THE IMPACT OF DEBT FINANCING ON PROFITABILITY OF MANUFACTURING COMPANIES IN SRI LANKA

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ABSTRACT

The study of a firms' debt financing constitutes a difficult decision because that involves several factors, such as risk and profitability. The decision becomes even more difficult for firms in environment with a high degree of economic instability. Therefore, the choice between ideal proportion of short term debt and long term debt can affect the value of the firm as much as the rates can.

Therefore, this is an empirical study that investigates to find out "what is the impact of the debt financing on the profitability of the manufacturing companies in Sri Lanka?" Financial statement of 20 listed manufacturing companies for the past 5 years from 2011 to 2015 were used for variables analysis. Debt financing of the companies are measured by using the short term debt ratio, long term debt ratio and total debt ratio. Profitability of the company is measured by using the return on asset and return on equity.

According to the univariate analysis of debt financing explore that short term debt average level is higher than long term debt average level. It is meaning Sri Lankan manufacturing companies most prefer to short term debt than long term debt. Furthermore, average level of profitability is in low value. On the other hand, researcher use correlation analysis to measure the relationship between the variables and regression analysis to measure the impact of independent and dependent variables. According to the correlation analysis there is a week negative relationship between the debt financing and the profitability of a company. The impact is mainly influenced to the return on assets and return on equity in low level. Long term debt financing in insignificant level and Short term debt in significant level. According to the total debt financing, ROE in insignificant.

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