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The Impact of Financial Risk on Financial Performance of Consumer Services Sector in Sri Lanka

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ABSTRACT

The purpose of this study is to investigate the impact of financial risk on financial performance of the listed consumer services sector in Sri Lanka. It aims to uncover the effects of financial risk under operational risk, market risk, liquidity risk, and credit risk on return on equity which is the measurement of the financial performance for the period 2011–2020 from 32 listed consumer service companies listed under Colombo Stock Exchange (CSE).This study used a quantitative research approach, and secondary data were collected from the published audited annual report of listed consumer service companies over ten years (2011–2020). The algorithms contained in Stata version 14.2 was used to evaluate hypotheses using the fixed effect regression model under panel data analysis. The study's outcome accepted three hypotheses while rejecting one. It was concluded that operational risk and liquidity risk have a positive statistically significant impact, and credit risk has a negative statistically significant. Further, it was revealed that market risk has a statistically insignificant impact on financial performance. The following study will enable consumer service firms to understand the impact and examine the financial risk impact on financial performance due to its unique nature, which would help firms increase shareholders' wealth maximization. The findings demonstrate statistical significance, which may aid policymakers and industry experts in intervening and developing policies and regulations.

Keywords: Colombo Stock Exchange, Consumer Services Sector, Credit risk, Financial Performance, Financial Risk, Liquidity risk, Market risk, Operational risk.

INTRODUCTION

Risk plays a critical position in firms because it makes management and directors eager to track financial variations (Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022). It is critical for establishments to control risk to prevent uncertainties on the returns and earnings to recover in the future as the industry enables to boost the economy (Kioko, Olweny, & Ochieng, 2019).The study will use annual financial data on listed consumer services companies which will ultimately help them to understand a variety of financial risks in the consumer service sector and how they might impact financial performance, implement strategies& procedures to manage financial risk, and finally enhance their financial performance.

The Importance of Assessing Financial Risk

When firms are exposed to the variability of the market, there is a probability of incurring gains or losses. This will offer strategic, operational, or competitive advantages, especially for the service industry. If this is not managed, the financial risk to the organization's performance will eventually lead to a financial crisis due to management skills and performance (Kioko, Olweny, & Ochieng, 2019). The logic for managing or reducing financial risk is the same as implementing risk management policies and procedures because financial risk is a sub-category of business risk. One of the main goals is to reduce the degree of variation in income or cash flows due to financial risk over time (Muriithi, 2016). Management may involve in decision-making through financial instruments and be keen in monitoring the financial performance of the firms as this will enable them to keep the pace of the financial performance of the service industry positively unless it leads to the downward performance of the financial institutions (Kioko, Olweny, & Ochieng, 2019). The firm must manage financial risk to reduce the impact of unexpected changes or unpredictability of adverse returns, which will lead to the collapse of the future of the firm's operations and be influenced by causes beyond the firm's control (Harvey, 2008).

Financial Performance

According to Leah (2008), overall financial performance refers to the outcomes attained from accomplishing the external goals and internal goals of an organization. It is a general measure of the organization's capacity to persevere in growth, survival, and competitiveness. The financial performance of an organization is the extent to which an organization's financial goals are achieved. It is the procedure with the aid of using which the outcome of an organization is measured in terms of momentary value. Many researchers follow Return on Equity (ROE) or Return on Assets (ROA) or both to make suitable measurements to examine the impact on the financial risk. ROE and ROA will eventually clear out the earnings from equity and assets to make decisions concerning controlling the financial risk or increasing the investment portfolio to maximize the shareholder wealth and financial performance of the firm (Ali & Oudat, 2020). Studies on financial performance have provided different results globally due to the nature of the competitiveness and its position in the market in which it operates (Doliente, 2003).

ROE has been used in a wide range of research concerning financial risk, and it helps investors gauge how their investments are generating income. As the consumer service industry becomes more established and expanded, facilities and property plant equipment are used to enhance and attract customers. Power conflicts between directors and shareholders have been brought on by shared ownership. In contrast, a shareholder dispute at the owner level will clearly have a negative impact on the owners themselves, including return on investment. These legal battles can also have a significant impact on the financial performance of the firms (Susan, Stephen, & Lucy, 2020).

The Impact of Financial Risk on Financial Performance of the Consumer Service Sector in Sri Lanka

Much of the research was performed in relation to the financial risk and financial performance in many industries but there was no conclusion that the studies performed for the consumer services industry, and this will also be the research gap. Due to the increased growth of the service industry, Gross Domestic Product (GDP) analysis in Sri Lanka shows a significant account in relation to consumer services (Central Bank of Sri Lanka, 2020) It can be concluded that this study will enhance the consumer service firm to get a better understanding in relation to the financial risk and financial performance as this will depend on financial performance factor which is the ROE as it is been used in a wide range of researches concerning the financial risk and it helps investors gauge how their investments are generating income (Susan, Stephen, & Lucy, 2020).

As the consumer service industry becomes more established and more expanded, facilities and property plant equipment's are used to enhance and attract customers. Power conflicts and the dangers of conflict between partners and shareholders have been brought on by shared ownership. while a shareholder dispute at the owner level will clearly have a negative impact on the owners themselves, including return on investment and these legal battles can also have a significant impact on the financial performance of the firms (Susan, Stephen, & Lucy, 2020). Hence, this study will focus on filling this gap, by examining the effect of financial risk on the financial performance of consumer services in Sri Lanka listed on CSE.

The main goal of the overall research is to identify the impact of the financial risk on financial performance with special reference to the consumer service industry. According to Susan, Stephen, & Lucy (2020), most of the past researchers considered the ROE as the dependent variable due to its course of response towards the impact of risk management and considered one or all variables of financial risk, which are liquidity risk, operational risk, market risk and credit risk to assess the impact of the thesis. This led to adopting the following variables to identify the financial risk on the financial performance and asset size and leverage will use be used as control variables for better feedback concerning the consumer service firms in Sri Lanka.

Research Problem

Many organizations have been obliged to abbreviate the term of their liabilities because of the emergency liquidity limitations, putting them at increased risk of refinancing (Ali & Oudat, 2020). If the firms are not considering the financial risk, the operation efficiency will decrease as companies may face refinancing or restructuring in the short-term or long-term (Hsiao, Chang, Cianci, & Huanga, 2010). Many firms try to obtain loans rather than issuing shares to the market as paying interest is more effective than paying dividends to satisfy the shareholders and affects the control of the firms. Higher debt will imbalance the gearing and will result in credit risk. Having more short-term obligations will also affect the liquidity of the firm, and this may give rise to the liquidity risk of the firm and, finally increase the expenses, which will decrease the earnings per share, ultimately affecting market risk (Herring, 2002). Consumer service firms will enable to flow of foreign currencies to Sri Lanka, which has already been proven before the covid-19 pandemic. Still, no research was conducted concerning the financial risk on the financial performance of consumer service firms in Sri Lanka (Sri Lanka Non Performing Loans Ratio, 2022).

The consumer service industry is known to be one of the income contributors to the GDP as in 2019, It represented 4.3%, and it contributed 13.7% through the overall distribution of total foreign exchange earnings (Sri Lanka Tourism Development Authority, 2019). According to the central bank of Sri Lanka and Tourist Development Authority, the tourism sector recorded 1.9mn tourists arrived which generated

$3,607mn in 2019, but in 2020, it was reduced to 540,000 which accounts to $682mn, which led to a significant drop in the tourist arrival and revenue of the consumer service industry due to Covid-19 pandemic. Hence, the researcher did not consider 2020 onwards as it will be directly linked to the pandemic. The researcher will assess how the consumer service sector performed before the pandemic (Central Bank of Sri Lanka, 2021; Sri Lanka Tourism Development Authority, 2022). Many organizations try to refinance their organizational structure to ensure their position in the market. The impact on the covid-19 led to the collapse of the tourism industry (Arachch & Gnanapala, 2020). Thus, the research will confine to understanding the impact of financial risk on financial performance within the period of 2011 to 2020 of consumer service organizations.

Furthermore, previous researchers have produced different empirical conclusions on many dimensions of risk due to methodological variations and time frames. Some researchers were confined to a 5-year period, whereas the present study employed a 10-year period, resulting in a methodological gap. The research by Ali & Oudat (2020) used capital risk, exchange rate risk, liquidity risk, and operational risk as the main independent variables and for the current research Credit risk, operational risk, liquidity risk, and market risk were employed which will be resulting in a contextual gap.

Furthermore, previous research has shown that financial risk had a major impact on financial performance (Onsongo, Muathe, & Mwangi, 2020). The findings of Wijewardana & Wimalasiri (2017) revealed that there is a strong link between financial performance and financial risk management. It was also noted that there was no research conducted on the topic concerning the consumer service sector in Sri Lanka. Therefore, this research attempts to bridge that gap by studying the impact of financial risk on the financial performance of listed companies with special reference to consumer service firms in Sri Lanka.

LITERATURE REVIEW

Theoretical Review

Theories emphasize the foundation and provide a theory-driven approach to the current study which studies the impact of financial risk on financial performance. The study focuses on the following theories,

Agency theory

According to Dawar (2014), agency theory argued that the interests of the shareholders and the company's managers are not perfectly aligned. To control the agency conflict between managers and shareholders of the firm, the management is rewarded for their performance, which leads to controlling the financial performance of the entities. Issuing debt may reduce the agency's costs, but it will impact the firm's performance and risk of financing. For instance, managers must act in the best interest of the shareholders rather than make decisions that are either directly or indirectly not recognized in the formal reward system or as per the organization’s function (Dawar, 2014).

Stakeholder theory

Every instance of business and stakeholder interaction creates a positive or negative financial relationship or risk for either party. Customers' interactions and buying power will probably result in financial risk to the operations of the organization (Agyapong, 2021).If the organizations manage to satisfy the stakeholders, this would positively impact the organization and its employees, which will lead to the satisfaction of the shareholders through dividends or growth opportunities towards the firm's operations (Agyapong, 2021; Yiannaki, 2012). The theory also provides new risk-oriented insights and guidelines to manage financial and risk management (Ghazieh & Chebana, 2021). According to Ngoc Ta & Thanh Dao (2020), agency theory will also impact the operation of the firm due to problems arising between shareholders and creditors as both prefer different levels of risk-taking behavior. In any instance, the firm must manage its equity and debt to control the financial risk and increase the organization's performance.

Credit risk theory

The lender will purposefully default while the economy is doing well since doing so gives the lender access to an imbedded put option. Being aware of the opportunistic activities of potential debtors, businesses, both financial and non-financial, should use the notion of credit risk management. Therefore, the right credit risk estimate must be done before businesses extend credit (Abbas, Ahmad, Zaidi, & Ashraf, 2014). From the lender's standpoint, the credit risk theory is most applicable to this study. Since borrowers may eventually become opportunistic, credit risk theory is important to nonfinancial businesses to lower risk exposure, and implement measures like client monitoring, account reference, and collateral restrictions (Muhammad, Sindhu, & Sohail, 2021).

Liquidity preference theory

The concept of "demand for capital" is used as the fundamental formulation of the liquidity theory which was proposed by Keynes (1936). The assumption of the argument is that, since longer-term assets are riskier, investors expect to pay more for them. This is because investors prefer to hold cash because it carries less risk; hence, the more liquid an investment is, the more rapidly it can be sold for its full market value. The firm maintains liquidity for speculative reasons, hoping to benefit from financially advantageous circumstances (Muhammad, Sindhu, & Sohail, 2021). Any business that sells things on credit risks may fall into liquidity problems and may default on loan repayments (Al-Khouri, 2011). Firms might eventually be forced to assume the counterparty's credit risk, resulting in a decline in financial performance (Njiru, 2020).

Financial risk

Due to the crucial role that these economic players play in development, the topic of financial risks had drawn the attention of academics in developing nations. Financial risk focuses on the uncertainty underlying the cash flow movement of the firm (Ekaterina & Thielmann, 2020). It is the unanticipated changes in price and their impact on the firm's future cash flows that the firm's financial risk is a projection of their future credit standing. It is anticipated that the suitability of their mitigation will aid in minimizing the monetary loss they endure (Agyapong, 2021; Wasiuzzaman, Nurdin, & Abdullah, 2020; Xu & Li, 2019). Hence, studies on financial risk on the performance will be useful to create barriers to risk (Kassi, Dilesha, & Ning Ding, 2019). Studies on financial risk and financial performance will enable to understand the shareholders wealth maximization and utilization of invested funds to generate returns more effectively (Oudatb & Alia, 2020).

Credit risk

The credit risk is the possibilities of defaulting to repay financial commitments within the agreed period (Spuchľáková, Adamko, & Valašková, 2015).Investors could be reluctant to invest if the firms are aware that they will not be able to pay back their loans and that their capital and future interest payments may be unclear. In addition, investor confidence finally deteriorates

(Muhammad, Sindhu, & Sohail, 2021). It is not difficult to see if other financial corporations have a substantial choice regarding liquidity preference for speculation. The firm may eventually wind up absorbing the counterparty's credit risk, which will ultimately contribute into lower financial performance (Muhammad, Sindhu, & Sohail, 2021). It is critical to study the effects of credit risk management strategies to increase shareholder value and improve financial performance through financial risk (Gisemba, 2010). Many past researchers had defined credit risk as an instrument for financial risk to measure the impact of the financial performance of the organization (Kioko, Olweny, & Ochieng, 2019; Mukino, 2018; Gisemba, 2010).

Liquidity risk

Liquidity risk is critical for controlling and improving the performance of firms. Liquidity management is critical for the operation of financial markets, even though liquidity risk is often seen as an exogenous element influencing business performance in many studies (Rudhani & Balaj, 2019). Higher liquidity shows the company is in better condition to manage its working capital requirements (Oduro, Asiedu, & Gadzo, 2019). According to Njiru (2020), a company's ability to satisfy both foreseen and unforeseen financial needs at any time is referred to as its liquidity risk. A failure in the firm's operation impacts purchasing raw materials, equipment and managing working capital more effectively (Syapikah, 2018).

Operational risk

Operational risk outlines some methods for controlling, managing and implementing the appropriate secure measures to improve an industry's financial performance. It is critical for the prevention and management of operational risk (Kioko, Olweny, &Ochieng, 2019). Operating risk, as a qualitative measurement and determinant of performance, also can be measured through staff quality, the effectiveness and efficiency of internal controls, organizational discipline, and the effectiveness of management systems. Management control quality affects operating expenses, which in turn affects a business's standard. Hence, managing operating risk has a significant impact on firm FP (Njiru, 2020; Ongore & Kusa, 2013).

Market risk

Market risk is the possible loss of value of assets and liabilities because of market price fluctuation created due to mismatches between a company's assets and liabilities. Market fluctuations result in income losses from assets kept for investment, resulting in the organization's poor financial performance. (Kahihu, Wachira, & Muathe, 2021). Since market risk is a systematic risk that investors cannot eliminate by diversification, it is an essential component of financial risk that can be mitigated by employing effective hedging measures.

Control Variables

Firm size helps the business to brand their reputation while better leverage will decrease deficiencies in cash flows (Wang, 2015).

Leverage

Leverage refers to a company's capacity to meet long-term obligations while continuing to grow and expand. Underwriting risk is the danger that the premiums may not provide adequate cost coverage. (Kioko, Olweny, & Ochieng, 2019). Higher leverage is a red flag indicating the business is in danger or within the risk (Borhan, Mohamed, & Azmi, 2014). Low leverage measures a company's financial strength and, allegedly, minimizes the need for management to raise investment earnings. To raise the company's leverage, the firms should have more broad borrowing policies, restructuring policies, and employ debt through considering the debt-to-equity ratio (Wanil & Dar, 2015).

Firm size

According to Wanil & Dar (2015), several studies on the effect of firm size on financial performance have found that large firms perform better than small firms because they can achieve operating cost efficiencies by increasing output and lowering the unit cost because of their greater resources, improved risk diversification, and improved expenditure management.

Empirical Review

Vas research concerning the financial risk on financial performance has been performed for different industries.

Table 1: Empirical Review

Author & Publish Year	Period & Companies	Country	Conclusion
Wani & Dar, (2013)	2011-2012 (24 insurance companies)	India	Large firms eventually increase output and lowering the unit cost
Wijewardana & Wimalasiri, (2017)	2011-2016 (13 commercial Banks)	Sri Lanka	operation risk had a negative impact in terms of the ROE and capital management risk, credit risk and liquidity risk had a negative impact on ROA
Onsongo, Muathe, & Mwangi, (2020)	2013-2017 (14 listed companies in NCE)	Kenya	Credit risk, market risk, liquidity risk and operational risk has been significantly affected the financial performance.
Rajkumar, (2014)	John Keels Holding PLC	Sri Lanka	Financial leverage has got a negative relationship with financial performance of John Keels Holding PLC
Kahihu, Wachira, & Muathe (2021)	2014-2018 (13 registered micro finace companies)	Kenya	Interest rate and financial leverage risk had a significant positive effect on the financial performance.

Hunjra A. I., Mehmood, Nguyen, & Tayachi, (2022)	2009–2018 (commercial banks of Pakistan, India, Bangladesh and Sri Lanka)	Pakistan	credit, liquidity, and operational risks are significantly associated with financial performance.
Agyapong, (2020)	214 food processors	Ghana	Operational risk, market risk, technological risk, credit risk, liqudity risks were considered as independent variables where as firm size and leverge was refered as control variables. The study was conducted by considering 214 food processors in Ghana. The study concluded that firms become more resource-efficient and compliant as financial risks increasese.
Oudatb & Alia, (2020)	2014 to 2018 (11 banks)	Bahrain	The study considered 11 commercial banks in baharai and used exchange rate risk, liwuidity risk and operational risk where as exchange rate risk, liquidity risk and operating risk shows a insignificant relationship whereascapital risk is the most significant form of risks for banks

Source: Summary of Findings in Prior Studies.

RESEARCH METHOD

Research Design Philosophy and Approach

A quantitative research design was adopted in the research and financial ratios were calculated for each organization during the research period (Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022; Muriithi, 2016). Positivism is the most identical research philosophy to be considered (Walsham, 1995). The research follows the deductive approach as the researcher formulates a set of hypotheses that need to be confirmed or rejected during the research process (Moyi, 2019; Saunders & Lewis, 2018). For the completion of the research, the most appropriate panel data analysis method will be used as it will help analyze a large number of quantitative data within a period (Agyapong, 2021; Moyi, 2019; Saunders & Lewis, 2018; Love & Ariss, 2014).

Conceptualization and Hypotheses Development

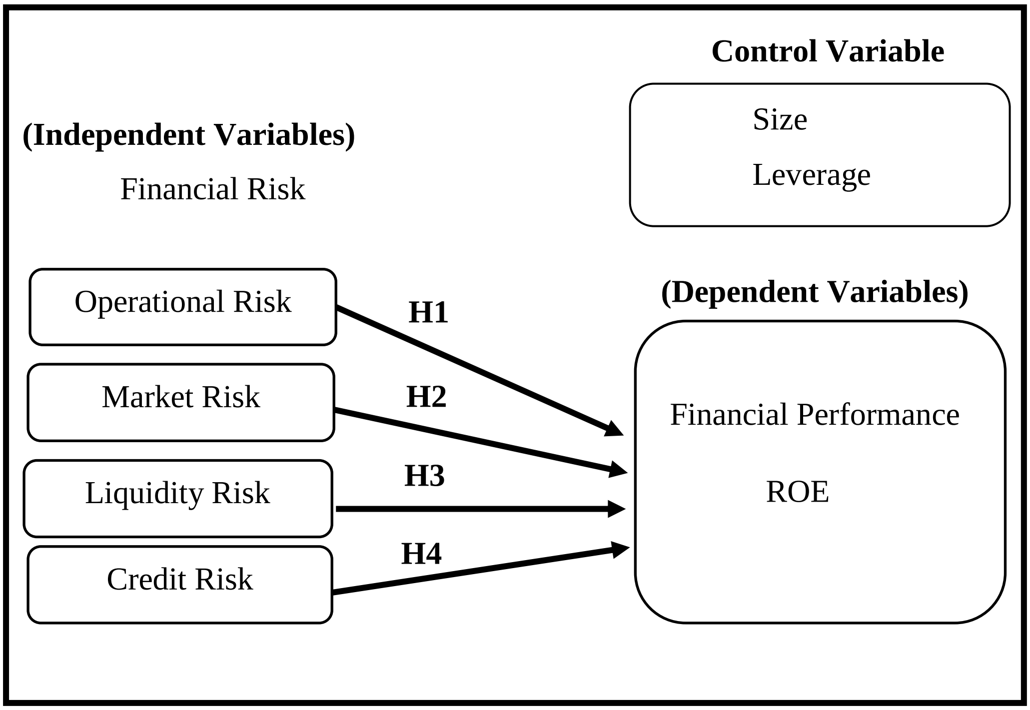

Figure 1: Conceptual Framework

Source: Author compiled based on panel data

Hypotheses Development

H_1: There is a statistically significant impact of operational risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka.

As per Syapikah (2018), operational risk refers to the dangers that a firm encounter when attempting to operate in a particular sector or industry, and operational risk management is a crucial qualitative internal factor in determining and analyzing a corporation's operational efficiency (Kioko, Olweny, & Ochieng, 2019).

Every instance of business and stakeholder interaction creates a positive or negative financial relationship or risk for either party (Agyapong, 2021). Growth of the organization contribute to a company's success, and there is evidence that the entity’s operation positively impacts financial performance (Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022). Therefore, the above hypothesis was created.

H_2: There is a statistically significant impact of market risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka.

Market risks are financial risks that arise from movements in the financial market and are created by a mismatch between a company's assets and liabilities (Kahihu, Wachira, & Muathe, 2021). Market risk is a systematic risk that investors cannot eliminate through diversification. It may be reduced by using sensible hedging strategies, making it an essential part of financial risk (Kassi, Dilesha, & Ning Ding, 2019). Sukcharoensin (2013), conducted a study on the sensitivity of stock returns using GARCH method. In conducting the study, secondary data were utilized. Value at risk was used to calculate market risk (VAR). Market risk also negatively impacts the firm performance as it revealed a moderate negative and significant correlation between the variables (Kioko, Olweny, & Ochieng, 2019). Therefore, the above hypothesis was created.

H_3: There is a statistically significant impact of liquidity risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka.

The recent global financial crisis reminded us that liquidity management is crucial to the operation of financial markets, even though liquidity risk is often seen as an exogenous element influencing business performance in many studies (Rudhani & Balaj, 2019). Liquidity preference theory assumes investors anticipate paying more for longer-term investments since they are riskier. Because cash carries less risk, investors want to retain it; therefore, more liquid an investment is, more quickly it may be sold for its market value (Muhammad, Sindhu, & Sohail, 2021). According to Njiru (2020), liquidity risk denotes a company's willingness to meet both expected and unexpected financial demand. As a result, firms must be liquid to continue operations and exist for as long as possible. The Results for liquidity risk for the chosen nations are inconsistent. Therefore, the above hypothesis was created.

H_4: There is a statistically significant impact of credit risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka.

Credit risk is the possibility of defaulting to repay financial commitments within the agreed period of time (Spuchľáková, Adamko, & Valašková, 2015).Lenders employ credit risk theory and analysis to evaluate the borrower's capacity to fulfill loan obligations as part of the business's strategies to protect itself from a loss of cash flows and minimize the severity of losses. This will also help the firm to better manage its financial risk and performance (Mukino, 2018). To raise shareholder value and boost financial performance by lowering financial risk, it is crucial to undertake research on the consequences of credit risk management solutions (Gisemba, 2010). Credit risk has been utilized by many studies in the past to quantify financial risk and understand its impact on financial performance (Kioko, Olweny, & Ochieng, 2019; Mukino, 2018; Gisemba, 2010). Therefore, the above hypothesis was created.

Operationalization

The following are the selection criteria for the dependent and independent variables of the study,

Table 2: Variables

Variable	Indicator	Measurement	Source
Dependent Variable			
Financial Performance	ROE	Net profit / Total equity	Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022.Mushafiq, Sindhu, & Sohail, 2021.
Independent Variables – Financial Risk			
Operation Risk	Efficiency ratio	Operating profit / Total income	Oduro, Asiedu, & Gadzo, 2019.Kioko, Olweny, & Ochieng, 2019.Muriithi, 2016.
Market Risk	Degree of financial leverage	Earnings before interest and tax / (Earnings before interest and tax – Interest)	Muriithi, 2016.Kassi, Rathnayake, Louembe, & Ding, 2019.
Liquidity Risk	Current ratio	Current assets / current liabilities	Hunjra A. I., Nguyen, Nguyen, & Tayachi, 2022.Marozva, 2015. S.T., 2014
Credit Risk	Gearing ratio	Total debt / Equity	Kassi, Rathnayake, Louembe, & Ding, 2019.Rajkumar, 2014.
Control Variables			
	Size	Ln (Total Assets)	Mushafiq, Sindhu, & Sohail, 2021.Doğan, 2013.Dang, Phan, Nguyen, & Hoang, 2020.
	Leverage	Short-term Debt / Total Assets	Vo, 2017.Danso, Lartey, Gyimah, & Adu-Ameyaw, 2021.

Source: Author compiled based on panel data

Sample and Sampling Design

The study focused on a population study by considering all the listed consumer services companies where audited annual reports are available within the period of 2011 to 2020. The research had to exclude the 2021 and 2022 financial reports as companies had incurred losses which may affect the normal data distribution as researcher may include abnormal data into the dataset. Including these data may affect the central tendency of the data set by providing different results for the mean, medium and mode (Rathnayake, Enticott, & Phillips, 2012). The research also excludes five consumer service companies as there was a lesser number of annual reports.

Data Analysis Technique

By aiming to describe a sample rather than using the data to infer information about the population that the sample of data is assumed to represent, descriptive statistics set themselves apart from inferential statistics. The correlation matrix will be used to summarize a dataset and detect trends that will ultimately influence decision-makers as such correlation could impact regression results (Liang & Zeger, 1993). Finally, regression analysis will investigate the impact of independent variables on the dependent variable (Almajali, Alamro, & Al-Soub, 2012). ROE was used to measure financial performance as it directly affects the shareholder's wealth maximization and agency theory (Agiomirgiannakis, 2006; Bo, Hongliu, & Xiaoqiang , 2017)

The research will be utilized panel data analysis and STATA is used to help with data processing techniques which consists of calculating data analysis models (Kim, Duvernay, & Thanh, 2021; Alshubiri, 2021; Ledhem & Mekidiche, 2021). Hence, the following regression model was developed.

$$\boldsymbol{FP = \beta 0 + \beta 1\ OR + \beta 2\ MR + \beta 3\ LR + \beta 4\ CR + \beta 5\ FS + \beta 6\ LE + \varepsilon} \ldots\ldots (1)$$

β0	=	Intercept or Constant
β1 OR	=	Operational Risk
β2 MR	=	Market Risk
β3 LR	=	Liquidity Risk
β4 CR	=	Credit Risk
β5 FS	=	Firm Size
β6 LE	=	Leverage
ε	=	Error Term

FINDINGS AND DISCUSSION

Descriptive Analysis

Descriptive statistics frequently portrayed as a summary of data that describes the contents of the data (Kim, Duvernay, & Thanh, 2021; Alshubiri, 2021).

Table 3: Results of the Descriptive Analysis

Variable	Mean	SD	Min.	Max.
FP	.0193489	.1152124	-.6961963	.2911981
OR	-.4585238	5.675231	-73.3801	19.76004
MR	.5089398	20.74586	-318.8368	185.8436
LR	1.586164	1.485318	.0688752	7.431048
CR	.3314729	.6160922	0	6.483086
FR	21.7426	1.388655	16.70017	25.03205
LE	.0491997	.057138	0	.3480238

Source: Author compiled based on panel data

As per the above descriptive analysis result obtained from the Stat a application, the mean of financial performance is 0.1935. Broadly it can be defined as, on an average basis, 19.35% of total equity is represented by net profit on listed consumer service companies in Sri Lanka. The standard deviation of financial performance is 0.1152, which indicates that financial performance measured by ROE has a low dispersion among the listed consumer service companies. According to the statistics, operational risk measured by the efficiency ratio, market risk measured through the average degree of financial leverage shows a high dispersion and liquidity risk measured by the current ratio and credit risk measured through gearing ratio has a low dispersion among the industry.

Correlation Analysis

To detect multicollinearity, researcher perform the correlation test using the variables of the study.

Table 4: Multicollinearity Test

	OR	MR	LR	CR	FS	LE
OR	1.0000					
MR	-0.0025	1.0000				
LR	0.0790	0.0264	1.0000			
CR	0.0005	0.0100	-0.3430	1.000		
FS	-0.0232	-0.0697	0.0111	0.1791	1.0000	
LE	-0.0049	-0.0156	-0.4490	0.3761	0.0423	1.0000

Source: Author compiled based on panel data

No variable is highly correlated to the other variable of the data set concerning to the consumer service companies in Sri Lanka.

Regression Analysis

The study requires regression analysis to investigate the impact of independent variables on the dependent variable (Almajali, Alamro, & Al-Soub, 2012). ROE was used to measure financial performance as it directly affects the shareholder's wealth maximization (Bo, Hongliu, & Xiaoqiang, 2017).

Table 5: Regression Analysis

Name of the Model	Method	Sources	Results	Conclusion
Fixed Effect Regression Analysis Model	Wald test	(Torres-Reyna, 2007)	F (6, 282) = 45.19 Prob > F = 0.0000	Fixed effect model is more appropriate.
Random Effect Regression Analysis Model	LM Test	(Torres-Reyna, 2007)	chibar2(01) = 132.60 Prob > chibar2 = 0.0000	Random effects are presented.

Source: Author compiled based on panel data

As both fixed and random effects were selected, the Hausman test was conducted to identify the most appropriate regression model (Park, 2010; Torres-Reyna, 2007).

Table 6: Hausman Test

Prob>chi2 = 0.0000

Source: Author compiled based on panel data

As the random effect is inconsistent, the fixed effect model will be carried out and afterwards four diagonal tests namely Multicollinearity test is represented under the correlation analysis, heteroskedasticity, serial correlation, cross sectional dependence test will be performed. Then the researcher can decide whether to use robust, cluster or Xtpcse for the modified regression analysis (Torres-Reyna, 2007; Park, 2010).

Table 7: Test Results

Name of the Test	Method	Results	Conclusion
Heteroskedasticity test	Modified Wald Test	chi2 (32) = 3075.83 Prob>chi2 = 0.0000	Standard errors are not constant, and there is heteroscedasticity.
Test for Serial Correlation	Waldridge Test	H0: no first-order autocorrelation F(1, 31) = 15.444 Prob > F = 0.0004	There is a first-order autocorrelation and there is a serial correlation.
Test for Cross-sectional Dependence	Pesaran Test	Pesaran's test of cross-sectional independence = 8.031, Pr = 0.0000 Average absolute value of the off-diagonal elements = 0.311	The residuals are correlated, and there is a cross-sectional dependence.

Source: Author compiled based on panel data

Considering the above tests, heteroskedasticity, Serial Correlation, and Cross-sectional dependence were identified in the data set and concluded that panel-corrected standard error regression model to be used.

Modified Regression Output

The following table VIII shows the results obtained through modified regression under panel corrected standard error,

Table 8: Modified regression output

Linear regression, correlated panels corrected standard errors (PCSEs)

FP	Coef.	Panel-corrected Std. Err.	z	P > [z]
OR	.0025052	.0010251	2.44	0.015
MR	.0000764	.0001045	0.73	0.465
LR	.0063479	.0031897	1.99	0.047
CR	-.0981843	.0133377	-7.36	0.000
FS	-.0114109	.0032144	-3.55	0.000
LE	-.1751806	.1130001	-1.55	0.121
_Cons	.2996573	.0707634	4.23	0.000

Source: Author compiled based on panel data

Operational Risk (OR) and Liquidity Risk (LR) has a positive statistically significant impact on financial performance (FP) whereas, Credit risk has a negative statistically significant impact on financial performance. The probability of all three independent variables amounts to 0.015, 0.047 and 0.000 which is less than 0.05 or 5%. As per Table, Market risk shows a statistically insignificant impact on the Financial Performance which amounts to 0.465, which is above the 5% confidence level. Firm Size (FS) shows a statistically significant impact whereas Leverage (LE) shows a statistically insignificant impact on Financial Performance.

The following represent the regression model as per the above results obtained from concerning to the consumer service industry.

$$\boldsymbol{FP = 0.2996573 + 0.0025052OR + 0.0000764MR + \beta 30.0063479LR - 0.0981843CR - 0.0114109FS - 0.1751806LE + \varepsilon} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

CONCLUSION | LIMITATIONS & FUTURE RESEARCH DIRECTION

Hypothesis Testing

Table 9: Hypothesis testing table

Hypothesis	Coefficient	Probability	Hypothesis Accepted or Rejected
H1: There is a statistically significant impact of operational risk on the financial performance of the listed companies in the	.0025052	0.015	Accepted

consumer service sector in Sri Lanka			
H2: There is a statistically significant impact of market risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka	.0000764	0.465	Rejected
H3: There is a statistically significant impact of liquidity risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka	.0063479	0.047	Accepted
H4: There is a statistically significant impact of credit risk on the financial performance of the listed companies in the consumer service sector in Sri Lanka	-.0981843	0.000	Accepted

Source: Author compiled based on panel data

H1 Hypothesis shows a statistically significant impact of operational risk on financial performance. Many researchers also suggest that operation risk summarizes the chances and uncertainties a company faces in due course and will try to mitigate issues concerning operations by implementing policies, practices, and strategies which had significantly affected the financial performance (Hosseininassab, 2013; Saeed, 2015; Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022).The companies maintain larger capital charges which will help them to mitigate economic and political instabilities in South Asian countries. A solid risk management program will enable hospitality operators to tackle risk management, compliance, and governance holistically, systemically, and methodically (Bharwani & Mathews, 2012).

The H2 hypothesis suggests a statistically significant impact of market risk on financial performance.In contrast, the findings supported that there is no statistically significant impact of market risk on financial performance with a probability value of 0.465, above 0.05 or 5%, concerning consumer service companies. This rejected the H2 alternative hypothesis and accepted the null hypothesis, in which there is no statistically significant impact of market risk on financial performance. The degree of financial leverage gauges a company's EPS sensitivity to changes in operating income caused by changes in its capital structure. This ratio suggests that the more financial debt there is, the more erratic earnings will be. As per the above study, due to the nature of the loans obtained, interest charges applicable for the period, percentages, and penalties imposed against the debt capital structure, companies have resulted in different profits before taxes, which hurt the performance of these consumer service companies.

Market risk measured through the degree of financial leverage had shown an insignificant relationship as per prior researchers. This had mostly due to changes in EBIT and interest charges for the period compared with the other companies in the same industry (Muriithi, 2016). According to Enekwe 2014, management considers the debt-to-equity structure, but the management will not consider the interest charges, which results in insignificant results. Management of the organization must alwaysmakedecisions to maximize the shareholder’s wealth which is already explained under the agency theory and this includes the maximization of the profits. An increase in profit maximization will increase the wealth of the shareholders.Swaps, derivatives, options, forwards, futures, portfolio management, and securitization techniques are therefore effective risk management solutions that managers and decision-makers of these organizations should employ to reduce market risk (Muriithi, 2016; Kassi, Dilesha, & Ning Ding, 2019).

The H3 hypothesis suggests a statistically significant impact of liquidity risk on financial performance.Rudhani & Balaj, 2019 supported that liquidity risk had a significant impact on both ROA and ROE during the period from 2010 to 2016 banks in Kosovo. The positive correlation between the bank's capacity to absorb liquidity shocks and its performance reveals that the larger the bank's ability to absorb liquidity shocks, the higher the bank's performance. Many companies try to maintain a necessary portion of short-term loans and deposits to meet their obligations effectively and efficiently (Hunjra A. I., Mehmood, Nguyen, & Tayachi, 2022). High liquidity eliminates management's need to improve operational performance. The two significant factors affecting the financial performance of life insurance firms in India are liquidity risk and firm size. Financial performance is significantly impacted by these microeconomic factors, and substantial liquidity eliminates the need for management to enhance annual operational performance (Wani & Dar, 2013). Furthermore, high liquidity may raise agency costs for owners by incentivizing managers to waste extra cash by investing in initiatives with negative NPV and engaging in excessive perquisite consumption (Almajali, Alamro, & Al-Soub, 2012).The current ratio measures a company's capacity to repay short-term obligations. It is a critical liquidity ratio that investors and financial experts rely on as this will assist managers in picking the best solution for increased profitability and managing short-term funds (Ghosh & Bhattacharya, 2022).According to Ngoc Ta & Thanh Dao (2020), due to issues that may arise between shareholders and creditors, agency theory will also have an impact on how the organization operates. This will ultimately have an impact on stakeholder theory as well. This will occur if the degrees of risk-taking preferences of creditors and shareholders diverge.

The liquidity preference theory is relevant because it takes into account how investors perceive non-financial businesses. The preference for liquidity among non-financial enterprises must shift because of the possibility of default. It is not difficult to determine whether a non-financial organization has the primary option of its liquidity preference for assumptions, and the firms would eventually be obliged to take on the counterparty's credit risk, which would have a negative impact on their financial performance (Njiru, 2020).Not financial companies have also adopted specialized methods, like credit rating systems and evaluations for risk assessment. A company should reduce its exposure to credit risks by investigating the creditworthiness of potential borrowers before the transaction is closed in light of the liquidity principle of finance.

The H4 hypothesis suggests a statistically significant impact of credit risk risk on financial performance.Managers in South Asian countries should focus on raising capital adequacy to increase monetary benefit while reducing non-performing loans by applying modern credit risk management methodologies, strategies (Siddique, Khan, & Khan, 2022). The debt yield ratio is a more dependable indicator since it only includes loan amounts in its calculation, making it less sensitive to fluctuations in market values, interest rates, and amortization periods (Gordon, 2014; Konecny, 2014). Similarly, if the corporation does not receive the credit amount by a specific date, the firm may charge a higher interest charge on the debtors. Finally, the speculative aspect of a company's credit risk can be controlled by investing in different industries if possible (Mushafiq, Sindhu, & Sohail, 2021).Hotel owners that operate these efficient and profitable properties are more likely to receive loans with lower credit spreads and offer less default risk (Singh, 2019).

According to credit risk analysis theory, the lender estimates the borrower's capacity to satisfy debt obligations using credit risk analysis to safeguard itself against a loss of cash flows and decrease the severity of losses where it had been relevant to the consumer service industry, this had a significant impact as higher consideration has been given by the board of directors and management of different consumer service companies to understand the borrower’s capacity to pay the debt which had improved its profits for the period. This also increases the potential to improve its assets. The credit risk theory is the one that applies to this study the most from the perspective of the lender. Credit risk theory is crucial for nonfinancial organizations since borrowers could ultimately out to be opportunistic. Cash rebates do not apply to credit sales. Therefore it is obvious when spending more and when extending credit. Additionally,Companies must pay close attention to the significant hazards of credit risk, liquidity risk, and operational risks. Companies taking on risky projects have the potential to either succeed or lose. In these situations, it is important to make decisions based on knowledge. As a result, when dealing with the performance of their organizations, managers must develop strategies capable of managing these by taking return on shareholder equity into account and significant impact on these results will enable regulators and policymakers to consider how systematic risk affects business performance externally (Onsongo, Muathe, & Mwangi, 2020). many non-financial organizations adopt methods like client monitoring, account reference, and collateral limits to reduce risk exposure (Muhammad, Sindhu, & Sohail, 2021).

Conclusion

The major conclusion that can be drawn from the findings of this study is that operational risk, liquidity risk, and credit risk significantly impact financial performance. There is a positive statistically significant impact of operational risk and liquidity on financial performance. In contrast, there is a negative statistically significant impact of credit risk on the financial performance of the listed consumer service sector in Sri Lanka, which accepted the H1, H3, and H4 hypotheses and rejects the H2 hypothesis.

Implication and Recommendations

The findings of the study could help the government and other policymakers promote tourism in the country by promoting or working with enterprises that have outperformed their peers in terms of financial performance. The study provides a framework for determining optimal future courses of action by assessing the impact of financial risk on the financial performance of consumer service organizations in Sri Lanka and their competitors. To design policies for the sector, authorities frequently need to understand the nature of the industry and the performance of the key players. The findings demonstrate statistical significance, which may aid policymakers and industry experts in intervening and developing current regulations. Organizations are urged to establish feasible internal approaches to measure and to execute operational risk management and control processes that involve the design, execution, and assessment of operational risk arises. Based on the findings, the following recommendations were concluded,

It is vital for the management of consumer service companies to be aware of their liquidity position and operational efficiency as it will help them to mitigate or reduce short-term obligations and risks associated with it to meet their financial commitments in a timely manner. Having adequate funds helps the entities to mitigate solvency, bankrupt situation, or increase in financial obligations, and will ultimately increase the shareholder's wealth maximization. According to the findings of the study, larger the debt-to-equity ratio, lower the financial performance. Therefore, firms need to restore capital structure toward raising the amount of equity in total capital and mobilizing capital from various sources. Furthermore, enterprises must enhance the use efficiency of fixed assets, which enables them to take the lead in extending the scale of operations, investment, and technological innovation. Management and directors should reduce their financial expenses by formulating policies aimed at optimizing fixed assets and equity while reducing interest-bearing loans. This will help the consumer service entities to reduce interest expenses. Companies must also enter into new loan agreements by considering their ability to pay and must ensure that the entities are able to make sufficient profits to recover the interest expenses, as the impact of interest expense on EBIT shows scattered variations among the consumer service industry.

Direction to the Future Research

The research may have considered all variables relating to financial risk but has selected only ROE as the dependent variable concerning financial performance and will only cover the consumer service industry. The research collects secondary data for the selected sample for a period of 10 years as it is difficult to assess annual reports more than that and it is noteworthy to conduct an additional survey analysis as it's difficult to contact and interview consumer services firms due to the firm safeguards and privacy concerns. Most consumer service firms concentrate on consumer behavior, and consumer taste as their market share consists of customer satisfaction towards their services. Hence, consumer service firms focus less on financial risk on financial performance which can be concluded as a major limitation of the study.

The researcher had only considered ROE as the dependent variable. In contrast, future researchers can perform the research by including ROE and ROA as the dependent variables. The researchers excluded 2021 and 2022 due to the impact of the covid-19 pandemic, and there was a smaller number of annual reports to assess the impact of covid-19 considering the financial risk on financial performance and future researchers can analyze the impact of covid19 on the consumer service industry. Future researchers can consider the interest rate, exchange rate, foreign investment, and legal risks as independent variables to measure the impact on financial performance of consumer service industry or any other industry as per the GICS classification.

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