

Contribution of Liquidity Management on Financial Performance of Listed Commercial Banks in Rwanda.

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Received: September 18, 2025

Revised: December 15, 2025

Accepted: April 13, 2026

Published online: 14 April 2026

Abstract

This study investigates the contribution of liquidity management on the financial performance of listed commercial banks in Rwanda. Key liquidity management indicators—Loan to Deposit Ratio (LDR), Deposit to Total Assets, Liquidity Coverage Ratio (LCR), and Capital Adequacy—were analyzed to determine their effect on profitability measured by Return on Assets (ROA) and Return on Equity (ROE). The results indicate that LDR has a significant and positive impact on profitability, while Deposit to Total Assets and LCR show mixed effects, positively influencing ROA but negatively affecting ROE. Capital Adequacy exhibits a dual effect, enhancing ROE while slightly reducing ROA, reflecting the trade-offs between regulatory compliance and operational profitability. Compared to prior studies, this research provides a comprehensive and integrated assessment of multiple liquidity indicators, offering a more nuanced understanding of their combined influence on bank performance in Rwanda. These findings suggest that adopting a balanced liquidity management strategy, which optimizes loan utilization while maintaining adequate reserves, can improve overall profitability and ensure sustainable financial stability, providing actionable guidance for bank managers and regulators

Keywords: Liquidity Management, Financial Performance, Listed Commercial Banks in Rwanda

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1. Introduction

The performance of commercial banks is critically influenced by how they manage liquidity, which represents their ability to meet short-term obligations while supporting long-term growth. Efficient liquidity management ensures that banks can fulfill withdrawal demands, optimize loan utilization, and maintain financial stability in the face of economic uncertainties. In Rwanda, listed commercial banks operate in a dynamic financial environment governed by the National Bank of Rwanda (BNR), which imposes stringent liquidity and capital adequacy requirements. Despite these regulatory measures, challenges persist in balancing profitability with compliance, and suboptimal liquidity strategies can adversely affect the financial performance of banks.

2. Literature Review

Previous studies have examined liquidity management and its impact on financial performance in various contexts. Research on Rwandan commercial banks highlights general relationships between liquidity indicators and profitability but often overlooks listed banks specifically, which face unique operational and regulatory challenges. Moreover, existing studies tend to analyze individual liquidity factors in isolation, leaving a gap in understanding how multiple indicators collectively influence performance.

This study addresses these gaps by examining the contribution of four key liquidity management indicators—Loan to Deposit Ratio (LDR), Deposit to Total Assets, Liquidity Coverage Ratio (LCR), and Capital Adequacy—on the profitability of listed commercial banks in Rwanda. By integrating these factors, the research provides a comprehensive view of how liquidity strategies impact financial performance and offers practical recommendations for improving profitability while ensuring regulatory compliance.

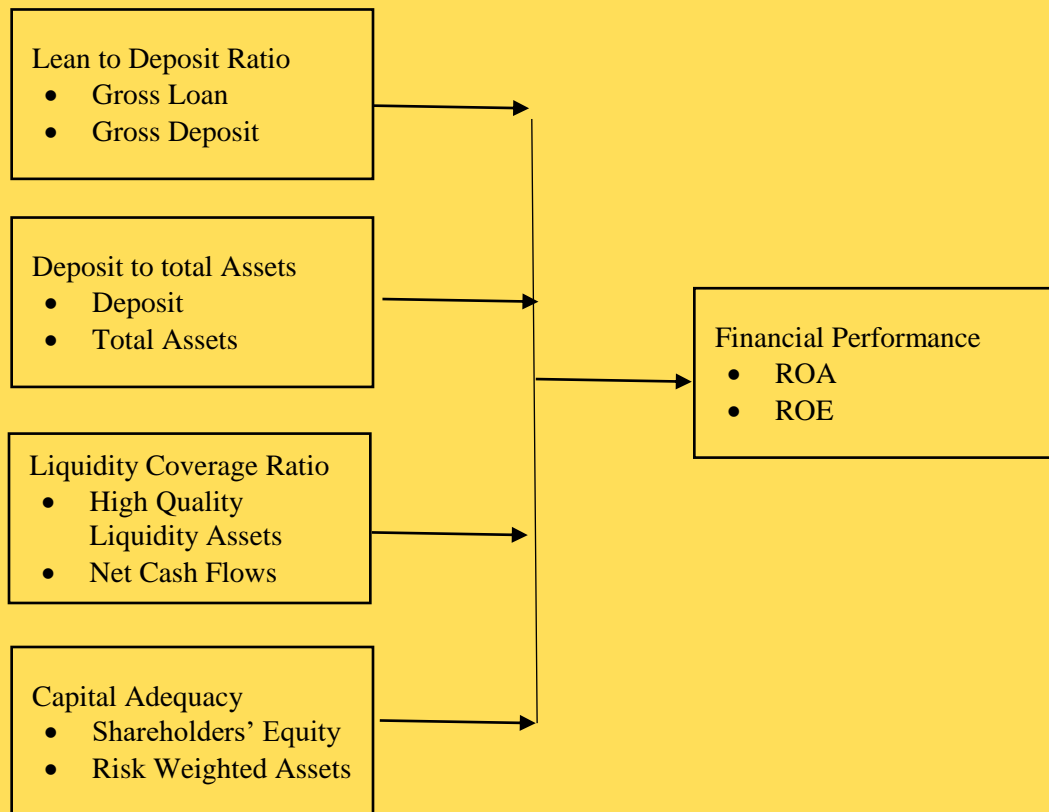


Figure 1: Conceptual Framework

Source: Researcher 2025

3. Methodology

This study adopted a quantitative research design to examine the contribution of liquidity management to the financial performance of listed commercial banks in Rwanda. Secondary data were collected from financial statements of four banks listed on the Rwanda Stock Exchange (Bank of Kigali, I&M Bank, Equity Bank, and Kenya Commercial Bank) over the period 2016–2023.

The study used purposive sampling, focusing only on the listed commercial banks, covering 32 firm-years for analysis.

- **Editing & Coding:** Data were cleaned, verified, and transformed into financial ratios for analysis using Stata 16.
- **Tabulation:** Data were presented in tables summarizing descriptive statistics and regression results.
- **Analysis:** Descriptive statistics (mean, median, standard deviation) and inferential statistics (Pearson correlation and multiple regression) were used to examine relationships between liquidity indicators and financial performance. The regression model is specified as:

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \epsilon$$

Where Y_{it} is financial performance, X_1 to X_4 represent Loan to Deposit Ratio (LDR), Deposit to Total Assets, Liquidity Coverage Ratio (LCR), and Capital Adequacy, respectively, and ϵ is the error term.

4. Results

This section presents the findings of the study on the contribution of liquidity management to the financial performance of listed commercial banks in Rwanda. Descriptive statistics, correlation analysis, and multiple regression results are reported to provide insights into the relationships between liquidity indicators and profitability, measured by ROA and ROE. The results are discussed in line with the study objectives and hypotheses.

Summary statistics for the listed commercial banks

Variables	N	mean	sd	min	max	skewness	kurtosis
ROA	32	3.250	0.738	1.200	4.400	-0.714	3.113
ROE	32	18.89	2.770	11.70	23.70	-1.028	4.034
Loan to Deposit	32	90.10	15.87	51.60	111.2	-0.410	2.364
Deposit to TA	32	61.59	7.178	41.10	78.30	-0.832	4.835
LCR	32	218.8	60.78	111.3	339.7	0.289	2.422
Capital Adequacy	32	20.47	2.135	15.50	24	-0.368	2.809
Liquid Assets to TA	32	31.38	2.541	28	38.20	0.969	3.328

Source: Field Data (2025)

4.1 Descriptive Statistics

The descriptive analysis for the study variables shows that financial performance and liquidity indicators of the listed commercial banks were generally stable and approximately normally distributed. **Return on Assets (ROA)** had a mean of 3.25% (SD = 0.738), slightly negatively skewed, while **Return on Equity (ROE)** averaged 18.89% (SD = 2.77), also showing a negative skew and slightly peaked distribution. The **Loan to Deposit ratio (LDR)** was high on average (M = 90.10, SD = 15.87), with a near-symmetrical distribution.

Deposit to Total Assets (DTA) averaged 61.59% (SD = 7.18), with a mild negative skew and higher tails, whereas the **Liquidity Coverage Ratio (LCR)** was 218.8 (SD = 60.78), exhibiting a roughly symmetrical distribution. **Capital Adequacy** averaged 20.47% (SD = 2.14) with minor negative skew, and **Liquid Assets to Total Assets** had a mean of 31.38% (SD = 2.54) with a slight positive skew.

Overall, all variables fell within acceptable skewness (-3 to +3) and kurtosis ranges, indicating approximate normality. This validates the use of parametric tests such as correlation and regression for further analysis.

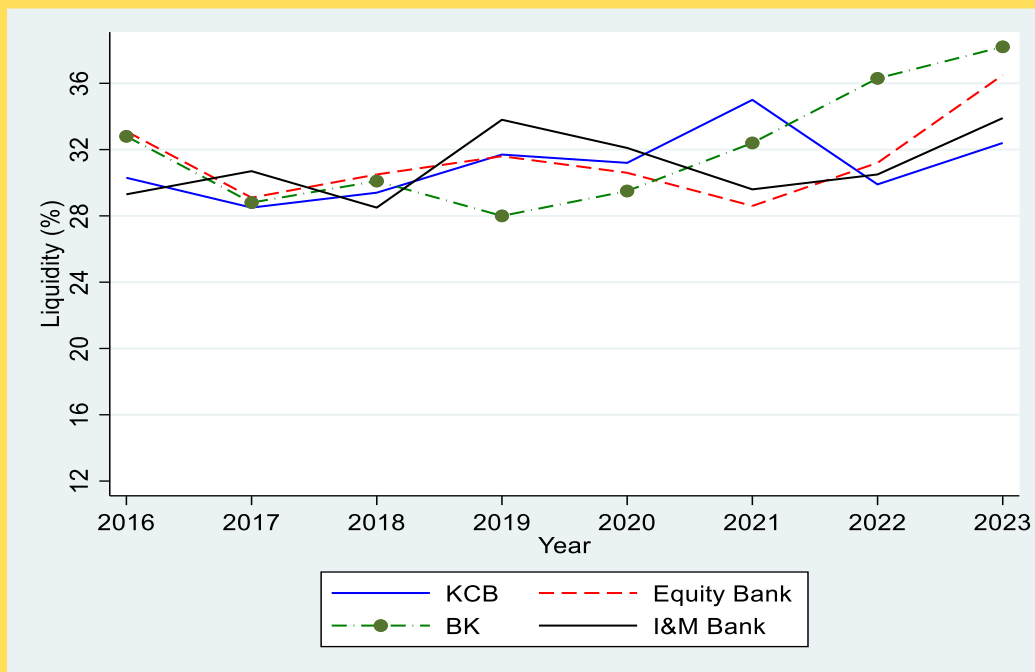


Figure 2: Diagram showing the liquidity (%) of the listed commercial banks (2016-23)

Source: Field Data (2025)

Pearson correlation analysis with ROA as dependent variable

Variables	ROE	Loan to Deposit	Deposit to TA	LCR	Capital Adequacy
ROE	1.000				
Loan to Deposit	0.794 (0.027)	1.000			
Deposit to TA	-0.397 (0.029)	0.337 (0.059)	1.000		
LCR	0.593 (0.012)	0.486 (0.005)	0.010 (0.157)	1.000	
Capital Adequacy	0.681 (0.020)	0.040 (0.827)	0.029 (0.877)	0.030 (0.870)	1.000

The p-values are in parenthesis

Source: Field Data (2025)

The Pearson correlation analysis shows significant relationships between liquidity management indicators and ROE for the four listed commercial banks in Rwanda. Loan to Deposit Ratio (LDR) has a strong positive correlation with ROE ($r = 0.794$, $p = 0.027$), indicating that higher LDR is associated with higher ROE. Deposit to Total Assets (DTA) exhibits a moderate negative correlation ($r = -0.397$, $p = 0.029$), suggesting that higher deposit levels relative to total assets may reduce ROE. Liquidity Coverage Ratio (LCR) is positively correlated with ROE ($r = 0.593$, $p = 0.012$), while Capital Adequacy also shows a strong positive correlation ($r = 0.681$, $p = 0.020$), implying that better capitalization supports higher equity returns.

Multiple Regression Analysis

In this section, the researcher analyzed the contribution of liquidity management on the financial performance of commercial banks in Rwanda. This was done using the multiple regression analysis where the results are displayed in the table below.

4.2 Multiple regression analysis Results

	(1)	(2)
Variables	ROA	ROE
Loan to Deposit	0.0142*** (3.474)	0.0561** (2.505)
Deposit to TA	0.000424*** (3.0228)	-0.121*** (-4.676)
LCR	0.00271*** (3.142)	-0.00311*** (-3.339)
Capital Adequacy	-0.0697*** (-3.201)	0.362** (2.614)
Constant	2.778* (1.704)	14.55** (2.309)
Observations	32	32
R	0.862	0.772
R-squared	0.743	0.596
p-value	0.013	0.004

t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Source: Field Data (2025)

The multiple regression analysis examined the contribution of liquidity management indicators—Loan to Deposit Ratio (LDR), Deposit to Total Assets (DTA), Liquidity Coverage Ratio (LCR), and Capital Adequacy—on the financial performance of four listed commercial banks in Rwanda over 2016–2023. Loan to Deposit Ratio had a positive and significant effect on both ROA ($\beta = 0.0142$, $p < 0.001$) and ROE ($\beta = 0.0561$, $p < 0.01$), indicating that higher LDR enhances profitability. Deposit to Total Assets showed a positive but minimal effect on ROA ($\beta = 0.000424$, $p < 0.001$) and a negative but significant effect on ROE ($\beta = -0.121$, $p < 0.001$). Liquidity Coverage Ratio (LCR) positively impacted ROA ($\beta = 0.00271$, $p < 0.001$) but negatively influenced ROE ($\beta = -0.00311$, $p < 0.001$), reflecting a nuanced contribution. Capital Adequacy negatively affected ROA ($\beta = -0.0697$, $p < 0.001$) but positively influenced ROE ($\beta = 0.362$, $p < 0.01$), suggesting regulatory reserves may limit immediate asset returns but enhance equity returns.

Overall, the regression models were statistically significant, with R^2 values of 0.743 for ROA and 0.596 for ROE, meaning that liquidity management indicators explain 74.3% and 59.6% of the variance in financial performance, respectively. These results confirm that liquidity management significantly affects both ROA and ROE, though the direction and magnitude of effects vary across indicators.

4. Discussion

The study's findings provide clear insights into the impact of liquidity management indicators on the financial performance of listed Rwandan commercial banks, highlighting both consistencies and divergences with prior research. Loan to Deposit Ratio (LDR) positively and significantly influences both ROA and ROE, emphasizing effective loan utilization as a driver of profitability, consistent with some studies but contrasting with others in different contexts. Deposit to Total Assets (DTA) shows a minimal positive effect on ROA but a negative effect on ROE, indicating that higher deposit proportions can slightly enhance asset returns while potentially reducing equity returns. Liquidity Coverage Ratio (LCR) positively affects ROA but negatively impacts ROE, suggesting that maintaining liquidity reserves supports asset performance but may constrain equity profitability due to costs or regulatory obligations. Capital Adequacy negatively influences ROA but positively affects ROE, reflecting a trade-off between regulatory capital requirements and equity returns, aligning partially with other international findings.

Overall, the regression models were statistically significant, with R^2 values of 0.743 for ROA and 0.596 for ROE, demonstrating strong explanatory power. These results underscore the complex, context-dependent effects of liquidity management on profitability and emphasize the importance of strategic, balanced approaches tailored to the Rwandan banking sector.

5. Conclusion

This study demonstrated that liquidity management indicators—Loan to Deposit Ratio, Deposit to Total Assets, Liquidity Coverage Ratio, and Capital Adequacy—significantly influence the financial performance of listed Rwandan commercial banks. The findings highlight both positive and negative effects on ROA and ROE, emphasizing the importance of strategic liquidity management. Future research could explore the impact of macroeconomic factors and integrate real-time banking data to enhance predictive insights.

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