International Journal of Innovative Finance and Economics Research 13(4):179-191, Oct.-Dec., 2025

 www.seahipublications.org **ISSN: 2360-896X**

doi:10.5281/zenodo.17441800

Financial Metrics And Operational Efficiency Of Deposit Money Banks In Nigeria

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ABSTRACT

This study investigated the effect of financial metrics on the operational efficiency of Deposit Money Banks (DMBs) in Nigeria between 2010 and 2024. Operational efficiency was measured using the Efficiency Ratio (EFFR), while financial metrics included the Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR). An ex-post facto research design was adopted, relying solely on secondary data from annual reports, audited financial statements, investor presentations, and publications of the Central Bank of Nigeria (CBN). A purposive sample of fifteen systematically important banks was selected. Data analysis was conducted using E-Views 9.0, with diagnostic tests such as descriptive statistics, correlation analysis, cross-sectional dependence tests, panel unit root tests, Pedroni cointegration tests, redundant fixed effects tests, and the Hausman specification test. Panel Least Squares regression was estimated under both fixed and random effects, with model selection guided by the Hausman test.The results revealed that CAR had a significant positive effect on EFFR, implying that while higher capital buffers enhanced solvency, they also increased operational costs and reduced efficiency. LDR showed a strong positive relationship with EFFR, indicating that aggressive lending relative to deposits raised cost burdens and weakened efficiency. Similarly, NPLR was positively and significantly related to EFFR, demonstrating that rising loan defaults undermined operational performance. In contrast, LCR was insignificant, suggesting that liquidity reserves had no consistent effect on efficiency. AQR significantly influenced EFFR, highlighting that poor asset quality increased operational costs, while stronger quality improved stability.Overall, the findings support the Efficiency Structure Theory, risk–return trade-off theory, and Financial Intermediation Theory. The study concludes that Nigerian banks' efficiency is shaped more by capital adequacy, lending behavior, credit risk, and asset quality than by liquidity management, recommending stronger credit risk frameworks, sustainable lending practices, and balanced capital deployment.

Keywords: Financial Metrics, Capital Adequacy Ratio, Loan-to-Deposit Ratio, Non-Performing Loan Ratio, Liquidity Coverage Ratio, Asset Quality Ratio and Efficiency Ratio

INTRODUCTION

The operational efficiency of Nigerian deposit money banks (DMBs) is widely recognized as a cornerstone of financial stability and long-term economic growth. Efficiency in this context is typically measured through the Efficiency Ratio (EFFR), which evaluates how well banks generate operating income relative to their expenses. A lower ratio indicates stronger cost management and better utilization of resources. The performance of banks, however, is not shaped by efficiency metrics alone. It is also profoundly influenced by a set of financial control indicators that highlight solvency, liquidity, credit quality, and resilience. Among these, the Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR) remain central. These indicators not only determine internal performance but also serve as signals of regulatory compliance and market confidence, particularly under the Basel III framework that Nigeria has adopted in response to macroeconomic shocks, exchange rate volatility, and persistent inflationary pressures (Okoye et al., 2022; International Monetary Fund [IMF], 2022). Each metric provides distinct insights into bank efficiency. The CAR measures solvency by comparing a bank's capital base to its risk-weighted assets. While a high CAR enhances stability and the ability to absorb shocks, it may also reduce returns by leaving excess capital underutilized. The Central Bank of Nigeria's (CBN) 2024 policy requiring international banks to raise their capital base to ₦500 billion by 2026 illustrates this trade-off, as it strengthens resilience but places pressure on smaller institutions that may be forced into mergers (Financial Times, 2024; Adewuyi & Eboh, 2023). The LDR, on the other hand, reflects the balance between loan creation and liquidity retention. Adenuga et al. (2021) observed that an increase in LDR from 70% to 90% significantly weakened liquidity buffers between 2019 and 2020. Similarly, high NPLRs undermine both profitability and asset quality, as shown by Abdulrauf (2023) and Eze and Nwankwo (2022). Liquidity, proxied by the LCR, and credit soundness, measured through AQR, remain critical in safeguarding banks against sudden liquidity drains and asset deterioration (Ibrahim & Yusuf, 2023; Tomi et al., 2022).

The interplay among these metrics is complex. While stronger capital buffers improve solvency, they can constrain lending capacity. Aggressive loan growth may generate higher income but risks deteriorating credit quality through rising NPLs. Empirical evidence consistently suggests that high levels of non-performing loans weaken profitability, while prudent liquidity and asset management practices bolster efficiency (Law-Biaduo et al., 2024; Afolabi & Tolu, 2023). Additionally, fintech-driven innovation and the rapid adoption of digital banking services are reshaping traditional cost structures, influencing efficiency benchmarks in new ways (Adebayo et al., 2023). Looking ahead, the CBN's recapitalization agenda is expected to stimulate consolidation, with larger banks enjoying economies of scale and operational advantages, while smaller banks may face challenges to survival (Nwachukwu & Iloh, 2024). Despite considerable scholarship, research gaps persist. Most prior studies have examined individual indicators such as CAR or NPLR, but few have assessed their combined effects on operational efficiency. Findings remain inconclusive: while some argue that higher capital levels support efficiency (Adebayo & Olalekan, 2023), others contend that excessive capitalization hinders resource utilization (Law-Biaduo et al., 2024). Likewise, LDR has been linked to both credit expansion and liquidity strain, while liquidity and asset quality indicators remain underexplored. This study therefore aims to provide an integrated analysis of CAR, LDR, NPLR, LCR, and AQR in relation to the operational efficiency of Nigerian DMBs. By doing so, it contributes to understanding the trade-offs between stability, liquidity, credit performance, and cost-effectiveness that define the evolving Nigerian banking landscape.

Conceptual Review

Financial Metrics

The efficiency of Nigerian deposit money banks (DMBs) is fundamentally shaped by five key financial indicators: the Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR). These measures collectively define the stability, profitability, and regulatory compliance of banks, while also guiding investor confidence and supervisory oversight. Each indicator serves as both a diagnostic and strategic tool, revealing the strengths and vulnerabilities of financial institutions in a challenging macroeconomic and regulatory environment.

The Capital Adequacy Ratio (CAR) functions as a critical measure of resilience by comparing capital to risk-weighted assets. While higher CAR values increase solvency and investor assurance, they may also reduce lending activity and profitability when banks over-capitalize. In Nigeria, fluctuations in CAR have forced some banks to raise additional equity, thereby increasing operational costs (Ekezie & Nwankwo, 2023). This challenge is particularly relevant under the Central Bank of Nigeria's (CBN) directive requiring a ₦500 billion minimum capital base for international banks by 2026, a policy aimed at correcting undercapitalization and addressing systemic risks (CBN, 2024). Consequently, CAR remains both a prudential safeguard and a strategic management tool.

Equally important is the Loan-to-Deposit Ratio (LDR), which reflects how effectively banks convert deposits into loans, balancing profitability with liquidity. A high LDR signals aggressive lending and strong income potential but exposes banks to liquidity strain, while a low ratio indicates underutilization of resources. The CBN's 2019 policy mandating a 65% minimum LDR was designed to stimulate credit growth, yet results were mixed. Some banks expanded lending to productive sectors, while others extended risky loans merely to comply (Osinubi & Onyekachi, 2023). Studies further reveal that moderate LDR levels enhance returns, but once thresholds are exceeded, defaults and liquidity pressures undermine efficiency (Adenuga et al., 2021).

The Non-Performing Loan Ratio (NPLR) highlights credit risk and asset quality by measuring the proportion of loans overdue by 90 days or more. High NPLRs erode profitability through increased provisioning costs and reduced efficiency. In Nigeria, persistent challenges such as poor credit appraisal systems, oil price shocks, exchange rate volatility, and the COVID-19 pandemic have pushed many Tier 2 banks above the prudential 5% benchmark (Ibrahim & Ajayi, 2023). Elevated NPLRs weaken capital and liquidity buffers while reducing both Return on Assets and Return on Equity. Stronger credit governance and recovery mechanisms are therefore essential for restoring efficiency.

The Liquidity Coverage Ratio (LCR), another Basel III metric, ensures that banks hold sufficient high-quality liquid assets to withstand 30-day liquidity stress scenarios. In Nigeria, LCR provides a buffer against shocks caused by macroeconomic volatility and depositor withdrawals. Larger Tier 1 banks generally maintain stronger LCR positions, while smaller banks often struggle due to limited funding bases and asset illiquidity (Okezie & Emeka, 2023). Adequate liquidity enhances depositor confidence and interbank credibility, though holding excessive reserves may constrain profitability (Oladimeji et al., 2023). Thus, balancing liquidity safety with lending activity is central to long-term stability.

Finally, the Asset Quality Ratio (AQR) measures the proportion of impaired or high-risk assets relative to total assets, serving as a key determinant of balance sheet sustainability. Weak asset quality, driven by macroeconomic instability and sectoral loan concentration, erodes profitability, raises provisioning costs, and undermines both capital adequacy and liquidity (Ademola & Olatunji, 2023). Regulatory reviews, such as the CBN's 2014 Asset Quality Review, revealed significant deficiencies in loan classification and collateral valuation, particularly among Tier 2 banks (CBN, 2020). Strengthening governance frameworks, improving credit infrastructure, and adopting technology-driven monitoring tools remain essential to safeguard asset quality.

Operational Efficiency

The operational efficiency of Nigerian deposit money banks (DMBs), often measured by the Efficiency Ratio (EFFR), is central to sustainability and competitiveness. A lower ratio indicates stronger cost control and income generation. Efficiency outcomes are shaped by financial indicators such as the Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR). While adequate capital buffers enhance stability, excessive capitalization can constrain lending and returns (Adegbite & Olayemi, 2024). Similarly, optimal LDR supports profitability, but aggressive lending raises default risks (Osinubi & Onyekachi, 2023). High NPLRs weaken asset quality and reduce efficiency (Eze et al., 2023), while LCR compliance enhances resilience but may reduce returns if excess liquidity remains idle (Ogunwale & Akinpelu, 2023). Poor asset quality reflected in high AQRs also raises impairment costs (Adewole & Yusuf, 2022).

Theoretical Review

Efficiency Structure Theory

The Efficiency Structure Theory (EST) explains how banks' cost structures, resource allocation, and operational efficiency shape profitability and competitiveness. In Nigeria, it provides a framework for analyzing how financial metrics such as Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR) influence operational efficiency, proxied by the Efficiency Ratio (EFFR) (Adebayo & Okechukwu, 2023). CAR strengthens stability and efficiency but may reduce profitability if excessively high (Oladimeji & Yusuf, 2024). LDR supports credit expansion and efficiency when balanced, though aggressive lending raises liquidity risks (Ogunleye & Alabi, 2022). NPLR reflects asset quality, with high levels eroding profitability and efficiency (Ojo & Folarin, 2023). LCR enhances resilience but excessive holdings limit returns (Ehinomen & Oloruntoba, 2023). Finally, strong AQR improves efficiency, while poor governance and weak credit monitoring increase risks (Adewole & Yusuf, 2022).

Financial Intermediation Theory

The Financial Intermediation Theory, introduced by Gurley and Shaw (1960) and expanded by Diamond and Dybvig (1983), emphasizes the role of banks as intermediaries that connect savers and borrowers, reduce transaction costs, address information asymmetry, and provide liquidity transformation. Through these functions, banks promote economic stability and efficiency (Egbide& Akinola, 2021). Over time, the theory has evolved to integrate risk management, regulation, and technological innovation in banking operations. In Nigeria, financial intermediation is central as deposit money banks mobilize savings and allocate credit to households and businesses (Adebayo & Adegbite, 2023). The effectiveness of this process is assessed using key financial indicators such as Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR), which together influence operational efficiency, proxied by the Efficiency Ratio (EFFR) (Ogunleye et al., 2022).

Empirical Review

Law-Biaduo et al. (2024) examined the effect of credit risk management on the performance of Nigerian deposit money banks (DMBs). Using secondary data and panel regression, the study analyzed the relationship between Non-Performing Loans (NPLs), Loan-to-Deposit Ratio (LDR), Liquidity Ratio (LQR), and Capital Adequacy Ratio (CAR) against Return on Equity (ROE). The results showed that while LQR and NPL had positive but insignificant effects on ROE, CAR negatively and significantly influenced profitability, suggesting that higher capital reserves may constrain returns. The authors recommended maintaining liquidity within regulatory thresholds to meet financial obligations.

Similarly, Akinroluyo (2024) applied Structural Equation Modeling (SEM) over a 15-year period to assess NPL, Capital Adequacy (CA), Cost Efficiency (CE), and Average Lending Ratio (ALR). The findings indicated that NPL negatively and significantly impacted profitability, while CA, CE, and ALR were positive drivers. The study emphasized strategies to reduce loan defaults to enhance performance.

Mohammed et al. (2024) investigated liquidity management's effect on CAR using data from 12 listed banks. Results revealed that while LDR had no significant effect, Liquidity Ratio significantly improved CAR. The authors recommended strict compliance with regulatory LDRs and efficient liquid asset management.

Afolabi and Tolu (2023) analyzed Tier 1 banks between 2015 and 2021. Their fixed-effects regression showed that moderate LDR levels improved ROA and ROE, but excessive lending above 80% weakened performance by straining liquidity. They recommended dynamic LDR targets, stronger deposit mobilization, and close liquidity monitoring.

Lawal et al. (2023) reexamined Liquidity Coverage Ratio (LCR) compliance across sub-Saharan Africa. While higher LCRs often increased cost-to-income ratios, some Nigerian banks offset these effects through revenue diversification and treasury innovation. They argued that flexible regulatory timelines and fintech adoption can reduce compliance burdens.

Adebanjo et al. (2023) found that managing defaults through provisioning raised cost-to-income ratios in nine banks, undermining efficiency. They recommended risk-based pricing, stronger borrower monitoring, and optimized provisioning.

Musa and Adebanjo (2023) extended analysis to West Africa (Nigeria, Ghana, Senegal) using VAR models. They observed that higher LDRs created short-term funding stress but could be alleviated through interbank integration and regional liquidity pooling.

Finally, Adebayo et al. (2022) assessed macroprudential regulations from 2014–2020. They reported that stronger governance allowed some banks to improve efficiency under new stability measures, while weaker banks lagged. The study recommended capacity-building and targeted implementation of stability frameworks.

RESEARCH METHODOLOGY

This study adopted an ex-post facto research design, suitable for examining cause-effect relationships using historical data without manipulating independent variables. The focus was on how financial control metrics influence the operational efficiency of Deposit Money Banks (DMBs) in Nigeria. Secondary data were sourced from audited financial statements, investor reports, regulatory disclosures, and other public records. The variables examined were Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR), with operational efficiency proxied by the Efficiency Ratio (EFFR). Panel data spanning 2010–2024 enabled assessment of cross-sectional and time-series dynamics, capturing the effects of financial reforms, macroeconomic shifts, and regulatory interventions such as Basel III and IFRS adoption. The population comprised 23 licensed DMBs, from which 15 were purposively selected to represent Tier 1 and Tier 2 institutions. Selected banks included Access, Zenith, First Bank, UBA, GTBank, Fidelity, FCMB, Union, Sterling, Wema, Stanbic IBTC, Polaris, Ecobank, Keystone, and Unity Bank. Data analysis employed E-Views 9.0 with panel least squares estimation. Fixed and random effects models were considered, guided by the Hausman test. Diagnostics, including correlation, unit root, cointegration and robustness checks, ensured reliability and validity of results. The panel regression model was specified as follows:

$$\mathbf{EFFRit = \beta_0 + \beta_1 CARit + \beta_2 LDRit + \beta_3 NPLRit + \beta_4 LCRit + \beta_5 AQRit + \mu i + \varepsilon it}$$

Where:

EFFRit = Efficiency Ratio for bank *i* at time *t*

CARit = Capital Adequacy Ratio

LDRit = Loan-to-Deposit Ratio

NPLRit = Non-Performing Loan Ratio

LCRit = Liquidity Coverage Ratio

AQRit = Asset Quality Ratio

μi = unobservable bank-specific effect (fixed/random)

εit = idiosyncratic error term

$\boldsymbol{\beta_0 \ldots \beta_5}$ = coefficients to be estimated

RESULTS AND DISCUSSION

This section presents the empirical findings derived from the panel data of fifteen (15) Deposit Money Banks (DMBs) in Nigeria spanning the years 2010 to 2024. The study utilized secondary data sourced from audited financial reports, which were structured into a panel format to capture both cross-sectional and time-series variations. This approach provided a comprehensive basis for analyzing the relationship between key financial control indicators such as Capital Adequacy Ratio (CAR), Loan-to-Deposit Ratio (LDR), Non-Performing Loan Ratio (NPLR), Liquidity Coverage Ratio (LCR), and Asset Quality Ratio (AQR) and operational efficiency, measured by the Efficiency Ratio (EFFR).

Descriptive Statistics

Descriptive statistics summarized the dataset by presenting measures of central tendency, dispersion, and distribution, including mean, median, standard deviation, minimum, and maximum values. These measures revealed outliers, asymmetries, and patterns across banks and years, as shown in Table 1

Table 1: Descriptive Statistics

	EFFR	CAR	LDR	NPLR	LCR	AQR
Mean	3.321293	1.555556	1.146667	2.514400	2.519422	1.415689
Median	3.307000	1.001231	0.012300	2.680000	2.710000	1.400000
Maximum	6.508000	1.012341	2.078351	5.017620	4.960000	2.970000
Minimum	2.012341	0.012343	1.067312	0.010000	0.000000	0.000000
Std. Dev.	3.127845	1.498012	0.354562	1.409098	1.406967	0.863870
Skewness	0.031697	0.223607	1.997513	0.090472	0.088646	0.116568
Kurtosis	1.817950	1.050000	4.990057	1.831084	1.811237	1.806919
Jarque-Bera	13.13683	37.52344	186.7552	13.11662	13.54302	13.85431
Probability	0.071404	0.0166273	0.078123	0.057418	0.061146	0.055981
Sum	7472.910	125.0000	33.00000	565.7400	566.8700	318.5300
Sum Sq. Dev.	39495.04	55.55556	28.16000	444.7647	443.4208	167.1649
Observations	225	225	225	225	225	225

Source: E-Views 9.0 Output, (2025).

Table 1 summarizes the descriptive statistics of 225 bank-year observations, showing varying distributional properties across variables. EFFR and NPLR exhibit near symmetry with approximate normality, though both display mild deviations. CAR shows high variability and significant non-normality, while LDR is heavily skewed and leptokurtic, reflecting strong outliers and tail risks. LCR and AQR indicate balanced central tendencies with moderate dispersion, both approximating normal distributions despite flatness. Overall, the results highlight diverse patterns, from symmetry and normality to skewness and heavy tails, suggesting that while some variables align with normal assumptions, others deviate, reflecting the heterogeneity of Nigerian banks.

Correlation Analysis

Correlation analysis assessed the strength and direction of linear relationships between dependent and independent variables using Pearson coefficients. Although not implying causality, coefficients of $|r| \geq 0.8$ signaled potential multicollinearity, requiring further econometric checks before estimation. Results are summarized in Table 2 below.

Table 2:Correlation Analysis

	EFFR	CAR	LDR	NPLR	LCR	AQR
EFFR	1.000000					
CAR	0.369470	1.000000				
LDR	0.255342	0.008427	1.000000			
NPLR	0.370893	-0.016095	0.099138	1.000000		
LCR	0.194125	-0.113204	-0.018264	0.131074	1.000000	
AQR	0.152448	0.096700	-0.049814	0.028092	-0.012780	1.000000

Source: E-Views 9.0 Output, (2025).

Table 2 shows that EFFR is positively correlated with all explanatory variables. Moderate associations exist with CAR (0.3695), LDR (0.2553), and NPLR (0.3709), the latter reflecting efficiency deterioration since higher EFFR signals weaker performance. Weaker positive links appear with LCR (0.1941) and AQR (0.1524). Among independents, CAR shows weak, mostly negligible correlations, while LDR, NPLR, LCR, and AQR display only mild relationships. Importantly, no coefficient exceeds 0.8, indicating limited multicollinearity. Overall, the variables exhibit low pairwise correlations, suggesting independence and suitability for regression analysis without significant risks of redundancy.

Residual Cross-Sectional Dependence Tests

The Pesaran Cross-sectional Dependence (CD) test was applied to panel data to check whether residuals were correlated across banks, indicating possible unobserved shocks or spillovers. Identifying such dependence was crucial to prevent biased standard errors and inconsistent estimates. Results are shown in Table 3 below.

Table 3: Residual Cross-Section Dependence Test
Null hypothesis: No cross-section dependence (correlation) in residuals
Equation: Untitled
Periods included: 15
Cross-sections included: 15
Total panel observations: 225
Note: non-zero cross-section means detected in data
Cross-section means were removed during computation of correlations

Test	Statistic	d.f.	Prob.
Breusch-Pagan LM	136.1890	105	0.0720
Pesaran scaled LM	1.117150		0.2639
Pesaran CD	0.443076		0.6577

Source: E-Views 9.0 Output, (2025).

Table 3 reports the residual cross-section dependence test for the 15 banks, assessing whether residuals were correlated due to unobserved shocks. The Breusch-Pagan LM statistic (136.1890, p = 0.0720) exceeded the 5 percent threshold, suggesting weak but insignificant evidence of dependence. Both the Pesaran scaled LM (1.1172, p = 0.2639) and Pesaran CD (0.4431, p = 0.6577) further confirmed no significant cross-sectional correlation. Overall, the results indicate that residuals are largely independent across banks, minimizing concerns of biased standard errors and validating the assumptions underlying the panel regression models.

Panel Unit Root Tests

Panel unit root tests, including Levin–Lin–Chu (LLC), Im–Pesaran–Shin (IPS), and Fisher-ADF, were conducted to confirm stationarity of variables at level or first difference. Ensuring stationarity was essential to avoid spurious regressions and support valid statistical inference. Results are presented in Table 4below.

Table 4: ADF Panel Unit Root Test

Variables	**Method**	**ADF Statistics**	**Prob.**	**@ Level**	**Check for Stationary**
	Levin, Lin & Chu t	-4.88141	0.0000	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-6.23848	0.0000	1(0)	
	ADF - Fisher Chi-square	94.7910	0.0000	1(0)	
EFFR	PP - Fisher Chi-square	196.946	0.0000	1(0)	
	Levin, Lin & Chu t	-5.39353	0.0000	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-5.96823	0.0000	1(0)	
	ADF - Fisher Chi-square	83.7794	0.0000	1(0)	
CAR	PP - Fisher Chi-square	168.894	0.0000	1(0)	
	Levin, Lin & Chu t	-2.71446	0.0133	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-2.22326	0.0131	1(0)	
	ADF - Fisher Chi-square	21.5890	0.00173	1(0)	
LDR	PP - Fisher Chi-square	44.9555	0.0000	1(0)	
	Levin, Lin & Chu t	-4.26221	0.0000	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-3.96168	0.0000	1(0)	
	ADF - Fisher Chi-square	64.7064	0.0002	1(0)	
NPLR	PP - Fisher Chi-square	118.939	0.0000	1(0)	
	Levin, Lin & Chu t	-9.92772	0.0000	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-7.39948	0.0000	1(0)	
	ADF - Fisher Chi-square	110.166	0.0000	1(0)	
LCR	PP - Fisher Chi-square	180.759	0.0000	1(0)	
	Levin, Lin & Chu t	-4.70199	0.0000	1(0)	Stationary
	Im, Pesaran and Shin W-stat	-6.07869	0.0000	1(0)	
	ADF - Fisher Chi-square	92.3551	0.0000	1(0)	
AQR	PP - Fisher Chi-square	204.216	0.0000	1(0)	
Variables	**Method**	**Statistics**	**Prob.**	**@Ist Diff.**	**Check for Stationary**

EFFR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-9.48305 -9.70801 140.829 311.656	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary
CAR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-8.77546 -9.57282 132.932 286.312	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary
LDR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-7.46745 -6.88168 72.6617 155.388	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary
NPLR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-6.87663 -7.36256 109.506 279.079	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary
LCR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-13.6477 -11.3434 159.080 294.694	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary
AQR	Levin, Lin & Chu t Im, Pesaran and Shin W-stat ADF - Fisher Chi-square PP - Fisher Chi-square	-12.1740 -13.5091 185.506 337.950	0.0000 0.0000 0.0000 0.0000	1(1)	Stationary

Source: E-Views 9.0 Output, (2025).

Table 4 presents panel unit root results confirming the stationarity of all variables. Using Levin–Lin–Chu, Im–Pesaran–Shin, ADF Fisher, and PP Fisher tests, EFFR, CAR, LDR, NPLR, LCR, and AQR all show significant probabilities below 5 percent at level, indicating I(0) stationarity. Re-estimation at first difference also yields highly significant results, suggesting robustness and consistency with I(1) properties. These findings confirm that the variables are free from unit root problems, ensuring reliable regression estimates. Stationarity at level allows direct use in panel regression, while confirmation at first difference demonstrates that shocks dissipate over time, preventing spurious results.

Pedroni Panel Cointegration Test

The Pedroni cointegration test was applied to variables integrated of the same order to determine if a long-run equilibrium relationship exists. Evidence of cointegration indicates that explanatory variables and operational efficiency evolve together, enabling models to account for both short-term dynamics and long-term adjustments. Results appear in Table 5.

Table 5: Pedroni Residual Cointegration Test

Series: EFFR CAR LDR NPLR LCR AQR
Date: 09/02/25 Time: 01:01
Sample: 2010 2024
Included observations: 225
Cross-sections included: 13 (2 dropped)
Null Hypothesis: No cointegration
Trend assumption: No deterministic trend
User-specified lag length: 1
Newey-West automatic bandwidth selection and Bartlett kernel

Alternative hypothesis: common AR coefs. (within-dimension)

	Statistic	Prob.	Weighted Statistic	Prob.
Panel v-Statistic	-3.045407	0.9988	-4.160834	1.0000
Panel rho-Statistic	2.876336	0.9980	3.097495	0.9990
Panel PP-Statistic	-5.609744	0.0000	-6.196810	0.0000
Panel ADF-Statistic	4.310056	0.0001	-4.030782	0.0000

Alternative hypothesis: individual AR coefs. (between-dimension)

	Statistic	Prob.
Group rho-Statistic	4.436006	1.0000
Group PP-Statistic	-7.592344	0.0000
Group ADF-Statistic	5.499530	0.0000

Source: E-Views 9.0 Output, (2025).

Table 5 reports the Pedroni residual cointegration test for EFFR, CAR, LDR, NPLR, LCR, and AQR. Within-dimension results show the panel v- and rho-statistics are insignificant, but the panel PP- and ADF-statistics are highly significant, confirming cointegration. Between-dimension results similarly show insignificant group rho-statistics but strongly significant PP and ADF statistics. Overall, the majority of tests reject the null of no cointegration, providing strong evidence of a long-run equilibrium relationship. This indicates that despite short-term fluctuations, operational efficiency and the explanatory ratios move together in a stable long-run path across Nigerian banks.

Redundant Fixed Effects Test vs. Correlated Hausman Test

The Redundant Fixed Effects Test assessed whether fixed effects improved model fit over pooled OLS by accounting for unobserved heterogeneity. The Correlated Hausman Test then guided the choice between fixed and random effects, with significant results favoring fixed effects and insignificant results supporting random effects. Results are shown in Table 6.

Table 6: Redundant Fixed Effects Tests Vs Correlated Hausman Test

Redundant Fixed Effects Tests			
Equation: Untitled			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	0.861182	(14,204)	0.6019
Cross-section Chi-square	12.919542	14	0.5329
Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	7.033361	6	0.3178

Source: E-Views 9.0 Output, (2025).

Table 6 shows that the redundant fixed effects test yielded insignificant results (F = 0.8612, p = 0.6019; Chi-square = 12.9195, p = 0.5329), indicating that fixed effects do not improve the model over pooled OLS. The Hausman test also reported an insignificant statistic (Chi-square = 7.0334, p = 0.3178), confirming the consistency of the random effects model. These results suggest that bank-specific heterogeneity is not strongly influential and that random effects estimation is more efficient. Overall, the evidence supports adopting the random effects specification as the most appropriate approach for analyzing the panel data.

Random Effects Pooled Regression

The Random Effects (RE) model assumed bank-specific effects were uncorrelated with explanatory variables, capturing both within- and between-bank variations for efficient estimates. Its validity relied on the Hausman test, which determined the consistency of the RE estimator. Results of this analysis are presented in Table 7 below.

Table 7: Random Effects Pooled Regression

Dependent Variable: EFFR
Method: Panel EGLS (Cross-section random effects)
Date: 09/02/25 Time: 17:58
Sample: 2010 2024
Periods included: 15
Cross-sections included: 15
Total panel (balanced) observations: 225
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	26.69747	3.009383	8.871409	0.0000
CAR	1.882361	0.870606	2.162127	0.0355
LDR	2.411364	2.625085	3.857658	0.0000
NPLR	1.263358	0.260718	4.845688	0.0000
LCR	1.140742	0.704542	1.619127	0.1070
AQR	1.779204	0.676189	2.631223	0.0249

Effects Specification			S.D.	Rho
Cross-section random			0.000000	0.0000
Idiosyncratic random			13.34413	1.0000

Weighted Statistics			
R-squared	0.525896	Mean dependent var	33.21293
Adjusted R-squared	0.500914	S.D. dependent var	13.27845
S.E. of regression	13.28451	Sum squared resid	38472.26
F-statistic	9.165917	Durbin-Watson stat	2.250783
Prob(F-statistic)	0.000209		

Unweighted Statistics			
R-squared	0.525896	Mean dependent var	33.21293
Sum squared resid	38472.26	Durbin-Watson stat	2.250783

Source: E-Views 9.0 Output, (2025).

The random effects pooled regression modeled operational efficiency (EFFR) as a function of financial ratios. The constant term was positive and highly significant, with a coefficient of 26.6975 (p = 0.0000), indicating that efficiency retains a baseline level even without explanatory variables. The model explained 52.6 percent of the variation in EFFR (R-squared = 0.5259; adjusted R-squared = 0.5009), while the F-statistic of 9.166 (p = 0.0002) confirmed the joint significance of the predictors. The Durbin-Watson statistic of 2.251 further suggested the absence of autocorrelation.

Capital Adequacy Ratio (CAR) showed a significant positive effect on EFFR (coefficient = 1.8824; p = 0.0355). Since higher EFFR implies weaker efficiency, this finding suggests that well-capitalized banks incur cost burdens that reduce efficiency. This aligns with Efficiency Structure Theory (EST), which recognizes that while capital enhances stability, excessively high CAR constrains profitability (Oladimeji & Yusuf, 2024). Financial Intermediation Theory (Gurley & Shaw, 1960; Diamond & Dybvig, 1983) also posits that while capital builds credibility, excessive reserves limit intermediation. Empirical evidence echoes this trade-off: Law-Biaduo et al. (2024) found that CAR negatively impacted ROE, while Akinroluyo (2024) highlighted its nuanced role in performance.

Loan-to-Deposit Ratio (LDR) was highly significant (coefficient = 2.4114; p = 0.0000). Higher LDRs raised EFFR, reflecting weaker efficiency, as aggressive lending increases income but also risk and costs.

From an EST perspective, this reflects costly structures tied to weak credit risk management (Ogunleye & Alabi, 2022). Financial Intermediation Theory supports this by noting that excessive lending strains liquidity. Afolabi and Tolu (2023) found that moderate LDRs improved ROA and ROE, but excessive ratios weakened performance, while Musa and Adebanjo (2023) showed that high LDRs triggered short-term funding stress. These findings suggest Nigerian banks must adopt dynamic LDR targets.

Non-Performing Loan Ratio (NPLR) also showed a highly significant effect (coefficient = 1.2634; p = 0.0000), confirming that higher defaults reduce efficiency. EST emphasizes that poor asset quality raises costs and reduces competitiveness (Ojo & Folarin, 2023), while Intermediation Theory explains that defaults tie up resources in non-productive assets. Empirical studies support this: Akinroluyo (2024) and Adebanjo et al. (2023) showed NPLs undermine profitability and cost efficiency, while Law-Biaduo et al. (2024) confirmed credit risk failures weaken performance.

Liquidity Coverage Ratio (LCR) had no significant effect (coefficient = 1.1407; p = 0.1070). Although liquidity buffers improve stability, they do not reliably influence efficiency in Nigeria's volatile context. EST suggests excess liquidity creates inefficiency through idle assets (Ehinomen & Oloruntoba, 2023). Lawal et al. (2023) showed LCR compliance raised cost-to-income ratios, though some banks offset this via diversification. Similarly, Mohammed et al. (2024) found liquidity ratios improved CAR but not profitability. Thus, while liquidity strengthens resilience, its efficiency impact remains limited.

Asset Quality Ratio (AQR) was significant (coefficient = 1.7792; p = 0.0249), showing that weaker asset quality reduces efficiency. EST highlights asset quality as central to cost structures (Adewole & Yusuf, 2022), while Intermediation Theory stresses its role in effective credit allocation. Empirical studies confirm this link: Adebanjo et al. (2023) found default provisioning raised costs, while Adebayo et al. (2022) emphasized stronger frameworks improve efficiency. The Central Bank of Nigeria's supervision of asset quality underscores its systemic importance.

CONCLUSION

The study concluded that financial metrics significantly shape the operational efficiency of Nigerian DMBs, with CAR, LDR, NPLR, and AQR emerging as key determinants, while LCR showed no significant impact. Efficiency was more influenced by credit quality, capital deployment, and lending practices than by liquidity buffers. CAR promoted stability but, when excessive, weakened efficiency by inflating costs and limiting productive capital use. LDR had adverse effects when lending exceeded sustainable levels, raising liquidity pressures and operational costs, while NPLR confirmed that rising loan defaults eroded efficiency through higher provisioning and monitoring expenses. AQR further highlighted the importance of asset quality, with poor assets undermining stability. Overall, Nigerian banks must prioritize credit quality, prudent lending, and balanced capital deployment as the main drivers of sustainable efficiency.

RECOMMENDATIONS

Based on the findings, the study recommends that:

i. Banks should balance capital strength with productive deployment into innovations, lending, and technology-driven cost management. Regulators should promote optimal, not excessive, capital requirements.

ii. Banks should maintain sustainable loan-to-deposit thresholds and strengthen deposit mobilization strategies to reduce cost inefficiencies.

iii. Credit appraisal systems should be enhanced with real-time monitoring, stricter loan recovery frameworks, and diversification to minimize default risks.

iv. Liquidity management should be linked to profitability objectives by investing in yield-generating liquid assets to reduce opportunity costs.

v. Banks should conduct periodic asset reviews, digitize loan monitoring, and diversify asset portfolios to sustain quality and prevent efficiency erosion.

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