

**COMPLIANCE OF CORPORATE GOVERNANCE BEST PRACTICE
CODE BY THE COMPANIES LISTED ON THE COLOMBO STOCK
EXCHANGE**

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Abstract

Good Corporate Governance practices are regarded as important in reducing risk for investors, attracting investment capital, and improving the performance of companies. The purpose of this study was to assess the level of compliance with Corporate Governance best practices through the development of the Sri Lankan Corporate Governance Index. The level of compliance with Corporate Governance practices was assessed based on the Corporate Governance Index developed on secondary data. Several aspects related to Corporate Governance, including the board of directors; chairman and chief executive officer; board balance and appraisal of performance; disclosure of remuneration of directors; shareholders; accountability and audit; institutional investors and other investors, and disclosure of sustainability reporting were examined to develop the Corporate Governance Index and the data were gathered from a sample of 96 publicly listed firms in 19 industries in the Colombo Stock Exchange in Sri Lanka. The overall level of compliance on Corporate Governance score was 69.34 by the Sri Lankan listed firms. Based on the one standard deviation score value of 10.93, the mean value of 64.49 was identified and 17 listed firms were identified below this level and 18 listed firms were identified as higher than this level. This study makes an original contribution to corporate governance literature by examining the level of compliance with Corporate Governance best practices in a developing country, namely Sri Lanka.

Keywords: Corporate Governance Codes, Corporate Governance Practices, Corporate Governance Index

1.1. Introduction

The convergence and adoption of similar Corporate Governance were stimulated by the Cadbury Report (1992) throughout most parts of the world, including Sri Lanka. The ICASL as the pioneer in introducing CG in Sri Lanka, the first Code; Code of Best Practice on matters related to financial aspects of CG, was issued in 1997. The aforementioned code was a voluntary best practice Code, guided by CG publications, and then globally applicable. Thereafter, the above-mentioned Code was updated to be in line with the Combined Code of the UK. The updated code was issued in March 2003 as the Code of Best Practice on CG and yet again it was revised in June 2008 to establish good CG practices in the Sri Lankan Capital Market upon consultation

with the SEC of Sri Lanka. The succeeding revision once again was a joint initiative between the above two institutions and having commenced in 2011 and thereafter continued in 2012 under the aegis of a well-represented, experienced, and knowledgeable committee. The corporate's were encouraged to adopt this code in discharging their CG responsibilities (ICASL & SEC, 2013). It is more so often said that CG has come on a long way journey and the present minimum rules of CG for mandatory compliance of PLCs have been evaluated by dint of voluntary code of compliance. The implementation of the mandatory code enhanced the effectiveness of the board, reinforced the company's relationship with its stakeholders, and strengthened the business integrity. Sri Lanka as an emerging market complies with the CG practices and reforms that are based on procedures and systems of developed markets, but sometimes fail to recognize such compatibility with Sri Lankan market practices.

1.2. The Objective of the Study

The investigations of the study ascertained the objective specifically:

To assess the level of compliance with CG best practices through the development of the Sri Lankan Corporate Governance Index.

2.1. Review of Literature

The researchers of developing countries have found that Sample firms generally exhibit a moderate CG structure, based on the CGS measures. Claessens et al. (2000) study conducted on "Corporate governance and different types of voluntary disclosure evidence from Malaysian listed firms" found that Sample firms generally exhibit a moderate corporate governance structure, based on the CGS measure, with an overall aggregate score of 46.6 percent. Ownership structure of the sample firms is characterized by concentrated shareholdings with the top five shareholders (OCON) averaging 59.2 percent. This high number is a typical feature in firms in East Asian countries. A study by Gompers et al. (2003) "Determinants of firm level governance: Malaysian evidence" drew a strong correlation between corporate governance and financial valuation, measured by Tobin's Q, by which the valuation of company in the democratic portfolio (higher level of corporate governance) is 56 percentage points higher than those in the dictatorship portfolio (lower level of corporate governance).

Gurgler et al. (2003) study conducted on "The governance-performance relationship: evidence from Ghana" argued that developing economies such as Ghana exhibit weak corporate governance mechanisms. The results show that there was an average (median) of 56 percent (50 percent) compliance with the features that are regarded as good governance. In terms of the sub-indices, researchers found that four of the six categories the compliance rates were between 65 (65 percent) and 75 (67 percent). The overall trend is that there is a greater degree of compliance in the various sub-indices which indicates that the Ghanaian firms had been adopting the Ghanaian corporate governance code.

Dissa Bandara (2010) examined the level of compliance of Sri Lankan companies with the Corporate Governance principles based on Governance, Research Institute of Sri Lanka involving 59 companies listed on the CSE, the time period of the study being 2006- 2010. Empirical evidence has revealed that 44 percent of the companies are non-compliant in relation to the adherence to the corporate governance practices. The researcher further stated that in

practice, in the Sri Lankan context the chairman and the CEO of certain companies sometimes is one and the same person, whilst even if such positions are held by different persons in some instances, more often than not, both the chairman and CEO sit on the same BODs of the company and the situations are contrary to the governance practices. Further, in the latter situation, it has become difficult to identify the leader of the board as well.

Manawaduge (2012) study conducted on ‘Corporate Governance practices and their impact on corporate performance’ results show that levels of compliance by Sri Lankan companies to CG best practices are very significant among companies and that such variations directly relate to the ownership structures of companies. The results further revealed that higher levels of compliance have a positive impact on financial performance, but have no impact on market performance. The analysis as per stakeholder perceptions on eight aspects of CG system in Sri Lanka, analysis of results showed the majority of stakeholders are in agreement that sound CG practices improve corporate financial, market and social performance and has recognized, present status of CG in Sri Lanka was not up to the required standard. Kajanathan (2012) study conduct on The Effect of Corporate Governance on Firms’ Capital Structure of Listed Companies in Sri Lanka found out that 34% impact of the corporate governance characteristics on the companies in Sri Lanka for the period of 2009 to 2011.

3.1. Survey of Compliance with Corporate Governance Best Practices

Despite the presence of legal and institutional framework, regulatory requirements, and voluntary CG Codes governing PLCs in Sri Lanka, how these instruments are applied may deviate from their intended application. In this context, this chapter dealt with the methods used to examine the objective of the study and described the method of empirical investigation relating to the aforesaid objective. In this part of the study, the level of compliance with CG practices is assessed based on the CGI developed for the study. The reconciliation of the SLCGC (2013) and UKCGC (2014) for the development of the CGI is shown in the table 3.1.

Table 3.1: Reconciliation of the CG Codes for developing CGI

CGI S.No	Reference No:		Main Principle
	SLCGC 2013	UK Code 2014	
			The Board and Directors
1	A.1.1	A.1.1	Meet regularly and have at least one meeting per quarter.
2	A.1.2	A.1	Provide entrepreneurial leadership.
3	A.1.3		The Board collectively, and Directors individually act in accordance with the laws of the Country.
4	A.1.4	B.5.2	Directors have access to the advice and services of the CS.
5	A.1.5		Directors bring independent judgment on business conduct.
6	A.1.6	B.3.1	Every Director dedicates adequate time and effort to the matters of the Board.
7	A.1.7	B.4.1	Every Director receives appropriate training when first appointed to the Board.
8	A.4		Board ensures its sufficient financial acumen and knowledge to offer guidance on matters of finance.
			Chairman and Chief Executive Officer
9	A.2.1	A.2.1	Justifies with adequate disclosure on combining the posts of Chairman and CEO in one person.
10	A.3.1	A.3	Chairman conducts Board proceedings in a proper manner.
11	A.5.7	A.1.2	A SID is appointed on the duality of positions.
12	A.5.9	A.4.2	Chairman holds meetings with the NEDs only.
13	A.6.1		Chairman ensures all directors are properly briefed on issues arising at board meetings.
14	A.8.2		Board chairman is selected by shareholders at the first opportunity after his appointment.
15	A.11.1		In every fiscal year, the Board and CEO set companies short and long-term objectives and determine financial and non-financial targets for the CEO.
16	A.11.2	B.6.3	The board evaluates the performance of the CEO at the end of each fiscal year.
			Board Balance & Appraisal of Performance
17	A.5.1	A.4	The Board includes NEDs of sufficient caliber.
18	A.5.2	B.1.2	Independency of both NEDs, when board is constituted by those two only.
19	A.5.3	B.1.1	Recognize an independent director.
20	A.5.4		Each NED declares his/her independency/Non-independency annually.
21	A.5.5	B.1.1	The Board makes an annual determination on the independence

			or non-independence of each NED.
22	A.5.6		An alternative director is appointed by a NED is not an executive of the Company.
23	A.5.8		SID makes confidential discussions with other Directors.
24	A.5.10	A.4.3	Directors concerns are recorded in the Board Minutes on the matters which cannot be unanimously resolved.
25	A.6.	B.5	Management provides the board timely information in a form and of a quality appropriate to enable it to discharge its duties.
26	A.6.2		Required memos of Board Meeting are provided to Directors at least seven (7) days before the meeting.
27	A.7.1	B.2.1	A Nomination Committee established.
28	A.7.2	B.2.2	NC or the Board annually assess Board-composition.
29	A.7.3	B.2.4	Appointment of a new director to the board discloses to SHs
30	A.8.1	B.2.3	Appointment of NEDs subject to re-election and provisions in the Companies Act.
31	A.9.1	B.6.1	The board annually appraises itself on its performance comply with Board Performance Evaluation Checklist” Schedule B of SLCGC 2013.
32	A.9.2	B.6	The Board undertakes an annual self-evaluation of its & committees performance.
33	A.9.3	B.6.1	Details on conducting performance evaluations are disclosed in the Annual Report.
34	A.10.1		Disclose director’s details in the Annual Report.
			Directors’ Remuneration and Disclosure
35	B.1.1	D.2.1	Remuneration Committee (RC) is established.
36	B.1.2	D.2.1	RC consists exclusively of NED, and a board appointed chairman.
37	B.1.3	D.2.1	The Chairman and RC members are listed in the AR.
38	B.1.4	D.2.3	Different NED’s remuneration determination members, on limits are set by Articles of Association and when fully permitted.
39	B.1.5		The RC consults the Chairman and/or CEO about its proposals and has access to professional advice.
40	B.2.1		The RC provides the packages needed to attract, retain and motivate Executive Directors.
41	B.2.2	D.1	The RC judges the position levels of remuneration of the Company, relative to other companies.
42	B.2.3	D.1	Sensitivity of RC to remuneration and employment conditions on the determination of annual salary increases.
43	B.2.4	D.1.1	Designed and tailored, performance-related elements of remuneration of Executive Directors.

44	B.2.5		Executive share options do not offer at a Discount.
45	B.2.6		RC follows the provisions of Schedule E, In designing schemes of performance-related remuneration.
46	B.2.7	D.1.4	RC considers the compensation commitments, in the contract, entailed by the directors on early termination.
47	B.2.8		RC trailers the legal constraints for compensation commitments on the directors' early termination, When the initial contract does not explicitly provide.
48	B.2.9	D.1.3	NED's remuneration levels reflect their time commitment and responsibilities and do not include share options.
49	B.3.1		AR includes names of directors of RC, remuneration policy statement, aggregate remuneration paid to EDs and NEDs.
			Shareholders
50	C.1.1	E.2.1	Count all proxy votes, proxies lodged on each resolution, balance for and against the resolution and withheld.
51	C.1.2	E.2.1	Separate resolution for each separate issue and adoption of the report and accounts at AGM.
52	C.1.3	E.2.3	Presence of 03 committee's chairmen's at the AGM to answer questions of Board's Chairmen at the AGM.
53	C.1.4	E.2.4	Notice the AGM, send related papers to shareholders as the statute, before the meeting.
54	C.1.5		Summary of the procedures governing voting, circulate with Notice of AGM.
55	C.2.1		Proper channel to disseminate timely information to SHs.
56	C.2.2		Disclose the policy and methodology for communication with shareholders.
57	C.2.3		Disclose how, implement the above policy and methodology.
58	C.2.4		Disclose the contact person for communicating.
59	C.2.5		Disclose the process to aware directors on shareholders' major issues and concerns.
60	C.2.6		Secretary or a member of Board of Director's is the Person to contact shareholders' matters.
61	C.2.7		Disclosed the Board process for responding to SH matters.
62	C.3.1		Disclose the purpose, all material facts of the Major related party transaction and take SHs' approval by ordinary resolution at an extraordinary general meeting.
			Accountability And Audit
63	D.1.1	C.1	The Board presents interim and other price-sensitive public reports, reports to regulators, statutory requirement information.
64	D.1.2	C.1.1	The Directors' Report contains declarations by the Directors.

65	D.1.3	C.1.1	AR contains statements of: Board responsibilities for the preparation and presentation of financial statements; Auditors reporting Responsibilities; and Internal Control.
66	D.1.4		AR contains a “Management Discussion & Analysis”.
67	D.1.5	C.1.3	The Director’s report that the business is a going concern, with supporting assumptions or qualifications.
68	D.1.6		Forthwith summon of an Extraordinary GM to inform SHs and discuss remedial action, In the event the net assets fall below 50% of the value of the SHs’ funds.
69	D.1.7		Board adequately and accurately disclose the RPTs in AR.
70	D.2.1	C.2.3	The directors annually conduct a review of the risks facing the company and the effectiveness of the system of ICs.
71	D.2.2	C.3.6	Company has an Internal Audit Function.
72	D.2.3	C.3.1	Board disclosures on ICs, on the reviews of AC on the effectiveness of risk management and ICs.
73	D.2.4		Comply with Schedule K to SLCGC 2013.
74	D.3.1	C.3.1	The Audit Committee comprises: minimum of two independent NEDs or exclusively by NED, a majority of whom independent, whichever is higher.
75	D.3.2	C.3.2	Review the scope and results of the audit & non-audit services and its effectiveness, the independence and objectivity of the Auditors are the duties of the AC.
76	D.3.3	C.3.3	The Audit Committee has a written Terms of Reference, dealing clearly with its authority and duties.
77	D.3.4	C.3.8	AR discloses Audit Committee’s report with Directors names, basis on determination of the independence of the Auditors and compliance by the Company.
78	D.4.1		Discloser on the compliance or non-compliance of Code of Business Conduct & Ethics for Directors and Key Management Personnel.
79	D.4.2		The Chairman's affirmation on the non-violation of any of the provisions of the Code of Business Conduct & Ethics.
80	D.5.1		Disclosure on the manner and extent to which the compliance with the principles and provisions of CG Code.
			Institutional Investors & Other Investors
81	E.1		Institutional SHs practically use their voting intentions.
82	E.1.1	E.1.1	Chairman conducts a regular and structured dialogue with shareholders on the objectives, issues on that Communicates to Board.
83	E.2		Evaluate board structure, composition and other governance arrangements, with due attention of institutional investors.
84	F.1		Encourage Individual SH to carry out adequate analysis or seek

			independent advice in investing or divesting decisions on shares.
85	F.2		Encourage Individual SH to participate in General Meetings and exercise their voting rights.
			Disclosure of Sustainability Reporting
86	G.1		Principles of Sustainability Reporting.
87	G.1.1		Principle of Economic sustainability.
88	G.1.2		Principles of The Environment.
89	G.1.3		Principles of Labor Practice.
90	G.1.4		Principles of Society.
91	G.1.5		Principles of Product Responsibility.
92	G.1.6		Principles of Stakeholder identification, engagement & effective communication.
93	G.1.7		Principle of Sustainable reporting and disclosure should be formalized as part of the Company’s reporting processes and take place on a regular basis.

Source: [SLCGC (2013) and UK Corporate Governance Code (2014)]

3.2. Selection of the Sample

The population for the study comprises PLCs incorporated under the Companies Act No.7 of 2007 or any other statutory corporation, incorporated or established under the laws of Sri Lanka or established under the laws of any other state (subject to Exchange Control approval) are eligible to seek a listing on the CSE to raise debt or equity. All the 291 CSE listed companies representing 20 business sectors as of 30th September 2017, excluding delisted companies per the listing schedule of the CSE website, have been selected as the study population. Although 291 companies are listed on the CSE, for the study purpose to be considered those should have been listed before the 2007/08 financial year. 215 companies were eligible for the sample selection compliance to the above criteria, and out of these companies 96 elements were selected based on market capitalization ≥ 0.1 as a % of TMC as the final sample (www.cse.lk, 2007). This is a representative rate of 44.65 percent of the population. Table 3.2 provides summary information of the firms in each industry sector to which companies are assigned, and the sample number of firms that data were collected.

Table 3.2: Sample Companies across each Industry Sector

	Industry Sector	Listed Entities	Reg: Prior the year 2007	Sample (MC \geq 0.1, as a % of TMC)	(%)
1	Bank Finance & Insurance	63	29	18	62.07
2	Beverage, Food & Tobacco	21	17	12	70.59
3	Chemicals & Pharmaceuticals	10	09	03	33.33
4	Construction & Engineering	04	03	02	66.67
5	Diversified Holdings	19	10	10	100.00
6	Footwear & Textile	03	02	01	50.00
7	Health Care	06	05	04	80.00
8	Hotels & Travels	38	30	09	30.00
9	Information Technology	02	01	00	0.00
10	Investment Trusts	09	08	03	37.50
11	Land & Property	19	17	03	17.65
12	Manufacturing	38	33	11	33.33
13	Motors	06	06	03	50.00
14	Oil Palms	05	05	05	100.00
15	Plantations	18	17	03	17.65
16	Power & Energy	08	03	03	100.00
17	Services	08	06	01	16.67
18	Stores Supplies	04	04	01	25.00
19	Telecommunications	02	02	02	100.00
20	Trading	08	08	02	25.00
	Total	291	215	96	44.65

Source: (CSE Data Library 2017)

The sample has been spread across 19 sectors of the 20 sectors as per the sector categorization of the CSE and in most industry sectors the sample elements rate is above 30 percent.

3.3 Construction of Corporate Governance Index and Level of Compliance

Another aspect considered in the objective was the assessment of the relative levels of compliance with Corporate Governance best practices amongst sample companies. The relative levels of compliance were assessed based on the scores of the Corporate Governance Index constructed in the study.

Table 3.3: Corporate Governance Index

Variables and Sub- Indices		Marks	Ref:
THE BOARD AND DIRECTORS			
01	Meet regularly, at least once in every quarter of the financial year	01	AR
02	Provide entrepreneurial leadership	01	AR
03	The Board collectively, and Directors individually act in accordance with the laws of the Country	01	AR
04	All Directors have access to the advice and services of the Company Secretary	01	AR
05	All Directors bring independent judgment on business conduct	01	AR
06	Every Director dedicates adequate time and effort to the matters of the Board	01	AR
07	Every Director receives appropriate training when first appointed to the Board	01	AR
08	Board ensures it's sufficient financial acumen and knowledge to offer guidance on matters of finance	01	AR
		08	
CHAIRMAN AND CHIEF EXECUTIVE OFFICER			
09	Justification with adequate disclosure on combine the posts of Chairman and CEO in one person	01	AR
10	The Chairman conducts Board proceedings in a proper manner	01	AR
11	A Senior Independent Director is appointed when Chairman & CEO are the same person	01	AR
12	Chairman holds meetings with the Non- Executive Directors only	01	AR
13	Chairman ensures all directors are properly briefed on issues arising at Board meetings.	01	AR
14	Board chairman is selected by shareholders at the first opportunity after his appointment.	01	AR
15	In every fiscal year, the Board and CEO set companies short and long-term objectives and determine financial and non-financial targets for the CEO.	01	AR
16	The board evaluates the performance of the CEO at the end of each fiscal year.	01	AR
SUBTOTAL		08	
BOARD BALANCE & APPRAISAL OF PERFORMANCE			
17	The Board includes Non-Executive Directors of sufficient caliber	01	AR
18	Independency of both Non- Executive directors, when board constitute by those two only	01	AR
19	Recognition of an independent director	01	AR
20	Each Non-Executive Director declares his/her independency/Non- independency annually	01	AR
21	The Board makes an annual determination on the independence or non-independence of each NED	01	AR
22	An alternative director is appointed by a NED is not an executive of the Company.	01	AR
23	The Senior Independent Director makes confidential discussions with other Directors	01	AR
24	Directors concerns are recorded in the Board Minutes on the matters which cannot be unanimously resolved	01	AR
25	Management provides the Board timely information in a form and of a quality appropriate to enable it to discharge its duties	01	AR
26	Required memos of Board Meeting are provided to Directors at least seven (7) days before the meeting,	01	AR
27	A Nomination Committee established	01	AR
28	Nomination Committee or the Board annually assess Board-composition	01	AR
29	appointment of a new Director to the Board disclose to shareholders	01	AR
30	Appointment of NEDs subject to re-election and provisions in the Companies Act	01	AR
31	The Board annually appraises itself on its Performance comply with Board Performance Evaluation Checklist" Schedule B of SLCGC	01	AR
32	The Board undertakes an annual self-evaluation of its & committees performance	01	AR
33	Details on conducting performance evaluations are disclosed in the Annual Report	01	AR
34	Disclose directors details in the Annual Report	01	AR
SUBTOTAL		18	
DIRECTORS' REMUNERATION AND DISCLOSURE			
35	Remuneration Committee (RC) is established	01	AR
36	RC consists exclusively of NED, and a Board appointed Chairman	01	AR
37	The Chairman and RC members are listed in the Annual Report.	01	AR
38	different NED's remuneration determination members, on limits are set by Articles of Association and when fully permitted;	01	AR
39	The RC consults the Chairman and/or CEO about its proposals and has access to professional advice	01	AR
40	The RC provides the packages needed to attract, retain and motivate Executive Directors	01	AR
41	The RC judges the position levels of remuneration of the Company, relative to other companies	01	AR
42	Sensitivity of RC to remuneration and employment conditions on the determination of annual salary increases	01	AR
43	designed and tailored, performance-related elements of remuneration of Executive Directors	01	AR
44	Executive share options do not offer at a Discount	01	AR
45	RC follows the provisions of Schedule E, In designing schemes of performance-related remuneration	01	AR
46	RC considers the compensation commitments, in the contract, entailed by the directors on early termination	01	AR
47	RC trailers the legal constraints for compensation commitments on the directors' early termination, When the initial contract does not explicitly provide,	01	AR
48	NED's remuneration levels reflect their time commitment and responsibilities and do not include share options.	01	AR
49	AR includes names of Directors of RC, remuneration policy statement, aggregate remuneration paid to Executive and NEDs.	01	AR
SUBTOTAL		15	
SHAREHOLDERS			
50	Count all proxy votes, proxies lodged on each resolution, balance for and against the resolution and withheld,	01	AR

51	Separate resolution for each separate issue and adoption of the report and accounts at AGM	01	AR
52	Presence of 03 committees chairmen's at the AGM to answer questions of Board's Chairmen at the AGM	01	AR
53	Notice the AGM, send related papers to shareholders as the statute, before the meeting	01	AR
54	Summary of the procedures governing voting, circulate with Notice of AGM	01	AR
55	Proper channel to disseminate timely information to SHs.	01	AR
56	Disclose the policy and methodology for communication with shareholders	01	AR
57	Disclose how, implement the above policy and methodology	01	AR
58	Disclose the contact person for communicating	01	AR
59	Disclose the process to aware directors on shareholders' major issues and concerns	01	AR
60	Secretary or a member of Board of Director's is the Person to contact shareholders' matters	01	AR
61	Disclosed the Board process for responding to shareholder matters	01	AR
62	Disclose the purpose, all material facts of the Major related party transaction and take SHs' approval by ordinary resolution at an extraordinary general meeting.	01	AR
SUBTOTAL		13	
ACCOUNTABILITY AND AUDIT			
63	The Board presents interim and other price-sensitive public reports, reports to regulators, statutory requirement information	01	AR
64	The Directors' Report contains declarations by the Directors	01	AR
65	AR contains statements of: Board responsibilities for the preparation and presentation of financial statements; Auditors reporting Responsibilities; and Internal Control	01	AR
66	AR contains a "Management Discussion & Analysis",	01	AR
67	The Director's report that the business is a going concern, with supporting assumptions or qualifications	01	AR
68	Forthwith summon of an Extraordinary GM to inform SHs and discuss remedial action, In the event the net assets fall below 50% of the value of the SHs' funds	01	AR
69	The Board adequately and accurately disclose the related party transactions in Annual Report	01	AR
70	The Directors annually conduct a review of the risks facing the Company and the effectiveness of the system of internal controls	01	AR
71	Company has an Internal Audit Function	01	AR
72	Board disclosures on internal controls, on the reviews of Audit Committee on the effectiveness of risk management and internal controls	01	AR
73	Comply with Schedule K to SLCGC	01	AR
74	The Audit Committee comprises: minimum of two independent NEDs or exclusively by NED, a majority of whom independent, whichever is higher.	01	AR
75	Review the scope and results of the audit & non-audit services and its effectiveness, the independence and objectivity of the Auditors are the duties of the Audit Committee	01	AR
76	The Audit Committee has a written Terms of Reference, dealing clearly with its authority and duties.	01	AR
77	AR discloses Audit Committee's report with Directors names, basis on determination of the independence of the Auditors and compliance by the Company,	01	AR
78	Discloser on the compliance or non-compliance of Code of Business Conduct & Ethics for Directors and Key Management Personnel	01	AR
79	The Chairman's affirmation on the non-violation of any of the provisions of the Code of Business Conduct & Ethics	01	AR
80	Disclosure on the manner and extent to which the compliance with the principles and provisions of Corporate Governance Code	01	AR
SUBTOTAL		18	
INSTITUTIONAL INVESTORS & OTHER INVESTORS			
81	Institutional shareholders practically use their voting intentions	01	AR
82	Chairman conducts a regular and structured dialogue with shareholders on the objectives, issues on that Communicates to Board	01	AR
83	Evaluate Board structure, composition and other governance arrangements, with due attention of institutional investors	01	AR
84	Encourage Individual shareholders to carry out adequate analysis or seek independent advice in investing or divesting decisions on shares	01	AR
85	Encourage Individual shareholders to participate in General Meetings and exercise their voting rights	01	AR
SUBTOTAL		05	
DISCLOSURE OF SUSTAINABILITY REPORTING			
86	Principles of Sustainability Reporting	01	AR
87	Principle of Economic sustainability	01	AR
88	Principles of The Environment	01	AR
89	Principles of Labour Practice	01	AR
90	Principles of Society	01	AR
91	Principles of Product Responsibility	01	AR
92	Principles of Stakeholder identification, engagement & effective communication	01	AR
93	Principle of Sustainable reporting and disclosure should be formalized as part of the Company's reporting processes and take place on a regular basis	01	60
SUBTOTAL		08	
TOTAL		93	

[Source: Sri Lankan Corporate Governance Code (2013); UK Corporate Governance Code (2014); OECD Principles on Corporate Governance: Manawaduge 2012]

The Corporate Governance Index scores of sample companies indicated the extent to which they have complied with the best practice.

3.2.1. Basis of preparation of the Corporate Governance Index

The CGI was constructed consisting of eight- indices representing CG dimensions (refer to table 3.4) examined in the study.

Table 3.4: Operationalization Model

	Variable	Dimensions	Reference		
1	B&D	1. The Role of the Board			
		1.1. Meetings	AR		
		1.2. Entrepreneurial Leadership	AR		
		1.3. Compliance with Country laws	AR		
		1.4. Company Secretarial matters	AR		
		1.5. Independent Judgments	AR		
		1.6. Time dedication and efforts	AR		
		1.7. Training	AR		
		2. Financial Acumen			
		2.1. Sufficient Financial Acumen	AR		
2	C&CEO	3. Chairman’s Role			
		3.1. Board proceedings	AR		
		3.2. Holding Meetings	AR		
		3.3. Ensuring Directors tasks	AR		
		3.4. Election of the Chairman	AR		
		3.5. Setting up CEOs objectives	AR		
		3.6. Performance appraisal of CEOs	AR		
3	BBAP	4. Board Balance			
		4.1. NEDs	AR		
		4.2. INEDs	AR		
		4.3. Recognition of Independence	AR		
		4.4. NEDs’ annual declaration	AR		
		4.5. Appointment of alternate director	AR		
		4.6. Senior Independent Director	AR		
		4.7. Minutes on director’s concerns	AR		
		5. Supply of information			
		5.1. Timely information	AR		
		5.2. Sending documents to directors	AR		
		6. Appointments to the board			
		6.1. NC’s role	AR		
		7. Re- election			
		7.1. NEDs	AR		
		8. Appraisal of board’s performances			
		8.1. Annual appraisal of board	AR		
		8.2. Annual appraisal of committees	AR		
		4	DRD	9. Remuneration Procedure	
				9.1.RC	AR
9.2.Exclusive NED	AR				
9.3.Determination of remuneration	AR				
9.4. Consultation with chairman	AR				

		10. The level and make up of remuneration	
		10.1. Attractive remuneration packages	AR
		10.2. Comparison of companies' remuneration levels	AR
		10.3. Sensitivity of RC	AR
		10.4. Performance related elements of remuneration	AR
		10.5. Offering executive share options	AR
		10.6. Schemes of performance related remuneration	AR
		10.7. Compensation of early terminated directors	AR
		10.8. Legal constraints on early terminated directors	AR
		10.9. NEDs' remuneration on time commitment	AR
5	SH	11. Constructive use of the AGM & conduct of GM	
		11.1. Proxy votes & disclosure	AR
		11.2. Separate resolutions	AR
		11.3. Presence of AC, RC & NC chairmen	AR
		11.4. Early notice of AGM	AR
		11.5. Early notice of GM	AR
		12. Communication with SHs	
		12.1. Proper channel	AR
6	AA	13. Financial reporting	
		13.1. Balance & understandable assessment	AR
		13.2. Extraordinary GM when net assets < 50% of SHs' value	AR
		14. Internal control	
		14.1. Effectiveness	AR
		14.2. Functions	AR
		14.3. compliance with 'Schedule K' of the SLCGC 2013	AR
		15. AC	
		15.1. Composition	AR
		15.2. Duties	AR
		16. Disclosures	
		16.1. Names of directors, independence, report	AR
7	IIOI	17. Voting	
		17.1. Responsibility of using	AR
		17.2. Communication	AR
		18. Evaluation of Governance Disclosures	
		18.1. Participation	AR
		19. Investing/Divesting Decisions	
		19.1. Analysis & advices	AR
		20. SHs' Voting	
		20.1. Participation at GM	AR
8	DSR	21. Sustainability report	
		21.1. Regular practice	AR

Sources: Annual Reports of the sample companies

The variables of CGI were recognized through the synthesis of the SLCGC (2013) and UK CG Code (2014). The recommended practices of SLCGC (2013) and the requirements of companies Act No. 07 of 2007 were provided on the basis for the construction of the CGI. The CGI was constructed having referred to the previous research studies (Balasubramaniam et al., 2010; HO, 2005; Manawaduge, 2012; Susilowati et al., 2005) and the CG Indices of rating agencies. Furthermore, the professional associations and rating agencies have also developed governance indices covering a broad range of areas using variables as discussed in the review of the literature. This structure and variables of these indices have provided useful guidance in developing the CGI. However, the CGI of the study differed from other indices in terms of its focus, coverage, and purpose. The CGI consists of 93 variables classified under eight dimensions.

3.2.2. Variables of Corporate Governance Index and Sub- indices

There is much focus on the conduct of board members and effective discharge of their responsibilities as the roles and responsibilities of a board reinforce the corporate governance structure of a company securing better performance. Hence, the board functions are given high priority in constructing the CGI. The practices required for effective corporate governance were identified under eight dimensions, namely the B&D, CCEO, BBAP, DRD, SHs, AA, IIOI, and DSR. The CGI was based on the data gathered through the checklist. Sub- indices represent each of the dimensions and were constructed to evaluate a level of compliance with each of these aspects. The number of variables of each sub-index consists of the B&D (08), CCEO (08), BBAP (18), DRD (15), SHs (13), AA (18), IIOI (05), and DSR (08). Accordingly, the maximum score of the CGI was equal to 93, which is the addition of the maximum marks of its eight sub-indices (Refer to the Table 3.3 above).

3.2.3. Quantification of the Level of Compliance of CG Best Practices

The researcher has determined the weightage of marks to be allocated to each of the abovementioned governance areas according to the importance of such areas on corporate governance, based on a survey conducted by the researcher involving three professionals and academics as detailed out below who were at the time of the survey holding the following positions.

Assessor 1- The Chairman of the SEC of Sri Lanka

Assessor 2- A senior academic mainly specialized in Corporate Governance and Finance

Assessor 3- A senior academic mainly specialized in Corporate Governance and Finance

Table 3.5: Weights Assigned to the Corporate Governance Index

Variable	Assessor 1 (as a %)	Assessor 2 (as a %)	Assessor 3 (as a %)	Final Weight Assigned (as a Rounded %)
The Board and Directors	20	10	20	17
Chairman and Chief Executive Officer	10	10	10	10
Board Balance & Appraisal of Performance	20	20	15	18
Directors' Remuneration and Disclosure	04	15	10	10
Shareholders	15	15	15	15
Accountability and Audit	22	15	15	17
Institutional Investors & Other Investors	04	05	08	06
Disclosure of Sustainability Reporting	05	10	07	07
Total	100	100	100	100

Source: Corporate Governance Index weighted Data from the Assessors (2017)

To examine the performance implications of corporate governance compliance, the sample was divided into two subsamples, as high compliance and low compliance companies based on the overall index score.

3.3. Evaluation of Level of Compliance of CG Practices

Analyzed results of the descriptive statistics of the overall index and sub-indices are given in section 4.1. Classification of the lower level of compliance firms & higher level of compliance firms, the analyzed results of the comparison of sub-indices across sub-samples, and the comparison of individual items of CGI across sub-indices are given in section 4.2. As indicated in section 3.1 the analysis of the index score was carried out with eight sub-indices representing different dimensions of governance. The maximum possible scores for each sub-index depended on the number of governance practices examined in the respective sub-index. The maximum possible score for overall CGI was 93, which is the addition of the maximum marks of its eight sub-indices. The sub-indices with maximum possible scores are given in Table 3.6.

Table 3.6: Basic Strata of CGI

Principle Areas	CGI Category	Sub Elements
Board and Directors	CGI-B&D	08
Chairman and CEO	CGI-CCEO	08
Board Balance and Appraisal of Performance	CGI- BBAP	18
Directors Remuneration and Disclosure	CGI- DRD	15
Shareholders	CGI- SH	13
Accountability and Audit	CGI- AA	18
Institutional Investors and Other Investors	CGI- IIOI	05
Disclosure of Sustainability Reporting	CGI- DSR	08

Sources: CGI Developed the Researcher

4.1. Frequency Distribution Analysis of Governance Scores

Table 4.1 provides data on the overall CGI and its sub-indices. There is a substantial spread on each of the sub-indices, and for the CGI as a whole. As shown in the descriptive statistic, the sub-indices indicate substantial variations of compliance to CG practices by Sri Lankan listed firms.

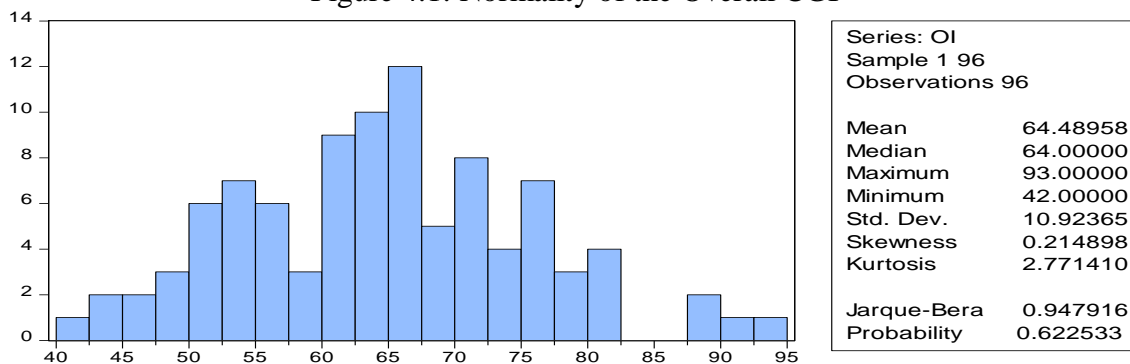
Table 4.1: Descriptive Statistics for GI Variables

	Mean	Mean (%)	Std. Devi.	Mini	Max	Max Possible	Skewness	Kurtosis	P Val:
BD	5.47	68	1.239	2	8	8	-.145	2.899	.828
CCEO	5.15	64	1.306	1	8	8	-.528	3.090	.105
BBAP	12.01	67	2.724	6	18	18	.105	2.278	.323
DRD	10.97	73	2.310	6	15	15	-.271	2.048	.091
SH	10.04	77	2.271	2	13	13	-.778	3.526	.004
AA	12.35	69	2.959	7	18	18	.004	2.075	.180
IIOI	3.72	74	0.903	1	5	5	-.195	2.634	.565
DSR	4.79	60	2.034	0	8	8	.057	2.300	.366
OI	64.50	69	10.923	42	93	93	.215	2.771	.623

Source: Annual Reports of the Sample Companies

As shown in Table 4.1 the overall CGI mean value is 64.50 and, sub-indices mean values are shown as 5.47, 5.15, 12.01, 10.97, 10.04, 12.35, 3.72, and 4.79 respectively for the BD, CCEO, BBAP, DRD, SH, AA, IIOI and DSR. Minimum and maximum CG scores are 42 & 93 for the Overall Index. When sample companies were considered based on the overall CG Practices as shown in Table 4.1 all the companies have better compliance with CG, have obtained a mean score of more than 50 percent. The p-value of 0.623 for overall CGI confirms that the overall index is normally distributed, indicating reasonable distribution is available in respect of high compliance and low compliance companies within the sample. Further, all other sub-indices except SH are normally distributed, as indicated by the p-value of the descriptive statistics which is lower than 0.005. The histogram (Figure 4.1) shows the fraction of firms with overall CG scores in indicated ranges.

Figure 4.1: Normality of the Overall CGI



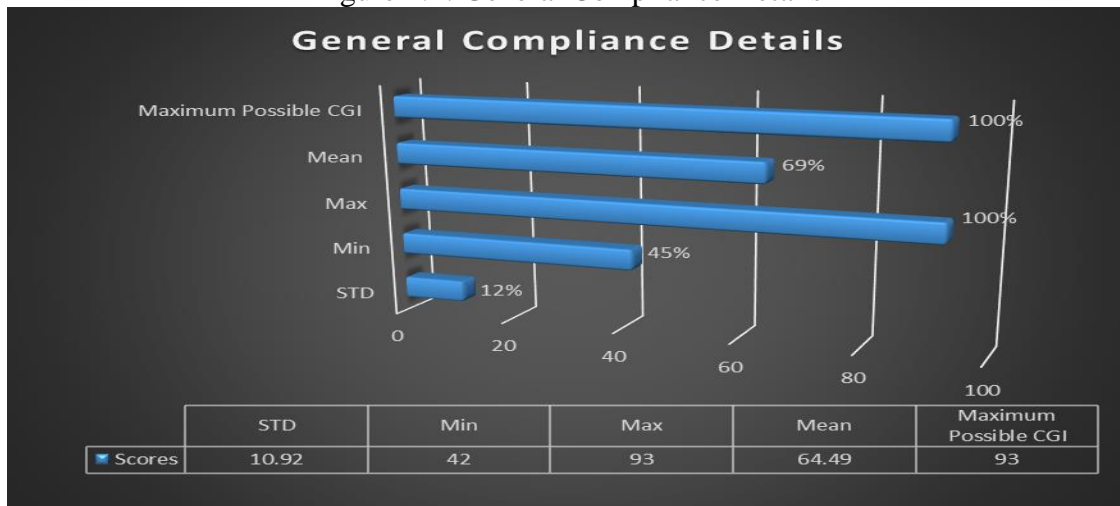
Source: Annual Reports of the Sample Companies

The histogram with a mean value of 64.49 (percent) and standard deviation of 10.923 shows the overall CGI is normally distributed.

4.2. Classification of the CG Higher & Lower level of Compliance Firms

Figure 4.2 shows a fraction of firms with overall CG scores in the indicated ranges with the standard deviation, minimum and maximum CG score recorded, mean value, and maximum possible CG score can be recorded.

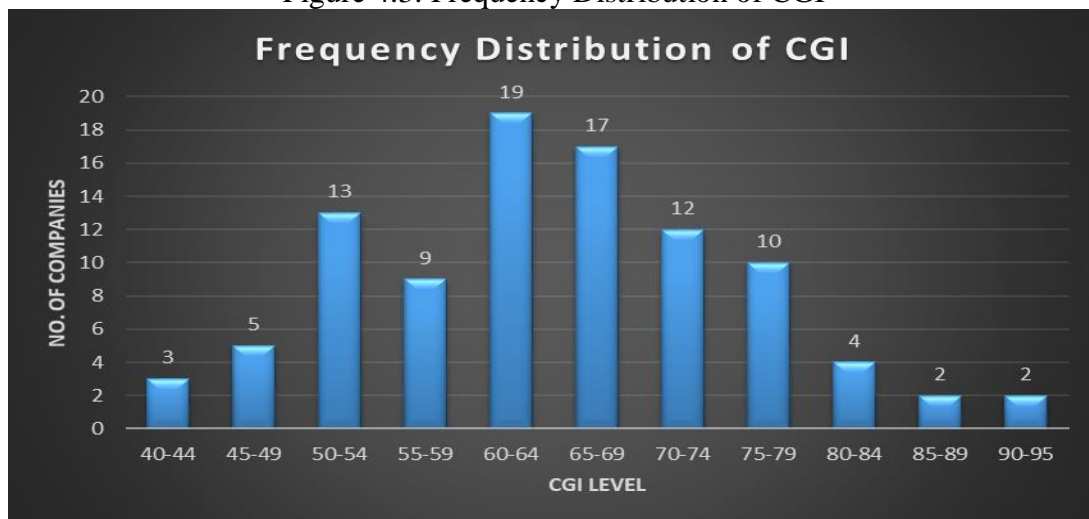
Figure 4.2. General Compliance Details



Source: Annual Reports of the Sample Companies

Figure 4.3 shows the frequency distribution of CG scores obtained by analyzing the secondary source data and the minimum score is recorded 42 and maximum 93.

Figure 4.3. Frequency Distribution of CGI

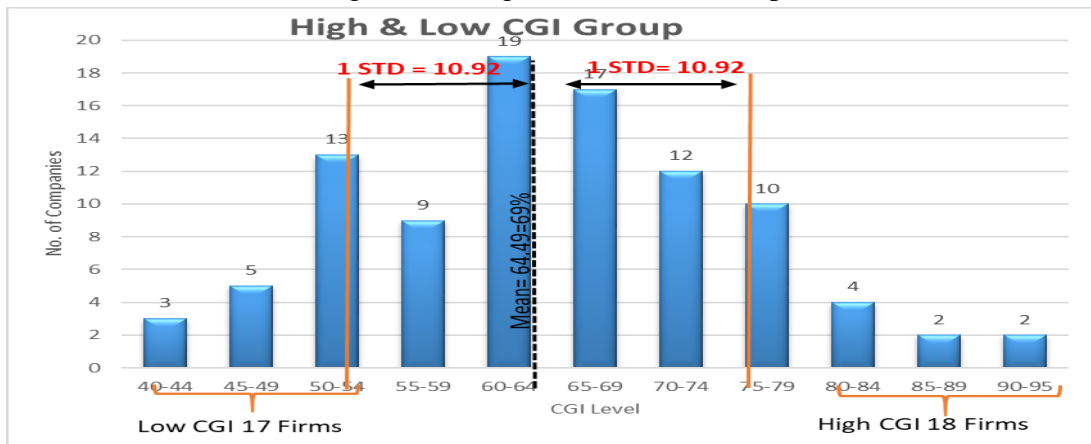


Source: Annual Reports of the Sample Companies

Each firm was categorized into the relevant range for the frequency distribution and 19 firms were categorized into the range between 60 and 64, which is the average score value. Further, 17 companies were filtered into the range of 65 to 69. 08 firms recorded the score value of less than 50 and were ranked between 40 to 49. Also, 02 companies recorded the highest score values of more than 90, and those are ranked in between the values of 92 to 95.

Figure 4.4 shows the High & Low CG Score groups based on the CG scores obtained in the survey.

Figure 4.4. High & Low CGI Group



Source: Annual Reports of the Sample Companies

The values based on standard deviation calculated 53 scores (64.49- 10.92) as the cut-off point for lower levels of compliance and 75 scores (64.49+ 10.92) was calculated as the cut-off mark to measure the firms' higher level of compliance. The figure shows 17 companies which are fallen under a lower level of compliance while 18 companies have a higher level of compliance.

4.2.1. Higher Compliance & Lower Compliance Firms

Table 4.2 shows the top 10 firms which are identified based on the CG scores on the developed CGI for the study.

Table 4.2: Top 10 CGI Firms

Rank Order	Company	Sector	Score
1	AAA	Plantation	93
2	BBB	Manufacturing	90
3	CCC	Power	89
4	DDD	Power	88
5	EEE	BFI	82
6	FFF	Manufacturing	81
7	GGG	Motor	80
8	HHH	Hotels	80
9	III	Diversified	79
10	JJJ	Telecommunication	78

Source: Annual Reports of the Sample Companies

The names of the companies are not used in forms of anonymity of the conglomerates and instead of the classified sector is used. Listed ten companies are registered in the sectors of Plantation, Manufacturing, Power & Energy, Bank Finance & Insurance, Motors, Hotel & Travels, Diversified Holdings, and Telecommunication. Results show that the firm which is classified in the plantation sector has recorded full scores of the study, which 93 scores is disclosing the highest level of compliance to CG practices. Further, results disclosed that all the companies have recorded CG scores above 78. Firms are classified under manufacturing and power & energy have recorded high CG scores twice although there are 20 sectors in the listed company directory. Firms are classified in the Telecommunication sector show greater performance compared to other sectors, although a small number of firms have been classified on it. Table 4.3 shows the worst 10 firms which were identified based on the CG scores on the developed CGI in the study.

Table 4.3: Worst 10 CGI

Rank Order	Company	Sector	Score
1	ZZZ	BFI	42
2	YYY	Hotels	43
3	XXX	Manufacturing	44
4	WWW	Hotels	46
5	VVV	BFT	47
6	UUU	Health	48
7	TTT	Health	48
8	SSS	Motors	49
9	RRR	Trading	50
10	QQQ	BFT	50

Source: Annual Reports of the Sample Companies

Listed ten companies are classified in the sectors of Bank Finance & Insurance, Hotel & Travels, Plantation, Manufacturing, Beverage Food & Tobacco, Health, Motors, and Trading. Results show that the firm which is classified under the Bank Finance & Insurance sector has recorded the lowest scores of the study, which 42 scores is disclosing the lowest level of compliance to CG. Further, results disclosed that all the companies have recorded CG scores below 50. Firms are classified under BFT, Hotels and Health have recorded low CG scores twice although they show poor performances.

4.2.2. Composition of the Compliance Level

This section resolves to disclose the composition of the compliance level in the specific areas of sub-indices of the developed CGI. Table 4.4, depicts the findings of the study.

Table 4.4: Composition of CGI

Specific Areas	Point Allocation	Score Obtained	Compliance Level
1. B&D	08	5.47	68%
2. CCEO	08	5.15	64%
3. BBAP	18	12.01	67%
4. DRD	15	10.97	73%
5. SH	13	10.04	77%
6. AA	18	12.35	69%
7. HIOI	05	3.72	74%
8. DSR	08	4.77	60%
Overall	93	64.49%	69.34%

Source: Annual Reports of the Sample Companies

5.0. Conclusion

The level of compliance of the CG of the companies was examined by developing a CGI in achieving the objective of the study. The analysis of the index score was carried out with eight sub-indices representing different dimensions of governance. The maximum possible scores for each sub-index depend on the number of governance practices examined in the respective sub-index. The maximum possible score for overall CGI was 93, which is the addition of the maximum marks of its eight sub-indices. The figure with a mean value of 64.49 (percent) and standard deviation of 10.923 was used for the identification of the level of compliance of the firms in line with the CG practices. The standard deviation was used as the measure of the dispersion of the set of data from its mean. The values based on standard deviation calculated 53 scores (64.49- 10.92) as the cut-off point for lower levels of compliance and 75 scores (64.49+ 10.92) was calculated as the cut-off mark to measure the firms’ higher level of compliance. The figure shows 17 companies that fall under a lower level of compliance while 18 companies have a higher level of compliance.

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