The Impact of Corporate Governance on Financial Distress: Evidence from Listed Non-financial Companies in Sri Lanka.

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Abstract

The study's goal is to investigate the impact of corporate governance on the financial distress of Sri Lankan listed non-financial companies. The three years straight negative cash flow and negative profit measures financial distress, while board size, board gender diversification, Frequency of board meetings, Education level of the board CEO duality and audit quality are proxies for corporate governance. The effect of corporate governance practices on financial distress is evaluated using 30 individual observations of non-financial firms listed in Sri Lanka from 2018 to 2023 and a fixed effects model. Additionally, Firm size, profitability are incorporated into the study as control variables to enhance the study's findings. And financial distress is measured based on an institute having a negative profit, cash flow or worth for three years as the unique nature of financial institutions prevents traditional methods of measuring financial distress, such as the Altman Z score model. In this study, descriptive analysis, corporate governance comparison model and regression analysis are used to analyze the data. The analysis results indicated that the following corporate governance variables, board size (BS), board gender diversification (BGD), frequency of board meetings (FBM), higher audit quality (HAQ), education level of the board (ELB), and the control variable of Firm size to have a significant negative impact on financial distress. Accordingly, these findings of the study can provide a framework to identify non-financial firms that are at risk of being financially distressed.

Keywords: Corporate Governance, Financial Distress, Profitability