Impact of Corporate Governance on Financial Distress: Evidence from Listed Financial Institutions in Sri Lanka

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This study focuses on the role of corporate governance in predicting financial distress of companies in the finance sector in Sri Lanka. Over the past two decades, a few finance sector companies collapsed in Sri Lanka affecting numerous victims with no proper compensation payments. The study aims to unveil the impact of corporate governance on financial distress of companies in the financial sector. Several key variables included to measure the corporate governance such as board size, board gender diversification, frequency of board meetings, audit quality, board member remuneration, CEO duality, education level of the board members, and board independence. As control variables firm size, profitability, and financial leverage are considered. Financial distress is operationalized through the measures of institutions negative profit, cash flow, or worth for three consecutive years. Data from 54 listed financial institutions in Sri Lanka were collected from 2017 to 2022. Descriptive analysis, Pearson correlation analysis, corporate governance comparison model, and regression analysis were employed for data analysis. The findings indicate that board size, board gender diversification, frequency of board meetings, higher audit quality, education level of the board, board independence, and return on equity have a significant negative impact on financial distress. These findings can help identify at-risk financial institutions, support decision-making for investors and stakeholders, guide the implementation of corporate governance policies, and inform policymakers in developing new governance policies.

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