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The Relationship Between Liquidity and Profitability: Empirical Evidence from Banks in Sri Lanka

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Banking sector plays a crucial role in the financial system of a country and provides significant contribution to the development of the economy. Importantly, this study investigates the relationship between liquidity and profitability of banks in Sri Lanka for the period of five years from 2011 to 2015. Moreover, this study attempt to find significant differences in liquidity and profitability among the selected banks. Data was gathered from annual reports of 10 selected banks in Sri Lanka. For data analyzing it employed descriptive statistics, multiple regression analysis, and ANOVA analysis. This study used current ratio and cash ratio as liquidity measures while profitability was measured by return on assets and return on equity. Further firm size was used as control variable. The findings of this study revealed that there is a significant and positive relationship between liquidity and return on assets while liquidity has an insignificant and positive relationship with return on equity. The impact of firm size on profitability is significant and positive. Moreover, there are significant differences in liquidity, profitability and firm size among the selected banks in Sri Lanka. These findings reveal that banks should pay attention in liquidity management and adopt efficient liquidity management techniques to maintain adequate liquidity level for maximizing its profitability.

Keywords: *firm size, liquidity, profitability, Liquidity management, Banks, Sri Lanka.*

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