



Analysis of Liquidity Management and Its Effect on Corporate Financial Stability

Dr. Shetty Deepa Thangam Geeta

Assistant Professor, School of Management Studies, Sathyabama Institute of Science and Technology, Chennai, India, Orc Id - 0000-0003-4645-0202, drshettydeepa@gmail.com

Rupendar Sirvi M

II MBA, Student, School of Management Studies, Sathyabama Institute of Science and Technology, Chennai, India, rupendarsirviz003@gmail.com

Ricchal A

II MBA, Student, School of Management Studies, Sathyabama Institute of Science and Technology, Chennai, India, ricchaldasso94@gmail.com

Muruga Nathan A

II MBA, Student, School of Management Studies, Sathyabama Institute of Science and Technology, Chennai, nathana4747@gmail.com

Abstract

Liquidity management keep solvent financial position which further help organisation in long-run stability. Managing current assets and current liabilities in such a way that the short-term financial obligations are duly fulfilled without disrupting the smooth operations of the business. The review of the different liquidity management is carried out to stabilize the corporate finance. The stabilization is done on the basis of current ratio, quick ratio, and cash flows. A strong liquidity position lowers insolvency risk, improves credit rating and permits continuity of operations. On the other hand, an excess of liquidity would reduce profitability. Study illustrates that it is necessary to maintain balance between liquidity and profitability which has been established in conceptual debate and numerical example.

Key Words: Liquidity Management, Financial Stability, Working Capital, Current Ratio, Cash Flow.

Introduction

Liquidity management is the ability of the firm to pay short-term obligation with current assets without affecting their activity. A cash management system allows an organization to do business without disruption and disturbing the financial condition and it regulates cash flow and component of working capital. In this changing world where businesses undergo changes day by day liquidity is a must-have for the survival of any business. Lack of liquidity may cause bankruptcy while surplus liquidity may harm profit the equilibrium should thus be maintained optimally. Organizations that have enough liquidity enhance their financial strength and continuity.

Conceptual Framework of Liquidity Management

Liquidity Management refers to the management of current assets and current liabilities in the short term as per the requirement of an enterprise. Corporate finance strategy is an important

one. Liquidity management means being able to maintain sufficient cash and near cash resources to successfully meet expected immediate liabilities with available funding. Liquidity can be defined in two forms, operational liquidity relates to the daily business activity and funding liquidity is a firm's ability to raise money when it requires (Wang, 2025).

Liquidity is measured by managing cash, receivables and inventory. Liquidity of a firm is directly influenced by various items that make up its working capital. The cash conversion cycle typically gauges the time from the cash outlay by the company for inventory of products to product sales and the cash inflow by the company from sales of products (Khodabakhsh, 2025).

A critical tradeoff is generating profits versus generating liquidity. Reducing financial risk by holding liquid assets means a business has less use of other assets. Limiting the accessibility of liquid resources increases profitability, but it further enhances the risk of distress.

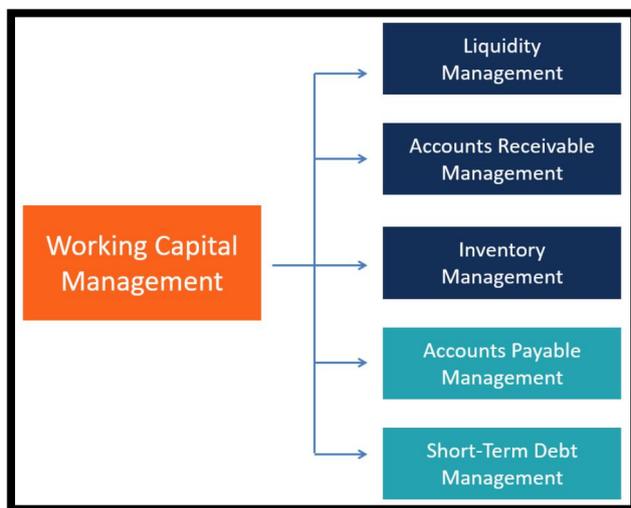


Figure 1: Working Capital Cycle
(Source: Corporatefinanceinstitute.com, 2026)

Consequently, companies should aim for an optimal combination which ensures both financial soundness and efficient allocation of resources.

Key Liquidity Ratios and Financial Indicators

Liquidity ratios which refer to the measures used to assess the ability of a firm to meet obligations. These ratios help evaluate the efficiency of liquidity management and provide insight into financial health.

The current ratio of the indicators is probably one of the most popular currently calculated by dividing the current asset from current liability. A ratio greater than one is often interpreted to mean that a company has sufficient assets to pay its debts. As an illustration, a current ratio of 2:1 indicates good liquidity because it means the firm has twice as many current assets as there are liabilities (Tran and Tran 2025).

The quick ratio, or acid-test ratio, refines by removing any inventory from current assets accounts. It is due to the fact that inventory is not always easy to turn into cash. A quick ratio close to or above 1 is normally taken as a sign of being in a liquid position.

More conservative than either ratio, this ratio measures only cash and cash equivalent against current liabilities. The ability of a company to meet its liabilities through cash and other equivalents without recourse to any credit is referred to as liquidity (Akpan, Eno and Etim, 2024).

The operating cash flow ratio assesses whether an organization's cash flow from operations suffices to cover its current liabilities. The liquidity that this ratio provides takes into account generation of cash in real terms.

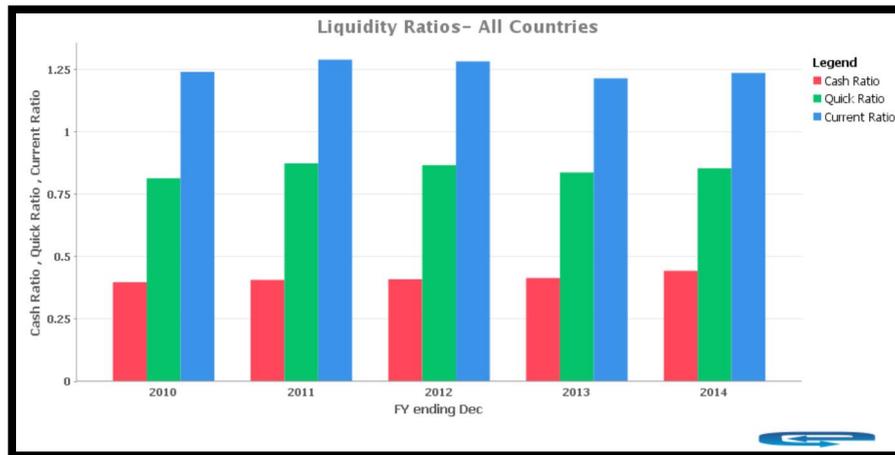


Figure 2: Liquidity Ratios Comparison

(Source: Etomate.com, 2026)

Collectively, these measures provide good insight into a company's liquidity and financial strength.

Impact of Liquidity Management on Financial Stability

Liquidity management is very important to a corporate firm to ensure its stability. Liquidity of the company means a company's short terms ability to meet obligations which signify a company with high financial capacity. Effective management of cash flow means that an organization can meet its short-term financing needs without expensive finance from the outside, thereby reducing the risk of failure (Thi Tran, 2024).

Strong liquidity has a lot of positive consequences. The most important of which is insolvency prevention. Businesses that possess adequate liquid assets that permit them to pay creditors and staff and service short-term debt to run smoothly. A company's ability to manage its cash flow and honour its obligations is the biggest factor in its credit rating. Companies that have liquidity of cash are less risky to investors and stakeholders, thus enhancing the market confidence and valuation of the companies (Xuanling & Meng, 2023).

Poor liquidity management can lead to serious financial issues. Insufficient cash flow can lead to late payments and high borrowing costs due to possible default on payment. In severe scenarios, such actions can lead to firms going bankrupt despite appearing profitable. A liquidity deficiency can disrupt, and influence supplier and customer relationships.

Excess liquidity is not always a good thing. Holding excessive cash is a sign that the firm is not efficiently utilizing its resources and not getting a good return on investment. Exceedingly conservative liquidity policies could cause firms to give up investments in growth or innovation.

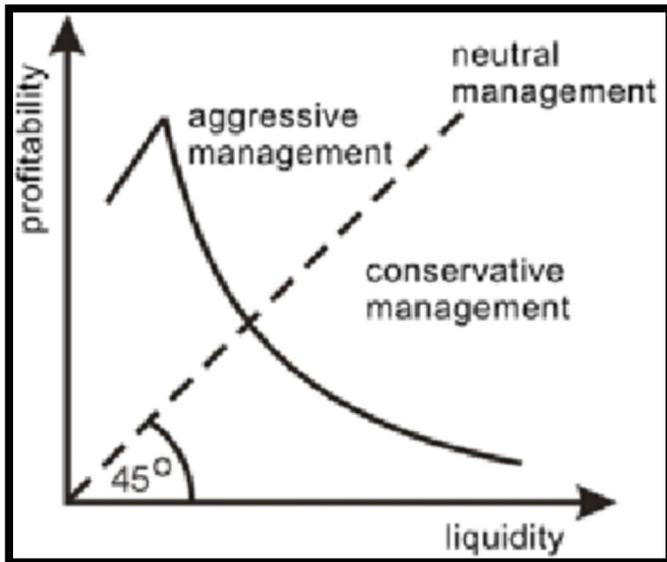


Figure 3: Liquidity–Profitability Trade-off

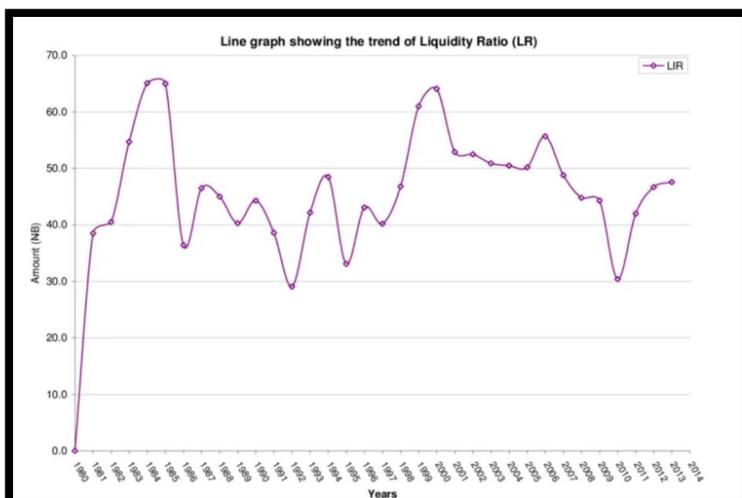
(Source: Researchgate.net, 2026)

Consequently, sustaining a certain degree of liquidity is crucial for the corporate performance to attain the long-term financial stability.

Data Illustration and Numerical Analysis

A straightforward numerical illustration can be utilized to evaluate a firm’s financial position for better comprehension of liquidity management. Consider a firm which has current assets of 500,000 and current liabilities of 250,000. Thus, the current ratio comes to 2.0 which means the firm has assets twice the amount required to pay its short-term liabilities. It indicates that liquidity position is strong.

Further analysis can be done using the quick ratio. If the stock is 150,000, the quick assets are 350,000. The quick ratio is reached by dividing this figure by current liabilities of 250,000 to give a quick ratio of 1.4. Also, if the firm generate operating cash flow of 200,000, it has an operating cash flow ratio of 0.8 highlighting that most liabilities can be matched through internal cash generation (Baumüller and Sopp, 2022).



balanced liquidity supports efficiency and stability during uncertainty. However, performance may be affected negatively by relatively low or excessive liquidity through increased insolvency risk or lower profitability.

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