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CORPORATE FINANCE PRACTICES IN SRI LANKA

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ABSTRACT

The aim of this study was to investigate the use of corporate finance practices in terms of capital budgeting, cost of equity capital and capital structure in Sri Lanka. A comprehensive primary survey was conducted of 38 out of 150 financial officers of companies listed on the Colombo Stock Exchange (CSE) in Sri Lanka. Stratified random sampling was used to select the participants in order to represent the different sectors in CSE. Collected data were then analyzed by applying mean and percentage analysis. Results of the survey revealed that NPV was the most frequently 'always' cited capital budgeting method, followed by IRR and PB. CAPM was the most preferred method to calculate the cost of equity capital followed by average historical rate of return on common stock. Remarkably, most firms would use a discount rate for entire company to evaluate the project. Further, it was evaluated that how finance professionals make adjustments for risk factors. It was concluded that risk of unexpected inflation, interest rate risk, term structure risk, business cycle risk, size based risk, market to book ratio and momentum were mostly adjusted by discount rate while commodity price risk, foreign exchange risk and distress risk were mostly adjusted by cash flow. Further, this study was to find out whether Sri Lankan finance professionals behave as expected by pecking order theory of capital structure patterns. Findings of the study are in line with the pecking order theory that firms are having preference to internal finance for their capital. This research has proffered a more reliable and comprehensive analysis of corporate finance practices in Sri Lankan companies.

Contribution/ Originality: This study was one of the very few studies which have investigated the corporate finance practices in emerging markets. The present study focused on capital budgeting, cost of equity capital and capital structure practices in Sri Lanka which give the geographical contribution to the existing finance literature.

1. INTRODUCTION

Over the last two decades, there have been many changes and challenges in making financial decisions due to the global financial crisis, fluctuations in value of money, advanced developments in technology, interest rate, exchange rate and inflation rates' risks and dramatic changes in economic and business environment both in national as well as in global markets. The corporate finance decision making is not a simple or straightforward approach, the risk is an important element in the decision making. There are number of risk techniques employed