IMPACT OF CORPORATE BOARD SIZE ON CORPORATE PERFORMANCE: EVIDENCE FROM SRI LANKA

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Abstract- The purpose of this is to examine the relationship between corporate board size and corporate performances of Sri Lankan listed companies. This study employs a cross sectional analysis of 109 firms listed in Colombo Stock Exchange (CSE) for the financial year ending 2013 and multivariate analyses are used to test the hypotheses. The results show that board size is significantly negatively associated with ROA and insignificantly negatively linked with ROE. Control variables of board independent, CEO duality and leverage are negatively related with ROA and ROE. Meanwhile, other variables of firm size and dividend yield are significantly positively linked with ROA and ROE.

Keywords- corporate governance, board size, corporate performance, ROA, ROE

I. INTRODUCTION

Corporate failures and huge corporate scandals in recent years have led to substantial interests in literature and research into corporate governance principles and codes of best practices with a view to improving corporate governance and enhancing corporate performance. A key component in corporate governance implementation is the role of the board of directors. The board monitors the management and set the strategic direction for the organization. The board reviews and ratifies management proposals, and it is the primary and dominant internal corporate governance mechanism in the organization (Brennan, 2006). The failures of Enron, WorldCom, Global Crossing and HIH, amongst others, have raised the question as to the ability of the board to effectively monitor management (Rashid, 2010 and Mizruchi, 2004).

This question is mostly relevant given that the boards were apparently not effective enough to have been able to present a check on some of the corporate governance failures, as they later came to be identified. This then calls to question the structure and composition of such boards. Board size is one of main determinant factors to decide the efficiency and decision making process of a firm. It refers to the number of directors on the board. Cheng (2008) in his article suggested that larger boards are less efficient and slower in decision-making, because it is more difficult for the firm to arrange board meetings and for the board to reach a consensus. He also argued that when the board size is bigger, it will be easier for CEO to have a dominant on the board and increase the CEO power in decision-making (Jensen, 1993). In addition, some studies document a negative association between board size and firm performance (Yermack, 1996; Eisenberg, Sundgren, & Wells, 1998). Although there exist several studies on corporate governance in less developed and emerging economies (Shleifer and Vishny, 1997; Sarkar et al. 1998; Asian Development Bank 2000; Rwegasira 2000; Gibson, 2003; Denis and McConnell, 2003; Machold and Vasudevan, 2004; Yammeeri et al. 2006), in the context of Sri Lanka there are very few studies on corporate board practices and governance (Fernando, 2007; Velnampy, 2013; Senarathe and Gunaratne, 2007; Kajanathan, 2012).

This study extends the literature on corporate board size and firm performance by providing evidence from this emerging economy. In particular, this study attempts to investigate whether board size in the form of number of directors as considered in advanced systems, can influence firm economic performance in Sri Lanka. This is to determine if the Sri Lankan situation is in line with global trend or if we can find a definite pattern of relationship between board size and corporate performance for the Sri Lanka corporate world. To achieve this purpose, the remainder of this paper is organized as follows: Section 2 discusses background and hypothesis development. Section 3 presents the methodology and the sample data of the study. Section 4 presents the findings of the study while Section 5 concludes this paper.

II. THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

The size of the board of directors is one of the most studied variables in the corporate governance literature. The impact of board size on corporate performance is not clear at least in the existing literature. Based on the resource dependency theory, it is anticipated that a board of directors with many networks to external environment is likely to improve a firm’s access to various resources resulting in improved corporate governance and firm performance (Mizruchi and Stearns, 1988; Zahra and Pearce, 1989; Hillman et al., 2000). Given the
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III. DATA AND RESEARCH METHOD

3.1. Data and Sample

The sample comprises the Colombo Stock Exchange (CSE) non financial listed companies whose annual reports are available in 2013. The total number of listed firms for year ending 2013 is 293 firms and final sample size is 109 firms. The data for this study are collected from the Colombo Stock Exchange (CSE) websites and annual reports.

3.2. Research Methods

A cross - sectional ordinary least square regression model is used to test the developed hypothesis for this study. The regression model utilized to test the relationship between the board size and firm performance are as follows:

Corporate Performance = α + β₁ Board Size+ β₂ Board Independence + β₃ CEO Duality + β₄ Leverage + β₅ Firm Size + β₆ Dividend Yield + ei

3.3. Variables and Descriptions

The variables for the study were chosen based on data availability and computational purposes.

Dependent variables
Return on Asset = Net Income / Total Assets
Return on Equity = Net Income / Shareholders Fund

Independent variables
Board Size = Number of directors on the board
Board Independence = No. of outside directors / Total Number of directors
CEO Duality = 1= Yes, 0= No
Leverage = Total debt / total equity
Firm size = Natural log of total assets
Dividend Yield = cash dividend paid / Shareholders equity.

IV. DATA ANALYSIS AND DISCUSSION

4.1 Descriptive statistics

Descriptive statistics were carried out to obtain sample characteristics. Table 1 provides descriptive statistics of dependent and independent variables. With regard to corporate governance characteristics, the number of directors on Sri Lankan board are between 3 and 12 with an average board size in the selected firms is approximately 8 persons. This result is reliable with the study by Fooladi (2012), Zubaidah et al. (2009), Lipton and Lorsch(1992) and Brown and Caylor (2004). The mean percentage of non executive directors on the board is approximately 71 percent, suggesting that Sri Lankan firms appear to follow the Anglo - Saxon's model of corporate governance best practices. In terms of CEO duality, about 14 percent of the firms have duality leadership while 86 percent of the firms have two individual hold the positions of CEO and
Chairman, suggesting that way for agency problems originating from conflict of interest are minimized. This implies that majority of the sample firms comply with the best practices as advocated by various international corporate governance bodies.

4.2 Correlation results
Table 2 shows the correlation results between board size and corporate performance variables (ROA and ROE). Board size and board independence are negatively correlated with ROA and ROE though not significant. In addition, CEO duality is significantly negatively correlated with ROA. Furthermore, firm size and dividend yield are significantly positively correlated with ROA and ROE. On the other hand, leverage is negatively correlated with ROA and ROE.

4.3 Regression results
Tables 3 and 4 present the regression results when ROA and ROE are used as the performance variables respectively. Recall that the Hypothesis predicts that board size is significantly negatively associated with corporate performance. Focusing on the association between board size and corporate performance, the results reported in Table 3 show that ROA is significantly negatively related with board size; at the same time Table 4 shows that ROE is also negatively associated with board size though not significant. Therefore, the Hypothesis is supported. Hence, in line with international research in the field (e.g., Yermack, 1996; Eisenberg et al. 1998) the current study offers some support for the view that a negative relation between board size and corporate performance is also obvious in the Sri Lanka setting.

In keeping with the literature, the study includes control variables in the regression analysis. Tables 3 and 4 indicate that board independence and CEO duality are negatively related with ROA and ROE. This result is consistent with the results of Agrawal and Knoeber (1996) and Bhagat and Black (1999). Leverage has a negative impact on firm performance. In contrast, both firm size and dividend yield are significantly positively linked with firm performance.

CONCLUSIONS
The importance of corporate governance cannot be over looked since it enhances the organizational climate for the internal structure and performance of a company. Indeed, corporate governance brings through external independent directors’ new dimension for effective running of a corporate entity, thereby enhancing a firm's corporate entrepreneurship and competitiveness. This study examines the relationship between some measures of corporate governance such as board size, board independence, CEO duality and firm performance of 109 listed non financial companies in Sri Lanka. Banks and other financial institutions sector were excluded in tandem with other studies due to their huge debt structure. The mean board size for the sample was found to be eight and the maximum twelve with a moderate deviation of 1.95 and the study predicts that board size is significantly negatively associated with corporate performance. This study also finds that, CEO duality is significantly negatively associated with ROA. Further, board independence and leverage are not significantly associated with both measures of corporate performance. Finally, firm specific variables such as firm size and dividend yield are consistently and significantly linked to corporate performance.

The results offered in this research are subject to a number of limitations. Firstly, it should be known that the analysis reported in the research is exploratory. Further empirical study, mainly on the unique aspects of Sri Lankan corporate governance is necessary. Secondly, this current study employs one year cross sectional dataset. Further research may extend the panel data to analyze and interprets in a more meaningful way. Given the limitations outlined above, the findings from this study add to the body of literature on corporate governance in Sri Lanka.

REFERENCES


Table 1: Descriptive statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.065</td>
<td>0.142</td>
<td>7.991</td>
<td>0.708</td>
<td>0.138</td>
</tr>
<tr>
<td>ROE</td>
<td>0.057</td>
<td>0.106</td>
<td>8.000</td>
<td>0.700</td>
<td>0.000</td>
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<tr>
<td>BOARD SIZE</td>
<td>0.544</td>
<td>2.394</td>
<td>12.000</td>
<td>1.000</td>
<td>1.000</td>
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<td>BIND</td>
<td>-0.793</td>
<td>-0.934</td>
<td>3.000</td>
<td>0.250</td>
<td>0.000</td>
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</table>

Table 2: Correlation Matrix (N=109)

<table>
<thead>
<tr>
<th>Variable</th>
<th>ROA</th>
<th>ROE</th>
<th>BOARD SIZE</th>
<th>BIND</th>
<th>CEO DUAL</th>
<th>LEVERAGE</th>
<th>FIRM SIZE</th>
<th>DIVID YIELD</th>
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<tbody>
<tr>
<td>ROA</td>
<td>1</td>
<td>0.767***</td>
<td>1</td>
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<tr>
<td>ROE</td>
<td>0.767***</td>
<td>1</td>
<td></td>
<td></td>
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<tr>
<td>BOARD SIZE</td>
<td>-0.148</td>
<td>-0.049</td>
<td>1</td>
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<tr>
<td>BIND</td>
<td>-0.139</td>
<td>-0.113</td>
<td>-0.160*</td>
<td>1</td>
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<tr>
<td>CEO DUAL</td>
<td>-0.169**</td>
<td>-0.032</td>
<td>-0.012</td>
<td>-0.108</td>
<td>1</td>
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<tr>
<td>LEVERAGE</td>
<td>-0.108</td>
<td>-0.104</td>
<td>0.030</td>
<td>0.098</td>
<td>-0.027</td>
<td>1</td>
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<tr>
<td>FIRM SIZE</td>
<td>0.212**</td>
<td>0.194**</td>
<td>0.306**</td>
<td>-0.275***</td>
<td>-0.014</td>
<td>0.177*</td>
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<tr>
<td>DIVID YIELD</td>
<td>0.503***</td>
<td>0.724***</td>
<td>-0.077</td>
<td>-0.079</td>
<td>-0.032</td>
<td>-0.058</td>
<td>0.109</td>
<td>1</td>
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Table 3: Regression analysis on ROA (N=109)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>t-Statistic</th>
<th>Prob.</th>
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<tr>
<td>C</td>
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<td>BOARDSIZ</td>
<td>-0.012047</td>
<td>-2.281122**</td>
<td>0.0246</td>
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<td>BIND</td>
<td>-0.047054</td>
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<tr>
<td>CEO DUAL</td>
<td>-0.058354</td>
<td>-2.065002**</td>
<td>0.0415</td>
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<tr>
<td>LEVERAGE</td>
<td>-0.017093</td>
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<td>0.1753</td>
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<tr>
<td>FIRMSIZE</td>
<td>0.043362</td>
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<tr>
<td>DIVIDYIE</td>
<td>0.225094</td>
<td>5.518886***</td>
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R-squared: 0.351963
Adjusted R-squared: 0.313843
F-statistic: 9.233052

Table 4: Regression analysis on ROE (N=109)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
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<th>Prob.</th>
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<td>BIND</td>
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<td>0.5857</td>
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<tr>
<td>CEO DUAL</td>
<td>-0.013365</td>
<td>-0.211412</td>
<td>0.833</td>
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<td>LEVERAGE</td>
<td>-0.034191</td>
<td>-1.220455</td>
<td>0.2251</td>
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<tr>
<td>FIRMSIZE</td>
<td>0.073756</td>
<td>1.896751*</td>
<td>0.0607</td>
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<tr>
<td>DIVIDYIE</td>
<td>0.941808</td>
<td>10.32207***</td>
<td>0.0000</td>
</tr>
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</table>

R-squared: 0.548965
Adjusted R-squared: 0.522434
F-statistic: 20.69112

*Correlation is significant at the 0.1 level (2-tailed)
**Correlation is significant at the 0.05 level (2-tailed)
***Correlation is significant at the 0.01 level (2-tailed)