

The Effect of Debt Financing on Corporate Profitability: Special Reference to Retailing Sector Listed in Colombo Stock Exchange

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Abstract

Introduction: Debt financing plays a crucial role in ensuring continuity of operations and achieving maximum profitability in firms. This study probes into how debt financing affects the profitability of retailing firms listed in the CSE, with emphasis on the management of STD, LTD, and TD to attain an optimal capital structure. The study also considers the control variables of firm size and firm growth in assessing the profitability as represented by ROA.

Methodology: A descriptive research design underpinned by a positivist philosophy was employed. Secondary panel data were collected from financial reports of 12 retailing firms listed on the CSE during 2019–2024. The data were analyzed using EViews 12, employing descriptive statistics, correlation analysis, regression analysis, and hypothesis testing. The relationships between STD, LTD, TD, and ROA were examined to understand the debt management strategies affecting profitability in the retail sector.

Findings: The results yielded a negative and significant coefficient of STD on ROA, thus explaining that short-term reliance by firms diminishes profitability. LTD, on its part, demonstrated a positive and significant relation to ROA; hence, the support of trade-off theory presents its merits in the form of tax shields. TD expressed an insignificant influence on profitability; hence, debt mix turns out to be more crucial as compared to total debt amount.

Conclusion: The study concludes that effective debt management is vital for enhancing profitability in the retail sector. Long-term debt should be used strategically to leverage tax benefits and stability, while excessive dependence on short-term debt should be avoided to prevent financial stress. The findings are consistent with the trade-off theory and provide actionable insights for retail firms on optimizing their capital structure. Future research can explore additional variables and their impact on profitability in evolving market conditions.

Keywords: Colombo stock exchange, profitability, total debt, short term debt, long term debt