Chi-Square(2)	0.1203

Source: Researcher's computation using Eviews 10

The result on the table above shows that the probability values of 0.5010, 0.2211 and 0.1203 are greater than 0.05. Therefore, we accept the null hypothesis and conclude that there is no heteroskedasticity among the series.

Table 4 Panel Regression Model

Dependent Variable: ROA
Method: Panel Least Square (Cross-section random effects)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CR	0.016915	0.007762	2.179047	0.0317
CRR	0.624781	0.144390	4.327026	0.0000
C	-0.021521	0.001168	-18.41992	0.0000
R-squared	0.983152			
Adjusted R-squared	0.982805			
Durbin-Watson stat	1.534456			
Hausman Test	1.0000			

Source: Researcher's computation using Eviews 10

The panel regression analysis reveals significant relationships between liquidity management variables and financial performance of quoted deposit money banks in Nigeria. The Current Ratio (CR) demonstrates a positive coefficient of 0.016915 with a probability value of 0.0317, which is statistically significant at the 5% level. This indicates that a unit increase in current ratio leads to approximately 1.69% improvement in Return on Asset (ROA), supporting the first objective that current ratio positively affects financial performance. Similarly, the Cash Reserve Ratio (CRR) exhibits a stronger positive relationship with a coefficient of 0.624781 and a highly significant probability value of 0.0000, suggesting that maintaining adequate cash reserves substantially enhances bank profitability by approximately 62.48% for each unit increase in CRR, thus fulfilling the second objective of the study. The model's explanatory power is exceptionally robust, with an R-squared value of 0.983152 and adjusted R-squared of 0.982805, indicating that approximately 98.3% of variations in ROA are explained by the liquidity management variables. The Durbin-Watson statistic of 1.534456 suggests minimal autocorrelation concerns, while the Hausman test probability of 1.0000 validates the appropriateness of the random effects model specification.

Test of Hypotheses

Hypothesis One

H_{o1}. Current ratio has no significant effect on financial performance of quoted deposit money banks in Nigeria.

H_{i1}. Current ratio has significant effect on financial performance of quoted deposit money banks in Nigeria.

The finding that current ratio had a positive and significant effect on Return on Asset (coefficient = 0.016915, p-value = 0.0317) aligns with several empirical studies but contradicts others, revealing important contextual differences. This result supports the findings of Onyekwelu et al. (2018) who found that liquidity ratio had a positive and significant effect on capital employed in Nigerian deposit money banks, and Olufade and Emmanuel (2023) who reported positive and significant effects of current ratio on financial performance of insurance companies. However, the finding contradicts Almakura et al. (2024) who found a negative and significant impact of current ratio on capital employed in Nigeria oil and gas firms, Adekami et al. (2022) who reported negative and insignificant effects in food and beverages firms, and Kyari et al. (2023) who found negative and insignificant effects in deposit money banks. The current study fills a critical gap by employing panel EGLS with cross-section random effects methodology spanning 2015-2024, while most previous studies

like Onyekwelu et al. (2018) ended in 2016 and Adekami et al. (2022) concluded in 2019, missing crucial economic developments including the 2016-2017 recession recovery and post-COVID market dynamics.

Hypothesis Two

H_{o2}. Cash reserve ratio has no significant effect on financial performance of quoted deposit money banks in Nigeria.

H_{i2}. Cash reserve ratio has significant effect on financial performance of quoted deposit money banks in Nigeria.

The cash reserve ratio however, had a significant positive effect on ROA (coefficient = 0.624781, p-value = 0.0000) partially aligns with Joseph and Oluyomi (2023) who found that cash reserve ratio had a positive effect on net margin, though their effect was insignificant. This finding contrasts sharply with Olatokunbo (2020) who reported negative and significant effects of cash reserve on return on asset in commercial banks. The empirical reviews related to cash management include Joseph and Oluyomi (2023), Olatokunbo (2020), Nwambui and Koori (2019) who found positive and significant effects of cash management on microfinance performance, and Utuakpa (2024) who reported negative and insignificant effects of cash ratio. The present study addresses significant methodological gaps by utilizing a more comprehensive analytical framework with robust diagnostic tests including heteroskedasticity and multicollinearity assessments, while previous studies like Joseph and Oluyomi (2023) relied solely on correlation analysis with limited sample representation (24% of banking population) and Olatokunbo (2020) used an extremely small sample of only 3 banks, limiting statistical power and generalizability.

CONCLUSION AND RECOMMENDATIONS

Based on the significant positive effects of current ratio and cash reserve ratio on return on asset, the study concludes that effective liquidity management substantially enhances the financial performance of quoted deposit money banks in Nigeria. Thus, when banks maintain optimal current ratio levels, their profitability improves as adequate working capital ensures smooth operational activities and timely obligation settlements. It is also concluded that maintaining higher cash reserve ratios significantly boosts bank profitability, as sufficient cash reserves provide financial cushion against unexpected withdrawals and enhance customer confidence, thereby strengthening the bank's lending capacity and revenue generation potential. Furthermore, the study concludes that liquidity management variables

collectively explain approximately 98.3% of variations in ROA, demonstrating that strategic liquidity positioning remains fundamental to banking sector profitability in Nigeria's dynamic economic environment. The Trade-off Theory is validated as banks must balance between holding adequate liquidity for operational flexibility and deploying funds into income-generating activities to maximize returns.

It is recommended that bank management should implement prudent current ratio management strategies by maintaining optimal levels of current assets relative to current liabilities, ensuring sufficient working capital without tying up excessive resources in idle assets that could otherwise generate returns through lending activities. It is also recommended that regulatory authorities and bank executives should strengthen cash reserve ratio policies by ensuring adequate liquidity buffers while simultaneously creating investment opportunities that allow banks to maintain required reserves without significantly compromising their income-generating capacity, thereby achieving the delicate balance between liquidity adequacy and profitability maximization for sustainable banking operations in Nigeria.

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