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Corporate Governance and Firm Performance: Evidence from Sri Lanka

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Abstract

This study has investigated the relationship between corporate governance and firm performance in Sri Lanka. Board Size, CEO duality, and proportion of non- executive directors are used as corporate governance variables and EPS, ROA, and ROE as measures of firm performance. Data are obtained from the annual reports of 100 listed companies in the Colombo Stock Exchange for the 2010-2012 financial years. Regression results indicate that board size is negatively associated with firm performance. This suggests that small boards are associated with higher firm performance, possibly through closely monitored management. Moreover, the results reveal that the separation of the two posts of CEO and chairman has a significant positive relationship with the firm performance. However, the presences of non-executive directors on the board are not associated with firm Performance of the listed companies in Sri Lanka.

Keywords: Corporate governance, Firm performance, Sri Lanka

1. Introduction

Corporate governance and its impact on corporate performance is a widely debated area. In the past decade, empirical research has shown significant relationships between various corporate governance features and corporate performance. Empirical research on corporate governance is based on the theoretical framework of agency theory advanced by Jensen and Meckling (1976), Fama (1980) and Fama and Jensen (1983). In particular, agency theory suggests that a better-governed firm should have better performance and higher valuation due to lower agency costs. This prediction is supported by many empirical studies. For example, Gompers, Ishii, and Metrick (2003) find that better corporate governance is associated with higher firm valuation as measured by Tobin's Q. Brown and Caylor (2009) find that better-governed U.S. firms have higher return on equity (ROE), higher return on assets (ROA), and higher Tobin's Q. Therefore it is arguable that aligning interest of owners and managers through adhering to good corporate governance practices would lead to reduced agency conflict between owners and managers and thereby would lead to enhanced performance of the company. However, as Klein, Shapiro & Young (2005) identifies there is no universal evidence to suggest that better governance enhances firm performance. As a result, investors are still much skeptic about the existence of the link between good governance and firm performance.

Meanwhile, governance mechanisms differ between countries, particularly between developed and emerging economies. Emerging markets differ substantially from developed economies in their institutional, regulatory and legal environments (Prowse 1999). Sri Lanka is an emerging market economy striving for economic growth. In recent years corporate governance has emerged as an important issue for Sri Lanka due to corporate scandals in recent past and the ongoing effects of globalization, as the domestic economy integrates with the global economy and firms strive to gain international competitiveness after the end of civil-war in 2009. Therefore, it has become essential to revisit the existing governance system to examine its impact on firm performance and suggest ways to bring about changes if necessary.

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This study examines the relationship between board characteristics, as a governance mechanism, and corporate performance in Sri Lanka. Board Size, CEO duality, and proportion of non- executive directors are used as corporate governance variables and EPS, ROA, and ROE as measures of firmperformance. The findings from the empirical analysis shows that among the three corporate governance variables that the research has focused on, separation of the roles of CEO and Chairman has a significant positive influence on corporate performance while Board size is negatively associated with firm performance. The reminder of this paper is organized as follows. Section 2 discusses corporate governance in Sri Lanka, reviews the related literature and develops the various hypotheses for testing. Section 3 describes the research methodology. Section 4 provides empirical results. Finally, Section 5 concludes the paper.

2. Background and Hypotheses Development

2.1 Corporate Governance in Sri Lanka

There has been a renewed interest about the Corporate Governance in Sri Lanka with corporate scandals in recent past and with the regulatory measures taken by regulatory bodies in protecting the interest of the shareholders. Collapse of certain financial institutions including pramuka and golden key has stressed the importance of adopting good governance principles in Sri Lankan community and has enlightened the regulators in setting effective governance mechanism in protecting shareholder interest. Though the concept of corporate governance was practiced by Sri Lankan companies in an informal way since British era, the development of formal codes on corporate governance started to take place from 1997 with the initiative of Chartered Accountancy Sri Lanka (ICASL). The first code on Corporate Governance in Sri Lanka has been introduced by Institute of Chartered Accountancy Sri Lanka (ICASL) in 1997 which is voluntary Code of best practice on matters relating to financial aspects of Corporate Governance. This code was mainly based on the recommendations of Cadbury code (1992).

In 2003, ICASL issued a new Code of Best Practice on Audit replacing the code in 1997 jointly with collaboration of Securities and Exchange Commission Sri Lanka (SEC). This initiation of the new code was largely based on the Hampel report (1998). Combined code on Corporate Governance (2003) was aimed at ensuring that Sri Lankan standards relating to Corporate Governance are in line with the developments taking place in other parts of the world. However the development of Sri Lankan corporate Governance was far behind from other countries such as UK and USA and at the time of Sri Lanka introduced new Code of Best Practice on Corporate Governance, the above countries has made lot of improvements to their governance systems by introducing several Governance codes between 1998 and 2003. Turnbull report on internal controls (1999), Smith report on Audit committees (2003), Higgs report on Review of the role and responsibilities of non executive directors (2003) and Sarbanes Oxley Act in USA following the collapse of Enron and WorldCom. Therefore the development of corporate governance codes and reforms were taken place in Sri Lanka at a slow pace. The ICASL code (2003) was subsequently replaced by the code of Best Practice on Corporate Governance (2008), which has been prepared by ICASL jointly with SEC for voluntary compliance of listed companies in conjunction with the mandatory rules on Corporate Governance that has been incorporated into Colombo Stock Exchange (CSE) listing rules. The aim of introducing combined code on Corporate Governance in Sri Lanka is to promote and enhance good governance in the listed companies in Sri Lanka and improve investor confidence and also to promote economic development of the company.

2.2 Literature Review

There is extensive body of knowledge which explores the correlation between Corporate Governance and firm performance. The previous literature has produced mixed results where one stream of literature suggest a positive correlation between Corporate governance and firm performance (Klapper & Love, 2004; Gompers, Ishii, and Metrick) while other stream of literature finds no significant association between corporate governance and firm performance (Hermalin & Weisbach, 1991; Klein, Shapiro, and Young 2005). However many scholars have focused on specific dimensions or attributes of corporate governance such as role of non executive directors, CEO duality etc and their influence on corporate performance. Hence the below section would provide a detailed knowledge on existing empirical evidence on specific corporate governance attributes which this study has mainly focused on, that is separation of CEO and Chairman, proportion of non-executive directors, and board size.

CEO Duality

Good governance principles by many governance codes highlight the fact that the roles of CEO and chairman of the company should be held by separate individuals to eliminate unvested power over one individual and for better performance of the company. However, though there is an extensive body of knowledge on how CEO duality would influence on firm performance, the results have produced mixed results. One stream of literature points out the importance of separate individuals holding the roles of CEO and chairman of the company (Pi &Timme, 1993) while the other stream of literature supports CEO duality (Stoeberl&sherony, 1985). Fama and Jensen (1983) suggest that involvement of one personality as firm CEO Chairman would violate the separation of decision management from decision control. Further they view that this would lead unvested power on one individual leading decision biasness over one individual leaving greater opportunity for him to act in accordance with his personal interest which would in turn be detrimental for the shareholders of the company. Supporting the view that separation of roles of CEO and chairman would lead to better performance, Daily and Dalton (1994) concludes that there is a strong and robust positive association between CEO duality and firm bankruptcies. Abdul, Rahman, and Haniffa (2003) concluded the fact that separate board leadership tends to perform well measured by accounting performance measures and role of duality tends to underperform. Dahya, Lonie and Power (2006) suggest that the market responds favorably to the separation of the two roles and unfavorably to their fusion of these two responsibilities over one person and further concludes the fact that the accounting performance of companies which adopt a 'dual CEO' appears to decline subsequent to this change. However, another stream of literature highlights the positive effects of CEO duality. Stoeberl and sherony (1985) contend that CEO duality would provide the company with good leadership and it is an indication of firms' stability and it enhances firm communication and ultimately leading to better confidence by the investors about the company.

This argument that CEO duality would have a positive impact on firm performance echoed in Donaldson and Davis (1991). Stewardship theory stresses the beneficial consequences on shareholder returns of facilitative authority structures which unify command by having roles of CEO and chair held by the same person. The empirical evidence is that the ROE returns to shareholders are improved by combining, rather than by separating, the role-holders of the chair and CEO positions. Brickley, Coles, and Jarrell (1997), argue that this separation of two roles as CEO and Chairman has potential costs, as well as potential benefits. Further they suggest that the costs of separation are larger than the benefits for most large firms. Rechner and Dalton (1991) find that firms with 'independent' leadership structures consistently outperform those with a duality structure with respect to return on investment (ROI), return on equity (ROE), and profit margins. Sridharan and Marsinko (1997) finds that CEO duality is positively associated with the market value of the firm in forest products industry and further stresses the point that While CEO duality may indeed reduce board independence, it may not necessarily imply that the firms with duality status would perform worse than their peers. Therefore, based on the previous literature following hypothesis is built;

Hypothesis 1: Separation of the roles of CEO and Chairman is positively associated with firm performance

Non- Executive Director Proportion

Boards of directors are widely recognized as an important mechanism for monitoring the performance of managers and protecting shareholders' interests (Fama & Jensen, 1983). A number of professional and regulatory committees have addressed the issue of board performance and some have recommended that companies should appoint a board of directors having a majority of non-executive directors, with an appropriate mix of experience. Cadbury report 1992 addresses the role of the non-executive directors; in bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. Further, the Sri Lankan combined code on Corporate Governance set guidelines for the minimum number of non executive directors that should present in the board and it further states the importance of appointing non executive directors with sufficient caliber. Empirical evidence does suggest that independent non-executive directors do play a important role of protecting the shareholder interest (Byrd & Hickman, 1992). Weisbach (1988) notes that Non executive directors are able to reduce managerial consumption of perquisites when they are independent and not intimidated by the CEO. Beasley (1996) found that independent Non executive directors reduce the likelihood of financial statement fraud. These studies indicate that independent Non executive directors do monitor and control management and this could lead to better company performance.

However another stream of literature has not found a link between independent Non executive directors and improved firm performance (Hermalin & Weisbach, 1991). The point that can be made from these studies is that there is no clear benefit to firm performance provided by independent Non executive directors. Therefore based on the previous literature following hypothesis is built:

Hypothesis 2: The proportion of non-executive directors in the board is positively associated with firm performance

Board Size

According to Lefort and Urzua (2008), board of directors are the central institution in the internal governance of a company and further concludes that board of directors , in addition to strategic direction , they provide a key monitoring function in dealing with agency problems in the firm. Cadbury report (1992) identifies the board of directors' responsibilities as; setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. Jensen (1993) remarks board as an effective internal control mechanism, and further he establishes that problem with the corporate internal control system start with the board of directors, where the board at the apex of the internal control system has the final responsibility for functioning of the firm. Board size may affect corporate performance directly and various explanations are presented by many scholars. According to Sanders and Carpenter (1998), board size would reflect the complexity of firm's environment. Jensen (1993), states that though causes for board failures cannot be clearly understood, he identifies board culture, information problems, lack of management and board member equity as causes for board failures and also he points out oversized boards as major cause for board failures. According to Jensen (2012), keeping small boards can help to improve their performance and concludes that when board gets beyond seven or eight members they are less likely to function effectively and are easier for CEO to control. Similar view of thought has been produced by Yermack (1996) where he examined the relationship between performance as measured by Tobins Q and the board size on a sample of large US corporations and found inverse relationship between the board size and the firm value, where financial ratios related to profitability and operating efficiency appear to decline as board size grows. Eisenberg, Sundgren, and Wells (1997) present evidence that a negative correlation between board size and profitability. This finding was in line with Yermack (1996) and Jensen (2012), which supports the hypothesis, even in smaller firms, when board size grows problems in communication and coordination could occur.

Lipton and Lorsch (1992) identifies lack of time of directors in carrying out their duties and further points out that another relate reason for the lack of meaningful dialogue is the size of the board. The arguments behind Jensen (2012) and Lipton and Lorsch (1992) is that large board would lead to higher amount of agency problems and would lead to ineffective management of the company. However, contrary to these views, Kathuria and Dash(1999) finds that performance improves if the board size increases, but the contribution of an additional board member decreases as the size of the corporation increases. Therefore the following hypothesis is built:

Hypothesis 3: Board Size is negatively associated with firm Performance

3. Research Design

3.1 Sample Selection

The sample is comprised of the 100 firms listed in the Colombo Stock Exchange for the 2010-2012 financial years. In line with previous studies, banks and Finance companies are excluded from the sample due to the fact that adhering to the Governance mechanisms is mandatory for Banking and Finance companies while for other companies it is voluntary with several mandatory rules. Therefore to protect the consistency of the conditions under which the research is carried out companies from Banking and Finance sector is ignored from the sample. Data collection was mainly based on annual reports of the companies in the sample. The information with regard to governance variables were obtained through the Corporate Governance information provided in each annual report. Data for dependent variables such as EPS, ROA and ROE were collected through the financial statements of each annual report.

3.2 Variables

This section presents the dependent, independent, and control variables used in the econometric analysis.

Dependent Variable

There is no consensus concerning the selection of an appropriate set of dependent variables which account for corporate financial performance.

It is unlikely, however, that any one corporate performance indicator could sufficiently capture this performance dimension. While they concede that there is no consensus concerning the choice of dependent variables, they argue that such measures fall into two broad categories: investor returns and accounting returns. Accordingly, three proxies are used to represent both categories: Return on assets (ROA), return on equity (ROE), and earnings per share (EPS) (Bhagat& Black, 2002; Mashayekhi and Bazaz, 2008). Return on assets is computed as operating profit after tax, divided by total assets. Return on equity is defined as operating profit after tax, divided by total equity. Earnings per Share Net income divided by total number of shares.

Independent Variable

This research employs three corporate governance variables as independent variables. That is separation of CEO and Chairman, proportion of non-executive directors on the board, and board size. Board size is measured as the natural logarithm of total number of board members. Non-executive directors are defined as the number of non-executive directors divided by the total board of directors. CEO duality, which indicates whether the CEO is also the chair of the board. This is a binary variable 1 = CEO duality, 0 = otherwise.

Control Variables

Recognizing company characteristics can affect both a company's financial market performance and its corporate governance practices, in different ways, three control variables: size; leverage, and age are included as control variables. Regarding company size, larger companies may have better performance because they utilize economies of scale. On the other hand, larger companies may incur inefficiencies that result in poor performance (Klapper & Love, 2004). In addition, they may have more resources that may allow them to adopt good practices, for example, hiring employees and consultants who are more capable of implementing good governance practices. Company size is measured by the logarithm of total assets. With regard to leverage, debt may affect company performance as it reduces the free cashflow (Jensen, 1986). Also, highly leveraged companies are more closely monitored by debt providers, who may put pressure on the companies to adopt good governance practices. For example, researches shown that companies with high leverage tend to disclose more information than those with low leverage (Broberg, Tagesson, & Collin, 2010). Leverage is measured by total liabilities divided by the total assets. AGE, the length of time that the firm's common stock has been traded on the CSE, is another control variable in this study (Mashayekhi and Bazaz, 2008). It is measured as natural logarithm of the number of years listed in the CSE.

3.3 Regression Model

This study employs multiple regression model to examine the relationship between the Corporate Governance variables and their relationship with corporate performance. This method of analyzing the relationship is supported by Mashayekhi and Bazaz (2008) and Mcknight and Weir (2006). The following regression model is used to test the hypotheses.

$$EPS_i / ROA_i / ROE_i = \alpha_i + \beta_1 DUAL_i + \beta_2 NED_i + \beta_3 BSIZE_i + \beta_4 AGE_i + \beta_5 SIZE_i + \beta_6 LEV_i + \varepsilon_i$$

Where EPS is earnings per share; ROA, return on asset, net income divided by total assets; ROE, return on equity, net income divided by equity DUAL is an indicator of whether or not a firm's CEO is also the chair of the board of directors; NED is the proportion of non-executive directors on the board; BSIZE is the number of directors on the board; Age is the number of years the firm listed in the CSE. SIZE is the size of the firm as measured by a natural logarithmic function of the firm's total assets; LEV is the total liabilities divided by total assets and ε, the error term.

4. Results and Discussion

4.1 Descriptive Statistics

Table 1 presents descriptive statistics of corporate governance characteristics and firm financial performance measures. The average number of persons on the board of directors is 7.91, with about 65 percent of them being non-executive managers or independent members. In the overall samples for this study, have 43.1% of the sample of firms has CEO duality and 56.9% has no CEO duality, which means most of the firms appointed individuals to assume the Chairman and CEO roles separately.

This descriptive statistics suggest that Sri Lankan listed companies is moving towards practicing good governance mechanisms that firms has shown an increased interest complying with combined code on Corporate Governance 2008 which has been issued by ICASL and SEC by maintaining two separate persons for the roles of Chairman and CEO and also including higher proportion of non-executive directors in corporate boards. This kind of movement by the Sri Lankan companies towards adopting good governance mechanisms could be seen as a positive trend despite the slow paced Corporate Governance reforms that had taken place in Sri Lanka.

Table 1: Descriptive Statistics

	Mean	Median	Max	Min	SD
Dependent Variables					
EPS	9.78	3.78	333.14	-69.12	26.93
ROA	0.053	0.041	0.702	-1.399	0.143
ROE	0.040	0.072	1.394	-16.11	0.960
Independent Variables					
BSIZE	7.91	8.00	14	4	1.79
DUAL	0.431	1.000	1.000	0	0.496
NED	0.650	0.667	1.000	0	0.241
Control Variables					
SIZE	9.144	9.232	10.653	6.869	0.654
LEV	0.431	0.361	8.213	0.001	0.566
AGE	26.7	27	80	7	12.9

Most of the firms appointed individuals to assume the Chairman and CEO roles separately. This descriptive statistics suggest that Sri Lankan listed companies is moving towards practicing good governance mechanisms that firms has shown an increased interest complying with combined code on Corporate Governance 2008 which has been issued by ICASL and SEC by maintaining two separate persons for the roles of Chairman and CEO and also including higher proportion of non-executive directors in corporate boards. This kind of movement by the Sri Lankan companies towards adopting good governance mechanisms could be seen as a positive trend despite the slow paced Corporate Governance reforms that had taken place in Sri Lanka.

4.2 Correlations

Table 2 presents Pearson's correlation for all the variables in the study. It examined the association between the corporate governance variables and firm performance variables. There is a positive correlation between the separation of the roles of CEO and Chairman and firm performance as measured by ROA, ROE and EPS. Non-executive director proportion is positively correlated with EPS and negatively correlated with ROA and ROE. Board size is positively correlated with ROA. However it shows a negative correlation with regard to EPS and ROE.

Table 2: Pearson's Correlations (N = 300)

	EPS	ROA	ROE	BSIZE	NED	DUAL	AGE	SIZE	LEV
EPS	1.000								
ROA	0.126	1.000							
ROE	0.027	0.424	1.000						
BSIZE	-0.071	0.130	-0.052	1.000					
NED	0.002	-0.048	-0.082	0.104	1.000				
DUAL	0.076	0.185	0.107	0.210	0.018	1.000			
AGE	0.067	0.019	-0.024	-0.003	-0.008	-0.120	1.000		
SIZE	0.121	0.238	0.194	-0.126	0.064	0.085	-0.120	1.000	
LEV	0.124	0.027	-0.092	-0.052	0.002	-0.040	-0.116	-0.129	1.000

EPS **is** earnings per share as measured by net income divided by total shares; ROA is net profit after tax divided by total assets; ROE is net profit after tax divided by total equity; DUAL is an indicator of whether or not a firm's CEO is also the chair of the board of directors; NED is the proportion of non-executive directors on the board; BSIZE is the number of directors on the board; SIZE is the size of the firm as measured by a natural logarithmic function of the firm's total assets; LEV is the total liabilities divided by total assets and AGE is the length of time that the firm's common stock has been traded on the Colombo Stock Exchange.

4.3 Regression Results

Table 3 shows ordinary least squares regression results for each of EPS, ROA and ROE on the independent variables. The results derived from the regression analysis reveals that the separation of the two posts of CEO and chairman has a significant positive relationship with the firm performance as measured by ROA,

Table 3: Regression Results for Corporate Governance Variables and Performance

Variables	EPS	ROA	ROE
Constant	-58.38	-0.256	-1.771
	(-2.249)**	(-2.161)**	(-1.932)**
BSIZE	-1.643	-0.118	-0.054
	(-1.84)*	(-9.012)**	(-1.679)*
DUAL	5.604	0.040	0.208
	(1.754)*	(2.774)**	(1.845)*
NED	3.334	-0.011	-0.196
	(0.515)	(-0.402)	(-0.860)
AGE	6.627	-0.001	-.0.042
	(2.095)**	(-0.082)	(-0.384)
SIZE	5.912	0.034	0.266
	(2.445)***	(3.095)***	(3.123)***
LEV	2.294	0.004	-0.124
	(0.800)	(1.148)	(-1.230)
F statistic	2.362	19.929	3.305
Prob(F-statistic)	0.030	0.000	0.003
R-squared	0.461	0.689	0.634
Observations	300	300	300

***, ** and * indicate the significance level at the 0.01, 0.05 and 0.1, respectively. Regression estimates are reported with t-statistics in parentheses. EPS **is** earnings per share as measured by net income divided by total shares; ROA is net profit after tax divided by total assets; ROE is net profit after tax divided by total equity; DUAL is an indicator of whether or not a firm's CEO is also the chair of the board of directors; NED is the proportion of non-executive directors on the board; BSIZE is the number of directors on the board; SIZE is the size of the firm as measured by a natural logarithmic function of the firm's total assets; LEV is the total liabilities divided by total assets and AGE is the length of time that the firm's common stock has been traded on the Colombo Stock Exchange.

ROE and EPS.Based on the results, it proves that separate leadership structures would lead to better performance of the listed companies in Sri Lanka. The results of the research supports the hypothesis, which states that separation of the roles of CEO and chairman, would lead to higher performance and the hypothesis is accepted at 5% significance level. The above view of thought has been supported by many scholars (Pi and Timme, 1993; Rencher and Dalton, 1991). Similar results have been produced by Abdul, Rahman, and Haniffa (2003) which states that firms with separate leadership structures outperformed firms with combined leadership structures. Therefore the results derived through the current study is in line with previous literature where it could be concluded that separation of the roles of CEO and chairman would have a positive influence towards enhancing performance of the listed firms in the Sri Lankan context as well. In the Sri Lankan context, the importance of separating the roles of CEO and chairman has been stressed by the amended Corporate governance code 2008 issued by SEC and ICASL, following the corporate scandals such as Golden key, Pramuka Bank and etc. Separation of the two roles is mandatory for financial companies and voluntary for other listed companies in Sri Lanka which are not operating under Banking and Finance sector.

However, though it is not compulsory we could observe that companies in the sample followed an increasing trend of separating these two roles and therefore it could be argued that separation of these two roles has positively influenced towards the corporate performance of the listed companies in Sri Lanka.

Non executive directors in the board are considered as an important governance mechanism which promotes better governance. Regression results indicate that the relationship that exists between number of non executive directors and firm performance is negative and insignificant at 5% significance level. Therefore the hypothesis that higher proportion of non-executive directors in the board would lead to higher performance is rejected.

Results suggest that incorporating increasing number of non executive directors would not contribute adding value to the organization. This could be supported by the view held by Hermalin and Weisbach (1991) where they conclude that that there is no link between independent non executive directors and improved performance. However, the results of the current study relating to non executive director proportion and firm performance are contrary with several governance literatures (Weisbach, 1988; Beasley, 1996) they suggest that proportion of non-executive directors is positively influenced towards improving company performance. Best practice code on corporate governance issued by ICASL and SEC and the listing rules by Colombo Stock Exchange specifies the minimum number of non executive directors that should be within the company. This is to oversee executive director's actions and to protect the shareholder interest.

Though many scholars argued that non-executive directors improve performance, it is questionable this really take place in the Sri Lankan context where the current research results also holds the view point that proportion non executive directors has no significant positive association with firm performance. This is because given the relationship that exist within Sri Lanka a question could be raised as whether the non executive directors are really in a position to make proper informed decisions and also whether the independent non-executive directors truly fulfills the non executive director characteristics which the best practice code recommends. Researchers have attempted to study the most absolute number of directors that should present in the board to obtain better performance. It is a widely accepted point that board size has a negative relationship with corporate performance (Jensen, 1993; Yermack, 1996; Loderer and Peyer, 2002). The results of this study also suggest a negative significant relationship between the board size and firm performance as measured by ROA, ROE and EPS. Therefore, the hypothesis which states the negative relationship between board size and firm performance is accepted. However, this result contradicts that of Dalton et al. (1998) who find a positive and significant relationship between board size and financial performance. Firm size has significant positive relationship and Leverage has no significant relationship with performance. Similar to Mashayekhi and Bazaz (2008) findings, the positive and significant coefficients on Firm size indicate that firm size has a positive impact on performance. The length of time that the firm has been listed in CSE (AGE) is not associated with firm performance. Finally, the test results indicatethat the leverage ratio of the firm does not have a statistically significant effect on firm performance.

5. Summary and Conclusion

This study has examined the influence of Corporate Governance variables such as CEO duality, Proportion of non-executive directors, and Board size on a firm's performance in Sri Lanka. EPS, ROA, and ROE are used as measures of firm performance. To test these hypotheses, this study use data from the CSE and information from annual reports of 100 Sri Lankan companies, excluding Banking and Finance sector, for the 2010-2012 financial years. The regression results suggest that board size is negatively associated with firm performance. This indicates that small boards are associated with higher firm performance, possibly through closely monitored management. Moreover, the results reveal that the separation of the two posts of CEO and chairman has a significant positive relationship with the firm performance. However, the presences of non-executive directors on the board are not associated with firm Performance of the listed companies in Sri Lanka suggesting that mere presence of non-executive directors in the corporate boards would not ensure the stakeholders that the firm is running in fair and smooth manner reducing agency conflicts between shareholders and the management.

The level of independence of the non-executive directors is not clear cut when it comes to Sri Lankan context, where Sri Lankan listed firms just increase the number of independent directors, however, they may not truly independent to take sound decisions for greater performance of the company. In view of above it could be concluded that just mere presence of non-executive directors on corporate boards within the company would not enhance firm performance. These findings have implications for policy makers, researchers, managers, and investors in general and those in emerging markets in particular.

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