THE IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF LISTED FINANCE SECTOR COMPANIES IN SRI LANKA DURING COVID-19 PANDEMIC

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INTRODUCTION

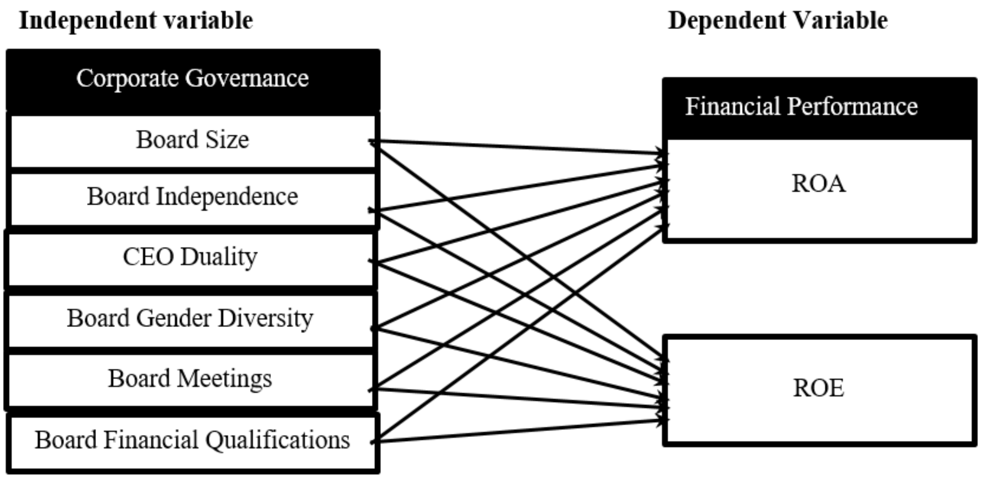
Corporate governance (CG) involves the management and operation of a business through various groups (Cadbury, 1992). It focuses on strengthening accountability to stakeholders through interactions between management, the board, and shareholders. Corporate governance is one of the key factors affecting a company's performance. According to Egiyi (2022) effective CG ensures that organizations prioritize the concerns of various stakeholders and the communities they operate in. The principal-agent problem arises when the objectives of a principal and agent clash. CG serves as a means to alter the agent's operating framework and realign it with the principal's interests. The significance of CG has increased due to recent global financial crises and multiple business scandals (Farwis & Azeez, 2019).

Recently one such crisis that happened globally was the COVID-19 pandemic. The Covid-19 pandemic led to the greatest worldwide recession since 1930 when the economy completely tanked on a macro level (Shen et al., 2020). According to Khatib and Nour (2021) the effectiveness of the companies as a whole has been significantly impacted by such measures as the policy on restricted movements and lockdowns. Because of these uncertainties, the Sri Lankan finance sector has deteriorated during the past few years. As a result, the performance of Non-Bank Financial Institutions such as Licensed Financial Companies (LFCs) and Specialized Leasing Companies (SLCs) deteriorated throughout the year (Central Bank of Sri Lanka, 2020). As well as several LFCs did not meet the minimum capital requirement, and in 2020 the licenses of two banks were canceled. Accordingly, the underlying CG weaknesses in that sector can be identified as one of the causes of the deterioration in the finance sector. Therefore, the researchers were motivated to study the impact of corporate governance on firm performance during crises like COVID-19. Several authors have done separate studies on the impact of CG on financial performance (Nizam et al., 2017; Perera & Haleem, 2020; Rajakaruna & Swaranapali, 2021; Egiyi, 2022) and the impact of COVID-19 on corporate governance practices (Jebran & Chen, 2021). Therefore, there is a dearth of previous studies on the influence of CG on financial performance during the COVID-19 pandemic in both Sri Lankan and global contexts. Hence, the objective of this study is to assess the impact of corporate governance on the financial performance of listed financial sector companies in Sri Lanka during the COVID-19 pandemic.

METHODOLOGY

This study belongs to the quantitative research approach. The 55 Financial sector companies listed on the Colombo Stock Exchange in Sri Lanka for 6 years, from 2016 to 2022 were selected as the target population. Ten companies were excluded due to the unavailability of data and the final sample consisted of 45 companies. The study divided the time frame into two periods: the pre-COVID period comprising the years 2016, 2017, and 2018, and the post-COVID period encompassing the years 2019, 2020, and 2021. To accomplish the objectives and hypotheses, the researcher has gathered secondary data. The study comprises seven variables: Board size (BSIZ), board independence (BIND), CEO duality (CEOD), board gender diversity (BGD), board meetings (BM), and board financial qualifications (BFQ) are considered as independent variables, with Financial Performance (FP) as the dependent variable. Based on the existing literature such as (Rajakaruna & Swaranapali, 2021; Ali et al., 2022; Egiyi, 2022; Nizam & Liaqat, 2022) the following conceptual framework was developed. Accordingly, the whole study is captured by this framework.

Figure 1



Conceptual Framework

Following hypotheses were formulated considering the limited literature.

H1: Corporate Governance has a significant impact on ROA

- H_{1a}: Board size has a significant impact on ROA
- H_{1b}: Board independence has a significant impact on ROA
- H_{1c}: CEO duality has a significant impact on ROA
- H_{1d}: Board gender diversity has a significant impact on ROA
- H_{1e}: Board meetings have a significant impact on ROA
- H_{1f}: Board financial qualifications have a significant impact on ROA

H2: Corporate Governance has a significant impact on ROE

- H_{2a}: Board size has a significant impact on ROE
- H_{2b}: Board independence has a significant impact on ROE
- H_{2c}: CEO duality has a significant impact on ROE
- H_{2d}: Board gender diversity has a significant impact on ROE
- H_{2e}: Board meetings have a significant impact on ROE
- H_{2f}: Board financial qualifications have a significant impact on ROE

Here, the relationship between corporate governance variables and their impact on the financial performance of Sri Lankan financial sector companies has been examined using reliability, validity, descriptive, correlation, and regression analysis. Accordingly, to investigate the impact of corporate governance on financial performance a regression model has been developed as follows.

$$FP_{it} = \alpha + \beta_1 BSIZ_{it} + \beta_2 BIND_{it} + \beta_3 CEOD_{it} + \beta_4 BGD_{it} + \beta_5 BM_{it} + \beta_6 BFQ_{it} + \beta_7 year_{it} + \varepsilon_{it}$$

Where,

FP_{it} = Financial Performance
$BSIZ_{it}$ = Board Size
$BIND_{it}$ = Board Independence
$CEOD_{it}$ = CEO Duality
BGD_{it} = Board Gender Diversity
BM_{it} = Board Meetings
BFQ_{it} = Board Financial Qualifications

RESULTS AND DISCUSSION

To interpret the empirical results and findings of the study, the researchers tested the descriptive statistics. The results are demonstrated in Table 1.

Table 1

Descriptive Statistics Pre-COVID Period and Post-COVID Period

	Pre-COVID Period				Post-COVID period			
Variable	Mean	Min	Max	Std. Deviation	Mean	Min	Max	Std. Deviation
ROA_{it}	0.023	-0.185	0.258	0.051	0.022	-0.197	0.268	0.059
ROE_{it}	0.094	-0.522	0.644	0.154	0.050	-1.123	0.479	0.169
$BSIZ_{it}$	8.141	5.000	13.000	2.213	6.852	5.000	12.000	1.883
$BIND_{it}$	0.441	0.143	0.889	0.164	0.525	0.222	1.500	0.214
$CEOD_{it}$	0.800	0.000	1.000	0.401	0.741	0.000	1.000	0.440
BGD_{it}	0.116	0.000	0.429	0.113	0.142	0.000	0.6000	0.146
BM_{it}	10.526	2.000	25.000	4.697	8.644	0.000	16.000	3.905
BFQ_{it}	0.545	0.125	1.000	0.216	0.653	0.167	1.400	0.233

The study compared the financial performance of companies in the pre-COVID and post-COVID periods. The mean values of ROA and ROE were higher in the pre-COVID period, indicating a decline in financial performance in the post-COVID period. BM_{it} has also decreased in the post-COVID period. This suggests that COVID-19 has had an impact on the financial performance of companies, leading to lower performance in recent years.

Table 2

Correlation Analysis for Post-COVID Period

Variable	ROA_{it}	ROE_{it}	$BSIZ_{it}$	$BIND_{it}$	$CEOD_{it}$	BGD_{it}	BM_{it}	BFQ_{it}
ROA_{it}	1							
ROE_{it}	0.570**	1						
$BSIZ_{it}$	0.563**	0.437**	1					
$BIND_{it}$	0.105	0.168	-0.002	1				
$CEOD_{it}$	0.450**	0.638**	0.395**	0.292**	1			
BGD_{it}	0.045	0.102	0.043	0.272**	0.128	1		
BM_{it}	0.422**	0.505**	0.335**	0.332**	0.611**	0.253**	1	
BFQ_{it}	0.413**	0.241**	0.186*	0.102	0.261**	-0.018	0.181*	1

N=*139*, **P<0.01, **P<0.05*

In the Post-COVID period, $BSIZ_{it}$, $CEOD_{it}$, BM_{it}, and BFQ_{it} have significant positive relationships with both ROA_{it} and ROE_{it} (p<0.01). Coefficients indicate moderate to strong positive associations. $BIND_{it}$ and BGD_{it} do not show systematic relationships. Hypotheses H_{2a}, H_{2c}, H_{2e}, and H_{2f} are supported by these findings.

Table 3

Regression Analysis for Pre & Post COVID Periods (Model 1 – ROA)

	Pre-COVID Period			Post-COVID Period		
Dependent ROA	Coef	P>t	Std.Error	Coef	P>t	Std.Error
$BSIZ_{it}$	0.005***	0.008	0.002	0.021***	0.000	0.003
$BIND_{it}$	0.047*	0.053	0.024	0.071**	0.014	0.028
$CEOD_{it}$	0.040***	0.001	0.011	0.033*	0.071	0.017
BGD_{it}	-0.034	0.341	0.035	0.107*	0.065	0.057
BM_{it}	-0.000	0.681	0.001	0.003*	0.064	0.001
BFQ_{it}	0.104***	0.000	0.018	0.054***	0.004	0.018
Industry Dummies Included, Year Dummies Included						
Constant			-0.116			-0.256
R-Squared			0.4591			0.3765
F						17.22***
N			135			135
Hausman Test			12.11			17.64**

*Note. N= 139, ***P<0.01, **P<0.05, *P<0.1*

Table 4

Regression Analysis for Pre & Post COVID Periods (Model 2 – ROE)

	Pre-COVID Period			**Post-COVID Period**		
Dependent ROE	Coef	P>t	Std.Error	Coef	P>t	Std.Error
$BSIZ_{it}$	0.018**	0.012	0.007	0.021***	0.003	0.007
$BIND_{it}$	0.088	0.255	0.078	0.011	0.853	0.060
$CEOD_{it}$	0.125***	0.000	0.034	0.177***	0.000	0.036
BGD_{it}	-0.029	0.810	0.121	0.017	0.856	0.092
BM_{it}	0.005	0.111	0.003	0.005	0.183	0.004
BFQ_{it}	0.185***	0.000	0.053	0.042	0.369	0.046
Industry Dummies Included, Year Dummies Included						
R-Squared			0.310			-0.284
F			0.4417			0.4740
N			135			135
Hausman Test			2.03			2.64

*Note. N= 139, ***P<0.01, **P<0.05, *P<0.1*

According to the regression analysis (Model 01-ROA), in the post-COVID period, all the CG characteristics have a significant impact on ROA. BGD_{it}, and BM_{it} which were not significant in the pre-COVID period have also become significant in the post-COVID period. The study indicates that larger board sizes, associated with greater knowledge, positively influence financial performance during the crisis period. It has been supported by various studies (Rajakaruna & Swaranapali, 2021; Nizam & Liaqat, 2022). In Model 02 - ROE, only $BSIZ_{it}$ and $CEOD_{it}$ are significant. The COVID-19 pandemic has highlighted the significant role of CG in managing uncertainties and protecting stakeholder interests.

CONCLUSIONS AND IMPLICATIONS

This study examines the impact of CG on financial performance during the Pre and post-COVID periods. Significant differences were observed between the two periods. In the post-COVID period, all CG factors have a positive impact on ROA. Similarly, board size and CEO duality positively impacted ROE. The study concludes that COVID-19 affected firm characteristics and supports the hypotheses related to ROA and ROE. The pandemic has emphasized the importance of agile decision-making and strategic oversight. Boards have had to adapt quickly to address emerging risks and uncertainties, leading to more frequent and intense board meetings, increased communication channels, and the need for diverse expertise. The pandemic has accelerated the adoption of digital technologies and remote working practices. It is confirmed by BM_{it} being significant on Financial Performance. This study fills a gap in the literature by exploring the impact of COVID-19 on CG and financial performance, providing valuable insights for regulators, management, and investors in decision-making.

Keywords: Corporate governance, COVID-19, finance sector, financial performance

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