

Impact of Liquidity on the Profitability of Listed Manufacturing Companies in Sri Lanka in Economic Crisis Period

M.A.C. Jayamali^{1,*} and M.A.U. Hansamali²

Department of Business Management, ICBT Kandy Campus¹

Sanasa Campus, Kegalle, Sri Lanka²

*Corresponding author: chathurikaj@icbtkampus.edu.lk

Abstract

In light of the recent economic crisis, understanding how internal financial management, particularly liquidity control, interacts with external economic shocks is vital for sustaining business performance. While prior research has explored the link between liquidity and profitability, limited attention has been given to this relationship during periods of economic crisis defined in the Sri Lankan context. The period 2019 to 2023 marked by severe foreign exchange shortages, inflationary pressures, and supply chain disruptions, particularly within the manufacturing sector. The analysis is based on panel data from ten manufacturing firms listed on the Colombo Stock Exchange over the period 2019 to 2023. Liquidity is measured using the current ratio and quick ratio, and profitability is assessed through return on assets, return on equity, and return on sales. A dummy variable captures the presence of economic crisis periods. The study applies a random effects panel regression model, selected based on the Hausman Test, to evaluate the effects of these variables on firm profitability. Findings reveal that while liquidity ratios exhibit a positive association with profitability indicators, their impact is statistically insignificant. Surprisingly, the economic crisis variable shows a significant positive effect on all three profitability measures, which may be explained by firms' adaptive responses such as cost-cutting, efficiency gains, reliance on local sourcing, and increased demand for domestic products due to import restrictions. These results suggest that during crisis periods, manufacturing firms may adopt strategic adjustments such as cost reductions and operational efficiencies that ultimately enhance profitability despite challenging external conditions. The study contributes to empirical literature by highlighting the nuanced role of economic crises in influencing firm performance beyond traditional financial indicators. It underscores the importance of agile financial planning and robust liquidity strategies during macroeconomic instability. The findings offer practical insights for corporate decision makers and policymakers, and call for further research incorporating broader firm specific and macroeconomic factors to better understand profitability dynamics in emerging markets.

Keywords: economic crisis, liquidity, manufacturing firms, profitability