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THE EFFECT OF CORPORATE BOARD FEATURES ON FIRM PERFORMANCE: SPECIAL REFERENCE TO MANUFACTURING SECTOR IN SRI LANKA

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Abstract:

Objective of the research remains to analyse the effect of board characteristics on firm performance of manufacturing sector in Colombo Stock Exchange, Sri Lanka. To analyse the impact of board characteristics, three factors were selected as independent variables for instance CEO duality, board size, non-executive capacity directors, and firm size is considered as a control variable. And the dependent variable of firm performance scaled by return on asset. Five years data of 33 companies out of 37 companies in manufacturing sector were selected as sample size of this study the from 2011 to 2016. Then the obtained data were analysed and presented with the aid of computer software SPSS 20.0 version. The study revealed that CEO duality, board size and non-executive director significantly negatively associated with ROA. Moreover control variable of firm size is significantly associated with ROA. Therefore, the researcher recommended some suggestions to improve the firm performance in line with corporate board characteristics.

Keywords*: Corporate Governance, Board Characteristics, Firm Performance, Sri Lanka*

1. INTRODUCTION

Governance system of Corporate is a significant theme of theoretical investigation and disclosure of policy in various nations round the world. The swelling status of mechanism of corporate governance derives from a huge frame of experiential and theoretic research which things to see the governance systems of corporate material in the effectiveness and development of firm. Governance system effects production and decisions in investment of companies through many channels which comprise possession and control arrangement, growth in monetary mediators and capital marketplaces, company financing, pattern of investment, protection of investment and credit privileges.

A corporate board is a form of selected members who together manage the actions of a firm. The selected director board performs as one of the greatest vital governance devices in brings into line the attention of administrators and stockholders of the organization. The board is exciting with the duty of observing the outcome and actions of upper management to approve that the later actions in the finest benefits of the proprietors (Jensen & Meckling, 1976). According to this opinion, boards obligate a possible precarious part to perform in alleviating problem of agency rising from the general parting of company possession from control (Fama, 1980; Jensen, 1993; Shleifer & Vishny, 1997). Moreover, Ruigrok et al, (2006) reveal that corporate panels also have significant parts to show with regard to actions for example planning and executing tactics and development relations among the companies and outside environs. Agreed their inclusive responsibilities consequently, it looks reliable that corporate board might influence on firm performance positively or negatively.

In Sri Lanka, the newly amended best performs codes in relation to corporate governance 2013 were delivered by the Institute of Chartered Accountants, Sri Lanka and Securities and Exchange Commission. This suggests that the panel to require equilibrium of managerial as well as non- executive directors for instance no single or set of persons can control the boards' decision – making. In addition, endorses that the responsibilities of the chairperson and the CEO would not grip by the similar person to confirm the constancy of control and power.

In the meantime, governance devices vary amongst countries, mostly between established and emergent economies. Developing markets vary considerably from established markets in their formal, governing and lawful settings (Prowse 1999). Sri Lanka is a developing market determined for monetary evolution. In latest years governance has arose a vital subject to Sri Lanka owing to business disgraces in the near past and the continuing impact of globalization, by way of the national economy mixes through the worldwide markets and companies struggle to increase global keenness afterward the finish of civil-war in 2009. Hence, it turned into important to reenter the prevailing governance structure to scrutinize its effect on companies' operational performance and propose techniques to bring out modifications if essential.

Many developed countries for instance USA, UK, Japan, Germany and France (Yermack, 1996; Hampel, 1998; Dahya et al. 2006) carried out the research in relation to the effect of corporate governance on company performance. Furthermore, Malaysia and Indonesia also (Abdullah, 2004; Zubaidah et al., 2009; Ghazaly, 2010) conducted research relating to the influence of board features on company performance were not decisive naturally.

Some other scholars for instance Weir and Laing (1999), Weir et al., (2002) concluded that firm performance would be affected by the board characteristics of a firm. On the other hand, a number of researchers originated positive relationship among selected board features and company performance (Bhagat & Black, 1999; Keil & Nicholson, 2003; Bonn, 2004). Regardless of greatness of governance system of corporate globally, few research carried out to express the view between corporate governance and firm performance in Sri Lanka (Azeez, 2015). In similar viewpoint, some academics have completed research on this

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topic considering practices of governance structure, ownership pattern and company performance for particular segments. (Senarathna & Gunaratne, 2007; Kajananthan, 2012). Hence, present research is attempted to investigate more insight on the theme.

The paper contributes CG and perm performance literature, by viewing that board characteristics associate with performance of firms in Sri Lankan perspective. This paper has been comprised four sections. Sections 2 provide a appraisal of the existing literature works and hypotheses development. Section 3 defines the method used. The experiential outcomes are offered in Section 4. Final unit closes the paper.

2. BRIEF REVIEW OF LITERATURE AND CONSTRUCTION OF HYPOTHESIS

Azees (2015) examined the effect of corporate governance on company performance of Sri Lankan companies. Size of the board, CEO dualism, and proportion of independent directors on the board were considered as variables of corporate governance also EPS ROE and ROA, as proxies for performance of firms. He concluded that size of the board is inversely linked with company performance. This proposes that boards with few members are connected with greater company performance, probably over carefully observed management. Moreover, the results revealed that the parting of the both positions of CEO and chairperson consumes a significant and positive association towards the performance of firms. Nevertheless, the results showed that the presences of non-executive capacity directors in the board are not related to company performance. Another Sri Lankan study done by Kankanamage (2015) stating that a company having few members on the board, high amount of independent directors and comprehensive monetary ability is talented of compelling the earnings management performs of the managers of the companies and improves the value of financial reportage.

Seyed et al. (2012) resolved that that size of the board and non-executive capacity directors were positively connected to company performance. The outcomes recommended that the effect of the size of the board on company performance was over and above the effect of the board structure on performance of firm. Further, Al-Matari et al. (2012) resolved that CEO dualism had positive relationship to the company performance. However, board size and board composition were negatively associated with company performance. Zubaidah et al. (2009) determined that both board structure and size of the board had a positive influence on company performance. Moreover, Augustine (2012) observed the influence of board features on the performance of Nigerian firm consuming the data for 122 registered companies from 1991 to 2008. Size of the, board, skill of the board, nationality of board, diversity in ethnicity of board and CEO dualism were considered as characteristics. The results of the study stated that size of board, CEO dualism and gender diversity remained adversely related to company outcome; however nationality of board, ethnicity of board were originated positive influence on company performance.

The following propositions established considering the above literature,

H_1: There is a negative significant relationship between CEO Duality and ROA

H_2: There is a negative significant relationship between Board Size and ROA

H_3: There is a positive significant relationship between Non-Executive Director and ROA

3. METHODOLOGY

3.1 Study Design

The research observes the relationship amongst board features and company performance. Board Size of board, CEO duality, and percentage of directors as a capacity of non-executive are taken as board features and ROA is used for firm performance. Size of the firm considered as controlling variable in this study.

The Study population was considered all registered firms in Colombo Stock Exchange (CSE). All listed companies in CSE are classified into 20 sectors. Within that researcher has selected Manufacturing sector as sample for the current reserach. Data collection for the study wholly depends on secondary data. All related data taken using the annual financial reports for the five years starting g from 2011 to 2016. Data gained from the reports used to check the hypothesis by SPSS software. SPSS Version 20 used for validity and reliability.

3.2 Model Specification

This research used a multiple regression models to inspect the relationship among the variable of Corporate Governance and their association with company performance

$$\textit{Firm Performance} = \alpha_i + \beta_1 CEODUAL + \beta 2BSIZE + \beta_3 NED + \beta_5 FSIZE + \varepsilon_i$$

Where,

Firm Performance is Return on assets (ROA) =. Net income divided by total assets.

CEO duality (CEODUAL) = an indicator of whether or not a firms' CEO is also the chair of the board of directors

NED = the proportion of non-executive directors of the board

BSIZE = the number of directors on the board.

Firm size (FSIZE) = firms' total assets

$\varepsilon_{i} =$ the error term.

4. RESULTS AND ARGUMENTS

4.1 Descriptive Figures

Statistics of descriptive used to elaborate the elementary landscapes of the study. They deliver simple reviews about the sample and the measures for the reserach.

Table: 4.1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
CEODual	165	0	1	.21	.406	.165
BSize	165	3	12	7.52	1.843	3.398

NED	165	.11	.80	.3675	.12679	.016
Valid (listwise)	165					

Table 4.1 shows that average value of CEO duality was 0.21. This result remarks that many firms selected persons to undertake the chairperson and CEO characters individually. This result endorse that Sri Lankan registered firms is moving in the direction of involved noble governance system. The lowest number of the board memberships is three as well as maximum number of board memberships is twelve and averagely seven to eight members are board members. Average non-executive capacity directors were in the board is 0.3675. And minimum and maximum range was 0.11 and 0.80. Minimum there are 0.11 proportions of non- executive independent board members as well as maximum there are 0.8 proportion of board size is non-executive independent board members and averagely 0.3675 quantity of board size is non- executive independent board members.

4.2 Correlation Statistics

Correlation describes the strong point of association among two variables. In this research the correlation co-efficient examination have done to discover the connection between board features and company performance.

Table: 4.2. Board Features correlated with Firm Performance

	CEO Duality	B.Size	NED	F.Size	ROA
CEODuality	1	.028	-.288**	-.213**	-.218**
BSize	.028	1	-.248**	.384**	-.045
NED	-.288**	-.248**	1	.064	-.036
FSize	-.213**	.384**	.064	1	.222**
ROA	-.218**	-.045	-.036	.222**	1

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

Table 4.2 gives Pearson’s correlation for entire factors in this study. It examines the relationship among the board characteristics factors and company performance. According to the above table a significant adverse correlation recorded between the CEO dualism and company outcome measured by ROA. Board size and percentage of non-executive capacity directors are adversely connected with ROA though insignificant. However, control variable of size of the firm significantly positively connected with ROA.

4.3 Regression Statistics

Analysis of regression is carried out to check the impact among the variables. At this juncture, dependent and independent variables are the profitability and board

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features of firms. The following relationships are formulated.

Table: 4.3 Coefficients for overall analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.194	.048		4.055	.000
CEODual	-.049	.020	-.190	-2.408	.017
BSize	-.011	.005	-.196	-2.322	.022
NED	-.119	.067	-.144	-1.790	.075
FSize	5.404E-12	.000	.296	3.470	.001

Table: 4.4. Model Summary (overall analysis)

R	R Square	Adjusted R Square	Std. Error of the Estimate
.368[a]	.136	.108	.099246

According to the Table 4.3, the impact of CEO dualism on ROA was significant and negative. The results are reliable with Azeez (2015) and Yermack (1996), and the argued that, companies are highly appreciated when assign two personnel for the post of the CEO and chairperson distinctly. Therefore, Hypothesis H1 accepted. The effect of board size on ROA was significant and negative. In keeping with worldwide investigation (Yermack, 1996: Eisenberg et al. 1998) present research provides an inverse association among size of the board and company performance was also apparent in the Sri Lankan background. Further this outcome is reliable with the conclusions of Azeez (2015). Therefore, Hypothesis H2 accepted. The influence of existence of non-executive capacity directors representing from panel on firm outcome is significant at 10% level. But it is negatively related with ROA. This might be supported by the opinion detained by Zubaidah et al. (2009) where they conclude that there stood an adverse affiliation among non-executive capacity directors and company performance. Hence, Hypothesis H3 not accepted due the relationship among the variables. In relation to control variable of firm size, significant positive effect recorded on company performance.

5. CONCLUSION AND RECOMMENDATION

5.1 Conclusion

The objective of the investigation is found out the association among the board features and company performance. Conferring to the experiential outcomes of this research, the researcher could be driven the conclusion concerning the effect of board characteristics on performance of

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firm. The regression results of the investigation provide that the association among the CEO dualism and company performance (ROA) as recorded significant and negative. It means that two separate persons assign for the post of CEO and chairman will lead to the upper company performance. Furthermore, regression results reveal that an adverse association exists among board size and ROA significantly. This shows that few numbers of members on the boards are connected with highest performance of companies, conceivably trough carefully supervised administration. Moreover, regression results show that presence of independent directors as a capacity of non-executive directors has significant negative connection with ROA. However, regression outcomes of this research show that a positive significant connection among size of the firm and ROA.

5.2 Commendations for future research

This research considered one proxy of ROA and future researchers may consider investigating corporate governance with other proxies like Tobin's Q, ROE, ROI and EPS.

This study has considered only tree variables as board characteristics for instance CEO duality, size of board, and non-executive capacity directors Even though, there are some board characteristics variables are available which may consider in future researches such as diversity of gender, amount of meetings and educational qualification of panel members.

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