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Corporate Governance practices and Firm Performance: Evidence from Sri Lanka

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Abstract
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. The main objective of the study is to find out the significant difference between corporate governance practices on Firm performance. And the secondary objective is to suggest the listed manufacturing firms in Sri Lanka to get the efficiency in the firm performance through the best corporate governance practices. Twenty eight listed manufacturing firms were selected as sample size in Colombo Stock Exchange for the periods 2007, 2008, 2009, 2010 and 2011. Independent sample one – way Anova (f-test) and Independent sample t-test have been utilized to find out the significant difference between corporate governance practices on firm performance. Finding revealed that, there is no significant mean different between the firm performance among corporate governance practices as board leadership structure, board committees, board meetings and proportion of non executive directors. We have suggested that, corporate governance practices should be reviewed in the systematic way to frame the best practices in the current Sri Lankan context.
Key Words: Corporate Governance practices, Firm Performance, Listed Manufacturing Firms.

1. Background of the study

Global financial crisis points out the importance of a strong corporate governance and financial management for a company that has to deal with effects of unexpected crises and uncertainties that bear future business events. Effective financial management decisions in the field of horizontal and vertical structure of capital, insurance of short-term and long-term capital, maintaining liquidity and solvency are viewed as a key function in the creation of competitive advantages (Mulili and Wong, 2011). According to the Australian Standard (2003), the corporate governance is considered as the process, by which organizations are directed, controlled and held to account. This implies that corporate governance encompasses the authority, accountability, stewardship, leadership, direction and control exercised in the process of managing organizations. Further, Morin and Jarrell (2001) argued the corporate governance mechanism, it implies that corporate governance mechanism is a framework that controls and safeguards the interest of the relevant players in the market which include managers, employees, customers, shareholders, executive management, suppliers and the board of directors. Comparing with the approach of Australian Standard, Morin and Jarrell (2001) have jointly approached the corporate governance in the holistic way; it implies that, corporate governance practices are the strategies which should be formulated, in line with the short, medium and long term objectives of the company with the interest of stakeholders. In this context, Firm performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities (Kajola ,2008). And also, good corporate governance practices contribute and enhance a firm's performance (Byrd and Hickman, 1992; Chung et al, 2003). Meanwhile, corporate governance rules have been mandated by the Securities and Exchange Commission of SriLaka. But, we have seen the differences between the practices and mandatory issues on the corporate governance in the listed companies except banking institutions in SriLanka. In which, the board structure and board committees have the significant difference between practical issues and mandatory issues (Senaratne and Gunaratne, ------------; Kumudini, 2011). In the case of board structure, the first issue that the srilankan code required for effective corporate governance was separation of the top two positions of the board (CEO and Chairman). And also, in the case of board committee, listed companies should form the three committees as audit, remuneration and nomination (Code of best practice on corporate governance, 2008). Because, three committees have the unique duties and responsibilities compare with each other. Due to that, this study is focused to answerer the research question as: **Is there any significant different between corporate governance practices on the firm performance.**

2. Objectives of the Study

The main objective of the study is to find out the significant difference between corporate governance practices on Firm performance. And the secondary objective is to suggest the listed manufacturing firms in Sri Lanka to get the efficiency in the firm performance through the best corporate governance practices.

3. Theoretical and Empirical Perspective: Corporate Governance Practices and Firm Performance

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 (Senaratne and Gunaratne,------------). Scholars normally describe the evolution of the corporate governance in terms of changes in relationship between ownership and control (Chandler, 1977; Fligstein, 1990). The idea of corporate governance was quickly adopted in different parts of the world but with some major variations because circumstances vary from country to country (Mulili and Wong, 2011). In this context, two main approaches of corporate governance can be identified as Agency theory and Stewardship theory. According to the Kiel and Nicholson (2003), Agency theory is viewed as the separation of control from ownership. It implies that the professional managers manage a firm on behalf of the firm's owners. Further , the theory suggests that a firm's top management should have a significant ownership of the firm in order to secure a positive relationship between corporate governance and the amount of stock owned by the top management (Mulini and Wong, 2011; Mallin, 2004). In contrast the Stewardship theory is considered as stake holder's theory. The theory suggests that a firm's board of directors and its CEO, acting as Stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests (Mulini and Wong, 2011). Furthermore, Kajananthan (2012) have identified the dimensions of the corporate governance practices as leadership style, board committee, board size, board meeting, and board composition in the SriLankan Manufacturing firm's perspective.

Scholars in the corporate governance have found that good corporate governance enhances a firm's performance (Byrd and Hickman, 1992; Lee et al, 1992; Chung et al, 2003). Mean while, other studies have reported negative relationship between corporate governance and firm performance (Bathala and Rao, 1995) or have not found any relationship (Park and Shin, 2003; Singh and Davidson, 2003). Further, Mokhtar, Sori, Hamid, Abidin, Nasir, Yaacob, Mustafa , Daud and Muhamad (2009) have approached the study on the relationship between corporate governance practices and company performance. Study was performed to compare the performance between five Malaysian companies that practice good corporate governance and another five Malaysian companies that did not practice good corporate governance. It is found that there is no difference in performance between companies that practice good corporate governance and companies that do not practice good corporate governance.

4. Conceptualization

Based on the research question and objectives of the study, the following conceptual model has been constructed.

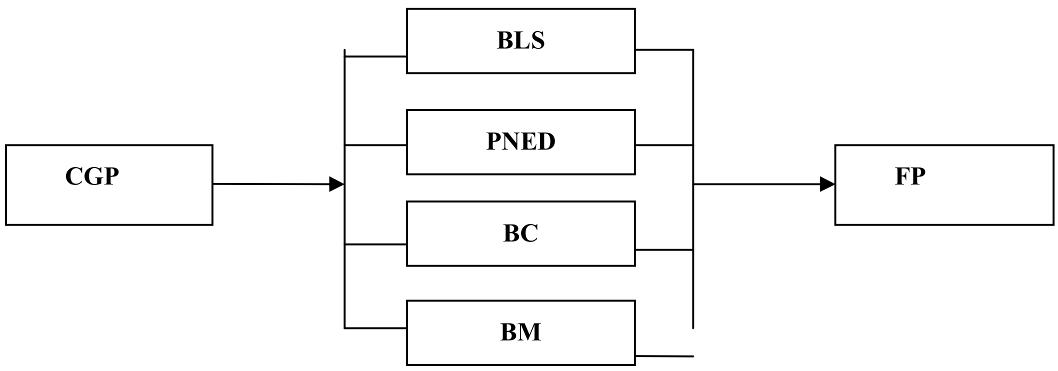

Figure no 1: Conceptualization Model

Where:
CGP: Corporate Governance Practices
FP: Firm Performance
BLS: Board Leadership Structure
PNED: Proportionate of non executive directors in the board
BC: Board Committees
BM: Board Meeting

5. Design of the variables: Operationalisation and Measurement of Variables

Table No 1: Design of the variables

Concept	Variables	Measures	Symbols
Corporate Governance Practices	Board Leadership Structure	1 for separate Leader ship and 2 for combined Leadership	BLS
	Proportionate of non executive directors in the board	1 for below the measure 0.70 and 2 for beyond the measure 0.70	PNED
	Board Committees	If less than two committees which has been represented as 1; available of all three committees has been represented as 2	BC
	Board Meeting	Based on the No of meeting; 1- 5 has been represented as 1; 6- 10 has been represented as 2; 11-15 has been represented as 3.	BM
Firm Performance	Return on Equity	Profit after interest & tax/Share holders fund * 100	ROE

Board Leadership structure, Board composition (Proportionate of non executive directors in the board), Board committees and Board meeting are considered as the key variables to determine the corporate governance practices (Kumudini,2011; Kajananthan, 2012). And also, Firm performance is measured by the Return on equity (Byrd and Hickman, 1992; Lee et al, 1992; Chung et al, 2003).

6. Hypotheses of the Study

H1: There is a significant mean different between firm performances across the Board Leadership Structure.
H2: There is a significant mean different between firm performances across the Proportionate of non executive directors in the board.
H3: There is a significant mean different between firm performances across the Board Committees.
H4: There is a significant mean different between firm performances across the Board Meeting.

7. Methodology

7.1. Data collection

Data on corporate governance and firm performances were collected from secondary sources as Annual reports of the manufacturing companies, Colombo stock exchange publications and URL of the Colombo stock exchange.

7.2. Sample Selection

Twenty eight listed manufacturing firms were selected as sample size in Colombo Stock Exchange for the periods 2007, 2008, 2009, 2010 and 2011. Further, earlier mentioned firms have been selected based on the availability of data on the corporate governance practices and firm performance of the listed manufacturing firms in SriLanka.

7.3. Data Analysis Method

Various Statistical methods have been utilized to compare the data collection from twenty eight listed manufacturing firms in Colombo Stock Exchange on corporate governance practices and firm performance.
Descriptive statistics which involve in collecting, summarizing and presenting data. This analysis is given information for the data through the frequency distribution, central tendency, and the dispersion.
Inferential statistical tools which involve in drawing conclusions about a population based on the sample data. In which Independent sample one – way Anova (f-test) and Independent sample t-test have been utilized to find out the significant difference between corporate governance practices on firm performance.

8. Results and analysis

8.1. Descriptive Statistics

Table No 2: Descriptive Statistics of the study

Dimension	Mean	Standard Deviation
Board Leadership Structure	1.42	0.50
Board Committee	1.14	.35
Board Meeting	2.03	.88
Proportion of Non executive Directors	1.57	.50
Return on equity	4.89	21.36

Based on the mean value in the descriptive studies, Return on equity is not in line with the standards. According to the Charted Institute of Management Accountants, Over 11 percentage of return of equity denotes the high return, and also percentage 2-5 denotes the risk margin.
Manufacturing firms in SriLanka are in the problematic situation to earn profit on the equity (Based on the Mean value of the Return on equity). Due to that, firms should focus on the return on the equity and capital employed in the proactive way.

8.2. Independent Sample t-test

In this study, Independent Sample t-test is utilized to find out the significant mean different between the firm performance across the Board Leadership Structure, Proportionate of non executive directors in the board and Board Committees.

Board Leadership Structure Vs Firm Performance

Based on the group statics, sixteen listed manufacturing firms have utilized the separate leader ship in the board structure, and rest of the twelve firms has utilized the combined leader ship in the board structure.

Table No 3: Results of t-test for Board Leadership Structure

t-test variable	t-value	P value	Mean difference
Return on equity	-.422	.676	-3.497

Note: Significant at 0.05 levels

Based on the table no 3, there is no significant mean different between Firm Performance across the Board Leadership Structure ($P > 0.05$). It means that, both separate or combined leadership structure in the corporate governance practices have earned the same level of return on equity approximately.

Hence Hypothesis one is rejected.

Proportionate of non executive directors in the board Vs Firm Performance

Based on the group statics, out of twenty eight listed manufacturing firms, twelve firms have utilized the non executive directors who have the proportion below 70 % in board size. And rest of the sixteen firms has utilized the non executive directors who have the proportion beyond 70 % in board size.

Table No 4: Results of t-test for Proportionate of non executive directors

t-test variable	t-value	P value	Mean difference
Return on equity	-.767	.450	- 6.309

Note: Significant at 0.05 levels

Based on the table no 4, there is no significant mean different between Firm performance across the Proportionate of non executive directors in the board ($P > 0.05$).

Hence Hypothesis two is rejected.

Board Committees Vs Firm Performance

Based on the group statics, out of twenty eight listed manufacturing firms, four firms have formed the all three committees as Audit, Remuneration, and Nomination. And rest of the twenty four firms has formed the one or two committees in the board structure perspective.

Table No 5: Results of t-test for Board Committees

t-test variable	t-value	P value	Mean difference
Return on equity	.104	.918	1.220

Note: Significant at 0.05 levels

Based on the table no 5, there is no significant mean different between Firm performance across the Board Committees (P > 0.05).
Hence Hypothesis three is rejected.

8.3. Independent Sample one –way ANOVA test

One –way ANOVA test can be utilized to find out the significant mean different between Firm performance across the Board Meeting.

Board Meeting Vs Firm Performance

Based on the descriptive statics, out of twenty eight listed manufacturing firms, ten firms have conducted the meetings which have the frequency as one to five meetings per annum. And also another ten firms have conducted the meetings which have the frequency as six to ten meetings per annum. Finally rest of firms has conducted the meetings which have the frequency as eleven to fifteen meetings per annum.

Table No 6: Results of f-test for Board Meeting

f-test variable	f-value	P value
Return on equity	1.208	.316

Note: Significant at 0.05 levels

Based on the table no 6, there is no significant mean different between firm performance across the Board meetings (P > 0.05).
Hence Hypothesis four is rejected.

9. Discussion and Conclusion

In this study, the research question as "is there any significant different between corporate governance practices on the firm performance" should be answered by the proper research methodology. Due to that, Independent sample one – way Anova (f-test) and Independent sample t-test have been utilized to find out the significant difference between corporate governance practices on firm performance. Based on the overall study findings, we are able to come to the point that, there is no significant mean different between the firm performance among corporate governance practices as board leadership structure, board committees, board meetings and proportion of non executive directors.

In the case of Board leadership structure, Kumudini (2011) has pointed that separation of responsibilities at the top promotes better results, because the chairman is accountable to the formulation of strategy and the CEO is accountable to the implementation of the strategy and the day-to-day operation of the firm. Therefore, it can be concluded that higher profitability for firms in Sri Lanka is due to better management, as a result of the separation of the position of CEO and chairman. In contrast, we have found that, there is no significant mean different between firm performances across the Board Leadership Structure as separate and combined leadership in the listed manufacturing firms in srilanka. It means that both separate or combined leadership structure in the corporate governance practices have earned the same level of return on equity approximately. In supportive way, Abdullah (2004) has noted that board leadership structure is not related to performance, because financial ratios may not capture the board and leadership roles in establishing a firm's value, but long-term measures such as firm's growth and their share price might be useful measures.

In the case of Proportionate of non executive directors in the board, Kumudini (2011) has approached that non-executive directors have a significant impact on firm performance in Sri Lanka. In contrast, we have found that, there is no significant mean different between Firm performances across the Proportionate of non executive directors in the board in the srilankan context. In the case of board committees, Weir , Laing & McKnight (2002) have viewed that, board committees had no influence on the firm performance in the United Kingdom context, in the same way we have found that, there is no significant mean different between Firm performance across the Board Committees. In contrast, Kumudini (2011) has pointed that Boards committees composed of audit, remuneration and/or nomination committees are positively associated with firm performance. Meanwhile, in our research frame, out of twenty eight listed manufacturing firms, four firms have formed the all three committees as Audit, Remuneration, and Nomination. And rest of the twenty four firms has formed the one or two committees in the board structure perspective. This may lead to the results as not significant level, because, Based on the study sample, only four firms have utilized the three committees in the listed manufacturing firms in the SriLankan context. In the case of board meeting, we have found that, there is no significant mean different between firm performances across the Board Meeting.

According to the Senaratne and Gunaratne (------------). We have suggested that, corporate governance practices should be reviewed in the Sri Lankan Context. In this context, board perspective should be adopted in future corporate governance reforms based on the stake holder approach to corporate governance rather than focusing only on the share holder primacy which gives a narrow connotation to corporate governance. Further greater independence and authority needs to be granted to oversight committees within the firm. In particular, the roles and functions of the remuneration and audit committees need to be strengthened. This will serve to facilitate both transparency and accountability within firm. Further, the corporate governance practices used in developed countries are not directly applicable in developing economies because of political, economic, technological and cultural differences. It denotes that there is a need to develop models of corporate governance that consider the conditions in each developing country and that are not directly borrowed from developed countries.

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