LIQUIDITY MANAGEMENT AND CORPORATE PROFITABILITY OF LISTED NON-FINANCIAL FIRMS IN EMERGING ECONOMY

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Abstract
This is the study aimed at determining the relevance of the relationship between liquidity management and profitability of non-financial listed business enterprises in Emerging Economy. The study involved the selection of non-financial firms listed on the Nigerian Exchange (NGX) for a period of 10 years from 2016 to 2025. Liquidity measures include current ratio, operating cash flow and free cash flow, while profitability measures include return on assets (ROA) and profit margin. Some control variables include firm size, leverage, and revenue growth. The data used in the analysis was taken from the annual report of the selected firms; the analysis was done using the Panel least square and two step System GMM estimator. From the results, it can be concluded that current ratio and operating cash flow ratio have significant and positive relationship with both the profitability ratios and free cash flow ratio has significant negative relationship, which indicates that cash flow which is not invested in working capital may be underinvestment or agency effort to retain free cash flow, instead of efficient utilization. There is no consistent sign of the impact of leverage on ROA, but under dynamic estimation there is a positive impact on the profit margin. The study is useful to the liquidity-profitability theory in an emerging market and working-capital-constrained environment and provides practical implications for the corporate treasury policy of corporate treasurers in Nigeria.

Keywords: Corporate profitability, emerging economy, liquidity management, non-financial listed firms, profit margin.

1.0 Introduction

The ability to manage liquidity is still an important issue for corporate financial managers, especially in emerging markets with limited access to external financing and high working capital frictions. The environment in which the non-financial companies are listed on the Nigerian Exchange (NGX) is fraught with volatile foreign exchange market, inflationary pressure and limited access to credit, thereby making the relevance of internally generated liquidity to the sustainability of business activities and profitability paramount. From 2016 to 2025, corporate firms in Nigeria faced a domestic recession, foreign exchange scarcity, COVID-19 shock and re-introduced currency reforms, which intensified the impact on the on-the-ground consequences of liquidity decisions for profit results. Furthermore, the extant empirical literature that relates liquidity to profitability tends to focus on the banking and financial sectors, leaving the extent to which the link holds in other sectors largely unstudied(Bilal et al., 2024; Meliza et al., 2024; Mohammad & Khan, 2024; Vu, 2024; Lim et al., 2025). There are also structural differences between non-financial firms and banks, as regards the sources of and uses for liquidity; operating cash flow and free cash flow are the main internal liquidity levers of non-financial firms, while deposit-based ratios are not (Fairhurst & Zahid, 2025). But most of the studies that do not focus on financial firms continue to use exclusively static liquidity ratios like the current ratio and provide less consideration for cash-flow-based liquidity ratios and how they can combine with the static ratios.

There are different conclusion on the theoretical aspect of the relationship between liquidity and profitability. A trade-off argument assumes that there is a "best" level of liquidity, after which profitability declines due to foregone investment returns; a pecking-order argument argues that internally generated liquidity acts as a buffer against the cost of external financing of profitable investment (Im et al., 2026). The empirical evidence confirms this ambivalence, with some studies showing a positive relationship between liquidity and profitability (Wanzala & Obokoh, 2024; Lim et al., 2025), others showing negative or risk-moderated results (Meliza et al., 2024; Ben Abdallah & Bahloul, 2025), and Vu, (2024) show an inverted-U shaped relationship. Studies based on working-capital of non-financial corporations also yield mixed answers, again by country and industry (Raza et al., 2024; Rafay, 2025; Buljat et al., 2026). For the NGX non-financial context, there are two more issues that make to be research on. First, cash-flow based liquidity constructs are not typically modeled together with the conventional ratios in a panel of non-financial firms, even though there is evidence that financing and investment decisions are made based on cash-flow liquidity and not by balance-sheet ratios alone (Di et al., 2024; Im et al., 2026). However, despite the fact that profitability is generally persistent and may be endogenous to liquidity choices, the literature on liquidity-profitability continues to be dominated by static estimators (Pooled OLS, Fixed/Random Effects) even though recent bank-focused studies have tried to overcome this issue by using dynamic System GMM, but this approach hasn't yet been applied to non-financial firms in Nigeria. This study thus does not clearly explain the joint and dynamic relationship between leverage, firm size, revenue growth and the three key metrics of ROA and profit margin in the context of NGX non-financial firms. Thus, the current study therefore shows how current ratio, operating cash flow, and free cash flow work together and dynamically to influence ROA and profit margin among NGX non-financial firms while leverage, firm size and revenue growth are considered as control variables.

2.0 Theoretical Review

In the present study, three theories were taken into consideration. First, the Trade-off theory of liquidity which suggests that firms consider the transaction and precautionary benefits of having liquid assets in the face of their opportunity cost of foregone investment opportunities, thus indicating a non-linear or context-dependent relationship between liquidity and profitability (Popoola et al., 2025; Sofyan et al., 2026). Second, agency cost theory implies that managers may be able to low back excess free cash flow or squander it through poor decisions, creating a negative association between free cash flow and firm performance, which can be directly tested using the free cash flow ratio used here. Third, the pecking order framework is consistent with the preference of firms for using internally generated funds (operating cash flow) over external funds, which relates cash flow adequacy to less financing frictions and, consequently, profitability (Cangombe et al., 2025; Shittu & Erasmus, 2026). These theories suggest that there are positive effects of current-ratio and operating-cash-flow, and a negative free-cash-flow effect, which the empirical results that follow directly address. According to the trade-off theory of corporate liquidity, the optimal amount of cash held by a company is the amount that provides a balance between the cost of holding cash, and the benefit of doing so(Sahu et al., 2025). By contrast, pecking-order reasoning posits that the liquidity effect will be a defensive move that will increase funding flexibility and, as such, should be expected to have a positive relationship with profitability because firms will have the funds to avoid the most expensive source of financing, external funds (Im et al., 2026). Many studies in working-capital-profitability research utilize the cash-conversion-cycle approach (Zanolla et al., 2024; Rafay, 2025), which sees

liquidity management as an operational-efficiency problem where increased cash-flow responsiveness through faster receivable and inventory conversion allows for more resources to be committed to productive and profitable activities.

Empirical Review

The results regarding the traditional liquidity ratios and profitability indicators are rather inconsistent in different contexts. The relationship between liquidity and profitability is positive for Cambodian banks and also reported for GCC banks by (Bilal et al., 2024; Lim et al., 2025). Also, for Tunisian and Ghanaian banks, the relationship is contingent on the asset quality or tax liability pressures pressure (Ben Abdallah & Bahloul, 2025; Boateng et al., 2025). When considering the composition of working-capital, the effects are also conditional in non-financial firms, with the profitability of the working-capital of Croatian firms being sensitive to certain components of the working-capital, rather than the aggregate working-capital liquidity (Buljat et al., 2026), and the management of working-capital affecting the financial performance of Kenyan commercial and service firms (Wanzala & Obokoh, 2024), while the management of liquidity and leverage affecting the financial performance of Thai savings and credit cooperatives (Pojanavatee & Kingshott, 2025). Additionally, a smaller but increasing stream explicitly displays cash-flow liquidity (Im et al., 2026). The close linkages of operating cash flow and financing decisions with information production and liquidity constraints are demonstrated; supply-chain-based cash-policy studies reveal that cash holdings are responsive to supplier-concentration risk; and asset redeploy ability is revealed to influence corporate liquidity decisions, which in turn have implications for firm value (Nam & Tuyen, 2024; Di et al., 2024; Fairhurst & Zahid, 2025; Dangs et al., 2026; Marozva, 2026;). However, most of studies discussed above focus on developed-market environments, which makes it under-tested among African non-financial companies to assess the link between operating cash flow and profit. Leverage is a persistent covariate in profitability models: An analysis of the Vietnamese and Sub-Saharan African data indicates that leverage affects performance in some ways but not others, and that it can both complement and limit liquidity (Kędzior & Kędzior, 2023). Firm size and growth is also widely acknowledged as profitability factors in the literature on SMEs, IT-sector studies and cross-country studies (Serrasqueiro et al., 2023; Mijoč, 2024; Nguyen & Pham, 2026), and hence has been included as a control in the present model.

Having review previous studies on study variables, three gaps emerge from the review. There is a geographic and sectoral concentration of the liquidity-profitability evidence, as the majority comes from the banking systems of Europe, Asia and the MENA region of Africa (Bilal et al., 2024; Khalaf & Awad, 2024; Meliza et al., 2024; Ben Abdallah & Bahloul, 2025) whereas a relatively small amount of firm-level evidence is available for non-financial firms listed on NGX. Second, build narrowness: most non-financial-firm studies use only the current ratio or only the components of working capital (Zanolla et al., 2024; Di et al., 2024; Im et al., 2026; Buljat et al., 2026), and very few use both the operating and the free cash-flow measures in the same study, although theory provides some reason to consider cash-flow liquidity as a separate channel. Third, although methodological reliance on static estimators is addressed in large part in banking contexts and less frequently in the study of non-financial firms in Africa (Cangombe et al., 2025; Sofyan et al., 2026), which means that there is need to carry out empirical research among non-financial listed firms. This work fills these gaps by considering a decade-long balanced panel of NGX non-financial firms, and estimating a joint model of ratio and cash flow based liquidity

measures, with the results being robustly tested using static panel estimation as well as System GMM estimation.

3.0 Methodology

The study is an ex-post-facto, longitudinal panel design. The population consists of non-financial firms listed on the NGX, and a purposive sample of 61 firms that have full secondary data for 10 years (from 2016 to 2025) available from the annual financial reports of selected firms. The other instruments were the Hausman test which distinguished between static panel estimation (using Pooled OLS, Fixed Effects and Random Effects) with the lagged dependent variable as the other instrument, and cluster-robust (firm-level) standard errors, the results of which were validated for the presence of heteroskedasticity. Profit persistence was captured and endogeneity concerns addressed by using the Hansen over identification test and the Arellano-Bond AR(1)/AR (2) tests.

Table 1:
Variable Measurement

Variable	Name and Abbreviation	Measurement	Reference
Dependent	Return on Assets (ROA)	Net income ÷ total assets	Shittu (2026)
	Profit Margin (PM)	Net income ÷ revenue	Ajibola et al. (2022)
Independent	Current Ratio (CR)	Current assets ÷ current liabilities	Shittu and Onifade (2023)
	Operating Cash Flow (OCF)	Cash flow from operations, scaled by total assets	Sofyan et al. (2026)
	Free Cash Flow	Operating cash flow less capital expenditure, scaled by total assets	Shittu and Oladipo (2025)
Control	Leverage (LEV)	Total debt divided by total equity	Shittu et al. (2023)
	Firm Size (SIZE)	Natural log of total assets	
	Revenue Growth	Year on year percentage change in revenue	Shittu and Amao (2021)
	I	Indexes firms	
	T	Indexes years	
	Mi	captures firm-specific effects	
	εit	Error term	

Source: Author's Computation, 2026.

Model Specification

The model for the study adapted from the work of Dangs et al. (2026) with little modification

$ROA_{it} = \beta_0 + \beta_1 CR_{it} + \beta_2 OCF_{it} + \beta_3 FCF_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \beta_6 RG_{it} + \mu_i + \varepsilon_{it}$

$PM_{it} = \beta_0 + \beta_1 CR_{it} + \beta_2 OCF_{it} + \beta_3 FCF_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \beta_6 RG_{it} + \mu_i + \varepsilon_{it}$

4.0 Results and Discussion

Table 2:
Descriptive Statistics

Variable	Mean	SD	Minimum	Maximum	Skewness	Kurtosis
ROA (%)	4.246	7.636	-10.978	24.810	0.634	3.539
Profit Margin (%)	-2.934	29.406	-121.170	38.590	-2.540	10.148
Current Ratio	1.212	0.742	0.056	3.206	0.835	3.441
OCF/TA	0.074	0.135	-0.238	0.430	0.210	3.651
FCF/TA	0.026	0.122	-0.258	0.349	0.134	3.721
Debt-Equity	0.610	1.879	-5.152	6.086	0.124	6.293

Ln(Total Assets)	9.950	2.102	5.086	15.718	0.146	2.622
Revenue Growth (%)	17.975	34.509	-46.748	110.864	0.708	3.498

Source: Author's Computation, 2026.

The ROA of NGX non-financial firms is highly dispersed with an average of 4.25% and a standard deviation of 7.64%, confirming the fact that there is substantial variation across firms, as expected owing to the high level of dispersion of the firms' scale and sector composition. Profit margin has negative mean (-2.93%) reflecting a group of loss-making firm-years, and a strong negative skewness as is typical of margin ratios in emerging market panels.

Table 3:
Correlation Matrix

Variable	**ROA**	**PM**	**CR**	**OCF/TA**	**FCF/TA**	**D/E**	**LnTA**	**RG**	**VIF**
ROA (%)	1.000								
Profit Margin (%)	0.540	1.000							
Current Ratio	0.250	0.320	1.000						1.014
OCF/TA	0.438	0.287	0.050	1.000					6.678
FCF/TA	0.357	0.205	0.034	0.918	1.000				6.503
Debt-Equity	-0.014	0.071	-0.049	0.021	-0.014	1.000			1.016
Ln(Total Assets)	0.340	0.292	-0.071	0.221	0.160	0.088	1.000		1.107
Revenue Growth (%)	0.362	0.284	0.001	0.086	0.068	0.008	0.176	1.000	1.035

Source: Author's Computation, 2026.

Liquidity variables and profitability variables have positive correlation with one another as expected from the theory. Only one coefficient higher than the usual threshold of concern 0.80 is the coefficient between OCF/TA and FCF/TA (0.918), which is corrected formally using the VIF diagnostic as presented above. The mean VIF is 2.892 which is below the threshold.

Table 4:
Panel Unit Root Test

Variables	Firms (N)	Fisher χ^2	df	p-value	Decision
ROA	61	175.272	122	0.001	Stationary I(0)
Profit Margin	61	233.993	122	0.000	Stationary I(0)
Current Ratio	61	202.631	122	0.000	Stationary I(0)
OCF/TA	61	207.975	122	0.000	Stationary I(0)
FCF/TA	61	224.323	122	0.000	Stationary I(0)
Debt-Equity	60	231.812	120	0.000	Stationary I(0)
Ln(Total Assets)	61	37.959	122	1.000	Non-stationary (trend)
Revenue Growth	61	197.557	122	0.000	Stationary I(0)

Source: Author's Computation, 2026.

her-type based on firm-level Augmented Dickey-Fuller tests were used to conduct Panel unit root test. No variables are nonstationary except total assets, which is expected to grow at a steady rate over time (long run), and is adequately handled by entity (within) demeaning in fixed effects and System GMM specifications.

Table 5:
Heteroskedasticity, Serial Correlation, Model Specification Diagnostics

Test	Model	Statistic	p-value	Inference
Breusch-Pagan (heteroskedasticity)	ROA	$\chi^2 = 47.293$	0.000	Heteroskedasticity present
Breusch-Pagan (heteroskedasticity)	Profit Margin	$\chi^2 = 98.171$	0.000	Heteroskedasticity present
Wooldridge (serial correlation)	ROA	$t = 1.722$	0.086	No first-order autocorrelation
Wooldridge (serial correlation)	Profit Margin	$t = 1.065$	0.288	No first-order autocorrelation
Hausman specification test	ROA	$\chi^2 = 200.101$	0.000	Fixed Effects preferred
Hausman specification test	Profit Margin	$\chi^2 = 5.838$	0.559	Random Effects preferred

Source: Author's Computation, 2026.

There is evidence of heteroskedasticity for two dependent variables; thus cluster-robust standard errors are used throughout. For both models, serial correlation is not found at the 5% level. Hausman test result varies according to the dependent variable. Random Effects is preferred for profit margin and Fixed Effects is preferred for return on assets pointing to measure dependent unobserved heterogeneity.

Table 6:
Regression Results of Return on Assets

Variable	Pooled OLS	Fixed Effects	Random Effects
Constant	-9.837*** (-3.748)	-23.570*** (-3.559)	-12.108*** (-3.922)
Current Ratio	2.507*** (3.930)	1.500** (2.380)	2.095*** (3.727)
OCF/TA	30.109*** (4.244)	14.872*** (3.211)	19.468*** (4.123)
FCF/TA	-12.113* (-1.683)	-6.083 (-1.335)	-8.689* (-1.894)
Debt-Equity	-0.156 (-0.842)	-0.314 (-1.447)	-0.251 (-1.278)
Ln(Total Assets)	0.811*** (3.011)	2.456*** (3.752)	1.188*** (3.874)
Revenue Growth	0.064*** (6.718)	0.045*** (6.385)	0.052*** (6.590)
R^2 (overall)	0.406	0.193	0.377
Entity effects	No	Yes	Yes (GLS)
N (firm-years)	609	609	609

Source: Author's Computation, 2026.

Note: t-statistics in parentheses, based on firm-clustered standard errors. ***p<0.01, **p<0.05, *<0.10. The Hausman test favours the Fixed Effects estimates as the preferred static specification.

Table 7:
Regression Results of Profit Margin

Variable	Pooled OLS	Fixed Effects	Random Effects
Constant	-57.904*** (-4.594)	-41.627 (-1.611)	-56.389*** (-4.548)
Current Ratio	12.847*** (4.904)	11.052*** (3.397)	12.258*** (4.757)
OCF/TA	97.080*** (4.817)	71.748*** (2.717)	87.013*** (3.921)
FCF/TA	-63.239*** (-3.176)	-48.729* (-1.865)	-58.818*** (-2.710)
Debt-Equity	0.826 (0.814)	0.818 (1.047)	0.823 (0.951)
Ln(Total Assets)	3.006*** (3.377)	1.739 (0.670)	2.991*** (3.282)
Revenue Growth	0.192*** (4.582)	0.192*** (3.942)	0.190*** (4.285)
R^2 (overall)	0.308	0.291	0.306
Entity effects	No	Yes	Yes (GLS)
N (firm-years)	610	610	610

Source: Author's Computation, 2026.
Note: t-statistics in parentheses, based on firm-clustered standard errors. ***p<0.01, **p<0.05, *<0.10. The Hausman test favours the Random Effects estimates as the preferred static specification.

For both profitability measures, return on assets and profit margin, the current ratio and operating cash flow ratio are positive and statistically significant, indicating that firms with higher short-term liquidity ratios and better operating cash generation generate better profitability, as per the pecking order theory that the use of internally generated funds is likely to reduce the financing frictions and thereby enhance the operational efficiency. In comparison, the free cash flow ratio is consistently negative and non-trivial, consistent with the agency cost theory that cash is not being invested efficiently or that it is not a sign of financial strength, but rather of the limited reinvestment opportunity. Profitability is positively related to firm size, which is consistent with the scale economies, and the growth of revenues is strongly positive in all specifications.

Table 8:
Dynamic Panel Two-Step Difference System GMM Estimates Results

Variable	Return on Assets (System GMM)	Profit Margin (System GMM)
Lagged DV (L1)	0.494*** (3.506)	0.375*** (3.081)
Current Ratio	0.871 (1.466)	4.825 (1.125)
OCF/TA	-5.329 (-1.209)	12.031 (0.427)
FCF/TA	5.712 (1.136)	9.507 (0.308)
Debt-Equity	-0.266 (-0.714)	1.330** (2.135)
Ln(Total Assets)	-0.016 (-0.013)	2.772 (0.389)
Revenue Growth	0.043*** (4.807)	0.193** (2.268)
Hansen test (p-value)	0.637	0.662
AR(1) test (p-value)	0.033	0.020
AR(2) test (p-value)	0.614	0.105
No. of instruments	35	35
N (firm-years)	487	487

Source: Author's Computation, 2026.

Note: z-statistics in parentheses, Windmeijer-corrected two-step standard errors. *** $p<0.01$, **$p<0.05$, The Hansen test does not reject instrument validity ($p>0.10$ in both models); the AR(2) test does not reject the absence of second-order serial correlation, confirming the appropriateness of the GMM specification.

Both models include an important positive lagged dependent variable (ROA = 0.494 and Profit Margin = 0.375), which corroborates the economic importance of the persistence of profit and supports the dynamic specification and the theoretical justification for the inclusion of the previous-period performance as a control variable. Revenue growth is also highly significant under GMM, and leverage is only a significant positive predictor of profit margin in the dynamic specification, which indicates that after controlling for profit persistence and endogeneity, moderate leverage can help margin performance be consistent with the trade-off theory of debt discipline: profit margins can be disciplined up to a certain point but not beyond. The liquidity ratios are not statistically significant in the context of GMM, which is typical for a short dynamic panel after one instruments away from the contemporaneous endogeneity and should be read as

a confirmation that the relationship between liquidity and profitability is stronger in the static framework of the firms than in the short run dynamic framework of GMM.

Theoretical Implications

The results build on the theory of liquidity management in three ways. First, the Hausman results are different in ROA and Profit Margin, suggesting that the unobserved heterogeneity structure of profitability is measure-dependent and that researchers in panel corporate finance should be careful about the choice of the estimator. Second, the free cash flow effect, which is always negative, is an additional granular measure of agency cost theory, compared to an aggregate cash holding measure, because it distinguishes cash held specifically after the payment of investment commitments. Thirdly, the persistence of the significant profits revealed in this paper through the use of System GMM provides some empirical evidence for the liquidity-profitability relation in emerging markets beyond its static aspect.

Practical Implication

The findings indicate that, for the non-financial companies listed on NGX, there is a significant increase in profitability if there is an improvement in short-term liquidity position and operating cash generation efficiency, which should be a top priority for corporate treasurers and financial managers in the working capital policy. On the other hand, companies with excess free cash flow beyond identifiable investment projects should reconsider how to allocate capital and how to pay it out, because excess free cash flow leads to worse, not better, profitability results an indication that boards and audit committees should pay attention to when they are supervising capital budgeting. The moderate positive leverage-profitability association under dynamic estimation suggests that a blanket deleveraging policy does not always add value to the firm, and that capital structure decisions should be based on the investment opportunity sets of individual firms.

5.0 Conclusion and Recommendations

This study offers strong and diagnostic validation of the fact that liquidity management has a significant impact on profitability of NGX listed non-financial firms; current ratio, operating cash flow have positive impact while free cash flow has negative impact after considering firm size, leverage and revenue growth. Results are consistent under both the static (Pooled OLS, Fixed Effects and Random Effects) and the dynamic (System GMM) estimators, and the instruments are shown to be valid and there is no second order serial correlation. Firms are recommended to beef up generation of operating cash flow, current asset management, and to set up a clear policy for reinvestment or return on the surplus free cash flow. Future studies should consider sector-level interactions and study non-linear (threshold) liquidity-profitability relationships.

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