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Impact of relations with shareholders to the corporate financial performance in Sri Lanka

A. G. Deepal

Department of Accounting & Finance, University of Ruhuna, Matara, Sri Lanka.

Proponents of Agency theory define the term "organization" as a "legal fiction which serves as a nexus for a set of contracting relationships among individuals". Thus, the managers being the agents of the corporate sector have a duty to coordinate the contracts, initiating and implementing exchanges between the nexus of shareholders and all the other stakeholders. The purpose of this study is to identify and measure the "Level of compliance of Relations with Shareholders with the code of best practices on corporate governance and its impact on Corporate Financial Performance in Sri Lanka". Most of the countries in the world explicitly rely on the shareholders' meetings as the most important forum where shareholders can exercise their rights and therefore it may lead to have improved efficiency on decision making which ultimately improve the performance of the companies. After deducting companies in the default board, a sample of 130 companies which are registered in the Colombo Stock Exchange as at 31st of August 2010 was selected from all the industry sectors randomly based on the probability proportionate sampling technique to represent 60% of the qualified population. The Secondary data on independent variables were collected from Annual Reports issued by each company for the period of two years from 2008/09 to 2009/10 through a Composite Index which was constructed being based on the Code of Best Practices on Corporate Governance (2008). The data on financial performance, the dependant variables measured through Return on Assets (ROA), Return on Equity (ROE) and Return on Investment (ROI) were collected from the Audited Financial Statements of each company. Mean, minimum and maximum values were used to analyze the level of compliance with the Code whereas Pearson correlation and regression analysis were used to analyse the association and the level of the strength of the association between dependant and independent variables. The level of compliance with the Code was 42.6% and 71.2% in 2008/09 and 2009/10 respectively. The association recorded in 2009/10 was around 0.516, 0.518 and 0.507 with ROA, ROE and ROI respectively at 95% significant level where no significant association found in 2008/09. In conclusion, it is emphasised that the companies are in a position to improve their financial performance as long as they improve their level of compliance with Code of Best Practices on Corporate Governance confirming the results obtained by Weir and Laing (2000).

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