

The Effect of Liquidity Management on The Financial Health of Deposit Money Banks in Nigeria

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Abstract- This study examined the effect of liquidity management on the financial performance of Deposit Money Banks. The objectives of this study were to determine individually and jointly, the extent to which liquidity ratio, Loan-to-Deposit ratio and Current Ratio significantly affects the financial performance of DMBs in Nigeria. Five (5) Deposit Money Banks were chosen through a purposive sampling technique and data were collected mainly from secondary sources, specifically banks' financial reports and relevant information obtained from the banks and CBN for the period 2015–2024. Financial performance was proxied by Return on Investment(ROI) while liquidity management was proxied by Liquidity Ratio, Current Ratio and Loan to Deposit Ratio. The statistical technique used in analyzing the data is multiple linear regression analysis, with SPSS Version 23 employed for computation. Findings revealed that liquidity ratio and current ratio has a positive significant effect on financial performance, while loan-to-deposit ratio has a negative significant effect on financial performance on financial performance of DMBs in Nigeria. Thus, it was concluded in the study that banks must strive to maintain an optimal level of liquidity sufficient to ensure stability but not excessive to the point of reducing earning capacity.

performing loans. Additional developments, including the implementation of the Treasury Single Account (TSA) and loan repayment challenges, further strained bank liquidity in Nigeria.

Banks generate profit primarily from interest on assets and fees for financial services, while incurring expenses such as interest on liabilities (Williams, 2020; Richard, 2023). Their intermediation function involves mobilizing deposits and channeling them into investments, which exposes them to liquidity risks when depositors demand withdrawals (Ibe, 2023; Goyit, 2020). Given the competitive nature of the banking sector and the need to sustain public confidence, DMBs must ensure profitability while maintaining adequate liquidity (Liargovas and Skandalis, 2018; Mayo, 2023). The challenge, therefore, lies in identifying an optimal balance that supports profit generation without compromising liquidity, as excessive focus on profit maximization can result in liquidity stress and potential insolvency.

Statement of the Problem

The banking sector in Nigeria continues to experience challenges in maintaining an optimal liquidity ratio, which affects the ability of deposit money banks to meet short-term obligations using liquid assets. Inadequate liquidity exposes banks to difficulties in meeting customers' withdrawal requests and other financial commitments, thereby undermining depositor confidence and financial stability, while excessive liquidity reduces profitability due to idle funds that could have been invested in income-generating assets (Olaleye, Adesina, and Yusuf, 2021). Despite regulatory policies by the Central Bank of Nigeria (CBN), many banks still struggle to balance liquidity maintenance and profitability (Adaramola et al., 2024). Similarly,

I. INTRODUCTION

In Nigeria, the challenges of liquidity management became prominent during the financial distress and liquidation era of the 1980s and 1990s, with effects extending to the 2005 banking sector recapitalization. Despite reforms introduced by the Central Bank of Nigeria to strengthen the system, liquidity problems persisted, leading to further interventions, including the 2009 rescue of distressed banks and the injection of ₦620 billion to stabilize the sector (Okaro and Nwakoby, 2016). The global financial crisis of 2008 further exposed the fragility of the banking system, necessitating unconventional policy measures such as the establishment of the Asset Management Corporation of Nigeria (AMCON) to address non-

the loan-to-deposit ratio (LDR) presents another major concern, as excessive lending relative to deposits increases liquidity risk, especially in cases of borrower default or sudden withdrawal demands, and poor credit management alongside rising non-performing loans continues to threaten the liquidity position and sustainability of lending practices in Nigerian banks (Olaleye, Adesina, and Yusuf, 2021; Amusan, 2025). In addition, the current ratio, which measures the ability to meet short-term liabilities with current assets, shows that a low ratio increases financial distress risk while an excessively high ratio reflects inefficient resource utilization, and empirical evidence indicates that these liquidity indicators significantly influence financial stability and market value of deposit money banks in Nigeria, making the balance between liquidity and profitability a persistent challenge (Moses-Ashike, 2024; Oyewole, 2025).

This paper is therefore written to examine the effects of liquidity management on the performance of Deposit Money Banks (DMBs) in Nigeria from 2015 - 2024.

Objectives of the Study

The main objective of this work is to evaluate the effect of liquidity management on the financial performance of DMBs in Nigeria.

Specifically, the objectives of this study are as follows:

- To evaluate the extent to which liquidity ratio significantly affects the financial performance of DMBs in Nigeria.
- To evaluate the extent to which Loan to Deposit ratio significantly affects the financial performance of DMBs in Nigeria.
- To evaluate the extent to which Current Ratio significantly affects the financial performance of DMBs in Nigeria.

Hypotheses

H₀₁: Liquidity Ratio does not significantly affect the financial performance of DMBs in Nigeria.

H₀₂: Loan-to-Deposit Ratio does not significantly affect the financial performance of DMBs in Nigeria.

H₀₃: Current Ratio does not significantly affect the financial performance of DMBs in Nigeria.

II. LITERATURE REVIEW

Conceptual Review

Liquidity Management

Liquidity is a financial term that means the amount of capital that is available for investment, and bank liquidity means the ability of the bank to maintain sufficient funds to pay for its maturing obligations. It is the ability to immediately meet cash, cheques, withdrawals obligations and legitimate new loan demand while abiding by existing reserve requirements. Nwaezeaku (2018) defined liquidity as the degree of convertibility to cash or the ease with which any asset can be converted to cash. According to Olagunji et al. (2021), liquidity refers to the ability of a bank to ensure the availability of funds to meet financial commitments or maturing obligations at a reasonable price at all times. Put differently, bank liquidity means banks having money when they need it particularly to satisfy the withdrawal needs of their customers, and the survival of deposit money banks depends greatly on how liquid they are, since illiquidity can erode public confidence and result in a run on deposit. Bank liquidity also means the ability of the bank to maintain sufficient funds to pay for its maturing obligations and immediately meet cash, cheques, other withdrawals obligations and legitimate new loan demand while abiding by existing reserve requirements (Colin, 2022; Abdallah, 2023).

Liquidity management therefore involves the strategic supply or withdrawal from the market or circulation of liquidity consistent with a desired level of short-term reserve money without distorting the profit making ability and operations of the bank, relying on daily assessment of liquidity conditions to determine liquidity needs and the volume to allot or withdraw (Adebayo et al., 2021; Agbada and Osuji, 2023). Bhattacharyya and Sahoo (2021) argued that liquidity management by central banks refers to the framework, set of instruments, and rules used in managing systemic liquidity, while modulating liquidity conditions by varying short-term interest

rates and influencing bank reserves in the interbank market, with long-term implications for the real sector and price level being more profound. The liquidity needs of the banking system are defined by reserve requirements imposed by a monetary authority (CBN, 2022), and liquid assets should be marketable or transferable, expected to be converted to cash easily and promptly and redeemable prior to maturity, with price stability making bank deposits and short-term securities more liquid than equity investments (Richard, 2023).

Effective liquidity management is a key factor that helps sustain bank profits and concurrently keeps the banking institution and the financial system from illiquidity and insolvency. Strategic bank management aims at keeping the bank solvent and liquid in order to earn good profits and remain sound (Bassey et al., 2020). In order to maintain public confidence in the financial system, banks are required to maintain adequate cash and near cash assets such as securities to meet withdrawal obligations, which is paramount for the survival of the financial system and banks' financial intermediation function (Eljelly and Deloof, 2023; Heibati et al., 2019).

Liquidity Ratio

Liquidity of a company is measured using financial ratios referred to as liquidity ratios, which measure the ability of firms to meet current obligations. Liquidity analysis may require cash budgets and cashflow statements, but liquidity ratios provide a quick measure by establishing a relationship between cash and current assets to current obligations (Pandy, 2020). Liquidity ratio is a financial measure used to determine the ability of a bank to meet short-term obligations without incurring significant losses, representing liquid assets such as cash, treasury bills, balances with the central bank, and other near-cash assets relative to deposit liabilities or short-term obligations (Akande, 2024; CBN, 2017). Liquidity ratios indicate financial strength and stability of banks, helping regulators and analysts evaluate their ability to withstand withdrawals or financial shocks, where higher ratios indicate stronger ability while lower ratios expose liquidity risk (Adebayo et al., 2021). The liquidity ratio is expressed as total liquid assets divided by total deposit liabilities, and while

adequate liquidity ensures stability, excessive liquidity may reduce profitability due to lower returns on liquid assets (Sani and Odunola, 2025).

Loan-to-Deposit Ratio

Loan-to-Deposit Ratio (LDR) measures the proportion of loans granted relative to total deposits, indicating the extent to which banks utilize deposits for lending activities, which is a primary source of income (Adenuga, 2024). It is calculated as total loans divided by total deposits multiplied by 100. LDR serves as a key indicator of liquidity and lending efficiency, where a higher ratio enhances profitability through interest income but increases liquidity risk, while a lower ratio indicates underutilization of deposits. It is widely used by regulators and analysts to assess stability and liquidity position, and maintaining an optimal LDR balances profitability with liquidity risk (Adenuga, 2024). The Central Bank of Nigeria (CBN) has used LDR as a regulatory tool, increasing it from 57% to 60% in 2019 and to 65% in 2020 to stimulate credit growth (Lawal, 2024), but reducing it to 50% in 2024 to stabilize the financial system and improve risk management (Ariemu, 2024).

Current ratio

The current ratio measures the extent to which current liabilities are covered by current assets and indicates a firm's liquidity and ability to meet creditor demands (Mayo, 2023). It compares current assets to current liabilities, where values below 1 indicate difficulty in meeting obligations, while very high values indicate inefficient use of current assets or short-term financing facilities (European Centre for Research Training and Development, 2020). It measures whether a firm has enough resources to pay debts within 12 months, although some firms operate with ratios below 1 depending on their cash cycle (Sani and Odunola, 2025). The current ratio is expressed as current assets divided by current liabilities.

Financial performance

Financial performance is a subjective measure of how well a firm uses its assets to generate revenues and reflects overall financial health over time, measured

through profitability, dividend growth, sales turnover, and return on investments among others (Govit, 2020; Liargovas and Skandalis, 2018). It evaluates management efficiency in resource utilization and is commonly measured using indicators such as Return on Assets, Operating profit margin, Earnings before Interest and Tax, Economic Value Added, or Sales growth (DeBusk, 2018; Smith, 2017). Financial performance is defined as the ability to make profit from business activities and is measured using ratios such as ROI, ROE, and ROA, where ROI is calculated as profit after tax divided by net assets, ROE as profit after tax divided by equity, and ROA as profit before taxes divided by total assets (Owolabi and Obida, 2022; Mayo, 2023; Damilola, 2017).

Empirical Review

Ali D. H and Urum R.G (2025) examined the effect of liquidity management on profitability of listed deposit money banks in Nigeria and found that current ratio and cash ratio have significant positive effects on profitability, while acid test ratio has a negative but insignificant effect and operating cash flow ratio has a negative but significant effect, with leverage significantly moderating the relationship, and recommended effective liquidity and debt management strategies.

Haliru et al. (2024) investigated liquidity management and financial performance of listed deposit money banks in Nigeria and found that operating cost ratio and capital adequacy ratio have positive and significant effects on return on assets, while current ratio has a negative but insignificant effect, recommending improved current ratio management, operating efficiency, and capital adequacy.

Lartey and Boadi (2023) studied liquidity and profitability of listed banks in Ghana and found a positive and statistically significant relationship between liquidity and profitability, with both variables showing a downward trend over time.

Idolor and Adelegan (2023) examined liquidity management and financial performance of deposit money banks in Nigeria and found mixed results, where deposit-to-asset ratio has a negative but

insignificant relationship with ROA, cash reserve ratio has a positive but insignificant relationship with ROE, and loan-to-deposit ratio has a negative but insignificant relationship with NIM, recommending stronger regulation, improved loan recovery, and staff training.

Bashiru et al. (2022) found that capital adequacy ratio has a positive and significant effect on financial performance of listed deposit money banks in Nigeria, liquidity ratio has a significant but negative effect, and loan-to-deposit ratio has a positive but insignificant effect, recommending improved capital adequacy and investment of idle funds.

Wuave et al. (2020) found that liquidity ratio has a positive and significant effect on financial performance of banks in Nigeria and recommended stronger liquidity management practices, risk management policies, and contingency funding plans. Bassey (2017) found a significant positive relationship between liquidity management and performance of deposit money banks in Nigeria, with mixed effects where liquidity and cash reserve ratios are positively related to return on equity while loan-to-deposit ratio is negatively related, concluding that optimal liquidity improves returns and recommending optimal liquidity models.

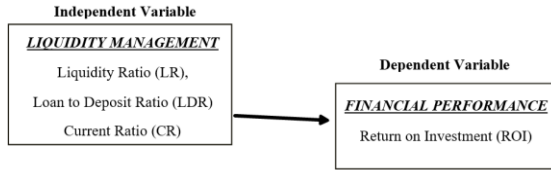
Nabeel and Hussain (2017) found mixed effects of liquidity management on bank profitability in Pakistan, where interest coverage ratio, capital adequacy ratio, and quick ratio show positive relationships with profitability while cash ratio and current ratio show negative relationships.

Okaro and Nwakoby (2016) found a negative and significant relationship between liquidity ratio and profitability of deposit money banks in Nigeria but a positive and significant relationship between cash to deposit ratio and profitability, recommending better liquidity utilization and investment of excess liquidity.

Olarewaju and Adeyemi (2015) found no causal relationship between liquidity and profitability for most banks, while a causal relationship running from liquidity to profitability was found for a few banks,

recommending stronger Central Bank supervision to ensure adequate liquidity and financial stability.

Conceptual Framework



Author’s conceptualization (2026)

III. RESEARCH METHODOLOGY

The study adopted an ex post facto research design because it is a panel data research and used secondary data from financial reports to examine the relationship between liquidity management and financial performance of deposit money banks in Nigeria. The data used for this study consist of secondary financial data obtained from annual financial reports of five selected Deposit Money Banks (UBA, GTB, Zenith Bank, First Bank, and Union Bank) over a ten-year period (2015–2024). The variables include Return on Investment (ROI) as the dependent variable, while Liquidity Ratio (LR), Loan-to-Deposit Ratio (LDR), and Current Ratio (CR) serve as independent variables.

Data were collected mainly from secondary sources, specifically banks’ financial reports and relevant information obtained from the banks and CBN for the period 2015–2024. The study made use of financial performance and liquidity management data extracted from annual reports, as publicly available data were considered suitable for accuracy. The statistical technique used in analyzing the data is multiple linear regression analysis, with SPSS Version 23 employed for computation. The hypotheses were tested using F-test at 5% level of significance, and descriptive, correlation, and inferential statistics were also used, where descriptive statistics showed mean, standard deviation, and coefficient of variation, while inferential statistics were used to draw conclusions on the relationship between liquidity management and financial performance variables.

Model Specification

This study employed the model below:

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \mu$$

Where;

Y = Return on Investment (ROI)

X₁ = Liquidity Ratio

X₂ = Loan to Deposit Ratio

X₃ = Current Ratio

b₁, b₂, b₃ = the slope or the co-efficient of the independent variables

μ = stochastic error term

IV. DATA ANALYSIS, RESULTS AND DISCUSSIONS

Test of Hypotheses

The study examines five Deposit Money Banks (UBA, GTB, Union Bank, First Bank, Zenith Bank) over the period 2015–2024, using ROI as proxy for financial performance and liquidity indicators (LR, LDR, CR) as independent variables.

Hypothesis One

H₀₁: Liquidity Ratio does not significantly affect the financial performance of DMBs in Nigeria.

Variable	B	R	R ²	Adj. R ²	F	T	P	Remark
Liquidity Ratio	13.540	0.621	0.386	0.373	28.45	5.33	0.00	Sig

From the model summary, the correlation coefficient (R = 0.621) indicates a moderate to strong positive relationship between liquidity ratio and financial performance. This suggests that as banks maintain higher levels of liquidity, their profitability tends to improve.

The coefficient of determination (R² = 0.386) further reveals that approximately 38.6% of the variation in financial performance (ROI) is explained by changes in the liquidity ratio. This is a substantial proportion in financial studies, indicating that liquidity

management plays a critical role in determining bank performance. However, it also implies that about 61.4% of the variation is explained by other factors such as management efficiency, macroeconomic conditions, asset quality, and regulatory policies.

The ANOVA results reinforce the validity of the model. The F-statistic of 28.45 with a corresponding p-value of 0.000 (which is less than the 5% significance level) indicates that the regression model is statistically significant. This means that the relationship observed between liquidity ratio and financial performance is not due to random chance but reflects a true underlying association in the population of Nigerian DMBs.

Further insight is obtained from the coefficients table. The liquidity ratio has a regression coefficient (B) of 13.540, which is positive and statistically significant ($p = 0.000$). This implies that a one-unit increase in liquidity ratio leads to an approximate 13.54-unit increase in ROI, holding other factors constant. The relatively high t-value (5.33) confirms the strength and reliability of this relationship. The constant term (6.215) represents the baseline level of financial performance when liquidity ratio is zero, though in practice this serves mainly as a statistical reference point.

Based on the decision rule ($p\text{-value} < 0.05$), the null hypothesis (H_{01}) is rejected, confirming that liquidity ratio has a significant effect on financial performance of DMBs in Nigeria.

Hypothesis Two

H_{02} : Loan-to-Deposit Ratio does not significantly affect the financial performance of DMBs in Nigeria.

Variable	B	R	R ²	Adj. R ²	F	t	P	Remark
Current Ratio	-6.120	0.487	0.237	0.212	13.22	3.64	0.001	Sig

Dependent variable: ROI

From the model summary, the correlation coefficient ($R = 0.487$) indicates a moderate relationship between loan-to-deposit ratio and financial performance. The coefficient of determination ($R^2 = 0.237$) shows that approximately 23.7% of the variation in ROI is explained by changes in the loan-to-deposit ratio. This relatively lower explanatory power compared to liquidity ratio suggests that while LDR is important. The ANOVA results further confirm the statistical validity of the model. The F-statistic of 13.22 with a p-value of 0.001 (which is less than the 5% significance level) indicates that the regression model is statistically significant. This implies that the observed relationship between LDR and ROI is not due to chance, and the model provides a reliable explanation of the relationship between the variables.

Examining the coefficients table, the loan-to-deposit ratio has a regression coefficient (B) of -6.120, which is negative and statistically significant ($p = 0.001$). This indicates that a one-unit increase in LDR leads to an approximate 6.12-unit decrease in ROI, holding other factors constant. The negative sign of the coefficient is particularly important, as it highlights that excessive lending relative to deposits can adversely affect bank profitability. The t-value of -3.64 further confirms that this relationship is statistically robust.

Based on the decision rule ($p\text{-value} < 0.05$), the null hypothesis (H_{02}) is rejected, indicating that loan-to-deposit ratio has a significant effect on financial performance of DMBs in Nigeria.

Hypothesis Three

H_{03} : Current Ratio does not significantly affect the financial performance of DMBs in Nigeria.

Variable	B	R	R ²	Adj. R ²	F	t	P	Remark
Current Ratio	4.120	0.513	0.263	0.240	17.29	4.16	0.000	Sig

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From the model summary, the correlation coefficient ($R = 0.534$) indicates a moderate positive relationship between current ratio and financial performance. The coefficient of determination ($R^2 = 0.285$) shows that approximately 28.5% of the variation in ROI is explained by the current ratio. This indicates that current ratio is a moderately important determinant of financial performance, though not as influential as liquidity ratio. The remaining 71.5% of the variation in ROI can be attributed to other factors such as loan quality, operational efficiency, macroeconomic conditions, and regulatory influences. The F-statistic of 17.29 with a p-value of 0.000 (less than the 5% significance level) indicates that the model is statistically significant. This means that the relationship between current ratio and financial performance is not due to random variation, but reflects a genuine relationship within the Nigerian banking sector.

Further evidence is provided in the coefficients table, where the current ratio has a regression coefficient (B) of 4.120, which is positive and statistically significant ($p = 0.000$). This implies that a one-unit increase in current ratio leads to an approximate 4.12-unit increase in ROI, holding other factors constant. The positive coefficient indicates that improved short-term liquidity enhances financial performance. The t-value of 4.16 further confirms that this effect is statistically strong and reliable.

Based on the decision rule ($p\text{-value} < 0.05$), the null hypothesis (H_{03}) is rejected, indicating that the current ratio has a significant effect on financial performance of DMBs in Nigeria.

V. CONCLUSION AND RECOMMENDATIONS

The findings from hypothesis one reveal that liquidity ratio has a positive and statistically significant effect on the financial performance of Deposit Money Banks (DMBs) in Nigeria. This implies that banks with higher liquidity levels tend to achieve better profitability outcomes. The result underscores the

importance of maintaining adequate liquid assets, not only for meeting short-term obligations but also for enhancing operational efficiency and investor confidence.

The result of hypothesis two shows that loan-to-deposit ratio has a significant but negative effect on financial performance. This indicates that excessive lending relative to deposit base reduces profitability. Although loans are a primary source of income for banks, aggressive lending increases liquidity risk and may expose banks to default risk and funding pressures. The negative relationship observed suggests that when banks overextend their lending activities, they may face challenges in meeting withdrawal demands, thereby increasing operational costs and reducing returns. This finding highlights the delicate balance banks must maintain between profit generation through lending and the need to preserve adequate liquidity.

Findings from hypothesis three indicate that current ratio has a positive and significant effect on financial performance. This suggests that banks with better short-term liquidity positions, reflected in their ability to cover current liabilities with current assets, tend to perform better financially. A sound current ratio enhances a bank's capacity to meet immediate obligations, thereby reducing the risk of financial distress and improving overall operational stability. This stability can translate into higher profitability through improved customer confidence and efficient resource utilization. However, it is also important to note that excessively high current ratios may indicate underutilization of funds that could otherwise be invested in higher-yielding assets.

Overall, the combined findings of the study demonstrate that liquidity management plays a crucial role in determining the financial performance of DMBs in Nigeria. While liquidity ratio and current ratio positively influence profitability, loan-to-deposit ratio exhibits a negative effect. The results suggest that banks must strive to maintain an optimal level of liquidity sufficient to ensure stability but not excessive to the point of reducing earning capacity.

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