THE EFFECTS OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE

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Abstract

Attention to corporate governance has quite a long history since the seminal paper on the subject of the "principal – agent problem" by Meckling (1976). They argued that the existence of the principal – agent problem as a consequence of the separation of ownership and control raises a conflict of interest between the interests of managers and shareholders. The financial crisis in 2008 and high sketch financial dishonours tends to have concentration of academic researches, policy makers, regulatory institutions and investors to study the level of corporate governance practices and its effect on firm's financial performance. Mostly, the quality of corporate governance can be assessed on the basis of the principals of disclosures and transparency, relationship with stakeholders including shareholders, policies and compliance, structure and the characteristics of board of directors and the ownership and control structure. According to Black (2006) worthy corporate governance practices strengthen the firm financial performance.

This research empirically examines the quality of corporate governance (CG) practices in Sri Lankan listed private banks and their impact on firm's financial performance in the context of an emerging market such as Sri Lanka. To evaluate the level of corporate governance practices at an identified firm, this study construct a corporate governance index (CGI) which involves four scopes: disclosure and transparency, composition of the board of directors, shareholders' rights and investor relations, ownership and control structure. Based on a sample of 10 private banks listed on the Colombo Stock Exchange (CSE) in Sri Lanka, the effects of corporate governance on financial performance are assessed. Tobin's Q is used to evaluate the firm's financial performance.

Key words: Corporate Governance, Financial Performance, Corporate Governance Index