

CHALLENGES OF CORPORATE GOVERNANCE: A STAKEHOLDER PERSPECTIVE IN THE EMERGING ECONOMY

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Abstract:

Compliance with Corporate Governance is imperative to achieve a higher level of sustainability in an economy. A dearth of studies has examined the challenges of achieving corporate governance from a stakeholder perspective in emerging economies. Accordingly, this study examines the challenges of corporate governance in Sri Lanka, an emerging economy currently facing an unembellished bankruptcy situation. Adopting a quantitative approach, using a questionnaire survey, this study found the significant challenges highlighted by stakeholders as insider trading, conflicts of interest of directors, political influences on regulatory authorities and lack of investor protection and confidence. This study is essential to the stakeholder theory and has implications for the policymakers in emerging economies by identifying challenges and overcoming them to achieve higher sustainable development.

Keywords: Corporate Governance, Sustainable Development, Emerging Economy, Stakeholder Theory

JEL classification: G30, G39, G19

Introduction

Corporate fraud in the world exhibited steady growth after 2018, but half of the organisations (46%) surveyed by PwC revealed that fraud was reported in 2021 (PwC, 2021). This situation illustrated that it is critical to comply with corporate governance to reduce corporate fraud and improve corporate sustainability. Dissabandara (2010, p.7) defined CG as "Corporate governance is the mechanism by which companies are rationalised, directed, controlled and monitored. Corporate governance coordinates stakeholders such as shareholders, directors, managers, employees, creditors, customers, global environment and the rest of the society to enhance corporate performance and wellbeing as a common goal." Empirical evidence of literature suggests corporate governance challenges are different in each country wise and time period (Bhasa, 2004; Manawaduge, 2012).

The Corruption Perception Index in Sri Lanka is 37 in 2021, at a higher level and ranked 102 among 180 countries (Transparency International, 2022). In addition, there is no requirement to disclose anti-corruption policies by the companies. Recent corporate financial accounting scandals in Sri Lanka, such as the Government of several enterprises, including the Central

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Investment and Finance Ltd.(previously Central Investment and Finance PLC), The Standard Credit Finance Ltd., TKS Finance Ltd., The Finance Company PLC, ETI Finance Ltd., and Swarnamahal Financial Services PLC (Kirinde, 2021), etc., have brought corporate governance to become a subject of heightened importance in the country and emerging challenges with more significant importance to the Sri Lankan capital market.

In addition, (Manawaduge, 2012) found that the compliance level of corporate governance in Sri Lanka was average (54.27) in the 2009-2016 period by measuring the comprehensive corporate governance index. This study further found a significant disparity between different sectors and sub-indexes, including the board of directors, shareholders, stakeholders, CEO and management and disclosure and transparency. But this considered data collection using an annual report and does not consider the stakeholder perceptions on corporate governance in Sri Lanka.

Accordingly, these significant problems in corporate governance in Sri Lanka may indicate that stakeholders are not confident in the corporate governance of companies based in Sri Lanka. Corporate governance reform is the obvious answer. Stakeholders can serve as observers of companies' activities and play an essential role in enforcing corporate governance procedures. Previous research on stakeholder perspectives on corporate governance has either focused on only one or two stakeholder groups or has ignored all but the company's internal stakeholders (Ajward and Weerasinghe, 2019). The lack of stakeholder input during the rulemaking process has been identified as the most pressing problem. The second dilemma was that the board of directors was not regularly evaluated. In contrast to domestic shareholders, foreign shareholders are not given as much advance notice of general meetings. In this study, they have not put much effort into investigating how the public perceives these kinds of company actions.

Stakeholders' views on corporate governance practices in Sri Lanka were analysed by (Manawaduge, 2012). The results show that most parties agree that good corporate governance practices are essential to a company's success in the marketplace and the community and that the current state of corporate governance in Sri Lanka falls short of expectations. Stakeholders have identified several issues with corporate governance, including a lack of education about and awareness of corporate governance; insufficient regulations and enforcement; a lack of integrity and independence among directors; inadequate ethical standards; a lack of transparency; a lack of diversity among owners; and political interventions, insider trading, and corruption. The overall level of corporate governance in Sri Lanka does not meet stakeholders' expectations. However, the results of this study are not adaptable to the current context as Sri Lanka adopts two corporate governance codes afterwards, and currently, Sri Lanka is in a crisis.

Description of the Problem

Despite introducing a code of best practices for corporations in Sri Lanka in 2013 and 2017, there has been no in-depth analysis of the stakeholder perspectives on corporate governance. Between 2012 and 2022, many changes in how businesses operate and stakeholders see things. The existing findings of previous studies by various researchers on corporate governance in Sri Lanka show many issues and weaknesses of corporate governance in Sri Lanka (Manawaduge, 2012; Dissanayake, Dissabandara and Ajward, 2021; Dissanayake, Dissabandara and Ajward, 2021).

Accordingly, no study has been conducted in Sri Lanka during this crisis with COVID-19 to understand the corporate governance issues faced by a developing economy impacted by the crisis. The primary goal of this research is to assess stakeholder perspectives on corporate

governance challenges in Sri Lanka and to provide recommendations to enhance existing processes.

Methodology and Data

This research examines the stakeholder perception of challenges and practices to improve corporate governance using a positivist paradigm, which necessitates using deductive reasoning and quantitative methods. This study adopted a questionnaire of (Manawaduge, 2012), which primarily includes a comprehensive questionnaire related to corporate governance challenges and recommendations. The questionnaire includes 14 Yes/No questions about challenges of corporate governance, 15 questions including disagree, neutral, and agree with questions, and two open-ended questions including what are the challenges and what are the recommendations. Table 1 lists relevant information about the selected sample.

Table 1 Sample Selection and survey responses by category of stakeholders

Stakeholder Group	Selected Sample Size	Response Received	Percentage
Non-Executive independent director	40	7	18%
Non-Executive non-independent director	40	2	5%
Director/Executive in a company	40	24	60%
Manager/Executive in the Govt.	30	15	50%
Academics	50	26	52%
Audit Superintendent/Audit officer	50	18	36%
Fin. Manager/Accountant	120	90	75%
Banker/Executive in a bank	50	40	80%
Partner/ Manager/Senior in audit firm	100	63	63%
Shareholders	60	10	17%
Total	580	295	51%

Source: Constructed by the authors

Data from participants are collected using a convenience sampling technique. The same questionnaire was developed in digital and manual answerable formats to lessen the impact of non-response bias. In all, 295 valid questionnaire responses were received, with a response rate of 51%. Table 01 displays the responses broken down by stakeholder group.

Descriptive statistics were primarily used to examine respondent demographics and the most salient features of corporate governance. The non-parametric Kruskal-Wallis test appears to outperform its parametric counterpart, the analysis of variance (ANOVA) when applied to asymmetric groups. Accordingly, the Kruskal-Wallis test is run across all items on the questionnaire to determine whether there are statistically significant differences between stakeholder groups concerning the corporate governance aspects addressed by the survey.

Results

Demographic Profile

Demographic profile Include 58% of the participants were males, while 42% were females. It is worth noting that there is parity between the gender in the chosen sample. Over half (55%) of those who took the survey are certified public accountants, with another 33% having passed some but not all of the required exams to become certified. The individuals who have chosen

to participate in the perception survey all have the necessary background knowledge and experience. Over 90% of respondents have some postsecondary education level, with 57% holding at least a bachelor's degree, indicating they can make objective decisions about the topics. Overall, over half of respondents (52%) have more than five years of work experience, with 24.0% having more than ten. 11% of respondents have stock in just one company, 19% have stock in between six and eleven companies, and 5% have stock in more than eleven companies. Only 10% of respondents have directorship experience, but those with direct experience implement corporate governance practices.

Reliability of Questionnaire

The reliability of corporate governance challenges is 0.711, and the `recommendations to adopt corporate governance improvement is 0.887.

Findings of Challenges of corporate governance

In this section, we examine how respondents in Sri Lanka feel about corporate governance challenges and recommendations related to corporate governance. Table 2 shows the descriptive analysis and Kruskal-Wallis test results of Sri Lankan corporate governance challenges.

Table 2 Descriptive Analysis and Results of Kruskal-Wallis Test on Challenges of Corporate Governance in Sri Lanka

Question		Occupation									Total	Chi-Square	Asymp. Sig.
		NEID	DEP	DEG	ACD	ASG	ACC	BEB	APP	SH			
CHG01	Yes	86%	73%	60%	92%	89%	79%	93%	79%	100%	82%	12.912	.115
	No	14.3%	27%	40%	8%	11%	21%	8%	21%	0%	18%		
CHG02	Yes	57%	81%	60%	38%	89%	72%	93%	81%	100%	76%	34.182	.000
	No	43%	19%	40%	62%	11%	28%	8%	19%	0%	24%		
CHG03	Yes	100%	96%	87%	77%	100%	90%	90%	90%	90%	90%	10.482	.233
	No	0%	4%	13%	23%	0%	10%	10%	10%	10%	10%		
CHG04	Yes	100%	88%	87%	58%	72%	82%	73%	59%	80%	74%	21.237	.007
	No	0%	12%	13%	42%	28%	18%	28%	41%	20%	26%		
CHG05	Yes	71%	96%	93%	77%	89%	88%	85%	84%	70%	86%	17.015	.030
	No	29%	4%	7%	23%	11%	12%	15%	16%	30%	14%		
CHG06	Yes	57%	85%	87%	77%	78%	64%	75%	60%	60%	70%	15.947	.043
	No	43%	15%	13%	23%	22%	36%	25%	40%	40%	31%		
CHG07	Yes	43%	85%	53%	65%	83%	84%	93%	71%	90%	79%	28.334	.000
	No	57%	15%	47%	35%	17%	16%	8%	29%	10%	21%		
CHG08	Yes	86%	92%	87%	58%	78%	82%	80%	87%	100%	82%	14.730	.065
	No	14.3%	8%	13%	42%	22%	18%	20%	13%	0%	18%		
CHG09	Yes	86%	85%	87%	31%	67%	72%	73%	68%	60%	69%	23.880	.002
	No	14.3%	15%	13%	69%	33%	28%	28%	32%	40%	31%		
CHG10	Yes	100%	85%	53%	42%	72%	74%	68%	52%	100%	67%	26.313	.001
	No	0%	15%	47%	58%	28%	26%	33%	48%	0%	33%		
CHG11	Yes	100%	81%	93%	42%	61%	71%	88%	71%	100%	74%	22.443	.004
	No	0%	19%	7%	58%	39%	29%	13%	29%	0%	26%		
CHG12	Yes	100%	85%	87%	73%	89%	78%	100%	90%	70%	85%	19.496	.012
	No	0%	15%	13%	27%	11%	22%	0%	10%	30%	15%		

CHG13	Yes	100%	81%	93%	65%	89%	80%	83%	87%	80%	82%	9.888	.273
	No	0%	19%	7%	35%	11%	20%	18%	13%	20%	18%		
CHG14	Yes	100%	88%	100%	92%	89%	88%	85%	79%	90%	87%	7.760	.457
	No	0%	12%	0%	8%	11%	12%	15%	21%	10%	13%		

Source: Constructed by the authors

The respondents of the questionnaire agrees that the five concerns raised are severe problems with the current corporate governance system. Top-level incompetence, insider trading, sloppy risk management, a concentrated ownership structure that controls the Sri Lankan capital market, and a general lack of protection for and faith in the market all fall into this category. Among the other topics covered by the survey, nine show statistically significant differences between stakeholder groups. Insider trading, conflicts of interest among directors, political influences on the CSE, and a lack of investor protection and confidence are significant problems with the corporate governance system in Table 02. There is widespread agreement that there is a significant problem with the unreliability of top management, sloppy risk management, and a concentrated ownership structure that controls the Sri Lankan capital market.

In addition, open-ended questions of the survey allow respondents to share their thoughts on corporate governance in Sri Lanka. About half of the people who answered this question gave feedback (138 out of 295). The most frequently cited problems are: a lack of knowledge and education about corporate governance; corporate governance rules that are not put into practice; political interference; weak regulatory institutions; ineffective independence among directors; a dysfunctional board; a lack of transparency, integrity, and accountability; and insider trading. Not managing minority shareholders' rights, poor internal controlling and risk management, a lack of clarity in cross-holding rules, financial reporting swayed by performance targets, and management's pressure on the profession all figure prominently among the list of problems with corporate governance that have been brought to light.

Findings of recommendations to improve corporate governance compliance level in Sri Lanka

Table 3 displays the findings of the analysis on recommendations to improve corporate governance compliance level in Sri Lanka.

All stakeholders generally agree upon the eight practices outlined in the questionnaire to be areas in which the corporate governance system could be strengthened.

The audit committee should have more authority to investigate financial reporting, important advisory committees should be independent, at least half of the board should be made up of independent directors, the recruitment policy of new directors should be disclosed, and the remuneration policy of new directors should be disclosed, the same compensation of each director should be disclosed in the annual reports, restrictions should be placed on the number of directorships that a single individual can hold at any given time, and the board should adopt a policy of adopting best practices in director recruitment and compensation.

Most stakeholders agree that separating the roles of CEO and chairman, ensuring that independent directors are truly independent of management and major shareholders, and instituting a code of conduct and ethics for all directors and officers. Employees are all crucial steps toward improving the effectiveness of a company's governance system.

In the second open-ended question, respondents were asked what they thought could be done to enhance corporate governance in Sri Lanka.

The recommendations of 35% of respondents (102 out of 295). Implementing a proper evaluation method of corporate governance; enforcing laws about corporate governance; raising public awareness of the importance of good corporate governance practices; streamlining the current governance system; increasing directors' compensation; and strengthening the current corporate governance system by adopting foreign best practices like the Sarbanes-Oxley act.

Further respondents suggest that Good governance should come from the top down, information should be appropriately disseminated among relevant personnel, good governance and independence should come from within an individual rather than from external rules, and companies should be encouraged to improve their internal governance.

Table 3 Descriptive Analysis and Results of Kruskal-Wallis Test on Recommendations to improve Corporate Governance compliance level in Sri Lanka

Question		Occupation									Total	Chi-Square	Asymp. Sig.
		NEID	DEP	DEG	ACD	ASG	ACC	BEB	APP	SH			
CGP01	D	28.6%	7.7%	0%	3.8%	22.2%	1.1%	5.0%	7.9%	0%	5.8%	15.019	.059
	N	0%	23.1%	6.7%	26.9%	5.6%	12.2%	5.0%	7.9%	0%	11.2%		
	A	71.4%	69.2%	93.3%	69.2%	72.2%	86.7%	90.0%	84.1%	100.0%	83.1%		
CGP02	D	14.3%	0%	0%	0%	16.7%	3.3%	0%	7.9%	0%	4.1%	17.077	.029
	N	14.3%	11.5%	40.0%	23.1%	11.1%	13.3%	2.5%	11.1%	0%	12.9%		
	A	71.4%	88.5%	60.0%	76.9%	72.2%	83.3%	97.5%	81.0%	100.0%	83.1%		
CGP03	D	0%	3.8%	13.3%	0%	33.3%	10.0%	7.5%	15.9%	0%	10.5%	26.773	.001
	N	71.4%	15.4%	33.3%	3.8%	16.7%	11.1%	20.0%	22.2%	20.0%	17.6%		
	A	28.6%	80.8%	53.3%	96.2%	50.0%	78.9%	72.5%	61.9%	80.0%	71.9%		
CGP04	D	14.3%	0%	6.7%	0%	0%	1.1%	2.5%	4.8%	0%	2.4%	21.564	.006
	N	42.9%	15.4%	13.3%	7.7%	22.2%	4.4%	15.0%	17.5%	10.0%	12.5%		
	A	42.9%	84.6%	80.0%	92.3%	77.8%	94.4%	82.5%	77.8%	90.0%	85.1%		
CGP05	D	71.4%	3.8%	6.7%	7.7%	16.7%	8.9%	2.5%	17.5%	20.0%	11.5%	23.685	.003
	N	0%	19.2%	13.3%	30.8%	22.2%	10.0%	15.0%	22.2%	10.0%	16.6%		
	A	28.6%	76.9%	80.0%	61.5%	61.1%	81.1%	82.5%	60.3%	70.0%	71.9%		
CGP06	D	28.6%	7.7%	6.7%	0%	16.7%	1.1%	2.5%	4.8%	0%	4.4%	12.569	.128
	N	0%	15.4%	13.3%	30.8%	11.1%	8.9%	17.5%	9.5%	0%	12.5%		
	A	71.4%	76.9%	80.0%	69.2%	72.2%	90.0%	80.0%	85.7%	100.0%	83.1%		
CGP07	D	14.3%	11.5%	0%	3.8%	22.2%	0%	2.5%	7.9%	0%	5.1%	12.320	.138
	N	28.6%	19.2%	20.0%	26.9%	11.1%	15.6%	17.5%	12.7%	0%	16.3%		
	A	57.1%	69.2%	80.0%	69.2%	66.7%	84.4%	80.0%	79.4%	100.0%	78.6%		
CGP08	D	0%	0%	0%	0%	22.2%	0%	2.5%	6.3%	0%	3.1%	18.150	.020
	N	14.3%	11.5%	0%	23.1%	5.6%	3.3%	10.0%	9.5%	20.0%	8.8%		
	A	85.7%	88.5%	100.0%	76.9%	72.2%	96.7%	87.5%	84.1%	80.0%	88.1%		
CGP09	D	14.3%	0%	0%	0%	16.7%	3.3%	2.5%	11.1%	30.0%	6.1%	5.350	.720
	N	0%	19.2%	6.7%	19.2%	11.1%	16.7%	17.5%	14.3%	0%	14.9%		
	A	85.7%	80.8%	93.3%	80.8%	72.2%	80.0%	80.0%	74.6%	70.0%	79.0%		
CGP10	D	0%	3.8%	0%	0%	27.8%	4.4%	2.5%	11.1%	20.0%	6.8%	12.216	.142
	N	0%	15.4%	6.7%	23.1%	11.1%	17.8%	20.0%	22.2%	0%	17.3%		
	A	100.0%	80.8%	93.3%	76.9%	61.1%	77.8%	77.5%	66.7%	80.0%	75.9%		
CGP11	D	14.3%	11.5%	0%	11.5%	11.1%	21.1%	10.0%	20.6%	0%	15.3%	14.021	.081
	N	42.9%	19.2%	13.3%	3.8%	27.8%	21.1%	25.0%	22.2%	20.0%	20.7%		
	A	42.9%	69.2%	86.7%	84.6%	61.1%	57.8%	65.0%	57.1%	80.0%	64.1%		
CGP12	D	28.6%	3.8%	0%	3.8%	17.6%	8.9%	7.5%	9.5%	0%	8.2%	11.683	.166
	N	28.6%	19.2%	6.7%	11.5%	11.8%	21.1%	15.0%	23.8%	20.0%	18.7%		
	A	42.9%	76.9%	93.3%	84.6%	70.6%	70.0%	77.5%	66.7%	80.0%	73.1%		
CGP13	D	0%	0%	0%	3.8%	16.7%	5.6%	2.5%	3.2%	0%	4.1%	13.726	.089
	N	14.3%	15.4%	6.7%	0%	11.1%	7.8%	12.5%	0%	0%	6.8%		
	A	85.7%	84.6%	93.3%	96.2%	72.2%	86.7%	85.0%	96.8%	100.0%	89.2%		
CGP14	D	57.1%	7.7%	0%	3.8%	16.7%	5.6%	2.5%	9.5%	10.0%	7.8%	21.165	.007
	N	0%	30.8%	0%	7.7%	27.8%	27.8%	37.5%	31.7%	10.0%	25.8%		
	A	42.9%	61.5%	100.0%	88.5%	55.6%	66.7%	60.0%	58.7%	80.0%	66.4%		
CGP15	D	14.3%	0%	0%	3.8%	16.7%	0%	2.5%	6.3%	30.0%	4.4%	23.230	.003
	N	42.9%	11.5%	33.3%	19.2%	11.1%	6.7%	12.5%	9.5%	0%	11.9%		
	A	42.9%	88.5%	66.7%	76.9%	72.2%	93.3%	85.0%	84.1%	70.0%	83.7%		

Source: Constructed by the Authors

Conclusions

Most researchers agree on fourteen issues: insider trading, director conflicts of interest, political influences on the CSE, and a lack of investor protection and confidence ranking as the highest. The majority of stakeholders advocated for a split between the CEO and chairman positions, for independent directors to be truly independent of management and major shareholders, for the adoption of a code of conduct and ethics for all directors, officers, and employees, and for the disclosure of all related party transactions as a means of addressing problems with corporate governance. This study adds contribution to the stakeholder theory by considering stakeholder perceptions related to corporate governance and considering these views to improve corporate governance system.

According to the findings of this study, Sri Lanka's corporate governance system is plagued by numerous problems. Stakeholders have offered solutions. This study's most salient finding is the recommendation that corporate governance is incorporated into university curricula as well as the training programs of professional organisations. In order to advance the current corporate governance system, simplify it, and adapt foreign best practices, the key players must conduct proper training programmes to improve knowledge, and the governing bodies must be strengthened with sufficient power. These recommendations must consider for improving corporate governance in Sri Lanka as well as in the world when making further changes.

Policymakers may use the study's findings to prioritise issues raised by stakeholders and reform the code of best practices for corporate governance. This study aims to remedy the theoretical vacuum left by the paucity of prior research conducted in the Sri Lankan and in developing country context, which is reflected in the existing body of scholarly work in the research field. Finally, this research is crucial to ensure that flaws in the current set of best practices are identified and fixed in the next set of best practice codes and improve the compliance level of corporate governance in the world and achieve sustainability.

Future Directions

This study considers stakeholder perception related to corporate governance in Sri Lanka. It is better to adopt this questionnaire in other developing countries and check about their corporate governance issues or cross-country studies related to comparison of results will enhance literature. In addition, future researchers can examine stakeholder perception related to corporate governance practices, key players, and corporate governance relationship with sustainability.

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