CORPORATE GOVERNANCE DEVELOPMENT IN SRI LANKA: PROSPECTS AND PROBLEMS

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ABSTRACT

The study appraises the current state of corporate governance development in Sri Lanka in relation to the publicly traded (listed) companies to identify the prospects and the associated problems in the socio-economic context of the country. The study finds that corporate governance best practices have evolved in Sri Lanka over a period of time from a voluntary code of compliance to the present mandatory rules. Accordingly, the study derives the existing corporate governance model for Sri Lankan listed companies, which is a mixture of both mandatory and voluntary rules on corporate governance and it has been developed in line with the Anglo-Saxon model of corporate governance due to both historical and economic reasons. Although the Anglo-Saxon model has instilled some good corporate governance practices in these companies, the institutional conditions necessary for its successful application are lacking in Sri Lanka mainly owing to the concentrated corporate ownership structure in the country. This raises serious concerns as to the implementation of an independent director system and the protection of minority shareholder rights in Sri Lanka. However, the ownership concentration is a distinguishing feature of the insider-based corporate governance model of Continental European and Asian countries. Thus, a hybrid system of corporate governance is practised presently in Sri Lanka, which in turn indicates that the traditional dichotomy of insider and outsider models of corporate governance is not suitable in the Sri Lankan context. Hence, the best model of corporate governance for Sri Lanka is one that could address effectively the critical corporate governance issues of the country.

Keywords: Corporate governance model, Ownership concentration, Sri Lanka

1. INTRODUCTION

Corporate governance, the system by which companies are directed and controlled (Cadbury 1992), has succeeded in attracting a good deal of public interest over the years because of its apparent importance for the economic health of companies and society in general in both developed and developing countries. The roots of the modern corporate governance movement dates back to the publication of 'The Modern Corporation and Private Property', by Adolf A. Berle and Gardiner C. Means in 1932, which argued that dispersion of equity ownership in the modern corporation had separated ownership from control. Based on this seminal summary of Berle and Means (1932) and extensions made by agency theorists (Jensen and Mackling, 1976), scholars normally describe the evolution of corporate governance in terms of changes in the relationship between ownership and control (Chandler, 1977; Galbraith, 1967; Fligstein, 1990). However, corporate governance received much attention during the last two decades owing to certain economic reforms in countries and accidents of economic history such as regional market crisis and large corporate debacles. Becht, Bolton and Roell (2005) identify these reasons as worldwide wave of privatization of the past two decades; pension fund reform and the growth of private savings; the takeover wave of the 1980s; deregulation and the integration of capital markets; East Asian crisis in 1998; and a series of recent scandals and corporate failures in United States of America (USA). During the East Asian financial crisis, a lot of the attention fell upon the corporate governance systems of developing countries (emerging markets), which tend heavily into cronyism and nepotism. Claessens and Fan (2002) find that lack of protection for minority rights from expropriation of controlling shareholders as the major corporate governance issue in Asia as in many other emerging markets. This in turn is strongly associated with the high ownership concentration of Asian companies. Thus, critical issue was that the returns went disproportionately to insiders, accompanies with extensive expansion into unrelated business, high leverage and risky financial structure. In this context, conventional corporate governance mechanisms were weak to mitigate the agency problem as insiders typically dominate the board of directors and hostile takeovers were extremely rare. Hence, these features were conducive to a macro economic crisis. However, with the mega corporate debacles in many developed countries, today corporate governance has become a worldwide issue and the development of corporate governance practices has become a prominent issue in all countries in the world.

Sri Lanka too is not immune from these developments and problems relating to corporate governance. On the one hand, the private sector dominated by the corporate form of entities has become a significant economic force in Sri Lanka with the introduction of open economic policies in 1977 and the continuation of the same by the successive governments. On the other hand, there had been a few isolated incidents of corporate failures in the past such as the collapse of finance companies in 1980s, the bankruptcy of Pramuka Bank in late 1990s and the downfall of Vanik Incorporation, which was a mega company once. These corporate failures had serious repercussions on depositors and investors of these organizations, which ultimately led to erosion of public faith in the finance sector of the country. Further, at present, some mega conglomerates in Sri Lanka have come into limelight due to corporate governance deficiencies. John Keels Holdings (JKH), the biggest listed conglomerate in Sri Lanka, came into the public scrutiny recently because of the landmark Supreme Court Judgment on one of its subsidiaries Lanka Marine Services Ltd (LMSL), which was previously a state owned entity. In this judgment, the Supreme Court declared that the privatization of LMSL was illegal, unlawful and arbitrary and severely criticized JKH accusing that its directors acted in collusion with Treasury Secretary in working against the public interest. Further, three of the founding directors of Stassens Group have taken the managing director of the company to the court accusing that he takes major business decisions without their knowledge. These incidents raise serious concerns as to the accountability of directors of these companies and the corporate transparency. Further, our previous study on the salient features of corporate governance practices of Sri Lankan listed companies (Senaratne and Gunaratne, 2007a) finds that there are both positive and negative features associated with the corporate governance practices of these companies based on their level of compliance with the ICASL Code of Best Practice (2003). These negative features in turn associated to a greater extent with the concentrated ownership structure of most listed companies. Hence, the critical governance issue in the Sri Lankan context too is the protection of minority shareholders from the opportunism of controlling shareholders (ibid.). Hence, corporate governance has become a topic of interest in the country and has led the regulatory bodies to strengthen corporate governance practices of listed companies.

In this context, the objective of the study is to appraise the current state of corporate governance development in Sri Lanka in relation to the companies that are listed on the Colombo Stock Exchange (CSE). Hence, the study firstly reviews the development of rules on corporate governance in Sri Lanka and thereby derives the existing corporate governance model of the country. Thereafter, this model is critically evaluated to identify its prospects and problems faced in the implementation by drawing inferences from the prior studies of the authors on corporate governance in Sri Lanka. Based on the findings of this evaluation, the study finally makes suggestions to improve corporate governance of Sri Lankan listed companies. At present, these companies are undergoing a transformation of corporate governance requirements from voluntary to mandatory compliance. In this context, it is necessary to derive the existing corporate governance model for these companies. Further, this study is also important in the context that no attempt has been made yet to combine the various rules on corporate governance, which are available in fragmentary published form, into one document.

The remainder of the paper is organized as follows. Section 2 presents an overview of the development of corporate governance best practices in Sri Lanka. Section 3 describes the existing model on corporate governance in Sri Lanka. Section 4 evaluates the prospects and problems of this model. Section 5 concludes with recommendations for future reforms.

2. DEVELOPMENT OF CORPORATE GOVERNANCE BEST PRACTICES IN SRI LANKA

The development of corporate governance structures and practices in Sri Lanka dates back to the British Colonial rule in the country from 1796 to 1948 as the corporate form of entities as well as share trading was introduced in the country during this period. Even most of the corporate entities presently listed on the CSE also have roots dating back to British era. Senaratne (2007) finds two categories of such listed companies: (1) Companies that have commenced during the British rule and continued after independence with or without foreign owners and (2) Companies that have commenced after independence through the amalgamation of several entities formed during the British rule. Therefore, the development of corporate governance best practices in Sri Lanka has been heavily influenced by British models and systems, which derive from the Anglo-Saxon (market based) model of corporate governance. Hence, the notable feature of corporate governance reforms in Sri Lanka is the close allegiance with the Anglo-Saxon model of corporate governance (Senaratne and Gunaratne, 2008). Even though indigenous businesses progressed after gaining independence in 1948, the traditional loyalty to this model did not fade away mainly due to the professional biasness towards this system and development of Sri Lanka's company law based on the British company law. The inclination towards this model is also connected to the adoption of liberalized economic policies in Sri Lanka (of which Anglo-Saxon model is the logical counter-part) and the influence of the international funding agencies such as World Bank and IMF (which usually advocate the use of a market based model).

The development of codes on corporate governance best practices began in Sri Lanka in late 1990s based on the developments that had taken place in this respect in United Kingdom (UK). The first Sri Lankan corporate governance code was introduced in 1997 by the Institute of Chartered Accountants of Sri Lanka (ICASL) to deal with financial aspects of corporate governance of Sri Lankan listed companies. This was a blueprint of the Cadbury Code (1992) - Financial Aspects of Corporate Governance, the first code of corporate governance introduced in UK and the first code of best practice developed based on the Anglo-Saxon model of corporate governance. The Cadbury Code deals with the structure and responsibilities of the board of directors; the role of auditors; and the rights and responsibilities of shareholders. The 1997 Code was replaced by the ICASL Code of Best Practice on Corporate Governance introduced in March 2003 and it was largely based on the Hampel Report (1998). Its focus is much larger than of 1997 code as it covers many aspects of corporate governance covering directors, shareholders and auditors not only the financial aspects. This is because the scope of Hampel Code was much broader than of Cadbury Code. However, by this time, UK had gone a long way by introducing Combined Code (2003) which superseded the Combined (Hampel) Code (1998), by deriving from three other codes that had been developed between 1998 and 2003 to deal with several specific aspects of corporate governance - Turnbull Report on Internal Controls (1999), Smith Report on Audit Committees (2003) and Higgs Report on Review of the Role and Responsibilities of Non-Executive Directors (2003). Further, Sarbanes-Oxley Act was introduced in USA in 2002 aftermath of the collapse of Enron and WorldCom. This shows that Sri Lankan codes on best practice have not kept pace with these latest global developments in corporate governance.

The essential characteristic of these Sri Lankan codes is that they were voluntary codes of corporate governance. Hence, they were only recommended to be followed by the listed companies. Further, these codes did not include 'comply or explain' provision, which requires companies to explain reasons for non-compliances. Therefore, these codes were neither prescriptive nor principle based. In addition, there were a number of supplementary codes to ICASL Code to deal with specific aspects or areas of corporate governance. These were

'ICASL Code of Best Practice on Audit Committees 2002' to provide detail guidance on the scope and functions of the audit committee of listed companies, 'Code of Corporate Governance for Banks and Other Financial Institutions 2002' issued by the Central Bank of Sri Lanka and 'Guidelines for Listed Companies in respect of Audit and Audit Committees 2004' issued by the Securities and Exchange Commission (SEC). None of these codes were also mandatory and the companies were expected to adopt them voluntarily. Further, the presence of a number of codes and guidelines indicates a lack of uniformity in corporate governance rules in the country.

The rules on corporate governance have been incorporated into the CSE Listing Rules from 2007 and made mandatory for listed companies from April 2008. These mandatory rules have been developed through a joint initiative of ICASL and SEC in consultation with the CSE. The Section Six of the Listing Rules deals with the rules on corporate governance that prescribes the minimum number of non-executive and independent directors to be present on the board, the criteria for determining 'independence' of non-executive directors, disclosures required to be made in respect of the directorate, and the minimum requirements to be met in respect of the audit committee and the remuneration committee. In respect of both audit committee and remuneration committee, the composition, functions and the relevant disclosures in the annual report have been specified. These rules have been largely derived from international corporate governance codes especially from UK Combined Code 2003. However, these rules at first instance provide only the minimum standards to be met by a listed company. Hence, ICASL jointly with SEC issued a Revised Code of Best Practice in October 2008 to be complied voluntarily by companies in conjunction with the mandatory rules. It is a comprehensive code covering many aspects on corporate governance including the following areas not addressed in the Listing Rules: appointments to the board (establishment of a nomination committee); re-election of directors; performance evaluation of directors; separation of roles of chairman and CEO; supply of information to directors; board and board committee meetings; internal controls, financial reporting; relations with shareholders and the role of institutional shareholders. A special feature of this code is that it requires companies to adopt a Code of Business Conduct and Ethics for directors and senior management.

On the other hand, the Central Bank of Sri Lanka has also issued a mandatory code of corporate governance - the Banking Act Direction No. 01 of 2008 on Corporate Governance for Licensed Commercial Banks in Sri Lanka in April 2008, which banks are expected to comply fully by 1st January 2009. This has been designed as a series of rules based upon certain fundamental principles which would promote a healthy and robust risk management framework for banks with accountability and transparency through policies and oversight by the board of directors. It is a comprehensive code of corporate governance setting out principles and rules for responsibilities of the board, composition of the board, criteria to assess fitness and propriety of directors, management functions delegated by the board, roles of chairman and CEO, board committees, related party transactions and disclosure. Further, the Central Bank has issued Direction, No. 3 of 2008 on Corproate Goverance for finance companies registered under Section 2 of the Finance Companies Act, No. 78 of 1988. This is mandatory from 2009.

It is clear that the development of corporate governance best practices for Sri Lankan companies have been gradually evolved over a period of time from the introduction of the first code of best practice in 1997 to the introduction of minimum rules of corporate governance for mandatory compliance of listed companies in 2008. The notable feature of these codes and rules is that they have been developed in line with the Anglo-Saxon model owing to both historical and economic reasons. Further, these developments in best practices have been influenced to a greater extent by the continuous international dialogue on the need to strengthen the corporate governance practices to achieve economic prosperity.

3. EXISTING CORPORATE GOVERNANCE MODEL OF SRI LANKA

At present the corporate governance practices of Sri Lankan listed companies are governed by the mandatory corporate governance rules included in the CSE Listing Rules. However, as Listing Rules provide only minimum standards to be complied by the listed companies, ICASL Code of Best Practice (2008) will provide the basis for the development of corporate governance practices that are not covered in these rules. Further, these companies are also required to comply with the provisions of the Companies Act No.07 of 2007 on the appointment and removal of directors and auditors and the listed licensed commercial banks have to comply with Central Bank Direction on Corporate Governance. Based on these governing rules and regulations, the Existing Corporate Governance Model for Sri Lankan Listed Companies (which they are expected to follow) has been derived in the study and it is presented in Figure 1.

This model has been developed on the assumption that the ownership of listed companies is separated from the management resulting in the shifting of power and control from shareholders to management. This requires having appropriate checks and balances over management. Hence, the directors are appointed by the shareholders to oversee the management on their behalf as depicted in Figure 1. The directors are appointed by the shareholders at the Annual General Meeting (AGM) of the company in terms of the Company Act. Due to the strong historical ties with the British corporate model, Sri Lankan companies have a unitary board structure consisting of both executive and non-executive directors as shown in Figure 1. Executive directors are employees of the company and usually senior managers, who are involved in the day to day running of the company with the management. On the other hand, the non-executive directors do not involve in the management of the company. Although both executive and non-executive directors have the same fiduciary duty to the company, the non-executive directors can bring an objective view to the evaluation of the management of the company due to the non-involvement in the management. Thus, the Listing Rules require listed companies to maintain a proper mix of executive and non-executive directors in the board by including a minimum of two non-executive directors or one third of total number of directors, whichever is higher. Further, the Listing Rules require these directors to be independent of management and free from any business or other relationship that impair their independence. These two aspects of listed licensed commercial banks are governed by the Central Bank Direction. Although not required under the Listing Rules, the ICASL Code and the Central Bank Direction require companies to separate the roles of chairman (Head of the Board) and CEO (Executive Head of the Company) as depicted in Figure 1. The chairman as the head of the board can play a central role in ensuring the effective governance of the enterprise and is responsible for the board's effective functioning. Hence, in the unitary board structure, the separation of the roles of the chairman and the CEO is proposed as a method of ensuring an appropriate balance of power and increasing accountability and the capacity of the board for independent decision making.

The directors' responsibilities are identified in Figure 1 based on the provisions of the Companies Act, Central Bank Direction and the ICASL Code. The Listing Rules do not contain specific provisions in this regard. Both ICASL Code and Central Bank Direction specify that the directors are responsible for financial reporting, maintenance of a proper system of internal controls and risk management of a company in addition to the conduct of business and other operational matters. The Companies Act too specifies that among other things the directors are responsible for the preparation of the financial statements of a company and dissemination of those to the shareholders. Further, these regulations require the listed companies to appoint board committees (Refer Figure 1) to oversee the areas where there is a potential conflict of interest between the shareholders and the managers. These committees are subsets of the board that are formed as means of strengthening the independence and accountability of the board and should consist mainly of non-executive directors. The Listing Rules require companies to establish board committees on audit and remuneration to oversee determination of executive remuneration, and financial reporting, internal controls and risk management respectively. In addition to these two committees, the ICASL Code requires companies to appoint a nomination committee to oversee the selection and appointment of directors. However, the appointment of all three committees along with an integrated risk management committee is mandatory for licensed commercial banks under the Central Bank Direction.

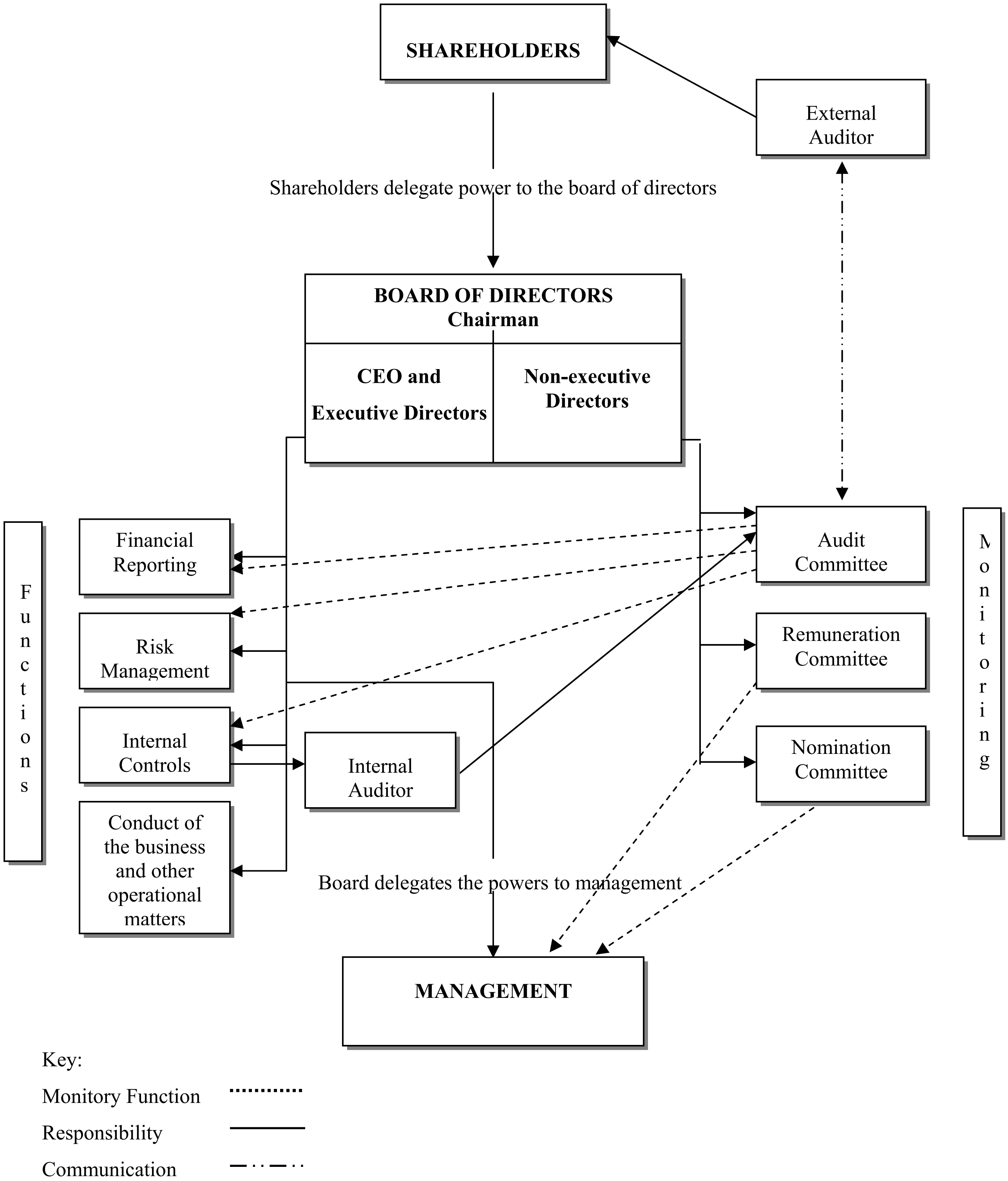

Figure 1: Existing Corporate Governance Model for Sri Lankan Listed Companies

In the corporate governance structure of a company the external auditor provides an external and objective check on the way in which the financial statements have been prepared and presented. Therefore, the external audit has become an essential part of the checks and balances on corporate managers as shown in Figure 1. The Companies Act requires the external auditor to be appointed by the shareholders at the AGM of the Company. Both Listing Rules and Central Bank Direction require that the board should deal with the external auditor through the audit committee. Further, the ICASL Code and Central Bank Direction recommend companies to appoint an internal auditor, who report directly to the audit committee to maintain the independence as reflected in Figure 1. However, the Listing Rules are silent on this matter.

It is clear from the above discussion that the existing rules on corporate governance proposes a comprehensive corporate governance model for Sri Lankan listed companies and it is a mixture of both mandatory (Companies Act, Listing Rules, Central Bank Direction) and voluntary (ICASL Code of Best Practice) rules on corporate governance. However, it is too early to comment on the actual level of compliance of Sri Lankan companies with this model as it is mandatory for compliance only from this year.

4. PROSPECTS AND PROBLEMS OF THE EXISTING MODEL

The introduction of the mandatory listing rules on corporate governance is a significant move towards the development of governance practices of Sri Lankan listed companies in the context that there is functional convergence in these companies to the previous voluntary code of compliance (Senaratne and Gunaratne, 2007a). Further, it can be considered as a response to the needs of the society to improve the governance of companies. However, these rules at present provide only the minimum standards of corporate governance that companies (other than licensed commercial banks) should comply with. Therefore, there is much room for further improvement in these mandatory rules in the future. On the other hand, a detailed mandatory code of corporate governance has been introduced for licensed commercial banks considering economic vulnerability of these institutions. However, having several mandatory rules on corporate governance could create a certain degree of confusion among companies. Hence, in the outset, it can be stated that while the existing model provides many prospects to improve governance practices of Sri Lankan companies, there are also several associated problems that need close attention.

The notable features of this model are the specification of a minimum number of non-executive directors to be present in the board and the inclusion of criteria to identify relationships and circumstances that impair the independence of non-executive directors. These features allow the non-executive directors to bring fresh perspective and contribute more objectively in supporting as well as constructively challenging and monitoring, the management team as they are not involved in the day-to-day running of the business (Higgs Report, 2003). The inclusion of outside directors as professional referees also enhances the viability of the board in achieving low-cost internal transfer of control and lowers the possibility of top management colluding and expropriating shareholders (Fama, 1980). Further, these rules will contribute to improve the independence of non-executive directors as lack of such directors is presently a negative corporate governance feature of many listed companies (Senaratne and Gunaratne, 2007a).

However, in light of the concentrated ownership structure of most Sri Lankan listed companies (Senaratne and Gunaratne, 2007b); the practicality of having independent non-executive directors in these companies is questionable. The majority of non-executive directors in these companies are not independent because they either represent a substantial shareholder or hold cross directorships with other directors of the company or in companies with which the company is having business dealings (Senaratne and Gunaratne 2007a). Further, Senaratne and Gunaratne (2007b) find that the concentrated ownership structure of these companies with a controlling shareholder and a family or a group of closely related individuals as the ultimate owner strongly influences the governance structure and practices especially the appointment and independence of directors. The high concentration in ownership is a common phenomenon in many Asian countries as revealed by OECD White Paper on Corporate Governance in Asia (2003) and Claessens et al. (2000). These studies state that the controlling shareholders usually select the entire board of directors. Hence, the non-executive directors fail to demonstrate in practice the independent judgment required to make their consent in an effective safeguard against abuse. Finally, these passive or acknowledgeable non-executive directors fail to monitor the executive directors closely. Thus, the appointment of independent non-executive directors is a challenging task in the Sri Lankan context as in other Asian countries and it is also a key to determine the effective discharge of functions of board committees. As large shareholding has become a norm in many countries in the world, it is even considered as one approach to corporate governance (Shleifer and Vishny, 1997). Hence, it is necessary to conider the trade-off between alignment and entrenchment effects of controlling shareholders' ownership on corporate governance (Denis and McConnel, 2003).

The mandatory provisions on the establishment of an audit committee and a remuneration committee with independent non-executive directors can be considered as a significant move towards the improving the quality and credibility of financial reporting, and the transparency on the determination of directors' remuneration. Although many Sri Lanka listed companies had appointed an audit committee as in many other Asian countries (OECD White Paper 2003), a transparent procedure was absent in the determination of directors' remuneration in them (Senaratne and Gunaratne, 2007a). The prominence of audit committees in Sri Lankan companies may have been associated with the dominance of accounting professionals in the boards of these companies and the developed accounting profession in Sri Lanka (Senaratne, 2007). However, the appointment of a nomination committee to oversee board appointments including succession planning and performance evaluation of directors is not yet mandatory for listed companies except for licensed commercial banks for which it is mandatory under the Central Bank Direction. It is questionable why the Listing Rules have not made the establishment of a nomination committee mandatory. A proper and transparent procedure on board appointments is a key to have an effective board as the roles and responsibilities of directors underpin the task of corporate governance. The lack of transparency in the board appointments has also been found as a negative corporate governance feature in many Sri Lankan listed companies (Senaratne and Gunaratne, 2007a). Hence, this area needs special attention in future reforms.

The Listing Rules has not paid a sufficient attention on establishment of a system of internal controls (including risk management processes and internal audit function), which is an integral part of an effective system of corporate governance. This could also have a negative effect on the enforcement of the authority of audit committee on the oversight of internal controls. However, the strengthening of risk management processes and internal controls has been identified as a key area of concern for licensed commercial banks under the Central Bank Direction. Although the Listing Rules allows the audit and remuneration committees of a listed parent company to govern the activities of subsidiaries, its practicality is questionable in relation to parent companies with a large number of subsidiaries.

The above analysis and discussion indicate that the existing corporate governance model for listed companies have many prospects to improve the governance practices of these companies as well as some critical problems that could act as an inhibitor in realizing the benefits of these prospects. The problems mainly result from the non-availability of necessary conditions for the successful implementation of the Anglo-Saxon model of corporate governance in the Sri Lankan context. It is based on a number of assumptions as to the ownership dispersion in corporate entities, presence of institutional shareholders, the central role the capital market play in the economy and the availability of an active takeover market. However, the previous studies on governance practices of Sri Lankan companies (Senaratne and Gunaratne, 2007a; Senaratne and Gunaratne, 2008) reveal that these conditions do not exist in Sri Lanka in the same manner as they present in the Anglo-American countires, which embrace this model. Many Sri Lankan companies are characterized by a high degree of ownership concentration, which acts as a hindrance to have an active takeover market and a liquid stock market, and a low number of arms-length institutional shareholders. The absence of these necessary conditions is closely associated with the variation in the socio-economic and political conditions of Sri Lanka from Anglo-American countries. Compared to these countries, Sri Lanka is a collectivistic society, which promotes family ownership and the investments of the general public in the CSE is low, which in turn to a certain extent associated with elitism (i.e. dominance of an elite group of businessmen or families) and emerging business class with political power and patronage in the Sri Lankan society. Further, the political governance in the country, which is marred by corrupt practices, no means facilitates improving corporate governance. This also leads to the distortion of market forces, which is against the very principles of liberalized economic policies adopted in the country from 1977. Aguilera et al. (2007) identify that the common elements of Anglo-Saxon corporate governance often absent in other countries where corporate governance practices interact in different combinations and display different set of complementarities. Thus, it is questionable whether the full benefits could be derived by Sri Lankan companies from the mandatory rules on corporate governance in this context. Hence, the pertinent question is whether the Anglo-Saxon model of corporate governance should be either contextualized or supplemented to suit the requirements of Sri Lankan corporate entities.

5. CONCLUSION

The review of existing model of corporate governance of the country shows that it has many prospects to develop the governance practices of listed companies. However, there are also problems associated with the implementation of some key provisions of the model, which mainly stem from the concentrated ownership structure of these companies. Under the concentrated ownership structure, ownership and control is separated between the minority shareholders and the controlling shareholders not between the owners and the managers as expected in the Anglo-Saxon model (Senaratne and Gunaratne, 2007b). Hence, the critical corporate governance issue in the Sri Lankan context is the protection of minority shareholders' interests. Thus, it is questionable whether this existing corporate governance model based on the Anglo-Saxon model could address this critical corporate governance issue effectively. It could solve these issues effectively only if the associated conditions facilitate its successful implementation. This requires changes in the ownership structure of these companies to suit the corporate governance structure proposed for them or vice versa. Further, the broad-basing of corporate ownership is strongly associated with the degree of capital market development in the country. Hence, corporate governance reforms cannot be carried out in isolation. Instead a holistic approach should be followed.

However, this issue could also be considered from a different perspective. Bebczuk (2007) states that in both conflicts (managers and shareholders as well as controlling-minority shareholders), that the powerful party uses their power to benefit themselves at the expense of the weaker party. Hence, the root of both conflicts is that the manager in the first case and the controlling shareholder in the second case enjoy control rights in excess of cash flow rights in a company and thereby they will maximize their utility even when the firm as a whole will not. However, the ability of these parties to fulfill their goals will be conditioned by the power they have in the decision making process. Thus, the corporate governance model should pay special attention to strengthen the rights of the weaker party. In the Sri Lankan context, the minority shareholders' voting and other rights should be strengthened.

A major weakness of the existing corporate governance model is the presence of several codes of compliance. It leads to lack of uniform direction for listed companies. On the one hand, rules for mandatory compliance are included in the CSE Listing Rules. On the other hand, there is a separate code of corporate governance for licensed commercial banks and similar code is in offing for finance companies. It is well accepted that these sectors need more stringent rules in corporate governance. However, there should also be a close link between the main regulation of corporate governance and these sector specific codes. Ideally the latter should stem from the former. This is not seen at present as a holistic approach has not been followed in corporate governance reforms. Further, the introduction of rules along will not ensure that corporate governance best practices will be followed by Sri Lankan companies. There should also be an effective enforcement mechanism to ensure that they comply with the best practices. Otherwise, there is a possibility that the regulator being captured by the regulated party and finally the regulator may not act as a neutral arbiter.

The different models of corporate governance (Anglo-Saxon model, Continental European model) have been evolved over a period of time in developed countries to suit their local environmental conditions. However, these models particularly the Anglo-Saxon model has been implanted in many developing countries due to colonial influence or pressure from international funding agencies. This itself is a barrier for the successful implementation of these models. Therefore, to a certain extent, these models need to be contextualized to suit the environmental conditions of developing countries. Hence, in developing a corporate governance model for Sri Lankan companies in the future, firstly the broad corporate governance principles should be identified. Thereafter, specific rules and criteria should be developed to suit the various sectors and conditions within the economy. Further, the corporate governance best practices should be able to protect the interests of all stakeholders not only of the shareholders as bad governance affects many other parties as clearly evident in the JKH scandal and in the failures in the finance sector. Hence, a broad perspective should be adopted in future corporate governance reforms in Sri Lanka based on the stakeholder approach to corporate governance rather than focusing only on the shareholder primacy, which gives a narrow connotation to corporate governance.

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