Effect of Corporate Governance on Financial Performance of Companies Listed in CSE

De Silva L.D.[1] and Wanniarachchige M.K.[2]

[1,2]*Department of Accountancy and Finance, Faculty of Management and Finance, University of Ruhuna, Sri Lanka*

dinukee@gmail.com[1], manjula@mgt.ruh.ac.lk[2]

Abstract

Corporate governance is in the limelight across the globe as result of a series of corporate failures directly attributable to agency issues. Consequently, many countries have formulated guidelines on corporate governance and incorporated into listing rules as well. Nevertheless, neither the level of compliance nor the effectiveness of the best practices is known without doubt. Therefore, this study measures the corporate governance compliance and investigates the effect of compliance on firm performance using a sample of 100 firms listed in Colombo Stock Exchange. Compliance was measured using a corporate governance index while firm performance was measured using ROA and Tobin's Q. Findings showed a higher compliance in 2018 compared to 2014 while the compliance was higher in larger firms compared to their smaller counterparts. Nevertheless, an association between compliance and firm performance was not observed contrary to conventional literature. The evidence suggests that the claims made in stewardship theory may be valuable in redefining what constitutes corporate governance in Sri Lanka.

Keywords: *Agency theory, Corporate governance, Firm performance, Sri Lanka, Stewardship theory*

1. Introduction

Increasing complexity has led to the separation of control of the businesses from their ownership, creating a potential for conflict of interest between shareholders and managers as explained in the agency theory (Jensen & Meckling, 1976). When appropriate incentives and/or monitoring mechanisms are absent, the managers can misappropriate corporate resources for their own benefit. Corporate governance aims to minimize the opportunistic managerial behavior and thereby to minimize agency costs through specifying the rights and responsibilities of different stakeholders of a firm while streamlining decision making process (Azeez, 2015; Manawaduge, 2012). As a result, an increase in firm performance is generally expected.