E-ISSN: 3123-2507
DOI: https://doi.org/10.64803/cessmuds.v1.100

The Impact of Liquidity, Liabilities, and Equity on Bank Profitability

Andini Syahputri[1,*], Khairun Niswa[2], Lita Hepika Ginting[3], Fadillah Nasution[4], Nur Aliah[5]

[1,2,3,4,5]Dapertemen of Accounting, Universitas Pembangunan Panca Budi, Medan, Indonesia
[1,*]andinisyahputri78@gmail.com, [2]khairunniswa50@gmail.com, [3]litahepikaginting@gmail.com, [4]fadilahnasution110@gmail.com, [5]Nur.aliah@dosen.pancabudi.ac.id
*E-mail Corresponding Author: andinisyahputri78@gmail.com

Abstract

This study aims to examine the role of liabilities in the financial structure of the banking sector and their implications for bank liquidity, solvency, and profitability through a literature review approach. The research method employed is a library study that analyzes relevant national journal articles published in recent years. Data analysis was conducted using content analysis by comparing and synthesizing the findings of previous studies. The results indicate that liabilities constitute the primary source of bank funding and are closely associated with liquidity and solvency risks. Partially, liabilities do not always have a significant effect on bank profitability; however, simultaneously with equity, liabilities contribute to overall bank financial performance. The conclusion of this study emphasizes that prudent liability management, balanced with assets and equity, is a crucial factor in maintaining banking stability and sustainability.

Keywords: Liabilities, Banking, Liquidity, Profitability, Literature Review

I. INTRODUCTION

Liabilities represent a bank's financial obligations to other parties arising from past transactions and must be settled within a specified period. In the banking context, liabilities primarily originate from third-party funds such as demand deposits, savings, and time deposits, which constitute the main source of funding for banks in performing their intermediation function (Sahetapy, 2023; Rafania et al., 2023).

Effective liability management is crucial because it is directly related to liquidity risk and the financial stability of banks. A mismatch between short-term liabilities and relatively illiquid assets can increase the risk of a bank's inability to meet its obligations as they fall due. Therefore, banks are required to manage their liability structure prudently to avoid pressure on liquidity and solvency (Putra et al., 2023).

Liabilities are also closely linked to a bank's profitability performance. The use of liabilities as a source of funding can enhance a bank's capacity to extend financing and expand operational activities, which may ultimately lead to higher profits. However, excessive reliance on liabilities can increase interest expenses and repayment obligations, thereby potentially eroding bank profitability (Sahetapy, 2023).

Empirical studies indicate that the effect of liabilities on bank profitability remains mixed. Several studies find that liabilities do not have a significant partial effect on net income or operating profit, suggesting that increases in liabilities are not necessarily accompanied by higher profits if they are not supported by optimal asset and capital management (Sahetapy, 2023; Rafania et al., 2023). Nevertheless, when considered simultaneously with equity, liabilities have been shown to exert a significant influence on bank profitability. This finding underscores that liabilities continue to play an important role in a bank's financial structure, particularly when utilized efficiently and supported by strong capitalization. Accordingly, balanced liability management is a key factor in maintaining financial performance and ensuring the sustainability of the banking sector (Rafania et al., 2023).

II. Literature Review

A. Capital Structure Theory

Capital structure theory explains how firms determine the composition of their financing between internal funds (equity) and borrowed funds (liabilities). According to this theory, the use of liabilities can provide benefits in the form of increased funding capacity and the potential for higher profits; however, it also entails risks arising from repayment obligations and interest expenses borne by the firm. In the banking context, liabilities play a central role as the primary source of funding derived from third-party funds, making their management a critical factor in maintaining financial stability (Sahetapy, 2023).

Capital structure theory emphasizes that an optimal combination of liabilities and equity can maximize firm value. Conversely, an imbalanced capital structure particularly excessive reliance on liabilities can increase bankruptcy risk and weaken banks' financial performance. Therefore, banks are required to maintain liability proportions that are aligned with their asset capacity and capital adequacy (Rafania et al., 2023).

B. Financial Intermediation Theory

Financial intermediation theory posits that banks function as intermediaries between surplus units (savers) and deficit units (borrowers). In performing this function, banks mobilize funds in the form of liabilities such as savings accounts, demand deposits, and time deposits which are subsequently channeled into financing or lending activities. Liabilities thus constitute a core component supporting banks' operational activities and fund distribution (Putra et al., 2023).

This theory also highlights that imbalances between liability and asset structures may trigger liquidity risk. When short-term liabilities are not supported by sufficiently liquid assets, banks may encounter difficulties in meeting their obligations. Consequently, efficient liability management is a fundamental prerequisite for ensuring that banks' intermediation function operates effectively (Ajmadayana et al., 2022).

C. Liquidity Risk Theory

Liquidity risk theory explains that liquidity risk arises when a bank is unable to meet its short-term obligations as they fall due without incurring significant losses. Liabilities particularly third-party fundsare a major determinant of a bank's liquidity risk exposure. Large-scale withdrawals by depositors can exert substantial liquidity pressure if not anticipated through sound liability management (Putra et al., 2023).

Within this theoretical framework, banks are required to implement liquidity risk management through strong managerial oversight, control of liability structures, and the provision of adequate liquid assets. Ineffective liability management may increase default risk and undermine public confidence in the banking system (Ajmadayana et al., 2022).

D. Banking Profitability Theory

Profitability theory asserts that bank earnings are influenced by the bank's ability to manage its financial resources effectively, including liabilities. Liabilities can be utilized as a funding source to expand financing volumes and operational activities, thereby potentially enhancing profitability. Nevertheless, inefficient use of liabilities may increase financial obligations and interest burdens, ultimately suppressing bank profits (Sahetapy, 2023).

Empirical evidence indicates that the effect of liabilities on bank profitability remains mixed. Some studies report that liabilities do not have a significant partial effect on profits, while others find that liabilities, when jointly analyzed with equity, exert a significant influence on bank profitability. These findings suggest that the impact of liabilities on profitability is highly dependent on the effectiveness of management practices and the overall financial structure of the bank (Rafania et al., 2023).

E. Relevant Prior Studies

Ajmadayana et al. (2022) demonstrate that solvency and banks' liability structures significantly affect financial performance, particularly in assessing banks' ability to meet their obligations. Putra et al. (2023) emphasize the importance of liquidity risk management in liability management to prevent banks from facing default risk.

Sahetapy (2023) and Rafania et al. (2023) find that liabilities do not always exert a significant partial effect on profits, but they have a significant impact when tested simultaneously with equity. These findings reinforce the view that liabilities remain an important component of banks' financial structure, yet they must be managed in balance with equity to support sustainable financial performance.

III. RESEARCH METHODOLOGY

This study employs a qualitative research method using a literature review approach. The literature review is chosen to examine, analyze, and synthesize findings from prior studies relevant to bank liabilities and their effects on financial performance and profitability. This approach aims to develop a comprehensive understanding of the concepts, theories, and empirical evidence that have been established in previous research.

A. Type and Research Approach

The study adopts a descriptive qualitative research design, focusing on the identification and analysis of scientific sources in the form of accredited national journal articles. This research does not involve primary data processing or statistical testing; instead, it emphasizes conceptual analysis and the synthesis of findings from prior studies.

B. Data Sources and Data Collection Techniques

The data used in this study consist of secondary data obtained from scientific journal articles relevant to the research topic. The data sources were collected through searches of national journal databases using the following criteria:

1. Articles addressing topics related to liabilities, liquidity, solvency, equity, or banking financial performance.
2. Articles published within a recent time frame (approximately the last 5–7 years).
3. Articles published in scientific journals with established credibility and academic relevance.

Data collection was conducted through the identification, selection, and classification of articles based on their relevance to the research topic and variables.

C. Data Analysis Techniques

The data analysis technique employed is content analysis. This analysis was conducted through the following stages:

1. Reading and comprehensively understanding the content of each article.
2. Identifying key concepts, applied theories, and research findings related to liabilities and banking performance.
3. Comparing findings across studies to identify similarities and differences in results.
4. Synthesizing research findings into a structured discussion based on relevant theoretical frameworks.

The results of the analysis are presented descriptively in the form of academic narratives that link theoretical perspectives with empirical findings from prior studies.

D. Literature Synthesis Technique

Literature synthesis was carried out by grouping research findings according to the following main themes:

1. Liabilities as a source of bank funding
2. Liabilities and liquidity risk
3. Liabilities and bank profitability

This synthesis aims to provide a comprehensive overview of the role of liabilities in banking financial structures and their implications for financial performance.

E. Research Limitations

This study is limited by the number and scope of the articles reviewed; therefore, the findings depend on the quality and relevance of the literature used. Future research is recommended to expand the number of references or to combine the literature review approach with empirical research methods to obtain more robust and comprehensive results.

IV. RESULTS AND DISCUSSION

A. Result

Based on the identification and analysis of various relevant journal articles, several key findings were obtained regarding bank liabilities and their relationship with liquidity, solvency, and profitability. The reviewed studies indicate that liabilities constitute a dominant component of banks' financial structures, primarily originating from third-party funds such as demand deposits, savings, and time deposits. These liabilities serve as the main source of funding for banks in carrying out their intermediation function.

The findings reveal that liability management is closely associated with liquidity risk. Prior studies emphasize that an increase in short-term liabilities that is not supported by adequate liquid assets can heighten the risk of banks' inability to meet their obligations as they mature. Consequently, banks are required to implement effective liquidity risk management to maintain a balance between assets and liabilities.

The literature review also shows that the effect of liabilities on bank profitability remains inconsistent. Several studies find that liabilities do not have a significant partial effect on net income or operating profit. However, when examined simultaneously with equity, liabilities are shown to contribute to improvements in bank profitability. This indicates that the role of liabilities in bank financial performance is highly influenced by capital structure and the effectiveness of liability management.

B. Discussion

The findings of this literature review are consistent with capital structure theory, which posits that the use of liabilities c an enhance funding capacity and profit potential, while simultaneously increasing financial risk if not managed optimally. In the banking context, the dominance of liabilities in the financial structure is a natural characteristic, given banks' primary role as institutions that mobilize public funds. Nevertheless, excessive reliance on liabilities may increase liquidity and solvency pressures.

From the perspective of financial intermediation theory, liabilities play a strategic role in supporting banks' financing and lending activities. Third-party funds collected by banks enable them to channel resources to the real sector and generate income. However, the review findings suggest that the effectiveness of this intermediation function depends heavily on banks' ability to manage liability maturities and maintain asset quality.

Viewed through the lens of liquidity risk theory, the results reinforce the notion that liabilities particularly short-term liabilities are a major source of liquidity risk. Large-scale withdrawals by depositors can create significant liquidity pressure if banks do not hold sufficient liquid assets. Therefore, liability management and liquidity risk control are critical aspects of maintaining banking stability.

With respect to profitability, the mixed findings in prior studies suggest that liabilities do not always have a direct impact on earnings. This implies that increases in liabilities do not automatically translate into higher bank profitability, especially when the mobilized funds are not managed efficiently. However, when combined with strong equity, liabilities can function as an effective funding instrument that supports the enhancement of bank profitability.

V. CONCLUSION

Based on the findings of the literature review of various prior studies, it can be concluded that liabilities constitute a core component of banks' financial structures and play a crucial role in supporting the intermediation function of banks. Liabilities particularly those derived from third-party funds serve as the primary source of financing for banks in conducting operational activities and extending financing or credit.

The review indicates that liability management is closely linked to banks' liquidity and solvency risks. An increase in liabilities that is not accompanied by sufficient liquid assets and adequate capital can heighten the risk of a bank's inability to meet its obligations. Therefore, the implementation of effective risk management practices is essential to maintaining banks' financial stability.

The impact of liabilities on bank profitability shows mixed results. On a partial basis, liabilities do not always have a significant effect on profits; however, when considered simultaneously with equity, liabilities are proven to contribute to banks' profitability performance. This suggests that the influence of liabilities on earnings is highly dependent on capital structure and the effectiveness with which mobilized funds are managed.

Overall, this literature review confirms that liabilities function not only as a source of funding but also as a key factor influencing risk exposure and financial performance in the banking sector. Accordingly, banks are required to manage liabilities in a balanced, prudent, and integrated manner alongside asset and equity management in order to maintain financial soundness and ensure long-term sustainability.

VI. RECOMMENDATION

Based on the findings of the literature review, banks are advised to manage their liabilities prudently and in balance with assets and equity in order to minimize liquidity risk and maintain financial stability. Bank management should ensure that the liabilities raised are utilized effectively for productive activities so as to support improvements in profitability. Furthermore, future research is expected to combine literature reviews with empirical studies to obtain more in-depth and comprehensive results regarding the impact of liabilities on the financial performance of the banking sector.

VII. REFERENCES

Ajmadayana, C. P., Akmalia, Z., & Hasibuan, A. F. H. (2022). Analysis of liquidity and solvency ratios at Bank Muamalat Indonesia for the 2019–2020 period. Ekobistek Journal, 11(3), 179–185. https://doi.org/10.35134/ekobistek.v11i3.328.

Putra, P. A., Agus, & Saparuddin. (2023). Implementation of liquidity risk management in Islamic banks. Tabarru': Islamic Banking and Finance Journal, 6(1), 81–91.

Sahetapy, I. F. (2023). The effect of liabilities and equity on net income at PT Bank Rakyat Indonesia (Persero) Tbk for the 2015–2022 period. Trisakti Journal of Accounting, 10(2), 343–356. https://doi.org/10.25105/jat.v10i2.17932.

Rafania, T. A., Anggraeny, N., Putri, K. D., Verdi, A., & Sarah, S. (2023). Analysis of liabilities and equity on operating profit at PT AlloBank Indonesia, Tbk. Journal of Economic and Accounting Research (JENSI), 7(1), 15–24.

Putra, P. A., Agus, & Saparuddin. (2023). Implementation of liquidity risk management in Islamic banks. Tabarru': Islamic Banking and Finance Journal, 6(1), 81–91.

E-ISSN: 3123-2507
DOI: https://doi.org/10.64803/cessmuds.v1.100

Sahetapy, I. F. (2023). The effect of liabilities and equity on net income at PT Bank Rakyat Indonesia (Persero) Tbk for the 2015–2022 period. Trisakti Journal of Accounting, 10(2), 343–356. https://doi.org/10.25105/jat.v10i2.17932.

Rafania, T. A., Anggraeny, N., Putri, K. D., Verdi, A., & Sarah, S. (2023). Analysis of liabilities and equity on operating profit at PT AlloBank Indonesia, Tbk. Journal of Economic and Accounting Research (JENSI), 7(1), 15–24.

Ajmadayana, C. P., Akmalia, Z., & Hasibuan, A. F. H. (2022). Analysis of liquidity and solvency ratios at Bank Muamalat Indonesia for the 2019–2020 period. Ekobistek Journal, 11(3), 179–185.

Putra, P. A., Agus, & Saparuddin. (2023). Implementation of liquidity risk management in Islamic banks. Tabarru': Islamic Banking and Finance Journal, 6(1), 81–91.

Sahetapy, I. F. (2023). The effect of liabilities and equity on net income at PT Bank Rakyat Indonesia (Persero) Tbk for the 2015–2022 period. Trisakti Journal of Accounting, 10(2), 343–356.

Rafania, T. A., Anggraeny, N., Putri, K. D., Verdi, A., & Sarah, S. (2023). Analysis of liabilities and equity on operating profit at PT AlloBank Indonesia, Tbk. Journal of Economic and Accounting Research (JENSI), 7(1), 15–24.

