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Application of Corporate Governance Practices in Companies Listed in CSE Sri Lanka

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ABSTRACT:

Purpose: The purpose of the article is to find out the application of corporate governance practices in companies listed CSE in Sri Lanka.

Methodology: The study aimed at the factors influence in the application of corporate governance practices and firm's financial performance in Sri Lanka. In this study, there are two dependent variables namely return on equity and return on asset and four independent variables namely board leadership, board structure, board size and number of board committees. The study used 20 top companies (blue-chip companies) as sample for period of five (5) years 2014-2018. The data was analyzed using the SPSS statistical software package. The descriptive statistics, correlation analysis and regression analysis were used in this study.

Findings: The results show that there is a positive relationship between corporate governance practices and firm performance, in the Sri Lankan context. And also it was found that there is a positive effect of board leadership board structure, board size and board committees on ROE and ROA the effect of board leadership, board size and board committees are significant with ROE & ROA. Only board structure has an insignificant effect on ROE and ROA.

Implication of the research: It is concluded that there is a positive effect of corporate governance practices on firm's financial performance of listed companies in CSE. On the other hand, some corporate governance practices has significant effect on firm's financial performance and some other corporate governance practices have insignificant effect on firm's financial performance

KEYWORD: ROE, ROA, board size, and board structure

BACKGROUND OF THE STUDY

Advances in information technology and globalization have revolutionized the global business environment. The business environment has become complex and has to face the competition from local market and foreign market to survive in the business world. The board of management need number of strategies to take care of overall performance of the company for competitive advances. The firms require a new breed of professionals who have a broader knowledge of their profession and best corporate governance practices to guide the business organization to achieve its objectives. The application of corporate governance becomes central role in managing organizations to improve economic efficiency and growth as well as attract investor in identifying potential investment confidently in the current global and complex environment. The term governance has two meaning of structures. The first meaning of governance includes formal structure such as statutory Act and regulations and the second meaning includes informal structure such as norms, values and assumptions and which create constrains on the behavior of a related party. Economists says that the term corporate governance to refer to the guide line by which operating managers have to act in the interests of the owners of the entities and other stakeholders. In fact, good corporate guide line helps promote welfare of the general public and governments.

The Corporate governance guide line consist of a set of rules, regulation and policies which governs to direct and control the relationships between management and owners. This guide line specifies the distribution of duties and responsibilities among various group of people participating in working in the firm and spells out the rules and procedures for making decisions on the affairs of the firm. This guide line also provides the structure through which the company objectives are achieved, and the means of attaining those objectives and monitoring mechanism for performance of the firm Organization for Economic Cooperation and Development (OECD, 2002).

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Firm with good corporate governance practices are achieving well for their profit and wealth rather than that of firms having weak corporate governance. According to, (Mwanzia, 2010) concluded that appropriate guide line help organizations to get improved financial performance in developing countries. At present the concepts of adopting corporate governance practices has become questionable due to the collapses of several well reputed companies that represented the corporate sector of the world. The main reason behind the failure of the firms was the unhealthy corporate governance practices. But the adoption corporate the governance differs from one country to another. It depends on the inclusion of requirement of financial statements, economic stability and political stability of the particular country. In other words, the practices of European country firms are differed from a developing country like Sri Lanka. After the ending three decades civil-disorder war in 2009 in Sri Lanka, it has emphasized to concentrate to revisit the existing corporate governance practices to examine its impact on firm performance and suggest make changes if it is necessary. Advances in information technology and globalization have revolutionized the business environment of the 21st century. The business environment has become complex and competitive; the business has to face the competition from local market and foreign market to survive in the market.

Therefore, it is motivated the researcher to study to what extent corporate governance practices impacts on financial performance of companies listed CSE, Sri Lanka.

SIGNIFICANCE OF THE STUDY

This study expects to understand the practice, implementation and influence of corporate governance practices on firm's financial performances of the listed companies in Sri Lanka. It helps the stakeholders to understand their roles responsibilities and their duties in the organization as it incorporates laws, policies, customs that direct and control the organization. Corporate governance makes easy to hold people accountable for their works. It reduces the stakeholder's risk and increase the reliability of the firm.

The findings from this study add knowledge for existing literature and provide valuable input to every company to achieve its objectives. It is mandatory to apply corporate governance guide lines all the organization in Sri Lanka. The study helps policy makers, board of directors, and managers to understand clearly these guide lines in order to improve the organization. This is a critical issue in both the private and public sector to apply continuously short and long run survival. This study helps the stakeholders to classify to which extent this practices effect on financial performance and what are the most significant variables that influence the overall performance of the organization. It enhances the accountability and responsibility of board towards the stake holders of the company. Always there is a conflict among management and equity holders regarding adoption of corporate governance practices. Now days it is become a trend to adopt corporate governance practices because it leads the organization to achieve good performance and goals of the firm. The study benefits to the researchers who would wish to undertake further studies under these topics of organizations in Sri Lanka. Furthermore, this research helps public who like to make investment in the companies focusing the application of these practices in the organizations. Therefore, this study become important to identify the effect of governance practices on financial performance of organizations.

LITERATURE REVIEW

Review of literature helps to evaluate all the relevant concepts, definitions and all theoretical frameworks and to review the past studies and documentation related to this topic. There have been many researches carried out around the world, in both developing and developed countries to identify the to what extent financial performances are influenced in adopting these guide lines. The review of literature of this study focus on various theories and practices on this topic applied in international context and Sri Lankan context.

THEORIES OF CORPORATE GOVERNANCE

This section includes all the theories related to corporate governance of the study.

Agency Theory

Agency theory elaborates the relationship on agent and the principal of a company. This theory appears the business alliance of principal-agent relationship. The theory is based on control they possess in the organization. The shareholders are called principals, while the managers are called agents of the company. The shareholders expect to maximize their wealth. The managers expect to expropriate the company's wealth by means of salaries and other benefits. It may not be achieved because of the discretionary powers they possessed. This concentrate is to develop rules and incentives, to eliminate or at least, minimize the conflict of interests among owners and managers. The Statutory Act is formulated some rules and incentives in additions to at its own set of provisions to avoid the conflict in a country. Further, this theory provides a guide line to links firm performance

(Meckling, 1976). The agency theory guide lines defined companies as nexus of contracts under which one party work on another party (the agent) to perform some service for common benefits (Subramaniam, 2009).

This relationship has been further expanded to economic, accounting and strategic management areas in the companies. (Meckling, 1976) defines the principal engages the agent to perform some services, expecting the agent to act and make decisions in the best interest of the principals. In that case, if the agent and the principal believe to maximize the utility of the own interest, there is a deduction of agent's actions to improve the principal's interest.

Therefore, agency theory guide as a framework to understand the alignment of incentives and information asymmetry that influence the management decisions (Okougbo, 2011) It means if the compensations and incentives of the agents are been high, then the there is less likely to have an agency problem between the agent and the principal. But, shareholder are able to control the management to maximize their self- interest. Mostly agency theory encompasses the problems relating to the differences between the goals and desires of agent and the principle of a company. Therefore, corporate governance practices have been arisen to solve the problem of agency conflict. In that case, agency theory implies that a firm with good guide line may have well improved performance and higher valuation as lower agency costs. In this model the interest of managers is taken action as a result, it becomes costly for the shareholders. Agency concept illustrates the other sub-concepts such as agency problem and agency cost.

In the decision process the controlling this problem is essential for the managers who take major decisions on share of wealth in the organization. (Meckling, 1976). In this case, the agent acts to self-interest rather than fulfilling the principal's interest. Therefore, agency cost has arisen since there is an agency conflict between both parties. The theory has three types of costs such as monitoring cost, bonding cost, and residual loss (Meckling, 1976). Monitoring cost is the costs that incurred by the principals to mitigate the devious behaviors, mistakes, and errors of the agents. Some of the examples are auditing, budgeting, control and compensation systems. The Bonding costs incurred by the managers to get the beneficial decisions on behalf of their counterparty. The residual loss is a potential cost that would be incurred due to the non-controllability of conflicting behavior of the managers. The shareholders always claim on the firm's net income. It is assumed that when there is a larger net income, it means that agency performance well. However, it is the responsibility of the owners recruit excellent people as manages do operate organization since owners do not operate their firm directly. If the recruitment is failure, then the managers who have no inherent interest or enough knowledge in business cannot operate the firm in profitable way. This behavior affects overall profit of the organization. This is a situation where the agency problem arises. Generally, managers' incentives are not lined with those of the owners. The managers of the organization should be allowed to draw better incentives so as to get results in better firm performance in order solving the agency problem. The agency problem can be addressed in two ways. The first way is the managers and owners participation, i.e., inside ownership. The second is process of monitor the managers to measure input a directly and then to reward or penalize managers based upon their measured behavior. A conflict or problems between agents and the principals have arisen when the incentive structure effect to the personal cost of the agent if they take actions and decisions to maximize the principal's wealth. On the other hand, agency, problem has arisen since there is a disparity between activities of the agent and expectation of the owners. The conflicts of interest are almost inevitable everywhere in organizational politics. The incentive scheme is a one of the tools to attract the agent to put in effort into the task. On the other hand, managers and the traders should have are high bonus for the success performances.

In Sri Lanka, primary agency problem arises owing to the more concentration given by major owners in entities specially, controlling shareholders and the minority shareholders nut, no problem between the shareholders and the managers. (Gunaratne, 2008). Therefore, corporate governance practices were very useful to resolve this agency problem.

Stakeholder Theory

The stakeholder theory is emphasized the responsibility of the managers to maximize the total wealth of all stakeholders of the firm, rather than only the shareholder's wealth. Hence, the corporate governance guide lines empower managers to contribute resources and skills and to ensure that the interests of these stakeholders are aligned with that of shareholders. Organizations are dependent upon these constituency groups for their success. This much is uncontroversial. Refer to these constituencies as stakeholders.

Stakeholder concept came from sociological and organizational disciplines. Indeed, the scope of this theory is incorporating philosophy, ethics, political, economics, law and organizational science. This theory focus the accountability of management to a broad range of stakeholders. The managers, as operators of the organizations have link with many different group such as suppliers, employees and business partners, bankers and tax authorities. The managerial decision making should be focus on the interests of all stakeholders and no sets of interests is assumed to dominate the others. In other words, this theory is an extension of agency theory where the board of the directors' responsibility has been increased from shareholders to stakeholder interest.

Stakeholders are legitimate groups to whom the managers owes an obligation based on their participation to constitutes the organization and makes it a going concern. They include customers, suppliers of capital, equipment, materials, and labor. Firms may have other legitimate stakeholder specific to their own situations. The stakeholder theory has been discovered to the improvement or advancement of agency theory and confirms the concept of corporate governance in organizations more well-set manner than the agency theory. Thus, stakeholder concept link with agency concept by dilating the classical relationship among managers and shareholders to incorporate all other group as stakeholders that provides a vehicle for connecting ethics and strategy and that firms that diligently seek to serve the interests of a broad group of stakeholders.

In another way, there is a moral perspective of stakeholder theory. All stakeholders have a right to be treated fairly by the managers in the organization. It is the responsibility to manage the all stakeholders as stakeholder management leads to the perfect financial performance of a company. This theory explore the need of various stakeholder with different interest of the organizational environment. Therefore, governing board of the organization should compromise and balance the interest of people who help the organization and rest of them hurt the organization.

Stewardship Theory

The stewardship concept states the executives and managers are working for the shareholders to protect and maximizes shareholders wealth through better performance. The stewards act more autonomously and are satisfied and motivated when organizational success is attained.

The managers as self-directed, goal-oriented and self-motivated stewards are working efficiently and honestly by high achievements and responsibility in discharging their duties in the interests of company and owners and feel constrained if they are controlled by outside directors. Top people in the firm operate the firm efficiently to maximize profits and financial performance of shareholders. They will not be concerned about fostering their own economic interests. They operate the form in a way that leads to collectivist /organizational utility rather than self-serving benefits. When they are working towards organizational goals, the personal needs of directors are fulfilled.

However, the theory CEO duality suggests that the power of the executives and best stewardship when the role of the CEO and Chairperson of the board is combined. The stewardship theory requires an organizational structure that allows harmonization to be maintained in most efficiently among directors and shareholders. Thus, the stewardship concept consider issues of motivation, goal congruence, and trust. (Puyvelde, 2013)

The Political Theory

The concept of organizational political is a voting power of shareholders. It highlights the allocation of corporate power, profits and privileges are determined by it. The organizational political concept states that legitimate power they possess to decide to allocation of control, rights, responsibility, profit etc. among owners, managers, employees and other stakeholders (Pandey, 2010).

This theory advises how the government sectors and corporate sector determine to the delegate the power and authority to managers of a particular organization maintaining their relationship towards other stakeholders. However, the term political has vast meaning without limiting it in the role of civil governments and it can also refer to a non-market entity. The corporate governance has two systems called market- oriented system and bank-oriented system. In the political theory approach, active potential investors seek to change corporate policy by voting support they held by purchasing majority of shares from other discrete shareholders. A governance guide line on politics is more flexible than the one based on finance because it can address specific problems at a corporation without imposing changes in control, changes in management, and the enormous transactions costs attendant to them".

Resource Dependency Theory

This concept explains the role of board of directors in providing access to resources needed by the firm. It states that directors play an important role and custodian of resources of the organization through their linkages to the external environment can be accessed. The provision of ensures proper functioning, firm's performance and its survival.

Resource dependency theory argues that a board exists as a provider of resources to executives in order to help them achieve organizational goals (Hillman, 2003). The directors who bring resources to the firm, can be classified into four categories of insiders, business experts, support specialists and community influential. Resource dependency theories recommend interventions by the board while advocating for strong financial, human, and intangible supports to the executives. Resource dependence theories recommend that most of the decisions be made by executives with some approval of the board.

Corporate Governance and Stakeholders

Corporate governance is a set of relationships between a company's management, its board, its shareholders and other stakeholders. The corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth and increasing growth.

Corporate Governance and Board Size

Firm's value influence on board size, shares held by insiders, board composition and number of board meetings held. For the purpose this study, the researcher has used board leadership, board structure, and board size and board committees as independent variables and ROA & ROE as dependent variables to measure financial performance of the firms. Kimosop, 2011 found that there is a significant relationship between board size, non-executive directorship with both ROA and ROE.

Empirical studies

Velnampy, T., & Pratheepkanth, P., 2013 indicated on the study of Corporate Governance and Firm Performance: A Study of Selected Listed Companies in Sri Lanka, a positive relationship between the variables and firm's performance. The multiple regression analysis was used to test the data taken from 10 manufacturing companies. Return on assets (ROA) Return on Equity (ROE) are the depend variables of this research.

A study by, Siromi, B., & Chandrapala, P., 2017 investigated whether attributes of corporate governance affect decisions on capital structure on the Effect of Corporate Governance on Firms Capital Structure. The findings revealed only board composition & board committee were significantly effect on capital structure. The study used multiple regression analysis to test 138 non-financial companies with board size, board composition, leadership structure, board committees, and managerial ownership as independent variable and debt ratio and ROA as dependent and firm size as control variables.

Velnampy, P. T., 2013 studied "Corporate Governance and Firm Performance: A Study of Sri Lankan Manufacturing Companies to identify the relationship between corporate governance and firm performance of 28 companies as sample by using descriptive analysis, correlation and multiple regression analysis as the statistical test. Finding revealed that determinants of corporate governance are not correlated to the performance. For this study, independent variables were board structure, board committee, board meeting, executive directors, independent non-executive directors, non-executive directors, board size and the dependent variables were Return on equity (ROE), Return on assets (ROA).

Anandasayanan, S., & Velnampy, T. (2018) undertook a research on the topic of Corporate Governance and Corporate Profitability of Listed Diversified Holding Companies in Sri Lanka to test impact of corporate governance on corporate profitability. It was revealed that the corporate profitability was statistically significant while debt to equity ratio and firm size have insignificant impact on corporate profitability. Influence of corporate governance on corporate profitability was statistically significant while debt to equity ratio and firm size have insignificant impact on corporate profitability is the problem of this study. 17 companies out of 20 were selected based on the availability of the data during the study period for this study. Considered as independent variables and Return on Assets (ROA) was used as profitability measurement. Hypotheses has been tested using panel Least Square regression analysis. Descriptive statistics were computed for the Diversified Holding companies to represent the main characteristics of the study variables.

Kengatharan, L., & Sivakaran, T., 2019 studied on the topic of Impact of Corporate Governance Practices on Corporate Social Responsibility, Evidence From Listed Banks, Finance And Insurance Companies in Sri Lanka to examine the impact of corporate governance practices on corporate social responsibility over the period of 2013 to 2017. It was revealed the firm committed their corporate social responsible activities rather than profit maximization. Return on assets and firm size were considered as control variables. SR index are dependent variable. Board size, women directors, Audit committee size, board independent are independent variables. Regression analysis, descriptive statistics of the variables, Correlation Matrix, Results of Multi-collinearity were used as statistical tools.

Andradi, D., Jayasinghe, W., Gunathilaka, M., Anosha, G., Ayesha, G., & Herath, M. (n.d.) investigated about the relationship between corporate governance best practices and firm performance of 100 listed companies to identify in highly volatile environment, the company's performance. Hence it is difficult to maintain the financial stability; companies have to be concentrated on non-financial aspects as well as financial aspects to achieve long-term success. The dependent variables were ROE and ROA while independent variable were Composition of board ownership, Board independence, and Board size to test descriptive analysis, correlation and multiple regressions analysis, correlation and multiple regressions analysis used as statistical tools.

Thavarasasingam, H., Ravindran, M., & Anandasayanan, S. (2018). Studied to what extent the corporate governance impact on firm performance. It found out a positive and significant relationship between ROA with auditors, board composition. 17 land and property companies was taken as samples to test the hypotheses by descriptive statistics, correlation analysis, and multiple linear regression analysis. The dependent variable was ROA and Independent variables were Auditors, Board size, Board composition, independent directors of remuneration committee while control variable was firm size.

Mudalige, N., & Ekanayake, A. (2015) carried out a study to find relationship between corporate governance and capital structure in emerging markets the influence of corporate governance on capital structure decisions of listed 30 companies in Sri Lanka" 30 manufacturing companies selected as sample listed on the Colombo Stock Exchange. Total debt-to-equity ratio is the variable of this study Descriptive Statistics used as statistical tool.

Kajananthan, R., 2012 mentioned the positive relationship for separate leadership, board composition, board committees and firm performance on the toipc of "Corporate governance practices and its impact on firm performance, special reference to listed banking institutions in Sri Lanka. A sample of 11 listed banks were considered for a period of 5years from 2006 to 2010. The variables of this study are board composition, board committees, board size, board meeting, return on equity, firm performance, return on total assets. The data was analyzed with SPSS to obtain quantitative measures of descriptive statistics, Spearman's correlation, regression analysis and analysis of variance.

Manawaduge, A., & Zoysa, A. D., 2013 indicated a strong positive relationship between ownership and accounting performance on the structure of corporate ownership and firm performance in 157 nonfinancial companies listed on the CSE over the period 2000–2008. Variables of this study are ROA, ROE, Proxy, MBR by using Statistical tools are Descriptive Statistics, Correlations and Regression as statistical tools to test the hypothesis.

Azeez, D. A., 2015 carried out a to investigate the relationship between corporate governance and firm performance on100 listed companies in the CSE as the samples of this study. The finding showed a significant positive influence on corporate performance while Board size is negatively associated with firm performance. The dependent variables of this study were ROA and ROE, EPS while independent variables were separation of CEO and Chairman, proportion of non-executive directors on the board, and board size. The control variables were size, leverage, and age. This study employed multiple regression model to examine the hypothesis.

Puwanenthiren, P. (2018), The empirical analysis indicated that associations between the corporate governance and IC disclosure are generally mixed for a sample of 150 Sri Lankan listed firms to establish a generally accepted Sri Lankan framework for IC disclosure. The independent variables comprise various forms of corporate governance attributes: board size, board independent, board meetings and CEO role duality. The ownership structure, firm size, profitability are control variables. The statistical tools, correlation and linear multiple regression analysis were used.

Ekanayakea, G. Y., i Senaratne, S., & Azeez, A. A. (2019), examined the effect of owner-based and lender-based governance mechanisms on the financial performance of 100 Companies listed CSE Sri Lanka in terms of profitability, firm value and firm survival. The independent variables are owner governance and lender governance and the dependent variables are ROA, ROE and ROI, Firm value distress level while Control variables are Firm Age and Firm Size. The data of the study were analyzed through quantitative techniques namely, descriptive statistics, correlation analyses and multiple panel regression using the Ordinary Least Square method.

RESEARCH METHODOLOGY

Research methodology is defined as techniques and the research approach that are used for conducting research such as conceptual framework, operationalization of variables, hypotheses, research design, data collection and data analysis methods and evaluation of the accuracy of the research results.

Problem Statement

The application of corporate governance guide lines become an important to every organization in the world. These guide lines can affect financial performance of the firms in many ways. A firm that adopts good corporate governance guide lines are achieving its goals significantly whereas a firm that does not apply this governance in an expected level become questionable in achieving their financial goals in the business world. The application of the practices differs from country to country, depends on the social, economic and political conditions of the particular nation. After the ending three decades civil-disorder in 2009 in Sri Lanka, it has emphasized to concentrate on the application of corporate governance practices to examine its impact on firm performance and suggest make changes if it is necessary.

Therefore, it motivated the researcher to study to what extent corporate governance practices are adopted in Sri Lanka. For this purpose, the researcher interested to examine the effect of corporate governance practices on financial performance in companies listed in CSE Sri Lanka.

Research Questions

Based on the research problem statement, the research question was developed as follow:

- What are the factors affecting the application of corporate governance practices financial performance on companies listed in CSE Sri Lanka?

Research Objectives

The objective of the study is to identify the factors affecting the application of corporate governance practices on financial performance of companies listed in CSE.

Developing Hypotheses

The objective of this study is to examine the effect of corporate governance practices on financial performance. Based on the extensive literature survey in this study, the researcher developed four hypotheses on financial performance indicators ROE and ROA , they as follows:

H_{01}: There is no significance relationship between board leadership style and firm's financial performance.
H_{a1}: There is a significance relationship between board leadership style and firm's financial performance.
H_{02}: There is no significance relationship between board structure and firm's financial performance.
H_{a2}: There is a significance relationship between board structure and firm's financial performance.
H_{03}: There is no significance relationship between board size and firm's financial performance.
H_{a3}: There is a significance relationship between board size and firm's financial performance.
H_{04}: There is no significance relationship between board committees and firm's financial performance.
H_{a4}: There is a significance relationship between board committees and firm's financial performance.

RESEARCH DESIGN

Research design is a plan and procedure that consist of broad assumption to detailed method of data collection, analysis and interpretation. Deductive approach style has used for this research. Deductive approach tests the validity of assumptions (hypotheses) formulated. Finally confirm the theory by analyzing data. Therefore, this research has been done deductive approach as the research approach. In here the researcher uses quantitative research techniques for analyzing and interpreting data.

Population of the Research

This study addresses the effect of corporate governance practices on firm's financial performance in listed companies in CSE. Therefore, the population of this study consisted of two hundred ninety-six (296) companies listed in the CSE as at the 31st march 2018.

Selection Sample

The selected sample is top 20 blue chip companies listed in CSE Sri Lanka for the time period of 2014-2018 for that the annual reports can be collect. The aim is to compare the companies in adopting corporate governance practices over the period. The top 20 companies have opportunity to adopt good corporate governance practices that were introduced in 2003 in Sri Lankan.

Data Collection and Sources of Data Collection

The secondary data extracted from annual reports of audited financial statements from CSE sourced, from the individual firm websites, magazines and newspapers for the period of five (5) years from 2014-2018 were used to analyze the data.

VARIABLES

Independent Variables

This quantitative non-experimental research uses variables determining Corporate Governance Practices such as board leadership (BL), board structure (BST), board size (BS) and board committees (BC) as independent variables for analyzing and interpreting data.

Dependent Variables

This study uses firm financial performance return on assets (ROA) and Return on Equity (ROE) as dependent variables for analyzing and interpreting data.

Return on equity means profit after tax / shareholders' equity

Return on asset means profit after tax / total assets

Data Analysis Techniques

The collected data were edited, coded, classified, and put into a table and information was properly transfers to the total worksheet. These numerical representations were analyzed by using the SPSS software package. The statistical procedures were conducted to determine the objectives of this study in a measurable way to interpret the results. The inferential analysis included linear multiple Regression analysis, Descriptive analysis, Correlation analysis, model summery

The First Regression Model is,

ROE = ß0 + ß1BLS + ß2BST + ß3BS + ß4BC + €

The Second Regression Model is,

ROA = ß0 + ß1BLS + ß2BST + ß3BS + ß4BC + €

Where,

ROE - Return on Equity
ROA - Return on Assets
ß0-ConstantTerm
BL-Boar Leadership Style
BST–Board Structure
BS- Board Size
BC- Board Committees
€- Error Term

Data presentation and Analysis

Table-1

Variable	Minimum	Maximum	Mean	Standard deviation
ROE	0.101	0.186	0.153	0.019
ROA	0.036	0.089	0.068	0.014
BL	0	1	0.80	0.402
BST	2	5	3.15	0.968
BS	6	9	7.76	0.806
BC	2	4	2.79	0.729

Source: SPSS RESULTS (2019)

Table-1 represents the overall summary of the dependent variables and independent variables of the study. According to the sample data collected the minimum value of ROE is 0.101, it means 10.10%. Based on the results maximum ROE is 0.186, it means 18.6% is the best return on equity which is earned by the sample of companies for the selected years. When comparing minimum and maximum values of ROE there is a difference of 8.5%. When consider the Mean value of ROE, it shows the value of 0.153. The average return on equity for the shareholders is 15.3%. The Standard deviation of ROE is 0.019 and so on.

Table 2. Correlation Analysis of ROE and ROA

	ROE	ROA
BL Sig	0.667** (0.000)	0.663** (0.000)
BST sig	0.694** (0.000)	0.706** (0.000)
BS sig	0.753** (0.000)	0.760** (0.000)
BC sig	0.694** (0.000)	0.709** (0.000)

Source: SPSS RESULTS (2019)

According to the Table-2, the Pearson correlation coefficient value of the Board Leadership Style (BL) and ROE is 0.667 and ROA is 0.663. It shows, a significant positive relationship between Board Leadership Style (BL) of the board and ROE at 0.01 significant level and so on. Further, results indicated that the Board Size (BS) and ROE is 0.753 and 0.760 for ROA. Further the Table shows a significant positive relationship exists between the Board Size (BS) and ROE and ROA. It means, number of directors on board increased the adequate return will also be increased value (p -value = 0.000) is less than the listed value (0.01), then statistically concludes that, the positive correlation between ROE and ROA with BS.

It is mentioned that with a firm having large number of directors on board will be able to effect on the ROE and ROA of the firms, because Board Size is highly correlated with ROE (0.753) and ROA (0.760)

Regression Analysis of ROE and ROA

The analysis uses multiple regression to measure the level of effect of independent variables on dependent variable ROE an ROA are represented as followings.

Table-3

Models	R	R Square	Adjusted Square	RStnd. Error
ROE	0.850	0.723	0.711	0.010
ROA	0.859	0.739	0.728	0.007

Based on the Table 3, the model summary of ROE and ROA give the R values for assessing the overall fit of the model and that is 0.850 and 0.859 respectively. The coefficient of determination (R square) is 0.723 for ROE and 0.739 for ROA. R squared represents the proportion of variance in the dependent variable that can be explained by our independent variable. The R square of 0.723 indicates that 72.30% of the variation in ROE and 73.9% in ROA is examined by the independent variables (BL, BST, BS and BC). The value of adjusted R Square is 0.711 for ROE and 0728 for ROA. This adjusted R square measure provides the explanatory power of the regression models. This can be used to analyze the goodness of fit of the regression model. Therefore, about 71.10% of the variability in ROE and 0.728 in ROA of the listed companies can be explained by board leadership style, board structure, board size, board, and board committees of the board. The mean standard error of the estimate for ROE 0.010 and 0.007 in ROA. This amount explains how to representative the sample is likely to be of the population.

Table 4- ANOVA Table of ROE and ROA

Model ROE	Sum of Sq	DF	Mean Sq	F	Sig
Regression Residual Total	0.260 0.010 0.270	4 95 99	0.006 0.000	62.029	0.000
Model ROA	Sum of Sq	DF	Mean Sq	F	Sig
Regression Residual Total	0.015 0.005 0.020	4 95 99	0.004 0.000	62.121	0.000

Source: SPSS RESULTS (2019)

The F value for ROE and ROA are 62.029 and 62.121 respectively and significant value is 0.000 both ROE and ROA which are lower than 0.05 level of significance. This indicate that regression model is fit to the data.

Table 5. Results of Regression Model for ROE

ROE	Coefficient	Std. Err.	T	Significance
CONSTANT	0.063	0.014	4.463	0.000
BL	0.014	0.003	4.371	0.000
BST	0.003	0.002	1.602	0.112
BS	0.006	0.003	2.247	0.027
BC	0.009	0.002	4.767	0.000

The coefficient and its associated t and p values are presented in Table 5. The following multiple linear regression model explained linear relationship of the dependent variables (ROE) to the independent variables (BLS, BST, BS, and BC)

ROE = 0.063 + 0.014BLS + 0.003BST + 0.006BS + 0.009BC

According to the above regress model the constant value is 0.063 indicators where the regression line intercept ROE axis, representing the amount dependent ROE will be when all independents variable are 0.

The coefficient value explains, that the extent to which changes in independent variable can be explained by the change in dependent variables. Moreover, constant value table indicates, how the typical value of the dependent variable changes when one of independent variable is changed, while other independent variables are held constant. Coefficient beta value of board leadership with financial performance (ROE) is 0.014. A regression coefficient beta of 0.014 implies that an increase in board leadership by one unit causes an increase in financial performance by 0.014 units. The Board Leadership has a p value of 0.000 at 0.05 significant level. Therefore, the results indicated that there is a positive and significant relationship between Board Leadership and ROE.

The regression coefficient beta value of board structure and financial performance (ROE) is 0.003. Therefore, there is positive relationship between Board Structure and ROE. The reported p value of the BST 0.112 is greater than the critical p value of 0.05. This implies that the BST has an insignificant effect on financial performance (ROE) of the firms.

The result is supported by a regression coefficient beta of 0.006 with board size and ROE. The regression coefficients results show a positive relationship between board size and ROE. It indicates that an increase in board size by one-unit, financial performance (ROE) increases by 0.003 units. Further, its reported p value is equal to 0.027 which is less than critical p value of 0.05. Thus, there is a positive and significant relationship between Board Size and ROE.

According to the results, board committee coefficient beta value is 0.009 and reported p value is 0.000 Therefore, there is a positive relationship between board committees and ROE. A regression coefficient beta of 0.009 implies that existence of board committees in a firm increase firm's financial performance by 0.009 units. The reported p value was less than the critical p value of 0.050. Thus, it implies that the board committee has a positive significant effect on ROE.

Table 6. Regression Analysis ROA

ROA	Coefficient	Std. Err.	T	Significance
CONSTANT	0.002	0.010	0.218	0.828
BL	0.010	0.002	4.213	0.000
BST	0.003	0.001	1.924	0.057
BS	0.004	0.002	2.156	0.034
BC	0.007	0.001	5.205	0.000

The following multiple linear regression model explained linear relationship of the dependent variables (ROA) to the independent variables (BLS, BST, BS, and BC)

$ROA = 0.002 + 0.010BLS + 0.003BST + 0.004BS + 0.007BC$

According to the above regress model the constant value is 0.002 indicators where the regression line intercept ROA axis, representing the amount dependent ROA will be when all independents variable are 0.

The results of ROA were supported by a regression coefficient beta value of board leadership (BL) with financial performance is 0.010. A regression coefficient beta of 0.010 implies that an increase in board leadership by one unit causes an increase in financial performance by 0.010 units. The reported p value is 0.000 which is less than critical p value of 0.05. Therefore, the results indicated that there is a positive and significant relationship between board leadership and ROA.

The finding of this study implies that, the coefficient beta value of board structure (BST) and financial performance is 0.003. Therefore, there is positive relationship between board structure and ROA. The reported p value ($p = 0.057$) of the board structure is greater than the critical p value of 0.050. This implies that the board structure has positive insignificant impact on financial performance (ROA).

Furthermore, the result of regression analysis of ROA has recorded coefficient beta of 0.004 with board size (BS) and ROA. The regression coefficients results show a positive relationship between board size and financial performance (ROA) of the companies. It indicates that an increase in board size by one unit will cause increase financial performance of the companies by 0.004 units. Further, its reported p value is 0.034 which less than critical p value of 0.050. Thus, there is a perfect positive and significant relationship between board size of the company and ROA.

According to the results, board committees (BC) regression coefficient beta value is 0.007 and reported p value is 0.000. Therefore, there is positive relationship between number of board committees and ROA of the firms. The reported p value is less than the critical p value of 0.05. Thus, it implies that the board committee has an significant impact on ROA.

HYPOTHESIS TEST - ROE and ROA

In this research, constructed hypotheses are tested by using regression analysis. This study has four significant hypotheses. Based on the regression analysis results following conclusions were made.

First Hypothesis

According to regression results coefficient value between board leadership style and ROE is 0.014 and significant value is 0.000 while ROA is 0.010 and significant value is 0.000. So, it can be concluded as there is a positive significance effect of board leadership style on ROE and ROA. So, first hypothesis of this study is there is no significance relationship between board leadership style and firm's financial performance. According to the regression results first hypothesis is rejected.

Second Hypothesis

According to regression results coefficient value between board structure and ROE is 0.003 and significant value is 0.112 while ROA is 0.003 and significant value is 0.057. So, it can be concluded as there is a positive insignificance effect of board structure on ROE and ROA. So, the second hypothesis of this study is there is no significance relationship between board structure and firm's financial performance. According to regression results second hypothesis is accepted.

Third Hypothesis

According to regression results coefficient value between board size and ROE is 0.006 and significant value is 0.027 while ROA is 0.004 and significant value is 0.034. So, it can be concluded as there is a positive significance effect of board size on ROE and ROA. So, the third hypothesis of this study is there is no significance relationship between board size and firm's financial performance. According to regression results third hypothesis is rejected.

Fourth Hypothesis

According to regression results coefficient value between board committees and ROE is 0.009 and significant value is 0.000 while ROA is 0.007 and significant value is 0.000. So, it can be concluded as there is a positive significance effect of board committees on ROE and ROA. So, the fourth hypothesis of the study is there is no significance relationship between board committees and firm's financial performance. According to the regression results fourth hypothesis is rejected.

DISCUSSION OF RESULTS

The study conducted to check whether the corporate governance guide lines have an effect on financial performance of listed companies in CSE. As for the study conducted, the board leadership style, board structure, the number of board of directors and the number of committees are allocated as independent variables while financial performance (ROE & ROA) is treated as his dependent variable. The study tried to establish the effect of each of independent variable on financial performance of listed companies in CSE. Secondary data was collected for a period of 5 years from annual reports of the companies. The population of the research study is 296 companies which are listed in CSE. The sample is 20 Blue-Chip companies from above 296 companies. The statistical tests of the study used were Descriptive Statistics, Correlation Analysis and Regression Analysis. The result of the study provides evidence that how does corporate governance practices effect on firm's financial performance. Results were analyzed by using SPSS.

According to correlation results the independent variables (BL, BST, BS and BC) were positively and significantly correlated with dependent variables (ROE and ROA). It means a change in one unit in board leadership is positively correlated with ROE and ROA. The study used Regression Analysis to show the significance of the model using a 95% confidence level from which significance value of $p < 0.05$ was established for each of the independent variable. Except the board structure (BST) which has a p value of 0.112, all other independent variables have less than 0.05 positively and significantly effect on ROE. In the case of ROA the except the board structure (BST) which has p value of 0.057 which is greater than the critical p value 0.05, all other independent variables have less than 0.05 positively and significantly effect on ROA.

CONCLUSION & RECOMMENDATION

Conclusion

The objective of this study is to identify the factors affecting corporate governance practices on firm's financial performance of companies listed in CSE. The study, by considering the results analyzed concluded the following. There is a strong positive correlation between corporate governance practices (independent variables) and firm's financial performance (dependent variable). The regression model confirms that when a company apply the corporate governance practices consistently, it will contribute to increase in financial performance of the company. (Bauer, 2004) argued that in developed countries initially they have found significant positive relationship between operating performance and corporate governance, but afterwards it has been turned to a significantly and statistically negative relationship between operating performance and corporate governance practices, And also in the Sri Lankan context, here also positive significant relationship has been found with corporate governance and firm's financial performance from this study.

The main objective of this study is to identify the factors affecting corporate governance practices on firm's financial performance of companies listed in CSE. According to the results Board Leadership Style (BL) has a positive significant effect on the firm's financial performance (ROE & ROA). CEO of the companies has an obligation of making important decisions that are impacting on the firm performance. They should work together with the board of directors to avoid conflicts of interest. It is better to provide opportunities to give all the rights to work in the best interests of the shareholders who have invested their money in the organization with the view to maximize their wealth. Good corporate governance practices can improve firm's financial performance in the long run. According to the study results, Board Structure (BST) has a positive insignificant effect on firm's financial performance as indicated by ROE & ROA. The management should therefore should consider the number of people and proportion that of non-executive directors in the board, that these elements are well adhered to because they lead to value addition which can translate to wealth maximization to shareholders.

RECOMMENDATIONS

This study was designed to identify effect of corporate governance practices on firm's financial performance of listed companies in CSE. The complexity of business is increasing day by day there is need for financial reports to include a more comprehensive corporate governance statement as investors rely on information, they receive from companies in making their investment decisions. Failure of corporate governance practices have intensified incidences where management manipulates financial reports for different purposes and thus making it difficult for shareholders to build confidence in them.

Managements of companies act as agents to its diversified stakeholders who are not involved in running the core activities of these firms. To reduce chances of conflicts among different stakeholders, management should implement fully the corporate governance practices. The Sri Lankan government and regulatory authorities should make it compulsory for all the public listed & non listed companies to make public the statement of corporate governance especially for those firms which are not listed in CSE. The government and regulatory authorities need to encourage companies to be listed by giving them some incentives and requirements for listing. Based on the findings and conclusions drawn under previous chapter of the study, the researcher has recommended following course of action to Sri Lanka students, researchers, financial lending institutions, investors and all relevant parties. Adopting better corporate governance practices helps the organization to reduce agency problem. Investors should have a better knowledge about investing various business sectors in which they can maximize their wealth. Management and directors of the companies should aware of above study variables when adopting best corporate governance practices for their company.

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