Macrothink Institute™

International Journal of Accounting and Financial Reporting
ISSN 2162-3082
2017, Vol. 7, No. 2

Board Leadership Structure and Firm Performance: Evidence from Listed Companies in Sri Lanka

Saseela Balagobei (Corresponding author)

Senior Lecturer, Department of Financial Management

University of Jaffna, Sri Lanka

E-mail: saseelas@yahoo.com

K.G.A. Udayakumara

Dean, Faculty of Management Studies, Rajarata University, Sri Lanka

Received: October 28, 2017 Accepted: December 5, 2017 Published: December 25, 2017

doi:10.5296/ijafr.v7i2.12072 URL: https://doi.org/10.5296/ijafr.v7i2.12072

Abstract

Corporate Governance as a mechanism helps to align management's goals with those of the stakeholders that are to increase firm performance. The aim of this study is to identify the relationship between board leadership structure and firm performance of listed companies in Sri Lanka during the period of 2014-2016. The data was collected from the secondary data sources and board leadership structure is measured by CEO duality. The sample of this study consists of 100 firms listed in Colombo Stock Exchange based on market capitalization. For the purpose of data analysis, Pearson's correlation analysis and independent sample t-test were used to examine the hypotheses of this study. The findings reveal that board leadership structure is positively correlated with firm performance in terms of Tobin's Q and there is no significant difference in firm performance between CEO duality firms & non-duality firms.

Keywords: Corporate governance, CEO duality, Firm performance, Tobin's Q

JEL: G30

1. Introduction

Chief Executive Officer (CEO) plays an important role in the corporate governance system. Corporate Governance has become an issue of global significance. For more effective corporate governance, all corporations must carefully select the composition of their board of

directors. Most of academicians and practitioners argue that an independent board of directors is the main condition of effective corporate governance. CEO duality, which allows the CEO to serve as board chairperson, has become an important issue in the discussions of board independence.

Separation of ownership and control in the modern corporation may cause self-interested managers to act in ways not beneficial to shareholders (Jensen and Meckling, 1976; Jensen, 1986, 1993). The impact of separation of ownership and control on performance of firms has been the subject of debate in numerous studies. Board leadership structure has become an important subject. In the case of board leadership structure, top managerial officer of the corporation simultaneously serves as chairperson of the board which has the charter of monitoring and overseeing top management. In other words, the expression 'dual' refers to a board leadership structure where the CEO of the firm wears two hats-one as CEO of the firm, the other as chairperson of the board of directors (Dalton and Rechner, 1991). Non-duality implies the case in which the different individuals serve as the CEO and the chairperson.

Firm performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities. Firm performance may also refer to the development of the share price, profitability or the present valuation of a company (Melvin and Hirt, 2005).

This study is conducted on board leadership structure and firm performance in Sri Lanka during the period after the civil war in the environment due to the favorable economic and political conditions. As a result, this study makes a significant contribution to the body of knowledge in developing countries and illustrates how board leadership structure correlate with firm performance after the civil war ending environment such as that experienced in Sri Lanka.

Colombo Stock Exchange (CSE) of Sri Lanka has been selected for this study due to its importance to Sri Lankan's economy. It operates as the only share market in the economy and is responsible for providing a transparent and regulated environment where both institutional and individual investors can operate in the capital market.

There are some researchers conducted on board leadership structure related to firm performance (Dalton and Rechner, 1991; Boyd, 1995; Baliga, Moye and Rao, 1996; Abdullah, 2004; Ramdani and Van, 2009). Most of the studies are concerned with the Western countries. But based on the best of the researcher's knowledge few studies are in listed companies in Sri Lanka during the period of 2014-2016. Therefore, this study is an endeavor to investigate the relationship between board leadership structure and firm performance of listed companies in Sri Lanka during the period of 2014-2016.

2. Statement of the Problem

The contemporary business environment is characterized by uncertainty and risk, making it increasingly difficult to forecast and control the tangible and intangible factors which

influence firm performance (Kuratko and Morris, 2003). Customers are becoming more demanding, necessitating increased focus on managerial professionalism and quality of service delivery (Lai and Cheng, 2003). In response to the external pressures, firms resort to different strategic responses such as restructuring, downsizing, business process reengineering, benchmarking, total quality management, management by objectives etc., to improve and sustain their competitive positions (Mangenelli and Klein, 1994; Jacka and Keller, 2002). In a dynamic environment, CEO's roles become very important for smooth functioning of organizations. CEO also has a responsibility to initiate organizational change and facilitate processes that support the organizational mission.

Crucial monitoring mechanism based on agency perspective is the separation of the roles of CEO from chairman (William, Judge, Naoumova and Koutzevol, 2003). CEO duality, which is known as one person holds both the CEO-Chairman positions, has become an emerging issue in the current era. When there is no separation, the CEO also serves as chairman. This situation, known as "CEO duality", is problematic from an agency perspective where the CEO chairs the group of people in charge of monitoring and evaluating the CEO's performance. In companies with CEO duality approach, the crucial question is "who monitors management?" or "who will watch the watchers?" (Zubaidah, 2009). This situation provides CEOs with the opportunity to have a dominant influence on the board's decisions. Therefore, CEO duality will weaken board's independency and make them unable to monitor management effectively.

There are many studies that have been done give mixed results on the exact relationship between board leadership structure and firm performance. Some of the reviewed studies revealed that there is no significant relationship between board leadership structure and firm performance (Rashid, 2011; Wang and Clift, 2008; Yu and Ashton, 2015; Kaymak, 2009) while a few other studies provide evidence a significant relationship between board leadership structure and firm performance (Duru, Iyengar and Zampelli, 2016; Pang and Shamsuddin, 2015). There is no consensus about significant relationship between board leadership structure and firm performance.

This paper is focused on "the degree of effectiveness of CEO duality when achieving higher firm performance in Sri Lankan listed companies".

The research answers to the following key questions which are: In Sri Lankan context,

- Is there any difference in firm performance between CEO duality firms and non-duality firms?
- Is there any relationship between the board leadership structure and firm performance?

3. Objectives of the Study

The primary objective of the study is to find out the relationship between board leadership structure and firm performance of listed companies in Sri Lanka during the period of 2014-2016. The secondary objectives are:

- To examine the difference in firm performance between CEO duality firms and non-duality firms.
- To set the backgrounds for further researches in corporate governance in Sri Lanka.

4. Literature Review

There are several studies which have examined the relationship between board leadership structure and firm's performance but the results still lacks the consistency.

Rashid (2011) examined if the CEO duality influence the firm economic performance in Bangladesh and the moderating effects of board composition in the form of outside independent directors. The finding is that there is a negative (non-significant) relationship between CEO duality and firm performance before appointment of outside independent directors in the board. Pang and Shamsuddin (2015) investigated the effects of board leadership structure on the performance of Chinese firms listed on the Singapore Stock Exchange. Using a sample of 105 firms covering 2009 to 2011, the study finds that CEO duality positively affects firm performance that can largely be explained by stewardship theory.

Wang and Clift (2008) studied the effect of board leadership structure on firm performance. The results indicate that, for Australian listed companies, there is no strong relationship between leadership structure and subsequent performance. It is reported that companies with higher block holder ownership or lower managerial shareholdings tend to have an affiliated chairman; firm with higher managerial shareholdings tend to have an executive chairman.

Yu and Ashton (2015)examined the relationship between board leadership structure and firm performance and the expense ratio, using propensity-score matching methods for Chinese PLCs from 2003-2010. It is reported that whilst CEO duality is not related to companies' profitability ratios, it is linked to a higher expense ratio compared to matched companies with a separate board leadership structure.

Duru, Iyengar and Zampelli (2016) provide convincing evidence that a joint leadership structure, i.e., CEO duality has statistically significant negative impacts on firm performance. The study also documents that this effect is positively moderated by board independence. The results are robust across a number of sensitivity tests.

Kiel and Nicholson (2003) found that CEO duality is positively correlated with Tobin's Q, yet insignificant in relation to ROA. Belkhir (2009) found the impact of internal corporate governance controls (i.e., CEO Chairman Duality, board size, block-holder ownership, proportion of outside directors) on banks' performance to be insignificant. Bektas and Kaymak's (2009) results indicated that board size and duality do not significantly influence the returns on assets of Turkish banks.

A meta-analysis by Johnson, Daily, and Ellstrand (1996) revealed no performance differences between firms with duality and non-duality structures. Brickley, Coles and Jarrell (1997) concluded that CEO duality is not associated with inferior performance. Dalton *et al.* (1998) suggested that markets are fairly apathetic to CEO duality. Abdullah (2004) and Weir and

Liang (2000) uncovered no significant relation between these variables in their regression analyses.

Singh and Harianto (1989) found that large boards improve board performance by reducing CEO domination within board, thereby making it difficult to adopt golden parachute contracts that might not be in the shareholder's interest. Lipton and Lorsch (1992) suggest that a major impediment to board effectiveness is a lack of time to complete board duties. So boards that meet frequently are more likely to perform their duties diligently and in accordance with shareholders interests.

From the literature review the following hypotheses are developed for the study purpose.

H_1: There is a significant relationship between CEO duality and the firm performance.

H_2: There is any significant difference in firm performance between CEO duality firms and non-duality firms.

5. Conceptualization

Based on the literature survey and problem statements of the study, the following conceptualization is developed to show the relationship between board leadership structure and firm performance of listed companies in Sri Lanka.

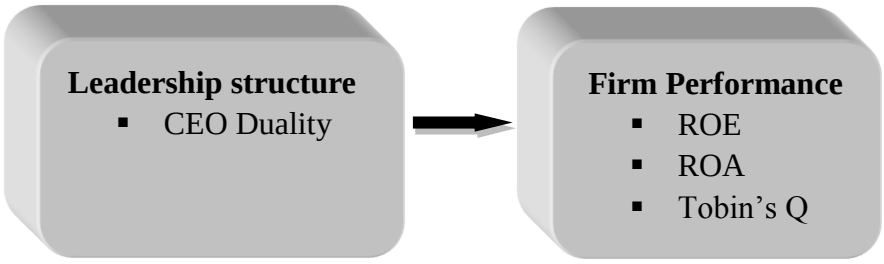

Figure 1. Relationship between board leadership structure and firm performance

Source: Developed by Researcher

This model shows the relationship between board leadership structure and firm performance. Board leadership structure is measured by CEO duality and three firm performance measures in the study, namely return on equity (ROE), return on assets (ROA) and Tobin's Q, are considered as proxies for accounting returns and market returns.

6. Data Collection

The data required for the study are collected from audited annual reports of listed companies and indexed journals. The secondary data is used for the present study during the three years of 2014-2016 to measure board leadership structure and firm performance of listed companies in Sri Lanka. The data required for the study includes CEO duality, return on equity (ROE), return on assets (ROA) and Tobin's Q.

7. Sample of the Study

The sample of this study is drawn from firms listed in the Colombo Stock Exchange (CSE) during the period of 2014 to 2016. The CSE is the organization responsible for the operation of the stock market in Sri Lanka. In 2015 there were 295 companies listed in the CSE, representing twenty business sectors. Only 100 companies belonging to 16 sectors are included in the sample which is only 33.90 % of the companies listed in the CSE. These firms are selected based on market capitalization.

8. Method of the Study

The following methods chosen to derive the results in this study:

- CEO duality: CEO duality is coded as 1 if an individual simultaneously serves as both CEO and chairperson of the board and 0'otherwise.
- Return on equity: Net profit after tax/Total value of equity shares.
- Return on assets: Net profit after tax /Total Assets.
- Tobin's Q = (Market capitalization + Total assets - shareholders funds)/ Total assets

9. Mode of the Analysis

The Statistical procedures can be divided into two major categories: descriptive statistics and inferential statistics. The following statistical tools or techniques are used in the study:

- Descriptive Statistics: Descriptive statistics have been widely used in academic research (Abdullah 2004; Laing and Weir 1999). The descriptive statistics used in this study consist of range, mean, maximum, minimum and standard deviation of variables. The mean is calculated to measure the central tendency of the variables from 2014 to 2016.
- Inferential statistics: This is concerned with making predictions about a population from observations and analyses of a sample. In this study the correlation and independent sample T-test were used.

10. Results and Discussion

10.1 Descriptive Analysis of Variables

Descriptive statistics measure the central tendency and dispersion. The mean is the most important measure of central tendency (Veal 2005).

Table 1. Descriptive statistics for listed firms

	N	Range	Minimum	Maximum	Mean	Std. Deviation
CEO duality	300	1	0	1	.25	.432
Return on Equity	300	6.930	-5.090	1.840	.10950	.509
Return on Assets	300	.870	-.280	.590	.07497	.102
Tobin's Q	300	9.185	.003	9.188	1.90729	1.464

Table 1 shows the descriptive statistics of all the variables used in the study. Of the firms studied, 75% of them adopt the 2-tier board structure implying that about 25% of the firms have their CEOs and Board chairman positions combined in one personality. The mean ROE of the sampled listed firms is 10.95 %. The mean value for ROA was 7.94%, with a minimum of –28% and a maximum of 59%. The Tobin's Q value of greater than 1 represents a positive investment opportunity. The mean value for Tobin's Q is 1.9, with a minimum value of 0.003 and a maximum value of 9.188.

10.2 Correlation Analysis

Correlation analysis was performed for fulfill the purpose to identify the strength and direction of the association among the variables of the study.

Table 2. Results of Pearson Correlation Analysis

	CEO Duality	**ROE**	**ROA**	**Tobin's Q**
CEO Duality	**1**			
ROE	-.053 .363	**1**		
ROA	-.038 .516	382** .000	**1**	
Tobin's Q	.151** .009	.035 .540	.236** .000	1

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

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

The value of correlation coefficient between CEO duality and Tobin's Q is 0.151** which is significant at 0.01 levels, represents a positive weak relationship between CEO duality and Tobin's Q. This is supported by previous study such as Kiel & Nicholson (2003). Further CEO duality is not significantly correlated with ROE and ROA as the measures of firm performance.

10.3 Independent Sample T-test

The t-test is used to compare the values of the means from two samples and test whether it is likely that the samples are from populations having different mean values.

10.3.1 Return on Equity

The difference in Return on equity between CEO duality firms and non-duality firms was investigated.

Table 3. Descriptive statistics of return on equity of listed firms

	CEO duality	N	Mean	Std. Deviation	Std. Error Mean
ROE	Non duality	226	0.1555	.0.59021	0.03926
	Duality	74	0.0916	0.20908	0.02431

Table 4. Independent-smple T-test for return on equity of listed firms

		Levene's Test For Equality of Variances		t-test for Equality of Means		
		F	Sig.	t	df	Sig.
ROE	Equal variances assumed	2.200	.139	.911	298	.363
	Equal variances not assumed			1.383	296.349	.168

Independent-samples t-test was run with SPSS. Before t-test, Levene's test for equality of variances was carried out to be certain about the homogeneity of variances of the comparing groups. According to the Table 4 from the Levene's test for equality of variances, it was found that variances were equal. Accordingly, the t-test shows t statistics of .911with 298 degrees of freedom. Hence, it can be inferred that the difference in return on equity between duality firms and non duality firms was statistically insignificant ($p=0.363$, $p > .05$). As a result, there is no mean difference in return on Equity (ROE) between CEO duality firms (0.0916) and non-duality firms (0.1555).

10.3.2 Return on Assets

The difference in Return on assets between CEO duality firms and non-duality firms was investigated.

Table 5. Descriptive statistics of return on assets of listed firms

	CEO duality	N	Mean	Std. Deviation	Std. Error Mean
ROA	Non duality	226	.0772	.10792	.00718
	Duality	74	.0682	.08331	.00968

Table 6. Independent-samples T-test for return on assets of listed firms

		Levene's Test For Equality of Variances		t-test for Equality of Means		
		F	Sig.	T	df	Sig.
ROA	Equal variances assumed	5.238	.023	.650	298	.516
	Equal variances not assumed			.740	159.625	.460

In the Table 6, from the Levene's test for equality of variances, it was found that variances were not equal. Accordingly the independent sample t-test shows that t statistics of 0.740 with 159.625 degrees of freedom. Hence, it can be inferred that the difference in return on assets between duality firms and non duality firms was statistically insignificant (p=0.460, p > .05). As a result, there is no mean difference in return on assets (ROA) between CEO duality firms (0.0682) and non-duality firms (0.0772).

10.3.3 Tobin's Q Ratio

The difference in Tobin's Q between CEO duality firms and non-duality firms was investigated.

Table 7. Descriptive statistics of Tobin's Q of listed firms

	CEO duality	N	Mean	Std. Deviation	Std. Error Mean
Tobin's Q	Non duality	226	1.9016	1.54662	.10288
	Duality	74	1.9248	1.18867	.13818

Table 8. Independent-samples T-test for Tobin's Q of listed firms

		Levene's Test For Equality of Variances		t-test for Equality of Means		
		F	Sig.	t	df	Sig.
Tobins' Q	Equal variances assumed	2.579	.109	-.118	298	.906
	Equal variances not assumed			-.135	160.376	.893

In the Table 8, from the Levene's test for equality of variances, it was found that variances were equal. Accordingly the independent sample t-test shows that t statistics of -.118 with 298 degrees of freedom. Hence, it can be inferred that the difference in Tobin's Q between duality firms and non duality firms was statistically insignificant (p=0.906, p > .05). As a result, there is no mean difference in Tobin's Q between CEO duality firms (1.9248) and non-duality firms (1.9016). This finding is also corroborated by previous works such as Johnson, Daily, and Ellstrand (1996) and Brickley, Coles and Jarrell (1997).

11. Conclusion

The purpose of the study was to investigate the relationship between board leadership structure and firm performance of listed companies in Sri Lanka during the period of 2014 to 2016. Operational hypotheses were formulated and tested which indicate that there is a significant relationship between board leadership structure and firm performance. The study reveals that there is a positive relationship between board leadership structure and firm performance in terms of Tobin's Q. Further there is no significant difference in firm performance between CEO duality firms and non-duality firms. This finding is also supported by the findings of other recent works such as Johnson, Daily, and Ellstrand (1996).

Further CEO duality did not contribute to performance measures of ROE and ROA. It can be suggested that the directors of the board should concentrate in playing their vital role properly for the activities of the companies and also advice the companies to have more independent directors within the benchmark for the number of directors. This is supported by Rosenstein and Wyatt (1990) and Baysinger and Butler (1985).

In the developing countries with unique business environment, this study provides the business owners as well as investors some insights into how the performance can be affected by board leadership structure. In general, this study provides academics and practitioners with a clear view about the relationship between board leadership structure and firm performances of listed companies in Sri Lanka.

12. Direction for Future Researches

In future research, corporate governance applications can be more advanced by combining related and opposing views of various theories. For instance, from the CEO duality- board

perspective, applying theories such as social network theory, stakeholder theory, and institutional theory, which could reveals a comprehensive multi theoretic approach to solve controversial applications. Specifically, with reference to CEO duality – firm performance studies, in future, it may be more fruitful studying other perspectives that could determine the boundary conditions in applying duality notion rather than examining performance consequences.

References

Abdullah, S. N. (2004). Board composition, CEO duality and performance among Malaysian listed companies. *Corporate Governance*, 4(4), 47-61.

Baliga, R. B., Moyer, C. R., & Rao, R. B. (1996). CEO duality and firm performance. *Strategic Management Journal*, *17*, 41-53.

Baysinger, B., & Hoskisson, R. (1990). The composition of boards of directors and strategic control: Effects on corporate strategy. *Academy of Management Review*, 15(1), 72-87.

Bektas, E., & Kaymak, T. (2009). Governance mechanisms and ownership in an emerging market: The case of Turkish banks, *Emerging Markets Finance & Trade*, *45*(6), 20-32.

Belkhir, M. (2009). Board structure, ownership structure and firm performance: evidence from banking. *Applied Financial Economics*, *19*, 1581-1593.

Boyd, B. (1995). CEO duality and firm performance: A contingency model. *Strategic Management Journal*, *16*(1), 301–312.

Brickley, J. A., Coles, J. L., & Jarrell, G. (1997). Leadership structure: Separating the CEO and Chairman of the Board. *Journal of Corporate Finance, 3,* 189-220.

Dalton, R., & Rechner, P. (1991). CEO duality and organizational performance: A longitudinal analysis. *Strategic Management Journal*, *12*(2), 155–160.

Duru, A., Iyengar, R. J., & Zampelli, E. M. (2016). The dynamic relationship between CEO duality and firm performance: The moderating role of board independence. *Journal of Business Research.*

Jacka, M. J., & Keller, P. J. (2002). *Business Process Mapping – Improving Customer Satisfaction*. New York: John Wiley & Sons, Inc.

Jensen, M. C. (1993). The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems. *Journal of Finance, 48*(3), 831–880.

Jensen, M. C., & Meckling, W. (1976). Theory of the firm: Managerial behaviour, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305–360.

Johnson, J., Daily, C., & Ellstrand, A.A. (1996). Board of directors: A review and research agenda. *Journal of Management*, *22*(3), 409-438.

Kiel, G.C., & Nicholson, G.J. (2003). Board Composition and Corporate Performance: how the Australian experience informs contrasting theories of corporate governance Corporate Governance. *An Int. Rev.*, *11*, 189–205.

Kuratko, & Michael, H. M. (2003). Corporate entrepreneurship: the dynamic strategy for 21st century organizations. In Gary D. Libecap (Ed.), *Issues in Entrepeneurship: Advances in the Study of Entrepreneurship, Innovation & Economic Growth* (Vol. 14, pp.21-46). Emerald Group Publishing Limited.

Lai, K. H., & Cheng, T. C. E. (2003). Initiatives and Outcomes of Quality Management Implementation across Industries. *Omega – The International Journal of Management Science, 31*(2), 141–154.

Laing, D., & Weir, CM. (1999). Governance Structures, Size and Corporate Performance in UK Firms. *Management Decision, 37*(5), 457-64.

Lam, T.Y., & Lee, S.K. (2008). CEO Duality and Firm Performance: Evidence from Hong Kong. *Corporate Governance*, *8*(3), 299-316.

Mangenelli, R. L., & Klein, M. M. (1994). *The Reengineering Handbook: A Step-bystep Guide to Business Transformation.* New York: AMACOM.

Melvin, C., & Hirt, H. (2005). *Corporate Governance and Performance: A Brief Review and Assessment of the Evidence for a Link between Corporate Governance and Performance*. London: Hermes Pensions Management Ltd.

Pang, R. W. F., & Shamsuddin, A. F. M. (2015). Board leadership structure and performance of chinese firms in singapore. *Corporate Ownership and Control*, *12*(4CONT6), 617-629. Retrieved from www.scopus.com

Ramdani, D., & Van, W. (2009). Board independence, CEO duality and firm performance: A quantile regression analysis for Indonesia, Malaysia, South Korea and Thailand. *Working Papers 2009004*, University of Antwerp, Faculty of Applied Economics.

Rashid, A. (2011). Board leadership structure and firm performance: An examination of resource dependence role. *Corporate Board: Role, Duties and Composition*, *7*(1), 7-23. Retrieved from www.scopus.com

Rosenstein, S., & Wyatt, J.C. (1990). Outside Directors, Board Effectiveness and Shareholders Wealth. *Journal of Financial Economics*, *26*, 175-191.

Balagobei, S., & Velnampy, T. (2017). A Study on Ownership Structure and Financial Performance of Listed Beverage Food and Tobacco Companies in Sri Lanka. *International Journal of Accounting and Financial Reporting, 7*(2), 36-47.

Vafeas, N. (2000). Board Structure and the informativeness of Earnings. *Journal of Accounting and Public Policy*, *19*(2), 139-60.

Veal, A.J. (2005). *Business Research Methods: A Managerial Approach* (2nd ed.). Pearson Education Australia, NSW.

Wang, Y., & Clift, B. (2008). Board leadership: Antecedents and performance outcomes. *Corporate Ownership and Control, 6*(2 A), 61-72. Retrieved from www.scopus.com

William Q. Judge, Naoumova I., & Koutzevol N. (2003). Corporate governance and firm performance in Russia: an empirical study. *Journal of World Business, 38*, 385–396.

Yu, M., & Ashton, J. K. (2015). Board leadership structure for chinese public listed companies. *China Economic Review*.

Zubaidah, Z.A., Nurmala, M.K., & Kamaruzaman, J. (2009). Board structure and corporate performance in Malaysia. *International Journal of Economics and Finance, 1*(1), 150-164.

Copyright Disclaimer