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Reducing Agency Costs through Balanced Decision-Making Power in Sri Lanka

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Abstract

This study examines how corporate decision-making dominance leads to agency conflict between managers and shareholders of Sri Lankan firms, where board members and managers are assumed to hold dominant decision-making power derived from legitimate authority and socio-cultural characteristics. The panel dataset spanning over thirteen years from 2011 to 2023 used in this study covers 200 firms listed on the Colombo Stock Exchange. Different proxies were separately used to measure board decision-making dominance, managerial decision-making dominance, and agency cost. The findings reveal that board decision-making dominance does not increase agency costs, suggesting that existing good practices of corporate governance may have encouraged a dual leadership structure and board balance. In contrast, managerial decision-making dominance leads to severe agency conflicts, suggesting that when managers hold excessive decision-making power, agency conflicts are intensified. In terms of large shareholders, their presence does not play any moderating role in the relationship between corporate decision-making dominance and agency dynamics. Their influence appears insufficient to produce a significant interaction effect, likely due to the absence of active shareholder engagement in Sri Lanka. In conclusion, the study recommends the implementation of checks and balances to prevent excessive concentration of decision-making power within the boardroom and management team. Thus, regular reviews and assessments on the distribution of power among upper echelons are required to maintain a balanced and effective governance structure.

JEL Classification*: G30, G32, G34, M12*

Keywords: *corporate governance, board dominance, managerial dominance, agency costs, large shareholders*

1. Introduction

Managerial power and decision-making behavior are crucial to understanding how organizations function. Managers control resources, set strategies, and influence people, which gives them power in shaping outcomes. Different theories explain how this power operates. Yukl (2013) explained that managers with knowledge can influence key strategic choices. French and Raven (1959) outlined that coercive power can lead to compliance, but excessive use can reduce trust and long-term commitment, affecting the quality of decisions. Pfeffer (1992) also argued that organizations are political systems where managers use power and influence to achieve their goals. This can ultimately lead to the maximization of shareholders' wealth.

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However, when the firm becomes larger, the problem of the separation of ownership and control, identified by Berle and Means (1932) for the large corporation, can arise where managers do not act in the best interest of shareholders. This can eventually lead to an agency cost, where the theory was first outlined by Smith (1776) as conflicts of interest between the so-called agent and principal. This was later formalized by Jensen and Meckling in 1976, highlighting the increased agency cost owing to the self-interested behavior of managers. When managers use their decision-making power to pursue such self-interested behavior, it can lead to agency costs. Such power can be generated through legitimacy and some socio-cultural characteristics of managers (Finkelstein, 1992). Though agency costs are supposed to be mitigated by the presence of shareholder-managers, their large equity stakes may create decision-making power among others, which may in turn create agency conflicts. This supports the entrenchment effect of managerial ownership (Onali et al., 2016), where managers would use their power to extract higher emoluments and other personal benefits (Dutta et al., 2011).

Managers with longer tenure are presumed to be more mindful of the firm, and consequently, they may exert authority over the departments and units. Hermalin and Weisbach (1998) underline that firms need to monitor new CEOs more than longer-tenured CEOs, given that the abilities of new CEOs are uncertain. However, such an experienced CEO may spread authority across the firm, and consequently, his/her dominating decisions may inspire self-interest. Chaganti et al. (2001) show that firms with longer-term CEOs underperform.

When managers gradually obtain experience and expert knowledge across a variety of functions, they would be offered board seats at other firms. CEO’s holding such cross-directorships are likely to be industry leaders, and in turn, they may showcase their power in decision-making within the firm, resulting in expropriation of corporate resources. This is theoretically argued as prestige power, which arises mainly from individuals’ prestige and popularity (Kim & Lu, 2011).

Expert knowledge of managers can also serve as a driver of decision-making dominance. According to Jensen and Zajac (2004), this educational background-based decision power is regarded as one aspect of the prestige power of managers. Such knowledge is basically presumed to be prevalent among managers who have completed higher education and/ or obtained memberships of professional bodies. When managers raise their voice with expert knowledge in corporate decision-making, other people would have less confidence in their decision contributions, resulting in a disparity in decision dominance.

Historically, males have dominated in almost all societies, from households to public administration. Such male dominance could also be prevalent in the corporate sector, particularly in holding key managerial positions. When male managers head some committee meetings, others would raise fewer counterarguments than on occasions where such committees are headed by female managers. Thus, with the presence of a male CEO, he would extend his decision-making power not only over committees but across the entire firm. Wang et al. (2019) highlight the prevalence of the gender imbalance problem at CEO and managerial levels in Asian countries.

Management behavior is particularly important in Sri Lanka, as cultural and organizational structures influence the way that decisions are made. Its corporate sector is also characterised by a concentrated ownership structure and family control. Sumanasiri (2020) shows that for Sri Lankan managers, sustainable leadership is most strongly driven by stakeholder relationships, ethical behavior, and change leadership, which plays a key mediating role. This shows that how managers behave can affect the alignment between their decisions and shareholder interests, which is directly related to agency costs.

The appointment of members of the board of directors and external auditors came to the forefront to monitor the management. Directors may particularly have incentives to maintain their independence in monitoring management. However, directors may build up their power in decision-making upon some firm-specific and socio-cultural characteristics: CEO duality, executive directorship, family directorship, founding chairmanship, and board ethic homogeneity (Nazliben et al., 2023). In these cases, board members would showcase decision-making dominance, resulting in decision bias. Thus, it is suspicious whether the expected monitoring role of directors towards managers is sustained. Whereas, as we discussed earlier, the CEO himself develops power in decision-making upon his large equity stake, longer tenure, cross-directorships, expertise, knowledge, and masculinity. Thus, we argue that corporate decision-making dominance held by the board as well as managers could lead to agency conflicts between managers and shareholders.

This study carries several important theoretical and practical implications. It may at first contribute to the larger literature on corporate governance in Sri Lanka by bringing a fresh viewpoint to the preexisting theoretical framework. Managers in Sri Lankan companies can benefit from understanding how specific traits within boards and management can influence decision-making and perhaps cause agency conflicts. They can reduce conflicts and enhance corporate governance processes using this knowledge. By disseminating the findings, Sri Lanka can improve shareholder protection in places where governance practices might benefit from improvement or reform. The study's findings can be used by regulators and policymakers to develop corporate governance laws in Sri Lanka. The creation of governance policies that better balance the interests of management and shareholders can be informed by this. Increased investor trust in Sri Lankan businesses can bring in more domestic and foreign investments and promote economic progress. This is made possible by having a better grasp of the variables causing agency disputes. This research may be used as a foundation for comparison assessments with other nations, providing insights into how corporate governance dynamics vary between countries and regions, which can be helpful for conversations about international trade and policy. By offering empirical data and insights particular to the Sri Lankan context, the study adds to the academic literature.

2. Literature Review

Corporate governance was initially defined by Andrei Shleifer and Robert Vishny (1989) as the mechanisms that ensure a favorable return for the company's financial stakeholders. The primary objective of corporate governance is to enhance returns to shareholders and creditors. As companies grow larger, separation of ownership and control becomes a concern, a concept first highlighted by Berle and Means (1932) for large corporations. In such cases, managers may not consistently act in the best interests of shareholders, leading to agency costs. This idea was initially discussed by Adam Smith (1776), addressing conflicts of interest between agents and principals. Jensen and Meckling (1976) formalized this concept, defining the agency relationship as a contract where one party (the principal) engages another party (the agent) to perform services on their behalf. Consequently, organizations have sought ways to enforce discipline on managers, leading to the prominence of appointing board members and the external auditor. Based on these, corporate governance mechanisms, including board and managerial structures, can influence agency costs. The importance and ways of protecting shareholders’ rights are further stressed by shareholder theory and resource dependency theory.

Shareholder theory suggests that the firm is looking to maximize the wealth of its shareholders (Ferrero et al., 2014). Managers should invest in positive NPV projects which seek to create the maximum value for the firm's investors. Jensen and Meckling (1976) highlighted that the agency cost arises when managers often fail to maximize profits, thereby shareholders invest time and money to create appropriate incentives and monitor the resulting behaviors. In contrast, shareholder theory is restricted to generating benefits for stakeholders by neglecting the important role of those players in or around a firm, including employees, suppliers, customers, the government and society. When it comes to stakeholder theory, Parmar et al. (2010b) stressed that corporations should be managed in a way that serves the interests of all contributors, not solely the shareholders. However, Sundaram and Inkpen (2004) stated that aiming for shareholder value maximization can be advantageous to all stakeholders since the cash flows from share ownership are residual claims, which are due only after all committed corporate obligations. Therefore, this indicates that managerial and board decisions aligned with shareholder interests can reduce agency costs.

According to Braam and Peeters (2017), firms depend on external resources for survival. The resource dependency theory emphasizes how the environment plays a key role in the fate of an organization and how adverse conditions make it difficult for the business to survive (Wu et al., 2023). The negative impact of the environment on the company can break its autonomy and cast doubt on its future. For example, a company's daily operations, resource management, and strategic decisions can influence the environment. One of the most important tools for reducing the company's dependence on the environment is the board of directors (Wijethilake & Ekanayake, 2019). Hence, board composition and decision-making power may directly impact agency costs by mitigating external risks.

2.1. Board Dominance

The appointment of members of the board of directors and external auditors came to the forefront to monitor the management. Directors may particularly have incentives to maintain their independence in monitoring management. However, directors may build up their power in decision-making upon some firm-specific and socio-cultural characteristics: CEO duality, executive directorship, family directorship, founding chairmanship, and board ethic homogeneity (Nazliben et al., 2023). In these cases, board members would showcase decision-making dominance, resulting in decision bias, which is commonly referred to as board dominance.

CEO Duality

Those who advocate either combining or splitting the roles of CEO and chairperson have their own theoretical justifications. Some refer to this as CEO duality and non-duality. Finkelstein and D'aveni (1994) argue that the roles of CEO and chairman within a firm are best filled by separate individuals. When these roles are combined into a single position known as CEO duality, it often indicates a powerful and dominant CEO who can exercise significant control over the board. As highlighted in research by Daly and Dalton (1993) and Jensen (1993), this integration may lead to a situation in which the board becomes less effective in its oversight role, particularly in detecting and preventing managerial selfishness and opportunistic behavior. CEO duality enhances CEO entrenchment and reduces board independence (Finkelstein & D'aveni, 1994b), so that fewer independent directors will be appointed to the board. Agency theory believes that CEO duality weakens board control and promotes CEO entrenchment. Therefore, CEO duality has negative implications for firm performance (Jensen & Meckling, 1976). However, it is worth noting that there are negative arguments for agency theory as well. A dual CEO leadership structure removes ambiguity in the decision-making process and can improve firm performance (Finkelstein & D'aveni, 1994b).

Executive Directorship

The executive director, usually a company's CEO, is the senior executive in the organization responsible for the day-to-day management of the company. Executive directorship, which leads to agency costs through decision-making dominance, refers to situations in which executives in key leadership positions in a company, such as the CEO or chairman of the board, use their influence and control to make primarily self-serving decisions. Bhagat and Black (2002) examine the relationship between CEO ownership and board independence. It finds that CEOs with high ownership stakes can have more influence on board decisions, which can lead to agency costs.

Family Directorship

Company ownership is concentrated in the hands of a few wealthy families (Lemmon & Lins, 2003). Claessens et al. (2002), for example, argue that using the family as the unit of analysis is useful as this approach better represents the actual control of the firm. Morck and Yeung (2003) argue that the management of family-controlled firms, acting only for the controlling family, may worsen the agency problem. The principal agency problem relates to the conflict between the controlling family and minority shareholders (Shleifer and Vishny 1997). It has been argued that the prevalence of family control provides a rationale for using the family rather than individuals as the unit of analysis, as family members of controlling owners share the same interests and adopt similar behaviors in contracting production. In Sri Lanka, family directorships are visible in many firms, showing a concentrated ownership structure.

Founding Chairman

As discussed by Demsetz and Lehn (1985), previous research suggests that founders of firms contribute value through a combination of factors such as specialized knowledge, significant and long-term ownership stakes, and nonfinancial ties such as reputation and emotional connections to the business (James, 1999). Founder-directors, because of their extensive firm-specific experience, are better positioned to minimize information gaps between the board and the management team that, as noted by Jensen in 1993, can impede effective monitoring. Consequently, firms with founder-directors are expected to face fewer agency problems and exhibit superior corporate governance relative to firms without founders. This may be why previous studies have shown that family-owned firms have higher valuations when founders are actively involved in managing the firm (Anderson & Reeb, 2003b).

Board Ethnic Homogeneity

According to Alesina and La Ferrara (2005), ethnicity is the distinctive cultural traits of certain groups made up of various abilities, experiences, and subcultures. Companies benefit from a competitive edge when their employee groups include people from a variety of cultural backgrounds (Cox & Blake, 1991b). Cook and Glass (2015) look into the relationship between racial diversity on CEO boards. They find that corporations with a white CEO and a diverse board of directors have superior corporate governance procedures and more active product innovation. Johnson and Mitton (2003) reveal that boards with higher ethnic diversity have less agency and are more autonomous. Marimuthu (2008) explains how racial diversity enhances the financial performance of businesses. Recent research by Nazliben et al. (2021) focuses on board diversity in Sri Lankan enterprises based on ethnicity, language, religion, and gender. They discover no evidence that board diversity is positively correlated with business success, and they find no indication that board heterogeneity causes interpersonal conflict or communication issues.

All these board dominance proxies capture different aspects of board dominance, but they are all related to the concentration of decision-making dominance of the board. Such higher board dominance would weaken monitoring effectiveness and decision independence, resulting in increased agency costs. Therefore, we hypothesize that *H_1: Decision-making dominance in the board increases agency costs*.

2.2. Managerial Dominance

When managers use their decision-making power to pursue such self-interested behavior, it can lead to agency costs. Such power can be generated through legitimacy and some socio-cultural characteristics of managers (see Finkelstein, 1992). Also, the CEO himself develops power in decision-making through his large equity stake, longer tenure, cross-directorships, expert knowledge, and masculinity.

Managerial Equity Ownership

It is one of the mechanisms used by corporate governance to bridge the gap between the interests of shareholders and the self-interested behavior of managers (Jensen & Meckling, 1976), thereby examining the relation between managerial equity ownership and firm performance as a proxy for agency costs (Morck & Yeung, 2003; Hermalin & Weisbach, 1998). Managers who own significant shares of their own company could exercise significant voting influence. This influence can lead to their entrenchment, thereby making it difficult to monitor the firm's operation effectively. In agreement with traditional theory, Holderness et al. (1999) predict that agency costs decline steadily as managerial equity ownership increases. However, some researchers have found that, at some levels, equity ownership aligns the interests of management with those of shareholders, reducing agency costs. Accordingly, share ownership of top management is positively related to firm performance (Chaganti & Damanpour, 1991).

CEO Tenure

CEO tenure and its relationship with strategic decisions and firm performance has attracted considerable scholarly attention (Dechow & Sloan, 1991). Jensen (1993) and Hermalin and Weisbach (1998) provide significant insight and emphasize a direct correlation between CEO tenure and agency costs. Previous research on the relationship between CEO tenure and agency costs suggests that as a CEO's tenure increases, they tend to accumulate more power and become stronger in their position. As a result, they may prioritize their own interests over those of shareholders and reduce the board's monitoring effectiveness due to their enhanced control. This dynamic may ultimately have a positive relationship with agency costs. In contrast, research by Fang et al. (2020) suggests that CEOs with extensive experience tend to enhance corporate performance through their expert knowledge and influence. On average, CEOs tend to hold their position for approximately seven years in Sri Lanka (Nazliben et al., 2023).

Interlocking Director (CEO Cross-directorships)

Consistent with Rahman's (2010) definition, a corporate governance concern arises when two directors simultaneously serve on the boards of two different companies. This situation often occurs when the CEO of Company A serves on the board of Company B, and the CEO of Company B serves on the board of Company A. This situation can increase the company's performance as it deals with additional information of rival companies, which ultimately enables it to do an indirect comparison (Haniffa & Cooke, 2002). In terms of decision-making structure, outside executives on corporate boards have been associated with strengthening management, as evidenced by Davis et al. (1997). This suggests that the presence of these external executives may lead to an imbalance of decision-making power within firms and may exert excessive influence on decision-making processes. Nevertheless, it gives competitive disadvantages to the company if executive directors sit on more than one board, which will make them less independent (Davis et al., 1997). However, this negative aspect of CEO power is related to nepotism and may be particularly relevant in the Sri Lankan context (Nazliben et al., 2023).

CEO Expertise Knowledge

In the field of prestige power measurement, it is recommended that knowledge and expertise play a vital role (Jensen & Zajac, 2004). As shown by Lei et al. (2023b), when the CEO is older, has a higher educational background and has more international experience, the agency costs associated with management tend to decrease. As suggested by Johnson et al. (2013) and Jiang et al. (2016), individuals with higher education are better at bridging the gaps and analyzing business problems and thus provide more comprehensive solutions, which can be considered as his expectation. We find that there is a positive relationship between firm performance and expertise knowledge (Fang et al., 2020). Moreover, the lack of supervision knowledge in a related industry is due to the inaccessibility of expert staff, and this could enhance the agency costs.

CEO Masculinity

The gender gap in senior management positions, particularly regarding CEOs, has been extensively discussed in the field of corporate governance (Flabbi et al., 2019). According to early studies, businesses with more executive female representation have lower organizational expenses. However, when diversity is considered, the negative association between the two is not as significant. For instance, Welbourne (1999) discovered that having women on a company's senior management team improves the short-term success of the company (as shown by Tobin's Q) as well as long-term performance (expressed as the price of a stock over three years), growth and EPS growth. According to several studies, businesses with more women on their boards typically pay less in agency fees (Antoni et al., 2011). It is important to note that female members may be more able to participate in board meetings, which might improve their efficacy (Kiliç et al., 2015). Jurkus et al. (2011) suggest that a rise in the proportion of women in top management positions might reduce agency expenses.

Overall, these factors emphasize how managerial dominance concentrates decision-making power in management, reducing oversight and increasing agency costs. Thus, we hypothesize that *H_2: Decision-making dominance in the top management team increases agency costs.*

2.3. Presence of Large Shareholder

The presence of large shareholders depends on the comparative size of the large shareholder (Maury, 2005). The presence of large shareholders may influence the board composition by having influence powers (Hermalin, 1995). When the interests of minority shareholders may not align with the interests of controlling shareholders, it may lead to agency costs (Jiang & Peng, 2010). The power of the largest shareholder, represented by the ownership rate, negatively moderates the relationship between board characteristics (Guizani, 2013). By considering such a critical role played by large shareholders, we propose that *H_3: The presence of a large shareholder moderates the relationship between decision-making dominance in the board and agency costs*

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Large shareholders also have strong incentives to put pressure on managers. For example, Shleifer and Vishny (1997) point out that large shareholders may address the agency problem while keeping their interest in profit maximization and enough control over the assets.

This supports us in testing *H_4: The presence of a large shareholder moderates the relationship between decision-making dominance in the top management team and agency costs.*

3. Methodology

This study investigates how corporate decision-making dominance created by board and managerial characteristics leads to agency conflict between managers and shareholders in Sri Lankan firms. The sample comprises 200 firms selected out of 284 firms listed on the Colombo Stock Exchange, representing 20 industrial sectors. When selecting the sample, banks, finance and insurance firms (owing to different accounting treatments and disclosure requirements), recently listed firms, delisted firms, and firms with missing observations were dropped. A panel dataset over 13 years from 2011 to 2023 was prepared based on the data obtained mainly from annual reports.

Based on Nazliben et al., (2023), decision-making dominance in boards was measured as a composite index using a combination of several board characteristics, namely, CEO duality (*CEO Dual.*), executive directorship (*Exec. Direct.*), family directorship (*Fam. Direct.*), founding chairman (*Found. Chair.*), and ethnic homogeneity (*Ethn. Homo.*). Each of these was measured as a binary variable and then aggregated to derive the composite index. Similarly, managerial decision-making dominance is also represented by a composite index encompassing several characteristics of the CEO, which enable her to be dominant in the top management team. These characteristics include CEO share ownership (*CEO Own.*), CEO tenure (*CEO Tenu.*), CEO cross directorship (*CEO Cros.*), CEO expertise knowledge (*CEO Exper.*), and CEO Masculinity (*CEO Mascu.*). These proxies are also measured as binary values and aggregated across the variables to derive the composite index of managerial dominance.

Both board decision-making dominance and managerial decision-making dominance are considered as explanatory variables of the study, while agency cost represents the dependent variable. Agency cost is measured using another composite index that combines capital expenditure (*Cap. Exp*), dividend payout ratio (*Div. Pay.*), *Leverage*, ownership concentration (*Own. Concen.*), *Free Cash Flow*, asset utilization (*Asset. Utili.*), and operating expenses (*Operate. Exp.*), where each is coded as a binary variable. Accordingly, higher capital expenditures, lower dividend payout, lower leverage, lower ownership concentration, higher free cash flow, lower asset utilization, and higher operating expenses are assigned a value of 1, and 0 otherwise. These binary values are then aggregated to construct the composite agency cost index. Firm size and age were used as control variables, and the presence of a large shareholder (*Larg. Shareh.*) was applied as a moderate variable. Table 1a/1b summarizes the measurements of these variables.

To establish the causal effect of managerial dominance and board dominance on agency costs, eight regression models, specified in equation 1 as the baseline form, are estimated using multiple model specifications, including pooled OLS, random effects, and fixed effects.

$$\begin{aligned} \textit{Agen. Cost}_{it} = {} & \beta_0 + \beta_1\, \textit{Board. Domi.}_{it} + \beta_2\, \textit{Manag. Domi.}_{it} + \beta_3\, \textit{Board. Domi.}_{it} * \textit{Larg. Shareh.}_{it} \\ & + \beta_5\, \textit{Manag. Domi.}_{it} * \textit{Larg. Shareh.}_{it} + \beta_7\, \textit{Size}_{it} + \beta_8\, \textit{Age}_{it} + \textit{Years} + \textit{Industries} \\ & + U_{it} \quad \ldots\ldots\ldots\ldots\ldots (1) \end{aligned}$$

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Table 1a: Variable Measurements

Variable (Acronym)	**Measurement**
Dependent Variable	
Agency Cost (Agen. Cost.)	Agency cost is measured by a composite index which combines several agency costs proxies; higher capital expenditure (*Cap. Exp.*), lower dividend payout ratio (*Div. Pay.*), lower leverage (Leverage), lower ownership concentration (*Own. Concen.*), higher free cash flow (*Free Cash Flow*), inefficient asset utilization (*Asset. Utili.*), and higher operating expenses (*Operate. Exp.*). All proxies are taken as binary variables. When they are present, the value is taken as one, otherwise zero. Values of each dummy are aggregated to develop the index. *Cap. Exp.* (capital expenditure by total assets) equals one if the capital expenditure is higher than the median of the sample and zero otherwise, *Div. Pay.* (Common dividends by net income) is one if the dividend payout ratio is below the median of the sample; *Leverage* (total debt by total equity) is one if leverage is lower than the median sample leverage; *Own. Concen.* takes a value of one if there is no single share block (10% or more) is a shareholder (who is not a director); *Free Cash Flow* (free cash flow by total assets) is equal to one if the free cash flow is higher than the sample median. Free cash flow is: [earnings before interest and taxes (1-tax rate) + depreciation and amortization – investments (including M&A expenditure) +/- changes in net working capital]; *Asset. Utili.* (Sales by total assets) equals one if the asset utilization ratio is lower than the median; *Operate. Exp.* (operating expenses by sales) equals one if the ratio is higher than the sample median.
Independent Variables	
Decision-Making Dominance in Boards (Board Domi.)	Decision-making dominance in the board is presented as a composite index which accounts for several board characteristics such as CEO duality (CEO Dual.), Executive directorship (Exec. Direct.), Family directorship (Fam. Direct.), Founding chairman (Found. Chair.), and Ethnic homogeneity (Ethn. Homo.). All characteristics are taken as binary variables. When they are present, the value is taken as one, otherwise zero. Values of each dummy are aggregated to develop the index. *CEO Dual.* equals one if the CEO holds board chair position, *Exec. Direct.* equals one if the majority of directors are executive directors, *Fam. Direct.* equals one if the majority of directors are family directors, *Found. Chair.* equals one if the founding chairman is still present, *Ethn. Homo.* equals one if the majority of directors belong to the same ethnicity.
Decision-Making Dominance in the Management Team (Manag. Domi.)	Decision-making dominance in the management team is represented by a composite index. It considers several characteristics of the CEO which enable him/ her to be dominant in the top management team. CEO share ownership (CEO Own.), CEO tenure (CEO Tenu.), CEO cross directorship (CEO Cros.), CEO expertise knowledge (CEO. Exper.), and CEO Masculinity (CEO Mascu.). All characteristics are taken as binary variables. When they are present, the value is taken as one, otherwise zero. Values of each dummy are aggregated to develop the index. *CEO Own.* equals one if the CEO and his family own 5% or more of the equity; *CEO Tenu.* equals one if the CEO’s tenure is higher than the sample median tenure; *CEO Cros.* equals one if the CEO holds cross directorships, *CEO. Exper.* equals one if the CEO has obtained a master’s degree or professional qualification, *CEO Mascu.* equals one if the CEO is a male.

Table 1b: Variable Measurements

Moderating Variable	
Presence of a Large Shareholder (Larg. Shareh.)	It equals one if a large shareholder (25% or more of equity) is present and otherwise zero.
Control Variables	
Firm Size (Size)	Natural logarithm of total assets.
Firm Age (Age)	Natural logarithm of firm age since listing status.

4. Findings

Table 2 indicates that, on average, the sample firms experience relatively moderate levels of agency costs, board dominance is relatively low, while there is a reasonable dominance in managerial decision-making. The presence of large shareholders is reported in 90.6 per cent of cases.

Table 2: Descriptive Statistics

Variable	**Mean**	**S.D.**	**Minimum**	**Maximum**
Agency cost index	3.443	1.457	0.000	7.000
Board dominance index	1.405	0.936	0.000	4.667
Managerial dominance index	2.915	0.989	0.000	6.000
Presence of large shareholder	0.906	0.292	0.000	1.000
Log (Total assets)	21.85	1.527	12.68	25.86
Log (Age)	1.643	0.727	0.000	2.485
Observations	2574	2574	2574	2574

As per table 3, both board dominance and managerial dominance show weak positive relation with agency cost. The presence of a large shareholder is also weakly related to agency costs. More importantly, the presence of a large shareholder is negatively associated with dominance in board decision-making and managerial decision-making.

Table 3: Correlation Metrix

	1	**2**	**3**	**4**	**5**	**6**
Agency cost index	1.000					
Board dominance index	0.043	1.000				
Managerial dominance index	0.087	0.041	1.000			
Large shareholder	0.047	-0.034	-0.043	1.000		
Log (Total assets)	0.111	0.061	-0.008	0.013	1.000	
Log (Age)	-0.175	-0.012	0.064	0.054	0.136	1.000

In Table 4, a set of models [(01)-(08)] is presented to explain the effect of corporate decision-making dominance on agency costs. Overall, board decision-making dominance negatively and significantly affects agency costs (see models (1), (2) and (8)) at 10 per cent level. Therefore, board decision-making dominance discourages agency conflicts between managers and shareholders. However, models (1) and (7) illustrate that managerial decision-making dominance leads to higher agency costs. The presence of large shareholders does not play any moderate role in the relationship between corporate decision-making dominance and

Table 4: Regressions

	Dependent Variable: Agency Cost							
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Board dominance	-0.055* (0.033)	-0.143* (0.082)	-0.012 (0.059)	0.005 (0.105)	0.009 (0.079)	0.037 (0.124)	-0.055 (0.034)	-0.143* (0.074)
Managerial dominance	0.078*** (0.029)	0.049 (0.047)	-0.007 (0.037)	-0.031 (0.056)	-0.037 (0.040)	-0.049 (0.060)	0.078*** (0.028)	0.049 (0.042)
Board dominance * Large shareholder	- -	0.103 (0.087)	- -	-0.018 (0.101)	- -	-0.030 (0.108)	- -	0.103 (0.080)
Managerial dominance * Large shareholder	- -	0.036 (0.042)	- -	0.026 (0.046)	- -	0.013 (0.049)	- -	0.036 (0.039)
Log (Total assets)	0.070*** (0.020)	0.071*** (0.020)	-0.057 (0.037)	-0.057 (0.037)	-0.232*** (0.053)	-0.231*** (0.054)	0.070*** (0.020)	0.071*** (0.020)
Log (Age)	-0.347*** (0.053)	-0.352*** (0.053)	-0.324*** (0.039)	-0.325*** (0.039)	-0.290*** (0.040)	-0.290*** (0.040)	-0.035*** (0.052)	-0.352*** (0.052)
Industry	yes	yes	yes	yes	no	no	yes	yes
Year	yes	yes	yes	yes	yes	yes	yes	yes
Constant	2.191***	2.223***	5.286***	5.277***	8.796***	8.778***	2.191***	2.223***
Pooled	yes	yes	no	no	no	no	no	no
RE	no	no	yes	yes	no	no	no	no
FE	no	no	no	no	yes	yes	no	no
Robust S.E	no	no	no	no	no	no	yes	yes
R^2	0.2169	0.2193	0.1997	0.2004	0.0057	0.0058	0.2169	0.2193
Groups	-	-	205	205	205	205	-	-
Obs.	2369	2369	2369	2369	2369	2369	2369	2369

agency costs. Regardless of the cross-sectional variation, agency conflicts are more prevalent in large firms (models (1)-(2)). However, all models exhibit that agency conflicts are minimal in mature firms. Models (1) and (2) are estimated using Pooled OLS. Models (3) and (4) apply the Random Effects (RE) model, while models (5) and (6) follow the Fixed Effects (FE) model. Models with Robust standard errors are presented in models (7) and (8). Industry and year fixed effects are included in the models as indicated in equation 1. Statistical significance is denoted by *, **, and *** corresponding to the 10%, 5%, and 1% significance levels, respectively.

Based on the regression results, the hypothesis testing was executed. The first hypothesis that decision-making dominance in the board increases agency costs is not supported, as the relationship between board dominance and agency costs is negative and statistically significant at the 10% level. Literature suggests that the board of directors acts as "professional referees" providing effective oversight, hence mitigating the agency problem (Jensen & Meckling, 1976). However, the second hypothesis related to decision-making dominance in the management team is supported, as the relationship between management dominance and agency costs is positive and statistically significant at 1% level. Studies prove that self-serving managerial behaviors may lead to increased agency costs (Jensen & Meckling, 1976). The CEO’s entrenchment may reduce board oversight due to managerial dominance prioritizing their interest over shareholders (Hermalin & Weisbach, 1998). On the contrary, some empirical evidence suggests that managerial dominance may improve performance (Fang et al., 2020), and executives are assumed to work for the success of the firm (Davis et al., 1997). The third hypothesis that the moderating role of the large shareholder on board dominance is not supported. Therefore, it does not moderate the relationship between board decision-making dominance and agency cost. Though theoretical literature suggests that large shareholders can reduce agency costs by influencing board decisions (Jensen & Meckling, 1976), the study fails to support this argument. However, there is not enough evidence to support our final hypothesis that the presence of a large shareholder has a positive but insignificant effect on agency costs. This finding is consistent with the resource dependence theory, which states that large shareholders can effectively influence management decisions and thereby influence agency costs (Wijethilake & Ekanayake, 2019).

5. Conclusions

The theoretical foundation of this study is grounded primarily in agency theory, which explains how the separation of ownership and control can lead managers to pursue their own interests rather than shareholders’ wealth maximization. The findings reveal that board decision-making dominance does not enhance agency costs emphasizing that the corporate governance code of Sri Lanka encourages a dual leadership structure and board balance. In contrast, managerial dominance shows a positive relationship with agency costs. When it comes to the role of large shareholders, it is revealed that they do not moderate the relationship between corporate decision-making dominance and agency costs. The results suggest that large shareholders’ influence is not strong enough to establish a mediating role, given the lack of shareholders’ activism in Sri Lanka.

The study concludes that board dominance, in isolation, does not significantly influence agency costs, indicating dual leadership structure and board balance. However, managerial dominance shows a positive relationship with agency costs, highlighting the potential risks associated with concentrated decision-making power. On the other hand, large shareholders do not significantly affect agency costs, suggesting that they fail to provide effective monitoring or reduce governance inefficiency. This emphasizes the need for firms to focus on increasing shareholder participation and enhancing balanced governance structures to improve overall performance. The results suggest that internal governance structures are necessary, and the involvement of large shareholders is essential to drive effective governance and minimize agency costs.

There are several implications of these findings. Firms should prioritize increasing shareholder participation as a means of leveraging their influence to reduce corporate costs. This can be achieved by creating mechanisms that facilitate active shareholder participation in governance processes. Additionally, it is critical to establish a balanced power structure within boards and management teams to prevent potential inefficiencies. Effective governance requires active shareholder participation and well-structured internal power distribution to achieve optimal performance and efficiency.

Future studies would investigate how the influence of board and managerial dominance varies across different industries. This can provide insight into whether industry-specific factors affect the effectiveness of governance implementation and their relationship with agency costs. Examining how regulatory changes affect the relationship between governance structures and agency costs could also provide valuable insights, mainly into restrictions on managerial behavior. Future research could also examine how legal proceedings involving senior executives influence governance reforms in peer firms.

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