Corporate Governance and Earnings per Shares: A Study of Sri Lankan Manufacturing Companies

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Abstract

Good corporate governance practices are important in reducing risk for investors, attracting investment capital and improving the performance of companies. This study is initiated on "corporate governance and firm performance" with the samples of 26 listed manufacturing companies in CSE. Data was analyzed using the data representing the periods from 2009 to 2014. Board size, board meeting, executive directors, non-executive directors were used as the determinants of corporate governance whereas earnings per share (EPS) is used as a measure of firm performance. Hypotheses were tested using SPSS statistical software. According to the finding of the research corporate governance make a significant influence on companies EPS. Thus, study concludes that the determinants of corporate governance used in the study are correlated to the performance measures of the organization.

Introduction

Corporate governance has become a popular discussion theme in developed and developing countries. The widely held view that corporate governance determines firm performance and protects the interests of shareholders has led to increasing global attention.

A Corporate governance system is comprised of a wide range of practice and institutions, from accounting standards and laws concerning financial disclosure, to executive compensation, to size and composition of corporate boards. A Corporate governance system defines who owns the firm and dictates the rules by which economic returns are distributed among shareholders, employees, managers and other shareholders. In its broadest sense, corporate governance refers to a complimentary set of legal, economic and social institutions that protects the interests of a corporation's owner.

Corporate governance is about putting in place the structure processes and mechanism that ensure that the firm is being directed and managed in a way that enhances long term shareholder value through accountability of managers and enhancing organizational performance (Velnampy, 2013) Good corporate governance practices are important in reducing risk for investors, attracting investment capital and improving the performance of companies (Velnampy & Pratheeplcanth, 2012)

The main focus of this study is to examine the relationship between corporate governance and earnings per share of listed manufacturing companies in Sri Lanka. Therefore we attempt to identify the relationship between corporate governance and earnings per share in our population.

This paper is organized as follows. The next section provides literature review and then describes the methodology used. Then present the analysis and interpretation. Finally the last section concludes the results and concludes the discussion.

Objectives of the Study

The following objectives are taken for the study.

1. To identify the relationship between corporate governance and earnings per share.
2. To identify corporate governance practices as a significant determinants of EPS.

Review of Literature

Corporate governance practices are seen to have great impact to maximization of stakeholder wealth and to the growth prospects of an economy. Then corporate governance tells "ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors" (Mayer, 1997). Corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability (Deakin and Hughes, 1997). It has also been defined by Keasey et al. (1997) to include 'the structures, processes, cultures and systems that engender the successful operation of organizations.

The limiting board size improves firm performance because the benefits by larger boards of increased monitoring are outweighed by the poorer communication and decision-making of larger groups. One of the most consistent empirical relationships about board of directors is that board size is negatively related

to firm performance (Hermalin and Weisbach, 2003). As well as Yermack also exhibited that companies with small boards have more favorable values for financial ratios. Similarly Eisenberg, Sundgren and Wells (1998) concluded the negative relationship between firm board size and performance measured by return on assets (ROA) for a sample of 879 small private firms in Finland. There are various arguments regarding board sizes. Lipton and Lorsch (1992) stated "When a board has more than ten members it becomes more difficult for them all to express their ideas and opinions." and add that the U.S. corporate boards are overcrowded which causes shareholders to lose money, employees to lose their jobs and the corporation to lose its competitive market position. The disadvantages of large boards lean on the idea that tasks like communication, coordination and decision making is much harder and costlier among large group of people than in smaller groups. Hermalin and Weisbach (2003) argued the possibility that larger boards can be less effective than small boards.

There have been differences in findings related to the dominance of outside directors on performance when different measures of firm performance have been utilized in academic research. Generally effective corporate governance enhances firm performance, some studies have reported negative relationship between corporate governance and firm performance (Hutchinson, 2002). Some other studies have not found any relationship (Park and Shin, 2003). Several explanations have been given to account for these apparent inconsistencies. Some have argued that the problem lies in the use of either publicly available data or survey data as these sources are generally restricted in scope. It has also been pointed out that the nature of performance measures(i.e. restrictive use of accounting based measures such as return on assets, return on equity...) or restrictive use of market based measures (such as market value of equities) could also contribute to this in cons

Code of Corporate Governance (2002) in Pakistan suggest to board of directors that they should meet regularly after notifying the issues to be discussed. Board of directors should conduct a meeting after each quarter. In the US, yearly six meetings are considered to be a good balance in most of corporation and include some special meetings. Dar et al. (2011) found that, frequencies of board meetings have positive relationship with performance. But these meetings have no significant relationship. Ward (1991) found that, board should conduct meetings four times in a year and also accompanying monthly meetings of various board committees attended by directors, CEO, and chairman. However, Vafeas (1999) concluded that, number of board meetings in a year is negatively related to performance. Boards that conduct higher board meetings in a year are usually linked with poor performance. A handsome cost is linked with board meetings;

it includes travel expenses, meeting fees and managerial time etc. As well as Jensen (1993) found that, the board meetings are not useful because directors spend very little time together and in this time there is no meaningful exchange of ideas with management and among themselves.

Methodology

Population and Sampling

The official list of companies in the Colombo stock exchange (CSE) contained 297 companies have been categorized under 20 different sectors according to the core business activities of the company at the end of the year 2014. The objective of this study was to conduct an investigation of corporate governance practices of listed manufacturing companies in Sri Lanka and their effect on the earnings per share. Out of 40 manufacturing companies, 26 companies were selected for the present study and data gathered from 2010 to 2014 (See annexes 1 for the selected companies). The other 14 companies were not coincided since some of them are listed only after 2010 and the unavailability of required information.

Data Collection

The secondary data were collected from Annual reports of the companies. The data representing manufacturing companies in the CSE at 2014 were extracted from the company's Annual reports for the analysis from year 2010 to 2014.

Method of data analysis

For the purpose of empirical analysis, this study uses descriptive analysis, correlation and multiple regression analysis as the underling the statistical test. A descriptive analysis of the data is conducted to obtain sample characteristics. The multiple regression analysis is performing on the dependent variable, EPS to test the relationship between the independent variables with earnings per share. The regression models utilized to test the impacts of corporate governance such as board meeting (BM), board committee (BC) including executive directors (ED), non-executive directors (NED), and board size (BOSZ) on earnings per share (EPS) are as follows.

Conceptual Frame work

The following conceptual model was formulated through the extensive literature.
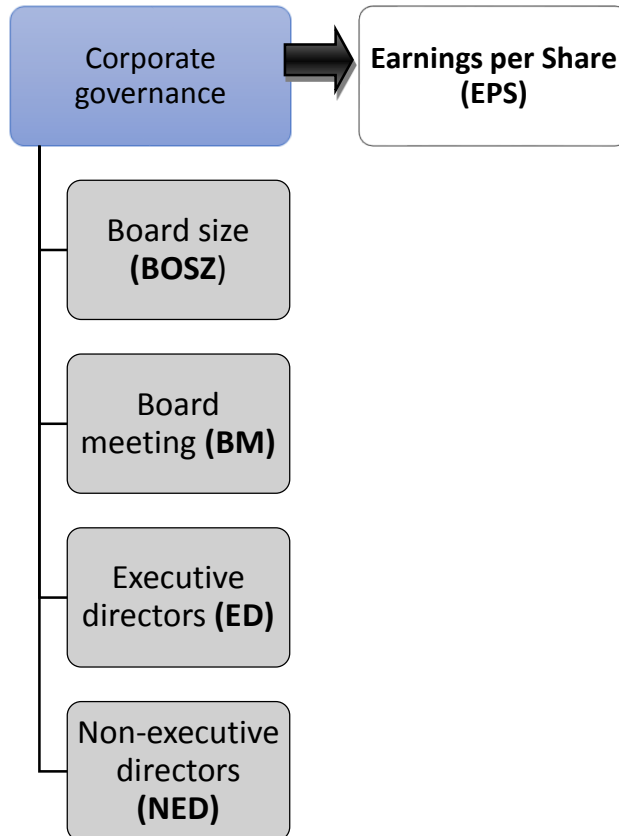
In order to measure the above relationship as in conceptual frame work, the following hypotheses are formulated in the study.

Hypotheses

To test the main objective of the research which is to identify the impact of corporate governance on earnings per share following hypotheses is formulated;

H1 = There is a significant impact from corporate governance on EPS

The Regression model

Regression model is developed using Earning per Share (EPS) as dependent variable. Also the model utilized board size, board meeting, executive directors

and non-executive directors as the determinants of corporate governance practices. Thus, Researchers could develop the regression models as follows;

$$EPS = \beta_0 \, Bosz + \beta_1 \, Bm + \beta_2 \, Ed + \beta_3 \, Ned + \varepsilon_i$$

Where;

ROE = return on equity	BOSZ = board size
ROA =return on assets	BM = board meeting
EPS = earnings per share	ED = executive directors
β_0 = constant term	NED=non- exe. Directors

Analysis and Interpretation

Researchers used descriptive statistics, correlation analysis and regression analysis to analyze data of this study. SPSS statistical software was used to analyze data. Analysis of these tests is presented in following tables.

Relationship between corporate governance and Earnings Per Share

The Purpose of Pearson correlation analysis (annex 02) is to identify the relationship between the dependent variable and the selected independent variables. This research considered firm performance measured by EPS as the dependent variable and four corporate governance measurement and independent variables such as Board size, Board meeting, Executive directors and Non – Executive directors.

There is a negative relationship between EPS and Board size (-.156). And we can see a weak relationship between EPS and Board meeting (.129), EPS and Executive directors (.031). There is a negative relationship between EPS and Non – Executive directors.

Determinants of EPS

Table 01 Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.466[a]	.217	.186	6.56932
a. Predictors: (Constant), Non - Exe. Directors, Executive Directors, Board Meeting, Board size				

The "**R**" column represents the value of "R", the *multiple correlation coefficients.* "R" can be considered to be one measure of the quality of the prediction of the dependent variable; in this case. According to the above table, approximately 47% of strength between the variables of the study exists. Meaning that an average level of strength is observed in the model. The "**R Square**" column represents the "R^2" value (also called the coefficient of determination), which is the proportion of variance in the dependent variable that can be explained by the independent variables. We can see from our value of 0.217 that our independent variables explain 21.7% of the variability of our dependent variable.

Table 02

Anova						
Model		Sumof Squares	Df	Mean Square	F	Sig.
1	Regression	1185.885	4	296.471	6.870	.000[b]
	Residual	4272.439	99	43.156		
	Total	5458.325	103			
a. Dependent Variable: Earnings Per Share						
b. Predictors: (Constant), Non - Exe. Directors, Executive Directors, Board Meeting, Board size						

According to the above table it is observed that the overall model is significant under 5% level of significance.

Table 03

Coefficients						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	17.492	3.387		5.164	.000
	Board size	1.562	.584	.377	2.676	.009
	Board Meeting	-.271	.302	-.082	-.896	.373
	Executive Directors	-3.060	1.006	-.333	-3.041	.003
	Non - Exe. Directors	-2.757	.600	-.651	-4.598	.000
a. Dependent Variable: Earnings Per Share						

In the above table there are three variables (BS, ED, NED) become significant. Since, P<0.05. There are three variables which influence the dependent variable (EPS). So we can conclude, Board Size (0.009), Executive Directors (0.003) and

Non- Executive Directors (0.000) are significant variable in determining Earning per Share.

As per the findings regression model can be developed as follows,
$$EPS = 17.492 + 1.562BS - 0.271BM - 3.060ED - 2.757NED$$

Conclusion

This study investigated the impact of corporate governance on Earnings per share of listed manufacturing companies at Colombo Stock Exchange. Findings of this research is robust as the corporate governance measures has a significant relationship with the EPS of the manufacturing companies. Further, the findings provide evidence to accept corporate governance has a significant impact on EPS. Accordingly we can suggest that corporate governance practices should be reviewed and monitored in Sri Lankan listed manufacturing companies in order to provide a better earning to the investors on shares.

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Annexure 01

Selected Listed manufacturing Companies

1. Sierra Cables Plc
2. Abans Electricals Plc
3. Regnis(Lanka) Plc
4. Ceylon Grain Elevators Plc
5. Blue Diamonds Jewellery Worldwide Plc
6. Chevron Lubricants Lanka Plc
7. Lanka Walltiles Plc
8. Printcare Plc
9. Acme Printing & Packaging Plc
10. Swisstek (Ceylon) Plc
11. Singer Industries (Ceylon) Plc
12. Tokyo Cement Company (Lanka) Plc
13. Dipped Products Plc
14. Acl Cables Plc
15. Kelani Tyres Plc
16. Lanka Tiles Plc
17. Bogala Graphite Lanka Plc
18. Royal Ceramics Lanka Plc
19. Lanka Aluminium Industries Plc
20. Hayleys Fibre Plc
21. Swadeshi Industrial Works Plc
22. Lanka Ceramic Plc
23. Piramal Glass Ceylon Plc
24. Samson International Plc
25. Richard Pieris Exports Plc
26. Kelani Cables Plc

Annexure 02
Correlations

		Board size	Board Meeting	Executive Directors	Non - Exe. Directors	Return On Equity	Return On Assets	Earnings Per Share
Board size	Pearson Correlation	1						
	Sig. (2-tailed)							
	N	104						
Board Meeting	Pearson Correlation	-.005	1					
	Sig. (2-tailed)	.963						
	N	104	104					
Executive Directors	Pearson Correlation	.438**	-.203*	1				
	Sig. (2-tailed)	.000	.038					
	N	104	104	104				
Non - Exe. Directors	Pearson Correlation	.649**	.167	-.399**	1			
	Sig. (2-tailed)	.000	.089	.000				
	N	104	104	104	104			
Return On Equity	Pearson Correlation	.013	-.146	.028	-.011	1		
	Sig. (2-tailed)	.899	.141	.780	.915			
	N	104	104	104	104	104		
Return On Assets	Pearson Correlation	-.072	-.076	-.099	.011	.894**	1	
	Sig. (2-tailed)	.470	.446	.315	.911	.000		
	N	104	104	104	104	104	104	
Earnings Per Share	Pearson Correlation	-.156	.129	.031	-.185	.147	.015	1
	Sig. (2-tailed)	.115	.192	.755	.060	.135	.880	
	N	104	104	104	104	104	104	104

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