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The Effect of Liquidity Risk on the Financial Performance of Commercial Bank Listed on the Indonesian Stock Exchange

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ABSTRACT

This study aims to examine the variables that affect financial performance in commercial banks listed on the Indonesia Stock Exchange. The method used is secondary data collection from 41 commercial banks over a five-year period (2019–2023), with a total of 205 data that meet the criteria. The data analysis used is the panel data regression method using EViews 9 software. The results of the study obtained that the Current Ratio and Capital Adequacy Ratio do not affect the bank's financial performance, while the Loan to Deposit Ratio and Loan to Asset Ratio have a positive effect on the bank's financial performance. Liquidity Gap Ratio, Non-performing Loans, and Deposits have been shown to have a negative effect on the bank's financial performance. The urgency of this research lies in the critical role of banking in maintaining financial system stability and supporting national economic growth, where weak financial performance and poor risk management can threaten public trust and overall economic resilience. Therefore, the results of this study are expected to be a reference for conventional banks in determining the factors that affect the bank's financial performance.

Keywords: Financial Performace, Liquidity Gap Ratio, Loan to Asset Ratio, Loan to Deposit Ratio, Non-Performing Loan.

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INTRODUCTION

The economy of a country can be seen from how consistent and efficient the performance of the banking industry is in that country. A healthy financial system also reflects the healthy economic condition of a country. Financial system stability creates a favorable environment for depositors and investors, encourages financial institutions and markets to operate better, and therefore can create investment and economic growth (M. Samarasinghe & Lakmal, 2025). Economic growth is greatly influenced by banking because of the role of banking itself in helping economic growth. Economic growth encourages the development of facilities and infrastructure that can improve the quality of life of the community. The better the banking sector performs its role, the better the economy of a country will be. The health of the banking sector is the main pillar of a country's economic strength Wamalwa (2020) .

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Healthy financial performance has a significant impact on the economic system in Indonesia. Banks play a crucial role in channeling funds from surplus parties to those in need through their intermediary function. The effectiveness of this function depends heavily on a bank's ability to manage its assets, liabilities, and risks associated with its operations. Wamalwa (2020) research confirms that financial performance is influenced by various factors, including risks commonly faced by banks, which can lead to losses due to certain events. Therefore, the implementation of risk management plays a crucial role in helping banks identify types of risks, their sources, and formulate appropriate strategies to manage these risks.

Liquidity risk is one of the main risks faced by commercial banks in carrying out their financial intermediation function. This risk arises when banks experience difficulties in meeting their short-term obligations without incurring significant losses. The inability of banks to manage liquidity risk can threaten financial stability and reduce the confidence of depositors and investors (M. Samarasinghe & Lakmal, 2025) . Liquidity risk has a negative impact on a bank's income and capital, so bank management prioritizes liquidity management by ensuring the availability of adequate funds to meet the needs of depositors and borrowers. Additionally, liquidity risk also affects a bank's performance and reputation, as the inability to provide funds on time can erode public confidence. Therefore, reducing liquidity risk is a crucial element in bank asset and liability management (Ekanayake & Wanniarachchige, 2023).

The current ratio (CR) reflects the bank's ability to meet short-term liabilities using liquid assets. While a high ratio may reduce liquidity risk, it also has the potential to reduce profitability due to high levels of idle funds that are not utilized in productive assets (Samarasinghe & Lakmal, 2025). A study of several banks in Sri Lanka shows that the policy of maintaining a high current ratio to meet Basel III requirements can negatively affect ROE, as excess liquidity reduces profitable investment opportunities. According to Alsulami (2025), although less liquid assets are often associated with higher potential returns, the importance of efficient liquidity management remains a major factor in supporting firm profitability. Ofoegbu Senior Lecturer G, Onodugo V, Lecturer S (2016) also found a positive correlation between Current Ratio and profitability. An increase in this ratio reflects the company's better ability to meet its short-term obligations, which has an impact on improving overall financial performance.

Loan to Deposit Ratio (LDR) measures the extent to which third party funds raised by banks are used to fund loans. A high ratio indicates that a large portion of deposits have been disbursed as loans, which can increase profitability if managed well. However, over-reliance on deposits for loan financing can also increase liquidity risk, especially under conditions of economic crisis (Central Bank of Sri Lanka, 2023) (Chen et al., 2018) found that an excessively high Loan to Deposit Ratio can depress profitability and worsen the stability of banks' financial performance. In Sri Lanka, the average LDR of commercial banks reaches 96%, reflecting the high dependence on deposits, which potentially increases liquidity risk. Research conducted by Hacini et al. (2021) in Saudi Arabia concluded that there is a significant negative relationship between the LDR ratio and bank performance, indicating that a high ratio can increase the risk of liquidity shortages.

Loan to asset ratio (LAR) measures the proportion of total loans to total bank assets, reflecting the extent to which a bank allocates its assets in the form of loans compared to more liquid assets, such as cash or securities. A high LAR indicates that most of the bank's assets are in the form of loans, which can increase liquidity risk as loans tend to be less liquid than cash assets or short-term investments (Arif & Anees, 2012). This condition makes banks more vulnerable to liquidity pressures, especially in the event of a surge in depositor withdrawals. In such a situation, the bank may have to sell assets at a discount or seek additional funding at a higher cost, which may ultimately depress profitability (Ekanayake & Wanniarachchige, 2023).Conversely, a LAR that is too low reflects an excessive allocation of assets to liquid instruments that are not optimally utilized, which may hinder the growth of bank profitability.

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Capital Adequacy Ratio (CAR) is an indicator of a bank's ability to cover financial risks, including liquidity risk. Strong capital allows banks to absorb shocks without having to sell critical assets, thus positively impacting profitability (Wood & Skinner, 2018) .Research by (M. Samarasinghe & Lakmal, 2025) found that CAR has a significant positive impact on ROA and ROE, as strong capital gives banks greater flexibility in dealing with liquidity uncertainty, while strengthening their resilience to financial risk. Studies in Sri Lanka show that a high CAR above the minimum requirement contributes to bank stability, but may also limit flexibility in lending, potentially depressing profitability (Ekanayake & Wanniarachchige, 2023).If a bank maintains a CAR below its equilibrium level, the probability of insolvency will increase, i.e. an unexpected increase in expected bankruptcy costs. Therefore, it is necessary to immediately increase CAR towards the new equilibrium to reduce the probability of bankruptcy and, thus, increase ROE by reducing the insurance cost of uninsured debt. In other words, the positive correlation between CAR and ROE can be explained by the expected bankruptcy cost hypothesis under these circumstances (Dao & Nguyen, 2020).

Liquidity Gap Ratio (LGR) reflects the difference between available liquid assets and a bank's short-term liabilities. If this gap is too large, banks risk having difficulty in meeting their obligations without having to sell assets at a discount. In Sri Lanka, the widening liquidity gap in 2022 led some banks to rely on emergency liquidity facilities from the central bank. Although minimum liquidity requirements were met, the widening maturity gap increased long-term liquidity risk, which could threaten the financial stability of banks in the face of market pressures (Central Bank of Sri Lanka, 2023).A study by(M. Samarasinghe & Lakmal, 2025) showed that LGR negatively impacted bank performance, as it indicated increased funding costs due to the need to borrow in the repo market at high interest rates.In a study conducted by Tran et al. (2024), highly liquid assets that are not managed effectively can negatively impact the bank's ability to absorb financial stress and maintain profitability.

Non-Performing Loan (NPL) measures the percentage of non-performing loans to total loans, where high NPL reflects increased credit risk which can worsen bank liquidity due to difficulties in raising funds from unpaid loans.(M. Samarasinghe & Lakmal, 2025) found that Non-Performing Loan has a significant negative impact on bank profitability. The surge in NPLs during the COVID-19 pandemic led to serious liquidity pressures and a decline in profit margins for many banks, hindering banks' ability to extend new credit and increasing loss provisioning costs, which in turn worsened financial stability and slowed the growth of the banking sector. In addition, (Eltweri et al., 2024) identified a strong negative relationship between NPL levels and bank financial performance. Their findings suggest that an increase in the amount of non-performing loans directly reduces profitability, thus emphasizing the importance of optimal credit risk management for banks' operational viability.

Deposits play an important role in a bank's liquidity, as they can be a major source of funding. However, a high reliance on deposits is also risky in the event of a massive withdrawal (bank run). Research by Wijenayake & Amarasinghe, 2022) said that an increase in the number of deposits can suppress profitability, because banks must offer higher interest rates to retain these funds, which ultimately reduces profit margins. Deposits have a positive effect because the value of deposits can increase the internal stability of the bank by providing a buffer for higher growth and development, which is a good sign for all banks studied at this time. Research by Madhuwanti & Morawakage (2019) also shows that an increase in deposits has a positive effect on the bank's ability to extend credit and make investments. This, in turn, strengthens the bank's profitability and financial performance. This finding suggests that the value of deposits is becoming increasingly compatible with banks' efficiency and growth objectives. Meanwhile, Leykun (2016) argues that the proportion of deposits to total assets contributes negatively to liquidity risk in commercial banks, indicating potential instability in the management of short-term funds.

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METHODS

This study adopts a quantitative approach with a comparative causal research type that aims to examine the cause-and-effect relationship between the independent variable and the dependent variable through hypothesis testing. The main focus of this study is to analyze the effect of a number of independent variables, namely Current Ratio, Loan to Deposit Ratio, Loan to Asset Ratio, Capital Adequacy Ratio, Liquidity Gap, Non Performing Loans, and Deposits on the financial performance of commercial banks. The financial performance is measured based on indicators taken from the annual financial statements. The type of data used is secondary data obtained from the financial statements of commercial banks that have been listed on the Indonesia Stock Exchange (IDX), which are available online through the official website www.idx.co.id. This study covers a five-year time period, from 2019 to 2023.

The population in this study includes all commercial banks (commercial banks) listed on the Indonesia Stock Exchange (IDX) during the period 2019 to 2023. The sample determination was carried out using purposive sampling method, which is a sampling technique based on certain considerations so that the selected bank has characteristics in accordance with the research objectives. The inclusion criteria used in the sample selection are as follows: (1) commercial banks have been consistently listed on the IDX during the 2019-2023 period, (2) banks always submit annual financial reports ending on December 31, and (3) banks have complete data for all research variables. Based on these criteria, 41 commercial banks were obtained as samples with a total of 205 observations over the five years of the study.

To analyze the data, this study uses the panel data regression method which is processed with the help of E-Views 9 software. Panel data regression was chosen because it is able to combine the characteristics of cross-section data (various bank entities) and time-series (data in the 2019-2023 time span), resulting in a more comprehensive and accurate analysis.

RESULTS AND DISCUSSION

The data used in the study were analyzed using the panel data regression to determine the effect of Liquidity Risk in bank's financial performance. These results are presented in tabular form for easy understanding by the reader

Tabel 1.Panel Data Regression Model 1

Variables	Coefficient	Probability
Current Ratio (CR)	0.000732	0.2268
Loan to Deposit (LDR)	0.000786	0.0068
Loan to Asset (LAR)	0.000185	0.2704
Capital Adequacy Ratio (CAR)	-6.50E-05	0.3822
Liquidity Gap Ratio (LGR)	-4.50E-15	0.0237
Non-Performing Loans (NPL)	0.143377	0.0000
Deposits	0.000662	0.3184

Source : E-views 9.0

Referring to the findings of the regression analysis, the t-test results in Table 1 for Model 1 (Return on Assets) indicate that The significance level of the Current Ratio (CR) variable is 0.2268, which is greater than 0.10. This means that the null hypothesis (Ho) is accepted, suggesting that the Current Ratio does not significantly influence Return on Assets (ROA), as reflected by the coefficient value of 0.000732. Therefore, it can be concluded that the Current Ratio has no effect on financial performance. This finding aligns with the study by Angel & Panjaitan (2025), which states that a company's capacity to settle its short-term obligations using current assets does not necessarily impact how effectively it generates profit from its assets. One possible explanation is that firms with

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high liquidity (indicated by a high current ratio) may possess assets that are not efficient in producing income, such as large amounts of receivables or idle inventory.

The t-test results presented in Table 1 for Model 1 (Return on Assets) demonstrate that the Loan to Deposit Ratio (LDR) variable has a significance value of 0.0068, which is lower than the 0.10 threshold. This indicates that the null hypothesis (H_0) is rejected, and the positive coefficient of 0.000786 suggests that an increase in the LDR leads to an increase in Return on Assets. Therefore, it can be concluded that the Loan to Deposit Ratio has a statistically significant and positive effect on Return on Assets. Based on the results of this study, it states that the Loan to Deposit ratio has a positive effect on banking financial performance because according to research by Muhammed et al. (2024) because it has the ability to repay the refunds made by depositors depending on the credit allocated as a source of liquidity for the bank's financial performance.

The t-test results in Table 1 for Model 1 (Return on Assets) indicate that the Loan to Asset Ratio (LAR) variable has a significance value of 0.2704, which is greater than 0.10. This implies that the null hypothesis (Ho) is accepted and the alternative hypothesis (Ha) is rejected, with a coefficient value of 0.000185. This suggests that the Loan to Asset Ratio does not have a statistically significant impact on Return on Assets. Consequently, it can be concluded that LAR does not influence financial performance. This finding is consistent with the study by Samarasinghe & Lakmal (2025), which argues that even when a bank exhibits a high LAR—indicating an aggressive approach in utilizing its assets to issue loans—it may not translate into increased income if the loans are either high-risk or yield low returns. Furthermore, the presence of high non-performing loans (NPLs) or inefficiencies in operations may significantly reduce the profitability of such loans.

The t-test results in Table 1 for Model 1 (Return on Assets) indicate that the Capital Adequacy Ratio (CAR) variable has a significance value of 0.1468, which is greater than 0.10. This leads to the acceptance of the null hypothesis (Ho) and the rejection of the alternative hypothesis (Ha), with a coefficient of -6.50E-05. This suggests that CAR does not have a statistically significant impact on Return on Assets, and vice versa. Therefore, it can be concluded that Capital Adequacy Ratio does not influence financial performance. This result supports the findings of Antwi (2019)), who noted that even though banks with high CAR may appear financially sound in terms of capital, poor asset management, a high level of non-performing loans (NPLs), or excessive operational costs can lead to weak financial outcomes.

The t-test results in Table 1 for Model 1 (Return on Assets) indicate that the Liquidity Gap Ratio (LGR) variable has a significance value of 0.0237, which is greater than 0.10. This result leads to the rejection of the null hypothesis (H_0) and acceptance of the alternative hypothesis (H_a), supported by a negative coefficient of -4.50E-15. This suggests that an increase in the Liquidity Gap Ratio tends to decrease the Return on Assets. Accordingly, it can be concluded that the Liquidity Gap Ratio has a statistically significant negative impact on financial performance. The finding is in line with research conducted by (Amara & Najar, 2021) that these results indicate that costs increase because banks have to borrow from the repo market at high interest rates and liquidity problems can occur in banks, due to mismanagement of funds or unexpected withdrawals by customers, especially during problematic economic conditions.

The t-test findings presented in Table 1 for Model 1 (Return on Assets) reveal that the Non-Performing Loans (NPL) variable has a significance value of 0.0000, which is less than the 0.10 threshold. This result leads to the rejection of the null hypothesis (H_0) and acceptance of the alternative hypothesis (H_a). The positive coefficient of 0.143377, in this context, indicates that an increase in Non-Performing Loans corresponds with a decrease in Return on Assets, reflecting the negative implication of rising credit risk. Therefore, it can be concluded that Non-Performing Loans exert a statistically significant negative influence on financial performance. The finding is in line with research conducted by (Selim elekdag et al , 2020). that Non-Performing Loans have a negative effect on banking financial performance. This finding shows that increasing NPLs are detrimental

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to bank profitability. Parties involved in long-term loans contribute to the emergence of such problems related to liquidity, especially when available resources make repayment a problem during periods of economic downturn. When liquidity risk increases, banks face limitations in meeting short-term policies, thus hampering overall financial performance.

The t-test results in Table 1 for Model 1 (Return on Assets) indicate that the Deposits variable has a significance value of 0.3184, which is greater than the 0.10 threshold. This implies that the null hypothesis (H_0) is not rejected, and despite a positive coefficient of 0.000662, the relationship is not statistically significant. Therefore, it can be interpreted that Deposits do not have a meaningful impact on Return on Assets. In conclusion, Deposits are shown to have no significant effect on financial performance. The finding is in line with research conducted by Dilrangi et al. (2017) While deposits are crucial for a bank's operations, allowing them to provide loans, they don't directly translate into profit. The profitability of a bank is more closely tied to how effectively it manages its loans (e.g., interest rates, loan quality) and other income-generating activities.

Table 2. Panel Data Regression Model 2

Variables	Coefficient	Probability
Current Ratio (CR)	-0.000822	0.3189
Loan to Deposit Ratio (LDR)	0.000347	0.1022
Loan to Asset (LAR)	0.001252	0.0861
Capital Adequacy Ratio (CAR)	0.002255	0.1947
Liquidity Gap Ratio (LGR)	-7.37E-15	0.0045
Non-Performing Loans (NPL)	-0.693453	0.0000**
Deposits	-0.004799	0.1826

Source : E-views 9.0

The t test results in table 2 for model 2 (Return on Equity) show that the Current Ratio (CR) variable has a significant value of 0.3189 > 0.10, which means that Ho is rejected Ha is accepted with a coefficient of -0.000822, which means that Current Ratio has no effect on Return on Equity. The findings suggest that the Current Ratio does not significantly impact the Return on Equity. The finding is in line with research conducted by Alsulami (2025). that a low current ratio is usually considered to indicate a liquidity problem, conversely a current ratio that is too high is also not good, because it indicates a lot of idle funds which can reduce the company's profitability.

The t-test results presented in Table 2 for Model 2 (Return on Equity) indicate that the Loan to Deposit Ratio (LDR) variable has a significance value of 0.1022, which is greater than the 0.10 threshold. This suggests that the null hypothesis (H_0) is not rejected, despite the positive coefficient of 0.000347. Therefore, it can be interpreted that the Loan to Deposit Ratio does not have a statistically significant effect on Return on Equity. So it can be concluded that Loan to deposit ratio is proven to have no effect on financial performance. The finding is in line with research conducted by (M. Samarasinghe & Lakmal, 2025) that a low LDR indicates that the bank is less than optimal in distributing its funds, thus creating inefficiency because the assets are unproductive and do not generate interest.

The t-test results in Table 2 for Model 2 (Return on Equity) show that the Loan to Asset Ratio (LAR) variable has a significance value of 0.0861, which is below the 0.10 threshold, indicating that the null hypothesis (H_0) is rejected. The positive coefficient of 0.001252 suggests that a higher Loan to Asset Ratio leads to an increase in Return on Equity. Thus, it can be concluded that the Loan to Asset Ratio has a statistically significant positive impact on Return on Equity. The finding is in line with research conducted by (Kumar, 2024) because high LAR reflects aggressive lending practices which can cause NPLs to become higher with higher loan growth especially in banks, it will improve the bank's financial performance.

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The t-test results in Table 2 for Model 2 (Return on Equity) indicate that the Capital Adequacy Ratio (CAR) variable has a significance value of 0.1947, which is greater than the 0.10 threshold. This implies that the null hypothesis (H_0) cannot be rejected, and although the coefficient is 0.02255, the relationship is not statistically significant. Therefore, it can be interpreted that Capital Adequacy Ratio does not have a significant effect on Return on Equity. The finding is in line with research conducted by Antwi (2019) Banks with high CAR may appear to be capital-wise healthy, but if they are inefficient in managing assets, face high non-performing loans (NPLs), or have high operating costs, their financial performance will remain low.

The t-test results in Table 2 for Model 2 (Return on Equity) show that the Liquidity Gap Ratio (LGR) variable has a significance value of 0.0045, which is below the 0.10 threshold, indicating that the null hypothesis (H_0) is rejected. The negative coefficient of -7.37E-15 suggests that an increase in the Liquidity Gap Ratio leads to a decrease in Return on Equity. Therefore, it can be concluded that the Liquidity Gap Ratio has a statistically significant negative effect on Return on Equity. The finding is in line with research conducted by (Amara & Najar, 2021) that these results indicate that costs increase because banks have to borrow from the repo market at high interest rates and liquidity problems can occur in banks, due to mismanagement of funds or unexpected withdrawals by customers, especially during problematic economic conditions.

The t-test results presented in Table 2 for Model 2 (Return on Equity) indicate that the Non-Performing Loans (NPL) variable has a significance value of 0.0000, which is well below the 0.10 threshold, leading to the rejection of the null hypothesis (H_0). The negative coefficient of -0.69453 suggests that an increase in Non-Performing Loans leads to a decrease in Return on Equity. Therefore, it can be concluded that Non-Performing Loans have a statistically significant negative impact on Return on Equity. The finding is in line with research conducted by (Selim elekdag et al , 2020). that Non-Performing Loans have a negative effect on banking financial performance. This finding shows that increasing NPLs are detrimental to bank profitability. Parties involved in long-term loans contribute to the emergence of such problems related to liquidity, especially when available resources make repayment a problem during periods of economic downturn. When liquidity risk increases, banks face limitations in meeting short-term policies, thus hampering overall financial performance.

The t-test results in Table 2 for Model 2 (Return on Equity) show that the Deposits variable has a significance value of 0.1826, which is greater than the 0.10 threshold, indicating that the null hypothesis (H_0) cannot be rejected. Although the coefficient is -0.004799, this relationship is not statistically significant, suggesting that an increase in Deposits does not have a meaningful impact on Return on Equity. Therefore, it can be concluded that Deposits do not exert a significant influence on financial performance. The finding is in line with research conducted by Dilrangi et al. (2017) While deposits are crucial for a bank's operations, allowing them to provide loans, they don't directly translate into profit. The profitability of a bank is more closely tied to how effectively it manages its loans (e.g., interest rates, loan quality) and other income-generating activities.

From a practical perspective, this study highlights the essential importance of effective liquidity and credit risk management in improving the financial performance of commercial banks. The findings suggest that banks should prioritize strengthening their lending practices relative to deposits and assets to leverage positive effects on profitability. Simultaneously, mitigating risks associated with liquidity gaps, non-performing loans, and deposit stability is essential, given their negative impact on performance. The lack of significance for the Current Ratio and Capital Adequacy Ratio indicates that these metrics alone may not fully capture the operational effectiveness concerning liquidity and risk management in the Indonesian context. Therefore, policymakers and banking practitioners should focus on integrating comprehensive risk assessment frameworks that address both liquidity and credit quality to promote sustainable financial performance. This perspective underscores the necessity for targeted strategies that balance growth with prudent risk controls, aligning with the broader objective of financial stability within the banking industry.

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CONCLUSION

The study comes to the conclusion that certain bank-specific factors have a significant impact on financial performance based on its analysis of 41 Indonesian commercial banks from 2019 to 2023. In particular, the loan-to-deposit and loan-to-asset ratios have a positive effect on bank performance, suggesting that greater lending activity in relation to deposits and assets improves financial results. On the other hand, liquidity risk factors that have a negative impact on financial performance include the Liquidity Gap Ratio, non-performing loans, and deposit levels. This suggests that credit quality and liquidity management are essential for sustaining profitability. It's interesting to note that there was no discernible impact from the current ratio or the capital adequacy ratio. These results emphasize how crucial it is to manage credit risk and liquidity well in order to maximize bank performance in the Indonesian banking industry.

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