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RESEARCH ARTICLE

Does CEO Duality affect the Firm Performance? Evidence from Sri Lanka

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Abstract

This article examines the impact of CEO duality on firm performance of listed non financial firms in Sri Lanka. This study uses the ROA as proxy measure for form performance. This study employs a cross sectional ordinary least square analysis of 128 firms listed in Colombo Stock Exchange (CSE) for the financial year ending 2013. The results show that CEO duality is significantly negatively associated with ROA. In the case of control variables, board size and leverage are significantly negatively associated with ROA on the other hand firm size is significantly positively linked with ROA. This paper contributes to the existing literature on corporate governance and firm performance by introducing a framework in identifying and analyzing variables that affect the relationship between CEO duality and firm performance.

Keywords: *Corporate governance, CEO duality, firm performance, ROA*

Introduction

Corporate leadership structure can be divided into combined leadership structure and separated leadership structure [1]. This has something to do with the position of the chairman of the board and CEO. Efficiency in monitoring management could be enhanced through CEO- chairman duality, where a single person assumes the position of chairman and CEO simultaneously because less contracting is needed and information asymmetry is reduced [2]. However, it was found that there is a negative relationship between CEO duality and corporate performance. The argument is that the CEO who is also a board chair will have a concentrated power base that will allow him or her to make decisions in their own-self interest and at the expense of shareholders. Jensen [3] maintained that the combined structure is an appropriate way to design one of the most critical power relationships in the firm.

CEO duality refers to the situation where the CEO also holds the position of the chairman of the particular company. The board of directors is set up to monitor managers such as the CEO on behalf of the shareholders. They design compensation contracts hire and fire CEOs. A dual CEO benefits the firms if he or she works closely with the board to create value.

CEO duality is an important issue in corporate governance because the status of CEO and chairman may have an influence on firm performance. There are arguments in favour of CEO duality, meaning CEO duality has a positive impact on the firm performance of an organization. Likewise, there are arguments against CEO duality asserting that it has negative impact on firm performance. Finally, there are also arguments that assert CEO duality has no influence on the performance of firm.

In the recent past years, hundreds of firms transformed from dual CEO leadership structure to non dual structure, while a smaller number of firms transformed in the opposite direction. This recent trend is partly due to several high profile cases where powerful dual CEOs were found to abuse their tremendous power at the expenses of the company and shareholders.

However, empirical evidence is scant and inconclusive on whether non dual as versus dual, CEO leadership structure is associated with better firm performance.

The aim of this study is to determine the relationship between the CEO duality and firm performance, using Sri Lankan corporate entities. This is to determine if the Sri Lankan situation is in line with global trend or if we can find a definite pattern of relationship between the CEO duality and firm performance for the Sri Lanka corporate world.

To achieve this purpose, the remainder of this paper is organized as follows: Section 2 theatrical background and hypothesis development. Section 3 presents the methodology and the sample data of the study. Section 4 presents the data analysis and discussion while Section 5 concludes this paper.

Literature Review and Hypotheses Development

According to Belkhir [4], it is considered that separating the titles of Chairman and CEO will decrease agency costs and will get better firm performance. The explanation is given by the fact that when the CEO is also chairman of the board, the power within the firm is concerted in one person's hands. This situation allows the CEO to control information available to other board members.

Agency problems tend to be higher when the same person holds both positions. Yermack [5] argue that, firms are more valuable when the CEO and board chair positions are separate. One of the important monitoring systems supported by the agency perspective is the separation of the roles of CEO from that of a chairman in a firm. When the chairman of a board also plays the role of the CEO, there is every likely hood that this may result in what is called role conflict in that particular firm. In contrast, an independent chairman is believed to effectively and efficiently monitor and control CEO and other management activities to maximize the shareholders' wealth.

Agency theorists argue that chairman and CEO should be separated, as this has the potential to increase the effectiveness of board monitoring [6]. Relating CEO duality more specifically to firm performance, researchers however found mixed evidence.

Yermack [5] highlighted that firm performance was higher when the CEO's and the chairman's positions are held by two different people. In addition, Fosberg and Nelson [7] found that the firm with separated roles between the CEO and the chairman yield a significant development in firm performance. In a study involving 348 Australia public listed firms, Kiel and Nicholson [8] reported a negative relationship between CEO duality and Tobin's Q after controlling for firm size. In similar view, Fooladi [9] concluded that CEO duality has inverse association with firm performance (ROE and ROA). On the other hand, stewardship theorists counter argue that CEO duality positively influence firm performance. The managers are inherently trustworthy and are good stewards of company resources [10]. Dehaene et al. [11] found that when both roles were combined, there was a positive relationship between duality and firm performance. Also, Brickley et al. [12] argued that separating the titles will reduce agency costs in corporations and will improve performance. Bhagat and Bolton [13] stated that the separation between the CEO and the chairman of the company is positively correlated and statistically significant with the current and future operational performance. However, Daily and Dalton [14] found that there was no relationship between CEO duality and firm performance. Furthermore, some other studies also concluded that there was no significant association between CEO duality and firm performance [15]. Therefore, the hypothesis can be formulated as follows:
H1: There is negative relationship between CEO duality and firm performance.

Methodology

Data and Sample

The sample comprises the Colombo Stock Exchange (CSE) non financial listed companies whose annual reports are available in 2013. The total number of listed firms for year ending 2013 is 293 firms and final sample size is 128 firms. The data use in the form of secondary data. The data and information for this study collected from the Colombo Stock Exchange (CSE) websites, annual reports, journals and CSE publications.

Research Model

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

Firm Performance = $\alpha + \beta_1$ CEO Duality + β_2 Board Size + β_3 Firm Size + β_4 Leverage + ei

Variables and Descriptions

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

Dependent Variables

Return on Asset = Net Income / Total Assets

Independent Variables

CEO Duality = which is equal to be one (1) if the CEO and Chairman are held by the same person, otherwise zero (0).

Control Variables

Board Size = Number of directors on the board
Firm size = Natural log of total assets reported on annual report
Leverage = Total debt / total equity

Data Analysis and Discussion

Descriptive statistics were carried out to obtain sample characteristics. Table 1 presents the summary statistics of all the variables used in the analysis. The table reports the mean, median, standard deviation, coefficient of variation, and the number of observations.

Descriptive statistics indicate that the majority of firms in the sample separate the position of the board chairman and CEO, thus about 86% of the firm practice dual leadership and balance 14% of the firm have their CEO and chairman positions combined in one personality.

Table 1: Descriptive statistics

	ROA	CEODUAL	BOARDSIZ	FIRMSIZE	LEVERAGE
Mean	0.058	0.141	7.898	9.666	0.373
Median	0.056	0.000	8.000	9.653	0.175
Maximum	0.544	1.000	12.000	11.202	7.371
Minimum	-0.793	0.000	3.000	8.056	0.000
Std. Dev.	0.118	0.349	1.964	0.638	0.746
Skewness	-2.176	2.068	0.124	-0.017	6.829
Kurtosis	25.768	5.275	2.725	2.919	62.132
Jarque-Bera	2865.777	118.792	0.729	0.041	19643.390
Probability	0.000	0.000	0.695	0.980	0.000
Sum	7.435	18.000	1011.000	1237.257	47.778
Sum Sq. Dev.	1.764	15.469	489.680	51.768	70.68533
Observations	128	128	128	128	128

This suggests that the way for agency problems originating from conflict of interest are minimized. The number of directors on board is between 3 and 12 persons with an average board size is about 8 persons. This result is reliable with the study by Lipton and Lorsch [16], Zubaidah et al. [15], and Fooladi [9].Table 2 presents the correlation matrix for all explanatory variables used in this study.

Table 2: Correlation matrix

	ROA	CEODUAL	BOARDSIZ	FIRMSIZE	LEVERAGE
ROA	1				
CEODUAL	-0.163*	1			
BOARDSIZ	-0.083	-0.082	1		
FIRMSIZE	0.233***	0.023	0.290***	1	
LEVERAGE	-0.099	-0.005	0.038	0.195**	1

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

CEO duality is significantly negatively correlated with firm performances (ROA) of selected firms at 10% level. Board size and leverage are negatively correlated with ROA but not significant. Furthermore, Firm size is significantly positively correlated with ROA at 1% level. Table 3 presents the regression results of the variables used in this study.

Table 3: Regression results

Dependent Variable: ROA				
Included observations: 128				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.408787	0.151977	-2.68981	0.0081
CEODUAL	-0.063096	0.02844	-2.21856**	0.0284
BOARDSIZ	-0.011145	0.005282	-2.11013**	0.0369
FIRMSIZE	0.059274	0.016499	3.592591***	0.0005
LEVERAGE	-0.024568	0.013505	-1.81921*	0.0713
R-squared	0.135957			
Adjusted R-squared	0.107859			
F-statistic	4.838525			

The main objective of this paper is to explore the relationship between CEO duality and the firm's performance (ROA), on a sample of Sri Lankan companies listed on Colombo Stock Exchange. Regression results show that there is strong negative relationship between CEO duality and firm performance, measured by the ROA. These findings are consistent with the results of Yermack [5], and Fosberg and Nelson [7]. Yermack [5] argues that, firms are more valuable when the CEO and the chairman positions are separated. Hence Hypothesis 1 is supported with the regression results in relation to ROA and accepted. In keeping with the literature, the study includes control variables in the regression analysis. Table 3 shows that board size and leverage are significantly negatively associated with ROA. In contrast, firm size is significantly positively linked with ROA.

Conclusion

The purpose of the study was to investigate the relationship between CEO duality and the performance of Sri Lankan listed companies in 2013. The theoretical and empirical literature on corporate governance presents two alternative perspectives. The agency perspective argues that the division of the two roles is an important determinant of a board's independence and effectiveness. On the other hand, the stewardship theory postulates that firms with a combined leadership structure operate more efficiently through better coordination and unambiguous command. The leadership structure of the majority of Sri Lankan listed companies is characterized by a separation of the roles of CEO and chairperson.

This study uses the ROA as a proxy measure for firm performance. The findings of the study show that CEO duality is significantly negatively associated with ROA. In the case of control variables, board size and leverage are significantly negatively associated with ROA but firm size is significantly positively linked with ROA.

However, these results must be interpreted with limitation for several reasons. First, the study was based on the cross sectional study which is only concerned about one year period. Hence, this raised the problem of generalization of the result. Second, this study used only ROA as a performance measure. Other performance measures such as ROE.ROCE and MTBV could have been employed to make the results generalize able. Thirdly, only a limited number of variables are addressed in this current study, which limits the generalizability of the findings. It is highly recommended that future research may extend the analysis to include panel data so that the association between variables can be interpreted in a more meaningful way.

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