

Liquidity and Capital Structure: Evidence from Sri Lanka

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Abstract: In the corporate finance, the decision on the capital structure and its components is viewed as one of the most extensively researched area. In this context, researchers carried out the study on liquidity and capital structure in the Sri Lanka Telecom Plc. Data on the Liquidity and Capital Structure from the year 2005 to 2011 were collected for the study purpose. Regression analysis was used to answer the research question as what extent the Liquidity influences on Capital Structure of the Sri Lanka Telecom Plc. Findings revealed that, the decision making on the capital structure is highly depending on the liquidity management of the Sri Lanka Telecom Plc. Due to that, the firm should focus on the liquidity management to take the decision on the capital structure which should lead to the firms value in the long term perspective.

Keywords: Capital Structure, Liquidity, and Sri Lanka Telecom Plc

Back Drop of the Study

In the corporate finance, the decision on the capital structure and its components is viewed as one of the most extensively researched area. Capital structure refers to the way a firm is financing its assets through a combination of equity and debt. It can be measured as the ratio between debt and total of equity and liabilities (Kajanathan, 2012; Sarlija and Harc, 2012). On the other hand, Liquidity management is vital for firms, where a major part of the assets is composed of current assets. It directly affects the profitability of the firms. Also profitability liquidity tradeoff is important because if working capital management is not given due consideration then firms are likely to fail and face bankruptcy (Raheman, Afza, Qayyum and Ahmed bodla, 2010; Raheman and

Nasr, 2008). In this context, the working capital is known as life giving force for any economic unit and its management is considered among the most important function of corporate management. Due to that, every organization whether, profit oriented or not, irrespective of size and nature of business, requires necessary amount of working capital for smooth functioning of the organization. Working capital is the most crucial factor for maintaining liquidity, survival, solvency, and profitability of the business (Raheman et al., 2010; Mukhopadhyay, 2004). Based on the research findings on the liquidity and capital structure, the positive significant relationship has been found. Meantime, the liquidity has the influence on the capital structure in the different countries context (Sarlija and Harc, 2012; Khalaj, Farsian and Karbalaee, 2013; Uremadu, 2012; Anderson and Carverhill, 2010).

In Sri Lanka, Sri Lanka Telecom is one of Sri Lanka's most valuable blue chip companies with an annual turnover in excess of Rs 50 Billion. Sri Lanka Telecom is the nation's number one integrated communications service provider and the leading broadband and backbone infrastructure services provider in the country. Listed on the Colombo Stock Exchange, the company's market capitalization as at 31 December 2011 topped Rs 87 Billion (Annual Report, Sri Lanka Telecom Plc, 2011). Based on it, as researchers, we have to check the strength of the decision making aspects of the Sri Lanka Telecom Plc in the capital structure context. Therefore, the decision on the capital structure is the complex. It means, on what basis, the debt and equity should be utilized to get the profit in terms of the return on assets or equity. Meantime, survival is also depending on the capital structure decision. Further, in the income perspective, if income, derived from the use of debt, is greater than