

**FOSTERING ECONOMIC RESILIENCE THROUGH CORPORATE  
GOVERNANCE PRACTICES:  
EVIDENCE FROM MANUFACTURING SECTOR COMPANIES IN SRI LANKA**

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**ABSTRACT**

This study examines the role of corporate governance practices (CGPs) in fostering economic resilience within the manufacturing sector companies in Sri Lanka. Economic resilience is a crucial aspect of sustainable economic development, enabling organizations to withstand and recover from adverse events or disruptions. Corporate governance, on the other hand, represents the mechanisms and processes through which companies are directed and controlled, influencing their performance and stability. Using data from ten manufacturing companies (n=10) listed on the Colombo Stock Exchange (CSE) this research analyzes the relationship between corporate governance practices and economic resilience in the context of the manufacturing sector in Sri Lanka. The study utilizes quantitative measures, such as board size, board independence, board gender diversity, the existence of an audit committee, the existence of a nomination committee, board meetings, and CEO duality to measure CGPs, and manufacturing sector performance as a mediating variable. Economic resilience was used as the considered as the outcome variable. Relevant data were extracted from the annual reports of the chosen companies for the period from 2015 to 2019. Finally, 50 observations were used for the data analysis. The Pearson correlation test was executed to determine the relationship between CGPs, manufacturing sector performance, and economic resilience. Multiple regression analysis was performed to determine the explanatory power of the combination of these three segments. The findings highlight that manufacturing sector performance has a negative correlation with fiscal deficit to GDP which means that manufacturing sector performance increases and the budget deficit goes down which impacts on economic resilience of the country. The regression results suggest that board gender diversity has a significant relationship with manufacturing sector performance and the performance of the manufacturing sector. Moreover, the performance of listed manufacturing companies has a mediating effect on the economic resilience of the country and CGPs. The insights from this study provide valuable guidance for policymakers, regulators, and manufacturing sector companies in Sri Lanka, enabling them to prioritize and implement corporate governance reforms that enhance economic resilience.

**Keywords:** *Corporate Governance Practices, Economic Resilience, Fiscal Deficit to GDP Ratio, Theory of Unbalanced Growth*

**1. INTRODUCTION**

Economic resilience is the capacity of an economic system to adapt in response to both short-term shocks and long-term changes in ecological, social, and economic conditions to support the community to thrive whilst using its fair share of ecological resources (Cordina 2004). It requires three abilities. (i) Absorb shocks and retain basic system functionality. (ii) Self-organization (social institutions and networks). (iii) Innovate and learn in response to disturbances. Key Features of a resilient economy are producing goods and services at an appropriate scale to support a balanced and diverse local and regional economy, adapting to climate change by reducing its reliance on fossil fuels, and reducing its ecological impact through the environmental transformation of infrastructure (energy, transport, and waste), and making more effective use of resources, supporting investment in social as well as financial capital, which aims to address poverty and

inequalities, supporting individuals and groups to experiment, develop and strengthen their adaptive capacities (i.e. self-organizing, innovation and learning) and comprising structures (enterprises, public organizations, and government) that support people to live the lives that bring them well-being. The global financial crisis highlighted the importance of strengthening the resilience of our economies to adverse shocks (Cordina 2004). Macroeconomic resilience has two components: instantaneous resilience, which is the ability to limit the magnitude of immediate production losses for a given amount of asset losses, and dynamic resilience, which is the ability to reconstruct and recover. The policy-induced ability of an economy to recover from or adjust to the negative impacts of adverse exogenous shocks and to benefit from positive shocks. Two types of abilities can be defined. (i) recover quickly from a shock, and (ii) withstand the effect of a shock.

This is associated with the flexibility of an economy, enabling it to bounce back after being adversely affected by a shock. This ability will be severely limited if, for example, there is a chronic tendency for large fiscal deficits. On the other hand, this ability will be enhanced when the economy possesses discretionary policy tools which it can utilize to counteract the effects of negative shocks, such as a strong fiscal position, which would entail that policymakers can utilize discretionary expenditure or tax cuts to contrast the effects of negative shocks (Briguglio et al, 2008; Munir & Riaz. 2019). This type of resilience is therefore associated with shock counteraction.

This relates to the ability to absorb shocks so that the end effect of a shock is neutered or rendered negligible. This type of resilience occurs when the economy has mechanisms in place to reduce the effects of shocks, which can be referred to as shock absorption. For example, the existence of a flexible, multi-skilled labor force could act as an instrument of shock absorption, as negative external demand shocks affecting a particular sector of economic activity can be relatively easily met by shifting resources to another sector enjoying stronger demand (Briguglio et al, 2014, 2008). This is the most focused area in this paper.

The manufacturing sector has played a stellar role in the growth and development of Sri Lanka. The emerging and developing countries place manufacturing at the driver's seat in their journey of economic growth. The share of manufacturing in GDP is, therefore, a basic indicator of the significance of the sector in a country's economy (Haraguchi, Cheng & Smeets. 2017). It is a well-known fact that manufacturing has long been a cornerstone of many national economies, being a crucial sector that generates productive jobs and sustainable economic growth. The World Economic Forum (WEF) Report highlights that manufacturing is significantly important to the prosperity of nations "with over 70% of the income. Beginning in the early 1960s, the manufacturing sector which comes under the industrial sector was seen essentially as an import-substituting activity, creating large-scale employment, and saving foreign exchange through the use of domestic inputs. Following liberalization, the manufacturing sector became the growth-oriented sector (Lankatilake, 1999). Another important irritating feature of the Sri Lankan manufacturing industry is the growing manufacturing trade deficit.

The economic view of corporate governance (CG) is that it has an impact on the vitality and integrity of the market system. According to Guillen (2000), corporate governance plays a key role in any economy by providing a framework for the division of labor and financial results in the firm. This study reiterates the fact that a well-functioning corporate governance system can contribute to economic efficiency and perhaps even social equity whereas, on the other hand, a poorly conceived system can wreak havoc in the economy by misallocating resources or failing to check opportunistic behavior by agents, which precipitates serious political risk for the ruling elites. Such observations have initiated discussions on corporate governance in a number of countries around the world, thus leading to the introduction of the globally recognized OECD principles of corporate governance (Ratnatunga & Ariff 2005).

Organizations which operate in the Manufacturing industry are profoundly involved in handling the higher level of investments in Sri Lanka. There is more concern about manufacturing companies in relation to ethics and social responsibility while operating well in line with economic resilience. They generate a vital necessity for the confirmation of accountability and transparency as any shortfall of accountability and transparency results in the financial health of the country being

severely affected. In Sri Lanka, CA Sri Lanka and Security Exchange Commission SEC govern how listed companies should conduct their business. CG is important for both public and private enterprises toward economic and social progress. High standards of CG and ethics as well as greater independence between enterprises and the societies in which they operate are also becoming a critical element of success. As such Sri Lanka's corporate law and governance strategy aims to promote an effective framework for corporate governance in the country for the purpose of giving confidence to investors, businesses, and other stakeholders. In the broadest sense, well-governed companies contribute more to economic growth, as those companies are stable, sustainable, and capable to provide regular profit to their shareholders and regular earnings to their employees and to strengthen investors' confidence in the capital market which enhances the overall resilience of the economy. However, the literature provides a very limited understanding in relation to CG practices and economic resilience in the context of the listed manufacturing sector in Sri Lanka. Therefore, this study focuses on how CG impacts manufacturing sector performance in listed manufacturing companies to withstand economic shocks.

## **2. LITERATURE REVIEW**

Economic resilience is defined by Rose (2017) and formalized by Dormady et al. (2019) in a production theory context. According to this approach, there are two major categories or dimensions of economic resilience.

### ***2.1. Static or Dynamic Economic Resilience***

Static economic resilience refers to the "ability of a firm to efficiently continue its operations with remaining resources at a given point in time after the occurrence of a shock and it indicates the need to compensate for deficiencies in the availability of production inputs" (Rose, 2004; 2007; Dormady et al., 2019). Dynamic economic resilience relates to "the ability of a firm to recover over time while using resources efficiently and after investing in repair and reconstruction as a means of accelerating and shortening recovery" (Rose 2007; Dormady et al., 2019).

The concept of static economic resilience is partially derived from Holling's definition (1973) of resilience as the ability of a system to absorb change and maintain functioning after a disturbance. However, in contrast to Holling's definition that considers that resilience is an asset of the system, the definition of static financial resilience additionally assumes that resilience may be more suitable earlier than disruption and additionally specializes in how the system (i.e., the firm) makes use of scarce assets correctly within the post-disaster (Rose, 2004; 2007; Dormady et al., 2019). On the other hand, the definition of dynamic economic resilience is more related to Pimm's definition (1984) of resilience as the ability and speed of the system to return to pre-disaster conditions.

### ***2.2. Inherent or Adaptive Economic Resilience***

Inherent resilience refers to movements that result from the capability already constructed into the system, which means the one's strategies that exist within the company or people who may be better extraordinarily inexpensively while the organization ambitions to construct resilience capability (Rose, 2017). few examples of inherent resilience include inventories, back-up equipment, the ability to utilize more than one fuel in an electricity generating unit, and established government policy levers" (Dormady et al., 2019).

Adaptive resilience, on the other hand, refers to "actions that result from ingenuity, extra effort, and improvisation under stress. Some examples include the technological change that transforms the way goods and services are produced, new contracting arrangements with external suppliers, and, in the case of governments, the design of new post-disaster assistance programs" (Rose, 2017; Dormady et al., 2019).

This paper mainly focuses on adaptive economic resilience which can reduce the effects of shocks as shock absorption. Although there have been different types of theoretical models to explain economic resilience, the following theory found an encouraging relationship with other core constructs of the study.

### ***2.3 The Theory of Unbalanced Growth***

The unbalanced growth theory is an antithesis of the theory of balanced growth (Hirschman 1958; Yeung 2017; Saliminezhad & Lisaniler 2018). In this theory, regional disparities are inevitable and necessary for the furtherance of growth (Hirschman 1958; Yeung 2017). The unbalanced growth theory is specifically applicable to the analysis of imbalances between various sectors in an economy. Unbalanced growth processes are considered necessary for economic growth (Hirschman 1958; Saliminezhad & Lisaniler 2018). Hirschman (1958) argues that due to the interdependence of sectors in the economy, the growth of one sector generates forces that eventually get rid of imbalances since growth in one sector should not be at the expense of the other sectors. The forces that underpin the economy ensure the disappearance of any imbalances through a self-correcting mechanism (Hirschman 1958). In addition, polarization effects are eventually outweighed by the trickling down effects as economic policies are enacted to address the unfavorable effects of polarization (Hirschman 1958; Dawkins 2003). The propositions of the theory are used to evaluate how forward and backward linkages influence the economic resilience of the study area. Furthermore, social overhead investments in Bulawayo are analyzed through the lens of the unbalanced growth theory. Likewise, strategy options for economic resilience in the metropolis are also discussed in light of this theory.

Unbalanced growth is a possible strategy to achieve economic growth in countries of the Asian region. These countries are characterized by low financial capital, an inability to create an environment for massive investment, and limited diversity in human resource skills (Saliminezhad & Lisaniler 2018). In these circumstances, simultaneous investment in all sectors is difficult to achieve. As such, adopting an unbalanced growth strategy in Bulawayo can prove to be a strategy option for resilience in the long run.

However, in the context of the manufacturing sector in Sri Lanka, How CGPs affect the Performance of listed Manufacturing Companies to foster economic resilience is still silent. Therefore, this study is to identify the relationship between corporate governance and the performance of the manufacturing companies which are listed on the Colombo Stock Exchange (CSE) in Sri Lanka.

#### ***Main Objective***

Investigate how corporate governance in listed manufacturing companies contributes to the performance of the companies to absorb the withstand economic shocks.

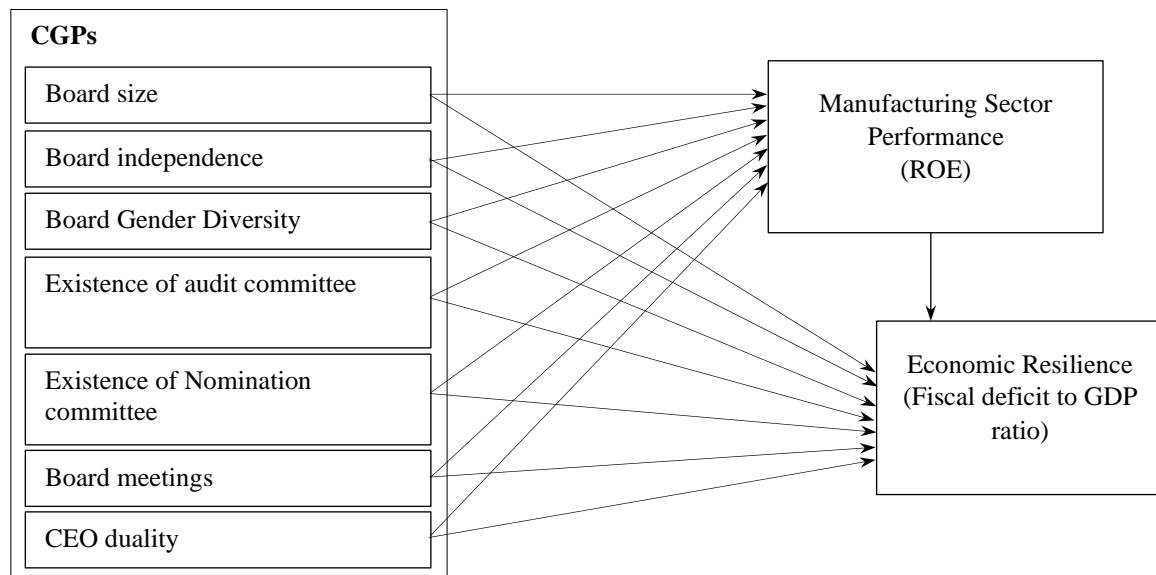
#### ***Specific Objectives***

- I. To understand the relationship between corporate governance, manufacturing sector performance, and economic resilience of the Sri Lankan economy.
- II. To evaluate the function of corporate governance in achieving economic efficiency for listed manufacturing companies and make proper recommendations.

### **3. METHODOLOGY**

The secondary data was collected from the top 10 manufacturing companies (contributed more than 60%) out of 41 listed on Colombo Stock Exchange whose financial year ended on 31st March for the period ranging from 2015 to 2019. All companies were sorted based on market capitalization and by means of systematic sampling all top ten companies were selected in a sequential order. Data in 2020 was purposely depleted due to unexpected uncertainty (Covid 19) in the economy. The source of secondary data for this study was audited accounts including Statements of comprehensive income, Balance sheet, notes, and statutory and sustainability disclosures extracted from the CSE website. Collected data were analyzed by using descriptive and inferential statistical tools such as measures of central tendency, correlation tests, and multiple regression analysis.

**Conceptual Framework**



**Figure 1: Conceptual Framework**

**4. RESULTS AND DISCUSSION**

**Table 1: General Overview**

Descriptives	Board Size	ROE	Fiscal deficit to GDP ratio
Minimum	5	1	0
Maximum	11	3	3
Mean	8	1.2	0.95

Source: Compiled by the author based on survey 2021

Taking a deeper look at the findings of the study eight directors were found to be the average board size in selected 10 no manufacturing companies in Sri Lanka. Moreover, the total contribution given to the manufacturing sector by these 10 companies in 2019 was 68%. Based on the correlation analysis (Table 2) indicates that manufacturing sector performance has a negative correlation of 66% with the fiscal deficit to GDP of the Sri Lankan economy which means when manufacturing sector performance goes up, the fiscal deficit goes down and further confirms that the association is statistically significant.

Briguglio et al. (2009) also confirm that contributions made by the manufacturing sector would be relatively easy for adverse shocks to result in economic and social chaos and unrest. Hence the effects of vulnerability would be exacerbated. On the other hand, good governance practices can strengthen the resilience of the economy.

**Table 2: Association between Manufacturing sector performance and economic resilience**

		ROE	Fiscal deficit to GDP ratio
<b>ROE</b>	Pearson Correlation	1	-.659
	Sig. (2-tailed)		.049
<b>Fiscal deficit to GDP ratio</b>	Pearson Correlation	-.659	1
	Sig. (2-tailed)	.049	

Source: Compiled by the author based on survey 2021

To evaluate the explainability of the proposed model, researchers have tested the R square, which indicates the proportion of variance in the dependent variable (Fiscal deficit to GDP ratio) that is explained by the model. In terms of testing the mediating effect (Performance of manufacturing sector), two models were diagnosed and the R-square value of the second model was greater, with a measure of 0.43 meaning 43% of the variance of Fiscal deficit to GDP ratio is explained by defined manufacturing sector performance. This measure indicates that the model does fit the data very well.

**Table 3: Overall Explainability (Model summary)**

Model	R	R Square	Adjusted R Square	Std. error in the Estimate
1	.602 <sup>a</sup>	.362	.256	.09921
2	.654 <sup>b</sup>	.428	.316	.09512

Source: Compiled by the author based on survey 2021

The ANOVA table shows that the two models are statistically significant. This indicates variance between groups and within groups. Also, the F values of the 2 models are considered to be lower variance. Moreover, the output shows that P values are less than 0.05 which means that the relationship between corporate governance and manufacturing sector performance is statistically significant, further relationship between manufacturing sector performance and Fiscal deficit to GDP ratio is also statistically significant. Hence the model fits perfectly. The performance of countries depends on their inherent vulnerability and their nurtured resilience (Briguglio et al. 2014).

**Table 4: Overall impact of CGPs, Performance of listed manufacturing sector companies, and economic resilience - ANOVA<sup>C</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.235	7	.034	3.405	.006 <sup>a</sup>
	Residual	.413	42	.010		
	Total	.648	49			
2	Regression	.27	8	.035	3.827	.002 <sup>b</sup>
	Residual	.371	41	.009		
	Total	.648	49			

a. Predictors: (Constant), BMEET, BGENDIV, ACOMMEET, CEODUAL, NOMCOMM, BIND, BSIZE.

b. Predictors: (Constant), BMEET, BGENDIV, ACOMMEET, CEODUAL, NOMCOMM, BIND, BSIZE, ROE

ANOVA Table 4 shows that two models are statistically significant. This indicates variance between groups and within groups. Also, the F values of the 2 models are considered to be lower variance. Moreover, output shows that P values are less than 0.05 which means that the relationship between corporate governance and Manufacturing sector performance is statistically significant. Additionally, the mediating effect of manufacturing sector firm performance has an impact on CGPs and the Fiscal deficit to GDP ratio. Moreover, the relationship between manufacturing sector performance and the Fiscal deficit to GDP ratio is also statistically significant.

Hence the model fits perfectly and confirms that fostering economic resilience can be achieved through the proper CGPs manufacturing sector. The results underpinned that the performance of countries depends on their inherent vulnerability and their nurtured resilience (Briguglio et al. 2014).

Based on the above coefficient table 5. indicates that board gender diversity is statistically significant in manufacturing sector performance during the past 5 years in Sri Lanka. Wagner (2008) showed that companies with the most women board directors perform better than boards with the least women board directors by 16%. The same report also showed that companies with the most women board directors showed a return on invested capital of 26% greater than boards with fewer women directors. Moreover, the study showed that companies that had three or more women board directors in at least four of five years had a higher rate of return on sales by 84%, a higher rate of return on invested capital by 60%, and a higher rate of return on equity of 46%.

Furthermore, the association between manufacturing sector performance and Fiscal deficit to GDP ratio is also statistically significant based on the SOBEL test which means there is a clear impact to withstand economic shocks. Škare and Hasic (2015) also found “between corporate governance and firms’ performances and thus country's economic growth.”

**Table 5: Overall impact of its core constructs - Coefficients**

Model	Unstandardized Coefficients		Unstandardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
<b>1</b>	(Constant)	.096	.105	.911	.367	
	BFSIZE	.006	.017	.082	.738	
	BIND	.021	.019	.247	1.082	.285
	CEODUAL	.064	.047	.184	1.369	.178
	NOMCOMM	-.055	.060	-.145	-.919	.363
	ACOMMEET	-.025	.032	-.127	-.794	.432
	<b>BGENDIV</b>	-.073	.020	-.494	-3.547	<b>.001</b>
	BMEET	-.006	.005	-.187	-1.276	.209
<b>2</b>	(Constant)	.276	.131	2.112	.041	
	BFSIZE	.001	.017	.021	.090	.929
	BIND	.024	.019	.279	1.272	.210
	CEODUAL	.062	.045	.178	1.387	.173
	NOMCOMM	-.050	.057	-.131	-.866	.391
	ACOMMEET	-.020	.030	-.101	-.661	.512
	<b>BGENDIV</b>	-.074	.020	-.505	-3.778	<b>.001</b>
	BMEET	-.006	.004	-.179	-1.271	.211
	<b>ROE</b>	.026	.012	.259	2.166	<b>.036</b>

a. Dependent Variable: Fiscal Deficit to GDP Ratio

Source: Compiled by the author based on survey 2021

## 5. CONCLUSION AND RECOMMENDATIONS

### 5.1 Conclusion

The result of this paper found an encouraging association between economic resilience and manufacturing sector performance combining corporate governance perspectives which is an important channel not only in achieving economic growth but also distributing the beneficial effects of growth throughout the different segments of the manufacturing industry. The study further highlighted that board size of the company is positively related to manufacturing sector performance and board gender diversity is the most prominent factor. Furthermore, the Fiscal deficit to GDP ratio is found to be more sensitive to shock absorption.

Our attention has been given to the question of how the manufacturing sector can restructure and reorganize its governance systems to enhance resilience in the face of increasingly severe natural and manmade shocks and stresses. We have centered the discussion on the critical role of corporate governance in making governance systems at all levels work better, including for resilience. We have also paid particular attention to the importance of both formal and informal institutions, noting how the latter are often more important in the sorts of contexts we describe here. Finally, we have highlighted that board gender diversification is important in corporate governance practices of all levels of governance between achieving resilience and achieving socio-economic development and opportunity. Just as we note how resilience is almost always found in the presence of good governance, so resilience is almost always found in the presence of widespread and equitable development opportunities for all members of society.

### 5.2 Recommendations

- 1) The mediating effect of manufacturing sector performance impacts the relationship between CGPs and economic resilience. Therefore, monitoring these CGPs is timely needed to foster economic resilience as the contribution of this sector given to the overall economy is stable.

- 2) Developing a resilience Index considering corporate governance metrics is needed to evaluate the practices of CG.
- 3) A stronger balance of female board members increases a corporation's productivity and profitability in the manufacturing sector further it encourages female labor participation in the Sri Lankan economy which will lead to absorbing shocks in the long run. This is probably a better reflection of consumer decision-making because women take the most responsibility for household decision-making.
- 4) If markets adjust rapidly to achieve equilibrium, then the effects of shocks can be easily absorbed in the economy.

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