

Impact of Corporate Governance Practices on Firm Capital Structure and Profitability: A Study of Selected Hotels and Restaurant Companies in Sri Lanka.

A.Ajanthan

Department of Accounting

Faculty of Management Studies and Commerce

ABSTRACT

Corporate governance issues have been a growing area of management research especially among large and listed firms. Good corporate governance practices are regarded as important in reducing risk for investors, attracting investment capital and improving the performance of companies. Companies need financial resources and better earnings to promote their objectives. Therefore, factors may affect the capital structure and profitability of companies should be considered carefully. The purpose of the present study is to investigate whether there is any relationship among some specific characters of corporate governance, capital structure and profitability of listed Hotels & Restaurant companies in Colombo Stock Exchange (CSE). To do so, 18 companies were selected from those which were listed in CSE during the 2007-2012. The 'Board Composition (BC)', 'Board Size (BS)' and 'CEO duality (CEOD)' were considered as independent variables, whereas, 'Debt Ratio (DR)', 'Debt-to-Equity Ratio (DER)', 'Returns on Equity (ROE)', and 'Return on Assets (ROA)' as dependent variable. The results indicate a positive relationship between 'BS; BC; CEOD; ROE; ROA and DER' whereas negative relationship between BS; BID and DR. In addition CEOD have a positive relationship with DR. In addition, none of the variables have a significant relationship with capital structure and profitability.

Key words: Corporate Governance; Capital Structure and Profitability.

INTRODUCTION:

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance comprises the long-term management and oversight of the company in accordance with the principles of responsibility and transparency (OECD, 2010).

Mechanisms that protect the interests of the shareholders are known as Corporate Governance mechanisms. Good corporate governance helps in economic development. Last two decades have seen an increasing intensity of research on the subject of corporate governance. Firms having weaker governance structures face more agency problems and managers of those firm's get more private benefits, due to weak governance structures (Core et al., 1999). According to Chuanrommanee and Swierczek (2007), corporate governance practices in financial corporations of the ASEAN countries are consistent with the international practices. Corporate Governance has become one the important research area in Pakistan after publication of SECP Corporate Governance Code 2002, for publicly listed companies. The code was met with a lot of criticism in the start and there was lot of difficulties in implementing and enforcing it. However, despite these criticisms, the Code has been the reason for the start of a new era of corporate governance in Pakistan. Rais and Saeed (2005) argued that the acceptance of Corporate Governance Code has improved overall structure of the corporation and environment of the businesses by ensuring transparency and accountability in reporting framework. Good corporate governance practices are important in reducing risk for investors; attracting investment capital and improving the performance of companies (Velnampy & Pratheepkanth, 2012)

The main focus of this paper is to find the corporate governance practices currently practiced in Sri Lankan companies. And to find the relationship between corporate governance and capital structure and corporate governance and profitability measured by Return on Equity (ROE), Return on Assets (ROA), Debt-to-Equity (DER) and Debt Ratio (DR) in Sri Lankan hotels & restaurant sector. These practices include: the size of the board, independence of the board and CEO status. By comparing these factors, we conclude how important it is for a firm to have a mix of different governance practices as they are interrelated to each other.

OBJECTIVES OF THE STUDY:

The present study is envisaged with the following objectives:

- To identify the relationship among corporate governance, capital structure and profitability in Hotel industries.

- To find out the impact of corporate governance on capital structure and profitability.
- To suggest the organizations for a good governance practices for their success..

REVIEW OF LITERATURE:

Corporate Governance Practices

In general, corporate governance is considered as having significant implications for the growth prospects of an economy, because best practice corporate governance reduces risks for investors, attracts investment capital and improves the performance of companies (Spanos, 2005). In Sri Lanka, effective corporate governance is considered as ensuring corporate accountability, enhancing the reliability and quality of financial information, and therefore enhancing the integrity and efficiency of capital markets, which in turn will improve investor confidence (Rezaee, 2009).

Cadbury (1992) defined corporate governance as “the system by which companies are directed and controlled”. It is concerned with the duties and responsibilities of a company’s board of directors to successfully lead the company, and their relationship with its shareholders and other stakeholder groups. It is also defined as a “process through which shareholders induce management to act in their interests, providing a degree of investor confidence that is necessary for the capital markets to function effectively” (Rezaee 2009).

Corporate Governance in Sri Lanka.

Corporate governance initiatives in Sri Lanka commenced in 1997 with the introduction of a voluntary code of best practice on matters relating to the financial aspects of corporate governance. Voluntary codes of best practices on corporate governance were issued in 2003 (ICASL 2003), and in 2007 corporate governance standards were made mandatory for all listed companies for the financial year commencing on or after 1st April 2008. This code covered the effectiveness of the board, separation of the position of CEO and the chairman, appointment of the chairman, non-executive directors, professional advice, director’s training, directors responsibility for the presentation of financial statements, compliance reporting, internal control and committee structures for boards, including audit committee, and remuneration committees and nomination committees (Watawala,2006). The new Companies Act No. 7 was enacted in 2007 to keep abreast with prevalent international laws and to safeguard the interest of all stakeholders including directors, major shareholders, minority shareholders and creditors. The act introduced greater protection to minority shareholders, directors’ duties, and transparency and accountability. The new Company Act No. 7 was based on Canadian, New Zealand and other modern practices. It became operative for all listed companies from 1st April 2007, and was mandatory from 1st April 2008. The civil war which ended in 2009 could have been expected to have had a major impact on economic growth. Instead, by 2007, the Sri Lankan economy recorded a growth rate of above 6 per cent for the third consecutive year. This raises the question: did the introduction of the corporate guidelines contribute to this result? If so, the changes in corporate governance practices would be expected to be significantly related to firm performance. The governance changes investigated in this study were the board structures.

Corporate Governance and Capital Structure:

According to the modern theories, agency cost is one of the main components of capital structure and corporate governance mechanisms reduce agency problems, therefore both are linked. Claessens et al. (2002) argues that good corporate governance mechanisms help firms through better access to financing and lower cost of capital.

The boards of directors are responsible for managing the overall firm and firm operations. They play a vital role in deciding about the financial mix. A significant relationship is found between capital structure and board size by Pfeffer and Salancick (1978). Berger et al. (1997) found that large boards of directors have low leverage levels and larger boards also exert pressure to enhance firm performance. On the other side, Jensen (1986) states that high leverage levels have large boards. Wen et al. (2002) found positive relationship between capital structure and board size. And large board size is associated with higher debt levels. Abor (2007) found a positive correlation between board size and capital structure.

(Rehman, Ramiz and Rehman, Muhammad Ateeq and Raof, Awais, 2010) investigate the relationship between corporate governance and capital structure of randomly selected 19 banks of Pakistan. The data was collected from financial statements issued by financial institution and multiple regression models were applied to find the relationship between the variables. Results show that there is no relationship between corporate governance and capital structure in the banking sector of Pakistan. Furthermore, their findings show that all independent variables are positively related with capital structure except ownership concentration which affects adversely to

capital structure but overall there is an insignificant relationship between capital structure and corporate governance.

Non-executive directors are essential part of modern corporate governance mechanisms. Pfeffer and Salancick (1978) states that presence of non-executive directors reduces uncertainties about the company and help in raising capital. And presence of higher numbers of non-executive directors lead to higher leverage levels. Jensen (1986) and Berger et al. (1997) also found the same, those companies having high leverage levels have relatively more external directors. Abor (2007) concluded that there is a positive correlation between board composition and capital structure. On the other side, Wen et al. (2002) concluded that a significant negative relationship between leverage levels and number of external directors. And that the presence of external directors leads to low leverage levels.

(Kumar, Jayesh, 2006) examines the relationship between corporate firm's ownership and capital structure in context of an emerging market economy, India. He used firm-level time series data of listed companies from 1994 through 2000 and analyzes the firm's corporate financing behavior in connection with its corporate governance arrangements, specially its shareholding pattern. Their results show that the debt structure is non-linearly linked to the corporate governance (ownership structure). They find that firms with weaker corporate governance mechanisms, dispersed shareholding pattern, in particular measured by the entrenchment effects of group affiliation, tend to have a higher debt level. Firms with higher foreign ownership or with low institutional ownership tend to have lower debt level. They do not find any significant relationship between ownership of directors and corporate with the capital structure.

CEO/Chair duality is also one of the important features of corporate governance. This can directly affect the capital structure decisions of the company. Fama and Jensen (1983) argue that role of CEO and chairman should be separate, as CEO is the chief decision management authority and chairman is the chief decision control authority. Fosberg (2004) found that separate CEO and chairman have higher leverage levels and results in optimal amount of debt. Abor (2007) concluded that there is a positive correlation between CEO duality and capital structure.

Abor, Joshua and Biekpe and Nicholas(2007) explore the link between corporate governance and the capital structure decision of SMEs. The results show negative association between capital structure and board size. Positive relationships between capital structure and board composition, board skills and CEO duality are, however, found. The control variables in the model show signs which are consistent with standard capital structure theories. The results generally suggest that SMEs pursue lower debt policy with larger board size. Interestingly, SMEs with higher percentage of outside directors, highly qualified board members and one-tier board system rather employ more debt. It is clear, from the study, that corporate governance structures influence the financing decisions of Ghanaian SMEs. Velnampy (2013) revealed that determinants of cooperate governance are not correlated with performance measures and no impact of cooperate governance on organizational performance.

Corporate Governance and Firm Performance:

Board Size

There is a view that larger boards are better for firm value because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. However, some authors have advocated for smaller boards. Jensen (1993) argues that large boards are less effective and are easier for the CEO to control. When a board gets too big, it becomes difficult to co-ordinate, encourages free riding and poses problems. Smaller boards however reduce the possibility of free riding, and increase the accountability of individual directors. Hence there will be a positive or negative relationship between board size and firm value.

CEO Duality

The first issue that the Sri Lankan code required for effective corporate governance was the separation of the top two positions of the board (CEO and Chairman). According to Abdullah (2004) the reason for separation is that when both the monitoring and the implementation roles are vested in a single person (Combined leadership) the monitoring role will be severely impaired. It could also be argued that, when one person is in charge of both tasks, favorable decisions are reached faster provided that person is well aware. Alternatively, companies that have combined leadership may have an individual who has too much power and able to make decisions that do not maximize shareholders wealth (Laing & Weir 1999).

Evidence in relation to company performance and board leadership structure is also mixed. Rechner and Dalton (1991) found that firms with separate leadership structures outperformed joint structures when measured on return on equity return on investment and profit margins, whereas Dalton et al. (1998) found no evidence of a relationship between leadership structure and financial performance. According to Abdullah (2004), board independence and combined leadership either singly or jointly are not related to performance, because financial ratios may not capture the board and leadership roles in establishing a firm's value, but long-term measures such as firms' growth and their share price might be useful measures.

Board Composition

In the code of best practice on corporate governance in Sri Lanka, board composition is also an important component of the board structure. The assumption is that an effective board comprised of a greater proportion of non-executive directors (Zahra & Pearce 1989), is significant to firm performance. However, the principle A.5 of the code of best practice on corporate governance states that it is preferable for the board to have a balance of executive and non-executive directors such that no individual or small group of individuals can dominate the board's decision-taking. Furthermore, Principle A.5.1 states the board should include non-executive directors of sufficient caliber and number for their views to carry significant weight in the board's decisions. The board should include at least two non-executive directors or such number of non-executive director's equivalent to one third of total number of directors, whichever is higher (ICASL & SEC of Sri Lanka 2008).

A wide variety of definitions of firm performance have been proposed in the literature (Barney, 2002, Velnampy, 2005 & 2005, Velnampy and Nimalathan, 2009, Velnampy and Nireesh, 2012, and Velnampy and Pratheepkanth, 2012). Empirical evidence regarding the relationship between firm performance and board composition is mixed. Some studies find that there is a positive link between the firms' performance and its composition. Weir and Laing (2001) state that "if non-executive directors resulted in effective monitoring, their effectiveness would increase in line with their board representation". Consistent with the above, Baysinger and Butler (1985), found that in 266 US firms with higher numbers of outside directors on the board had a greater return on equity than the board with executive directors. Ezzamel and Watson (1993) also found that non-executive directors were positively associated with profitability among a sample of UK firms.

Frahnaz Ghanbari's study (2007) investigated the relationship between corporate governance mechanisms and performance. The number of non-executive members making up the directors board is considered as an internal mechanism and institutional investors as an external mechanism. A sample of 73 enterprises admitted in Tehran Exchange Stock participated in the study. The data on the enterprises' activities in years 2003-2005 were collected and analyzed, using correlation, regression analysis, and Independent T-test). The findings showed no effect of the number of non-executive members making up directors board on the performance. Moreover, there is a positive relationship between institutional investors and performance.

Black et al. (2006) concludes that firm's having higher governance scores have a high market value. Chen (2008) suggested that establishing effective governance mechanisms leads to improvement in firm's value. Harford et al. (2008) concluded that poorly governed firm's destroy firm's value.

Mintzberg (1983) and Kosnik (1990) argue that large board size negatively influences performance of firms. Lipton and Lorsch (1992) and Jensen (1993) argue that larger board size turns less effective because of poorer communication and decision making process. Van den Berghe and Levrau (2004) argue that increasing the number of directors increase expertise, knowledge and skills than smaller boards. A high negative relationship between performance of firm and board size was found by De Andres, Azofra and Lopez (2005). Analysis by Dalton and Dalton (2005) found that superior performance resulted from larger boards while Bhagat and Black (1999) and Hermalin and Wiesbach (2003) proposed an opposite view.

Brown and Caylor (2006) showed firms with board size in between 6 and 15 yield higher returns on equity. Jackling and Johl (2009) found that large board size impacts performance positively.

Baysinger and Butler (1985) found that board with more outside directors performed better than other firms. Fosberg (1989) found no relationship between proportion of outside directors and firm's performance. Rosenstein and Wyatt (1990) found that there is slight increase in stock prices when more outside directors are appointed by firms. Hermalin and Weisbach (1991) found no relationship between board composition and firm value. Yermack (1996) showed that proportion of non-executive directors does not affect performance of firm significantly. Agrawal and Knoeber (1996) while conducting a study on US firms found negative relationship between proportion of outside directors and performance of firms.

Shrader et al. (1997) found negative relationship between proportion of women on board and firm's value. Bhagat and Black (1999) found no significant between board independence and firm's performance in a long run in case of US firms. Roberts et al. (2005) suggests that the active participation of an independent director brings to team, independent ideas. And can be helpful in better functioning the organization and board. In support of the above assumption, Brown and Caylor (2006) found that firms with more independent directors performed well than others with higher ROE, greater profits, more dividends and higher repurchase of stock. And the most important factor in the above study affecting firm's performance was independence of directors. Chan and Li (2008) found that firm value is enhanced by presence of expert-independent directors in board. Jackling and Johl (2009) found that large number of independent outside directors on board impacts performance positively. Rechner and Dalton (1991) found that firms with CEO duality performed better. Daily and Dalton (1992), while conducting a study on entrepreneurial firms, found no relationship between CEO duality and performance of firms. Peel and O'Donnell (1995) showed that splitting both roles lead to improved performance. Yermack (1996) argued that those firms are more valuable which have separate CEO and chairman position. Brickley et al. (1997) concluded that CEO duality doesn't leads to inferior performance.

Sanda et al. (2003) also found a positive relationship between separate CEO and chairman positions and firm's performance. Brown and Caylor (2006) also concluded the same that when CEO and chairman positions are separate, firms are more valuable. Kang and Zardkoochi (2005) concluded regarding studies of the relationship between CEO/Chair duality and other measures that the results are complex. They proposed that if such duality exists as a reward, it might result in positive performance. But if the reason is to increase the CEO's power than it may have a negative effect on the performance of the firm.

Elsayed (2007) concluded that CEO duality has no effect on performance. But it varies from industry to industry. Uzun et al. (2004) found that higher audit committee independence resulted in a lower chance of fraud. So, audit committee reduces agency cost and improves overall performance. Brown and Caylor (2006) found positive relationship between dividend yield and independent audit committees. But found no relationship between independent audit committee and performance. Chan and Li (2008) found that firm value is enhanced by presence of expert-independent directors in audit committee.

Lybaert (1998) stated that better performance of firms is due to higher and better level of education among entrepreneurs. On the other side, Powel (1991) stated that occupational and professional affiliations of qualified managers with firms may have a negative effect. Lawrie (1998) stated that the gaps in management expertise are considered less as a barrier in development of SME. What happens at meetings of board and how many directors attend those meetings tells shareholders, how seriously the governance responsibilities are met. According to Lipton and Lorsch (1992), more meetings of board results in improved performance. A positive association exists between frequency of meetings and performance of firm and also in between the attendance of directors and performance of firm (Brown and Caylor, 2006).

Corporate Governance and Firm Performance and Capital Structure:

Hayat M. Awan, Khuram Shahzad Bukahri & Rameez Mahmood Ansari (2010) find the relationship between corporate governance and capital structure and corporate governance and firm performance in Pakistani Textile sector. 100 manufacturing companies listed at Karachi Stock Exchange (KSE) and Lahore Stock Exchange (LSE) from Textile sector are included in sample. Data on Corporate Governance internal mechanisms is collected through self-administrated survey, interviews etc. Data related to financial part of the study is collected from Annual Reports and time horizon of the data is from 2005 to 2009. Regression Analysis and Structural Equation Modeling are used to determine the relationship between corporate governance and capital structure and corporate governance and firm performance. Corporate Governance is measured by fourteen internal governance mechanisms. Debt Ratio is used as measure of Capital Structure and Return on Assets is used as measure of performance of the firm. Results indicate that Corporate Governance Mechanisms taken together impact Debt Ratio negatively and Return on Assets positively.

CONCEPTUALIZATION:

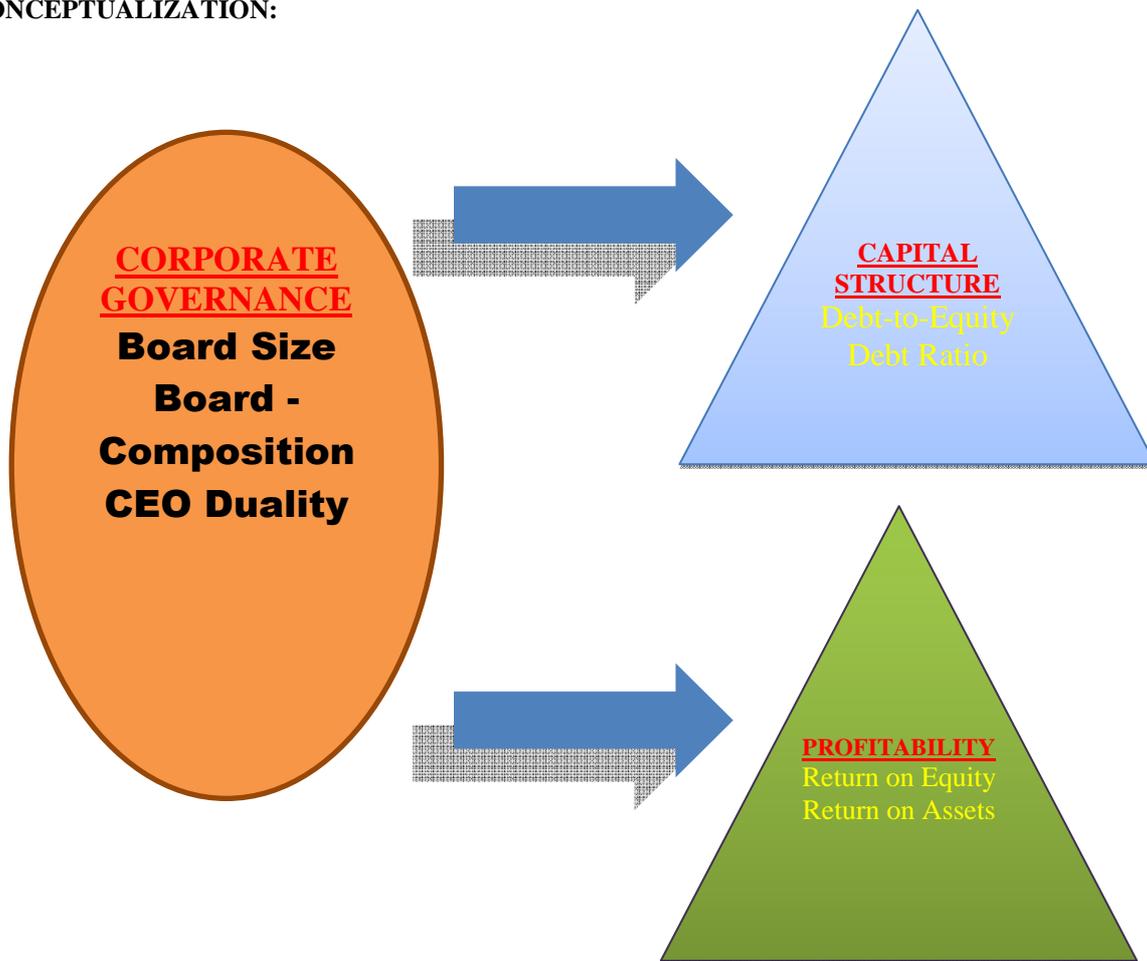


Figure 1: Author Constructed

HYPOTHESES OF THE STUDY:

The hypotheses below are operationalized as a basis for analysis and conclusion on the relationship among corporate governance practices, capital structure and profitability of the firm.

H1: There is a significant relationship between corporate governance practice and profitability.

H0: There is no significant relationship between corporate governance practices and profitability.

H2: There is a significant relationship between corporate governance practice and capital structure.

H0: There is no significant relationship between corporate governance practice and capital structure.

H3: There is an impact of corporate governance practices on profitability.

H0: There is no impact of corporate governance practices on profitability.

H4: There is an impact of corporate governance practices on capital structure

H0: There is no impact of corporate governance practices on capital structure.

Hypothesis one & two are evaluated based on the correlation analysis while regression analysis the basis of evaluation of hypothesis two & three.

METHODOLOGY:

DATA SOURCE:

The present study used secondary data for the analysis. The data utilized in this study is extracted from the comprehensive income statements and financial position of the sample hotels and restaurant companies quoted in Colombo Stock Exchange (CSE) database. In addition to this, scholarly articles from academic journals and relevant text books were also used.

SAMPLING DESIGN:

Sampling design is a definite plan for obtaining a sample from a given population. It refers to the technique or the procedure the researcher would adopt on selecting items for the sample (Kothari, C.R., 2004). The sample of this study is confined to the trading sector consists of 08 trading companies listed in the Colombo Stock Exchange (CSE).

MODE OF ANALYSIS:

In the present study, we analyze our data by employing correlation & multiple regressions analysis. For the study, entire analysis is done by personal computer. A well-known statistical package like ‘Statistical Package for Social Sciences’ (SPSS) 16.0 Version was used in order to analyze the data. The following liquidity and profitability ratios are taken into accounts which are given below.

Table-1: Calculations of Dependent and Independent Variables.

Corporate Governance Practices	
Board Size	Total number of board of directors.
Board Composition	Dividing number of independent or non-executive directors by total number of board of directors.
CEO Duality	1 if CEO is chairman as well and 0 if otherwise.
Profitability Ratios	
Return on Equity	= Profit after Interest and Tax / Equity Capital X100
Return on Assets	= Profit after Interest and Tax / Total Assets X100
Capital Structure Ratios	
Debt-to-Equity	= Debt Capital / Equity Capital X100
Debt Ratio	= Debt Capital / Total Assets X100

Multiple regression analysis was performed to investigate the impact of corporate governance practices on capital structure and profitability which the models used for the study is given below.

Profitability = f (BS; BC; and CEOD)
 Capital Structure = f (BS; BC; and CEOD)

It is important to note that the Profitability and capital structure depend upon Board Size (BS); Board Composition (BC) & CEO Duality (CEOD). The following models are formulated in the study.

$$ROE = \beta_0 + \beta_1 BS + \beta_2 BC + \beta_3 CEOD + e \text{ ----- (1)}$$

$$ROA = \beta_0 + \beta_1 BS + \beta_2 BC + \beta_3 CEOD + e \text{ ----- (2)}$$

$$D/E = \beta_0 + \beta_1 BS + \beta_2 BC + \beta_3 CEOD + e \text{ ----- (3)}$$

$$DR = \beta_0 + \beta_1 BS + \beta_2 BC + \beta_3 CEOD + e \text{ ----- (4)}$$

Where,

- $\beta_0, \beta_1, \beta_2, \beta_3$ are the regression co-efficient
- ROE → Return on Equity
- ROA → Return on Assets
- D/E → Debt-to-Equity
- D/R → Debt Ratio
- BS → Board Size
- BC → Board Composition
- CEOD → CEO Duality

RESULTS & ANALYSIS:

CORRELATION REGRESSION AND RELIABILITY ANALYSIS:

Table 2: Correlation, Regression & Reliability Value

Model	Dependent	Independent	r	P – value	R ²	F-Value	Durbin-Watson
1	ROE	BS	0.143	0.572	0.125	0.372 (0.775)	1.922
		BC	0.102	0.687			
		CEOD	0.162	0.522			
2	ROA	BS	0.308	0.213	0.092	1.575 (0.240)	1.507
		BC	0.260	0.298			
		CEOD	0.269	0.280			
3	D/E	BS	0.167	0.509	-0.145	0.284 (0.836)	1.817
		BC	0.171	0.498			
		CEOD	0.106	0.674			
4	DR	BS	-0.259	0.299	-0.122	0.384 (0.766)	2.242
		BC	-0.173	0.494			
		CEOD	0.156	0.538			

The above mentioned table indicates the relationship between the various independent and dependent variables used in the study. As it is observed in the table, the correlation values were found to be mixed (both positive and negative) between the variables. The correlation values indicate that there are no relationships between corporate governance variables such as board structure, board committee, and CEO duality and profitability variables (ROE, and ROA) as well as capital structure ratios namely Debt-equity ratio and Debt-total fund ratio...

REGRESSION:

Regression analysis is used to test the impact of corporate governance practices on capital structure and profitability of the listed hotel and restaurant companies in CSE. As we mentioned in mode of analysis, four models were formulated and the results are summarized in the above Table-2.

The specification of the three variables such as BS; BC and CEOD in the above model revealed the ability to predict profitability (R² = -0.125,0.092,-0.145 & -0.122). In this model R² value of above two profitability measures and two capital structure measures denote that 12.5%,9.2%,14.5% &12.2% to the observed variability in can be explained by the differences in three independent variability namely Board Size; Board Composition and CEO Duality. The remaining 87.5%, 90.8%,75.5% & 87.8% are not explained, because the remaining part of the variance in profitability and capital structure is related to other variables which are not depicted in the model.

An examination of the model summary in conjunction with ANOVA (F-value) indicates that the model explains the most possible combination of predictor variables that could contribute to the relationship with the dependent variables. All model 1, model 2, model 3 and model 4 are not significance in this study. However, it should be noted here that there may be some other variables which can have an significant impact on profitability and capital structure, which need to be studied. In addition to the above analysis Durbin-Watson test also carried out to check the auto correlation among the independent variables. The Durbin-Watson statistic ranges in value from 0 to 4. A value near 2 indicates non-autocorrelation Model 1, 2, 3 and 4 have the value is 1.922, 1.507, 1.817 and 2.242 respectively. This indicates that there is no auto correlation.

HYPOTHESES TESTING:

Table 3: Testing of Hypotheses

No	Hypotheses	Results	Tools
H0	There is no significant relationship between corporate governance practices and profitability.	Accepted	Correlation
H1	There is significant relationship between corporate governance practices and profitability.	Rejected	Correlation
H0	There is no significant relationship between corporate governance practices and capital structure.	Accepted	Correlation
H2	There is significant relationship between corporate governance practices and capital structure.	Rejected	Correlation
H0	There is nosignificant impact of corporate governance practices on profitability.	Accepted	Regression
H1	There issignificant impact of corporate governance practices on profitability.	Rejected	Regression
H0	There is no significant impact of corporate governance practices on capital structure.	Accepted	Regression
H2	There is significant impact of corporate governance practices on capital structure.	Rejected	Regression

CONCLUSION:

'Capital structure decisions' is one of most fundamental issues managers of firms have to face. Based on the new theories of capital structure, such decisions can be affected by different factors, one of which is Corporate Governance. Whereas maximizing shareholders' wealth also another important issues in this context. Therefore, in the present study, eight hypotheses were used to test the relationship between practices of Corporate Governance and firms' capital structure and practices of Corporate Governance and firms' profitability. In each of these hypotheses, debt ratio and debt-to equity ratio (the criterion for capital structure) and return on equity and return on assets (the scale of profitability) were used as dependent variable; however, 'Board Size', 'Board Composition' and 'CEO duality' were utilized as independent variables. The results obtained from testing the research hypotheses indicate that there is a mix relationship (positive and negative) among corporate governance practices, firm profitability and capital structure.

LIMITATIONS & SCOPE FOR FURTHER RESEARCH:

There are two main limitations identified in this study. Firstly, the sample only covers five years data and an external validity problem exists that the results may not be transportable over different time periods and locations. Secondly, only three corporate governance variables were considered. Many more variables could be considered. sepecially external corporate governance variables have significant impact on firms' activities. Future research should include these types of external factors.

The above study has outlined the internal corporate governance structures and their relationship with capital structure and firm performance. It adds to the literature and opens new avenues for future studies, in which both internal as well as external corporate governance structures can be taken and then their relationship can be found with different proxies of capital structure and firm performance. And due to lack of time and large number of firms, only one sector was taken; future studies can incorporate different sectors and can also find differences in those sectors related to corporate governance structures and their relationship with capital structure and firm performance.

REFERENCES:

1. Abdullah, SN 2004, 'Board Composition, CEO Duality and Performance among Malaysian Listed Companies,' *Corporate Governance*, vol. 4, no. 4, pp. 47-61.
2. Abor, J. 2007. Corporate governance and financing decisions of Ghanaian listed firms. *Corporate Governance*, 7: 83-92.
3. Agrawal, A. & Knoeber, C. R. 1996. Firm performance and mechanisms to control agency problems between managers and shareholders. *Journal of Financial and Quantitative Analysis*, 31:377-397.

4. Baysinger, B & Butler, H 1985, 'Corporate Governance and Board of Directors: Performance Effects of Changes in Board Composition', *Journal of Law Economics and Organization*, vol. 1, pp. 101-24.
5. Berger, P. G., Ofek, E. & Yermack, D. L. 1997. Managerial Entrenchment and Capital Structure Decisions. *Journal of Finance*, 52:1411-1438.
6. Black, B. S., Hasung, J. & Woochan, K. 2006. Does Corporate Governance Predict Firms' Market Values? Evidence from Korea. *Journal of Law, Economics and Organization*, 22:366-413.
7. Brickley, J. A., Coles, J. L. & Jarrell, G. 1997. Leadership Structure: Separating the CEO and Chairman of the Board. *Journal of Corporate Finance*, 3:189-220.
8. Brown, L. D. & Caylor, M. L. 2006. Corporate Governance and Firm Valuation. *Journal of Accounting and Public Policy*, 25:409-434.
9. Cadbury, A 1992, *Report on the Committee on the Financial Aspects of Corporate Governance*, Gee, London.
10. Chan, K. C. & Li, J. 2008. Audit Committee and Firm Value: Evidence on Outside Top Executives as Expert-Independent Directors. *Corporate Governance*, 16:16-31.
11. Chen, Y. 2008. Corporate governance and cash holdings: listed new economy versus old economy firms. *Corporate Governance*, 16:430-442.
12. Claessens, S. & Fan, J. P. H. 2002. Corporate Governance in Asia: A Survey. *International Review of Finance*, 3:71-103.
13. Dalton, C. M. & Dalton, D. R. 2005. Boards of directors: Utilizing empirical evidence in developing practical prescriptions. *British Journal of Management*, 16:91-97.
14. De Andres, P., Azofra, V. & Lopez, F. 2005. Corporate boards in OECD countries: Size, composition, functioning and effectiveness. *Corporate Governance*, 13:197-210.
15. Elsayed, K. 2007. Does CEO duality really affect corporate performance? *Corporate Governance*, 15:1203- 1214.
16. Ezzamel, MA & Watson, R 1993, 'Organizational Form, Ownership Structure, and Corporate Performance: A Contextual Empirical Analysis of UK Companies', *British Journal of Management*, vol. 4, no. 3, pp. 161-76.
17. Fama, E. F. & Jensen, M. 1983. Separation of Ownership and Control. *Journal of Law and Economics*, 26:301-325.
18. Fosberg, R. 1989. Outside directors and managerial monitoring. *Akron Business and Economic Review*, 20:24-32.
19. Fosberg, R. H. 2004. Agency problems and debt financing: leadership structure effects. *Corporate Governance: International Journal of Business in Society*, 4:31-38.
20. Harford, J., Mansi, S. A. & Maxwell, W. F. 2008. Corporate governance and cash holdings. *Journal of Financial Economics*, 87:535-555.
21. Hayat M. Awan, Khuram Shahzad Bukahri & Rameez Mahmood Ansari (2010). Corporate governance practices and their impact on firm's capital structure and performance; case of Pakistani textile sector. Proceedings 8th AFC samos-2011, volume-1.
22. Hermalin, B. E. & Weisbach, M. S. 1991. The effects of board composition and direct incentives on firm performance. *Financial Management*, 20:101-112.

23. Hermalin, B. E. & Weisbach, M. S. 2003. Boards of directors as an endogenously determined institution: A survey of the economic literature. *Economic Policy Review*-Federal Reserve Bank of New York.
24. ICASL & SEC of Sri Lanka 2008, Code of Best Practice on Corporate Governance, Colombo.
25. ICASL 2003, *Code of Best Practice on Corporate Governance*, The Institute of Chartered Accountants of Sri Lanka, Colombo.
26. ICASL 2003, *Code of Best Practice on Corporate Governance*, The Institute of Chartered Accountants of Sri Lanka, Colombo.
27. Jensen, M. C. 1986. Agency costs of free cash flow, corporate finance and takeovers. *American Economic Review*, 76:323-329.
28. Jensen, M. C. 1993. The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems. *Journal of Finance*:831-880.
29. Kothari, C.R. (2004). *Research Methodology: Methods & Techniques*, p.55.
30. Kumar, Jayesh, 2006. *Capital Structure and Corporate Governance*, Xavier Institute of Management.
31. Lawrie, A. 1998. *Small Firms Survey: Skills*. British Chambers of Commerce, London.
32. Lipton, M. & Lorsch, J. 1992. A Modest Proposal for Improved Corporate Governance. *The Business Lawyer*, 48:59-77.
33. Lipton, M. & Lorsch, J. 1992. A Modest Proposal for Improved Corporate Governance. *The Business Lawyer*, 48:59-77.
34. Lybaert, N. 1998 The information use in a SME: its importance and some elements of influence. *Small Business Economics*, 10:171-191.
35. Mintzberg, H. 1983. *Power in and around organizations*. Englewood Cliffs: Prentice Hall.
36. Peel, M. & O'Donnell, E. 1995. Board structure, corporate performance, and auditor independence. *Corporate Governance*, 3:207-217.
37. Pfeffer, J. & Salancick, G. R. 1978. *The external control of organizations: a resource dependence perspective*. New York: Harper and Row.
38. Rechner, P. L. & Dalton, D. R. 1991. CEO duality and organizational performance: a longitudinal analysis. *Strategic Management Journal*, 12:155-160.
39. Rehman, Ramiz and Rehman, Muhammad Ateeq and Raoof, Awais, 2010. Does corporate governance lead to a change in the capital structure? *American Journal of Social and Management Sciences*.
40. Rezaee, Z 2009, *Corporate Governance and Ethics*, John Wiley & Sons, Inc., USA.
41. Rosenstein, S. & Wyatt, J. 1990. Outside directors, board effectiveness and shareholders' wealth. *Journal of Financial Economics*, 26:175-191.
42. Sanda, A. U., Mukaila, A. S. & Garba, T. 2003. *Corporate Governance Mechanisms and Firm Financial Performance in Nigeria*. Final Report Presented to the Biannual Research Workshop of the AERC, Nairobi, Kenya, 24-29.
43. Spanos, LJ 2005, 'Corporate Governance in Greece: Developments and Policy Implications'', *Corporate Governance*, vol. 5, no. 1, pp. 15-30.

44. Uzun, H., Szewczyk, S. H. & Varma, R. 2004. Board composition and corporate fraud. *Financial Analysts Journal*, 60:33-43.
45. Velnampy, (2013) Corporate Governance and Firm Performance: A Study of Sri Lankan Manufacturing Companies; *Journal of Economics and Sustainable Development* 4(3); 228-236.
46. Velnampy & Pratheepkanth, (2013) Corporate Governance and Firm Performance: A Study of Selected Listed Companies in Sri Lanka, *European Journal of Commerce and Management Research*, 2(6); 123-127.
47. Velnampy.T and Pratheepkanth.P,(2012),Portfolio Structure and Performance:A Study on Selected Financial Organisation in Sri Lanka, *Opinion: International Journal of Business Management*, 2(2).
48. Velnampy.T and Aloy Niresh.J.(2012),The Relationship Between capital Structure and Profitability, *Global Journal of Management and Business Research*, 12(13).
49. Velnampy.T.(2005), Application of Investment Appraisal Techniques in Kanchipuram Modern Rice Mill, *International Conference on 'Emerging Trend in Capital Market'*, Madras University.
50. Velnampy.T.(2005), A Study on Investment Appraisal and Profitability. *Journal of Business Studies*, (2); 23-35.
51. Watawala, L 2006, 'Country Report, Sri Lanka', paper presented to South Asia Corporate Governance Workshop, June 17-18, 2006.
52. Weir, CM & Laing, D 2001, 'Governance Structures, Director Independence and Corporate performance in the UK', *European Business Review* vol. 13, no. 2, pp. 86-94.
53. Weir, CM, Laing, D & McKnight, PJ 2002, 'Internal and External Governance Mechanisms: Their Impact on the Performance of Large UK Public Companies', *Journal of Business Finance and Accounting* vol. 29, no. 5 & 6, pp. 579-611.
54. Wen, Y., Rwegasira, K. & Bilderbeek, J. 2002. Corporate Governance and Capital Structure Decisions of Chinese Listed Firms. *Corporate Governance*, 10:75-83.
55. Zahra, SA & Pearce, JA 1989, 'Board of Directors and Financial Performance: A Review and Integrative Model', *Journal of Management*, vol. 15, pp. 291-334.

This academic article was published by The International Institute for Science, Technology and Education (IISTE). The IISTE is a pioneer in the Open Access Publishing service based in the U.S. and Europe. The aim of the institute is Accelerating Global Knowledge Sharing.

More information about the publisher can be found in the IISTE's homepage:

<http://www.iiste.org>

CALL FOR JOURNAL PAPERS

The IISTE is currently hosting more than 30 peer-reviewed academic journals and collaborating with academic institutions around the world. There's no deadline for submission. **Prospective authors of IISTE journals can find the submission instruction on the following page:** <http://www.iiste.org/journals/> The IISTE editorial team promises to review and publish all the qualified submissions in a **fast** manner. All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Printed version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

Recent conferences: <http://www.iiste.org/conference/>

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

