

PREDICTING THE CORPORATE FAILURE OF LISTED COMPANIES IN SRI LANKA.

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ABSTRACT

Corporate failure is a critical issue that can have a significant negative impact on companies, investors, and the economy. The rapid increase in sudden corporate failure motivates studies on the prediction of corporate failure, which enhances the importance of corporate failure prediction. This study aims to investigate the ability of corporate governance and financial variables to predict the corporate failure of listed companies in Sri Lanka and to develop a sustainable model for failure prediction with higher accuracy. Furthermore, the study examined the applicability of the prediction model to all listed companies, including the finance industry, using eighty-nine (for all industries) and sixty-two (except the finance industry) matched pairs of failed and non-failed companies listed on the Colombo Stock Exchange (CSE) in Sri Lanka from 2010 to 2022. The study employed a total of ten financial ratios, and nine corporate governance variables were used as predictors of corporate failure. Logistic regression was employed to develop the prediction model, and expectation-prediction evaluation was used to identify the prediction accuracy of the models. The results indicate that the model consisting of both corporate governance and financial variables had the highest prediction accuracy in both samples, with more than 80 percent predictive accuracy in all three years prior to failure. It was further found that three financial variables, cash flow from operations to total assets, debt to asset ratio, revenue to asset ratio, and two corporate governance variables, CEO duality and director's remuneration, are significant variables in the failure prediction of listed firms except in the finance industry, while five financial variables, cash flow from operations to net income, cash flow from operations to total assets, debt to asset ratio, return on assets, revenue to asset ratio, and three corporate governance variables, CEO duality, outside ownership, and board size, have more explanatory power to predict corporate failure in all listed companies in Sri Lanka. Research indicates that an organization's failure can occur due to poor corporate governance variables, as well as poor financial performance. Findings related to predictions of corporate failure are useful for many parties to make decisions and identify the going-concern issues of firms.

Keywords: Corporate failure, corporate governance, CSE, Failure predictions, financial variables