MODERATING IMPACT OF CORPORATE GOVERNANCE ON THE RELATIONSHIP BETWEEN RISK MANAGEMENT AND FINANCIAL PERFORMANCE OF LICENSED FINANCE COMPANIES IN SRI LANKA

M.G.G.J. Buddhika[1,*] and H.M.D.N. Somathilake[2]

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

*Corresponding author (Email: jayanimahanama98@gmail.com)

ABSTRACT

Risk Management (RM) encompasses the identification, assessment, and prioritization of risks, followed by coordinated efforts to minimize, monitor, and control the probability and impact of adverse events. Effective RM is essential for businesses in today's dynamic business climate, especially financial institutions. Sri Lanka is currently a nation with severe economic instability, shifting laws and policies, and volatile raw material costs. This study examines the moderating impact of corporate governance on the relationship between risk management and financial performance of licensed finance companies in Sri Lanka. Despite extensive research on the direct effects of risk management on financial outcomes, the moderating role of corporate governance remains underexplored. This study aims to fill this gap by focusing on the moderating influence of corporate governance mechanisms including board composition, audit committees, and ownership structure. This research adopts a panel data approach, analyzing data from licensed finance companies over the period 2018-2022. This study measures risk management through dimensions such as risk identification, risk evaluation, and risk monitoring, which are more aligned with the theoretical underpinnings of risk management. The Non-performing Loan Ratio (NPLR) and Capital Adequacy Ratio (CAR) are considered outcome variables influenced by risk management practices rather than direct dimensions of risk management itself. This methodology involves the use of advanced statistical software suitable for panel data analysis to ensure robustness of the results. The study employed descriptive statistics, correlation, and regression analysis using SPSS to provide a comprehensive understanding. The findings reveal that corporate governance significantly moderates the relationship between risk management and financial performance, with variations observed across different governance mechanisms. These results suggest that strong corporate governance can enhance the effectiveness of risk management practices, leading to better financial outcomes. The study concludes with managerial implications and emphasizes the importance of integrating corporate governance with risk management strategies to optimize financial performance. This study contributes to the existing literature by providing empirical evidence on the moderating role of corporate governance in the risk management-financial performance nexus, offering valuable insights for practitioners and policymakers in the finance sector.

Keywords: Capital adequacy, financial performance, licensed finance companies, non-performing loan, risk management