

Trade-off between Working Capital Management and Firms profitability: Panel Data Analysis Based on Listed Manufacturing Companies in Sri Lanka

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Working Capital Management is central to get the right balance between profitability and short-term liquidity of a firm. The study is undertaken to uncover the impact of Working Capital Management on firm performance thereby providing a framework for emerging firms to learn from the best practices. Working capital management leads a firm to generate sufficient funds to be able to meet its immediate obligations and therefore to continue trading. Financial figures all look good on paper as higher profitability does not always guarantee liquidity; this relationship is more pronounced in the context of Working capital management. In response, this study investigates Manufacturing Companies listed in the Colombo Stock Exchange for the period from 2011 to 2018, in an attempt to establish a relationship between working capital management and firm performance. The results, analyzed by Fixed Effect regression model, demonstrate that working capital management should be factored in firms' financial planning. Panel data analysis, undertaken for 196 observations collected from 28 companies, generated results that are simply not detectable in pure cross-sections or pure time-series studies. The Gross profit margin, Operating profit margin, Earnings before Interest and Tax, Return on assets are termed as independent variables whereas Efficiency ratios, liquidity ratios, Current liabilities-to-Total assets ratio, Current liabilities-to-Total fixed assets ratio, firm size and sales growth were dependent variables. The results depicted a negative relationship between Return on Assets and Current ratio. In contrast, a positive relationship is uncovered between Return on Assets and Quick ratio. The growing companies depicted a negative relationship with Inventory and receivable days ratio, and a positive relationship with payable days ratio. The study suggests a practical guide to manage tradeoff between Working capital management and firm performance in the context of liquidity.

Keywords: Working capital management, Firm performance, Short-term liquidity, Panel data, Operating cycle