

Impact of Working Capital Management on Financial Performance of Diversified Holdings Companies in Sri Lanka: A Panel Data Analysis

L.Kengatharan^{1*}

¹Department of Financial Management, University of Jaffna, Jaffna, Sri Lanka.

According to the finance theory, management of working capital which aims at maintaining an optimal balance between each of the working capital components, that is, cash, receivables, inventory and payables is a fundamental part of the overall corporate strategy to create value and is an important source of competitive advantage in businesses. Objective of the study was to examine the impact of working capital management on financial performance of diversified holding companies in Sri Lanka. Data were collected from randomly selected 16 diversified holding companies listed on Colombo Stock Exchange for period from 2011 to 2016. Working Capital Management (WCM) was measured by Current Ratio (CR) and Quick Ratio (QR) and firm's financial performance was measured by Return on Equity (ROE). Firm Size was considered as control variable. Impact of working capital management on firm performance was analyzed by using statistical software STATA. Since 16 companies included in the study with the 6 years data, Pooled OLS regression, fixed effect and random effect models were performed to evaluate the impact of WCM on ROE. F test was performed to diagnose the time fixed effect in the fixed effect model and outcome of the test revealed that p value was less than 0.05. Therefore, null hypothesis was rejected that there are time fixed effects in the model. Further, Lagrange Multiplier test for random effect was performed. The result indicated that the p value was 0.000 and rejected the null hypothesis in favor of the alternative which implied that random effect model was more appropriate than pooled OLS. Therefore, Hausman specification test was performed to check which model whether random effect or fixed effect is most suitable in this study. According to the Hausman test, fixed effect model was considered as suitable model. Results of the fixed effect model revealed that there was a significant positive relationship between CR and ROE, while there was a negative significant relationship between QR and ROE. Findings of the study may useful to the companies to maintain optimal level of working capital in order to maximize the financial performance of the companies.

Keywords: Current ratio, Quick ratio, Return on equity