

The Moderating Effect of Corporate Governance (CG) Gender Diversity on the Relationship of CG attributes and Financial Performance of Listed Companies in Sri Lanka

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Abstract

This research aims to explore the Moderating Effect of Corporate Governance (CG) Gender Diversity on the relationship of CG attributes and Financial Performance of Listed Companies in Sri Lanka. The sample of the study consists of all companies listed in CSE exclusive of bank & financial institutions which are practicing unique governance practices issued by CBSL. The final sample consists of 183 listed non-financial companies during the period of 2009 to 2015. This research deployed panel data regression analysis to test the relationship formulated in the hypotheses by using the E view 9 software. The results showed that the board structure related variables such as separate leadership structure, proportion of non-executive director on board, and women representation on boards appeared to be significant influence on agency costs. Meanwhile, board size and presence of interlocking directorship on boards does not have any direct impact on agency costs. On the other hand, all selected board structure variables did not have any direct impact on shareholder wealth of companies listed in Sri Lanka. The findings of this study regarding board structure, agency costs and shareholder wealth have important managerial implications that these findings are unlikely to the prediction of theory and best practices. Agency theory is not applicable of these companies since the exiting corporate governance practices increase agency costs. The potential benefits of this study led to re-think the board of directors of the

companies, managers, shareholder, and the policy makers to re organize the implementation of best practices.

Keywords: Board structure, Agency costs; corporate governance; Code of best practice; corporate governance mechanisms.

Introduction

1.1 Background of the Study

There is widely held view that corporate governance deals with the ways in which the investors assure themselves of maximizing the return on their investment (Chilosi & Damiani, 2007). Regardless with the selected issues of corporate governance practices in Sri Lanka highlighted by (Dissabandara, 2012), (Kalainathan & Vijayarani, 2014), (Senaratne & Gunaratne, 2008), the stock market has generally continued to perform well, and the value of firms increased in companies listed in Sri Lanka. This poses a question on the effectiveness of corporate governance practices such as the influence of board structure on Organizational Profitability and shareholder wealth leading to resolve conflict of interest. (Kalainathan & Vijayarani, 2014), state that conflict of interest index shows that there is a need to protect investors in Sri Lanka. The variation between standard and actual practice of corporate governance in Sri Lanka is noteworthy (Dissabandara, 2012). According to the experience of corporate scandals in companies listed in Colombo Stock Exchange (Kalainathan & Vijayarani,

2014), investors are paying more attention to corporate governance practices, particularly aligning the interest of shareholders and managers to minimize the exposure to the principal and agents problem. In addition, Ownership concentration is major issue in the companies listed in CSE (Kalainathan & Vijayarani, 2014). This also raises serious concern on the implementation of an independent director system. In regard to the principal-agent relationship, the fundamental question arises to ensure that how does the board balance the interests of shareholders in order to reduce agency costs associated with principal-agent problem? These issues stressed to revisit the existing corporate governance mechanisms to examine its influence on agency costs and shareholder wealth. Therefore, this study seeks to establish the influence of board structure on agency costs and shareholder wealth of listed companies in Sri Lanka.

To investigate the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka in the context of Sri Lanka, this study examines literature on the relationship between board size, separate leadership structure, board composition, interlocking directorship and financial performance.

1.2 Problem Statement

Corporate governance is defined as a system by companies which are directed and controlled (Cadbury, 1992). This broadly refers to a set of relationship between management, its boards, shareholders, and other stakeholders and the process by which a firm is controlled and directed which involves balancing the interest of the shareholders of companies. It is noted that better corporate governance directs the board and management to maximize shareholders wealth that are in the interest of the firm as a result of

effective monitoring & evaluation systems in an organization through managing the resources effectively and efficiently reducing the agency costs.

In order to have better governance practices of listed companies in Sri Lanka, corporate governance practices were introduced in 1997 with the introduction of a voluntary code of best practice which is related to the financial aspects of corporate governance. Thereafter, it was modified throughout the period till 2013. The existing corporate governance model for Sri Lankan listed companies is the combination of both mandatory and voluntary rules on corporate governance and it has been developed in line with the Anglo-Saxon and Continental model of corporate governance due to both historical and economic reasons (Senaratne & Gunaratne, 2008). Voluntary codes of best practices on corporate governance were issued in 2003 by ICASL, jointly with SEC, and in 2007, corporate governance were made mandatory for all listed companies for the financial year commencing on 1st April 2008. This was induced the firms to adopt with best practices to align the interest of the shareholders with management. The effectiveness of best practice of corporate governance in line with balancing the many interest of the shareholders of the firm is debatable topic in Sri Lanka due to the variation between standard and actual practice of corporate governance in Sri Lanka is noteworthy (Dissabandara, 2012). (Kalainathan & Vijayarani, 2014), state that there is lack of confidence to investors to make more capital in Sri Lanka as a result of investors' protection ranked as 52 out of 187 countries in 2013. (Azees, 2015), states that investors are having lack of confidence on the existence of the link between standard practice of corporate governance and firm performance in Sri Lanka. This raises a serious concern over the corporate governance practices and its impact on the agency costs and shareholder wealth of

listed companies in Sri Lanka.

Many researchers have pointed out differences in the practices of corporate governance mechanisms affect agency costs of a firm in the developing and developed markets. (Chilosi & Damiani, 2007), state that corporate governance mechanisms vary country to country such as USA, Norway and the Russia. The Anglo-Saxon model is based on the agency theory which focuses on dispersed ownership and control. This model is presently practiced in USA, UK. The other model, Continental model is common in Continental Europe such as German, Japan, Emerging Asian countries. It is primarily based on the stakeholder theory and relatively high concentration of both ownership and control.

Much corporate governance researches have focused on the U.S context (Brick & Chithambaran, 2010).

The association between corporate governance mechanism and agency cost was investigated by many researchers and scholars such as (Bhatia & Tuli, 2017) investigates the impact of several corporate governance mechanisms on agency costs; Agency theory and managerial ownership: evidence from Malaysia (Velte, 2017). Corporate governance mechanisms and agency costs: cross-country analysis (Garanina & Kaikova, 2016). The results show that corporate governance mechanism of particular country work more effectively in a company with a specific corporate governance model. Managerial ownership, managerial compensation and ownership concentration are strongly associated with agency costs while internal governance mechanisms on agency costs varies with firm's growth opportunities (Florackis, 2008). (Pfeffer & Salancik, 1978), conducted a study on corporate governance structure and shareholder wealth maximization. They point out that further research can be replicated using more comprehensive governance variables such as board activity intensity. It has been

pointed out that the findings based on the data from developed markets are not applicable to the corporate governance systems in emerging markets due to the differences in regulatory and economic environment, cultural differences, political and social context, and the size of the capital markets (Kalainathan & Vijayarani, 2014) (Cadbury, 1992). This creates the need to understand the effect of these governance mechanisms on agency costs and shareholder wealth maximization in the Sri Lankan context.

Cadbury (1992) considered board structure as an important corporate governance mechanism, which would result to enhance shareholder wealth as well as firm performance. The code of best practice on corporate governance issued in Sri Lanka addressed board structure such as board size, separate leadership structure, board composition, and interlocking directorship. Due to their importance in affecting agency costs and shareholder wealth, board structure will be considered in this study. Evidence in relation to board structure, agency costs, and shareholder wealth is mixed and inconclusive. Following to (Florackis, 2008), (Garanina & Kaikova, 2016), they argued that small board results in lowering agency costs. According to accounting based measures, it is found no significant association between governance mechanism and firm performance (Kiel & Nicholson, 2003).

The past study (Florackis, 2008) highlights that conflict of interest will be resolved when the firm separate the position of the role of CEO & Chairman and CEO duality does not have significant impact on agency costs mitigation (Brick & Chithambaran, 2010), concluded that the results on CEO duality and its impact on shareholders' wealth maximization are inconclusive. The existing evidence relating board composition to performance and agency costs is mixed and inconclusive (Fathi, 2013). There are some arguments favors to

agency theory which state that larger number of non-executive directors on the board would lower the agency costs (Garanina & Kaikova, 2016). Non-executive directors do not bring clear benefits of lower agency costs (Florackis, 2008) and shareholder wealth maximization (Reguera & Bravo, 2017).

The findings are in-consistence with proportion of women participation on boards and its influence on agency costs. There are little research conducted on women on board and its influence on shareholder wealth. In line to the argument, Garanina and Kaikova (2016) conducted a cross-country analysis on women participation on boards and its impact on agency costs. They state that there is negative relationship between women on board and agency costs which means participation of women tends to reduce agency costs. The results are favor to USA context. In the context of Norwegian sample, the findings are contrast to US in which they state that there is positive relationship between women on boards and agency costs mitigation but no significant evidences found in Russian sample.

Interlocking directorship may be either a positive or a negative effect on firm performance, depending on the firm's available resources (Zona, Mejia, & Withers, 2015). (Low, Roberts, & Whiting, 2015), state that corporate governance mechanisms have positively impacted on performance of firms in New Zealand listed companies. In contrast, Kiel and Nicholson (2003) state that interlocking directorship is positively correlated with firm performance, measured as market based, but not for the accounting based measures.

Few researches have been conducted in Sri Lankan context on corporate governance and firm performance (Azees, 2015) but these are not directly address the agency costs as well as the shareholder wealth in companies listed in CSE. In contrast, the past studies pointed

out that the first stream of research must focus on the mechanisms that have a direct effect on the agency conflict and shareholder wealth, rather than investigating effects on the firm performance (Garanina & Kaikova, 2016). Though many arguments were put forward by the researchers on corporate governance, agency costs and shareholder wealth, there is no single research directly tackled on this interest such as agency costs and shareholder wealth in developing countries such as Sri Lanka which had experienced in corporate scandals (Kalainathan & Vijayarani, 2014), main issues in application of corporate governance practices, such as ownership concentration and poor governance practices (Dissabandara, 2012). Even though having such poor governance practices and challenges for future, firms in Sri Lanka are expected to adopt corporate governance practices consistent with a combined code of best practice.

It is thus important to understand the effectiveness of corporate governance mechanisms such as board structure and its influence on agency costs and shareholder wealth. This research focus on corporate governance mechanisms, agency costs and shareholder wealth with the expectation to reveal the interesting results to fill the gap in knowledge of the relationship between board size, separate leadership structure, board composition, interlocking directorship, and agency costs and shareholder wealth of listed companies in Sri Lanka. It is thus important to investigate that how does board structure influence on agency costs and shareholder wealth of listed companies in Sri Lanka.

1.3 Research Questions

The introduction of code of best practice on corporate governance as voluntary and

mandatory practices in Sri Lanka focused to resolve the agency conflict and enhance shareholder wealth which is to promote economic development of the country. However, efficiency of the corporate governance best practices of firms is still debatable topics and the investors are having lack of confidence to invest in Sri Lanka. Empirical evidences in global context related with effectiveness of corporate governance, agency costs and shareholder wealth are mixed and inconclusive which has not been empirically investigated in Sri Lanka. Therefore, in order to understand the effectiveness of corporate governance practices such as board structure and its influence on agency costs and shareholder wealth of listed companies in Sri Lanka, this research in particular seeks to establish the relationship between existing corporate governance mechanisms such as board structure, agency costs and shareholder wealth of companies listed in Sri Lanka. Thus the study seeks to answer the following research question:

Does corporate governance mechanism such as board structure influence on financial performance of companies listed in Sri Lanka?

1.4 Research Objectives

Code of best practices on corporate governance direct the companies to enhance shareholder wealth through reducing agency costs. Corporate governance best practices were introduced in 1997 and has been developed & modified till 2013. It has become mandatory all companies listed in Sri Lanka to adopt the best practices to resolve conflict of interest between managers and shareholders. Though, there are many issues reported with the existing corporate governance practices on companies listed in Sri Lanka (Dissabandara, 2012; Kalainathan & Vijayarani, 2014; (Senaratne & Gunaratne , 2008) the companies are performing well,

and the number companies has increased to listing on CSE in the past. This raises serious concern on the influence of board structure on agency costs and shareholder wealth of companies listed in Sri Lanka. The primary objective of this research is to investigate the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka. The secondary objectives of the research are to:

- Examine the influence of board size on financial performance of companies listed in Colombo Stock Exchange in Sri Lanka.
- Examine the influence of separate leadership structure on financial performance of companies listed in Colombo Stock Exchange in Sri Lanka.
- Investigate the influence of board composition (proportion of non-executive directors and women on boards) on financial performance of companies listed in Colombo Stock Exchange in Sri Lanka.
- Investigate the influence of presence of interlocking directors on boards on financial performance of companies listed in Colombo Stock Exchange in Sri Lanka.
- Significance of the Study

The present study contributes to the knowledge concerning corporate governance mechanisms, agency costs and shareholder wealth by examining the board structure of companies listed in Colombo Stock Exchange in Sri Lanka. The past studies focused on the relationship between corporate governance mechanisms and firm performance (Azees, 2015). However, the relationships between board structure, agency costs, and shareholder wealth have not been investigated in a single study in previous research. In addition, the studies of the above relationships particularly have not been studied in the companies in Sri Lanka in the existing literature. Therefore, this study will contribute to knowledge as discussed below:

- This study contributes to agency, resource dependence, and shareholder theories through adoption of corporate governance best practices resulting to reduce agency costs as well as enhancing shareholder wealth of listed companies in Sri Lanka.
- Though prior researches were conducted in countries such as USA, UK, Norway, Russia, Australia, Germany, New Zealand and Malaysia which are in the well-established corporate governance standard practices, this will be the first study in Sri Lankan listed companies to be carried out to understand the effectiveness of corporate governance best practices in relation to board size, separate leadership structure, board composition, and interlocking directorship and their effect on agency costs and shareholder wealth.
- This research extends the stream of gender diversification component and interlocking directorship in the company and contributes to the gender-diversity issues and appointment of non-executive directors in Sri Lankan listed companies.
- This study also provides framework for international policy makers who are interested in adopting similar corporate governance practices in their own countries. The research findings will be significant for other South Asian countries that are having similar corporate governance practices to Sri Lanka.

1.4 Scope of the Study

This study focuses on the influence the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka. Corporate governance practices were introduced in 1997 and then revised throughout the period till 2013 to enhance the shareholder wealth of the companies. Every companies listed in CSE must be adopted the code of best practices on corporate governance which help to resolve agency

problem and thus to maximize shareholder wealth. There are 290 companies listed in CSE as at 31st March 2017 in which this study consists of 183 companies exclusive of bank & financial institutions, and few non-financial companies which are not having data for the period of study. The period of study consists of 05 years, 2017-2022. This study examines the relationship between board structure related variables such as board size, separate leadership structure, proportion of non-executive directors & women on boards, presence of interlocking directorship and financial performance on companies listed in Sri Lanka.

Chapter Two

Literature Review

2.1 Introduction

Corporate governance has become debatable topics in the recent past because of its importance to the stakeholders due to the major corporate collapses and the effect of the crisis (Mustapha & Ahmad, 2011). In order to overcome the issues related with corporate governance around the world, the corporate governance standard was undertaken by countries to enhance corporate governance practices to maximize shareholder wealth. The purpose of corporate governance is to provide effective leadership that can be delivered sustainable development of the company. Effective corporate governance is imperative to attract investors, expands the private sectors, stimulate economic growth, and reduce opportunity for fraud thus creating a healthy and robust investment climate (Code of Best Practice on Corporate Governance, 2013).

Implementing the standard practice of corporate governance will lead to align the interest between the managers and shareholders which will direct to resolve agency problem and enhance wealth of the shareholders. It is imperative to every firm to adopt the standard practice to

provide effective leadership to meet the objective of the organization.

Corporate governance facilitates to mitigate agency costs associated with the separation of ownership and control (Dissabandara, 2012). Corporate governance standards in certain areas are particularly important to align the interest between shareholders and management, and creating shareholder wealth – such as those relating to board size, separate leadership structure, board composition, and inter-locking directorship. In order to understand the corporate governance practices, mechanisms to be used to mitigate agency costs and shareholders wealth creation of listed companies in Sri Lanka, a review of relevant literature is necessary.

2.2 Theoretical Perspectives of Corporate Governance

This section explains theoretical perspectives on corporate governance practices to realign the interest between shareholders and the agent. It provides the basis on which the subject of corporate governance will be studied and helps in formulation of a framework for this study. There are numbers of internal agency-mitigating mechanisms available in the firm such as Boards of directors, its structure, and the composition to realign the interest between shareholders and managers of firms. It draws on agency theory, stewardship theory, resource dependence theory, shareholder theory, stakeholder theory, social contract theory, and legitimacy theory.

2.2.1 Agency Theory

The problems of agency are classified as the principal, agent, and policy mechanisms and incentives related issues. The principal faces the problem of motivating the agent to act according to the principal's interest. The agent faces the

problem with the decisions to act either in the principal interest or his own interest. Policy mechanisms and incentives system limit the agents' discretion. The principals also offer incentives to the agents for their effort to align their interest to that of the principals. Kiel and Nicholson (2003) stated that agency theory also provides incentive schemes for managers for maximizing shareholders wealth. Such schemes include plans for senior executives to obtain shares at a reduced price, aligning interest of managers with shareholders.

(Jensen, M.C & Meckling, 1976), describe that the firm as a nexus of contract among individual factors of production resulting in the emergence of the agency theory. The purpose of the contracts is to align the interest of all the parties, and monitoring to maximize the value of the firm, as a results to reduce agency costs. Firm set-up risk bearing mechanisms to monitor the management's activities through a nexus of organizations and contract to minimize the agency problems between principals and agent. Agency theory facilitates to enhance the shareholder wealth in the organization.

The literature on agency theory largely focuses on methods and systems – and their consequences that arise to align the interests of the principal and agent. Agency theory highlights that the principals will try to bridge the informational asymmetries by setting-up information systems and through monitoring of agents to make better functions of financial markets. The role of the board of directors is to govern the function of the board through monitoring the decisions made by the managers and implementation of those decisions to enhance shareholder wealth (Jensen, M.C & Meckling, 1976). In contrast, the argument is that managers may involve in non-value adding activities which may not improve the value of the firm which arise

agency problems as well as agency costs. The agency problem directs to raise agency costs (Jensen, M.C & Meckling, 1976). They define agency cost as the sum of monitoring expenditure by the principal to limit the unusual activities of the agent; bonding expenditure by the agent, and the residual loss as a result of wrong decision taken by agent. As far as agency costs concern, these are inevitable when there is a separation of ownership and control. In order to overcome the agency problems and then reduce agency costs, agency theory proposed that the board of directors should be consist of largely of non-executive and/or independent directors in order to enhance wealth of the shareholders (Chilosi & Damiani, 2007). The presence of independent directors directs the firms to reduce agency costs as it enhances through monitoring of insiders. Further, it explains that the role of management and control have to be separated in order to have effective boards (separate leadership structure).

(Bhatia & Tuli, 2017) Argue the way to prevent managerial opportunistic behavior at the expense of shareholders interest. The board of directors is considered a major structural mechanism to curtail such managerial opportunism. The board provides a monitoring of managerial actions on behalf of shareholders. It is suggested that the chairperson of the board must be independent of executive management. Where the chief executive officer is chair of the board of directors, there is opportunity to influence on management decision making. Agency theory predicts that if the CEO holds the dual role of chair, then the interests of the owners will not be achieved.

Agency theory highlights that board interlocks reduce performance of the firm by enhancing managerial opportunism. It posits that managerial opportunisms magnify a resource shift from scarcity to abundance. In the event of resource

scarcity, managers are more likely to engage with managerial opportunisms. Under the resource abundance, managers are more likely to engage in opportunism at the expense of shareholders. At the given opportunity, executives will maximize their private interest at the expense of shareholders, generating agency costs (Jensen, M.C & Meckling, 1976). Interlocks impair monitoring, raising agency costs and depressing performance. From this perspective, directors may be less likely to monitor management in order to maintain social status (Cadbury , 1992). Board interlock serves as a means to maximize the private utility of the resource rich firm's executives.

2.2.2 Stewardship Theory

Stewardship theory is an alternative theory to the agency model. Stewardship theory presents a different approach on management of firms. In contrast to agency theory, it highlights that managers are considered good stewards to the organization where they will act in the best interest of the owners. Stewardship theory predicts a strong relationship between managers and the organizational performance as well as maximizing shareholders wealth. Kiel and Nicholson (2003) present favor to stewardship theory that shareholder interests are maximized by stewards of managers.

Monitoring and controlling the management activities are not the main concern of the stewardship theory which focuses to facilitates and empower the managers to safeguard the corporate assets. Stewardship theory proposes mechanisms to align the interest of the shareholders with the managers of the firms. CEO duality is the main concern of this theory where the position of the CEO and Chairman is held by a single person and he/she holds the power to determine the strategy of firm (Kiel & Nicholson,

2003). Therefore, stewardship theory stress on the view of appointing a single person for the position of Chairman and CEO.

Board diversity was not the main concern of the stewardship theory which believes that firm should appoint majority of executive directors than the non-executive and/or independent directors. Kiel and Nicholson (2003) state that internal directors are having better knowledge about the organization than the external directors who are busy with other firms. Outside directors will not be able to contribute to the firm performance. Stewardship theory propose appointing higher proportionate of internal directors than outsiders.

2.2.3. Resource Dependence Theory

Resource dependence theory is the study of how the external resources of firm affect the performance of the organization. Resource dependence theory highlights that the board of directors provides resources to the managers of the firm to achieve organizational goals (Leung, Richardson, & Jaggi, 2014). The core idea of the resource dependence theory is that directors exchanges the resources between internal and external environment needed to survive.

Board of directors plays an important role in connecting the external resources with internal to streamline the organizational process to overcome the uncertainty of the firm. Firms may face uncertainty from various stakeholders such as customers, suppliers, competitors, macroeconomics condition. (Leung, Richardson, & Jaggi, 2014) Support to the argument that boards of directors are important corporate governance mechanisms for acquiring resources to overcome the uncertainty of the firm. Other resources such as information, skills, policy and procedures, and legitimacy are brought by the directors to reduce uncertainty (Pfeffer & Salancik,

1978).

Resource dependence theory hypothesized that organizations are having resource constraints. Aligning the manager's interest with shareholders depends on the availability of the resources. Managers limit the scope for deliberate actions and managerial opportunism when the organizations are resource constraints. (Pfeffer & Salancik, 1978), suggest that resolving the conflict of interest between the managers and shareholders depends on companies available resources. Resource dependence theory proposes mechanisms to relax resource constraints and improve the performance of the organization. Board interlocks are one of the corporate governance mechanisms that enabling organizations to gain access to critical resources, including both tangible and intangible. Board diversity is also the main concern of the resource dependence theory which suggests that board diversity control the environmental uncertainty which affects the firm performance positively (Chilosi & Damiani, 2007). Resource dependence theory holds the argument on the gender difference on board of directors similar to the agency theory perspective. Board diversity enhances the independence of the board because of the different demographic characteristics of the directors which may bring different views in which it may affect the performance of the organization.

Table 2.1
Theoretical Prediction on Board Structure

Subject	Agency Theory	Stewardship Theory	Resource Dependence Theory
Board of Directors	Headed by effective board	Trustworthiness of managers than board of directors	Headed by effective board
Board Size	Larger board Preferable	N/A	Larger board preferable
Leadership Structure	Separated the role of Chairman & CEO	Not to separate the role of Chairman & CEO	N/A
Board Composition	Composed largely of outside independent Directors	Composed largely of specialized executive directors	Appoint more non-executive, independent directors
Board Diversity	Promote board Diversity	N/A	Promote board diversity
Inter-Locking Directorship	Less number of interlocking Directorship	N/A	Appoint more interlocks

Source: Author Compiled

2.2.4 Shareholder Theory

The shareholder theory was presented by Milton Friedman who claims that the firm's responsibility is to maximize profits. This theory states the idea that primary objective of the firm is to increase profit and maximize shareholder wealth. The concept of shareholder theory is concerned with the principals-agent relationship between shareholders and management which is similar to agency theory (Bhatia & Tuli, 2017). The argument is based on the premise that managers are hired by the shareholders as the agent to run the company by using the limited

resources to enhance shareholder wealth. Responsibility of

the agents is to protect the interest of the shareholders (Friedman, 1962). Shareholder theory provides guidelines to align the interest of shareholders with managers' interest (Friedman, 1962). He further explains that shareholder wealth maximization is the primary responsibility of a firm which emphasize by shareholder theory. Manager's responsibility is to choose profitable investments which seek to maximize the wealth of the shareholders which can be achieved through effective corporate

governance mechanisms in which the efforts in raising the value of the firm.

The shareholder theory directs the firms into the historic way of doing the business which realized to maximize the shareholder wealth. Friedman (1962) posits that shareholder theory focuses on shareholder wealth, not the social development of the society which is handled by the government (Friedman, 1962). In contrast, this concept was criticized and having inherent limitation too in which this theory might force the managers to destroy firm value - cases from Enron and World com corporate scandals - where the shareholders put more pressure on managers to increase return on investment which led them to manipulate the company accounts.

2.2.5 Stakeholder Theory

Corporate governance research has been underlying the stakeholder theory in relation to firm's responsibility as part of the development of corporate governance to maximize the wealth of the stakeholders at large. Stakeholder theory provides a clear direction to the business organization (Brick & Chithambaran, 2010). Stakeholder theory goes beyond the scope of shareholders wealth maximization (Fathi, 2013).

Stakeholder theory underlies the disciplines on four of the social sciences; sociology, economics, politics, and ethics. This theory was developed and presented by Freeman (1984). This perspective also concerns the organizational strategic decision and actions to be aligned to the interest of the stakeholders. It is further explained that having good

relationship with stakeholders could improve the organizational performance and can be considered as a valuable sources of competitive advantage (Brick & Chithambaran, 2010).

2.3 Corporate Governance Mechanisms

The study of corporate governance mechanisms, special reference to board structure, has been the focus of listed companies in Sri Lanka. Corporate governance is a mechanism where a board of directors is an essential monitoring device to align the interest between the principal-agent. Agents are the managers, principals are the owners and the board of directors acts as the monitoring mechanism. The agency role of the directors is to ratify the decision made by the managers and monitor the implementation of those decisions. Agency costs arise as a result of monitoring the agent's actions.

Agency costs are identified at least two other sources; bonding costs borne by agent and the wealth of loss borne the principals (residual loss). This section explores empirical literatures on corporate governance mechanisms as board structure, agency costs, and shareholder wealth maximization.

2.3.1 Board Size

Board of directors is considered as the most important element of corporate governance mechanisms. They are responsible to enhance wealth of shareholders through improve performance as result of better corporate governance mechanisms. Every company listed publicly should be headed by an effective board which is responsible to direct, lead

and control the entire companies operations. Many scholars on corporate governance across the world cite that the firm can enhance performance if they govern properly. There is an ongoing argument that large boards are usually effective than small boards. In line to the board size, there are few theories argued favor to the boards to be larger than smaller. From agency theory perspective, it is argued that larger board is more likely to resolve agency problems because a larger number of people will be monitoring management actions. From a resource dependence theory perspective, it can be similarly argued that a larger board brings greater access to resources and then enhance performance of firm (Fuzi, Halim, & Julaizaerma, 2016).

In contrasting to the view of larger board, Florackis (2008) argued from the research findings that small boards are more effective than larger boards. The argument is that larger boards make coordination, communication and decision making cumbersome, than it is in smaller boards. Large boards tend to be more beneficial for heavily regulated industries, such as financial or health sectors. The potential problems of large boards are related with the effectiveness of board's specific function which is determined by the institutional and legal environment (Garanina & Kaikova, 2016). Even though having smaller board to have better communication and decision making, it is most important to balance skills required in the board room. Reddy and Locke (2014) argued that it will be difficult to balance the right skills and expertise with smaller boards. It is indeed requires a larger board to have better management and enhance

performance of the organization.

To test the effectiveness of the board size in mitigating agency problems, this study includes the variable that total number of directors on boards. Similar studies in USA, UK and other countries are also used the same measurement (Garanina & Kaikova, 2016) (Fathi, 2013). It is found that average board size is 6.97 directors in UK firms, 9 in Russia, 8 in U.S.A, 6 in Norway (Garanina & Kaikova, 2016). Jensen (1993) suggests that the board limit at around eight directors. If it is more than eight directors which will interference with group dynamics and inhibit board performance. It is argued that the board size has to be optimum. Board size is negatively related to the asset turnover ratio which means that larger board tends to in-efficient in managing the corporate assets which leads to higher agency costs. On the other hand, firms with below median board sizes have larger asset turnover ratios, lower agency costs. Singh & Davidson (2003) argue that small boards records larger asset turnover ratios. Larger boards seem to be in-efficient since they are associated with reduced asset utilization efficiency. (Garanina & Kaikova, 2016), state that large boards are in-efficient to manage the assets of the organization in which it increases agency costs in all sample companies such as USA, Norway and Russia. The findings conclude that smaller boards are more effective in managing the corporate assets resulting to have lower agency costs. As far as shareholders' wealth maximization concern, there are few studies conducted on corporate governance and shareholder wealth. (Tudawe, 2010), conducted a study on corporate governance and maximization of shareholder value in African

perspective. The empirical finding notes that the board size relate positively correlated with all the variable of shareholders wealth maximization. In contrast, the relationship is statistically insignificant with dividend yield and positive relationship with dividend per , enhance the value of the shareholders' wealth (Brick & Chithambaran, 2010).

share as proxy to shareholder wealth (Brick & Chithambaran, 2010). The positive relationship between board size and shareholders' wealth maximization suggests that larger boards adopt policy that ensure high dividend payment and therefore

Table 2.2
Summary of Empirical Evidence on Board Size, Agency Costs and Shareholders' Wealth Maximization

Subject	Study	Theoretical Perspectives
Small board results in lowering agency costs	(Garanina & Kaikova, 2016)	Stewardship Theory
Larger board results in lowering agency costs	(Dissabandara, 2012)	Agency theory & Resource Dependency Theory
Larger board results in shareholders' wealth maximization	(Bhatia & Tuli, 2017)	Agency theory & Resource Dependency Theory
Board size does not have impact on agency costs and shareholder wealth	(Jensen, M.C & Meckling, 1976)	N/A

Source: Author Compiled

2.3.2 Board Leadership Structure

The board's role is to provide effective

leadership of the company within a framework of corporate governance practices which enables to mitigate agency costs and maximize shareholder wealth. There are two key tasks of companies listed on Colombo Stock Exchange – conducting of the business of the board, and facilitating executive responsibility for management of the company's business. Cadbury (1992) argued that the balance of power and authority will be ensured by having separate division of responsibility at the company which will enhance the power of decisions. Florackis (2008) stated that the separated role of CEO and Chairman of the Board (COB) or CEO duality affects the degree independency of the board of directors. It is further argued that separated roles of CEO and COB can lead to better board performance and hence fewer agency conflict (Florackis, 2008).

The result shows contrary to stewardship theory, presence of CEO duality does not have any impact on shareholder wealth. McKnight and Weir (2009) report that the CEO duality falls from 10% to 6% in large UK publicly quoted companies. They suggest that CEO duality in UK firms does not

influence on mitigating agency costs. Kiel and Nicholson (2003) state that no correlation between the CEO duality and firm performance which refers the increase the influence of a single person on the decision making. They further explains that majority of the firm would practice the separated role of CEO and COB to lead better board performance since the duality resulting in poor performance in an organization.

Stewardship theory provides mechanisms as CEO duality to mitigate agency costs and enhance wealth of the shareholder to align the interest of managers and shareholders. There is little research conducted to investigate the impact of CEO duality on shareholder wealth. There is negative relationship between CEO duality and shareholder wealth in terms of dividend per share and positive relationship with dividend yield. This makes the CEO duality effects on shareholders' wealth maximization inconclusive (Florackis, 2008). The empirical findings support of the agency theory perspective of separating the position of CEO and COB to mitigate agency costs and enhance shareholder wealth.

Table 2.3
Summary of Empirical Evidence on

Board Leadership, Agency Costs and Shareholders' Wealth Maximization

Subject	Study	Theoretical Perspectives
Separated role of CEO & COB, fewer agency conflict	(Cadbury , 1992)	Agency Theory
Duality does not lead lower agency costs	Kiel and Nicholson (2003)	Contrast to Stewardship Theory
Duality and Shareholders' wealth maximization is inconclusive	(Leung, Richardson, & Jaggi, 2014)	N/A

Source: Author Compiled

2.3.3 Proportion of non-executive directors on board

Agency theory promotes number of outside members on the board. A board that consists of outside members will bring information to the board and be able to provide important resources in creating and sustaining competitive advantage (Velte, 2017). It is also preferable for the board to have a balance of executive and non-executive and/or independent directors in which the board can take rational and moral decision making (Leung, Richardson, & Jaggi, 2014). The board should include non-executive and/or independent directors of sufficient caliber on whose view contribute significantly in the board's decision. The proportionate of non-executive and/or independent

The board composition might be more important from the point of view of the perception of the performance of stock markets rather than performance measured on historical accounting base. Higher proportionate of non-executive directors on board are more effective in monitoring management actions and can limit the managerial opportunisms which leads to better performance of the firms (Garanina & Kaikova, 2016); (Florackis, 2008). Kiel and Nicholson (2003) state that proportion of non-executive directors has a significant correlation with the market based measures of performance, but no significant correlation with the accounting-based measures. The board composition represents an optimal outcome given the costs and benefits associates with different types of directors on board.

This study measures the board composition as non-executive directors that the ratio of the number of non-executive directors to the number of total directors on board. This measure is used in other studies (Florackis, 2008) (Friedman, 1962). Average proportion of non-executive directors on board is 49.5 per cent in UK firms (Florackis, 2008). Non-executive directors are increased from 45.2% to 50% in large UK publicly quoted companies and no evidence that non-executive director

representation affects agency costs. It suggests that the proposed ratio of non-executive directors on board as one third disclosures in the Combine Code in UK does not have any impact to shareholders in the form of lower agency costs (Leung, Richardson, & Jaggi, 2014).

There is an argument against to the appointment of non-executive directors that they are usually characterized by lack of information about firm, do not bring the required skills to the position. They play less confrontational role rather than a more critically monitoring the managers. Florackis (2008) states that non-executive directors do not have significant impact on value of firms in UK. The board independent is negatively related with all the variables of shareholders value maximization.

The evidences relating board composition to performance and agency costs are mixed and inconclusive (Chilosi & Damiani, 2007). On the other hand, the company with larger number of independent directors will have lower agency costs because independent directors have a significant influence on the performance of the firm (Kiel & Nicholson, 2003).

Table 2.4**Summary of Empirical Evidence on Proportion of Non-Executive Directors, Agency Costs and Shareholders' Wealth Maximization**

Subject	Study	Theoretical Perspectives
Larger number of non-executive directors on the board, fewer agency costs	(Garanina & Kaikova, 2016)	Agency Theory
Non-Executive directors do not bring clear benefits of lower agency costs and shareholders' wealth maximization	(Florackis, 2008)	Stewardship Theory

Source: Author Compiled

2.3.4 Proportion of Women on board

The participation of women on board has been increasing around the world which inspires heated debate among the researchers. The empirical evidence has shown that the participation of female directors has a direct and positive impact on companies' profits (Fuzi, Halim, & Julaizaerma, 2016). There is an evidence to support the argument that corporations are increasing board diversity overtime (Chilosi & Damiani, 2007). Gender diversity is believed to have an influence on firm's financial value in several ways which enhance the shareholder wealth such as promoting a better understanding of the market place, increases creativity and innovation, produces more effective problem-solving, enhances effective corporate leaderships, and promotes more effective global relationships (Chilosi & Damiani, 2007).

Gender diversity in board rooms has been paid more attention in the academic research (Garanina & Kaikova, 2016) because of the composition of board of directors is still not very diverse in terms of gender, racial and cultural (Chilosi & Damiani, 2007). Adams and Ferreira (2009) remark that the percentage of women directors on corporate boardrooms in Australia, France, Europe, Sweden, and Norway is 8.3%, 7.6%, 9.7%, 26.9%, and 44.2% respectively.

There are few countries given quota for women participation on business affairs in respecting their contribution towards the organizational performance. Garanina and Kaikova (2016) state that Norway given quota for women on company boards and ranked as the first country to introduced quota system for women. The participation of women on board differs from country to country. The proportion of female members on board is 50% in Norway, 18% in U.S.A and 10% in Russia (Garanina & Kaikova, 2016). It is reported that women in Sri Lanka made up 35.9% of labor force participation in 2015 (Ministry of Finance and Planning 2015). In contrast to this evidence, (Tudawe, 2010), remarks that there is only 1% or less participation of women in management positions Sri Lankan companies. The above arguments stress to revisit the proportionate of women on board and its impact on the costs and benefits of the firms.

Board diversity is defined as the ratio of proportionate of women participation on the corporate boardrooms (Chilosi & Damiani, 2007). Agency and resource dependence theory are the theoretical frameworks most often used by researchers to understand the relationship between board diversity and firm value. Empirical evidences show that there is no consistency for the relationship between board diversity and firm value, and also

no single study focused on the relationship between board diversity, agency costs and shareholder wealth around the world.

(Adams & Ferreira, 2009) stated that proportionate of women on board have a significant impact on firm value. The results suggest that gender-diverse boards allocate more effort to monitoring the management actions. (Chilosi & Damiani, 2007), find significant positive relationships between the participation of women on the board and firm value. (Garanina & Kaikova, 2016), stated that proportion of women on board tends to increase asset utilization ratio which means lower agency costs in firms in U.S.A. In contrast, larger proportion of women on board tend to decrease asset utilization ratio which increase agency

costs in Norway, but it is found that no significant evidence in Russia related with proportion of women on boards and the agency costs.

Although many recent proposals for government of Sri Lanka to the reform process explicitly stress the importance of gender diversity in the boardroom, it is very difficult to predict the relationship between board diversity, agency costs, and shareholder wealth in the Sri Lankan context based on the inconsistency on findings of prior studies. These studies provide a basis for our empirical tests.

Table 2.5

Summary of Empirical Evidence on Women on Boards, Agency Costs and Shareholders' Wealth Maximization

Subject	Study	Theoretical Perspectives
Positive relationship between board diversity and firm value	(Adams & Ferreira, 2009)	Agency and Resource Dependence theory
Negative relationship between board diversity and firm value	(Chilosi & Damiani, 2007)	Agency and Resource Dependence theory
Results are inconclusive	(Garanina & Kaikova, 2016)	Agency and Resource Dependence theory

Source: Author Compiled

2.3.5 Interlocking Directorship

Interlocking directorship means that a director sits his or her own company while sits on at least one other board. (Fathi, 2013), defined an interlocking directorship is a board member in one company who sits as board members in another company at particular time. The interlock may indicate the director's quality. A company is

having more presence of interlocking directors on board signals wider acceptance of his/her expertise and sincerity in their profession. If this is true, then multiple directorships will enhance active monitoring and reduce agency costs. Therefore, it would result in enhancing shareholders confidence and lead to higher stock price.

As far as reputation and information

concern, directors holdings multiple board appointments will be having the advantage of allowing them to learn about different management styles and to update the recent economic trends. The interlocking directors function as

information exchange motives (Johl, Kaur, & Cooper, 2015). They bring information relating to policies and procedures, trade secrets and practices among the firms. Resource dependence theory suggests that interlocking directorship is an asset to the company due to the knowledge, expertise, and skill of the directors in which they gain from their experience from other boards (Fathi, 2013). Kiel and Nicholson (2003) argue that interlocking directorship is positively correlated with firm performance, measured as market-based, but not for the accounting-based measures.

Agency scholars criticized that board interlocks reduce performance by enhancing managerial optimism (Jensen, M.C & Meckling, 1976). Directors who are having multiple boards' appointments may be so busy and then they do not function as effective monitors. The lack of monitoring the management actions may cause more severe agency costs as managers gain their private benefits at the expense of shareholders and may result a negative relationship between multiple directors appointment and market return. It indicates that interlocking directorship is positively related with agency costs. Jensen and Meckling (1976) contend that board interlocks reduce performance.

Resource dependence theory presents that firms performance can be improved

in a resource constraints organizations through relaxing the resource constraints where the board of directors would be the resource providers (Zona, Mejia, & Withers, 2015). Interlocking directorship is one of the corporate governance mechanisms which acquire resources to the management of firms in which interlocking directorship may influence either a positive or a negative effect on subsequent firm performance (Zona, Mejia, & Withers, 2015). However, empirical evidences on the interlocking

directorship, agency costs and shareholder wealth relationship has remained mixed (Upadhyay, Bhargava, & Fiarcloth, 2014) (Pfeffer & Salancik, 1978). Firm performance is determined by firm's relative resources (Zona, Mejia, & Withers, 2015). They further state that the presence of board interlocking directorship has positive relationship with firm performance of the resource constraint firms, where the managers limit the managerial opportunisms. On the other hand, managerial opportunisms are very high in the resource rich firm which results decrease in performance. Therefore, presence of interlocking directors may be either beneficial or detrimental to wealth of shareholders depending on the relative available resources.

Table 2.6
Summary of Empirical Evidence on Interlocking Directorship, Agency Costs and Shareholders' Wealth Maximization

Subject	Study	Theoretical Perspectives
Interlocking directorship, lower agency costs	(Fathi, 2013)	Resource Dependence Theory

Interlocking directorship, higher agency costs	(Jensen, M.C & Meckling, 1976)	N/A
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Source: Author Compiled

2.4.Previous Research on Corporate Governance: Global Context

Though much of the corporate governance researches were focused on the US context, there are researches on corporate governance was conducted in the context on Japan, German, Russia, and U.K (Uyar & Kuzey, 2009)) due to the corporate governance issue was evolved all over the world. Corporate governance issue was evolved in Russia as the result of privatization announced by the government in the middle of 1990s. This was lead to create agency problem between managers and shareholders (Garanina & Kaikova, 2016). (Velte, 2017), studied the relationship between CEO governance and shareholders returns on U.S corporations. The study primarily focuses on the issues related with CEO duality. The research was investigated two contrasting theories such as agency and stewardship theory and its application to the CEO duality. The sample of the study consists of 337 U.S firms. The data was obtained from Standard and Poor's Composted Services Inc. They found that separated role of CEO and Chairman of the board and shareholder return backed by agency theory was not significantly influence on ROE. The CEO duality and shareholders return posited by stewardship theory was significantly related with ROE. The findings support to the argument favor to stewardship theory and against to agency theory. The further research is suggested to go for further inquiry of board structure, shareholder return and/or agency costs.

(Velte, 2017), conducted a study to investigate the behavioral aspects of European and UK CFOs on the adopted strategies to create shareholders value.

This study is similar to US survey which was investigated the European and UK CFOs value maximizing strategies to create shareholder value. The shareholder wealth maximization is measured in terms of market capitalization in this study. The findings show that certain strategies adopted by the firms related to create shareholder value. The results also state that European managers adopted long-term value creating strategies than UK managers.

Kiel and Nicholson (2003) examined the relationship between board demographics and corporate performance in largest publicly listed companies in Australia. The study also describes the attribute of the 348 firms and their boards. The results state that board size is positively correlated with firm value while controlling for firm size and board size. The findings also state that the proportionate of inside directors and higher level of interlocking directorship are positively correlated with firm performance measured on market based. In contrast, CEO duality did not have any relationship with firm performance. Further research is required to look into see the relationship between board structure and how it solves agency problems in the organizations.

Singh and Davidson (2003) investigated the relationship between corporate ownership structure and agency costs to large publicly traded corporations. The study is extended the work of Ang, Cole, and Lin (1999) to large firms. The results state that managerial ownership is positively related to assets utilization ratio which means that lowering the agency costs. In contrast, the managerial ownership and

independent directors do not significantly influence on discretionary expenses. Outside block ownership is having a limited effect on mitigating agency costs. This study contributes to understand the influence of corporate ownership on agency costs in large corporations after controlling corporate governance variables. This study fails to investigate the influence of board structure on the agency costs mitigation in firms. Future research could be examining this issue. (Florackis, 2008), examined the empirical literature on determinants of agency costs in UK listed firms. The research investigates the impact of corporate governance mechanisms on agency costs which is measured as alternative proxy such as assets utilization ratio and SG&A. The study mainly focuses on debt maturity, managerial compensation and its impact on resolving agency related problems. The results show that bank debt and debt maturity considered as important corporate governance mechanisms for UK firms. The findings also state that strong relationship is associated between managerial ownership, managerial compensation, ownership concentration, and agency costs. The results also suggest that the impact between internal governance mechanisms and agency costs varies with firm's growth opportunities. The findings further reveal that range of corporate governance mechanisms is consistent with firm value maximization. They also found that agency costs is determined by nomination committee which means appointing more nomination committee would increase agency costs of larger firms in UK. Board ownership and debt tend to reduce agency costs. It seems that the adoption of Code of best practice in UK was not much difficult since the results are consistent with the

theory. However, the results also show that further work is required to develop the understanding of the environmental factors.

(Bhatia & Tuli, 2017), investigated the impact of ownership structure and capital structure on agency costs in co-operatives and mutual societies in New Zealand. They examined the changes of capital structure and the ownership structure during the period 2005-2001 and its impact on agency costs mitigation. The ordinary least square regression was used for statistical analysis of the panel data for the period 2005-2001. The results suggests that higher proportionate of independent directors, board members experience and board size tend to reduce agency costs in co-operatives and mutual in New Zealand. Bank debt does not have any impact on agency costs but the borrowing from members reduces agency costs. Since the study is restricted to New Zealand business environment and the sample size is also relatively small, further research is also required to inquire on this area with larger sample in other countries.

(Fuzi, Halim, & Julaizaerma, 2016), provide empirical evidence on the relationship between corporate governance mechanisms and shareholders' value maximization of listed companies in Ghana. The research strategy is designed as a case study approach for the period 2008-2013 from 10 companies listed on Ghana Stock Exchange which is considered as panel data. In this study, the dividend per share and dividend yield is measured as proxy to shareholders' wealth maximization. The results show that the board size is positively related with, and the independence director system is negatively associated with shareholder wealth maximization. The relationship

between CEO duality and shareholder wealth maximization is not significant and the overall results are inconclusive. In-consistencies on findings lead to further research to examine in other countries.

Zona et al. (2015) investigated the adoption of agency and resource dependence theory into the study of interlocking directorates in Italian firms. The findings highlights that interlocking directors does have either a positive or a negative effects on firm performance which is determined by availability of firm's resources and ownership concentration. This study provides significant contribution of agency and resource dependence theory in determining the firm performance to ascertain the effectiveness of board interlock in line with those specified theories. Future research could be examined the hypotheses in other countries or conduct the comparative analysis to examine the effects across country.

Garanina and Kaikova (2016) conducted a cross-country analysis and investigated the impact of board size, board composition, leverage and firm size on agency cost in the USA, Russia and Norway. The sample of the study consist of 243 US firms, 196 Russian companies and 175 Norwegian joint stock companies for the period from 2004 to 2012.

Regression analysis was employed to analyze the data and to test the model. The findings reveal that board size is positively associated with agency costs in all sample companies. The proportion of women on board is positively related with agency costs in US companies and negatively influence in the Norwegian sample. The women participation on board is not significant in the Russian companies. The further research is

suggested to investigate the agency costs effects in emerging markets by including more explanatory variables such as ownership structure, CEO duality and CEO tenure.

2.5 Corporate Governance in the Sri Lankan Context

Corporate governance practices in Sri Lanka was introduced as a voluntary code of compliance and then presented as rules of corporate governance for mandatory compliance of listed companies. The first code of best practice on corporate governance for Sri Lankan companies was introduced in 1977 and was developed over a period of time. Later, minimum of corporate governance for mandatory compliance for companies was presented in 2008. The implementation of the voluntary and mandatory code of compliance led the firms to enhance board effectiveness and strengthen the relationship between the company and the stakeholders.

2.5.1 Code of Best Practice on Corporate Governance in Sri Lanka

Code of best practices on corporate governance such as voluntary and mandatory mechanisms was develop to the companies listed on Colombo Stock Exchange to direct the firms into best corporate governance practices. The first voluntary code of best practice was introduced in 1997 which included the effectiveness of the board, appointment of chairman, non-executive directors, and directors responsibility for the presentation of financial statements, compliance reporting, internal control and committee structures for boards, including audit committee, and remuneration committee.

Section 1, Principle A.1 state that every company listed publicly should be headed by an effective board. The

board should direct, lead and control the companies to achieve the objective. The board of directors is responsible to meet regularly, at least once in every quarter, to discuss about the progress of the company. The board role is to provide effective leadership to the management of the company within the framework to enhance the shareholder wealth. The Principle A.7 presents a formal and transparent procedure to appoint directors to the board. The importance of separating the position of Chairman and CEO was identified in the 2013 code (Section 1, Principle A.2). These code emphasis key tasks to the companies such as conducting the business of the board and facilitating the management of the company's business. The code also point out to separating the responsibility of the CEO and the Chairman of the board. If it is to combine the posts of the CEO and the Chairman as a single person, justification should be given in the annual report of the company.

The code emphasis that companies must balance the executive and non-executive directors of the board (Section 1, Principle A.5). It addresses that the board should include at least two non-executive directors or such number equivalent to one third of total number of directors on board, whichever is higher. The non-executive directors must contribute significantly in the board's decision. If the Chairman and CEO is a

single person, non-executive directors should represent majority of the board members (Section 1, Principle A.5.1). This is further elaborated in the principle A.5.2. Principle A.5.5 of the 2013 code also states the criteria for defining independence and disclosure relating to directors.

The corporate governance disclosures and the requirement by the directors to disclose are stated in the principle D.3.4 and D.5 of the 2013 code which extent the best practices of corporate governance of listed companies. The information related to inter- locking directorship should disclose in respect of directors in annual report. Principle A.10 of the code 2013 addressed that the annual report of the company should disclose the names of listed companies in Sri Lanka in which the director is having multiple director's appointment, provided whether he/she holds directorship in companies within a group, their names need not be disclosed. Further it states that the company should disclose the total number of board seats held by each director indicating listed and unlisted companies and whether in an executive or non-executive capacity.

Table 2.7: Summary of Code of Best Practice on Board Structure and the Composition

Subject	Code	Reference
Board Size	Headed by effective board, optimum size is not indicated	Section 1, Principal A.1, A.7 (Code 2013)
	Board limits to 8 directors	Jensen (1993)
Leadership Structure	Separate the position of CEO and Chairman	Section 1, Principal A.2 (Code 2013)

	If it is combined the position (Duality), justified & highlighted in the annual report	Section 1, Principal 2.1 (Code 2013)
Board Balance	02 non-executive directors or 1/3 of total number of directors whichever is high	Section 1, Principal A.5 (Code 2013)
	If the Chairman and CEO same person (Duality), non-executive directors comprise a majority of the board	Section 1, Principal A.5.1, A.5.5 (Code 2013)
Inter-locking Directorship	Inter-locking directorship should be disclosed in respect of directors	Section 1, Principal A.10 (Code 2013)
Disclosure	Disclose the practice of good corporate governance in the annual report	Section 1, Principal D.4, D.5 (Code 2013)

Source: Author Compiled

2.5.2 Previous Research on Corporate Governance Practices: Sri Lankan Context

The confidence of the investors widely depends the rapid development of the capital market and the effective corporate governance systems which will lead the economy to growth at an average rate. Sri Lanka's economy has been growing at an average rate 4.79 per cent in 2015 as result of implementing economic reform process by the government in trade & business, taxation, privatization, and the labor market since the end of civil war in 2009 (Gunathilake, Chandrakumara, & Zoysa, 2011). Rapid development of the capital market and economic reform process led the economy to perform better in South Asia with effective corporate governance systems which enhance the performance of the listed companies and thus increases the

confidence of investors (Azees, 2015).

The companies listed in Colombo Stock Exchange has grown from 141 in 1977 (Gunathilake, Chandrakumara, & Zoysa, 2011) to 295 in September 2016 which records an increase of 109 per cent in this period which reveals the interest of investors' participation in the equity capital market and the predicted of agency conflict. This conflict of interest might be overcome through having better governance systems in the listed companies. Sri Lanka's corporate governance systems and practice have been largely influenced by both colonial economic policies and post independent government policies. Corporate governance practice in Sri Lanka has been improving with the expansion of business and the development of governance systems of listed companies to resolve the conflict of

interest.

The successful application is lacking in Sri Lanka due to the concentrated corporate ownership structure prevail in companies. Ownership concentration raises serious concerns to the appointment of board of directors such as executive and non-executive directors which challenges the protection of minority shareholders rights in Sri

Lanka. Majority shareholders influence on the appointment of board of directors and the CEO to nominate their representatives. This raises serious concern on influencing management decision making (Denis & McConnell, 2003). This enhances to the managers to pursue managerial opportunisms at the interest of shareholders (Gunathilake, Chandrakumara, & Zoysa, 2011). Board of directors is responsible to formulate strategy and control the management actions where the CEO is responsible for the day-to-day management of the companies (Garanina & Kaikova, 2016). In line with the ownership concentration issues, it is questions that how CEO and the board would be competence to reach the objectives of the company as well as to reduce the agency problem at large in the firms.

One of the most important issues in corporate governance is misuse of assets – the use of corporate assets by the company management for their personal use which creates conflict of interest. Extent of conflict of interest regulation index is 6 out of 10 while extend of disclosure index, extent of director liability index, and ease of shareholders suits index are also little bit higher than the South Asian Countries. This statistics shows that there is a need to protect investors in Sri Lanka through safeguarding the assets and effective corporate governance practice.

Corporate governance standards in certain areas are particularly important – such as those relating to board size, leadership structure, board composition, and interlocking directorship systems relative to the board of directors and managers. Another study found that board of directors is the most important elements of corporate governance systems, they are responsible for the governance of respective firms and the transparency of operations. It is noted that in the recent past, there is lack of transparency in the board's appointment which lead to ineffective corporate governance features in Sri Lanka (Dissabandara, 2012). The standard practice of corporate governance is felt as essential elements to enhance the wealth of the shareholders which is lacking in Sri Lankan context.

Ineffective corporate governance practices tend to increase agency problem between shareholders and management. Dissabandara (2012) explains that the variation between standard practice and actual practice of corporate governance in Sri Lanka (Over all variation - 56%; firm level variation – maximum 69% Minimum 39%; industry level variation 48%-61%). This study shows that the existence of agency problem in Sri Lankan listed companies. Further it explains that Sri Lankan boards are weak at staff roles, monitoring and evaluation and the relationship with key stakeholders.

Chapter Three

Research Methodology

3.1 Introduction

The purpose of this chapter is to describe the research methodology. The design of the research methodology is based on prior researches to test the effectiveness of corporate governance

practices on gender diversity and the profitability of listed companies in Sri Lanka. This chapter describes the conceptual model, hypothesis, operationalization of variables, and the research design. A conceptual model provides a framework to understand the effects of corporate governance practices on Financial Performance in the companies listed on Colombo Stock Exchange in Sri Lanka. It also facilitates to develop the hypotheses regarding the relationship between board structure related variables, financial performance in listed companies in Sri Lanka.

3.2 Development of a Conceptual Model

There are various studies focused on corporate governance practices and the recent development in the Sri Lankan context. The evidences reveal that the variation between standard and actual practice of corporate governance in Sri Lanka is noteworthy (Dissabandara, 2012), lack of confidence to investors to make more capital in Sri Lanka due to weak in corporate governance practices (Kalainathan & Vijayarani, 2014) (Senaratne & Gunaratne, 2008). On the other side, a review of the limitations in previous research suggests that the relationships between corporate governance practices such as board size, separate leadership structure, board composition, interlocking directorship and their effect on agency costs and shareholder wealth has not been sufficiently studied in developed and developing countries. In addition, it is noted the importance to investigate the relationship between corporate governance practices and agency costs (Garanina & Kaikova, 2016). The conceptual framework based on theoretical perspectives is given below.

Figure 3.1

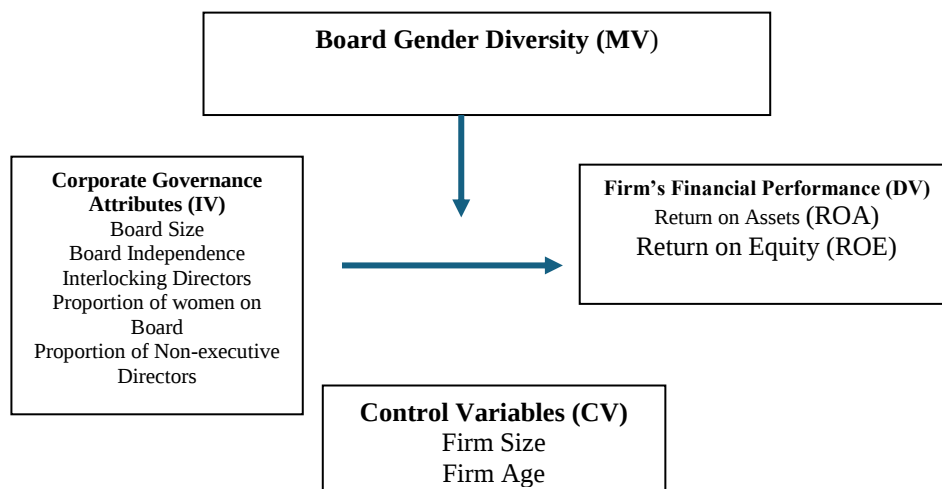
Conceptualization and Conceptual Model

The conceptual framework (figure 1) was developed based on two well established corporate governance theories such as Agency theory and Resource Dependency theory to explain the importance and relationship between corporate governance attributes and firms financial performance.

Source: Author Compiled

The conceptual framework (figure 3.1) illustrates the link between the theoretical perspectives, operationalization of the corporate governance variables and firm's financial performance that are investigated in this study. Empirical evidences from various researches suggested that there are several corporate governance variables that influence the relationship between corporate governance attributes, gender diversity and financial performance. This study examines the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka. The conceptual model comprises of internal corporate governance variables such as board structure which are considered important in affecting financial performance.

Figure 1: Conceptual Framework of the Study



3.3 Development of Hypothesis

The conceptual framework illustrated in figure 3.1 will be used to develop the

testable hypothesis for the study. The basis of the hypothesis development is that the introduction of corporate governance best practices namely the board size, separate leadership structure, board composition, and presence of interlocking directors will be reflected in agency cost mitigation and shareholder wealth maximization. Therefore, the hypothesis presented in this study will be tested to investigate the effect of corporate governance best practices such as board structure on agency cost and shareholder wealth.

According to the developed conceptual framework in Figure 1, the hypotheses relevant to this study are given below.

H0a: There is a Negative relationship between board size and firm's Performance

H0b There is a negative relationship between board independence and firm's performance

H0c: There is a negative relationship

between interlocking directors and Firm's performance

H0d: There is a negative relationship between proportion of women on board and firm's performance

H0e: There is a negative relationship between proportion of non-executive director's and firm's Performance.

3.4 Operationalization and Measurement of Variables

This section describes the variables used to operationalize the construct illustrated in the conceptual model. The conceptual model includes the board structure related variables such as board size, separate leadership structure, proportionate of non-executive director, proportionate of women on board, interlocking directorship impact on agency costs and shareholder wealth and controlling variables of leverage and firm size. This study will be conducted based on the method adapted from sources in the prior study. All data will be gathered and used for this study are empirical secondary data extracted from corporate published annual reports.

Table 1: Operationalization of Variables

Variable	Measurement	Sources
Board Size (IV)	Total number of Board of directors appointed to the board	(Malik, Wan, Ahmad, Naseem, & Rehman, 2014) (Johl, Kaur, & Cooper, 2015)
Board Independence (IV)	The proportion of independent director will be measured against the total number of directors in %	(Upadhyay, Bhargava, & Fiarcloth, 2014) (Liu, Miletkov, Wei, & Yang, 2015) (Fuji, Halim, & Julaizaerma, 2016) (Reguera & Bravo, 2017)
Interlocking directors (IV)	Coded as “1” if CEO and chairman roles are separated and “0” otherwise	(Azees, 2015) (Fathi, 2013)
Proportion of women on board (IV)	Total number of women on board	(Upadhyay, Bhargava, & Fiarcloth, 2014) (Leung, Richardson, & Jaggi, 2014)
Proportion of non-executive directors (IV)	Total number of non-executive directors on board	(Yatim, 2010)
ROA (DV)	PBIT/Total Assets	(Wickramasinghe, Ajward, & Wijesinghe, 2019)
ROE (DV)	Net Income/ Shareholders Fund	(Brick & Chithambaran, 2010)
Board Gender Diversity (MV)	The proportion of women director will be measured against the total number of directors in %	(Low, Roberts, & Whiting, 2015) (Velte, 2017)
Firm Size (CV)	Natural Logarithm of total assets of the firm	(Uyar & Kuzey, 2009)
Firm Age (CV)	Number of years from the incorporation of the firm	(Bhatia & Tuli, 2017)

Source: Author Compiled

3.5 Research Design

The research design refers to selection regarding the purpose & type of the study, the extent to which the study is manipulated and control by the researcher, the research aspects, and the statistical methods which the data will be analyzed, which are compatible with the theoretical paradigm. The term paradigm refers to the set of belief or assumptions about the nature of the (social) world and how to know about the (social) world. The two main research paradigms used in social research are referred to as ontology and epistemology. This research is based on epistemology which is named as positivist.

The positivist paradigm focuses on the view that researchers are act as independent of the research. The process for the positivist approach is to study the literature to establish a relevant theory and develop the hypotheses, which can be tested for association or causality by deducting logical consequences that are tested against empirical evidence. The following sections describe the sample selection, data collection methods, validity and reliability of data, and the proposed statistical methods.

3.6 Population and Sample

The objective of the study is to investigate the corporate governance gender diversity influence of financial

performance listed companies in Sri Lanka. The sample used in the study consists of all public companies listed in Colombo Stock Exchange except - companies that have unique ownership and different management structure such as banks and financial institutions are excluded from the sample. The period of the study consists of recent seven years from 2016-2022. The final sample consists of 183 companies. The reason for selection of the years was that the corporate governance guidelines were introduced in 2003, and then four years later, the code of corporate governance was mandated in 2007 to be effective for companies reporting on or after the 1st April 2008. Later, the code of best practice on corporate governance was revised and reviewed in 2013. During the period of 2009-2015, the code of best practice was criticized with the real practice of governance systems (Dissabandara, 2012) (Kalainathan & Vijayarani, 2014) (Senaratne & Gunaratne, 2008).

Therefore, the period 2017-2022 was an important to examine the board effectiveness regarding the agency costs mitigation and shareholder wealth maximization.

3.7 Data Collection Methods

This section describes the method of data collection and types of data that were collected to conduct the study. The study investigated the association between board structure, agency costs and shareholder wealth of listed companies in Sri Lanka. The data and information required for the study were collected from the Colombo Stock Exchange (CSE) websites, Audited annual reports of listed companies. Data on board structure, agency costs and shareholder wealth were extracted from the annual report which published data on all the financial information relevant to the performance and financial position of the

company. Information relating to corporate governance practices, board structure, was extracted from annual reports of the companies.

The data required for the study included board size (total number of board of directors), separate leadership structure (if the position of chairman and the CEO were held by two persons), composition of the board (number of non-executive directors on board and the proportionate of women directors on board), interlocking directorship (the proportion of directors on the board with directorships on other companies to the total number of directors on the board of the company), leverage (proportion of total debt to total assets), firm size (natural logarithm of annual assets), agency costs (assets utilization ratio and the ratio of selling, general and administrative expenses to sales), and shareholder wealth (dividend yield and dividend per share).

3.8 Validity and Reliability of Data

The data source of this study was secondary data. The data was collected from Audited Annual Report published by the company, and the handbook published by the Colombo Stock Exchange. Since the data was audited and the publication was done by recognized institutions, there is high validity and reliability of the data.

3.9 Methods of Analysis

Data analysis was carried out for the years from 2016 to 2022. To test the relationship suggested in the hypotheses stated in the conceptual framework, the E- Views-9 statistical program was employed. The analysis included descriptive statistics, spearman's correlation, multiple regression analysis, stationary tests, multicollinearity, auto correlation and heterogeneity tests.

Since the data comprising both time series and cross-sectional elements, the data- set of this study would be known as

a panel of data or longitudinal data. The data used in this thesis are typically of a panel nature, which enrich empirical analysis. It consists of both time series and cross section data. The specific advantage of panel data makes available a large number of observations and facilitates more accuracy of prediction, (Bhatia & Tuli, 2017).

3.9.1 Panel Regression FE/RE

This research deployed panel data methods facilitated by sample, containing data across companies and over time. The utilization of panel data increases information, variability, extent of leeway as well as efficiency while reducing collinearity amongst factors (Bhatia & Tuli, 2017). Moreover, he shows that panel regression (fixed impact and casual impact) have advantages than merged OLS, disregarding the cross section and time series nature of the data.

The fixed impacts model considers the uniqueness of each entity or cross-sectional unit encompassed in the test piece by allowing the intercept change for each company, but still presume that the incline coefficients are fixed across companies. The casual impacts model calculates the coefficients presuming that the single or combined results are inconsistent with other elucidatory factors and can be worked out (Adams & Ferreira, 2009). Further, Hausman test (1978) is also done in this study to corroborate the above outcome.

The common formula for the panel regression model could be:

$$Y_{it} = \alpha + \beta X_{it} + v_{it}$$

Y_{it} is the dependent variables, α is the intercept term and β is a $K \times 1$ vector of parameters to be estimated on the explanatory variables. Also, X_{it} is a $1 \times K$ vector of observations on the explanatory variables and $t = 1 \dots T$, $i = 1 \dots N$, v_{it} is the error terms.

3.9.2 Descriptive Statistics

The descriptive statistics was conducted to examine the behavior of the variables used in the study which presents the mean, median, maximum, minimum and standard deviation for corporate governance variables related to board structure, agency costs and shareholder wealth.

3.9.3 Correlation Analysis

Spearman's correlation analysis was used to assess the relationship between the variables and to check for multicollinearity. The Variance Inflation Factor (VIF) was also tested for the multicollinearity which measures the amount of multicollinearity in a set of multiple regression variables. Criterion for calculating multicollinearity of linear regression models is not available. According to Green (2000); indications of multicollinearity may be seen in conditions where little variations in the data causes large fluctuations in the parameter calculations or coefficients could possess very big standard errors and shallow worth levels, despite being jointly worth and the R^2 for the regression is pretty big. VIF less than 10 indicates no symptom for multicollinearity issue.

3.9.4 Stationary Test

The stationary of data was tested by employing the Unit Root test of panel data which suggested by Levin, Lin, and Chu (2002). The test was used to investigate whether a time series variables is non-stationary and possess a unit root.

3.9.5 Test of Panel Effect

Breusch-Pagan test was used for the model selection whether it is pooled ordinary least square or panel ordinary least square. The Lagrange multiplier test would determine the model

selection. Since the data is based on panel effect, it is important to determine appropriate model whether the pooled OLS or Panel regression.

Chapter Four

Data Analysis and Findings

4.1 Introduction

The statistical analysis of Moderating Effect of Corporate Governance (CG) Gender Diversity on the relationship of CG attributes and Financial Performance of Listed Companies in Sri Lanka data tested the in this chapter. The analysis uses descriptive statistics to explain behavior of the variables during the period of 2016 to 2022. Spearman's correlation analysis assesses the association between board structure related variables, agency costs and shareholder wealth. The unit root test of panel data was employed to examine the stationary of data, and Lagrange multiplier tests was used to select the ordinary least square whether panel or pooled. Determination of regression model whether fixed or random effect was determined through using Hausman

specification test. The regression analysis was used to test the hypotheses of the study.

4.2 Descriptive Statistics of Selected Variables

Descriptive statistics in this study summarize the data set for corporate governance variables related to board structure, agency costs and shareholder wealth, which is the representation of the entire sample population. Descriptive statistics are used as a tool to compare the compliances by the companies adopted with code of best practice of corporate governance in 2013. They describe the characteristics of board structure and the variables used to measure the agency costs and shareholder wealth. It shows the mean, median, maximum, minimum, and standard deviation worth of each variable. Table 4.1 illustrates a summary of the descriptive statistics

Table 4.1

Descriptive Statistics – Companies Listed in Colombo Stock Exchange in Sri Lanka

Variables	Mean	Median	Maximum	Minimum	Standard Deviation
Dependent Variables					
Assets to sales ratio (Ratio)	0.837	0.690	5.900	0.000	0.761
Selling, general and administrative expenses to sales (SG&A) (Ratio)	0.306	0.170	29.470	0.000	0.894
Dividend per share (Rs.)	3.509	0.600	80.000	0.000	8.715
Dividend yield (Ratio)	0.021	0.013	0.887	0.000	0.039
Independent Variables – Board Structure					
Board Size (Nos)	8.048	8.000	15.000	2.000	2.076
Separate leadership structure (%)	0.958	1.000	1.000	0.000	0.199
Non-executive directors (%)	0.366	0.333	1.000	0.000	0.133
Women on Boards (%)	0.065	0.000	0.666	0.000	0.101
Presence of interlocking directors (%)	0.631	0.666	1.000	0.000	0.260
Control Variables					
Leverage (Ratio)	0.185	0.150	0.863	0.000	0.168
Firm size (Ln)	21.881	21.947	26.208	15.817	1.696

Assets to sale ratio measures the efficiency of management which reflects in using firm's assets to generate sales. High ratio

4.2.1 Assets-to-Sales Ratio

indicates that management generates significant amount of sales with the given level of assets which suggests lower agency costs and maximizing shareholder wealth. This ratio of greater than 1 represents the firm's management is highly efficient to manage assets to generate sales which lead to productive investment decision to maximize the wealth of shareholders. The mean value for assets to sales ratio was 0.837, with a maximum value of 5.90 and a minimum value of 0.000. The average value for assets to sales ratio of 0.837 represents the higher ratio of entire listed companies in Sri Lanka which implies the management efforts towards mitigates agency costs and maximizes shareholder wealth.

4.2.2 Selling, General and Administrative Expenses to Sales

(SG&A)

Selling, a general and administrative expense to sales (SG&A) is a direct proxy for agency costs. The mean value for SG&A was 0.306, with a minimum of 0.000 and a maximum of 29.470. The average value indicates that companies listed in Colombo Stock Exchange was having lower SG&A, it is around 30.6% of total sales. This implies that effort put by the companies' management to mitigate the agency costs. The standard deviation shows a greater variation of SG&A among the companies listed in Sri Lanka. The standard deviation of SG&A was 0.894.

4.2.3 Dividend per Share

The companies listed in Colombo Stock Exchange in Sri Lanka declared dividend during the period from 2009 to 2015 was Rs. 3.50 per annum which shows in the mean value of dividend per share. There is huge variation in dividend declaration among the companies, the minimum value

of Rs. 0.00, maximum value of Rs. 80.00 and the standard deviation of dividend payment of companies was 8.715. It shows that companies are having different type of dividend policy which has an impact on shareholders' wealth.

4.2.4.Dividend Yield

Dividend yield is the market based measures of shareholder wealth. Higher the dividend yield would indicate of maximization of shareholder wealth against their investment. The mean value of dividend yield was 0.021. The investors of companies in Sri Lanka gained 2.10% of return from their investment annually. The maximum value of 88.7%, minimum value of 0.00% and the standard deviation was recorded as 0.039 which implies a low variation of return on investment to the shareholder among the companies.

4.2.5 Board Size

The average board size of listed companies in Sri Lanka is 8.048. The minimum size of board reported was 2 and maximum size was 15. This is closer to the recommendations of the European and US codes for ideal board size between 5 and 15 members. The standard deviation of board size was 2.076. It proves that the board of listed companies in Sri Lanka was having optimum board size as per the mean value.

4.2.6 Separate Leadership Structure

Descriptive statistics of the separate leadership structure reports that 95.8% of the companies listed in Sri Lanka separated the position of CEO and Chairman of the board. The majority of the companies in the sample identified the importance of separating the position of CEO and Chairman that are complying with the code of best practices (Section 1, Principal A.2) in 2013 jointly issued by ICASL and SEC. Less than 5% of companies in Sri Lanka are still

combining the position of CEO and Chairman of the board.

4.2.7 Non-Executive Directors

The proportion of non-executive directors on the boards shows that there is a variation in the percentage of non-executive directors on the boards. The component of non-executive directors in the board of companies listed in Sri Lanka is between zero and 100%, the standard deviation is about 0.133. The mean of proportion of the non-executive directors on the boards was 36.6% which is closer to the recommendation of code of best practices issued in 2013 which was presented in Section 1, Principal A.5. There are companies having majority of the non-executive directors on the boards which compliance with the code of best practices in Section 1, Principal A.5.1 where they had combined the position of CEO and the Chairman of the board. Less than 5% of the companies had combined the both position.

4.2.8 Women on Board

The proportion of women on boards shows that there is variation in the participation of women on boards of affairs among the companies. The standard deviation of 0.101 and the minimum and maximum proportionate of women on the board of companies in Sri Lanka is between zero and 66.6%. The mean proportion of women participation on board was 6.5% which is less than the gender balance that is at least 35% of the total number of directors on board. There are companies not having single female representation on the board's decision making in Sri Lanka.

4.2.9 Presence of Interlocking Directors

The mean value of presence of interlocking directors on board in Sri Lankan companies was 63.1%. It shows that majority of the directors on the boards are having multiple seats on other companies' board. The code of best practice issued in 2013 encouraged the companies' directors to have multiple seats in other companies. If so, they are requested to disclose such information on their annual report. There is greater variation on the practice of interlocking directorship among the companies where the standard deviation of 0.260. The presence of interlocking directors among the companies in Sri Lanka is in between zero and 100%.

4.2.10 Firm Size

Firm size is measured by natural logarithm of total assets. The mean value for log of total assets was 21.881, the maximum value of 26.208 and the minimum value of 15.817. The standard deviation of log of total assets was 1.696. The higher the log of total assets suggests increased investors' confidence in companies in the sample.

4.3 Spearman's Correlation Analysis

Spearman's correlation for corporate governance variables – related with board structure, agency costs and shareholder wealth is presented in the table 4.2. It examined the association between the board structure and financial performance in the companies listed in Sri Lanka. It shows that the overall correlation results between the dependent and independent variables were low, and not significantly correlated. The findings does not indicate multicollinearity problems, which is considered a serious problem if the correlation coefficient between independent variables is above 0.8 (Gujarati, 1995). It is found that there are

few exceptions in the data, while it is not much harm for multicollinearity issues.

Table 4.2
Correlation Matrix of Dependent and Independent Variables

	Assets to sales ratio	SG&A	DPS	DYD	Board size	Non-ExD	WOB	PINT	Lev	FSize
Assets to sales ratio	1.0000									
SG&A	-0.1570	1.0000								
DPS	0.3255	-0.0610	1.0000							
DYD	0.0774	-0.0628	0.2617	1.0000						
Board size	0.0185	-0.0554	-0.0568	0.0240	1.0000					
Non-ExD	-0.1561	0.0580	-0.1032	0.0367	-0.0390	1.0000				
WOB	-0.0248	0.1062	0.0011	-0.0540	0.0202	-0.0325	1.0000			
PINT	-0.2042	-0.0330	-0.0420	0.0214	-0.0644	0.0075	-0.1197	1.0000		
Lev	0.0611	-0.0210	-0.1785	-0.0035	0.0356	0.0838	-0.0140	-0.0106	1.0000	
FSize	-0.0258	-0.0697	0.0411	0.0587	0.2628	0.1041	-0.0156	0.1243	0.2025	1.0000

4.4 Board Structure and Financial Performance

Board size is positively correlated with assets to sales ratio and negatively correlated with SG&A which are reported as weak correlation. The other board structure related variables such as proportion of non-executive directors on board was positively correlated with SG&A and negatively correlated with assets to sales ratio. The association between these variables is also reported as weak. Women on boards is negatively correlated with assets to sales ratio and

positively correlated with SG&A which are reported as weak correlation. The correlation results between the presences of interlocking directorship and agency costs related variables such as assets-to-sales ratio and SG&A are negatively correlated. The result further suggests that board size is positively correlated with dividend yield, and negatively correlated with dividend per share which is reported as weak correlation. Proportion of non-executive directors on board was positively correlated with dividend yield and negatively correlated with dividend

per share. The association between these variables is reported as weak. Women on boards is negatively correlated with dividend yield and positively correlated with dividend per share which are weak correlation. The correlation results between the presence of interlocking directorship and shareholder wealth related variables are found a mixed results. Negative relationship is reported between the presence of interlocking directorship and dividend per share and positively correlated with dividend yield.

4.5 The Unit Root Test of Panel Data

The stationary of data set can be tested by scrutiny of the time series for a unit root. There are many panel unit root tests available in the statistics. This study was employed the test suggested by Levin, Lin and Chu (2002) to test the stationary of the data. The table 4.3 summarizes the unit root test of variables and the statistics (LLC) along with the Probability value.

Table 4.3: Unit Root Test of Variables

Variables	Statistic (LLC)
Assets to sales ratio	-8.382**
Selling, general & administrative expenses	-23.662**
Dividend per share	-38.945**
Dividend yield	-27.462**
Board size	-6.921**
Non-executive directors	-14.757**
Women on board	-18.590**
Presence of interlocking	-92.168**
Leverage	-5126.46**
D (Firm size)	-25.710**

** denotes significant at 5%

Table 4.3 presents the panel unit root tests. Based on the results, it can be concluded that for all variables, the null of a unit root rejected. At 5 per cent significance level, the LLC model confirmed that the variables are stationary.

4.6 Regression Analysis

This section presents the results of regression analysis to test the hypothesis of the study. Prior to the regression analysis, there are pre-test carried out to determine whether the regression is pooled ordinary least square or panel ordinary square, and to judge the regression model whether the model is fixed effect or random effect. Following to

the test, the regression output is explained to test the hypothesis. The study consists of four models in which the model 1 presents the relationship between board structure and assets to sales ratio (proxy to agency costs). Association between board structure and SG&A (proxy to agency costs) is designed with the model 2. Board structure and shareholder wealth is presented in the Model 3 & 4. The model 3 is designed to predict the association between board structure and dividend per share (proxy to shareholder wealth) and the association between the board structure and dividend yield is presented in the model 4.

4.7 Determination of Ordinary Least

Square regression (Pooled / Panel Effect)

Breusch-Pagan Lagrange Multiplier test, which performs to determine whether the data contains panel effect or not. The null hypothesis of this Chi-Square test is that there is no panel effect and the alternative

hypothesis is that there is panel regression effect. If the test statistics has a p-value below an appropriate threshold (p-value < 0.05) then the null hypothesis is rejected and alternative hypothesis is accepted. The table 4.4 summarizes the results of the Chi-square statistics and p-value.

Table 4.4: Lagrange Multiplier Tests

Breusch-Pagan Test for Models Selection	Chi-Square Statistic	p-value	Model
Financial Performance and Board Structure			
Model 1 (assets to sales ratio and board structure)	1996.500**	0.0000	Panel effect
Model 2 (SG&A and board structure)	29.973**	0.0000	Panel effect
Shareholder Wealth and Board Structure			
Model 3 (dividend per share and board structure)	1374.035**	0.0000	Panel effect
Model 4 (dividend yield and board structure)	202.427**	0.0000	Panel effect

** denotes significant at 5%

The above table summarizes the statistical test results for the model 1, model 2, model 3 & model 4 with their respective p-value. The Chi-square statistics for all the models are very high and statistically significant (p-value < 0.05) at 5% level. Since the models are statistically significant, the null hypothesis was rejected and the alternative hypothesis was assumed to be a panel regression effect.

4.8 Determination of Regression Models (Fixed / Random Effect)

This section focuses on performing the pre-test to determine an appropriate model

for the panel of data being used in this study. It is important to determine the suitability of effect of panel data whether it is fixed effect or random effect model. The Hausman specification test is performed to compare fixed and random effect model in this study. If the null hypothesis is rejected, then alternative hypothesis will be assumed that there is a significant fixed effect, thus the fixed effect model is better than the random effect model. Table 4.5 presents the results of Hausman specification test.

Table 4.5: Hausman Specification Test

Models	Chi-Square Statistic	Chi-Sq. d.f.	p-value	Model
Financial Performance and Board Structure				

Model 1 (assets to sales ratio and board structure)	20.501* *	7	0.0046	Fixed effect
Model 2 (SG&A and board structure)	5.602**	7	0.5869	Random effect
Shareholder Wealth and Board Structure				
Model 3 (dividend per share and board structure)	16.405* *	7	0.0217	Fixed effect
Model 4 (dividend yield and board structure)	9.035**	7	0.2501	Random effect

** denotes the 5% significance level

A Hausman (1978) test was performed in this study to compare the fixed effect model and random effect model whether to select the relevant model. Significant chi square value proves the relevancy of fixed effect model and otherwise random effect model. According to the above results, the model 1 and model 3 are preferred by fixed effect, and the model 2 and model 4 are preferred by random effect.

4.9 Results of Panel Regression for Board Structure and Financial Performance

This section presents the results of the multivariate analysis relating to board structure (board size, separate leadership structure, proportion of non-executive director on boards, proportion of women on boards, and presence of interlocking directors on boards) and Financial Performance (assets utilization ratio and selling, general & administrative expenses). Breusch-Pagan Lagrange Multiplier test was performed for the appropriateness of the Ordinary Least Square regression model in which it is chosen as panel regression effect. A Hausman specification test carried out to check the models are fitted with fixed or random effects regression. According to the results of Hausman test, the fixed effects multivariate regression was conducted for the model 1, and random effects multivariate regression for the model 2 to investigate the relationship between the selected variables of board

structure and agency costs. The following sections describe the regression results relating to the study.

F-test in regression results compares the fits of different linear models which determines whether the relationship between board structure related variables and financial performance is statistically significant. The overall F-test of the model 1 & 2 are 41.198** and 3.325** significant at 0.0000 & 0.0016 (5% level). The P-value for the overall F-test is less than 5% significant level ($p = 0.0000 < 0.05$). Therefore, the null hypothesis is rejected and it concludes that the model 1 & 2 provides better fit with the data. R-square in the regression model 1 shows the 90.58% of the effect from selected variables while the regression model 2 accounts only for 2.09% of the effect in agency costs respectively.

Durbin Watson Statistics is used to test the autocorrelation in the residuals from model 1 & model 2. The statistics accounts for 1.5 for model 1 and 2.2 for model 2 which reveals that there is no cause for autocorrelation.

Detecting multicollinearity using Variance Inflation Factors (VIF) tested to see the correlation between the independent variables in the regression model 1 & 2. If VIF value is less than 10 proves the non-existence of multicollinearity issue in the model. The VIF statistics for model 1 is accounted for 8.771 and model 2 is 1.021 which reveals that there is no existence of multicollinearity between the independent variables in the regression models. Wald-test determines the joint significant of

selected independent variables in the regression model. In addition, significant chi square value of Wald test results revealed that the determinants used in this study can be considered, as a whole,

explanatory of the agency costs. In addition, the below table 4.6 show the results of the heterogeneity of residual.

Table 4.6: Results of Heterogeneity

Types of Statistics		Model 1	Model 2
		Assets-to-Sales Ratio	SG&A
		Fixed Effect	Random Effect
Sum of Square Regression (SSR)	Rho	6.33	6.42
	Theta	3.16	3.21
	Chi-square stat	14.06	14.06
	df	7	7

Breusch – Pagan – Godfrey test shows that Theta (3.16) is less than chi-square test statistics of 14.06 (7d.f). The evidence shows that there is no heteroscedastic problem with the residual. Also in the second model of Theta (3.21) less than the chi-square test statistics of 14.06 (7d.f) which proves that there is no heteroscedastic problem

in the regression model. The table 4.7 shows the results of the regression of financial performance over board structure related variables.

Table 4.7
Estimation Results of Determination of Agency Costs and Board Structure

Explanatory Variables	Model 1		Model 2	
	Assets-to-Sales Ratio		SG&A	
	Fixed Effect		Random Effect	
	Coefficient	P. Value	Coefficient	P. Value
C	1.0921**	0.0000	0.2396	0.3296
Board size	0.0109	0.2426	-0.0290	0.0743
Separate leadership	-0.3023**	0.0279	0.0834	0.6318
Non-executive director	-0.1401	0.1971	0.4711**	0.0409
Women on board	0.3093	0.1939	0.9747**	0.0047
Presence of interlocking	-0.0706	0.2673	-0.0432	0.7330
Leverage	0.0018	0.9840	-0.0964	0.6216
D (Firm size)	-0.2813**	0.0000	-0.2632**	0.0049
R-squared	0.9058		0.0209	
Adjusted R-squared	0.8861		0.0146	
S.E. of regression	0.2610		0.8928	
F-statistic	46.198**		3.325**	
Durbin-Watson stat	1.4137		2.3187	
VIF	8.771		1.0210	
Wald test	2530.243**		98.591**	
No of firms	183		183	
No of observation	1098		1098	

** denotes the 5% significance level

4.9.1 Board Size and Financial Performance

The results of the panel regression analysis conducted to find the relationship between board size and performance of companies listed in Colombo Stock Exchange reported mixed results. The results above indicate a positive relationship between the board size and assets to sales ratio, meaning that larger boards are associated with higher assets utilization ratio and thus higher efficiency in the companies. However, the relationship were not significant with coefficient 0.0109 ($p = 0.2426 > 0.05$). As for the second model, the relationship between board size and selling, general & administrative (SG&A) expenses is reported a negative relationship, meaning that larger boards are associated with lower agency costs which are also statistically insignificant with coefficient -0.0290 ($p = 0.0743 < 0.05$). However, based on the insignificant relationship on both models (model 1 & 2), do not reject the null hypothesis and it can be concluded that board size has insignificant influence on Financial Performance of listed companies in Sri Lanka.

4.9.2 Separate Leadership Structure and Financial Performance

The relationship between separate leadership structure and financial performance of listed companies in Sri Lanka reported mixed results. The results above indicate a negative relationship between the separate leadership structure and assets to sales ratio, meaning that separate leadership structure is associated with lower assets utilization ratio and thus higher agency costs in the companies. Hence, the relationship was significant with coefficient -0.3023 ($p = 0.0279 < 0.05$). As for the second model, the relationship between separate leadership structure and selling, general &

administrative (SG&A) expenses is reported a positive relationship, meaning that separate leadership structure is associated with higher agency costs which are statistically not significant with coefficient 0.0834 ($p = 0.6318 > 0.05$). However, based on the significant relationship between separate leadership structure and assets to sales ratio (model 1), null hypothesis ($H0b$) is rejected and it can be concluded that separate leadership structure has significant positive influence on agency costs of listed companies in Sri Lanka, evidence to accept the alternative hypothesis ($H1b$).

4.9.3 Non-Executive Directors on Boards and Financial Performance

The results of the panel regression analysis conducted to find the relationship between proportion of non-executive directors on boards and financial performance of listed companies in Sri Lanka reported mixed results. The results above indicate a negative relationship between the proportion of non-executive directors on boards and assets to sales ratio, meaning that higher the proportion of non-executive directors on boards is associated with lower assets utilization ratio and thus higher agency costs in the companies. Hence, the relationship was not significant with coefficient -0.1401 ($p = 0.1971 > 0.05$). As for the second model, the relationship between proportion of non-executive directors on boards and selling, general & administrative (SG&A) expenses is reported a positive relationship, meaning that higher the proportion of non-executive directors on boards is associated with higher agency costs which are statistically significant with coefficient 0.4711 ($p = 0.0409 < 0.05$). However, based on the significant relationship between proportion of non-executive directors on boards and SG&A (model 2), null hypothesis ($H0c$) is

rejected and it can be concluded that higher proportion of non-executive directors on boards has significant positive influence on financial performance of listed companies in Sri Lanka, evidence to accept the alternative hypothesis.

4.9.4 Women on Boards and Financial Performance

The results of the panel regression analysis conducted to find the relationship between proportion of women on boards and financial performance of listed companies in Sri Lanka reported mixed results. The results above indicate a positive relationship between the proportion of women on boards and assets to sales ratio, meaning that higher the proportion of women on boards is associated with higher assets utilization ratio and thus lower agency costs in the companies. Hence, the relationship was not significant with coefficient 0.3093 ($p = 0.1939 > 0.05$). As for the second model, the relationship between proportion of women on boards and selling, general & administrative (SG&A) expenses is reported a positive relationship, meaning that higher the proportion of women on boards is associated with higher performance which are statistically significant with coefficient 0.9747 ($p = 0.0047 < 0.05$). However, based on the significant relationship between proportion of women on boards and SG&A (model 2), null hypothesis (H_{0d1}) is rejected and it can be concluded that higher proportion of women on boards has significant positive influence on agency costs of listed companies in Sri Lanka, evidence to accept the alternative hypothesis (H_{1d}).

4.9.5 Presence of Interlocking Directors on Boards and Financial Performance

The results of the panel regression analysis conducted to find the relationship between presence of interlocking directors

on boards and financial performance of listed companies in Sri Lanka reported mixed results. The results above indicate a negative relationship between the presence of interlocking directorship on boards and assets to sales ratio, meaning that higher the presence of interlocking directors on boards is associated with lower assets utilization ratio and thus higher agency costs in the companies. Hence, the relationship was not significant with coefficient -0.0706 ($p = 0.2673 > 0.05$). As for the second model, the relationship between presence of interlocking directorship on boards and selling, general & administrative (SG&A) expenses is reported a negative relationship, meaning that higher the presence of interlocking directorship on boards is associated with lower agency costs which are statistically not significant with coefficient -0.0432 ($p = 0.7330 > 0.05$). However, based on the insignificant relationship between presence of interlocking directorship on boards and agency costs (model 1 & 2), do not reject the null hypothesis and it can be concluded that there is not enough evidences to proof that higher the presence of interlocking directors on boards has significant influence financial performance of listed companies in Sri Lanka.

4.10 Discussion of the Results

This section presents the discussion and consistency of the results of the relationship between board structure related variables and profitability of companies listed in Sri Lanka. The conceptual model presented in chapter 03 was tested using the statistical techniques regarding the relationship between board size, separate leadership structure, non-executive directors on boards, women on boards, presence of interlocking directors, and the profitability. The findings based on Sri Lankan context reveals that the existing corporate governance

mechanisms such as separate leadership, non-executive director, and women on board influence on agency costs. Board size and interlocking directorship do not influence on agency costs of companies listed in Sri Lanka. In case of the determinants of shareholder wealth over board structure related variables, the results shows that board structure does not influence on shareholder wealth in Sri Lankan companies except the firm size which influences on shareholder wealth.

4.10.1.Board Size and Financial Performance

Board of director is considered as important corporate governance mechanisms, which are responsible to enhance shareholder wealth through mitigating agency costs. The association between board size, agency costs, and shareholder wealth are presented in this section.

H0a: Board size is not influence on financial performance of companies listed in Sri Lanka. The results show that board size is insignificantly associated in Sri Lankan companies based on the measure assets-to-sales ratio and SG&A. According to the evidences, the null hypothesis was not rejected. It can be concluded that board size is not the effective governance mechanisms to influence on performance of companies listed in Sri Lanka.

4.10.2 Separate Leadership Structure and Financial performance

The leadership structure of the board is an important corporate governance mechanism to provide effective leadership of the company within a framework of mitigating agency costs and enhance the firm's profitability. The results of the relationship between separate leadership structure and profitability is discussed in this section in relation to the proposed conceptual framework.

H0b: Separate leadership structure is not influence on profitability of companies listed in Sri Lanka. The results of this study show that separate leadership structure is negatively associated with profitability. The alternative hypothesis was accepted based on the measures assets-to-sales ratio. This means that separate leadership structure leads to inefficient management of assets which leads to higher agency costs of companies. Therefore, it can be concluded that separate leadership structure has significant influence on agency costs of companies in Sri Lanka.

4.10.3 Non-Executive Directors on Boards and Financial Performance

Non-executive director representation on boards of listed companies in Sri Lanka was investigated in this study. The influence of non-executive directors on profitability (assets-to-sales ratio and SG&A) was proposed in the conceptual framework.

H0c: A majority of non-executive directors on boards is not influence on profitability of companies listed in Sri Lanka. The results of this study show that a majority of non-executive directors was positively associated with financial performance based on the measure SG&A, meaning that majority of non-executive directors is associated with higher SG&A and thus higher agency costs in companies in which the result is statistically significant at 5% level. Therefore, the null hypothesis was rejected. The above results suggest that outside directors have significant positive impact on financial performance in Sri Lankan companies.

4.10.4 Women on Boards and Financial Performance

Gender diversity has been believed to have significant influence on organizational profitability in several ways. Gender diversity in the board room has been paid more attention in recent past, and the relationship between women on boards and profitability was investigated in this sections.

H0d: Higher proportion of women on boards is not influence on profitability of companies listed in Sri Lanka. The results of this study shows that proportion of women on board is positively associated with financial performance based on the measures SG&A which is statistically significant. Therefore, the null hypothesis was rejected. The above results suggest that majority of women on boards has significant impact on financial performance in Sri Lankan companies.

4.10.5 Presence of Interlocking Directorship and Financial Performance

Presence of interlocking directorship is another corporate governance mechanisms investigated in this study. The relationship between presence of interlocking directors and shareholder wealth was examined in this sections.

H0e: Higher presence of interlocking directorship is not influence on financial performance of companies listed in Sri Lanka. The results of this study show that presence of interlocking directorship does not influence on profitability of listed companies in Sri Lanka, based on measures assets-to-sales ratio and SG&A. Therefore, the null hypothesis was not rejected.

Chapter Five

Conclusion

5.1 Summary of the Study

This study investigated the moderating effect of corporate governance (CG)

gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka. The companies listed in CSE are required to adopt code of best practices of corporate governance to enhance financial performance. The existing corporate governance practices are not up to the standard (Dissabandara, 2012). It is thus important to examine the relationship between corporate governance mechanisms and financial performance of companies listed in Sri Lanka. This section provides brief description of purpose of the study, research objectives, key methodological concern, and summary of the key findings.

The purpose of the research was to explore the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka resulting in resolving agency problem between managers and shareholders through adopting the corporate governance best practices by companies listed in Sri Lanka. The relationship between board structure (board size, separate leadership structure, non-executive directors on board, women on board, and presence of interlocking directorship on board) and financial performance of companies listed in Sri Lanka was investigated. The sample of the study consists of all companies listed in CSE exclusive of bank & financial institutions which are practicing unique governance practices issued by CBSL. There is non-finance companies removed from the sample due to unavailability of data. The final sample consists of 183 listed companies in this study.

5.2 Key Findings

The summary of results of the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial

performance of listed companies in Sri Lanka are presented in this section based on the objectives of this study.

- The average board size of listed companies in Sri Lanka is consisted of 8 directors which are considered as optimum number of directors on boards (Jensen, 1993). The minimum and maximum size of board are 2 & 15 directors respectively. The range is closer to the recommendation of the European and US codes for ideal board size between 5 and 15 directors on board. The results of the multiple regression analysis shows that the board size does not influence on financial performance of listed companies in Sri Lanka.
- Separate leadership structure reports that 96% of the companies listed in Sri Lanka separated the position of CEO and Chairman of the board which are complying with the code of best practices (Section 1, Principal A.2). Results in relation to the separate leadership structure and financial performance were statistically significant and positively influence on profit based on measures assets- to-sales ratio.
- The average proportion of the non-executive directors on boards was 37% which is complying with the recommendation of code of best practices presented in Section 1, Principal A.5. The results of the relationship between proportion of non-executive directors and financial performance were statistically significant and positively influence based on measures SG&A.
- The average proportion of female directors on board in listed companies in Sri Lanka was 6.5% which is less than the gender balances of at least 35% women participation on the total number of directors on board proposed by Kanter (1977). Results regarding the relationship between the proportion of female directors on board and financial performance were significant and positively influence based

on measures SG&A.

- The presence of interlocking directorship on board does not influence on profitability of companies listed in Sri Lanka. This implies that majority of the directors were having cross-directorship with other company and not having enough time to concentrate on companies affairs due to the busyness concern. It is reported that 63% of the directors on board are having cross-directorship with other companies. The code of best practice on corporate governance 2013 does not include guidelines regarding the interlocking directorship rather than enhancing the disclosure requirements for the listed companies in Sri Lanka.

5.3 Implications of the Study

In the existing corporate governance practices in Sri Lanka, investors are having lack of confidence on the existence of the link between standard practice of corporate governance and corporate performance due to the influence of majority of shareholders in companies' affairs. This raises serious concern on the effectiveness of the board structure and its impact on organizational financial performance. The findings of this research show that the existing corporate governance practices such as board structure increases agency costs and does not impact on profitability of companies in Sri Lanka. As a result, this research has significant implications for the listed companies in Sri Lanka, investors (existing & future), policy makers, government, stakeholders, and South Asian countries who are having similar corporate governance practices in their companies. Since the investors are having lack of confidence on companies' affairs, the findings of this research will also discourage them to divert their investment into other sources of investment. It is necessary to build the confidence of the investors through reforming the corporate

governance practices to reduce agency costs and maximize organizational profitability of companies. The purpose of implementing corporate governance best practices as mandatory to listed companies in Sri Lanka was to enhance financial performance. The results of this study shows that corporate governance practices are not effective in Sri Lankan companies which provides insights to the policy makers for their future decision.

5.4 Limitation of the Study

The study focuses on the moderating effect of corporate governance (CG) gender diversity on the relationship of CG attributes and financial performance of listed companies in Sri Lanka. The variables selected for board structure was board size, separate leadership structure, non-executive directors on board, women on board, and presence of interlocking directorship and its influence on agency costs and shareholder wealth. This study was not covered all the code of best practices issued by ICASL & SEC, due to time constraint, such as ownership structure, sustainability reporting, directors' remuneration, accountability and audit committee.

This study conducted on companies listed in CSE in Sri Lanka. This study cannot be generalized to include non-listed companies or private companies who are not following the code of best practices on corporate governance which was issued to the publicly listed companies. Furthermore, the study also excluded bank & financial institutions due to their unique ownership and governance structure.

This study was only considered the proportion of female directors on board. The research was not addressed the quality of the female representation on board such as education level, years of experience, and age.

Regarding to the interlocking directorship,

the study focuses on presence of interlocking directors on board rather number of interlocking directorship due to the unavailability of the data in CSE annual report even the listing rule urge the companies to disclose relevant information.

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