

Board Independence and Corporate Performance

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The large number of dramatic corporate collapses around the world over the last decade, focused attention on the importance of corporate governance to the long term success of a firm. The separation of ownership from management raises a key issue of how to effectively monitor managers to ensure that they act in the best interest of the shareholders and other stakeholders as well. The role of independent directors in improving the effectiveness of control has been the subject of debate in academic literature, especially in the context of a culture of poor corporate governance.

The study explores this issue, paying particular attention on the relationship between corporate board independence and firms' financial performance in Sri Lanka. Using data obtained from Colombo Stock Exchange for the period 2004 through 2009, a sample consisting of fifty non-financial firms were used to assess board independence and their possible effects on firm performance. Data was gathered through published reports and a primary survey. Independence of the board was deconstructed to board composition as measured by proportion of independent directors and proportion of non-executive directors, and board leadership structure as measured by CEO non duality. The firm performance was measured using both financial and market performance indicators. After controlling for industry, firm size and changes in leadership structure, the results indicate support for stewardship perspective, with no convincing evidence to indicate that inclusion of independent directors is associated with improved financial performance. The weak governance structure which could be exemplified by ownership entrenchment, cross sitting of board members and lack of cumulative voting may explain the lack of evidence found. However, the results indicate that inclusion of independent directors is valued by investors and reflected in enhanced firm value.

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