Corporate Governance and Banking Performance: A Comparative Study between Islamic and Conventional Banks in Sri Lanka

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Abstract

The recent global financial crises emphasized this idea and shown that the problem of bank governance is very severe. Therefore, this study was carried out as a comparative study of Islamic and conventional banks' corporate governance and banking performance in Sri Lankan context. This study's main objective is to compare the different corporate governance and banking performance practice of Islamic and conventional bank of Sri Lanka and also identify the relationship between corporate governance and banking performance in conventional and Islamic bank of Sri Lanka. The study is based on secondary data, which covers a period of four years, i.e. 2011-2014.Two banks are selected for this study. One is for Islamic Banks and other one bank is from Conventional banks. To analyze the data and find out Ratio analysis, descriptive statistical techniques and Correlation Analysis were used as a method of analysis. Key findings of this study, there is a different corporate governance practice and banking performance between Islamic and conventional banks. The results revealed that, variables of corporate governance are positively correlated with ROA in conventional bank as well as , Islamic bank except BS and NED other variables have normal negative relation with ROA which is not significant. Similarly, except BS and NED other variables have negative association with ROE in both banks. BS has strong negative with ROE in conventional banks, But Islamic bank has a normal negative relationship. Further corporate governance has a moderate impact on the performance of both Islamic and conventional banks. Practice of Islamic bank's corporate governance poorer than Practice of conventional banks' corporate governance in Sri Lanka. The implication of this research will guide for the decision makers, policy makers as well as a future researcher.

Keywords: Corporate governance, Islamic bank, Conventional bank and banking performance.

Introduction

Corporate governance refers to the way an organization is directed, administrated or controlled. It includes the set of rules and regulations that affect the manager's decision and contribute to the way the company is perceived by the current and potential stakeholders. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as; boards, managers, shareholders and other stakeholders and spells out the rules and procedures and also decision making assistance on corporate affairs. By doing this, it also provides the structure through which the company's objectives are set and the means of obtaining those objectives and monitoring performance. Corporate governance may be the ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors.

This study focus on the relationship between governance and performance. There are several reasons to expect that better governed banks may have more efficient operations and better performance. First, governance may reduce the incidence and amounts of related parties' transactions. Since such transactions are usually sub- optimal from the efficiency point of view, the reduction in such transactions should translate into improved performance. Second, better governed banks may have lower cost of capital, especially if they employ subordinated debt financing. Third, better governance may translate into more efficient and streamlined operations, as the supervisory board and management functions are separated and modernized.

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 of corporate governance were issued in 2003 (ICASL, 2003), and also 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 Chief of Executive Officer (CEO) and the chairman, the appointment of the chairman, non-executive directors, professional advice, director's training, directors responsible for the presentation of financial statements, compliance reporting, internal control and committee structures for boards, including audit committee, remuneration committees and nomination committees (Watawala, 2006).

The new Companies Act No. 7 was enacted in 2007 to keep abreast with prevailing 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, accountability and transparency .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 percent 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.Most of Islamic banks (IB) are located in the Gulf Cooperation Council (GCC) countries and Southeast Asian countries and they have many special features compared to their conventional counterparts. First, Islamic finance is based on the profit-losses-sharing arrangements; hence IBs want to improve their financial performance. Second, religion plays a crucial role in Islamic banking, since the activities of Islamic banks must be in accordance with the Sharia principles. (Hamad and rihab, 2012).

This study seeks to examine corporate governance in Islamic and conventional bank in Sri Lanka. This study examines corporate governance variables of Islamic Bank (Board Size - BS, Non-Executive Directors - NED, Board Meeting Frequency - BMF and Number of Board Committee - BC). This study provides a comprehensive investigation about of the corporate governance of Islamic and conventional Banks and their impact on the performance of banks.

Problem Statement

Governance has become an issue of interest ever since people began to organize themselves for a common purpose. As a corporate form of entity is considered as one way of organizing people towards a common purpose, corporate governance has become a critical area of concern. It has also become a much discussed issue today owing to constant occurrence of corporate frauds, abuse of managerial power and social irresponsibility of corporate entities. Therefore, a quest for good corporate governance can be witnessed today. It is the ultimate responsibility of boards of directors of banks to oversee the establishment of a proper good governance structure in banks. The senior management should cooperate with the boards in introducing such systems. However, due to the general protective attitude which the banking regulators have taken towards banks and the unsatisfactory resolution of the principal agent problem, there is a natural tendency in banks for the violation of the good governance principles by both the board members and the senior management.

Today corporate governance has become a worldwide issue and the development of corporate governance practices has become a prominent issue in all countries in the world. Sri Lanka too is not immune from these developments and problems relating to corporate governance. On the one hand, the private sector dominated by the corporate form of entities has become a significant economic force in Sri Lanka with the introduction of open economic policies in 1977 and the continuation of the same by the successive governments. On the other hand, there had been a few isolated incidents of corporate failures in the past, such as the collapse of finance companies in 1980s, the bankruptcy of the Pramuka Bank in the late 1990s and the downfall of Vanik Incorporation, which was a mega company once. These corporate failures had serious repercussions for depositors and investors of these organizations, which ultimately led to erosion of public faith in the financial sector of the country. Further, at present, some mega conglomerates in Sri Lanka have come into limelight due to corporate governance deficiencies. John Keels Holdings (JKH), the biggest listed conglomerate in Sri Lanka, came into the public scrutiny recently because of the landmark Supreme Court Judgment on one of its subsidiaries Lanka Marine Services Ltd (LMSL), which was previously a state owned entity. In this judgment, the Supreme Court declared that the privatization of LMSL was illegal, unlawful and arbitrary and severely criticized JKH accusing that its directors acted in collusion with Treasury Secretary in working against the public interest. Further, three of the founding directors of Stassens group have taken the managing director of the company to the court accusing that he takes major business decisions without their knowledge. These incidents raise serious concerns as to the accountability of directors of these companies and the corporate transparency.

The effect of corporate governance on the financial performance of banks has been an important issue since the last financial distresses over the world. Thus, the main idea of this study is to examine whether or not the independent variable factors (Corporate Governance - CG) taken into consideration in this study can influence the performance indicators of the firms' financial performance. Therefore, the major intention of this study is to examine the relationship between corporate governance practices of Islamic and conventional bank. And bank performance in the selected bank in Sri Lanka. In other words, the issue of concern was how the practices of corporate governance influence financial performance of both banks. The study was set to determine how corporate governance practices affect firms’ financial performance in Islamic and conventional bank. The objective of this study is to check the impact of good CG practices on performance in the comparisons between Islamic and conventional bank in Sri Lanka.

Islamic banks demonstrated a strong resilience among the current financial crises. Thus, it seems to be an interesting question to examine whether the corporate governance of Islamic banks are different from their conventional counterparts; and how these differences could affect the performance of Islamic banks.

Research Questions

Specifically, this study has been undertaken to explore the answers to the following research questions;

1. What are the dimensions that represent the corporate governance and banking performance?
2. Is there any relationship between corporate governance and banking performance in conventional and Islamic banks?
3. Does corporate governance have any impact on banking performance?

Research Objectives

The main objective of this study is developed, in order to achieve the answer to the above research questions. The major objective of this study is to compare the different corporate governance and banking performance practice of Islamic and conventional bank of Sri Lanka and also to identify the relationship between corporate governance and banking performance in conventional and Islamic bank in Sri Lanka. Further the research discusses the following secondary objectives,

- To identify the dimensions that represent the corporate governance and banking performance.
- To identify the impact of corporate governance on banking performance.

Literature Review

It is a general belief that good corporate governance enhances a firm performance. However, there have been some studies that have gone against this notion. For this reason it is inconclusive or inconsistent to say that corporate governance and firm performance are directly correlated. In a study by Akyereboah-Coleman (2008), the effect of corporate governance on the performance of firms in Africa was carried out. The researcher found a clear relationship between corporate governance and performance. An empirical analysis was also carried out in Kenya, between the relationship of corporate governance and bank performance (Barako and Tower, 2007). The research was to empirically examine the relationship between ownership structure and bank performance (Barako and Tower, 2007: 139). Good corporate governance leads to increased valuation, higher profit, higher sales growth and lower capital expenditure. (Wolfgang, 2003).

The governance of banking firms may be different from that of unregulated nonfinancial firms. When addressing corporate governance of banks, we should, firstly, take into consideration particular features of corporate governance of the financial sector (Adams and Mehran, 2003). Since banks are not like other firms, why they should be treated differently? Banks are characterized by the liquidity production function, the deposit assurance fund, the assets structure, and problems of loyalty, and the greater opaqueness that cause a heavily regulation (Macey and O'hara, 2003). Furthermore, Islamic banks include other special corporate governance features that make corporate governance of IBs different from conventional banks. Islamic finance is based on Sharia law and the Islamic bank must undertake activity only on the basis of Islamic principles.

Hence, the risk of noncompliance to Shari'a principles can create financial confusion. Moreover, Islamic banks are characterizes by the existence of the unrestricted Investment Account holders, which leads to commingling their funds with the shareholders' stakes. As a result, the return will be commingled. This can be a source of a principal agent problem and an interest conflict issue and give rise to the unresolved corporate governance issue regarding the protection of the rights of investment account holders versus shareholders. As well, less transparency, weak market forces and sometimes-weaker government oversight characterize the institutional environment in which Islamic banks operate (Claessens, 2006). All these factors make the corporate governance of IB different from their conventional counterpart.

Board Size - BS

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 Chief Executive Officer to dominate. However, some authors have advocated for smaller boards. (Fama & Jensen, 1983) argue that, large boards are less effective and are easier for the CEO to control. When a board gets too big, it becomes difficult to coordinate, 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.

Eisenberg, Sundgren, and Wells (1998), documented a similar pattern for a sample of small and midsize Finnish firms. Their study also revealed that board size and firm value are negatively correlated. Beiner, Drobetz, Schmid and Zimmermann (2003) conducted a study over companies listed on the Swiss Stock Exchange (SWX). Study did not find a significant relationship between board size and firm valuation, as measured by Tobin's Q. Authors suggested that Swiss firms, on average, choose their number of board members just optimally.

Non- Executive Director - NED

Baysinger, (1985) and Hambrick, (2000) found evidence for the proportion of independent non-executive directors to be positively correlated with the accounting measure of performance. On the other hand, studies by Klein (1998), Bhagat, (1997), Hermalin, (1991) experienced a high proportion of independent directors does not predict a better future accounting performance. Using accounting measures Agrawal, (1999) observed a negative relationship between board independence and firm's performance.

Zubaidah (2009)found that independent non-executive directors contribute significantly in the long term performance of the company in addition. dehance et al (2001) concluded that there was a significant positive relationship between the independent directors' percentage in a firm and return on equity (ROE) among Belgian companies. O'Connell and creamer (2010) found that there was a positive and significant association between the percentage of non-executive directors on the board and firm performance.

Board Meeting Frequency - BMF

Board meeting frequency potentially carries important governance implications as it is less costly to adjust the frequency of its board meetings to attain better governance of the firm, than to change the composition of its board or ownership structure. The association between board meeting frequency and firm value remains unclear. In addition, the linkage between board activity and the degree of monitoring is difficult to isolate. Jensen (1993) argues that boards of well-functioning firms should be relatively inactive and exhibit few conflicts.Frequently scheduled meetings generate costs, including managerial time, travel expenses, administrative support and directors' meeting fees. As a firm's performance decline, boards are likely to become more actively scrutinized by shareholders and are likely to meet more often to cope up with the declining value. The benefits of increased board activity will include more time for directors to confer, set strategy and monitor management. Hence, there will be a positive or negative relationship between board meeting frequency and firm value.

Board committee - BC

Klein (1998) examines the relationship among audit, compensation, nominating, investment, and finance committees and firm performance. Researcher finds firm performance is positively related to fractions of inside directors serving on finance and investment committee.

Board members are also part of committees, therefore, it is beneficial to examine various aspects of committees. The NZSC (2004) recommends that companies have audit committees and remuneration committees to oversee the audit of financial statements and to set up remuneration for executive officers and directors. The committees are important to ensure that the financial procedure is carried out well and the directors are appropriately compensated, hence, mitigating any agency problems. Felo, Krishnamurthy and Solieri (2003) empirically examine the relationship between expertise, independence, the size of audit committees and the quality of financial reporting. Researchers find that, expertise and size are positively related to financial reporting quality, but are not related to committee independence. State that given the prior evidence of a negative relationship between financial reporting quality and cost of capital, firms could improve their reporting quality by appropriately structuring their audit committees, thus reducing their cost of capital. The presence of audit committees in public, corporate entities has a positive effect on reducing agency costs when measured by cost to revenue (Reddy, 2010). Furthermore, an effective nomination committee should ensure the appointment of non-executive directors whose interests are aligned with those of the shareholders and reduce any agency problems.

Firm Performance

Bank performance is the bank profitability and productivity in banking (Jeon and Miller, 2006). In addition that, performance may also refer to the development of the share price, profitability or the present valuation of a company (Melvin and Hirt, 2005). A wide variety of definitions of firm performance have been proposed in the literature (Velnampy and Nimalathasan (2008) examined about firm size on profitability between Bank of Ceylon and Commercial Bank of Ceylon in Sri Lanka during ten year period from 1997 to 2006 and found that, there is a positive relationship between Firm size and Profitability in Commercial Bank of Ceylon Ltd, but there is no relationship between firm size and profitability in Bank of Ceylon. Various studies identified the determinants of profitability (Velnampy, 2005 & 2005, 2013, Velnampy and Pratheepkanth, 2012, and Niresh and Velnampy, 2012) The existing literature on corporate governance practices has used accounting-based performance measures, such as Return on Equity (ROE) and Return on Assets (ROA), and market-based measures, such as Tobin's Q, as proxies for firm performance. (Abdullah 2004; Bhagat & Black 2002; Daily & Dalton, 1992).

Methodology

Sample Selection

This study uses the financial statements and the statement of corporate governance of both conventional bank and Islamic bank in Sri Lanka, as the sources of sample data, for the sample period from 2011 to 2014. There are a total of 23 conventional banks and 1 Islamic banks present the licensed commercial banks under the regulated by the central bank of Sri Lanka. The sample consists of one conventional bank, which is a commercial bank of Ceylon PLC and one Islamic bank which is Amana Bank PLC.

Data & data collection method

Data was collected from secondary source mainly from the financial report of the selected banks as the sources of sample data for the sample period from 2011 to 2014. Furthermore, this research focuses on the directors' reports, balance sheets, and income statements in their annual reports and Newsletters, News articles and websites. Further researcher has read some books and lot of research papers to have broad knowledge regarding the study. Secondary data for the study is drawn from audited accounts [i.e., income statements (statement of comprehensive income) and balance sheets (statement of financial position) of the concerned banks as fairly accurate and reliable.

Methods of Analysis

In this study examine the extent to which the corporate governance practices and banking performance are different in Islamic and conventional bank in Sri Lanka, a comparative analysis was conducted. Ratio analysis was used to compare the different bank performance of Islamic and conventional bank. In the present study, researchers analyze data by employing correlation. Correlation analysis was conducted to find out if there is an association between the corporate governance and banking performance. For the study, the entire analysis is done by personal computer. A well-known statistical package like 'Statistical Package - IBM SPSS 20 was used in order to analyze the data.

Conceptual Framework

The following conceptual model was formulated to illustrate the relationship between corporate governance and banking performance.

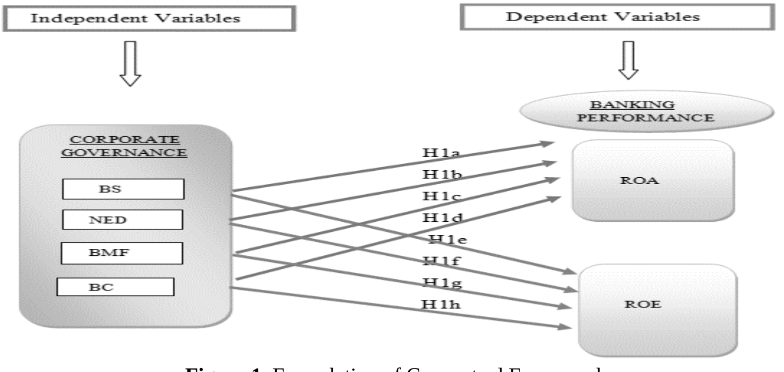

Figure 1. Formulation of Conceptual Framework

Where,

BS – Board Size ; NED – Non – Executive Directors; BMF – Board Meeting Frequency ;
BC – Number of Board Committees; ROA – Return on Asset; ROE – Return on Equity

Operationalization

Table 1. Operationalization

Concept	Variable	Types of Variable	Measurement
Corporate Governance	• Board size (BS) • Non – Executive Directors (NED) • Board meeting frequency (BMF) • Number of board committees (BC)	Independent Variables	• Number of directors • The number of the non - executive director in the board • Number of the meeting during the year • Number of board directors' committee
Performance	• ROA • ROE	Dependent variables	• Net profit after tax • Total asset • Net profit after tax • Shareholders' equity

Hypothesis Development

H_0: There is no relationship between corporate governance and banking performance
H_1: There is a relationship between corporate governance and banking performance.
H_{1a}: There is a relationship between BS and ROA
H_{1b}: There is a relationship between NED and ROA
H_{1c}: There is a relationship between BMF and ROA
H_{1d}: There is a relationship between BC and ROA
H_{1e}: There is a relationship between BS and ROE
H_{1f}: There is a relationship between NED and ROE
H_{1g}: There is a relationship between BMF and ROE
H_{1h}: There is a relationship between BC and ROE

Results and Discussion

Corporate governance variables analysis based on the historical data from the period 2011 to 2014 on the Islamic and conventional bank of Sri Lanka. The variables include BS, NED, BMF, and NBC. For the best comparison, each year the corporate governance variables for Islamic and conventional banks are estimated.

Board Size (BS)

Board size is one of the determinants of banking performance. The board size of Islamic bank is significantly larger than conventional banks. In 2011, board size value of Islamic bank is more than 12, while it is less than 12 in conventional bank from year 2012, to 2014. This is confirming that there are different practices of corporate governance between both Islamic and conventional banks in Sri Lanka.

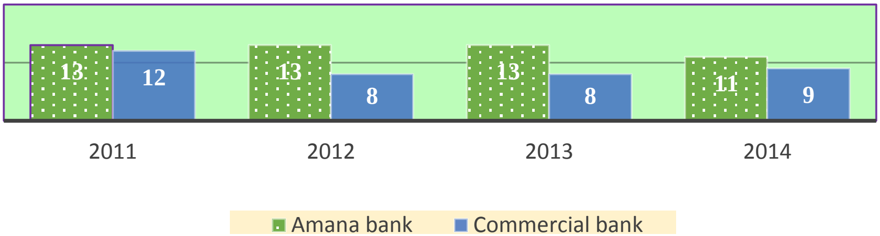

Figure 2. Size of Board

Non – Executive Directors (NED)

Non –Executive Directors have also been another determinant of banking performance. This determinant also seems different between both banks. The number of non - executive directors of Islamic bank is higher than conventional banks, as it is 12 in Islamic bank from year 2011, 2012 and 2013. While it is less than 10 in conventional bank. From year 2011 to 2014 non – executive directors' ratio of the Islamic bank is also higher than conventional banks.

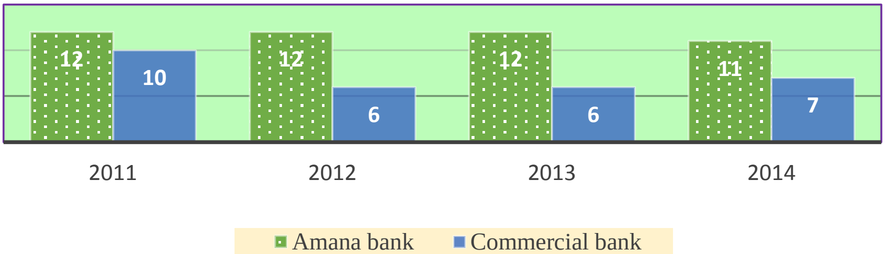

Figure 3. Non-Executive directors

Board Meeting Frequency (BMF)

Number of board meetings of conventional bank are higher than Islamic bank. The number of board meetings of Islamic bank is 5 in 2011, because that, the bank commenced commercial operation in august 2011. In 2014, the commercial bank has conducted 18 boards meeting while Islamic bank has just 12. Year 2011, to 2014 while number of board meetings of conventional bank are more than 12, the number of board meetings of conventional bank is no more than 12. This also indicates the different corporate governance practices of both Islamic and conventional banks.

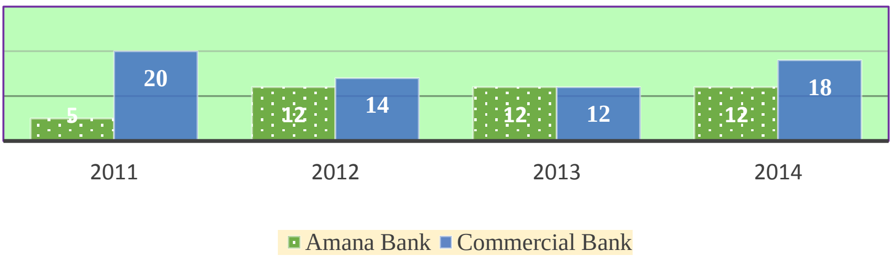

Figure 4. Board Meeting Frequency

Number of Board Committee (BC)

Number of board committee also is another dimension of banking performance. This determinant was also different between both Islamic and conventional bank. Number of board committees of conventional bank are higher than Islamic bank, as it's more than 05 in conventional bank and less than 05 in Islamic bank from year 2011 to 2014. This indicates that there is a different corporate governance practices of both Islamic and conventional banks.

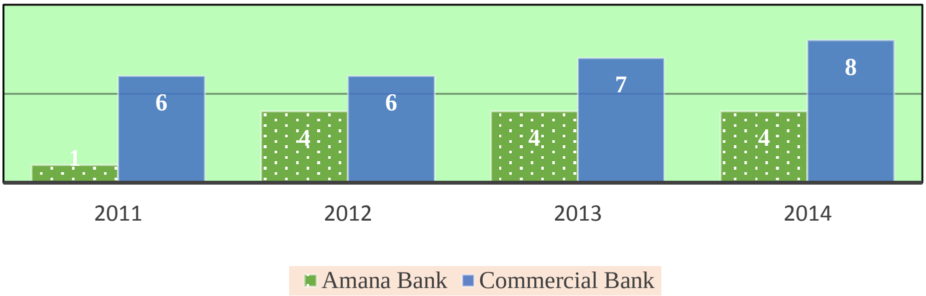

Figure 5. Number of Board Committees

The ratio analysis on the historical data from the period 2011 to 2014 of the Islamic and conventional banks of Sri Lanka was done. The ratios include the ROA and ROE. For the best comparison, the average ratio of Islamic and conventional banks are calculated for each year.

Return on assets (ROA)

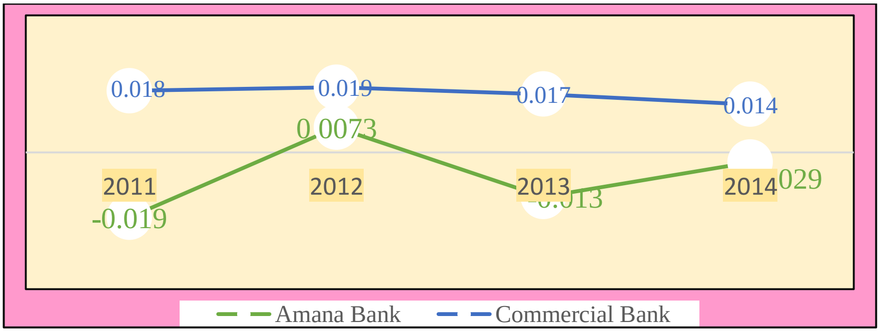

Figure 6. Comparison Return on Assets of Commercial Bank of Ceylon and Amana Bank

Return on assets of conventional bank is higher than Islamic bank. It shows better ROA from 2011 to 2012. It is increased by 0.019. But ROA of conventional bank decreased from the year 2012 to 2014. However, comparing with Islamic bank, conventional bank has achieved higher profit than Islamic bank. The results show the return on asset for conventional bank is 0.018 whereas the return on assets for Islamic bank is -0.019. While the conventional bank earns profit, Islamic bank (loss). The losses recorded in Islamic bank in this period are due to the pre – operating expenses incurred within the financial budget for the period. But in 2012 Islamic bank has gained the profit

Even though ROA of Islamic bank decreased from the year 2012 to 2014. This result indicates the difference between ROA of conventional and Islamic banks.

Return on Equity (ROE)

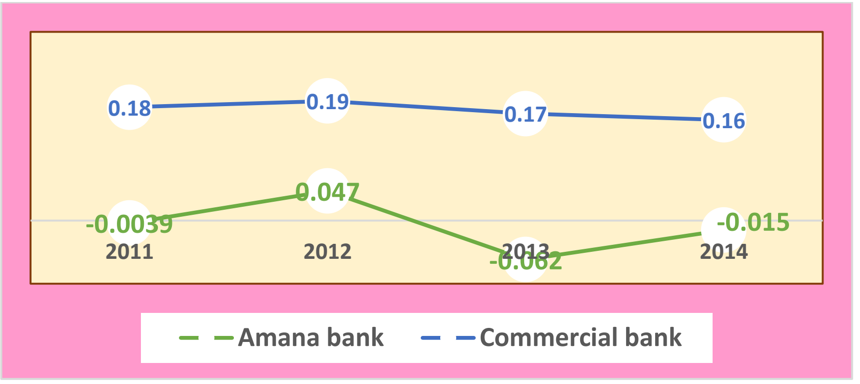

Figure 7. Comparison Return on Equity of Commercial Bank of Ceylon and Amana Bank

Return on equity of conventional bank is higher than Islamic bank. It shows better return to the investments of the shareholders of conventional bank. The result shows that the ROE for conventional bank is 0.018 whereas the ROE for Islamic bank is -0.0039. ROE of conventional bank increased from the year 2011 to 2012. But in later years ROE of the conventional bank decreases the trends year by year. Return on equity of Islamic bank is going down. It was increased from the year 2011 to 2012 by 0.047. But in 2013 it decreased by -0.062 and also increased from the year 2013 to 2014 by -0.015.This results indicates there is a difference between the value of ROE of conventional and Islamic banks.

Table 2. Correlation Matrix for conventional Bank

		ROA	ROE	BS	NED	BMF	BC
ROA	Pearson Correlation	1	-.395	.600	.600	.305	.073
	Sig. (2-tailed)		.605	.400	.400	.695	.927
ROE	Pearson Correlation	-.395	1	.068	.068	-.141	-.944
	Sig. (2-tailed)	.605		.932	.932	.859	.056
BS	Pearson Correlation	.600	.068	1	1.000**	.868	-.322
	Sig. (2-tailed)	.400	.932		.000	.132	.678
NED	Pearson Correlation	.600	.068	1.000**	1	.868	-.322
	Sig. (2-tailed)	.400	.932	.000		.132	.678
BMF	Pearson Correlation	.305	-.141	.868	.868	1	.000
	Sig. (2-tailed)	.695	.859	.132	.132		1.000
BC	Pearson Correlation	.073	-.944	-.322	-.322	.000	1
	Sig. (2-tailed)	.927	.056	.678	.678	1.000	

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

Those tables and graph describe corporate governance practices and compare the performance and the perspective of the assets, equity growth of Islamic bank and conventional bank in Sri Lanka. Using the ROA and ROE ratio, the researchers find that conventional bank performs better than Islamic bank. It also revealed that, even conventional banking assets are significantly more important than Islamic assets. The growth of banking assets is increasing in Islamic bank. Even though the Islamic has grown, the bank has to spend more to get profit. For the development, such as implementing branch network, ATMs…etc… Islamic bank can't manage it because the Islamic bank is newly entrance banking industry in Sri Lanka. But, as conventional bank (commercial bank of Ceylon) running for a long time, they have received profit more than Islamic bank.

Result of Correlation Analysis

Correlation analysis is performed to find out the relationship between variables; BS, NED, BMF, BC ROA and ROE.

Table (2) shows the correlation values of conventional banks. Corporate governance is positively correlated with ROA, which is not significant as well as corporate governance is negatively correlated with ROE except BS and NED.

Table 3. Correlation Matrix for Islamic Bank

		ROA	ROE	BS	NED	BMF	BC
ROA	Pearson Correlation	1	.665	-.231	-.231	.697	.697
	Sig. (2-tailed)		.335	.769	.769	.303	.303
ROE	Pearson Correlation	.665	1	.097	.097	-.068	-.068
	Sig. (2-tailed)	.335		.903	.903	.932	.932
BS	Pearson Correlation	-.231	.097	1	1.000**	-.333	-.333
	Sig. (2-tailed)	.769	.903		.000	.667	.667
NED	Pearson Correlation	-.231	.097	1.000**	1	-.333	-.333
	Sig. (2-tailed)	.769	.903	.000		.667	.667
BMF	Pearson Correlation	.697	-.068	-.333	-.333	1	1.000**
	Sig. (2-tailed)	.303	.932	.667	.667		.000
BC	Pearson Correlation	.697	-.068	-.333	-.333	1.000**	1
	Sig. (2-tailed)	.303	.932	.667	.667	.000	

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

Table (3) shows the correlation values of Islamic banks. BS and NED are negatively correlated with ROA, which is not significant. Other variables BF and BC are positively correlated which is not significant. Corporate governance is negatively correlated with ROE except BS and NED. All corporate governance variables of Islamic and conventional banks are not significantly correlated with ROE and ROA as the measures of bank performance. It means banks are still not properly practiced corporate governance guidelines. Therefore, banks should pay attention on the role of corporate governance measures.

Concluding Remarks and Recommendation

This study examined corporate governance and banking performance: a comparative study between Islamic and conventional banks in Sri Lanka. The comparative analysis shows all variables of corporate governance are positively correlated with ROA in conventional bank as well as, in Islamic bank except BS and NED other variables have normal negative relation with ROA which is not a significant level. Similarly, except BS and NED other variables have negative relation with ROE in Islamic and conventional banks. BS has strong negative with ROE in conventional banks. But the Islamic bank has a normal negative relationship. Further corporate governance has a moderate impact on the performance of both Islamic and conventional banks.

The results of analyses indicates that the correlation coefficient for all four variables such as board size, non –executive directors, board meeting frequency and board committee are not significant. The board committee, including independent non-executive directors and executive directors should have an effective and complete role in controlling the opportunistic behavior in management and also banks should have regular meetings to discuss and monitor the activities of the firms. Furthermore, values for all four variables of corporate governance are insignificant event at the 5% level. It revealed that, these variables are not contributing to the performance measures of ROA and ROE. The results of the correlation analysis indicate that the determinants of corporate governance such as board size, non –executive directors, board meeting frequency and board committee are not significantly correlated with ROE and ROA as the measures of firm performance of Islamic and conventional banks. It means banks are still not properly practiced corporate governance guidelines in Sri Lanka. Consequently, banks should pay attention on the role of corporate governance measures. To conclude that, the results of this study provide evidence that the corporate governance measures are not significantly correlated with ROE and ROA as the performance measures. So that, all alternate hypotheses are rejected.

Anchored on the above summary of findings and conclusion, the following recommendations are made: the banking sector should:

1. Ensure greater compliance with legal and regulatory requirements since it was found to be performance enhancing. This would ultimately translate to significant positive effect on performance via substantial increases in return on equity and return on assets.
2. Embark on cost-saving composition of board size and structure as well as proactive strategies in order to reverse the negative effects on operational performance.
3. Ensure optimal compliance with laid down rules, optimal board composition proactive practices to push for significant positive effect on the performance of corporate governance practices in the sector.
4. Evolve additional corporate governance practices to mitigate the overbearing negative effects of board composition and proactive practices of the boards and managements. This would be likely reverse the negative effects and enhance the power of corporate governance practices in explaining the dynamics of operational performance.
5. Where appropriate, substitute new found more performance-friendly corporate governance practices for those considered in this analysis whose effects on performance were negative.
6. Banks should look beyond corporate governance structure and incorporate these and other corporate governance practices into their management policies within their internal and external business environments.
7. Embark on holistic re-examination of corporate governance practices in the sector to enhance their update and dialogue with legal/regulatory authorities in the manufacturing sector. Government and Regulatory agency in the banking sector should:
   a) The regulatory agency for banks should develop a checklist with which firms can score them in the aspect of compliance with corporate governance

practice. This score should become an inherent component of every firm's (public and private) annual financial report.

b) To ensure adherence to the rules of scoring, there should routine and sentinel auditing of the scoring by the regulatory agency concerned. It is vital to ensure deeper investor engagement and involvement in the affairs of the banks. To facilitate, firms should set fairly high or competitive standards in the selection of non-executive and independent directors for board committee duties. This is critical if such committees are to have a strong impact on the governance of the firm.

It can be suggested that the directors of the board should concentrate on playing their essential role properly for the activities of the banks and also advice the banks to have more independent directors within the benchmark for the number of directors. This is supported by Wyatt (1990) and Baysinger and Butler (1985). As per the study, the average number of committees which company had is two. It is better to have all relevant committees such as remuneration committee, audit committee and nomination committee to look after the activities and task of the banks. The banks should have a regulate meeting. Further decisions made at the meetings are also important for the success of the company. Companies can concentrate on segregation of duties for their efficient operations. An effective board is one that facilitates the effective discharge of the duties imposed by law on the directors and adds value in a way that is appropriate to the particular bank's circumstances. The board should be structured in such way that it:

- Has a proper understanding of and competence to deal with the current and emerging issues of the business.
- Exercises independent judgment and Encourages enhanced performance of the bank.
- Can effectively review and challenge the performance of management

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