Impact of Liquidity Ratios on Profitability: With Special Reference to Listed Manufacturing Companies in Sri Lanka

Rila, M.F.M.[1] and Tilakasiri, K.K.[2]

[1]mohrila2@gmail.com; [2]ktilakasiri@kln.ac.lk

Abstract

The ultimate goal of the companies is to enhance the wealth of the shareholders. For that purpose, liquidity and profitability play a vital role. Especially the liquidity and its management are caused to a great extent by the growth and profitability of a firm. Liquidity management becomes the most important one as inadequate liquidity may be injurious to the smooth operations of the firm as well and the excess liquidity can be disturbed to achieve greater profits. In this way, the present study is aimed to investigate the relationship between liquidity and profitability. The analysis is based on 7 manufacturing companies listed on the Colombo Stock Exchange over past five years from 2018 to 2022. Correlation and regression analysis as well as descriptive statistics were applied in the analysis and findings suggest that there is a significant relationship exists between liquidity and profitability while the Quick ratio has no significant relationship with the ROE among the listed manufacturing companies in Sri Lanka. However, there has a low degree of influence in liquidity on the profitability of manufacturing companies. The relationship between liquidity and profitability is crucial to a company's goal of maximizing shareholder wealth. The current study explores the complex link between these two financial factors in this environment, highlighting the critical role that liquidity management plays. Both too little and too much liquidity present different problems that affect a company's ability to maximize profits and run its operations effectively. This research aims to unravel the dynamics between liquidity and profitability within the Sri Lankan manufacturing sector. Analyzing data from 7 manufacturing companies listed on the Colombo Stock Exchange over five years (2018-2022), the study employs correlation and regression analysis, along with descriptive statistics. The findings reveal a significant but nuanced relationship between liquidity and profitability, highlighting that while liquidity generally influences profitability, this impact varies in magnitude. Notably, the Quick ratio demonstrates an insignificant relationship with Return on Equity (ROE), suggesting complex financial dynamics at play in these firms. Beyond financial management procedures, the study's consequences provide business executives with information on strategic planning and decision-making. It emphasizes the necessity of a well-rounded approach to liquidity management that is in line with both more general strategic goals and operational requirements. The study provides a valuable empirical perspective on financial management in emerging markets, offering opportunities for future research on sector-specific liquidity management and external economic variables' impact on profitability.

Keywords: Liquidity, Profitability, Colombo Stock Exchange, Manufacturing Sector, Sri Lanka