CASH CONVERSION CYCLE AND FIRM'S PROFITABILITY; A STUDY ON LISTED MANUFACTURING COMPANIES IN SRI LANKA

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ABSTRACT

Cash conversion cycle is one of the most widely used measures to evaluate and measure the risks and returns associated to liquidity management. Since every corporate organization is extremely concerned about how to sustain and improve profitability, hence organizations have to keep an eye on the factors affecting the profitability. Due to changes of world economy organizations try to keep their cash conversion cycle in an optimum level to increase profitability.

This study examines of cash conversion cycle and firm's profitability of manufacturing companies listed in CSE. Among population of 38 manufacturing companies listed on Colombo Stock Exchange 34 were used as sample. The collected secondary data from 34 companies covered the period from 2012 to 2016 was used to examine the relationship and effect between cash conversion cycle and the profitability of manufacturing companies in Sri Lanka.

Cash conversion cycle, inventory conversion period, receivable collection period and payment deferral period were used to measure the profitability in terms of return on assets and return on equity while taking firm size as control variable. The study adopted both descriptive and quantitative research design. Descriptive Statistics, Pearson's correlation, Partial correlation, Simple linear regression analysis and multiple regression analysis are used to analyze the data.

The study found that cash conversion cycle components of inventory conversion period have negative effect on profitability. Receivable collection period also have a negative effect on profitability. Payable deferral period have an insignificant but positive effect on profitability. Firm size measured by natural logarithm of sales has a positive effect on profitability. Cash conversion cycle have a negative effect on profitability.

The results provide useful insights for the relationship and effect between cash conversion cycle and firm's profitability to owners, managers, debt holders, academic researchers, and policy makers. This study will contribute to the literature by analyzing the relationship and impact of cash conversion cycle on the profitability of manufacturing firm by validating the results of previous studies stated in the literature.

At the end it can conclude that as a part of working capital management, cash conversion cycle has a great effect on the profitability of the companies and the managers can create value for the stockholders by decreasing receivable accounts, inventory and lengthening payable period. This means better to maintain lower cash conversion cycle for high profitability.
Key words: Cash Conversion Cycle, Inventory Conversion Period, Receivable Collection Period, Payable Deferral Period, Return on Assets, Return on Equity, Firm Size.

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