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

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## Abstract

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, several 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. A number of 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.

**Keywords:** *Corporate governance, Code of best practice, Financial distress*

## Introduction

The financial sector is a critical component of any economy, influencing all other industries and the economic cycle. However, despite being the most regulated and monitored sector in the country, any crises within this sector can have severe and wide-ranging consequences. Sri Lanka has experienced several corporate failures in the financial sector over the past two decades, which have been attributed to poor corporate governance practices (Seylan Bank PLC, 2009).

Some examples of corporate failures in the financial sector in Sri Lanka include the Golden Key Credit Card Co. Limited and ETI Finance. Golden Key accepted deposits like a bank without the necessary license, leading to a collapse when investors withdrew funds after the exposure of the Sakvithi scam. In the case of ETI Finance, the board of directors committed multiple offenses, leaving the company financially distressed and thousands of savings account holders unable to recover their funds (Seylan Bank PLC, 2009). The bankruptcy of these corporations has significant repercussions on fund providers, related businesses, and the overall economy. For example, the Golden Key collapse caused depositors to lose their money, while the ETI Finance debacle damaged the reputation of the financial sector and led to a loss of confidence among investors.

Corporate governance practices have come under scrutiny due to these scandals and the need for improved direction and control in organizations, driven by globalization and cultural changes. Financial distress, a prevalent issue globally, has led to the collapse and legal troubles of organizations. Therefore, studying and understanding the corporate governance factors that contribute to financial distress is crucial to prevent future debacles (Sameera & Senaratne, 2015).

Predicting and addressing financial distress plays a vital role in the long-term survival and growth of firms in a dynamic business environment. By identifying and addressing weaknesses in corporate governance, similar crises can be avoided in the future.

## Research Problem

The overarching research problem this study aims to solve can be structured as below,

“When analyzing the real-world cases of firms who faced financial distress, it is a common fact that those firms had some sort of failure in their corporate governance structure. And out of all failures, it seems like financial distress within financial institutions has caused the most harm to all parties involved. However, the specific impact of corporate governance failures on financial distress in listed financial institutions, particularly within the Sri Lankan context, remains under-explored. So, does this failure in the corporate governance structure of listed financial institutions in Sri Lanka have an actual impact that may lead these firms to be financially distressed and is it possible to build a framework around these two concepts to identify such firms who are at risk of being financially distressed so that stakeholders especially shareholders, the management and the investors can make quick, informed and better decisions?”

Based on this identified problem, several research questions and objectives were developed as stated below.

## Research Questions

The research questions that were derived can be listed as below,

1. Does corporate governance have an impact on the financial distress of listed financial institutions in Sri Lanka and if there is such an impact on the financial distress of listed financial institutions in Sri Lanka, what is the nature of that said impact?
2. How to identify financially distressed companies among listed financial institutions in Sri Lanka?
3. What corporate governance factors are influencing the financial distress of these listed financial institutions, and what kind of significance do they hold?

## Research Objectives

The corresponding research objectives that were derived based on the above research questions can be listed below,

1. To establish whether corporate governance has an impact on the financial distress of listed financial institutions of Sri Lanka. And to establish the nature of the said impact.
2. To establish a criterion to identify financially distressed companies among listed financial institutions in Sri Lanka.
3. To identify different corporate governance factors that influence financial distress. And to identify whether some of these corporate governance factors are more significant regarding this impact and if so, identify those so-called significant corporate governance factors.

An in-depth exploration of the above research questions and objectives is expected to enhance the significance and contribution of this study to this particular topic.

This paper is structured as reviving of the literature in the second section followed by the conceptual framework, hypothesis development, variable operationalization, and research methodology, section four discusses on the data analysis and the last section presents the results and discussions and ends with the conclusion chapter.

## Literature Review

This Literature review section aims to review past literature to identify and discuss the fundamental concepts of the research, analyzing their significance and the relationships explored in prior studies. It also provides insight into the theoretical background and relevant codes and guidelines.

### Fundamental Concepts

Starting with the two main concepts that act as the foundations of corporate governance and financial distress. Prior literature has studied these concepts both individually as well as

incorporating them together. The below two sub-sections will discuss the two main concepts separately.

**Corporate Governance**

"The system by which companies are directed and controlled" (Cadbury, 1992)

It is based on the concepts of ownership and control, with the Cadbury report being a significant piece of literature in this field. Good corporate governance aims to add value to organizations and ensure that resources are managed for profitability and efficiency.

Corporate governance can be categorized into external or institutional governance when imposed by an outside legal system, and internal or contractual governance when voluntarily adopted by the organization. In Sri Lanka, the concept of corporate governance emerged in 1977 with the country's open economic policy, which privatized state-owned enterprises and emphasized the need for a robust governance system. The development of corporate governance practices began in 1997 with the introduction of a voluntary code of best practice by the Institute of Chartered Accountants.

Significant developments in Sri Lanka's corporate governance include the introduction of the Code of Best Practice on Corporate Governance, which outlines voluntary and mandatory rules for listed companies, and the Banking Act Direction, a mandatory code for licensed commercial banks to strengthen risk management. Both codes have been revised to align with evolving business trends.

The next subsection will focus on the concept of financial distress.

**Financial Distress**

The second foundational concept is financial distress, and it is defined as,

"When a firm's business deteriorates to the point where it cannot meet its financial obligations" (Carliss & Scott, 1983, p. 1).

Financial distress is the state in which a firm is unable to meet its financial obligations and can be seen as the late stage of corporate decline. Direct costs of financial distress include liquidation expenses, while indirect costs arise from penalties imposed by suppliers, customers, and capital providers, as well as losses relating to customers, competitors, and employees. Poor management is often cited as a cause of financial distress, emphasizing the importance of effective governance in mitigating this risk.

Various financial distress prediction models have been developed, such as Beaver's Univariate Model, Altman's Z-Score model, and Ohlson's O-Score Model. In the context of Sri Lanka, Altman's Z-Score model has been found to be valid for predicting financial distress. However, it is worth noting that the Altman Z-Score model may be less effective in predicting financial distress in banking and financial organizations.

Empirical studies have explored the relationship between corporate governance and financial distress. The next section will discuss the findings and conclusions of these studies.

**Exploring prior empirical studies**

A catalogue of literature that questioned the impact and the effect of corporate governance practices on financial distress can be found. Each of these studies within this catalogue has focused on different governance factors in various industries in various countries in evaluating the relationship and the impact between these two variables.

Tahir et al. (2018) examined the impact of corporate governance factors such as the board size, CEO's duality, board independence, insider's directorship, no. of board meetings, audit quality, managerial ownership, financial institutions ownership, ownership by investment companies on financial distress in non-financial firms in Pakistan. The results of this study have concluded that board size, insider director's ownership, audit quality, managerial ownership, financial institutions ownership, investment companies' ownership, and firms' profitability have a significant negative impact on the likely hood of financial distress. In contrast, the CEO's duality, board independence, frequency of board meetings and the control variables considered financial constraints and financial leverage proved to have a positive and significant impact on the probability of financial distress. Freitas, Peixoto & Barboza (2019) has also conducted a research that analyzed the relationship between board structure and financial distress with a sample of Brazilian-listed non-financial firms to identify the best model to predict financial distress. The results of this study have presented some conflicting findings. The results of this study have concluded that A U-shaped (non-linear) relationship exists between the size of the board of directors and financial distress. And the author also discovered that board characteristics related to composition and director's independence are insufficient to align the shareholder's interests and unsuitable for avoiding or even reducing financial distress in firms when other factors are neglected. This is directly in contrast with the findings of the research carried out by Tahir et al. (2018), where the results of that research project concluded that board independence had a significant positive relationship with financial distress and that board size has a linear negative relationship. Again, similarly Ahmad & Adhariani (2017) have tested the impact of the nature of ownership (family or institutional), the proportion of independent directors, and the sizes of the audit committee, board of directors, and board of commissioners which are all corporate governance factors on the significance of mitigating financial distress. This study has focused only on non-financial companies in Indonesia. The results of this study have concluded that family ownership, the size of the board of directors, the size of the board of commissioners, and the size of the audit committee have significant roles in preventing companies from experiencing financial distress. In contrast, institutional ownership and the proportion of independent directors were found to have no effect. And similarly, Werner et al. (2018) have also conducted a research that focused on the relationship between financial distress and corporate governance variables board size and audit opinion. The data for this research have been extracted from a sample of 337 Indonesian companies. And it concluded that there is a negative relationship between board size and financial distress, but audit opinion has a significant positive impact on financial distress. The findings of these two researches Ahmad & Adhariani (2017) and Werner et al. (2018) also give similar results to the conclusions of Tahir et al. (2018) relating to the size of the board of directors, but contradictory results relating to board independence since Ahmad & Adhariani (2017) concluded that board independence has no any effect on financial distress while Tahir et al. (2018) concluded that board independence has a significant positive impact on financial distress. Adding on to the variable of board independence a research study done by Mariano et al. (2021) concluded that within the United Kingdom context low degree of board independence increases the probability of financial distress or in other words that board independence has a significant negative impact on financial distress. When comparing the findings relating to board independence, one might come to the conclusion that the reason for the conflicting results between these findings might be caused by the economic status of the country in which the study was done since Mariano et al. (2021) have carried out their research in U.K which is a country that is considered to have a developed economy while Tahir et al. (2018) has carried out his research in Pakistan which is a country that is supposed to have a developing economy. This is just a surface-level observation, and

in order to determine the accuracy of this conclusion, research findings in countries with similar economic statuses must be compared.

So, to satisfy the above requirement going through a similar study in the Sri Lankan context that has been carried out by Sameera & Senaratne (2015) was considered. This study has examined the corporate governance structures of financially distressed companies and investigated whether that structure has consequently affected the firm's financial distress and its resolution in the Sri Lankan public listed companies. And it has concluded that individual governance variables that were considered board structure, director's remuneration procedure and audit committee procedure have a negative but insignificant impact on the financial distress of the firm. The findings of the study relating to the individual variables of board structure audit committee procedure are conflicting with the results of the research carried out by Tahir et al. (2018), which concluded that the variables in the board structure (board size, CEO's duality, board independence, insider's directorship, no. of board meetings) and audit procedure (audit quality) had a significant impact on financial distress. Similarly going through another study that has considered the impact of board configuration on financial distress in listed manufacturing firms in Sri Lanka has been carried out by Dissanayke et al. (2017) has concluded that only the CEO duality and board size have a significant negative impact on financial distress and other corporate governance factors namely board activity and board independence only showed an insignificant positive impact on financial distress. This study supports the findings of the study carried out by Ahmad & Adhariani (2017) in relating to board independence but gives conflicting results about CEO duality and board size with the findings of the research carried out by Tahir et al. (2018), which proposed that these two variables have a significant positive impact on financial distress. So going by the results of (Sameera & Senaratne, 2015; Tahir, et al., 2018; Dissanayke, et al., 2017), it is important to note, the previous notion which stated that different economic situation might be the sole reason for some researches to have conflicting results regarding the relationship between different corporate governance variables and financial distress might not necessarily be accurate and some other factors that are unique to that population the sample was extracted might have influenced those outcomes. So, expecting research done in a similar economic context to give similar results is not practical, and further research must be done to find these other influencing factors in order to solidify the findings of research done in each economic context. Further, it is essential to see whether the industry where the research was done impacted the outcome of the findings in any way. So, focusing on a research which was carried out solely concentrating on the finance sector, Nizar, Frédéric, Gautier & Habib (2016) carried out a research testing the relationship between corporate governance and financial distress in European commercial banks. And as a result, they have concluded that the division of the function of CEO and chairman had led to a more efficient board reducing the risk of financial distress due to the fact that they are given a larger supervision ability. This conflicts with the finding that CEO duality has a positive impact on financial distress (Tahir, et al., 2018). Yet again, this proves that the context and the industry vary the impact of corporate governance have on financial distress. A thing to note is that the above studies have left out some of the other important corporate governance variables, such as diversity, ownership structure and board member remuneration. So, the below paragraphs will discuss the impact of those particular corporate governance variables on financial distress.

Yousaf, Jebran & Wang (2021) carried out research that was solely focused on the impact of board diversity and whether it can predict the risk of financial distress. The previous studies which were analyzed have not considered board diversity as a corporate governance factor. This study has used Chinese A-listed companies as its sample. And they have considered board diversity dimensions of gender, age, education and expertise. The results concluded that

board diversity attributes have a significant negative relationship, and it can significantly predict the financial distress of the firm. Similarly, Guanping (2019), who carried out a research that had a sole focus on the effect of board gender diversification on financial distress in China, has identified through his research that organizations with women directors will decrease their risk of financial distress by one forth and that female board members behaviour on investment had influenced the insolvency in a significant manner and has concluded that in fact, board gender diversification has a negative impact on financial distress. This is on par with the findings presented by Yousaf et al. (2021). With these results, it seems that gender diversification has a considerable negative impact on financial distress. And another study was done by (Santen & Donker, 2009), which considered organizations in the Netherlands have come to the conclusion that there is no relationship between financial distress and the gender diversification of the board members. Here it is important to note that both studies (Yousaf, et al., 2021; Guanping, 2019) have been done in China while (Santen & Donker, 2009) have done their research in the Netherlands, which has different cultural backgrounds and it has given conflicting results. It is a known fact that how both genders act and their roles are heavily influenced by the cultural background they reside. This might be the reason for these conflicting results. But to confirm this speculation, further studying of these variables within different cultural backgrounds is required. Another important board diversity factor that needs to be considered is the education level of the board. As mentioned previously, Yousaf, Jebran & Wang (2021) have, in fact, tested the relationship between board education and expertise level against financial distress and have concluded that a negative relationship does exist between these two variables in Chinese A-listed companies. And a study done by Iskandar, Noor & Omar (2012) has concluded that the financial distress of Malaysian listed companies is also negatively related to board members' education and financial literacy. Though this finding may seem expected, it is important to note that in the same study done by Iskandar, Noor & Omar (2012) have also concluded that even though the members of the board have low financial literacy, if they are actively involved in the company operations, they are capable of mitigating and overcoming financial distress situations. So, this suggests that a highly educated board may not necessarily be a mandatory requirement to avoid and overcome financial distress, nor a guarantee that it will avoid financial distress since only active participation of the board members in a company might be enough to avoid financial distress. Further research is required to identify the truthfulness of this notion.

The impact of board members' remuneration and compensation on financial distress is also highlighted by some of the previous studies. A study conducted by Sourour & Amal (2021) by collecting data from Singapore-listed companies has concluded that excess remuneration will lead organizations to financial distress situations. Similarly, Elloumi & Gueyié (2001), who carried out the same research in the Canadian context two decades prior, also concluded board composition does in fact can be used to explain financial distress. The findings of these two articles are as expected since it is common for almost all the organizations that went bankrupt or who are at the risk of being financially distressed to have questionable payouts for the board of directors that made things worse. See, for example (Pendleton, 2022). The securities exchange commission of Sri Lanka has taken some steps to prevent listed entities from falling into financial distress due to the overcompensation of board members by mandating new rules relating to the remunerations committee for listed entities in CSE in 2021 ( Securities and Exchange Commission of Sri, 2021). But the effectiveness of these mandated rules still has not been tested. And despite the findings of the above-mentioned studies, the findings of a research done by Mariano et al. (2021) express the notion that larger and better remuneration will reduce the likely hood of financial distress. This notion is further complemented by the findings of another research done by Lemma et al. (2022), which also states that organizations that provide higher or even excessive remuneration to the board have

superior financial performances, so firms can use board remuneration as a governance tool induce board effectiveness and reduce financial distress. Both studies allude to the fact that remuneration is a good tool to solve agency problem and align stakeholder interests. Mariano et al. (2021) express that if board members are not compensated properly, they will allude to fraud which significantly increases the risk of an organization being financially distressed in the future.So, it is important to identify whether board remuneration and compensation is a significant corporate governance factor that influences the financial distress in the Sri Lankan context.

The below table summarizes the various corporate governance variables that were discussed above in this section which have been undertaken by different researchers to investigate and explore the relationship with financial distress subjected to different countries and industries.

**Table I: Summary of Empirical Studies**

| Article citation | Country | Variables |
|---|---|---|
| (Tahir, et al., 2018) | Pakistan | • Board size<br>• CEO's duality<br>• Board independence<br>• Insider's directorship<br>• No. Of board meetings<br>• Audit quality<br>• Managerial ownership<br>• Financial institutions ownership<br>• Ownership by investment companies |
| (Freitas Cardoso, et al., 2019) | Brazil | • Board structure |
| (Ahmad & Adhariani, 2017) | Indonesia | • Nature of ownership<br>• The proportion of independent directors<br>• Sizes of the audit committee<br>• Size of the board of directors<br>• Size of the board of commissioners |
| (Werner, et al., 2018) | Indonesia | • Board size<br>• Audit opinion and quality |

| | | |
|---|---|---|
| (Sameera & Senaratne, 2015) | Sri Lanka | • Board structure<br>• Director's remuneration<br>• Audit committee procedure and audit quality |
| (Dissanayke, et al., 2017) | Sri Lanka | • CEO duality<br>• Board size |
| (Nizar, et al., 2016) | Europe continent | • CEO duality |
| (Yousaf, et al., 2021) | China | • Board gender<br>• Board age<br>• Board Education |
| (Guanping, 2019) | China | • Board gender |
| (Santen & Donker, 2009) | Netherlands | • Board gender |
| (Sourour & Amal, 2021) | Singapore | • Director's remuneration |
| (Elloumi & Gueyié, 2001) | Canada | • Director's remuneration |
| (Iskandar, et al., 2012) | Malaysia | • Board Education |
| (Mariano, et al., 2021) | UK | • Board independence<br>• Board remuneration<br>• Board size |
| (Lemma, et al., 2022) | South Africa | • Board remuneration |

*Source: Author constructed*

As much as it is important to analyze the prior empirical studies, it is also important to explore the codes and guidelines that supplement the research. So, the next section will establish the codes and guidelines background of the study.

Codes and guidelines

The "Code of Best Practice on Corporate Governance 2017" issued by the Institute of Chartered Accountants is a prominent set of guidelines for corporate governance in Sri Lanka. It succeeds the 2013 version and incorporates global developments relevant to the country. The code covers various aspects such as board composition, meetings, and member roles, applicable across industries without specific industry specifications. For licensed finance companies, the Central Bank of Sri Lanka issued "Finance Business Act Directions No.05 of 2021," effective from 01.07.2022, providing more contextually relevant guidelines. The directions stress the need for qualified, skilled, and experienced senior management to achieve strategic objectives. They recommend a board size between six to thirteen members, with at least 1/3 being independent. Additionally, the board is advised to hold at least twelve meetings per financial year. These directives hold particular significance for the study focused on Sri Lankan licensed finance companies.

The literature review section provides a comprehensive overview of the main concepts, empirical studies, theories, and codes and guidelines relevant to the research project. It focuses on the impact of corporate governance variables on financial distress, highlighting that previous studies have produced varying findings in terms of nature and significance. These differences could be attributed to factors such as industry, region, or unidentified variables. Therefore, conducting similar research within the context of Sri Lankan listed finance institutes is necessary to address these gaps.

The literature review identifies several knowledge gaps, such as the exclusion of variables like board gender diversification, frequency of board meetings, board member remuneration, and education level of the board in previous Sri Lankan studies. Incorporating these variables will help close existing knowledge gaps. Additionally, the importance of introducing control variables is recognized, as highlighted by weaknesses in prior research.

Furthermore, the review points out the limited number of studies conducted solely within the finance sector and specifically in Sri Lanka after the introduction of the new code of best practice on corporate governance in 2017. The study's findings can serve as a benchmark for evaluating the effectiveness of the directives recommended by the "Business Act Directions No.05 of 2021" in preventing financial distress in licensed finance institutions. Expanding knowledge on the impact of corporate governance practices on financial distress in the context of Sri Lankan listed financial institutions is crucial for mitigating adverse effects on the country's overall economy.

Summary

The literature review comprehensively explored prior research on corporate governance and financial distress, revealing conflicting findings across studies due to variations in industry, region, and potential unknown variables. It identified crucial knowledge gaps in the Sri Lankan context, specifically the lack of research on board diversity, meeting frequency, board member remuneration, and education level, as well as the missing consideration of control variables in some studies. Additionally, limited research exists on the impact of corporate governance post-2017 code and Business Act No. 05 of 2021 within the Sri Lankan finance sector. Recognizing these gaps and their potential impact on the overall economy, the research aims to expand knowledge in this specific context, potentially closing knowledge gaps,

isolating the true impact of governance on financial distress, and evaluating the effectiveness of recent regulations, ultimately contributing to mitigating financial distress and its broader economic consequences.

The next chapter will discuss the research methods that will be used to address the gaps in the literature and to answer the research question: What is the impact of corporate governance on financial distress among listed financial institutions in Sri Lanka?

## Research Methods

This section illustrates the impact the selected corporate governance variables have on financial distress through the conceptual framework of the study, and it is accompanied by the hypothesis development, which is based on prior research findings. In addition to that, this section also focuses on the sample selection as well as the data collection of the selected sample and finally the operationalization of the selected variables.

## Conceptual Framework

The following independent and dependent, as well as control variables, were identified based on the theory and prior literature, which was analyzed in the literature review section.

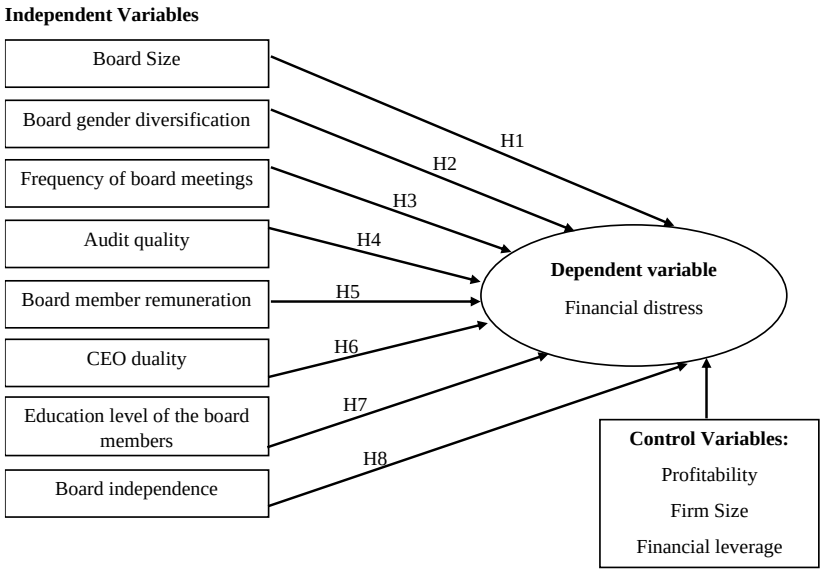


**Figure I: Conceptual Framework of the Study**

### Development of Hypothesis

The hypothesis development process relies on prior literature, identifying the supposed impact of variables on financial distress. If literature findings agree, the same impact is hypothesized for Sri Lankan financial institutions. If there are contradictions, the presence of an impact is hypothesized without specifying its nature.

**Table II: Hypothesis Development**

| Governance factor | Related article | | Hypothesis |
|---|---|---|---|
| | Positive relationship | Negative relationship | |
| Board size<br>H1 | - | (Tahir, et al., 2018)<br>(Dissanayke, et al., 2017)<br>(Sameera & Senaratne, 2015)<br>(Werner, et al., 2018)<br>(Ahmad & Adhariani, 2017) | H1. Board size has a significant negative impact on financial distress. |
| Board gender diversification<br>H2 | - | (Guanping, 2019)<br>(Yousaf, et al., 2021) | H2. Board gender diversification has a significant negative impact on financial distress. |
| Frequency of board meetings<br>H3 | (Tahir, et al., 2018) | | H3. The frequency of board meetings has a significant positive impact on financial distress. |
| Audit quality<br>H4 | | (Tahir, et al., 2018)<br>(Werner, et al., 2018) | H4. Audit quality has a significant negative impact on financial distress. |
| Board member remuneration<br>H5 | (Hazami-Ammar & Gafsi, 2021)<br>(Elloumi & Gueyié, 2001)<br>(Sourour & Amal, 2021) | (Mariano, et al., 2021)<br>(Lemma, et al., 2022) | H5. Board member remuneration has a significant impact on financial distress. |
| C.E.O duality<br>H6 | (Tahir, et al., 2018) | (Dissanayke, et al., 2017)<br>(Nizar, et al., 2016) | H6. C.E.O duality has a significant impact on financial distress. |
| Education level of the board<br>H7 | | (Yousaf, et al., 2021)<br>(Iskandar, et al., 2012) | H7. The education level of the board has a significant negative impact on financial distress. |

| | | | |
|---|---|---|---|
| Board independence<br><br>H8 | (Tahir, et al., 2018) | (Mariano, et al., 2021) | H8. Board independence has a significant impact on financial distress. |

*Source: Author Constructed*

**Sample Selection**

When considering the Sri Lankan financial institutions which had the most notable and impactful cases of financial distress in the past two decades, it either included a licensed commercial bank (Seylan bank), a licensed specialized bank (Pramuka savings and Development Bank) or a licensed finance company (ETI finance). Due to this case, since these three types of authorized institutions had the most impact on the financial system of the country by being financially distressed in the recent past, only these three types (licensed commercial banks- 24, licensed specialized banks- 6, licensed finance companies- 39) will be considered as the target population.

With that target population, a sample of 54 firms which includes both financially distressed and non-distressed firms, will be considered based on simple random sampling method. The list of organizations selected as the sample of the study is depicted in annexure no 01.

**Data Collection and Sources of Data**

Data from the entities within the sample will be extracted for five years from the financial year of 2017/2018 to 2021/2022. This period was mainly selected due to the fact that the new code of best practices on corporate governance was introduced in 2017, which caused some reforms in corporate governance practices within the country. The data collection will be done through secondary data sources such as company annual reports, the Colombo stock exchange website, Sri Lankan central bank website and LinkedIn profiles.

**Operationalization of Variables**

**Table III: Operationalization of Variables**

| Variable | Operationalization |
|---|---|
| Dependent variable<br>Firm financial distress | 0 = Firm is not financially distressed<br>1 = Frim is financially distressed |
| Independent variables | |
| 1. Board size | Natural logarithm of the number of directors |
| 2. Board gender diversification | The ratio of female directors to the total number of directors. |
| 3. Audit quality | 0 = Audit is not carried out by one of the big four firms,<br>1 = Audit is carried out by one of the big four firms |
| 4. Frequency of board meetings | Natural logarithm of the number of board meetings per annum |

| | |
|---|---|
| 5. Board member remuneration | Natural logarithm of the number of board member remuneration value |
| 6. CEO duality | 0 = Chairman and CEO roles are combined<br>1 = Chairman and CEO roles are separated |
| 7. Education level of the board | 0 = Board members do not possess any higher academic or professional education qualifications<br>1 = Board members possess higher academic or professional education qualifications |
| 8. Board independence | Natural logarithm of the number of independent directors within the board of directors. |
| Control variables | |
| 1. Profitability | Net earnings/equity (Return on equity) |
| 2. Firm Size | Natural logarithm of total assets |
| 3. Financial leverage | Liabilities/Total Assets |

*Source: Author Constructed*

The study refers to prior literature that used the Altman Z-score model to differentiate financially distressed and non-distressed firms. However, due to the model's limitations within the banking sector, an alternative model suggested by Balagobei & Keerthana (2022) was used.

Financial distress was defined based on negative profit, cash flow, or worth for three years or more. For regression analysis, binary logistic regression was employed to predict the relationship between predictors and the binary dependent variable, financial distress.

## Findings and Discussion

The analysis chapter presents the main analysis tests conducted in the study and their interpretations. It begins with descriptive analysis, followed by a comparison of means and observations between distressed and non-distressed firms, testing the effectiveness of new recommendations. The chapter concludes with regression analysis. Outliers in the dataset were removed before the analysis, confirmed by boxplot graphs in annexure no. 02.

Descriptive Analysis

Table no.04 depicts the descriptive analysis of fifty-four organizations expanding over five years from 2017 to 2022. Out of the fifty-four organizations, twenty-three organizations were recognized as financially distressed, whereas the rest was recognized as not being in any financially distressed situations. For this analysis, data extracted for the variables of firm size and board member remuneration was converted into log form from its raw data form to enable better comparisons among different financial entities.

**Table IV: Descriptive Statistics**

| Variable | Mean | Maximum | Minimum | Std. Deviation | Skewness | Kurtosis |
|---|---|---|---|---|---|---|
| FD | 0.417625 | 1.000000 | 0.000000 | 0.494115 | 0.334067 | 2.811601 |
| BS | 8.509579 | 14.00000 | 4.000000 | 2.245841 | 0.315404 | 2.626817 |
| BGD | 0.173272 | 0.400000 | 0.000000 | 0.157081 | 0.298990 | 2.681724 |
| FBM | 13.99617 | 28.00000 | 7.000000 | 3.835560 | 0.540943 | 3.231167 |
| HAQ | 0.593870 | 1.000000 | 0.000000 | 0.492053 | -0.382276 | 2.546135 |
| BMR | 16.44286 | 19.37631 | 13.78195 | 1.247649 | 0.169679 | 2.752003 |
| CD | 0.800766 | 1.000000 | 0.000000 | 0.400192 | -0.506000 | 3.268035 |
| EL | 0.739464 | 1.000000 | 0.000000 | 0.439771 | -0.091131 | 2.905678 |
| BI | 0.363317 | 0.675000 | 0.071429 | 0.192375 | 0.714291 | 2.931460 |
| ROE | 0.074241 | 0.261000 | -0.176000 | 0.103053 | -0.460820 | 2.648878 |
| FS | 24.58082 | 28.96689 | 20.74064 | 1.807595 | 0.308318 | 2.556257 |
| FL | 0.067334 | 0.102000 | 0.022000 | 0.016787 | -0.076666 | 2.667194 |

*Source: Author Constructed*

Note: Table 01 shows descriptive statistics for 1) Financial distress (FD) 2) Board size (BS 3) Board gender diversification (BGD) 4) Frequency of board meetings (FBM) 5) Higher audit quality (HAQ) 6)Board member remuneration (BMR) 7) C.E.O duality (CD) 8) Education level of the board (EL) 9) Board independence (BI) 10) Return on equity (ROE) 11) Firm size (FS) 12) Financial leverage (FL)

**Table V: Variance inflation factor analysis**

| Variable | Coefficient Variance | Uncentered VIF | Centered VIF |
|---|---|---|---|
| BGD | 59.23764 | 3.043493 | 1.904391 |
| BI | 78.85091 | 62.23108 | 6.903373 |
| BMR | 0.640813 | 973.6884 | 3.023410 |
| BS | 14.75859 | 393.8572 | 8.334664 |
| CD | 6.574801 | 27.48053 | 6.958755 |
| ELB | 4.670023 | 18.97913 | 5.198124 |
| FL | 2302.868 | 66.21771 | 2.941562 |
| FS | 1.115974 | 3715.407 | 6.167767 |
| FB | 12.87552 | 461.1079 | 1.770998 |
| HQ | 5.778942 | 21.77378 | 7.116053 |
| ROE | 32.21094 | 2.516923 | 1.715596 |
| C | 802.1992 | 4489.882 | NA |

*Source: Author Constructed*

Test results indicate that none of the variables can be identified as having multicollinearity since the centered VIF value of all variables was less than 10. As the next step of the descriptive analysis process, a comparison was made on variable mean values and observations of distressed and non-distressed organizations.

Mean and observation comparison test for distressed and non-distressed companies.

Table 06. depicts the mean values for variables that are expressed in ratio format (BGD, FBM, BI, ROE, FL) as well as the number and natural log value format (BS, BMR, FS). For dummy variables (HAQ, CD, EL), the number of observations is expressed within the table. The table was developed based on the "equality test of means".

**Table VI: Mean and observation comparison - Equality test of means**

| Variables | Non-distressed entities | | Distressed entities | | Difference |
|---|---|---|---|---|---|
| | Mean | Observations | Mean | Observations | |
| Ratios and natural numbers | | | | | |
| BS (number) | 10.5 | - | 05.2 | - | 05.30 |
| BGD | 00.28 | - | 0.03 | - | 00.25 |
| FBM (number) | 16.3 | - | 10.8 | - | 05.50 |
| BMR (ln) | 16.6 | - | 16.4 | - | 00.20 |
| BI | 00.48 | - | 00.27 | - | 00.21 |
| Dummy variables | | | | | |
| HAQ | | | | | |
| 0 | - | 23 | - | 103 | -80 |
| 1 | - | 129 | - | 06 | 123 |
| CD | | | | | |
| 0 | - | 18 | - | 12 | 06 |
| 1 | - | 134 | - | 97 | 37 |
| EL | | | | | |
| 0 | - | 10 | - | 58 | -48 |
| 1 | - | 142 | - | 51 | 91 |
| Control Variables | | | | | |
| ROE | 0.115 | - | 0.02 | - | 00.095 |
| FS(ln) | 25.4 | - | 23.37 | - | 02.030 |
| FL | 0.066 | - | 0.068 | - | -00.002 |

*Source: Author Constructed*

The analysis results in Table No. 06 reveal differences between financially distressed and non-distressed firms.

Non-distressed firms generally have larger board sizes (11 members) compared to distressed firms (5 members). Board gender diversification is higher in non-distressed firms (28%) compared to distressed firms (3%). Non-distressed firms hold more board meetings (around 16 per fiscal year) than distressed firms (around 10-11 meetings). Board member remuneration shows a minor difference between both types of firms. Board independence is higher in non-distressed firms (48%) than distressed firms (27%), supporting a recommendation for at least 33.33% independence.

Dummy variables highlight that non-distressed firms are more likely to be audited by one of the big four firms and have separate C.E.O and chairman positions. Furthermore, non-

distressed firms more frequently possess higher education qualifications among board members, reinforcing a recommendation for strategic objectives. Control variables show significantly higher return on equity (11.5%) in non-distressed firms compared to distressed firms (2%). Although non-distressed firms have slightly larger firm size (ln 25.4) than distressed firms (ln 23.37), the difference is small. Similarly, financial leverage is slightly higher in distressed firms (6.8%) compared to non-distressed firms (6.6%).

The appropriate dataset and differences between variables justify moving on to the next step: Binary Logistic Regression Analysis.

Binary Logistic Regression Analysis

The regression output results are based on the below econometric model,

$$FD = \beta_{0+} \beta_1(BS)_{it} + \beta_2(BGD)_{it} + \beta_3(HAQ)_{it} + \beta_4(FBM)_{it} + \beta_5(BMR)_{it} + \beta_6(CD)_{it} + \beta_7(ELB)_{it} + \beta_8(BI) + \beta_9 ROE + \beta_{10} FS + \beta_{10} FL + e_{it.}$$

And due to the categorical nature of the dependent variable financial distress (FD), the binary logistic regression analysis was adopted. To test the goodness of fit of the model Hosmer and Lemeshow test was incorporated, and these test results are depicted in table No 07 alongside the binary logistic regression output.

**Table VII: Binary Logistic Regression Analysis and Hosmer and Lemeshow test**

| Variable | Coefficient | Std. Error | z-Statistic | Prob. |
|---|---|---|---|---|
| Regression | | | | |
| Corporate governance variables | | | | |
| BS | -7.662312 | 3.841691 | -2.000315 | 0.0455 |
| BGD | -9.38475 | 3.561408 | -2.551451 | 0.0107 |
| FBM | -12.401745 | 4.347430 | -2.852661 | 0.0043 |
| HAQ | -2.661443 | 2.375542 | -2.197962 | 0.0280 |
| BMR | -1.273310 | 1.058102 | -1.203391 | 0.2288 |
| CD | -0.687551 | 1.633438 | -0.420923 | 0.6738 |
| ELB | -5.14223 | 2.530984 | -2.031712 | 0.0422 |
| BI | -19.08399 | 7.971469 | -2.394037 | 0.0166 |
| Control variables | | | | |
| ROE | -7.39465 | 5.675469 | -2.248491 | 0.0245 |
| FS | -0.885367 | 0.835556 | -1.059614 | 0.2893 |
| FL | +136.7677 | 60.82647 | 0.882015 | 0.3778 |
| C | +94.43110 | 31.75247 | 2.973976 | 0.0029 |
| Regression cont.…. | | | | |
| McFadden R-squared | 0.795322 | | | |
| Log-likelihood | -18.56505 | | | |
| LR statistic | 317.576 | | | |

| | | | | |
|---|---|---|---|---|
| Prob(LR statistic) | 0.000000 | | | |
| | | | | Observations |
| Obs with Dep=0 | 152 | Total obs | | 261 |
| Obs with Dep=1 | 109 | | | |
| | | | | |
| Hosmer and Lemeshow test | | | | |
| $H_0$ – Specified model is correct and a good fit<br>H1 – Specified model is incomplete and not a good fit Source: (Graphpad, 2022) | | | | |
| H-L Statistic | 0.8108 | | Prob. Chi-Sq(8) | 0.9992 |

*Source: Author Constructed*

First, considering the results of the Hosmer and Lemeshow test, which measures the goodness-of-fit of logistic models, it can be concluded that this model is a good fit to the data since the null hypothesis (H0) will be accepted as the Prob. Chi-Sq value is higher than 0.05. And considering the McFadden R-squared, which is a pseudo-R-squared measurement developed by (McFadden, 1974), it can be stated that the independent variable can explain 79.5% of the prediction of the dependent variable.

Concerning the results of the regression analysis, the following conclusion can be made regarding the hypothesis which was developed within the methodology chapter. The coefficient value of the first variable, board size (BS), indicates that it has a negative impact on financial distress. This is on par with the H1 of the study, which states that ***board size has a significant negative impact on financial distress,*** which was built based on the findings of prior researchers such as (Tahir, et al., 2018; Dissanayke, et al., 2017; Sameera & Senaratne, 2015; Werner, et al., 2018). The results also indicate a p-value of 0.0455, making it statistically significant and which makes the acceptance of the hypothesis (H1) of the study appropriate. All these previous studies have been carried out surrounding the non-financial sector. So, this suggests that same, as non-finance institutes, the financial institutes with a higher number of board members are less likely to be financially distressed than finance institutes with a low number of members. The second variable of the regression analysis, board gender diversification (BGD), indicates it has a negative impact on financial distress. Yet again, this is in line with the second hypothesis of the study that was based upon previous studies done by (Guanping, 2019; Yousaf, et al., 2021), which state that ***board gender diversification has a significant negative impact on financial distress.*** The p-value associated with this variable in terms of this analysis is 0.0107, yet again making this finding statistically significant and making the second hypothesis (H2) of the study valid and appropriate to accept. Both studies on which the hypothesis was based have been carried out surrounding non-financial entities. So, it can be concluded that same as non-financial institutes, finance institutes with a higher level of gender diversification are at a lower risk of being financially distressed. The third variable, the frequency of board meetings (FBM) coefficient value, also indicates that it has a negative impact on financial distress. But on the contrary, the third hypothesis that was built around the same variable frequency of board meetings (FBM) which was based on the findings of (Tahir, et al., 2018) states that ***the frequency of board meetings has a significant positive impact on financial distress.*** The P-value related to this variable is 0.0280, which indicates that this finding is statistically significant, and thus, the third hypothesis (H3) of the study needs to be rejected. The third hypothesis (H3) was developed based on studies that were done surrounding the non-financial

industry. So, in conclusion, it can be stated that a higher number of board meetings within financial institutes will play a part in reducing the risk of financial distress, which contrasts with the non-financial institute's situation where a higher number of board meetings increases the risk of financial distress. Higher audit quality is the fourth variable of the regression analysis and based on the coefficient value, it has also proven to have a negative impact on financial distress. Which is on par with the fourth hypothesis (H4) of the study that ***audit quality has a significant negative impact on financial distress,*** which was built based on the findings of (Tahir, et al., 2018; Werner, et al., 2018). The p-value partnering to this variable is calculated to be 0.0280 making this variable statistically significant as well. This means that the fourth hypothesis (H4) of the study should be considered valid and should be accepted. So, same as a non-financial institute, if a finance institute is being audited by one of the big four firms, the likelihood of that institute being financially distressed is less than an institute that is being audited by a professional organization other than the big four firms. The fifth variable of the regression analysis is the board member remuneration (BMR), which the regression analysis depicts that it has a negative impact on financial distress. The hypothesis developed for this variable (H5) was based on the findings of (Hazami-Ammar & Gafsi, 2021; Elloumi & Gueyié, 2001; Sourour & Amal, 2021), which stated that board member remuneration (BMR) has a significant positive impact on financial distress and findings of (Mariano, et al., 2021; Lemma, et al., 2022), which stated that board member remuneration (BMR) has a significant negative impact on financial distress. Due to these conflicting findings, it was hypnotized that ***(H5) board member remuneration has a significant impact on financial distress.*** The previous comparative analysis showcased the difference in the average remuneration of board members to be very low between distressed and non-distressed firms. So in a similar fashion, the regression analysis showcases the p-value related to board remuneration as 0.2288, which makes this variable statistically insignificant within this model at a confidence interval of 0.95. So, the fifth hypothesis (H5) of the study is rejected. And it can be concluded that board member remuneration is not a significant corporate governance factor in determining financial distress. C.E.O duality (CD) is the sixth variable of the regression analysis, and its coefficient value indicates that it has a negative impact on financial distress. The previous research has given some conflicting findings in terms of C.E.O duality. So the sixth hypothesis (H6) was developed as ***C.E.O duality has a significant impact on financial distress*** based on the conflicting findings of (Tahir, et al., 2018), which indicated a positive impact and the findings of (Dissanayke, et al., 2017; Nizar, et al., 2016) which indicated a negative impact. Though the coefficient value indicates a negative impact, the p-value related to this variable is 0.6738, which makes this variable statistically insignificant at a confidence interval of 0.95. So, the sixth hypothesis (H6) of the study will be rejected. Referring back to the comparative analysis, it also indicated that the majority of both distressed and non-distressed have incorporated C.E.O duality into their corporate governance structure and that there wasn't any major difference between distressed and non-distress related to this variable. Based on all of this evidence, it can conclude that C.E.O duality is not a significant corporate governance factor in preventing financial distress. The seventh variable of the regression is the education level of the board. Here the coefficient value calculated also indicates a negative impact on financial distress. This is accompanied by a p-value of 0.0422, which means that the seventh hypothesis (H7) of the study ***education level of the board has a significant negative impact on financial distress*** that is based on the findings of (Yousaf, et al., 2021; Iskandar, et al., 2012) is consistent with the findings of the regression analysis and the variable is statistically significant within this model. So the seventh hypothesis (H7) of the study will be accepted. This proves that the board members' education level is a significant corporate governance factor in preventing financial distress, even though Noor & Omar (2012) stated in the same research that even if the board have low financial literacy, if

they are actively involved in the company operations, they are capable of mitigating and overcoming financial distress situations. So, it can be concluded that having a board with a majority of members (at least 80%) who has a higher education qualification relating to banking or finance will reduce the likelihood of financial distress in Sri Lankan-listed financial institutes. The eighth and final corporate governance variable of the regression analysis is board independence (BI). The coefficient value of board independence points towards board independence having a negative impact on financial distress. The P-value associated with this variable is 0.0166, which makes the finding of this variable statistically significant. So, this favours the acceptance of the eighth hypothesis (H8), which states that ***board independence has a significant impact on financial distress*** which was based on the conflicting findings of (Tahir, et al., 2018) and (Mariano, et al., 2021)**.** This means that the finding of (Tahir, et al., 2018), which concluded that board independence has a significant positive impact on financial distress, does not apply to the Sri Lankan context, and the finding of (Mariano, et al., 2021) which concluded that board independence has a significant negative impact on financial distress applies to Sri Lankan context. So, in conclusion, it can be stated that board independence has a significant negative impact on financial distress and is crucial in preventing financial distress.

The study also incorporated three control variables to further enhance the model of the study. The control variables are return on equity (R.O.E), firm size (FS) and financial leverage (FL). And their associated coefficient values indicate that return on equity (R.O.E) and firm size (FS) impact financial distress negatively, whereas the coefficient value of financial leverage (FL) indicates that it impacts positively to financial distress. But among these variables, only return on equity (R.O.E) seems to be statistically significant within this model based on the p-values of 0.0245, which is lower than 0.05, unlike the P-values of firm size (FS) and financial leverage (FL) 0.2893 and 0.3778 respectively which are higher than 0.05 making them statistically insignificant. This was a pretty much-expected outcome since, in the previous comparison analysis, firm size (FS) and financial leverage (FL) didn't show that much of a difference between distressed and non-distressed firms. So, based on this, it seems that financial firms with higher R.O.E ratios have less likelihood of being financially distressed than a financial firm with a lower R.O.E ratio.

The below table summarizes the results of the regression analysis,

**Table XIII. Summary of Regression Analysis**

| Variable | Predicted impact | Impact based on regression | Status of statistical significance |
|---|---|---|---|
| Corporate governance variables | | | |
| BS | Negative | Negative | Significant |
| BGD | Negative | Negative | Significant |
| FBM | Positive | Negative | Significant |
| HAQ | Negative | Negative | Significant |
| BMR | Indecisive | Negative | Insignificant |
| CD | Indecisive | Negative | Insignificant |
| ELB | Negative | Negative | Significant |
| BI | Indecisive | Negative | Significant |
| Control variables | | | |

| | | | |
|---|---|---|---|
| ROE | Negative | Negative | Significant |
| FS | Negative | Negative | Insignificant |
| FL | Negative | Positive | Insignificant |

*Source: Author Constructed*

The predicted impacts were developed based on the findings of prior studies. And these predicted impacts of corporate governance variables on financial distress are confirmed and backed up by the results of this study's regression, except for the variables of frequency of board meetings (FBM), board member remuneration (BMR), C.E.O duality (CD) and board independence (BI). The frequency of board meetings (FBM) was predicted to have a positive impact on financial distress. But the analysis results of this study which solely focused on financial institutions, point towards that variable having a negative impact on financial distress. The predicted impacts of C.E.O duality (CD), board member remuneration (BMR) and board independence (BI) were indecisive due to conflicting findings of the prior studies. But here, the regression analysis of all three of these variables indicates that they have a negative impact on financial distress within the context of financial institutions. In terms of control variables, only financial leverage (FL) showed a different nature of impact than what was predicted.

In terms of statistical significance among both corporate governance variables and control variables, all except for board member remuneration (BMR), C.E.O duality (CD), firm size (FS) and financial leverage (FL) were founded to be statistically significant within the econometric model of the study.

With these findings in hand, the next chapter will explore the broader implications and recommendations. Analyzing the relevance for policymakers, practitioners, and academics, the concluding chapter will draw connections to overarching corporate governance considerations and identify potential avenues for future research.

## Discussion

This particular study was motivated by the observation that firms experiencing financial distress often exhibit weaknesses in their corporate governance structures.

This study used secondary data from 54 licensed financial institutions between 2017 and 2022. Corporate governance variables such as board size, gender diversification, board meetings frequency, audit quality, board member remuneration, C.E.O duality, board independence, and education level of the board were incorporated as independent variables, with financial distress as the dependent variable.

A comparative analysis between distressed and non-distressed firms revealed significant differences in several corporate governance variables. Notably, board size, gender diversification, board meetings frequency, board independence, audit quality, education level of the board, and return on equity showed significant impacts on financial distress. The study also confirmed the effectiveness of new directives issued by the central bank of Sri Lanka regarding specific corporate governance aspects.

One of the objectives of this study was to establish whether corporate governance has an impact on the financial distress of listed financial institutions in Sri Lanka which the study concluded that there is in fact an noticeable impact on financial distress caused by the corporate government structure of the financial institutions. Moreover, this study also had the objective to establish the nature of this impact which the study established as both negative

and positive across the variety of corporate governance variables that was employed. And the final objective was to identify different corporate governance factors that influence financial distress as well as to identify whether some of these corporate governance factors are more significant than others. To achieve this objective, a binary logistic regression analysis was carried out, which indicated that all corporate governance variables had a negative impact on financial distress. Among these variables, board size, gender diversification, board meetings frequency, audit quality, education level of the board, and board independence were identified to be statistically significant.

Based on these findings, the study concluded that financial institutions with specific characteristics, such as higher board members, gender diversification, qualified board members, independent directors, and being audited by big four firms, are better equipped to avoid financial distress. The study recommends financial institutions to align their corporate governance practices accordingly, and regulatory bodies, like the central bank, should promote these characteristics through corporate governance policies.

The study's findings have important implications for policymakers, regulators, investors, listed financial institutions, and other stakeholders in the Sri Lankan financial sector. Policymakers and regulators can promote good corporate governance practices among listed financial institutions through legislation, regulations, and other incentives. Investors can use corporate governance information to assess the risk of financial distress when making investment decisions. Listed financial institutions can adopt and implement good corporate governance practices to reduce the risk of financial distress and improve their overall performance. Other stakeholders, such as academics, researchers, financial analysts, rating agencies, and the media, can play a role in promoting awareness of the importance of corporate governance and encouraging listed financial institutions to adopt good corporate governance practices.

However, the study's limitations include its focus solely on listed financial institutions in Sri Lanka, limiting the generalizability of the findings. Future research is suggested to include data from non-financial institutions and compare corporate governance practices between financial and non-financial firms to expand the framework's applicability.

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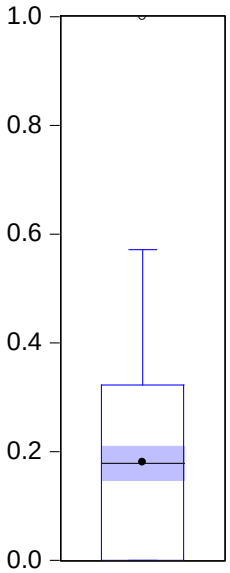
# Appendices

## Appendix A: Sample organization list

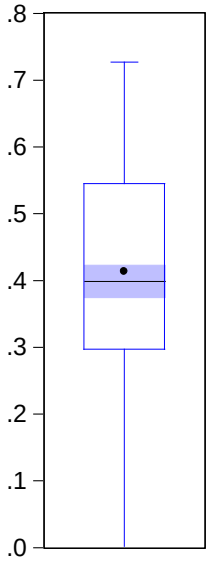
| | |
|---|---|
| Amana Bank PLC | Commercial Credit & Finance PLC |
| Bank of Ceylon | Dialog Finance PLC |
| Cargills Bank Ltd | ETI Finance Ltd |
| Commercial Bank of Ceylon PLC | Fintrex Finance Ltd. |
| DFCC Bank PLC | HNB Finance PLC |
| Habib Bank Ltd | Kanrich Finance Ltd |
| Hatton National Bank PLC | Lanka Credit and Business Finance PLC |
| National Development Bank PLC | L B Finance PLC |
| Nations Trust Bank PLC | LOLC Development Finance PLC |
| Pan Asia Banking Corporation PLC | LOLC Finance PLC |
| People's Bank | Mahindra Ideal Finance Ltd. |
| Sampath Bank PLC | Mercantile Investments & Finance PLC |
| Seylan Bank PLC | Merchant Bank of Sri Lanka & Finance PLC |
| Union Bank of Colombo PLC | U B Finance Co. Ltd |
| National Savings Bank | Alliance Finance Co. PLC |
| Multi Finance PLC | AMW Capital Leasing and Finance PLC |
| Nation Lanka Finance PLC | Asia Asset Finance PLC |
| Orient Finance PLC | Associated Motor Finance Co. PLC |
| People's Leasing & Finance PLC | Bimputh Finance PLC |
| People's Merchant Finance PLC | Central Finance Co.PLC |
| Sarvodaya Development Finance PLC | Citizens Development Business Finance PLC |
| Senkadagala Finance PLC | |
| Singer Finance (Lanka) PLC | |
| Siyapatha Finance PLC | |
| Softlogic Finance PLC | |
| Swarnamahal Financial Services PLC | |
| Vallibel Finance PLC | |
| Pradeshiya Sanwardhana Bank | |
| Sanasa Development Bank PLC | |
| Sri Lanka Savings Bank Ltd | |
| State Mortgage & Investment Bank | |
| Abans Finance PLC | |

**Appendix B: Boxplots**

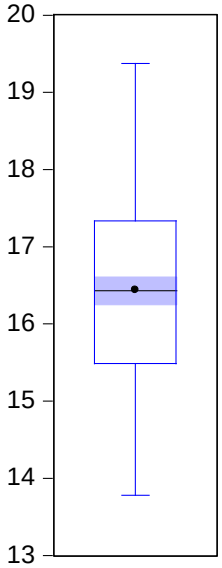
Board gender diversification



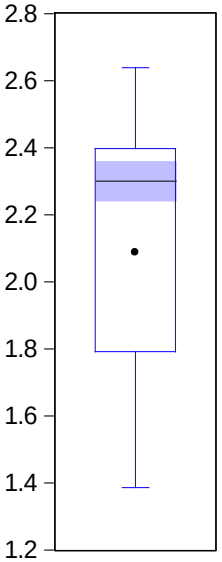

Board independence



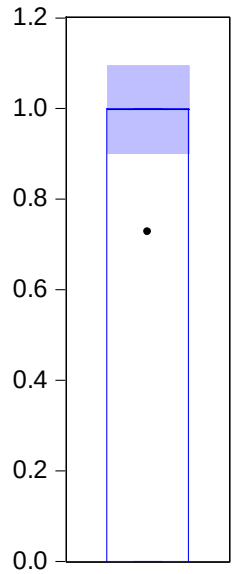

Board member remuneration



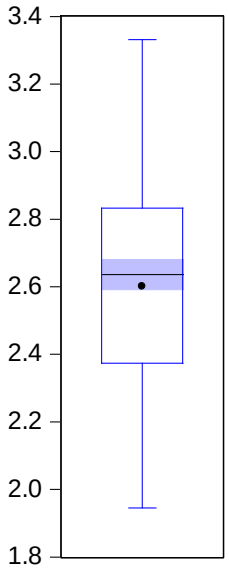

Board size



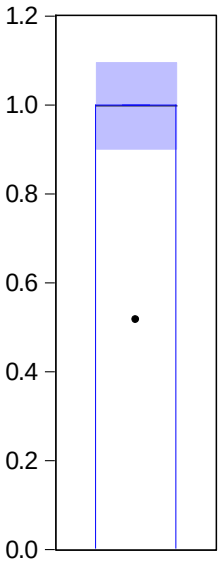
Education level of the board



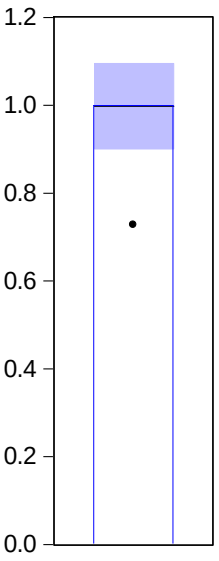

Frequency of board meetings



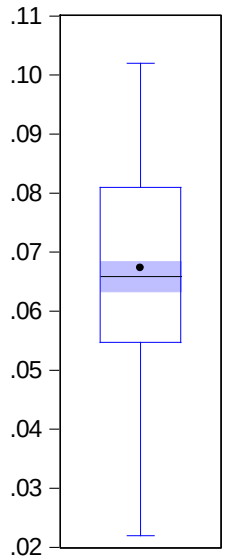

Higher audit quality



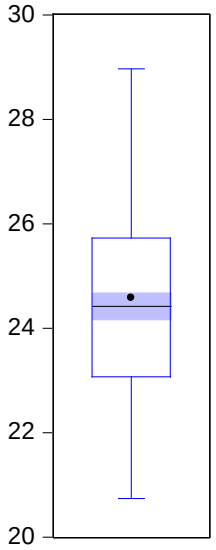

C.E.O Duality



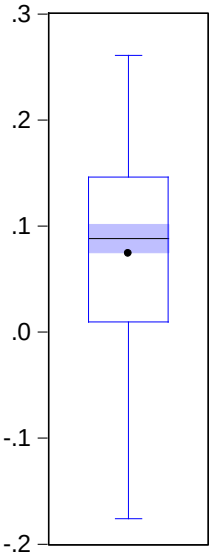
Financial leverage




Firm Size (Total Assets)




Profitability (ROE)




Financially distressed