

# Student Conference in Finance 2024

## Proceedings



Department of Finance  
Faculty of Management Studies and Commerce  
University of Sri Jayewardenepura

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**Nugegoda**  
**Sri Lanka**



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Sri Lanka  
28<sup>th</sup> February 2024**

The ideas expressed are the ideas of the authors and the Department of Finance cannot be held responsible.

@ Department of Finance

Proceedings of the Student Conference in Finance  
Department of Finance  
Faculty of Management Studies and Commerce  
University of Sri Jayewardenepura  
Sri Lanka

ISSN: ISSN 2659 - 2304

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Edited by: Prof. R P C R Rajapakse

Cover Design: Prof. A G C Gunathilaka

Print: Cybergate, Wijerama

Published by:

The Department of Finance  
Faculty of Management Studies and Commerce  
University of Sri Jayewardenepura  
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## **Message from the Vice-Chancellor**



It gives me great pleasure to extend my congratulations and best wishes to all participants of the Undergraduate Research Conference linked with the 20<sup>th</sup> International Conference on Business Management (ICBM 2024), hosted by the Faculty of Management Studies and Commerce (FMSC) at the University of Sri Jayewardenepura.

As an institution committed to the pursuit of knowledge and academic excellence, the University of Sri Jayewardenepura takes pride in providing a platform for undergraduate students to showcase their research endeavors.

Your participation in this conference not only demonstrates your dedication to academic inquiry but also highlights your potential as future leaders and innovators in the field of business management.

I would like to express my sincere gratitude to the Dean of the Faculty of Management Studies and Commerce, the Conference Co-Chairs, and the entire Organizing Committee for their hard work and dedication in organizing this event. Your efforts have provided a valuable opportunity for undergraduates to present their research findings, exchange ideas, and engage in meaningful discussions with peers and faculty members.

I offer my heartfelt congratulations to all the paper presenters of the Undergraduate Research Conference. Your enthusiasm, passion, and commitment to academic excellence are truly inspiring. I encourage you to continue pursuing your academic and professional goals with dedication and determination. Your contributions are a testament to your potential to make a positive impact in the field of business management and beyond.

Once again, congratulations to all participants, and I wish you a successful and enriching experience.

**Senior Professor Pathmalal M. Manage**

Vice-Chancellor

University of Sri Jayewardenepura

**Message from the Dean  
Faculty of Management Studies and Commerce**



I am delighted to express my best wishes for the Undergraduate Research Conference held in conjunction with the 20<sup>th</sup> International Conference on Business Management (ICBM) 2024. As part of our ongoing efforts to foster a vibrant research culture within our faculty, we are proud to provide undergraduate students with the opportunity to engage in scholarly pursuits and share their research findings.

The Undergraduate Research Conference holds significant importance as the main research event of our faculty this year, running concurrently with the prestigious ICBM. We are pleased that we, as a faculty, have extended this invaluable opportunity to our undergraduate students.

For the students who have been selected to present their papers at the Undergraduate Research Conference, this marks a remarkable milestone in your academic journey. Congratulations on being chosen to represent our faculty in this capacity.

I extend my heartfelt gratitude to all the research supervisors, research coordinators, and academic staff from various departments who have worked tirelessly to support these students in their research endeavors.

To the participating students, I encourage you to leverage the experience gained from this conference and aspire for further academic pursuits, such as journal publications. May this event serve as a steppingstone towards developing an inquisitive and scholarly mindset as you progress in your academic journey. Once again, congratulations to all selected participants, and my best wishes for your continued success.

**Dr. Dushan Jayawickrama**

Dean

Faculty of Management Studies and Commerce

University of Sri Jayewardenepura



## Message from the Head of the Department



As the pioneering finance faculty of Sri Lanka, we continue to support institutions, industry practitioners, and policymakers to shape the future of business. We are committed to increasing the potential of our undergraduates through continuous improvements in the curriculum, teaching, knowledge creation, and dissemination. It is in this process that the student conference is organized where the young finance researchers' talents are recognized.

Our aim is not merely to disseminate knowledge but to cultivate a vibrant community of thinkers and doers, where intellectual discourse thrives, and innovation knows no bounds. We established an academic research journal in the Asian context, *Asian Finance Review*, the journal has been recognized by EBSCOhost recently and the respect goes to the chief editor Professor Champa Rajapakse. Additionally, a research center for finance was established within our department in 2023. The goal is to unleash the boundless potential within each student of our program, empowering them to become catalysts for positive change in their respective work environment, community, and beyond. We are not just disseminators of knowledge; we are architects of a brighter future!

I congratulate the organizing team, young researchers, and stakeholders of this conference.

**Prof. Chandana Gunathilaka**

Head

Department of Finance

Faculty of Management Studies and Commerce

University of Sri Jayewardenepura

## **Message from the Conference Chairperson/ Coordinator**



I consider it an obligation and a privilege to chair/coordinate the Student Conference in Finance (SCF) as the coordinator of the research study/ project of the Department of Finance. The Department organizes SCF for the 7<sup>th</sup> consecutive year.

This is an annual event of the Department of Finance organized to showcase research findings of the students who complete B.Sc. Finance (Special) degree program. Fourteen students will present their findings on diverse topics at this year's conference. This conference would enable the world outside to be aware of the new knowledge created by universities. We wish the presenters every success in their careers in future research.

The support of the Head of the Department of Finance, the Dean of the Faculty of Management Studies and Commerce, and the Vice-chancellor of the University of Sri Jayewardenepura is acknowledged with gratitude. We also thank the ICBM team for funding the event, the reviewers for their valuable contribution, the organizing committee, and the FMSC technical support staff for their untiring efforts in making this event a success.

**Prof. R P C R Rajapakse**

Conference Chairperson/ Coordinator

Department of Finance

Faculty of Management Studies and Commerce

University of Sri Jayewardenepura

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# THE IMPACT OF CORPORATE GOVERNANCE PRACTICES ON FIRM PERFORMANCE OF SRI LANKAN LISTED COMPANIES

Raigama R.D.S<sup>1</sup>, and Dissabandara D.B.P.H<sup>2</sup>

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## Abstract

This study looks at the manner of which how corporate governance practices have impacted on firm performance of companies listed in Colombo Stock Exchange, Sri Lanka in 2016 and 2022. A comprehensive corporate governance index (CGI) is constructed to assess the adherence of corporate governance practices based on the Code of Best Practices on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka, UK Corporate Governance Code, and the OECD principles. Study determines the degree of corporate governance compliance level by constructing the CGI with the assistance of four sub areas as board, stakeholders, CEO and executive management and disclosures and transparency. A sample of 60 companies is selected to investigate the nature of the relationship between the CGI and firm performance. Tobin's Q has been employed to measure the market performance and ROA and ROE have been chosen to measure the financial performance of the selected sample. Data has been extracted from the published annual reports from the website of Colombo Stock Exchange. This study has explored further details by analysing the corporate governance compliance of firms before and after the Covid 19 pandemic. In line with the findings, the mean compliance level of CGI is 76.80% in 2016 and 80.19% in 2022 respectively. It has indicated a 3.90% of increase in the CGI after the Covid 19 pandemic. In accordance with the correlation analysis and the regression analysis, it reveals a significant positive relationship between the CGI and financial performance which is measured by ROA and ROE. In contrast, no significant relationship has been identified between CGI and the Tobin's Q ratio. Overall, this research study adds a novel knowledge to the existing body of literature and offers an important greater detailed insight for the firms and decision makers to reinforce the corporate governance adherence in an emerging market like Sri Lanka in the future.

**Keywords:** Corporate governance index, Board, Stakeholders, CEO, Disclosures, Firm performance

# INVESTIGATING THE IMPACT OF INTERNAL FACTORS ON PROFITABILITY OF LISTED COMPANIES UNDER FOOD, BEVERAGE AND TOBACCO AND MATERIALS INDUSTRIES IN SRI LANKA

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## Abstract

Profitability stands as a pivotal determinant for a company's growth, sustainability, and overall success in the business world. While external forces undoubtedly impact an organization's success, understanding the internal factors influencing profitability is crucial for effective strategic decision-making. Hence, using the deductive approach, this comparative study investigates the extent to which internal factors such as firm size, liquidity, working capital, company efficiency, and leverage influence the profitability of listed companies in the food, beverage and tobacco and materials industries in Sri Lanka. This research is based on five independent variables, namely firm size, working capital, liquidity, company efficiency, and leverage, and two dependent variables, ROE and ROA. The study tests and confirms hypotheses on a data of sample from 27 companies out of 46 companies in the food, beverage and tobacco industry and 13 companies out of 19 companies in the materials industry covering the timeframe 2016 to 2023 extracted from companies' annual reports. Panel regression analysis was performed to determine the extent to which each internal factor impacts profitability. The findings show that ROE and ROA, which measure profitability in the food, beverage and tobacco industry, are highly impacted by all internal factors, except company efficiency. Further, apart from company efficiency and leverage, all other variables have a considerable impact on ROE, and all internal factors considered in this study have an impact on ROA in the materials industry. When examining the relationship between internal factors and profitability in this research, it was found that firm size, working capital, and company efficiency have positive relationships with profitability, while leverage and liquidity have negative relationships in both industries. This study is most significant for managers, shareholders, and employees of the food, beverage and tobacco and materials industries in Sri Lanka.

**Keywords:** Profitability, Internal factors, Food, Beverage & Tobacco industry, Materials industry

## ASSETS CORRELATION IN SRI LANKAN STOCK MARKET BEFORE, DURING, AND AFTER THE COVID-19 PANDEMIC

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### Abstract

This paper examines the impact of asset correlation in the Sri Lankan stock market across three distinct periods including “before, during, and after the COVID-19 pandemic.” The study observes a sample of 120 firms listed on the Colombo Stock Exchange across 19 different sectors, over a period of 187 weeks from June 17, 2019, until March 27, 2023. This study employs a mathematical approach, utilizing secondary data. This research is based on four independent variables, namely “before, during, and after the COVID-19, and whole period, and one dependent variable, stock return. It analyses the degree of asset correlation among sectors using an analytical method based on the Pearson Correlation Coefficient. According to the findings, a comparison of assets correlation between all sub-periods indicates that “before the pandemic” the number of negative assets correlation was 22%. This is higher compared to “during, after pandemic and whole period” duration. The food, and staples retailing (10) sector has the highest negative assets correlation. Further, this study finds the number of negative correlations for the period of “During and After the pandemic” are 12% and 15% respectively. The results of the study indicate that the Healthcare Equipment & Services and Telecommunication Services sectors have a higher number of negative correlations in the period “during and after the COVID-19 Pandemic”. Hence, the results of the study could inform investors and fund managers to identify appropriate opportunities by looking at the correlation value in different sub-periods to minimize investment risk and maximize investment return.

**Keywords:** Assets correlation, Colombo Stock Exchange, Investment, Portfolio, Diversification

## FACTORS AFFECTING FIRMS' DECISION TO GO PUBLIC IN SRI LANKA

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### Abstract

In recent years, there has been a noticeable trend in Sri Lankan companies going public which is known as Initial Public Offerings (IPOs). This trend has piqued the interest of researchers, prompting an exploration into the underlying factors influencing firms' decisions to go public. Existing literature in the Sri Lankan context has primarily concentrated on the underpricing phenomenon using secondary data sources, often presenting it as the sole significant factor motivating companies to go public. Identifying this research gap, our study delves into a broader spectrum of factors impacting firms' decisions to go public and examines the nuanced ways in which these factors exert influence. To address this, we conducted a survey using a questionnaire distributed to Finance Managers of companies listed in the past five years, spanning from 2019 to 2023. Unlike previous studies relying solely on secondary data, our approach allowed us to gather insights directly from key decision-makers. The survey targeted the Finance Managers of the twenty-two companies listed during this period, with responses received from seventeen participants. The study focused on five key variables: Motivation, Timing, Underwriter Performance, Underpricing phenomena, and Market Signals. Through regression analysis, we aimed to decipher the relationship between these independent variables and firms' decisions to go public. The results unveiled a positive correlation between Motivation, Underwriter Performance, Underpricing phenomena, and Market Signals with firms' decisions to go public. However, an intriguing finding was the negative impact of Timing on these decisions. It's crucial to acknowledge the limitations of our study, notably the exclusive focus on the last five years and the omission of sector-wise performance considerations. Future research endeavors are recommended to explore factors influencing firms to go public while categorizing them based on the sectors designated by the Colombo Stock Exchange. This sector-specific approach could offer a more nuanced understanding of the dynamics at play in the decision-making process for companies contemplating going public.

**Keywords:** Initial Public Offerings, IPOs, Go Public, Motivation, Timing, Underwriters' performance, Underpricing, Signaling



# DYNAMIC LINKAGES BETWEEN EXCHANGE RATES AND STOCK PRICES: EVIDENCE FROM SOUTH ASIAN MARKETS

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## Abstract

This study investigates the dynamic linkages between exchange rates and stock prices in selected South Asian countries, including Sri Lanka, India, Pakistan, Bangladesh, and the Maldives. The analysis covers the period from January 2000 to December 2020. The primary objective is to discern the causal relationships between exchange rates and stock prices in these economies, considering the influence of regional and global economic events. The methodology involves employing Granger causality tests, variance decomposition analysis, and impulse response analysis to examine the direction and strength of the relationships over time.

The empirical results reveal noteworthy findings within the South Asian context. Prior to significant economic events, such as the global financial crisis and other regional shocks, a significant causal relation from exchange rates to stock prices is identified in Sri Lanka, India, and Bangladesh. Notably, the Maldives exhibits a distinct pattern with limited causality during these periods. Additionally, the study explores the reverse causality from stock prices to exchange rates, with variations observed across the selected countries during crises. Further analysis indicates that the observed linkages are influenced by factors such as exchange rate regimes, trade sizes, capital control measures, and the size of the equity market.

This research significantly contributes to the nuanced understanding of the complex relationships between exchange rates and stock prices in South Asian countries. The findings emphasize the importance of considering contextual economic factors and policy measures in comprehending the evolving and dynamic nature of these linkages.

**Keywords:** Exchange rates, Stock prices, Granger Causality, South Asian Countries, Financial markets

## **ROBO-ADVISORS AS BEHAVIOURAL BIAS MITIGATORS: A SYSTEMATIC LITERATURE REVIEW**

Iddamalgoda M.M<sup>1</sup>, and Nanayakkara N.S<sup>2</sup>

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### **Abstract**

This literature review examines the role of robo-advisors in mitigating behavioural biases within the decision-making processes of individual investors in the context of investment advisory services. With a focus on the rapid growth of robo-advisory services, the study addresses two key research questions. Firstly, it explores the concept of robo-advisory in investment services, and secondly, it assesses the effectiveness of robo-advisors in mitigating the behavioural biases in the decision-making processes of individual investors. Employing a systematic literature review (SLR) methodology, the authors initially identified a pool of 70 relevant publications based on the research criteria. This selection was guided by content analysis of the articles' abstracts and conducted through keyword searches across databases such as Science Direct and Google Scholar, spanning the period from 2010 to 2023. Subsequently, the selection process employed specific selection and elimination criteria facilitated by the EPPI Reviewer software and narrowed them down to 25 articles to include in the final analysis. The results of the review indicate that while robo-advisors play a significant role in fostering better-informed and less biased decision-making, they are not yet fully autonomous in eradicating behavioural biases; instead, they demonstrate a capability to reduce them. The practical implications of this study extend to fintech start-ups, banks, robo-advisor architects, product owners, and wealth management service providers. Insights derived from this study can inform the refinement of products and platforms, enhancing the efficacy of automated advisory services in assisting individual investors to navigate and mitigate behavioural biases in investment decision-making. These services would be beneficial to all investors facing difficulties in affording financial advisors, providing a means to mitigate behavioural biases and enhance their investment decision-making. Lastly, the study contributes valuable empirical evidence to guide future research agendas and inform stakeholders about the potential of robo-advisors in addressing behavioural biases in investment decision-making.

**Keywords:** Robo-advisor, Behavioural biases, Investment decision-making, Behavioural bias-mitigation

## ACCESS TO FINANCE AMONG SMALL AND MEDIUM ENTERPRISES AND JOB CREATION IN SRI LANKA

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### Abstract

This research investigates the relationship between Small and Medium-sized Enterprises, access to funding, and job creation in Sri Lanka, recognizing the pivotal role of these enterprises in fostering inclusive growth. Utilizing data from the Sri Lanka Enterprise Survey by the World Bank in 2011, the study examines challenges faced by these entities in securing financial support and evaluates the consequential impact on job generation. The results indicate that there is a significant relationship between financial access and job creation. Through statistical analysis, the study unveils distinct patterns, offering insights into how financial inclusion positively affects employment outcomes within the context of Sri Lanka. The implications extend to policymakers, financial institutions, and business stakeholders, advocating for targeted interventions and policy measures to fortify financial support mechanisms for small and medium entities, thereby creating a more favorable environment for sustained employment growth. In essence, this research advances our comprehension of the interplay between access to finance and job creation, providing pragmatic insights for driving economic development in Sri Lanka and contributing to the existing body of literature.

**Keywords:** Access to finance, Small and Medium Enterprises, Employment, Enterprise survey, Sri Lanka

## INVESTMENT AWARENESS AMONG YOUNG GENERATION IN SRI LANKA: EVIDENCE FROM UNDERGRADUATES OF UNIVERSITIES IN SRI LANKA

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### Abstract

Owing to the complexity of the global economy, people need to manage their increased living expenditures. Therefore, each individual should make his or her financial decisions more deliberately, proactively and in a well-informed manner. Therefore, investment awareness can be considered as a critical component that will enhance the economic development of the country. Having a solid understanding of investment environment and technical knowledge of finance is of paramount importance for individuals, young adults in particular, to make well-informed financial decisions. Accordingly, the present study aims to examine the level of investment awareness among young generation in Sri Lanka with special reference to undergraduates of universities in Sri Lanka. Further this study explores the influence of financial literacy, impact of family and saving behaviour on investment awareness among young generation. Using convenience sampling technique, an online questionnaire (using five-point Likert scales) was distributed among a sample of 384 of undergraduates from universities in Sri Lanka, following a pilot test conducted to check the validity and reliability. Results indicate that investment awareness among the young generation is currently reasonable. Further, analysis reveals that financial literacy, impact of family and saving behaviour have a significant and positive influence on investment awareness among the young generation. With regard to investment awareness and its putative factors such as financial literacy, impact of family and saving behaviour, this study provides impressive new insights. In addition, assessing the level of investment awareness may have significant implications for government, educational institutions and families on how to raise the level of investment awareness among the young investors and assist them in making prudent investment choices.

**Keywords:** Investment awareness, Financial literacy, Impact of family, Saving behaviour, Young generation

# THE IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF LISTED FINANCE COMPANIES IN SRI LANKA

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## Abstract

The purpose of this study is to examine the empirical relationship between the financial performance of Sri Lankan finance companies, which generally provide loans to individuals and enterprises, and their corporate governance procedures. These financing organizations neither accept customer cash deposits nor provide standard services like checking accounts, in contrast to banks. The direction and control of a firm is known as corporate governance. It covers the duties of the board of directors to direct the business and supervise its relationships with stakeholders and shareholders. Recent high-profile scandals and financial crises have highlighted the importance of robust corporate governance structures in financial institutions. Sound governance practices are crucial for the success and stability of financial entities. The main objective of this study is to evaluate how important governance systems affect three key financial performance metrics: Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q. The independent variables are CEO-duality, board-size, board-independence, and audit committee size, whereas the control variables are leverage and firm size. Data is mainly collected from the published annual reports of the 19 listed finance companies in the sample for the period from 2018 to 2022. Results of the panel data regression analysis indicate that there is no significant impact from CEO-duality, board size, board independence, audit committee size, and leverage on ROA and ROE. Conversely, there is a positive significant impact from firm size on ROA and ROE. It was also found that while CEO-duality, board independence, audit committee size, leverage, and firm-size indicate a negative significant impact on Tobins' Q, board-size depicts no significant impact. Correlation analysis is also employed to assess the degree of association among variables. The mixed results of this study manifest upon further investigation to improve robustness.

**Keywords:** Corporate Governance, Return on Assets, Return on Equity, Tobins'Q, Sri Lanka

## A COMPREHENSIVE ANALYSIS OF INTEREST RATE PARITY (IRP) AND PURCHASING POWER PARITY (PPP) IN SAARC COUNTRIES WITH THE MAJOR CURRENCIES

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### Abstract

Countries are involved in international trade with other countries using different currencies because all countries do not have the proper technology and resources to produce all essentials. Then the countries face the foreign exchange rate risk which can be reduced by forecasting exchange rates using the PPP and IRP. Investors, importers, and policymakers are unsure whether these theories hold or not based on the different findings of existing literature. So, this paper analyzes purchasing power parity (PPP) and interest rate parity (IRP) for SAARC countries with USD, GBP, and JPY to understand the impact of interest rates and inflation rates on exchange rate fluctuations using monthly data over the period 2000 January to 2023 June. Based on this study investors, policymakers, and traders can make decisions about their future activities by managing the foreign exchange risk. This study utilizes the Auto Regressive Lag model (ARDL) to address the research questions. The study concluded that there is a long-run association between the interest rate differential and exchange rate yield and inflation differential and exchange rate yield for all the currency pairs. Further in purchasing power parity there is a short-run association between the inflation differential and exchange rate differential for PKR/USD, PKR/GBP, PKR/JPY, and LKR/JPY. In interest rate parity, there is a short-run association between the interest rate differential and exchange rate differential for BDT/GBP, PKR/USD, PKR/GBP, PKR/JPY, LKR/GBP, and LKR/JPY.

**Keywords:** Interest Rate Parity (IRP), Purchasing Power Parity (PPP), Interest rate differential, Inflation differential, Exchange rate yield

# STOCK MARKET OVERREACTION AS A PREDICTOR OF SUBSEQUENT PRICE MOVEMENT IN COLOMBO STOCK EXCHANGE SRI LANKA

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## Abstract

This study examines how the overreaction phenomena can be used to predict subsequent stock price movements in the Colombo Stock Exchange (CSE). Overreaction challenges the market efficiency by people's overreaction to unexpected and dramatic information. Thus, the study uses a robust method to examine CSE data collected over a three-decade period from 1991 to 2021 for 291 listed companies. It classifies companies into Winners (W) and Losers (L) portfolios by modifying De Bondt-Thaler's methodology where it has non-overlapping 36-month formation period. It quantifies the overreaction through Average Cumulative Abnormal Returns (ACARs) of the winning and loser portfolios during a sixty-month post-formation period. A clear overreaction trend appears in the evidence, where the loser portfolio often outperforms the market in the short run (1–12 months) and dilutes subsequently. The findings of the study emphasize that losers earn 0.28% ACAR and winners earn negative 3.38% over the 12 months indicating that losers outperformed the winners by revealing evidence for the overreaction hypothesis. In addition, the results show loser portfolio outperformed the winners significantly during 1-12 months after the portfolio formation, and the level of significance diluted during the post-formation months of 13 to 24. In conclusion, this study provides comprehensive understanding of the CSE overreaction phenomena by illustrating a unique time related pattern with strong short-term effects and a progressive slowing down of overreaction over long post-formation times. The study provides meaningful insights into the dynamic relationship between behavioral characteristics and market price movements in the CSE through advisors, analysts, finance researchers, and students in the field of finance while significantly contributing to the literature on overreaction phenomena.

**Keywords:** Overreaction, Abnormal returns, Markets efficiency

# RELATIONSHIP BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND FINANCIAL PERFORMANCE: EVIDENCE FROM DOMESTIC COMMERCIAL BANKS IN SRI LANKA

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## Abstract

Corporate social responsibility (CSR) stands as a burgeoning trend in the corporate landscape, influenced both directly and indirectly by business operations. While managers typically prioritize profitability to meet shareholders' expectations, addressing the interests of all stakeholders becomes imperative. This study aims to uncover the correlation between CSR and the financial performance of domestic commercial banks in Sri Lanka. Given the distinct economic, political, and ethical contexts compared to other nations, drawing clear conclusions about the CSR-financial performance nexus proves challenging. Therefore, this paper concentrates on scrutinizing this relationship within the Sri Lankan context, utilizing annual CSR investment data from 2016 to 2022 and analyzing eight domestic banks with EViews software. Financial performance, measured through Net Interest Margin, Return on Assets, and Earnings Per Share, serves as the dependent variable, while firm size and financial leverage act as control variables. Employing descriptive, correlation, and regression analyses, the study finds an insignificant negative correlation between CSR and financial metrics at a significance level of 0.05. Consequently, it concludes that Sri Lankan domestic commercial banks demonstrate limited involvement in CSR activities that directly impact financial performance.

**Keywords:** Corporate social responsibility, Financial performance, Domestic commercial banks, Return on Asset



## SEASONALITY ANOMALIES: EVIDENCE FROM THE COLOMBO STOCK EXCHANGE

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### Abstract

The study investigates the Seasonal Effect in the Colombo Stock Exchange focusing on monthly stock returns from 1991 to 2021. Highlighting the market's unique challenges, this study explores the risk-return relationship and how the stock returns vary with the different levels of systematic and idiosyncratic risks, and the limitations of traditional finance models. The hypothesis tests whether low beta and low idiosyncratic volatility stocks outperform low beta stocks in the Colombo Stock Exchange. The methodology involves univariate and bivariate portfolio sorting based on beta and idiosyncratic volatility, estimated using the market model. Results shed light on the existing body of knowledge of the impact of systematic and idiosyncratic risks on the performance of stocks in frontier markets. Further, this investigates whether the overall stock market returns are dominated by the unique risk-return trade-offs that occur in specific months. Results show that there is a risk-return trade-off in the CSE; beta and IVOL have a positive relationship with the stock returns. However, we do not observe any seasonal patterns worth highlighting. These observations are consistent across the analyses performed using univariate and bivariate portfolio sorting. Therefore, the study does not provide evidence for the January effect or any other seasonality effect, unlike the other developed financial markets. This could be due to the different financial year ends, the Investor's perception towards published financial statements, or cultural differences. This paper has implications for investors, firms, and policymakers.

**Keywords:** Risk and return trade-off, Systematic risk, Idiosyncratic risk, Seasonal periods, January effect

## THE IMPACT OF EXCHANGE RATE VOLATILITY ON FOREIGN DIRECT INVESTMENT IN SRI LANKA

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### Abstract

In the recent decades, foreign direct investment (FDI) has drawn more attention as a significant source of economic inflows, especially in emerging and developing countries. This study investigates the impact of exchange rate volatility in Sri Lanka on FDI for the period from 2001 to 2022. The main independent variables are the exchange rates of four major currencies against Sri Lankan Rupee (LKR) namely, US Dollar (USD), British Pound (GBP), Euro (EUR), and Japanese Yen (JPY). The nominal effective exchange rate (NEER) and the real effective exchange rate (REER) are also included as independent variables. FDI measured in terms of the USD and foreign portfolio investment are employed as dependent variables, whereas the control variables are the GDP growth rate, inflation rate, and the interest rate. According to the results of the regression analysis, exchange rates, GDP growth rate, inflation rate, and interest rate have significant impacts on FDI inflows. As per the correlation analysis, exchange rates, GDP growth rate, inflation rate, and interest rate are positively associated with FDI. When considering the general situation, high GDP growth rates, along with low to stable exchange rates, inflation rates and interest rates encourage FDI inflows.

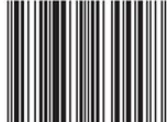
**Keywords:** Exchange rate volatility, FDI, GDP growth rate, Inflation rate, Interest rate, Sri Lanka



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ISSN 2659-2304



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