CORPORATE GOVERNANCE AND INSOLVENCY RISK: A STUDY OF LISTED NON-FINANCIAL COMPANIES IN SRI LANKA

S.H.R.E. Kumari[1,*] and R.M.N.C. Swarnapali[2]

[1,2]*Department of Accountancy & Finance, Faculty of Management Studies, Rajarata University of Sri Lanka*

*Corresponding author: (Email: ruwanierandi6@gmail.com)

ABSTRACT

Recently, discussions on corporate governance have become increasingly prominent in developed and developing countries, driven by the growing recognition of its role in ensuring corporate accountability and financial stability. According to the Agency Theory, the primary goal of corporate governance is to align the interests of managers and shareholders to mitigate potential conflicts. While numerous studies have explored this concept, only a few have considered the intricate interrelationship between corporate governance practices and insolvency risk. This study addresses this gap by focusing on listed non-financial companies in Sri Lanka. To shed light on the critical interaction, this study examines the impact of corporate governance on insolvency risk using data from a sample of 158 non-financial companies listed on the Colombo Stock Exchange for five years from 2018 to 2023. Board independence, women on the board, audit committee independence, board meetings, audit committee meetings, financial agreements of the board of directors, and the dual role of the chief executive officer were used as corporate governance variables. In contrast, aspects of the risk management committee and indicators of insolvency risk, such as profitability and solvency ratios, liquidity ratios, leverage ratios, and the Altman Emerging Market Z-Score Modification Model, are used as the measures of the dependent variable in this study. Additionally, the non-performing loan ratio was used as the control variable. This study uses quantitative research data using a deductive technique gathered from annual reports, financial statements, and other relevant sources. The collected data were analyzed using descriptive statistics, correlation analysis, and panel regression analysis. Increasing the number of board members and strengthening the composition of the audit committee can decrease the risk of insolvency. Other corporate governance components do not significantly affect insolvency risk. Panel regression analysis underscores that increasing board independence and risk management committees can mitigate the risk of insolvency within the sample companies. This study offers practical implications for stakeholders, policymakers, and investors in developing specific best practices to mitigate financial risk and improve financial stability.

***Keywords*:** Agency theory, corporate governance, insolvency risk, non-financial listed companies