The Use of Corporate Governance in Predicting Corporate Failure of Listed Companies in Sri Lanka

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Abstract

The main purpose of this study is to investigate the relationship between corporate governance variables and corporate failure of listed companies in Sri Lanka. In modern business world sudden failure of corporation became one of most discussed topics and it is a common problem of both developing and developed economies. It is claimed that corporations are failed due to poor corporate governance systems. An analysis of literature revealed that only few studies were carried out on corporate failure prediction in Sri Lanka and such studies were based solely on financial ratios. Therefore, this study addresses the empirical gap exists in the local context.

The study used logistic regression analysis to a data set of 58 matched pairs of failed and non-failed companies listed in the Colombo Stock Exchange in Sri Lanka over the period 2008 to 2017. Seven corporate governance variables were used for prediction of corporate failure such as board size, CEO duality, Outside directors, Audit opinion, Presence of audit committee, director's remuneration, foreign ownership.

The results of the study revealed that CEO Duality alone has significant positive impact to the failure of the corporations in the first year before failure and two years before failure. In three years before the failure both CEO duality and outside directors has significantly impact to the prediction of corporate failure. Therefore, results of this study can assist investors, managers, shareholders, financial institutions, auditors and regulatory agents in Sri Lanka to forecast corporate failure of listed companies.

Keyword: Corporate Failure, Corporate Governance, Logistic Regression, Sri Lanka