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THE EFFECT OF CORPORATE GOVERNANCE ATTRIBUTES ON FIRM PERFORMANCE

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ABSTRACT

This study examined the effects of corporate governance attributes on firm performance of listed firms in Sri Lankan Colombo Stock Exchange. To achieve the objectives of this study 13 listed plantation companies in the Colombo stock exchange were selected and analyzed as the sample by considering annual reports for the period 2012/2013-2015/2016. Measures of corporate governance attributes employed in this study are Board Composition, Board Size and CEO Duality. On the other hand, this study employed ROA, ROE and Tobin's Q as the measurement of the Firm performance. And Firm Size and Leverage were employed as control variables. The data were analyzed and hypotheses were tested using descriptive statistics, correlation analysis and regression analysis. The findings revealed that, there are relatively mixed results regarding corporate governance and various performance measures among listed firms in Sri Lanka.

Keywords: Corporate Governance Attributes, Firm Performance, Colombo Stock Exchange

Introduction

Corporate governance is affected by the relationships among participants in the governance system. Therefore, corporate governance variables like size of board, composition of board, skill set at board and CEO/Chair duality may have direct impact on firm performance (OECD Principles of Corporate Governance, 2004). The nature of corporate governance structures of a firm has critical impact on the its performance and it refers to a set of rules and incentives by which the management of a company is directed and controlled. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

Corporate governance is basically concerned maximize the well-being of interested parties. For that appropriate measures are always taken by managers and other insiders for the safeguard the interest of the stakeholders. Therefore, various measures are necessitated. Because, separation of ownership from management, an increasingly decisive feature of the modern organization. An exact firm is enlarged by numerous owners having no management role and with manager with no equity interest in the firm. Corporate governance concentrates on monitoring managers without taking interest, their interest different from owners' equity. In the global market a corporation can manage effectively by practicing corporate governance in their organization. When consider previous researches conducted by different researchers on this topic, we can identify that they have made different conclusions based on their studies. Some researchers have identified positive relationship between board size and firm performance while some researchers have identified negative relationship between board size and firm performance. So that board size and firm performance still remains as unsolved problem and further studies on this issue must be needed. As well as most of researches on corporate governance issues are conducted in developed countries. However, though there are lots of researches, studies on corporate governance in western countries they couldn't be applied into Sri Lanka. Therefore the present examines the impact of corporate governance on firm performance listed in Colombo Stock Exchange Sri Lanka.

Objectives of the Research

- To identify the relationship between board size and firm performance.
- To identify the relationship between CEO duality and firm performance.
- To identify the relationship between board composition and firm performance.

Research Questions

- Is there any relationship between board size and firm performance?
- Is there any relationship between CEO duality and firm performance?
- Is there any relationship between board composition and firm performance?

Literature Review

Board Size and Firm Performance

Shakir,(2008) found a negative relationship between board size and firm performance. In relation to that, Haniffa & Hudaib,(2006) argued that a large board is seen as less effective in monitoring performance and could also be costly for companies in terms of compensation and increased incentives to shirk. The same conclusion was drawn by Bozeman & Daniel,(2005) conclusion implies that the board size was also shown to have a negative relationship with performance measured by return on sales, sales efficiency and ROA. According to Jensen and Meckling (2002) argued that a bigger size board of directors may improve the companies' board effectiveness and support the management in reducing agency cost that resulted from poor management and consequently leads to better financial results. The Chairman should be allowed to provide commands to all the executive and non-executive directors. Eisenberg et al. (2010) stated that there is a significant negative correlation between board size and profitability in a sample of small and midsize Finnish firms. Al-matari,(2012) found that the board size to be negative and insignificant determinants of firm performance. Gill & Mathur,(2011) have studied to examine the impact of board size and the CEO duality on the value of Canadian manufacturing firms and results show that larger board size has a negative impact on the value of Canadian manufacturing firms. In Ghana, it has been identified that small board sizes enhances the performance of MFIs, Coleman & Biekpe,(2005) Mak & Yuanto,(2003) found that firm valuation is highest when board has five directors, a number considered relatively small in those markets. On the contrary, (Adams & Mehran, 2005) found a positive relationship between board size and performance in the U.S. banking industry. Moreover, Rechner & Dalton,(1991) have also reported that large boards are associated with stronger performance. These results supported the conclusion made by Zahra & Pearce,(1989) regarding the relationship between the board size and firm performance.

H1 - There is a significant impact of board size on financial performance.

CEO Duality and Firm Performance

According to Alexander,(1993) explained that CEO duality plays an important role in affecting the value of a firm. A single person being the Chairman and the CEO leads to the enhancement of the firm's value and the cost between the two is eliminated. However, White & Ingrassia,(1992) indicate that CEO duality can lead to the board's worse performance as the board is unable to remove the underperforming CEO which can generate agency costs in cases where the CEO works for his own interest as opposed to the shareholders. Yarmark,(1996) argued that, when the CEO and board chair positions are separate, it increases the firm's value. Fama & Jensen,(2002) argue that CEO duality in a firm favors the underperforming CEO as it is difficult for the board to remove him. According to Donaldson & Davis,(1991) studied the relationship between CEO duality and firm's performance by using a sample of US companies and found the positive relationship between CEO duality and

performance. Al-matari,(2012) identified that there is a positive relationship between CEO duality and company performance. Accordingly the empirical results show that the CEO duality has a positive impact on the value of Canadian manufacturing firms. And also Mei & Young,(2010) there is a negative relationship between CEO duality and firm performance. Gill & Mathur,(2011) examined the impact of board size and the CEO duality on the value of Canadian manufacturing firms and identified various moderating macroeconomic factors to the relationship between CEO duality and firm performance. Ramdani & Witteloostuijn,(2009) concluded that CEO duality has an effect on firm performance solely on firms displaying average performance as opposed firms performing below or above par.

H2 - There is a significant impact of CEO duality on financial performance.

Board Composition and Firm Performance

According to Ramdani & Witteloostuijn,(2009) found that proportion of independent directors has an effect on firm performance. Boards mostly compose of executive and non-executive directors. Executive directors refer to dependent directors and non-Executive directors to independent directors (Sahin et al, 2011). At least one third of independent directors are preferred in board, for effective working of board and for unbiased monitoring. Non-executive directors are not involving in day-to-day running of the business and only bring fresh perspective and contribute more objectively in supporting management team. Even though both executive and non-executive directors have the same general legal duties to the company non-executive directors do not need to report to the chairman of the board (Higgs Report, 2003). According to Forsberg, 1989; Hermalin & Weisbach, 2003; Zahra & Pearce, 1989 found that there is no significant relationship between board composition and firm performance. Ranti & Stephen,(2011) found that the negative association is likely to be because non-executive directors are too busy with other commitments and are only involved with the company business on a part-time basis. Wanyama & Olweny,(2013) identified that board composition positively influence the financial performance of insurance companies to a great extent. Moreover, Forsberg,(1989) found no relationship between the proportion of outside directors and various performance measures. From a different perspective, Coleman & Biekpe, (2006) found a positive association between the proportion of outside board members and performance. Hermalin & Weisbach,(2003) and Bhagat & Black,(2002) found there is no relation between the degree of board Independence and four measures of firm performance.

H3 - There is a significant impact of board composition on financial performance.

Research Methodology

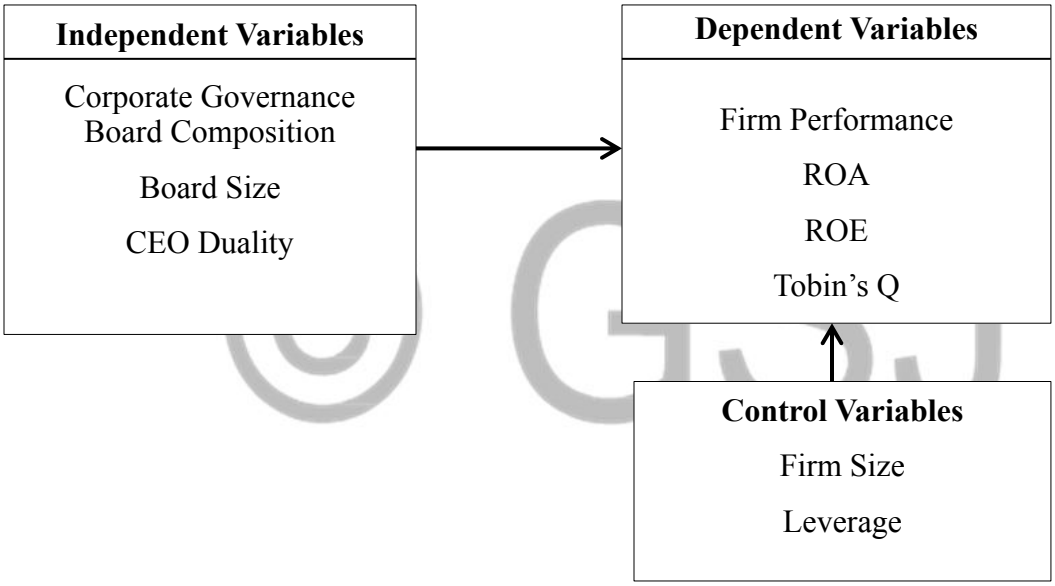
Study Period and Data Coverage

The population of this study consists of all listed companies in Colombo Stock Exchange (CSE) in Sri Lanka. Among them all plantation companies selected as the sample of this study. There are 20 listed companies under plantation sector, among them 13 plantations companies were selected as the final sample by considering the period from 2012/2013 to 2015/2016 and other seven companies are eliminated because of unavailability of data.

Conceptual Framework

The model of independent variables, dependent variables and control variables can illustrate in graphically as follow,

Figure 1: Conceptual Framework



Source: Developed by Researcher

Operationalization of Variables

Firm performance is typically measured by using the Return on Equity (ROE), Return on Assets (ROA) and Tobin's Q. Return on Equity (Profits after tax divided by Shareholders' equity), Return on Assets (Profits after tax divided by total assets of the firm), Tobin's Q {(Market capitalization+ Total assets- Shareholders funds)/ Book value of Total Assets} considered as the dependent variables. Board Size (Number of Directors), Board Composition (Number of non- executive directors / Board size *100), CEO Duality (If the CEO is chairman it takes value as 1 and if not value as 0) considered as the independent variables. Firm size (Total outstanding shares in to the market value of a share), Leverage ((Debt Capital/ Shareholders' Equity) X 100) considered as control variables.

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Research Model

The study consists of three independent variables (Board Size, CEO Duality and Proportion of Non-executive directors) and three dependent variables (Return on Assets, Return on Equity and Tobin's Q,) and two control variables (firm size, leverage). Following regression models are used in this study.

Model: 1
ROA= β0+β1 BSIZE+β2CEOD+β3BCOM+β4FSIZE+β5LEV+ei

Model: 2
ROE= β0+β6BSIZE+β7CEOD+β8BCOM+β9FSIZE+β10LEV+ei

Model: 3
TQ = β0+β11BSIZE+β12CEOD+β13BCOM+β14FSIZE+β15LEV+ei

Where;
ROA= Return on Assets
ROE= Return on Equity
TQ= Tobin's Q
β0= Constant
β1toβ15= Coefficients of Variables
BSIZE= Board Size
CEOD= CEO Duality
BCOM= Board Composition
FSIZE= Firm Size
LEV= Leverage
ei= Error Term

Descriptive Statistics Analysis

Table 1 shows the descriptive statistics of the independent variables and dependent variables and control variables.

Table1.-Descriptive Statistics of Independent, Dependent, and Control variables

	BSIZE	BCOM	CEOD	FSIZE	LEV	ROA	ROE	TQ
N	52	52	52	52	52	52	52	52
Mean	7.52	.60	.23	14.07	.31	.05	.09	.98
Std. Deviation	1.99	.18	.43	.73	.31	.06	.15	.29
Minimum	5.00	.40	.00	12.66	.00	-.09	-.31	.55
Maximum	12.00	.89	1.00	15.59	1.60	.21	.51	1.69

Source: Developed by Researcher

As per Table 1, average number of directors in the board 7.52. Standard deviation is 1.99 for the plantation companies in Sri Lanka. In the case of non-executive directors data reflect that those companies have an average of 60% of non-executive directors in their boards. According to this study, 23% of plantation companies' still have CEO duality with their companies. Accordingly, over 77% of the firms in the sample identified the importance of separating the position of chairman and CEO and comply with the code of best practice recom-

mendations issued in 2008. The mean value of Tobin's Q is 0.98, with a minimum value of 0.55 and a maximum value of 1.69. The results of Tobin's Q show that positive investment opportunities as they provide their average Tobin's Q value close to 1.

Correlation Analysis

Table 2- Correlation of the variables

		ROA	ROE	TQ	BSIZE	BCOM	CEOD	FSIZE	LEV
ROA	Pearson Correlation	1							
	Sig. (2-tailed)								
ROE	Pearson Correlation	.908**	1						
	Sig. (2-tailed)	.000							
TQ	Pearson Correlation	.388**	.388**	1					
	Sig. (2-tailed)	.005	.004						
BSIZE	Pearson Correlation	-.295*	-.232	-.010	1				
	Sig. (2-tailed)	.034	.097	.944					
BCOM	Pearson Correlation	-.083	.016	.280*	.768**	1			
	Sig. (2-tailed)	.559	.911	.045	.000				
CEOD	Pearson Correlation	.222	.192	.012	.180	.237	1		
	Sig. (2-tailed)	.113	.172	.931	.201	.091			
FSIZE	Pearson Correlation	.638**	.547**	.694**	-.063	.171	.404**	1	
	Sig. (2-tailed)	.000	.000	.000	.657	.226	.003		
LEV	Pearson Correlation	-.070	-.020	.066	-.168	.164	.430**	.126	1
	Sig. (2-tailed)	.621	.885	.643	.235	.246	.001	.375	

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

According to table 2 shows that there is a negative correlation between board size (r= -0.295, p=0.034) with ROA at the 0.05 level of significance. However board size has negative insignificant relationship with other performance variables such as ROE and TQ.

In addition to that, there is a positive but insignificant relationship between ROA and CEO,ROE and CEO duality, Tobin's Q and CEO duality. When consider relationship between board composition and TQ there is a positive significant relationship at 0.05 significance level. Also there is a positive insignificant relationship between ROE and BCOM. In contrast there is a negative insignificant relationship between board composition and ROA.

Multiple Regression Analysis

Regression analysis was used to examine the impact of independent variables on dependent variables.

Table 3: Dependent Variable: Return on Assets

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.(p value)
		B	Std. Error	Beta		
1	(Constant)	-.468	.150		-3.124	.003
	BSIZE	-.018	.006	-.584	-2.949	.005
	BCOM	.098	.065	.288	1.508	.138
	CEOD	.031	.019	.211	1.614	.113
	FSIZE	.043	.010	.513	4.271	.000
	LEV	-.075	.027	-.370	-2.779	.008
R Square		.549				
F Value		11.180				
Sig.		.000[a]				

a. Predictors: (Constant), LEV, FSIZE, BSIZE, CEOD, BCOM

b. Dependent Variable: ROA

Source (SPSS output)

R square was 0.549 indicate that there is 54.9% of variation on the financial performance (ROA) of plantation companies due to changes in Board Size, Board Composition, CEO duality, Firm size and Leverage at 95% confidence interval. Based on the results in Table 3, there is a negative significant relationship between board size and ROA at the 0.05 significance level. Also board composition is found to have a positive but insignificant impact on the firm performance. When consider CEO duality and ROA, it has a positive but insignificant relationship at the 0.05 level as above two occasions. The study includes control variables in the regression analysis, the table indicates that firm size has a positive significant impact on ROA. On the other hand, Leverage and ROA has a negative but significant relationship.

Y (ROA) =- 0.468 - 0.018*BSIZE+0.098*BCOM + 0.031*CEO+0.043*FSIZE - 0.075*LEV

Multiple Regression Analysis on ROE

Table 4: Dependent Variable: Return on Equity

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.837	.399		-2.099	.041
	BSIZE	-.047	.016	-.643	-2.857	.006
	BCOM	.360	.173	.453	2.085	.043
	CEOD	.062	.051	.183	1.231	.225
	FSIZE	.079	.027	.397	2.905	.006
	LEV	-.157	.072	-.331	-2.184	.034
R Square		.416				
F Value		6.553				
Sig		.000[a]				

a. Predictors: (Constant), LEV, FSIZE, BSIZE, CEOD, BCOM

b. Dependent Variable: ROE

Source (Results of SPSS output)

The value of R square was 0.416 an indication that there was variation of 41.6% on the financial performance (ROE) of plantation companies due to changes in Board Size, Board Composition, CEO duality and Leverage at 95% confidence interval. The F ratio in the model is 6.553, which is significant at $P<0.001$. There is a negative significant relationship can be seen among board size and ROE. Also Board composition was found to have a positive impact on the ROE at the 0.05 level of significance. When consider CEO duality and ROE, it has a positive but insignificant relationship at the 0.05 level of significant. The table indicates that firm size has a positive significant impact on ROA. On the other hand, Leverage and ROA has a negative but significant relationship among them.

Y (ROE) = -0.837 -0.047* BSIZE +0.360*BCOM + 0.062*CEOD +0.079*FSIZE-0.157*LEV

Multiple Regression Analysis on TQ

Table 5: Dependent Variable: Tobin's Q

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.470	.638		-5.437	.000
	BSIZE	-.022	.026	-.149	-.831	.410
	BCOM	.549	.276	.343	1.987	.053
	CEOD	-.258	.081	-.375	-3.183	.003
	FSIZE	.308	.043	.772	7.102	.000
	LEV	.047	.115	.049	.408	.685
	R Square	.631				
	F Value	15.757				
	Sig.	.000[a]				

a. Predictors: (Constant), LEV, FSIZE, BSIZE, CEOD, BCOM

b. Dependent Variable: TQ

R square 0.631 indicate that there was variation of 63.1% on the financial performance (TQ) of plantation companies due to changes in Board Size, Board Composition, CEO duality, Firm size and Leverage at 95% confidence interval. The F ratio in the model is 15.757, which is significant at P<0.001. There is a negative insignificant relationship can be seen among board size and firm performance (TQ) at the 0.05 level of significance. Also CEO duality was found to have a negative significant impact on the firm performance (TQ) at the 0.05 level of significance. When consider board composition and firm performance (TQ), it has a positive insignificant relationship. The study includes control variables in the regression analysis, the table indicates that firm size has a positive significant impact on firm performance (TQ) (β= 0.722, p=0.000<0.05). On the other hand, Leverage and TQ has a positive insignificant relationship among them (β= 0.049, p= 0.685>0.05).

Y (TQ) = -3.470 - 0.022*BSIZE + 0.549*BCOM - 0.258*CEO + 0.308*FSIZE +0.047*LEV

Testing Hypotheses

Table 6: Testing Hypotheses

	Hypothesis	Results		
		ROA	ROE	TQ
H1	There is a significant impact of board size on firm performance of firm.	Accepted	Accepted	Rejected
H2	There is a significant impact of CEO duality on firm performance of firm.	Rejected	Rejected	Accepted
H3	There is a significant impact of board composition on firm performance of firm.	Rejected	Accepted	Rejected

Conclusion and Recommendations

The study examined the relationship between some corporate governance attributes such as board size, board composition, and CEO duality on firm performance of 13 listed plantation companies in Sri Lanka considering the period of 2012/2013-2015/2016.

The regression results show that board size is negatively related to ROA, ROE and Tobin's Q. also board composition has positive significant relationship with ROE and positive insignificant relationship with ROA, and Tobin's Q. On the other hand, CEO duality is found that there is positive but insignificant relationship with ROA and ROE, but negatively significantly related with Tobin's Q. Results showed that firm size was found to have positive significant impact on various performance measures such as ROA, ROE and Tobin's Q. and leverage was found to have a negative and significant effect on ROA and ROE, but positively in insignificantly related with Tobin's Q. It is obvious therefore that various corporate governance variables have an impact on the of firms performance of plantation sector in Sri Lanka.

This study only three corporate governance variables were considered. Hence, future studies can consider other aspects of corporate governance variables. The research was done by using secondary data which plantation industry represent in their annual reports. So research findings are depends on the disclosure of annual reports. If the plantation firms disclose the information with mistakes or incorrectly the findings will not be true.

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