РАЗДЕЛ 3 КОРПОРАТИВНОЕ УПРАВЛЕНИЕ В АЗИИ

SECTION 3 CORPORATE GOVERNANCE IN ASIA

DOES CEO DUALITY IS REALLY MATTER? EVIDENCE FROM AN EMERGING MARKET

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Abstract

The relationship between board leadership, firm financial performance and agency costs is examined on behalf of a sample of multinational company subsidiaries (MNCs) and local public companies (LPCs) in Sri Lanka. Five years of data for 86 MNC subsidiaries and 113 LPCs, are collected and observations are analysed using a dynamic panel GMM estimation. This study provides empirical support for stewardship theory and contingency theory when firms are multinational subsidiaries. Moreover, findings support agency theory when firms are local public companies. Finally, this study indicates that there is no optimal board leadership structure. Hence, when companies commence their exploration of corporate governance practices, firms need to recognised that firm characteristics and contingency perspective boost the impact of board leadership structure on corporate financial performance.

Keywords: CEO, emerging market, corporate governance, stewardship theory

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1. Introduction

This paper investigates the linkage between board leadership, firm financial performance and agency costs in MNC subsidiaries and LPCs in Sri Lanka. Since the twenty first century, hundreds of companies converted from a non-CEO duality structure, while few companies converted to CEO duality (Wei-Chen, Lin and Yi, 2008). With the outbreak of large US corporate scandals, CEO duality received more concentration, due to powerful CEOs abusing their terrific power at the expropriation of the company assets and shareholders. According to Faleye (2007) the number of US shareholders calling for non-duality roles increased continuously from 3 in 2001 to 32 in 2004. Further, states that the proportion of firms switching from non-duality increased from 55% in 1999 to approximately 70 percent in 2003. Overall, 84% of European companies separated CEO and chairman roles. In Australia, Germany, Netherland, Sweden and UK, the role is always distinguished ("Boards in Turbulent Times", 2009). The Sri Lankan code of best practice on corporate governance (2008), second principle, emphasises the importance of balance of power and authority in a company, so that no individual has unfettered powers of decision. Further, that code mentions that if there is CEO duality in a company, non-executive directors should comprise the majority of the board to provide board balance.

Though board leadership, firm financial performance and agency costs are highly debated in literature, mixed empirical evidence leads to inconclusive findings. Findings from prior empirical studies either be support agency theory or stewardship theory, which are directly at odds with each other. Later, some findings provide evidence of a contingency perspective, to specify the nature of resource scarcity and environmental dynamism under which CEO duality may be especially advantageous. Consequently, most of the early studies used ordinary least square (OLS) estimation to evaluate the relationship between CEO duality and financial performance of a company. However, if the ownership structure in terms of CEO duality is in fact endogenously determined, OLS estimates are biased and inconsistent. This may be one reason most of the early studies fail to control potential selection bias and results in inconclusive findings.

This paper makes a number of contributions to corporate governance firm financial performance and agency costs in several ways. First, this paper contributes to the literature by examining the CEO duality, firm financial performance and agency costs. Second, this is one of the pioneer studies that empirically explore CEO duality, firm financial performance and agency costs in emerging market MNC subsidiaries and emerging market operating LPCs. Thirdly, this paper undertakes the first direct study of impact on board leadership, firms financial performance and agency costs, based on the Sri Lankan environment. Finally, the econometric analysis is more robust than prior research, due to the use of GMM dynamic panel technique to control the endogeneity effect of corporate governance variables, firm characteristics and their impact on firm financial performance and agency conflicts.

The next section of the paper reviews prior literature and developed hypotheses and is followed by discussion of the data, variable, method and procedures used for this empirical study. Findings and implications then follow.

2. Literature review

There are two different theories on board leadership structure. Based on agency theory, Fama and Jensen (1983) suggest that the CEO duality hinders board ability to monitor management and therefore increase the agency problem. As a result, CEO duality increases management entrenchment and reduces board independence (Finkelstine and D' Aveni, 1994; Rhoades, Rechner and Sundaramurthy, 2001). Conversely, stewardship theory argues that managers are inherently good stewards of company resources (Donaldson and Davis, 1991). They explain that CEO duality creates strong leadership and a clear sense of strategic decision. Splitting roles may create high communication costs and decision making processes can be less effective and less efficient when there are two leaders.

However, empirical evidence about the relationship between CEO duality and company financial performance is mixed and inconclusive. The empirical evidence shows there is no optimal board leadership structure, and company models depend on their own organisational characteristics and business environment (Finkelstine and D' Aveni, 1994; Rhoades et al., 2001). In recent studies, Dahya and Travlos (2000) find a positive relationship between CEO duality and company financial performance. Further, Dahya (2005) explains that two leaders do not improve firm financial performance in UK companies. Faleye (2007) shows CEO duality is positively related with organisation complexity, CEO reputation and managerial ownership. This finding is in line with Peng, Zhang and Li (2007) and their findings of CEO duality show strong support for stewardship theory rather than agency theory. Using Hong Kong market data, Lam and Lee (2008) argue neither agency theory nor stewardship theory can effectively explain the duality-performance relationship. They find CEO duality is perfect for small family businesses in Hong Kong and larger businesses need to split the two leadership roles.

Additional studies detect a negative relationship with CEO duality and firm financial performance (Donaldson and Davis, 1991; Brickley et al., 1997; Cole et al., 2001). Pi and Timme (1993) find a negative relationship with CEO duality and firm accounting financial performance when measured in the banking industry. Westphal and Zajac (1994) argue that a CEO duality firm has greater stature and political influence over board members. From a cultural perspective, this duality leadership structure embodies greater power distance. However, some studies do not detect any significant relationship between board leadership role and financial performance (Baliga, Moyer and Rao, 1996; Daily and Dolton, 1997). Consequently, most of the early studies used ordinary least square (OLS) estimations to evaluate the relationship between CEO duality and financial performance of a company. OLS estimates are biased and inconsistent. Therefore, most of the early studies fail to control potential selection bias. Wei-Chen, Lin and Yi (2008) control this potential bias and use the Heckman two-step procedure and a fixed effect model to control for unobservable factors. However, their study does not show any significant relationship between firm financial performance and CEO duality.

Boyd (1995) developed a contingency model to explain sign and magnitude of the CEO duality-firm performance relationship vary systematically across the environmental conditions of dynamism

and complexity. Further, Elsyed (2007) explains CEO-duality and financial performance relationship differ across industries. Ramdani and Witteloostuijn (2010) study the CEO duality and company financial performance relationship in Indonesia, South Korea, Malaysia and Thailand, using quantile regression. Supporting stewardship theory, they find a positive relationship between the financial performance of low performance companies' and CEO duality and a negative relationship between the financial performance of high performance companies' financial performance and CEO duality. Similar to above findings, Finkelstine and D' Aveni (1994) explain that when the company shows low performance and CEO power is informal then CEO duality is ideal. On the other hand, board vigilance is negatively associated when CEO power is informal and company performance is high. Further, based on contingency theory, Faleye (2004) explains that when companies operate in a complex environment, strong CEO reputation, higher managerial ownership and small board size are more likely to have a dual role CEO. Recent studies by Aguilera et al (2008) explain CEO duality and firm financial performance is related to the institutional environments. In the Australian context, Kiel and Nicholson (2003) posit non-CEO duality is common in larger firms with larger boards, whereas CEO duality exists in smaller companies. Therefore, company size and environment has a huge impact on the structure of CEO duality in Australia.

Sri Lankan companies' ownership is highly concentrated and more than 64% of listed firms are family businesses (Masulis, Pham and Zein, 2009). Therefore CEO duality is common. However, Claessens et al (1999) explain that a dominant and large shareholder with CEO duality is increases managerial opportunism and expropriation of minority shareholders in family firms. Therefore, the presence of CEO duality can adversely affect Sri Lankan LPCs financial performance and corporate governance practices. That is despite the new mandatory code of best practice on corporate governance (2008) supporting the creation of independent boards with separate leadership positions. On the other hand, Zahra (2003) finds a positive relationship between CEO duality and international sales volume of family firms. This may be stewards who hold the dual leadership concurrently have higher performance. Testable hypothesis regarding the LPCs CEO duality, firm financial performance and agency costs is:

H_1: There is no significant relationship between LPCs, CEO duality and their financial performance, and agency costs.

The role and importance of MNCs are now established as part of the global economy. This form of businesses has become more common place with the practice of globalisation. While MNC headquarters are mainly based in developed countries their resources, key markets and productive facilities are often domiciled in emerging markets. As a result of increasing the number of multinational companies and their subsidiaries activities, MNC parent-agent relationship is also critical to firm success and minimise agency costs. However, there is limited research on the MNC subsidiaries corporate governance mechanisms (Kiel et al., 2006).

Different empirical studies based on contingency theory, argue that CEO duality needs to focus on environmental and temporal considerations (Brockman et al, 2004). Environmental dynamism is a major manifestation of MNC subsidiaries face, especially when operates in emerging markets. Moreover, the organisational complexity of MNC subsidiaries also leads to conclude that duality board leadership is more advantageous in MNC subsidiaries, because of the complex and dynamism environment. CEO duality avoids conflicts among stakeholders and facilitates more timely and effective decision making.

Therefore, splitting two leadership roles may potentially introduce conflicts among the CEO and chairman which may delay decision making. Moreover, unlike family businesses, foreign subsidiaries with their own board of directors are generally not wholly owned by the CEO. Therefore, duality does not entrench on MNC subsidiaries like family businesses do. On the other hand, in a MNC subsidiaries complex environment, it is difficult for one person to handle two leadership responsibilities. Therefore, splitting two roles is encouraged. Testable hypothesis regarding the MNC subsidiaries CEO duality, firm financial performance and agency costs is:

H_2: There is no significant relationship between MNC subsidiaries, CEO duality and their financial performance, and agency costs.

3. Sample Design and Measurement of Variables

This study collected the data from Handbook of Listed Companies-2008, Fact Book-2008 and Data library CD issued by Colombo Stock exchange (CSE). Further data for firms listed on the CSE during 2006-2010 that published audited annual reports is collected. For the LPCs and MNC subsidiary companies, the sampling period is 2006 through 2010. The final sample consists of 86 MNC subsidiaries and 113 LPCs exclusive of the financial sector firms on the CSE over the period 2006 through 2010.

The dependent variables in this study are firm financial performance proxy and agency costs proxy. Tobin's Q is used as a financial performance proxy in the studies about the

corporate governance and firm performance relationship in developing and developed financial markets (Agrawal and Knoeber, 1996; Claessens et al, 1997, Elsayed, 2007). In this research followed by McConnell and Servaes (1990) and McKnight and Weir (2008) Tobin's Q ratio is defined as market capitalisation plus total debt divided by total assets. In addition, following Ang, Cole and Lin (2000) the assets utilisation ratio (ASSETS) is used as agency proxy for this study. The assets utilisation is defined as a total sale is divided by total assets.

The main independent variable in this study is board leadership structure. A binary variable is used as a proxy for CEO duality. CEO is equal to 1 if CEO duality is present, otherwise it is set to equal to zero. There is a recent trend of increased number of firms that convert duality to a non-duality CEO structure. Therefore, CEO duality is expected to be negatively correlated with financial performance and positively affect with agency costs proxy in this study. The corporate governance variables include, insider ownership percentage (INSIDER), ownership type (OWNER) i.e. institutional or board ownership, board size (BOARD) and non-executive directors percentage (NONE) is also included in the model. In addition to the above, corporate governance variables firm size (SIZE) is measured by the natural logarithm of total assets, log of firm age (AGE) and firm leverage ratio (DEBT) is also included to ensure that the estimated model have no specification errors. Based on the industry type, the study divides all companies into seven major categories and uses an industry dummy (INDUSTRY) to capture industry-specific characteristics. Appendix 1 provides glossary of variable definitions.

Table 1 reveals a descriptive statistic of this study. The mean value of MNC subsidiaries Tobin's Q ratio is lower than LPCs Tobin's Q mean value. However, the mean value of MNCs assets utilisation (0. 962) is higher than the mean value of LPCs assets utilisation (0.771). Only 15% of MNC sample companies have CEO duality, and CEO duality variable value is approximately double when considering LPCs. In family owned Sri Lankan LPCs, they more likely to have CEO duality. More than 95% of the MNC sample has institutional ownership and 80% of LPCs also have institutional ownership. This is consistent with Lee (2010) who explains that, due to undeveloped equity market and weak investor protection, individual investors are reluctant to invest in emerging market with low levels of corporate governance reform. This may be one reason why institutional ownership is dominant in Sri Lanka.

Table1. Descriptive statistics

Variables	Observations MNC	Mean MNC	Std. deviation MNC	Observations LPC	Mean LPC	Std. deviation LPC
Tobin's Q (TOBIN'S Q)	424	0.9539069	0.4129902	546	1.003821	0.0943042
Assets utilisation (ASSETS)	424	0.9620755	0.8151745	548	.771517	.5873418
CEO duality (CEO)	430	0.155814	0.3631013	560	.2964286	.4570905
Board size (BOARD)	408	7.615196	1.976885	532	7.12594	1.906754
Insider ownership (INSIDE)	430	0.0659588	0.1484407	553	.0991110	.0014628
None-executive directors (NONE)	381	0.6135439	0.2552809	532	.6114741	.2822366
Ownership type (OWNER)	430	.9534884	.2108357	560	.8	.4003576
Firms size (LNSIZE)	424	14.15943	1.829995	548	14.01471	1.528535
Firm age (LNAGE)	430	3.507893	0.725386	565	3.133499	.629244
Leverage ratio (LNDEBT)	319	2.300421	2.173559	405	2.535112	1.682633

4. Method

Panel data covering six years of variable for 86 MNC subsidiary companies and 113 LPCs is initially prepared. One of the debated issues in recent research is whether board composition and leverage is determined endogenously. Wen et al (2002) support an endogenous board composition argument showing that board composition have a probability of endogenously determined, and some of control variables and firm financial performance can be determined simultaneously.

Durbin-Wu-Hausman (DWH) test is used as a diagnostic test for endogeneity of financial performance and agency costs structure proxies and other variables. The results of the DWH confirm an endogeneity effect for board composition variables. This finding confirms that OLS coefficient-estimates will be unreliable and biased. The result of the DWH test for endogenity suggests

that a dynamic panel GMM estimator is preferable. The GMM panel estimator was first introduced by Holtz-Eakin, Newey and Rosen (1988) and Arellano and Bond (1991). First-differencing, removes potential unobservable heterogeneity bias. First-differencing estimates are obtained via GMM using lagged values of the explanatory variables as instruments for the explanatory variables.

$$\Delta Y_{it} = \propto + k_p \sum_p \Delta Y_{it-p} + \beta \Delta X_{it} + \gamma \Delta Z_{it} + \Delta \varepsilon_{it} \quad p > 0 \qquad (1)$$

An important aspect of the dynamic panel estimator is its use in the company's history as instruments for explanatory variables. If the exogeneity assumptions are valid, then the following orthogonality conditions are required:

$$E(X_{it-s}\varepsilon_{it}) = E(Z_{it-s}\varepsilon_{it}) = E(Y_{it-s}\varepsilon_{it}) = 0 \ \forall \ s > p \qquad (2)$$

Arellano and Bover (1995) and Blondell and Bond (1998) further develop the GMM estimator using first-differenced variables as instruments for the equations in a stacked system of equations which also includes the equations in both levels and differences. However, the equations in the stacks may include unobservable heterogeneity. To deal with this problem, it is assumed that the corporate governance and other control variables exhibit a constant correlation over time. This assumption leads to an additional set of orthogonality conditions.

$$E[\Delta X_{it-s}(n_i + \varepsilon_{it})] = E[\Delta Z_{it-s}(n_i + \varepsilon_{it})] = E[\Delta Y_{it-s}(n_i + \varepsilon_{it})] = 0 \quad \forall s > p \quad (3)$$

A GMM panel estimation using the orthogonal conditions (2) and (3) assumes there is no serial correlation in the error term,ε. Serial correlation order 1 and order 2 tests, a Hansan/Sargan overidentification test, and joint significance tests indicates the validity of this model specification.

5. Results

According to the Hemalin and Weisbach (2003) it is rational to consider that the board size is determined endogenously. Further, Drkos and Bekiris (2010) explain board composition, leadership structure and board size are strongly endogenous. Therefore, based on above literature and DWH test results (Table 2), endogeneity is confirmed in between corporate governance variables, financial performance proxy and agency costs proxy, in this study.

Table 2. The Durbin-Wu- Hausman test for endogeneity of regressors

H_0: Regressors are exogenous

Variable	TOBIN'S Q		ASSETS	
	MNCs	LPCs	MNCs	LPCs
CEO	5.10812**	6.92353**	8.06762***	4.34115*
BOARD	5.65087**	4.83837**	7.62734**	5.40243**
INSIDE	16.0587***	5.0527**	6.07671**	9.25049**
NONE	4.42349**	3.42761*	5.00135**	6.35914**
OWNER	.34753	1.10299	.545053	1.10151

A DWH diagnostic test suggests that dynamic panel GMM estimator concerning potential endogenity using lag instrumental variables may be more appropriate than OLS regression, to investigate relationship between CEO duality, firm financial performance and agency costs in MNCs and LPCs. Table 3 shows dynamic panel GMM estimator regressions of MNCs and LPCs financial performance. Table 3, column 2, presents regression results for MNCs and column 3 presents regression results for LPCs. Table 4 shows dynamic panel GMM estimator regressions of MNCs and LPCs agency costs. Table 4, column 2,

presents regression results for MNCs, and column 3 presents regression results for LPCs.

Table 3. Dynamic panel GMM estimator regressions of MNCs and LPCs financial performance

Variables	Dynamic-panel GMM MNCs	Dynamic-panel GMM LPCs
Number of observations[a]	217	285
Number of groups	84	107
L_1	.0272078	7.44e-07
	(.0245952)	(2.83e-06)
Corporate Governance variables		
CEO duality (CEO)	.0390701**	6.87e-07
	(.0184964)	(9.78e-07)
Board size (BOARD)	-.0072854 **	2.76e-07
	(.0030292)	(3.17e-07)
Insider ownership (INSIDE)	.8827401***	.99994 ***
	(.143651)	(.0003003)
None-executive directors (NONE)	.001471***	-4.83e-08**
	(.0004258)	(2.49e-08)
Ownership type (OWNER)	.2814552	4.74e-06***
	(.6691827)	(1.60e-06)
Control variables		
Firm size (LNSIZE)	-.042988*	7.59e-07
	(.0255066)	(5.68e-07)
Firm age (LNAGE)	.0184118	-1.21e-06
	(.0627369)	(1.84e-06)
Leverage (DEBT)	-.0032954	4.45e-07*
	(.0029513)	(2.55e-07)
Industry 1 (INDUS1)	-.082868*	-.0000975*
	(3.451662)	(.0000554)
Industry 2 (INDUS2)	3.032293	1.97e-06
	(1.941752)	(2.92e-06)
Industry 3 (INDUS3)	-.8941918**	-2.17e-06**
	(2.406691)	(4.73e-06)
Industry 4 (INDUS4)	-.4791741*	-1.99e-06*
	(2.377443)	(3.12e-06)
Industry 5 (INDUS5)	-.6641746 ***	-4.30e-07
	(2.407883)	(3.72e-06)
Industry 6 (INDUS6)	.2577188	-1.33e-06
	(.2296239)	(2.81e-06)
Industry 7 (INDUS7)		
Regression summary statistics		
AR(1)	0.1338	0.0000
AR(2)	0.3514	0.1912
J statistics	21.29174	24.65515
Wald-Chi test	14110.27***	3.6e+11***

[a] Unbalanced panel; *significant at 10% level; **significant at 5% level; ***significant at 1% level; This model provide standard error which are in parentheses

Table 3, column 2, reveals that CEO variable is positively and statistically significant at the 5% level for MNCs Tobin's Q, indicating that unitary leadership increases MNC subsidiaries' financial performance. CEO duality may create more advantages when MNC subsidiaries operate in a Sri Lanka complex and dynamic environment within Sri Lanka. Consistent with Faleye (2007) who explain, when operates in complex environment, unitary board leadership creates more advantages. Complex challenges of pressuring global integration and efficiency, local market cultural and institutional differentiation makes a complex environment for MNC subsidiaries. Furthermore, when firm operates in an uncertain environment and when the role CEO and chair of the board are performed by different people conflicts may arise, such as of communication and decision making process will delay and a company can loss its competitive edge. Table 3, column 3, indicates CEO duality variable has no significant impact with a LPCs financial performance. This is consistent with Baliga et al (1996) who find that CEO duality has little or no impact on various financial performance proxies. Moreover, Weir et al (2002) and Florackis (2005) also do not indicate any significant relationship between CEO duality and firm financial performance in UK context.

With respect to other corporate governance variables, empirical analysis for MNCs and LPCs financial performance model document that, board size has a significant negative impact on MNCs financial performance, indicating larger boards reduce MNCs financial performance. As a result, board size decreases effective communication and coordination among shareholders, thereby, decreasing financial performance of MNC subsidiaries. This is in line with Yermack (1996) who finds a negative relationship between board size and financial ratios. This finding indicates that, when an extra member is included in MNC subsidiary board exists, there is a potential trade-off between diversity and coordination. However, this study indicates, there is no significant impact on the financial performance of the LPCs board size. Moreover, both MNCs and LPCs indicate a significant positive relationship between firm financial performance and insider ownership percentage. One possible explanation is, due to weakness of investor protection and absence of well-developed markets for corporate control, which leads to internal control mechanisms becoming more vigilant in Sri Lankan listed companies. Consistent with effective monitoring concept by Fama and Jensen (1983) this study identified that a coefficient of non-executive directors increases a MNCs financial performance. Conversely, non-executive directors have significant negative impact on LPCs financial performance.

Table 4. Dynamic panel GMM estimator regressions of MNCs and LPCs agency costs

Variables	Dynamic-panel GMM MNCs	Dynamic-panel GMM LPCs
Number of observations[a]	217	285
Number of groups	84	107
L_1	.3414737***	-1.006842***
	(.1189672)	(.0012452)
Corporate Governance variables		
CEO duality (CEO)	.4814023***	-.023657**
	(.1183331)	(.0507269)
Board size (BOARD)	-.0023599	.0050155
	(.0173536)	(.0122278)
Insider ownership (INSIDE)	-.0572057	-50.75153***
	(.0870639)	(11.56764)
None-executive directors (NONE)	.0044469***	.0011031
	(.0013395)	(.0013888)
Ownership type (OWNER)	5.095463	-.1284439
	(8.124787)	(.094878)
Control variables		
Firm size (LNSIZE)	-.6536791***	.0163315
	(.0781263)	(.0436923)
Firm age (LNAGE)	1.293663***	-.0941107
	(.328296)	(.0963154)
Leverage (DEBT)	-.0547004***	-.0330705**
	(.0218719)	(.016356)
Industry 1 (INDUS1)	28.50438*	-.23789
	(37.68597)	(.4935389)
Industry 2 (INDUS2)	3.803158	.433808**
	(2.403431)	(.6566211)
Industry 3 (INDUS3)	3.032292	-.5672907
	(19.41752)	(.4107569)
Industry 4 (INDUS4)	16.93393	-.1997572
	(22.10394)	(.297384)
Industry 5 (INDUS5)	11.99839	-.2345188
	(22.53928)	(.3098034)
Industry 6 (INDUS6)	8.411789	-.498299
	(23.78412)	(.3938414)
Industry 7 (INDUS7)		
Regression summary statistics		
AR(1)	0.4074	0.3680
AR(2)	0.0991	0.9752
J statistics	16.01726	19.5032
Wald-Chi test	499.36	1.2e+06

[a] Unbalanced panel; *significant at 10% level; **significant at 5% level;***significant at 1% level; This model provide standard error which are in parentheses

Non-executive directors served in LPCs may not be independent, suffer from less information availability, and lack business knowledge. On the other hand, based on Jensen (1993) this may include LPCs with many non-exertive directors CEO influence may swamp that of the outside

directors. Consideration of the OWNER variable, in Table 3 reveals, it is positively related with LPCs Tobin's Q at the 1% significance level. This is apparently, institutional owners have a greater incentives to monitor management than board ownership. However, ownership variable is not correlated with the MNCs Tobin's Q financial performance matrix.

With respect to control variables, firm size shows a significant negative relationship with MNCs financial performance, indicating that the larger MNC subsidiaries financial performance is lower than smaller counterparts. Furthermore, leverage shows significant positive relationship with LPCs financial performance, indicating high levered LPCs have high financial performance. Finally, this study provides evidence that industry factors play an important role, in MNCs and LPCs with some industries being more prone to leverage than others.

Table 4, indicates CEO duality has a positive impact on MNCs agency proxy indicating that CEO duality increases MNCs asset utilisation ratio. This is in line with Stewardship theory that CEO duality creates strong leadership and a clear sense of strategic decision. Splitting roles may create high communication costs and decision making processes which can be less effective and less efficient when there are two leaders. Specifically, when MNC subsidiaries operate in different locations two leadership positions this may delay the decision making process and increase agency conflicts. In contrast, Table 4, reveals, the coefficient of the CEO variable is negative and statistically significant, at the 1% level for LPCs assets utilisation ratio, which indicates that CEO duality reduces LPCs asset utilisation. This may be due to CEO duality mitigating board independency in decision making and increasing misalignment of interests between managers and shareholders. This leads to poor assets utilisation. This finding is consistent with Jensen (1993) who proposes that with CEO duality gives too much power to one person and controls others in the decision making process. The monitoring and control power is compromised to a single person, and CEO entrenchment may be the reasons for increase LPCs agency costs.

Insider ownership shows a significant negative relationship for LPCs assets utilisation, indicating higher insider ownership and increased LPCs agency conflict. However, insider ownership has no significant impact on a MNCs agency conflict. Furthermore, coefficient of MNCs non-executive directors is positively and statistically significant for MNCs assets utilisation ratio, indicating non-executive directors reduce MNCs agency conflicts. On the other hand, results reveals non-executive directors have no significant impact on a LPCs agency costs.

Control variables, firm size shows significant positive impact on a MNCs agency cost, indicating large firms suffer from high agency conflicts. Moreover, firm debt level shows significant negative impact on MNCs and LPCs assets utilisation ratio, indicating high levered firms have high agency conflict. Similar to financial performance findings, it can be seen from Table 4, LPCs and MNCs agency conflict is related to industry type.

6. Implications

The general purpose of this study is to explore the impact of board leadership on LPCs and MNCs financial performance and agency conflicts by applying the dynamic panel GMM method. This study finds that unitary leadership increase MNC subsidiaries financial performance while reduce agency conflicts. On the other hand, unitary leadership has no significant impact on LPCs financial performance. However, it is positively effect in LPCs agency conflicts. In line with stewardship theory, this result suggests that MNC subsidiaries need strong leadership and unitary command to increase their performance. On the other hand, LPCs need to avoid CEO entrenchment. This is in line with agency costs theory. These conclude MNCs will benefit from unitary leadership and LPCs required board independence. Thus, the results in this paper are consistent with Boyd (1995) and Brickley et al (1997) who explain there is no optimal leadership structure, and company needs to adopt best structure according to the institutional environment and firm characteristics. This is potential merit in promulgating rules and regulations not to design strictly "one size fits all" corporate governance practices. Moreover, it shows the impotence of introduce" comply or explain" governance code will be more benefit to Sri Lanka than mandatory corporate governance code.

On a more speculative note, the corporate governance changes in Sri Lanka in favour of splitting two leadership positions, regardless of firm type, cannot be fully justified from a performance view point. Based on contingency perspective to specify the nature of conditions such as uncertainty environment and resource scarcity is valuable; otherwise duality reduce firm performance. For practitioners and policy makers who aspire to improve corporate governance in Sri Lanka, it is important to note firm characteristics when decide board leadership.

Furthermore, it is required to promulgating rules of ensure board independence via unbiased selection procedure of non-executive directors. Then, based on agency theory, these independence directors can control CEO entrenchment or as a good steward enhances accessibility of external

resource to the firm. Moreover, strengthening internal and external corporate governance practices on firms can reduce CEO entrenchment and get further advantages from duality leadership.

7. Limitations

Notwithstanding the findings, the current study suffers from the following limitations, which would potentially represent opportunities for further investigations. Firstly, current study only consider firm type (MNC subsidiaries or LPC), further studies may want to consider other aspects of institutional contexts. Secondly, while this paper has provided useful insights into board leadership and firm financial performance and agency costs the findings are based on research in a single country.

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APPENDIX

Variable definition

Variable name	Definition
Financial performance	
Tobin's Q (TOBIN'S Q)	Tobin's Q ratio is defined as market capitalisation plus total debt divided by total assets. This ratio is calculated as equity market value plus liabilities book vale divided by equity book value plus liabilities book value.
Agency costs Sales to assets ratio (ASSETS)	This ratio is calculated as total sales divided by total assets.
Corporate governance variables	
CEO duality (CEO)	Dummy variable 1, if the CEO duality present, zero otherwise
Board size (BOARD)	Total number of board directors on board
Insider ownership (INSIDE)	Proportion of general ownership board ownership
Non-executive directors (NONE)	Percentage of non-executive directors serving on board
Ownership type(OWNER)	Dummy variable 1, if the ownership type is equal to institutional ownership, zero otherwise
Control variables	
Firm size (LNSIZE)	Logarithm of total assets
Firm age (LNAGE)	Logarithm of number of years firm operating in the industry
Leverage ratio (DEBT)	This ratio is calculated as total debt divided by total assets
Industry 1 (INDUS1)	Dummy variable 1, if the industry is equal to Beverage or Chemical
Industry 2 (INDUS2)	Dummy variable 2, if the industry is equal Alt energy, automobile, electricity, oil and gas
Industry 3 (INDUS3)	Dummy variable 3, if the industry is equal to service
Industry 4 (INDUS4)	Dummy variable 4, if the industry is equal to Travel and leisure and general retailers
Industry5 (INDUS5)	Dummy variable 5, if the industry is equal to food production
Industry6 (INDUS6)	Dummy variable 6, if the industry is equal to Media and mobile technology
Industry7 (INDUS7)	Dummy variable 7, if the industry is equal to general industries