

IMPACT OF CORPORATE CASH HOLDINGS ON FIRM VALUE: EVIDENCE FOR TRADE-OFF THEORY

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Trade-off theory suggests an optimal level of cash holdings for firms; however, the empirical results are inconclusive and lacking in the developing country context. The purpose of this study is to empirically test the existence of an optimal cash level, the point at which the firm's value is maximized in a developing country context, Sri Lanka. A quantitative research approach was adopted in conducting this study, for which secondary data from annual reports of companies listed in the Colombo Stock Exchange was collected for a period of 8 years from 2012-2019. To test the impact of corporate cash holdings on firm value, a panel data regression analysis was performed. Results show that there is a concave relationship between corporate cash holdings and firm value. Accordingly, it provides evidence on the existence of an optimal level of cash holdings that maximizes firm value. As a result, this study supports the Trade-off theory therefore, companies should maintain an optimal level of cash holdings in order to maximize the firm value. This implies that financing and investment policies should be targeted to maintain the optimal level of cash holdings.

Keywords: *Cash holdings; Concave relationship; Firm value; Optimal cash level; Trade-off theory*
