

## The Mediating Effect of Profitability on The Relationship Between Working Capital Management and Shareholder Wealth: Evidence from Colombo Stock Exchange

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### Abstract

The management of working capital plays a crucial role in enterprises and has a substantial influence on the wealth of shareholders. Working capital management, profitability, and shareholder wealth have emerged as significant subjects of discussion in contemporary discourse, since they have been acknowledged as expansive areas of study. The primary aim of this research was to investigate the mediating role of profitability in the association between working capital management and shareholder wealth, focusing specifically on empirical data from the Colombo Stock Exchange. The working capital management was measured using Current Ratio, profitability was quantified by Return on Investment and shareholders' wealth was measured through Tobin's Q. Data for the research was collected by examining the annual reports of 100 non-financial firms listed on the Colombo Stock Exchange. Upon conclusion of the study, it yielded findings that addressed the research inquiries, so signifying the successful attainment of the research aims. This paper examines profitability, working capital management, and shareholder wealth in Sri Lankan businesses. A weak, but significant association between working capital management and all factors was found based on the correlation analysis. It was found a significant impact of working capital management on shareholders' wealth. Further, the findings revealed a significant impact of working capital management on profitability and a significant impact of profitability on shareholders' wealth. Finally, it was evidenced that profitability plays a partial mediation role on the relationship between working capital management and shareholders' wealth.

**Keywords:** *Working Capital management, shareholder's wealth, profitability, Colombo Stock Exchange*



## **1. Introduction**

Effective working capital management is a critical challenge that significantly impacts shareholder wealth in businesses. Working capital, referring to the funds needed for day-to-day operational tasks such as purchase of raw materials, payment of salaries, and covering daily expenses, plays a vital role in a company's financial health. Proper management of working capital ensures suitable levels of liquidity, profitability, and shareholder value creation. It involves efficiently governing current assets and liabilities to maximize return on assets and minimize liabilities. Working capital management is vital for a company's market presence, liquidity, and shareholder value growth.

The concept of shareholder wealth maximization theory, rooted in Adam Smith's "The Wealth of Nations," has been a fundamental corporate goal for more than two centuries. Maximizing profits and enhancing shareholder wealth are considered primary objectives of businesses. Numerous studies in industrialized nations have focused on the impact of effective working capital management on shareholder value. Scholars assert that efficient working capital management is crucial in achieving the goal of maximizing shareholder wealth as it influences a firm's risk, profitability, and overall value. Efficiently managing working capital is critical, for the success of any company. Conversely businesses in developed economies like the USA, UK, Canada and Australia have experienced failures due, to management of their working capital. Multivariate predictor models and studies on failure prediction include working capital as a crucial component, highlighting its significance in financial performance. The global financial crisis underscored the importance of working capital management as many firms faced strained financial resources. In light of this, this study argues that working capital management is a vital aspect of the shareholder wealth maximization process. Efficient working capital management impacts a firm's long-term survival, profitability, liquidity, and overall value. Therefore, analyzing the effect of working capital management on firm performance, including profitability and value, is imperative in the Asian business environment (Hinguralaarachchi & Vijayakumaran, 2017).

Efficient working capital management is vital for the financial health of a firm and overall performance. It contains effectively managing the company's short-term assets and liabilities to confirm smooth functioning of day-to-day operations while optimizing profitability and shareholder wealth. Extensive research, in literature has delved into the connection between working capital management and firm performance (Kodithuwakku, 2015).

The primary goal of any business is to generate value for its shareholders. Shareholder wealth serves as a gauge of a company's success often evaluated through its stock performance in the capital market. When there exists a correlation between working capital management and shareholder wealth it suggests that efficient practices in managing working capital can result in improved profitability and higher returns, for shareholders. However, the mediating role of profitability between working capital management and shareholder wealth has garnered less attention in the literature, especially in the context of emerging markets like Sri Lanka. As such, there exists a research gap in understanding how profitability mediates the relationship between working capital management and shareholder wealth in the specific context of the Colombo Stock Exchange (CSE) (Perera & Wickramasinghe, 2014).

The Colombo Stock Exchange, being the stock exchange, in Sri Lanka offers an environment to examine this mediating impact. Sri Lanka economy has been consistently. The CSE plays a role in the country's financial landscape by providing a platform for both local and international investors to engage in the capital market. Exploring how working capital management, profitability and shareholder wealth interact in this market can have implications for policymakers, corporate managers, investors and other stakeholders (Perera & Priyashantha, 2018).

Hence, this research aims to investigate how profitability acts as a mediator between working capital management and shareholder wealth by focusing on companies listed on the Colombo Stock Exchange. The study will thoroughly analyze the data of selected firms during a timeframe examining their practices related to working capital management, measures of profitability and performance in the stock market. The outcomes of this study will contribute to the existing knowledge about working capital management's influence on shareholder wealth while offering insights for decision makers, investors and regulators, within Sri Lanka financial market.

The connection between working capital management and shareholder wealth has garnered attention in literature. However there hasn't been research on the ways in which working capital management influences shareholder wealth or the potential role of profitability as a mediator in this relationship especially concerning the Colombo Stock Exchange (CSE) in Sri Lanka (Kodithuwakku, 2015). According to the theoretical aspect of working capital management, there is a conflict between liquidity and profitability. However, if firm is able to manage its working capital effectively, the conflict between liquidity and profitability can be minimized. Apart from that, if firm maintains an optimum level of working capital, avoiding excess and inadequate investment in working capital it leads to create shareholder wealth through

enhancing the firm's profitability. Thus, the relationship between firm's working capital management and shareholder's wealth depends on the profitability. If firm manages its working capital effectively, it will enhance the profitability and if profitability is enhanced, it affect positively to the shareholder's wealth.

Studies exploring the relationship between working capital management (WCM) and firm performance in both developed and emerging markets have yielded inconsistent results, with many indicating unfavorable relationships (Jayarathna, 2014).

However, despite the valuable insights provided by the theories and empirical findings, there are several gaps and limitations in the existing literature. Firstly, the majority of the studies have focused on the manufacturing and service sectors, with limited research specifically addressing the construction industry. This presents a gap in the understanding of the unique dynamics and challenges of working capital management and stakeholder wealth in the context of the Colombo Stock Exchange.

Secondly, while profitability is recognized as a key financial performance measure, there is a need for further research on its specific role as a mediating variable between working capital management practices and stakeholder wealth outcomes. Existing studies have predominantly focused on the direct relationship between these variables, neglecting the potential mediating effect of profitability. Moreover, there is a lack of empirical evidence on the mediating role of profitability in the context of the Colombo Stock Exchange. Most of the existing research has been conducted in other geographical locations, limiting the generalizability of the findings to the specific context of the study.

Therefore, the present study aims to address these gaps by examining the mediating effect of profitability on the relationship between working capital management and stakeholder wealth in the context of the Colombo Stock Exchange. By focusing on this specific industry and geographical location, the study will provide valuable insights into the unique dynamics and factors influencing the relationship between these variables. The findings will contribute to bridging the gap in the literature and provide practical implications for construction firms listed in the Colombo Stock Exchange to enhance their working capital management practices and stakeholder wealth outcomes.

This study significantly contributes to the research and literature in the field of finance and working capital management. By investigating the mediating effect of profitability on the relationship between working capital management and shareholder wealth, the research fills an existing research gap. The findings of this study offer practical implications for businesses

operating in the Colombo Stock Exchange. By identifying the mediating role of profitability, businesses can develop more effective working capital management strategies. Understanding how profitability acts as a mediator in this relationship empowers firms to make informed financial decisions, optimize their financial performance, and achieve sustainable growth. The study's results can be valuable for policymakers and regulators in Sri Lanka's financial market. A clear understanding of the mediating effect of profitability on the working capital management-shareholder wealth relationship can assist policymakers in formulating effective financial policies and guidelines for businesses.

The study's objectives are as follows;

1. To investigate the impact of working capital management on shareholder's wealth
2. To examine the impact of working capital management on firm's profitability
3. To identify the impact of firm's profitability on shareholder's wealth
4. To examine the mediating effect of profitability on the relationship between working capital management & shareholders' wealth

In accordance with reaching to the above research objectives, the following research questions were addressed;

1. What is the impact of working capital management on shareholder's wealth?
2. How does the working capital management affect on firm's profitability?
3. What is the impact of firm's profitability on shareholder's wealth?
4. What mediating effect of profitability exist on the relationship between working capital management and shareholder's wealth?

The rest of the article comprises with; the literature review, research methodology, findings and discussion, and conclusion.

## **2. Literature Review**

### **2.1 Theoretical Framework**

#### **2.1.1 Agency Theory**

Agency theory provides insights into the principal-agent relationship within organizations and the potential conflicts of interest that may arise (Jensen & Meckling, 1976). In the context of working capital management, agency theory discovers the conflicts between shareholders (principals) and managers (agents) regarding the allocation and management of working capital components.

Agency conflicts may arise due to diverging interests and information asymmetry between shareholders and managers. Effective working capital management plays a vital role in minimizing agency conflicts and aligning the interests of shareholders and managers. By implementing sound working capital management practices, companies listed on the Colombo Stock Exchange can improve transparency, accountability, and communication between shareholders and managers. This, in turn, enhances the overall financial performance and stakeholder wealth. Exploring agency theory within the context of working capital management and stakeholder wealth provides valuable insights into addressing agency conflicts and improving corporate governance practices within the Colombo Stock Exchange.

#### **2.1.2 Shareholder Theory**

The Shareholder Theory was presented by Milton Friedman in 1962 and it was based on the Chicago school's neoclassical economists. This theory's central tenet is that since the company's owners are its shareholders, it should generate value on their behalf. Consequently, management's primary focus should be on optimizing the company's profitability, as indicated by dividends and equity market value. Some claim that the idea has only driven corporate objectives to maintain the greatest stock price currently in existence, to pay dividends in any way possible, and to participate in mergers, acquisitions, and takeovers whenever management has failed to increase shareholder value. (Teti *et al.* 2014).

### **2.1.2 Working Capital Management**

Deloof (2003) defines working capital management as the process of effectively managing the short-term assets and liabilities of a company to ensure the availability of sufficient funds for daily operations and maximize profitability (Deloof, 2003). Eljelly (2004) defines working capital management as the management of current assets and liabilities of a company to maintain an optimal level of working capital that balances profitability, liquidity, and risk. In accordance with Filbeck & Krueger, (2005), working capital management is the strategic management of a company's operating liquidity, including cash, accounts receivable, and inventory, to ensure smooth operations and financial stability. The management of a company's current assets and liabilities to minimize costs, maximize operational efficiency, and improve cash flow and profitability is the working capital management (Shin & Soenen, 1998). Lazaridis & Tryfonidis, (2006) define working capital management as the systematic approach of managing short-term assets and liabilities of a company to optimize its liquidity position, enhance operational efficiency, and maximize profitability.

From the definitions presented above, it is evident that working capital management involves the effective management of current assets and liabilities of a company to maintain optimal levels of working capital. Although there may be slight differences in emphasis, the overall consensus in the literature supports the notion that working capital management plays a crucial role in balancing profitability, liquidity, and risk.

### **2.1.3 Shareholders' Wealth**

Panigrahi *et al.* (2022) describe shareholders' wealth as the accumulation of financial benefits and returns that shareholders gain from their investments in a company, including capital appreciation and dividends. According to Kieschnick *et al.* (2011), shareholders' wealth is the total value or financial well-being of shareholders in a company, reflecting the market price of its shares and any dividends received. The value created for shareholders through the increase in the market price of shares and the distribution of dividends, reflecting their ownership stake in the company is the shareholder wealth in accordance with Lövgren & Sande (2019). Oseifuah & Gyekye, (2017) define shareholders' wealth as the net present value of all future expected cash flows to shareholders from their ownership of shares in a company, incorporating capital gains and dividend payments. Further, shareholders' wealth is defined by Brigham and

Houston (2019) as The prosperity and financial well-being of shareholders resulting from their investments in a company, encompassing capital gains, dividend income, and overall returns on investment.

The definitions of shareholder wealth converge around the idea that it represents the financial well-being and value created for shareholders through their investments in a company. While the specific measures and components of shareholder wealth may vary, the general understanding is that it encompasses capital appreciation, dividend income, and overall returns on investment.

#### **2.1.4 Profitability**

The capacity of a company to produce revenue that exceeds its expenses and costs, resulting in net income or profit that contributes to the growth and sustainability of the business is known as the profitability (Maad *et al.* 2022). The ability of a company to generate profits and earnings from its operations, indicating its financial performance and success in generating a return on investment is the profitability according to Brigham and Houston (2019). Gitman and Zutter (2018) define profitability as a measure of how effectively a company exploits its resources to generate profits, indicating its ability to create value for its shareholders. Further, Dong and Su (2010) describe profitability as the ability of a company to generate positive and sustainable returns on its invested capital, enhancing its financial strength and competitiveness in the market. The measurement of a company's ability to generate earnings from its core business activities, indicating its efficiency in converting resources into financial gains is the profitability according to García-Teruel & Martínez-Solano (2007).

Based on the definitions provided, there is a consensus among the authors that profitability refers to a company's ability to generate profits and earnings from its operations. While the exact measures and perspectives may vary, the general concept of profitability as a measure of financial performance and value creation is widely accepted in the literature.

## **2.2 Empirical Review**

### **2.2.1 Empirical findings on Working Capital Management, profitability and Shareholders' Wealth in International Context**

With an emphasis on the moderating influence of exchange rate volatility, Mushitala & Hapompwe (2024) conducted research to examine the effects of working capital management methods on the profitability of manufacturing companies listed on the Lusaka Securities Exchange (LuSE). A quantitative methodology was used in the study, which made use of primary and secondary data sources. Questionnaires were used to gather primary data, and 80 replies from people in management and financial positions from manufacturing companies with listings on the LuSE were obtained. Exchange rate volatility data were acquired from the Bank of Zambia, while secondary data covering the years 2010–2023 was gathered from corporate annual reports. The study's conclusions are consistent with previous research showing a link between profitability and effective working capital management.

In order to find out how working capital management affected European automobile companies' profitability both before and after the COVID-19 epidemic, Demiraj et al. (2022) conducted a study. The results show that during the pre-pandemic and pandemic periods, the cash conversion cycle, accounts payable period, inventory conversion period, and receivables collection period significantly lower ROA.

The empirical results of the study conducted by Hernandez et al. (2022) to determine the relationships between working capital, its components, and the profitability of Chilean companies indicate that there is a non-linear trend in the relationship between the profitability of firms and the individual components of working capital, which is consistent with the findings of earlier studies.

The impact of working capital management policies on the profitability of manufacturing SMEs in the Czech Republic is examined in the research by Arnaldi et al. (2021). 105 manufacturing enterprises were taken into consideration throughout the course of five years, from 2014 to 2018. Research indicates that offering clients longer extensions has little effect on profitability. In addition, the other variables' results indicated a negative correlation with the businesses' profitability.

Anton & Nucu (2021) conducted research on a sample of 719 Polish listed companies between 2007 and 2016 to examine the relationship between working capital and business profitability. According to the results, working capital increases profitability.

The above findings can be seen as inconsistent and hence, the theoretical underpinning of agency theory and shareholder theory are also debatable according to the empirical findings showing a theoretical gap to be filled by undertaking more empirical studies in his nature.

## **2.2.2 Sri Lankan context**

### **2.2.2.1 Profitability in Sri Lanka**

Studies focusing on profitability in Sri Lanka have examined various factors that influence the financial performance of companies. Research by Thenuwara & Ekanayake (2021) found that profitability in Sri Lanka is significantly influenced by factors such as firm size, leverage, liquidity, and industry characteristics. They emphasized the importance of efficient resource allocation, cost management, and market positioning for achieving profitability in the Sri Lankan business context. Furthermore, studies by Perera & Priyashantha (2017) and Thenuwara & Ekanayake (2021) explored the impact of macroeconomic variables, such as inflation rates, exchange rates, and interest rates, on the profitability of Sri Lankan companies (Perera & Priyashantha, 2017; Thenuwara & Ekanayake, 2021). These studies highlighted the

significance of managing macroeconomic risks and adapting to economic fluctuations for sustaining profitability in Sri Lanka.

### **2.2.2.2 Working Capital Management in Sri Lanka**

Research on working capital management in Sri Lanka has emphasized the importance of efficient cash flow management, inventory control, and trade credit practices for companies operating in the local business environment. Studies by Puwanenthiren (2020) and Senanayake & Semasinghe (2017) found that effective working capital management positively affects the financial performance of Sri Lankan firms, leading to increased profitability and liquidity (Puwanenthiren, 2020; Senanayake & Semasinghe, 2017). Additionally, Hasan & Banu (2014) examined the impact of working capital management practices on the profitability of Sri Lankan manufacturing companies (Hassan & Banu, 2014). They found that firms adopting proactive

working capital management strategies, such as optimizing cash conversion cycle and managing inventory levels, tend to achieve higher profitability in the Sri Lankan context.

Further, Gooneratne & Jayasinghe (2022) elaborated that when reviewing the impact of Sri Lankan macro-economic factors on working capital management of listed firms in CSE, the interest rate shows the most significant role in working capital management in Sri Lankan context. Moreover, the growth rate of gross domestic product also shows a significant impact on the Sri Lankan companies' working capital management. It shows that, in Sri Lanka, the economic condition also affects to the effective working capital management system in firms.

### **2.2.2.3 Shareholder Wealth in Sri Lanka**

Studies on shareholder wealth in Sri Lanka have explored the relationship between corporate governance practices, financial performance, and stock market performance. Research by Amarasekara et al. (2021) examined the impact of corporate governance mechanisms on shareholder wealth in Sri Lankan listed firms. They highlighted the significance of transparent and accountable corporate governance practices in protecting shareholder interests and enhancing long-term shareholder wealth. Moreover, studies by Perera & Priyashantha (2017) and Puwanenthiren (2020) investigated the relationship between financial performance and shareholder wealth in Sri Lanka. They found that companies with higher profitability and effective working capital management tend to create greater shareholder wealth, as reflected in capital gains and dividend payments on the CSE (Perera & Priyashantha, 2017; Puwanenthiren, 2020; Amarasekara, et al., 2021).

Overall, in the Sri Lankan context, profitability, working capital management, and shareholder wealth are interconnected concepts that have significant implications for the performance and value creation of companies listed on the Colombo Stock Exchange. The existing literature provides valuable insights into the factors influencing these concepts in Sri Lanka, highlighting the importance of efficient resource allocation, macroeconomic factors, working capital management practices, and corporate governance mechanisms in driving financial performance and shareholder wealth in the Sri Lankan business landscape.

### **3. Research Methodology**

#### **3.1 Research Design**

The selection of positivism and objectivism as the philosophical underpinnings for the present research are based on a deliberate and considered rationale that aligns with the nature and objectives of the study. This choice stems from the need to attain a rigorous and systematic exploration of the relationships between working capital management, profitability, and shareholder wealth within the specific context of the Colombo Stock Exchange. In the context of the present research, the research type adopted is descriptive research, a methodology that serves as a pivotal conduit for comprehending the intricate interplay between working capital management, profitability, and shareholder wealth within the context of the Colombo Stock Exchange. In the context of the present study, a deductive research approach is employed.

#### **3.2 Population and Sampling**

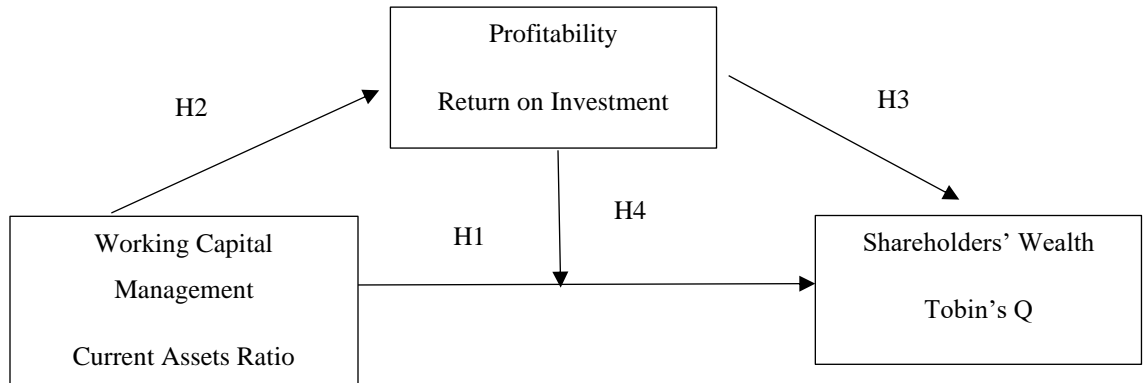
Non-financial companies listed on the Colombo Stock Exchange are chosen as the unit of analysis because they represent the entities for which financial and operational data is readily accessible. This choice enables the study to examine the financial dynamics and relationships of interest within a specific and well-defined context. In the present research, the population comprises "216 Non-Financial Companies listed in the Colombo Stock Exchange as of December 31, 2022." By defining the population as non-financial companies listed on the exchange, the research focuses on a specific and relevant subset of entities that are directly pertinent to the research questions. In this study, recognizing the constraints imposed by time and resource considerations, a deliberate sample size of "100 non-financial companies" has been deemed appropriate. This decision takes into account the practical limitations while ensuring a manageable yet informative sample. Considering the practical realities governing this research, a convenient sampling technique has been selected to assemble the sample.

#### **3.3 Conceptual Framework**

The conceptual framework provides a structured foundation that guides the research by elucidating the relationships between key variables. It integrates existing theories, constructs, and empirical evidence to offer a comprehensive understanding of the research phenomenon. The framework aids in formulating research hypotheses, identifying relevant variables, and establishing a logical framework for data collection and analysis. It also serves as a roadmap

for interpreting findings and drawing meaningful conclusions. The conceptual framework for the present research is illustrated below.

**Figure I: Conceptual Framework**



Source: Developed by authors

### 3.4 Operationalization

Operationalization denotes the process of translating abstract concepts or constructs into measurable and observable variables or indicators. The following table illustrates the operationalization of variables in the present research.

Type of Variable	Variable	Measurement	Sources
<b>Independent Variable</b>	Working Capital Management	Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Afrifa, 2015
<b>Mediating Variable</b>	Profitability	Return on Investment = $\frac{\text{Net Profit}}{\text{Cost of Investment}} \times 100$	Ahmad & Samim, 2018
<b>Dependent Variable</b>	Shareholders	Tobin's Q =	Adekola, et al.,

<b>Variable</b>	Wealth	(Market Value of Equity – Book Value of Debts) ————— Book Value of Assets	2017
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Source: Constructed by authors

**Table I: Operationalization of Variables**

### 3.5 Hypotheses

Following four hypotheses were formulated based on the research objectives, literature review and the conceptual framework of the study.

H1: There is a significant impact of working capital management on shareholders' wealth.

H2: There is a significant impact of working capital management on profitability.

H3: There is a significant impact of profitability on shareholders' wealth.

H4: There is a mediating effect of profitability on the relationship between working capital management and shareholders' wealth.

## 4. Findings and Discussion

### 4.1 Descriptive Statistics

Descriptive statistics refer to brief and informative measures that describe either the entire population or a specific subset within that population.

	<b>N</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Mean</b>	<b>Std. Deviation</b>
<b>CR</b>	500	-909.96	2884.99	210.5078	362.00077
<b>ROI</b>	500	-1287.38	1645.78	93.5737	305.91911
<b>TQ</b>	500	-1012.82	1841.54	142.0608	269.30715

Source: Constructed by authors based on SPSS output

### **Table II: Descriptive Statistics**

Within the field of statistical analysis, the maximum and minimum of a function refer to the largest and smallest values, respectively, that the function can attain. Minimum values of Current Ratio (CR), Return on Investment (ROI) and Tobin's Q (TQ) are -909.96, -1287.38% and -1012.82 respectively. As well 2884.99, 1645.78% and 1841.54 are the maximum values of CR, ROI and TQ respectively.

In the fields of mathematics and statistics, the mean is a fundamental method used to condense a large dataset into a single numerical value that serves as a representative measure of the dataset's central tendency or average. 210.5078, 93.5737% and 142.0608 are the mean values of CR, ROI and TQ respectively.

The standard deviation is a statistical measure, which quantifies the extent to which data points vary from the mean. When the magnitude of the standard deviation is modest, the data exhibits a tendency to concentrate closely around the mean value. Contrariwise, when the standard deviation is large, the data has a propensity to be more widely dispersed. CR, ROI, and TQ has the standard deviation of 362.00077, 305.91911% and 269.30715 respectively.

## **4.2 Normality Test**

The normality test assesses whether the data within a sample accurately represent a population that follows a normal distribution. The utilization of this method is prevalent in assessing the presence of a Gaussian distribution within research data. Skewness and kurtosis values are used to analyze the normality of dataset.

	<b>CR</b>	<b>ROI</b>	<b>TQ</b>
<b>Skewness</b>	0.569	0.670	0.789
<b>Kurtosis</b>	2.972	3.183	3.213

Source: Constructed by authors based on SPSS output

**Table III: Results of Normality Test**

Hair et al. (2010) and Byrne (2010) argued that data is considered to be normal if skewness is between -2 to +2 and kurtosis is between -7 to +7. The findings of the study for skewness and kurtosis are in these ranges and therefore, it is concluded the normal distribution of data.

### **4.3 Correlation Analysis**

Following table illustrates the findings of correlation analysis in this study.

		<b>CR</b>	<b>ROI</b>	<b>TQ</b>
<b>CR</b>	Pearson Correlation	1	.251**	.280**
	Sig. (2-tailed)		.000	.000
	N	500	500	500
<b>ROI</b>	Pearson Correlation	.251**	1	.284**
	Sig. (2-tailed)	.000		.000
	N	500	500	500
<b>TQ</b>	Pearson Correlation	.280**	.284**	1
	Sig. (2-tailed)	.000	.000	
	N	500	500	500

Source: Constructed by authors based on SPSS output

**Table IV: Results of Correlation Analysis**

There is a statistically significant correlation between “working capital management and profitability” since it is significant at 1% level. As well its 0.251 Pearson correlation coefficient means that there is weakened relationship between “working capital management and profitability”. There is a significant correlation between working capital management and shareholders’ wealth because it is significant at 1% level. Its Pearson correlation coefficient is 0.280 and it means that there is a weakened correlation between working capital management and shareholders’ wealth. Furthermore, there is a significant correlation between profitability and shareholders’ wealth since it is significant at 1% level. 0.284 is its Pearson correlation coefficient and it means that their relationship is also weakened.

#### **4.4 Regression analysis**

##### **4.4.1 Working Capital Management and Shareholders’ Wealth**

<b>Model</b>	<b>Unstandardized</b>		<b>Standardized</b>	<b>t</b>	<b>Sig.</b>
	<b>Coefficients</b>		<b>Coefficients</b>		
	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>		
<b>1 (Constant)</b>	98.145	13.390		7.330	.000
<b>CR</b>	.209	.032	.280	6.519	.000
<b>R Square</b>					.079
<b>Adjusted R Square</b>					.077

Source: Constructed by authors based on SPSS output

**Table V: Regression Results - Working Capital Management and Shareholders’ Wealth**

The first model analyses the relationship between working capital management and shareholders’ wealth. Its constant is significant at 1% level since its significant value is 0.000 and t value is 7.33. It is also greater than 2. Its beta coefficient is 98.145 and it means that when current assets ratio equal to zero, Tobin’s Q is 98.145. As well current ratio is significant at 1%

level since its significant value is 0.000 and t value is 6.519. 0.209 is its beta coefficient and it means that when current asset ratio increases by 1%, Tobin’s Q will increase by 0.209%.

When we analyzed the relationship between working capital management and shareholders’ wealth, R Square is 0.079 and it means that working capital management explains the shareholders’ wealth by 7.90%.

**1.4.2 Working Capital Management and Profitability**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
<b>1 (Constant)</b>	48.999	15.341		3.194	.001
<b>CR</b>	.212	.037	.251	5.776	.000
<b>R Square</b>					.063
<b>Adjusted R Square</b>					.061

Source: Constructed by authors based on SPSS output

**Table VI: Regression Results - Working Capital Management and Profitability**

This model is explained the relationship between current ratio and Return on Investment. Its R square is 0.063 and it means that return on investment explains the current asset ratio by 6.30%. Constant is significant at 1% level because its significant value is 0.001 and t value is 3.194. Its beta coefficient is 48.999 and it means that when current ratio equals to zero, return on investment is 48.999%. T value and significant value of current asset ratio are 5.776 and 0.000 respectively because it is significant at 1% level. 0.212 is its coefficient and it means that when current asset ratio increases by 1%, return on investment will increase by 0.212%.

**1.5.3 Profitability and Shareholders’ Wealth**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
<b>1 (Constant)</b>	118.688	12.090		9.817	.000
<b>CR</b>	.250	.038	.284	6.603	.000
<b>R Square</b>					.081
<b>Adjusted R Square</b>					.079

Source: Constructed by authors based on SPSS output

**Table VII: Regression Results – Profitability and Shareholders’ Wealth**

Constant is significant at 1% level because its significant value is 0.000 and t value is 9.817. Its beta coefficient is 118.688 and it means that when ROI equals to zero, Tobin’s Q is 118.688%. T value and significant value of Tobin’s Q are 6.603 and 0.000 respectively because it is significant at 1% level. 0.250 is its coefficient and it means that when ROI increases by 1%, Tobin’s Q will increase by 0.250%. R Square of the model is 0.081 and it means profitability explains the shareholders’ wealth by 8.10%.

**4.4.4 Mediating analysis**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta		
<b>1 (Constant)</b>	88.320	13.178		6.702	.000
<b>ROI</b>	.201	.038	.228	5.262	.000
<b>CR</b>	.166	.032	.223	5.160	.000

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<b>R Square</b>	.127
<b>Adjusted R Square</b>	.124

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Source: Constructed by authors based on SPSS output

### **Table VIII: Results of Mediating Analysis**

This analyses the mediating effect of profitability towards working capital management and shareholders' wealth. Constant of the model is 88.32 and it is significant at 1% level since its significant value is 0.000 and its t value is 6.720. It means that when current asset ratio and return on investment equal to zero, shareholders' wealth is 88.32. Current asset ratio is significant at 1% level since its significant value is 0.000 and t value is greater than 2. Its beta coefficient is 0.166 and it means that when current assets ratio increases by 1%, Tobin's Q will increase by 0.166%. As well return on investment is significant at 1% level because its significant value is 0.000 and t value is 5.262. Its beta coefficient is 0.201 and it means that when return on investment increases by 1%, Tobin's Q will increase by 0.201%. In the model that explains the relationship between working capital management and shareholders' wealth, beta coefficient is 0.209 and in the mediating analysis it decreased to 0.166. Then it can be concluded that there is a partial mediation of profitability towards working capital management and shareholders' wealth.

Under the mediating analysis, R Square is 0.127 and it means that working capital management and profitability explain the shareholders' wealth by 12.70%.

#### **4.5 Hypotheses Testing**

Four different hypotheses are built and they are tested based on the above analysis. This section depicts the hypotheses testing.

##### **4.5.1 Hypothesis 01**

**H1: There is a significant impact of working capital management on Shareholders' wealth**

First hypothesis is explained the impact of "working capital management" on shareholders' wealth. Since there is a statistically significant impact of working capital management on shareholders' wealth, alternative hypothesis is accepted and null hypothesis is rejected because

current asset ratio is significant at 1% level by showing a positive impact towards shareholders' wealth.

#### **4.5.2 Hypothesis 02**

**H2: There is a significant impact of working capital management on profitability**

Second hypothesis is tested the impact of “working capital management” on profitability. The analysis shows a statistically significant impact of working capital management on profitability since it is significant at 1% level by showing a positive impact. Therefore, the second hypothesis is accepted.

#### **4.5.3 Hypothesis 03**

**H3: There is a significant impact of profitability on shareholders' wealth**

Next hypothesis is related to the impact of profitability on shareholders' wealth. According to the analysis there is a statistically significant impact of profitability on shareholders' wealth. Then the third hypothesis is also accepted since it is significant at 1% level by showing a positive impact.

#### **4.5.4 Hypothesis 04**

**H4: There is a mediating effect of profitability on the relationship between working capital management and shareholders' wealth**

Final one examines “the mediating effect of profitability on the relationship between working capital management and shareholders' wealth”. The finding shows a statistically significant positive effect of profitability on the relationship between working capital management and shareholders' wealth. Therefore, null hypothesis is rejected since it said that as well alternative hypothesis is accepted.

The following table illustrates the summary of hypotheses testing.

	<b>Hypotheses</b>	<b>Accept/Reject</b>
<b>1</b>	There is a significant impact of working capital management on Shareholders' wealth	Accept
<b>2</b>	There is a significant impact of working capital management on profitability	Accept
<b>3</b>	There is a significant impact of profitability on shareholders' wealth	Accept
<b>4</b>	There is a mediating effect of profitability on the relationship between working capital management and shareholders' wealth	Accept

Source: Constructed by authors

**Table IX: Summary of Hypotheses Testing**

#### **4.6 Discussion**

According to the correlation analysis, working capital management has a weak correlation with all variables. In addition, the first model of the regression analysis is analyzed the relationship between working capital management and shareholders' wealth and the results of the study revealed that there is a significant relationship second model of the regression analysis analysed the mediating effect of profitability towards working capital management and shareholders' wealth and results revealed that that there is a significant relationship between working capital management and shareholders' wealth. The findings of the study are consistent with the prior literature (Perera & Priyashantha, 2018; Phassawan, 2023; Alavinasab & Davoudi, 2013; Ponsian *et al.* 2014; Kieschnick *et al.* 2013).

## **5. Conclusion**

Effective working capital management is a critical challenge that significantly impacts shareholder wealth in businesses. Working Capital Management, Profitability, and Shareholder Wealth have become highly concerned topics today since they have been recognized as critical topics in the field of finance. The main objective of the study was to examine the mediating effect of profitability on the relationship between working capital management and shareholder wealth, with special evidence from the Colombo Stock Exchange. The annual reports of 100 non-financial companies listed on the Colombo Stock Exchange were examined to collect data for the study. In addition, four hypotheses were built up and tested. The study was mainly pursued in order to find an answer to the question, “What is the mediating effect of profitability on the relationship between working capital management and shareholder wealth with special evidence from the Colombo Stock Exchange?” It answered the research questions at the end of the study, demonstrating that the study's objectives were achieved.

According to the correlation analysis, working capital management has a weak correlation with all variables. In addition, the first model of the regression analysis analyzed the relationship between working capital management and shareholders' wealth, and the results of the study revealed that there is a significant relationship between working capital management and shareholders' wealth. Furthermore, the second model of the regression analysis analyzed the mediating effect of profitability on working capital management and shareholders' wealth, and the results revealed that there is a significant relationship between working capital management and shareholders' wealth.

This study will help professional practitioners to evaluate the impact of mediating effect of profitability on the relationship between working capital management and shareholder wealth with special evidence from Colombo Stock Exchange. In addition, the working capital management, profitability and shareholder's wealth are important factors not only for shareholders but also for the company as a whole. Moreover, this study will give an idea about how is the working capital management and shareholder wealth of companies in Sri Lanka. The findings of this study offer practical implications for businesses operating in the Colombo Stock Exchange. By identifying the mediating role of profitability, businesses can develop more effective working capital management strategies. Understanding how profitability acts as a mediator in this relationship empowers firms to make informed financial decisions, optimize their financial performance, and achieve sustainable growth. Improved working capital management can lead to better cash flow management, reduced liquidity risk, and increased profitability, thereby positively impacting business practices and overall financial health.

There is a sizable and expanding body of literature that examines the relationship between shareholder wealth and working capital management in various nations with a focus on various industries. The mediating role that profitability plays in the relationship between working capital management and shareholder wealth has, however, received much too little attention. They will be able to review the literature with the aid of the study, which will add to the body of knowledge already known about the connection between shareholder wealth and working capital management. Since profitability mediates the relationship between working capital management and shareholder wealth of companies listed on Sri Lanka's Colombo Stock Exchange, this study will be more beneficial to academic understanding of that relationship.

Little studies have been conducted to examine the relationship between working capital management and shareholder wealth in different countries. And there are various methods to measure working capital management, profitability and shareholder wealth. However, the most interesting thing is this study looks mediating effect mediating effect of profitability on the relationship between working capital management and shareholder wealth. Therefore, this study will be more helpful to future researchers within the Sri Lankan context or international context.

Future research studies can consider financial sector companies in CSE as well to perform this kind of investigation. Further, it can be done a comparison between financial and non-financial companies in CSE in relation with this investigation. Moreover, the future studies can use other measurements to quantify the working capital management, shareholder wealth and profitability rather than the measurements used in this study. The time period of data collection can also be increased to obtain more precise findings.

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