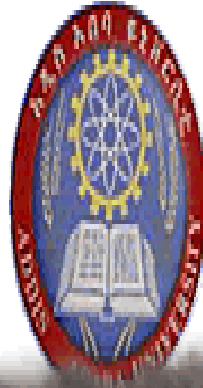


Addis Ababa  
University

(Since 1950)



# **The Impact of Corporate Governance on the organizational Performance of Bank of Abyssinia**

**A Thesis Submitted to Addis Ababa University College of Business  
and Economics, Graduate studies in Partial Fulfillment of  
the Requirements for the Degree of Master of Business  
Administration, Specialization in Management**

**By: Kirubel Minichil**

**Advisor: Ethiopia Legesse (PhD)**

**Addis Ababa University**

**College of Business and Economics**

**2019**

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## **Declaration**

I, Kirubel Minichil Abay, hereby declare that the thesis entitled **the impact of corporate governance on performance of bank of Abyssinia** is my own original work and has not been submitted for any degree in any other university. It is offered for the award of the degree of Master of Business Administration in Management from Addis Ababa University.

Name: Kirubel Minichil

Advisor's Name: Ethiopia Legesse (PhD)

Signature \_\_\_\_\_

Signature \_\_\_\_\_

## Statement of Certification

This is to certify that the thesis prepared by Kirubel Minichil Abay entitled **the impact of corporate governance on performance of bank of Abyssinia** and submitted in partial fulfillment of the requirements for the degree of Master of Business Administration specialization in Management complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

Approved by:

Internal Examiner \_\_\_\_\_ Signature \_\_\_\_\_ Date \_\_\_\_\_

External Examiner \_\_\_\_\_ Signature \_\_\_\_\_ Date \_\_\_\_\_

Advisor: Ethiopia Legesse (PhD) Signature \_\_\_\_\_ Date \_\_\_\_\_

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

**ANOVA** - ANALYSIS OF VARIANCE

**BGD** - **BOARD** GENDER DIVERSITY

**BOA** – BANK OF ABYSSINIA

**BSZ** - BOARD SIZE

**BOW** - **BOARD** OWNERSHIP

**CAR** - CAPITAL ADEQUACY RATIO

**IQL** - **INDUSTRY** RELATED QUALIFICATION

**LER** - LEGAL RESERVE

**LEV** - LEVERAGE

**LIQ** - LIQUIDITY RATIO

**LOGBKS** - LOG OF BANK SIZE

**MEF** - MANAGEMENT EFFICIENCY

**NPA** - NON-PERFORMING ASSETS

**NBC** - NUMBER OF BOARD COMMITTEES

**NBM** - NUMBER OF BOARD MEETINGS

**OECD** - **ORGANIZATION** FOR ECONOMIC COOPERATION AND DEVELOPMENT

**ROA** - RETURN ON ASSET

**SPSS** - STATISTICAL PACKAGE FOR SOCIAL SCIENCES

**VIF** - VARIANCE INFLATION FACTOR

## *Abstract*

*Corporate governance is an important factor for well-functioning of firms. Given the importance of banks, their governance assumes a central role. This paper looked at the effects corporate governance has on organizational performance in Bank of Abyssinia. The study was guided by the following specific objectives; effect of transparency on organizational performance; contribution of accountability on organizational performance; and effect of board composition on organizational performance at Bank of Abyssinia. Six years data for the period 2013-2018 was used for the study. Audited annual reports and questionnaires were also used to collect data to determine causal link between the independent and dependent variables. The major findings of the study revealed that, there is a significant relationship between transparency and organizational performance and transparency was a predictor of bank performance. Likewise, a significant relationship was observed between accountability and organizational performance where accountability was seen to be a predictor of bank performance. Further still, the relationship between board composition and organizational performance showed a significant relationship. In conclusion, transparency, accountability and board composition as dimensions of corporate governance, determine organizational performance at Bank of Abyssinia. Future researchers need to focus on these significant variables and additional corporate governance mechanisms.*

**Keywords:** *Corporate governance, bank performance*

# Chapter One

## Introduction

### 1.1. Background of the study

The development and refinement of corporate governance standards has often followed the occurrence of corporate governance failures that have highlighted areas of particular concern (Kirkpatrick, 2009). Governance means to control and regulate; the exercise of influence to maintain good order and adherence to predetermined standards of behavior. Corporate Governance is the regulating influence applied to the affairs of a company to maintain good order and apply predetermined standards. Put simply, corporate governance is an ethical environment in which all business processes are undertaken (Knell, 2006).

According to Baker and Anderson (2010) the importance of corporate governance became dramatically clear at the beginning of the twenty-first century as a series of corporate meltdowns arising from managerial fraud, misconduct, and negligence caused a massive loss of shareholder wealth. The firm's owners (shareholders) asked who, if anybody, is responsible for protecting and promoting the value of their investment. Yet governance issues and problems have a long and sometimes shocking history. According to Adam Smith (1776/1904, V.1.107) in *Wealth of Nations* (cited in Baker & Anderson, 2010) Being the managers of other people's money rather than their own, it cannot be expected that they (managers) should watch over it with the same anxious vigilance which (they would) watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies (Organization for Economic Cooperation and development, OECD, 2015). The subprime-mortgage crisis was the latest event to highlight shortcomings in corporate governance. Many past failures, including that of Enron, were often the result of poor corporate oversight. In some cases, out-and-out fraud was involved. However, fraud that goes undetected or unaddressed is, to some extent, a failure of

corporate governance. Banks and other financial companies, as well as their investors, were dramatically hit as the effect rippled throughout the world (Lamm, 2010).

Corporate governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized. Good corporate governance structures encourage companies to create value and provide accountability and control systems commensurate with the risks involved (Australian Stock Exchange corporate governance council, 2003).

Corporate governance provides a framework that reflects an interplay between internal incentives (which define the relationships among the key players in the corporation) and external forces (notably policy, legal, regulatory, and market) that together govern the behavior and performance of the firm. In its narrowest sense, corporate governance can be viewed as a set of arrangements internal to the corporation that defines the relationships between managers and shareholders. At the center of this system is the board of directors. Its overriding responsibility is to ensure the long-term viability of the firm and to provide oversight of management. The internal mechanisms for corporate governance are strengthened by external laws, rules, and institutions that provide a level, competitive playing field and discipline for the behavior of insiders. Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability, and responsibility to protect shareholders, consumers, workers, the environment, and even competitors from abusive practices. A good legal and regulatory framework efficiently addresses the entry, operations, and exit of firms (Iskander & Chamlou, 2000).

## **1.2. Background of the Banking Industry**

Banks serve a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the

banking sector and the economy as a whole (Basel committee on banking and supervision, 2014).

Bank regulation is justified by the negative externalities that are associated with a bank failure. Specifically, an individual bank failure not only affects its shareholders but also poses serious consequences to depositors and other participants in the financial system and in the global economy. Bank regulation aims to protect depositors and promote stability of the financial system (John, De Masi & Paci, 2016).

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they set corporate objectives, operate the bank's on a day-to-day basis, meet the obligation of accountability to shareholders and interest of depositors, supervisors, align corporate activities and behavior with expectation that bank operates in safe and sound manner, and in compliance with regulations (Basel committee on banking and supervision, 2006).

The Basel Committee on Banking Supervision and the Organization for Economic Co-operation and Development has been at the forefront in establishing international norms of corporate governance that apply to the banking institutions. They have developed principles, guidelines, and codes that help ensure adoption and implementation of sound corporate governance practices by banking organizations. In Ethiopia, the National Bank is responsible to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia (National Bank of Ethiopia establishment proclamation number 591/2008). Hence, the National Bank of Ethiopia has issued Bank Corporate Governance Directives No SBB/62/2015 to be effective from September 21, 2015 with the aim of giving way to balanced risk taking and enhancing business prudence, prosperity and corporate accountability with the ultimate objective of realizing long term shareholders' value and customers' and other stakeholders' interest. The directive states that corporate governance plays a vital role in maintaining the safety and soundness of financial system in general and banking sector in particular.

According to Obeten, Ocheni, and John (2014) corporate governance affects banks' performance and value of the firm and that strong governance lead to higher levels of investment and to growth opportunities. Corporate governance in banks contributes to collaborative working

relation between bank management and bank supervisors (Katrodia, 2011). The balance and effectiveness of the corporate governance mechanism can create a better corporate financial performance (Dharmastuti & Wahyudi, 2013).

Corporate governance is about building credibility, ensuring transparency and accountability as well maintaining an effective channel of information disclosure that would foster good corporate performance. It is therefore crucial that banking sector observe a strong corporate governance ethos (Onakoya, Ofoegbu, & Fasanya, 2012). Given that the corporate governance has been introduced for less than a decade in Ethiopia, many questions arise about the relation between corporate governance and banks' performance in the financial industry in Ethiopia and particularly; are banks in Ethiopia committed to any of the corporate governance policies? And if yes, is there any relation between these policies and banks' performance? If a relation exists, what factors influence this relation?

### **1.3. Statement of the Problem**

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (Organization for Economic Cooperation and development, OECD, 2015). Bank governance has been blamed to varying degree for the recent financial crisis (Baker & Anderson, 2010). Regulations affect governance because regulators care about financial stability; they pressure bank boards to act to ensure the safety and soundness of the financial institution through direct and indirect restrictions.

Banks efficiently mobilize and allocate funds; this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. Thus, weak governance of banks reverberates throughout the economy with negative ramifications for economic development. Given the importance of banks, the governance of banks themselves assumes a central role. Banking crises dramatically advertise the enormous consequences of poor governance of banks. Banking crises have crippled economies, destabilized governments, and intensified poverty. When bank insiders exploit the bank for their own purposes, this can increase the likelihood of bank failures and thereby curtail corporate finance and economic development, banks are frequently very heavily regulated (Levine, 2004).

Good Corporate governance fosters efficient monitoring of corporate assets, effective risk management and greater transparency of banking activities and it helps to achieve and maintain Public trust and confidence in the banking sector. In contrast, poor corporate governance may contribute to bank failures which could, in turn, trigger a bank run or liquidity crisis. The standard of corporate governance sets the nature of the relationship among shareholders, members of board of directors, managers, employees and other stakeholders with whom the company has business links. It mainly protects the rights of the company and specifies its obligations. (Baker & Anderson, 2010).

Private commercial banks are corporations that have a dominant position in developing economic financial systems of the country. Banking failure would affect the entire financial system and the economy. Therefore, in order to ensure the improvement of the bank's performance, economic efficiency and growth, and to enhance investors' confidence, strong, effective and good corporate governance has to be developed and implemented.

One of the core proposes of bank regulation is to prevent bank failure. Regulators try to reduce two problems at the root of bank failures. One is the phenomenon of a bank run. The second source of failure is a problem of moral hazard: owners and managers of banks may misuse the funds they are given by depositors. To address these issues, regulators limit the types of assets that banks can hold in their balance sheet, and set minimum levels of capital that banks must maintain (Ball, 2012). Regulators intervene to modify the corporate governance of banks. The main rationale of bank regulation is the safety and the soundness of the financial sector, reducing systemic risks and protecting depositors (John et al. 2016).

There are few studies conducted on corporate governance of private Banks. There is also significant literature and empirical studies that link board characteristic and central regulators role to improved bank performance. Studies have been conducted in (Rao & Kidane, 2016; Olani & Berhanu, 2015; Ashenafi et al. 2013; Assefa & Megbaru, 2014; Yenesew 2012; Kibrysfaw 2013; Firehiwot 2015; Abdurazak 2017) to identify the impact of corporate governance on the performance of Ethiopian banks, But those studies are piloted as a group and generalized to the industry based on their findings. Corporate governance mechanism and its impacts on performance of individual private banks remain sufficiently uncovered due to the researchers' interest to see the effects at industry level. The number of samples and observations

were also limited in those studies because of the sample size distribution to many banks. Methodology of data gathering and analysis of some studies were also limited only on secondary data.

There were no much studies conducted on single privately owned commercial banks of Ethiopia to understand the impact of corporate governance mechanisms on performance and clearly understand the similarity and difference on corporate governance mechanisms on each private bank.

The problem area that is going to be dealt in this particular paper is the impact of corporate governance practices on the performance of a single privately owned bank with a particular emphasis on Bank of Abyssinia.

#### **1.4. Objectives of the study**

##### **1.4.1. General objective of the study**

The general objective of this study is to examine the impact of corporate governance practices on the organization performance of Bank of Abyssinia.

##### **1.4.2. Specific Objective of the study**

Specifically, the objective of the study includes the following:

1. To identify effect of transparency on organizational performance.
2. To examine the effect of accountability on organizational performance.
3. To examine the effect of composition of the Board of Directors on organizational performance.

#### **1.5. Research Questions**

1. What is the effect of transparency on organizational performance at bank of Abyssinia?
2. What is the effect of accountability on organizational performance at bank of Abyssinia?
3. What is the effect of Board Composition on organizational performance at bank of Abyssinia?

## **1.6. Hypotheses of the Study**

The study will be guided by the following hypotheses;

1. Financial transparency has a positive organizational performance.
2. Accountability has a positive effect on organizational performance.
3. Board composition greatly contributes to organizational performance.

## **1.7 Significance of the Study**

Banking holds one of the most important positions in the economic world. The importance of a transparent and healthy banking system in the mobilization and intermediation of fund, for the growth and development of the economy is of paramount importance. Studying and understanding the effects of corporate governance mechanism in banks provides insight to the banks and regulators, and policy makers that enforcing the governance principles will create discipline in the industry, strengthen and stabilize banks and the economy as a whole, and create trust and dependability among various stakeholders.

To date there has been much research carried out on the effect of corporate governance on organizational performance in commercial banks. This study may therefore add knowledge to the already existing current stock of knowledge regarding this area of study for future researches especially the study of variables and their relationships. The findings of the study is also vital to policy makers as it clearly points out the effect of corporate governance on organizational performance in banks as well as other factors which affect performance. The possible solutions to these causes may be used by policy makers since they are a point of reference while writing government policies. The commercial banks may therefore benefit since the right recommendations which suit their particular problems have been made. The findings of the study enlighten the relevant authorities, namely the staff, public top/senior management and finally the State and its organs, on the areas that need improvement. And when this improvement is effected, bank performance may raise hence clients benefiting in terms of effective and efficient service delivery. The study also makes recommendations for what should be done in order to improve on corporate governance and reduce its negative effects on bank performance.

## **1.8 Scope of the Study**

The bank has Nine Executive Officers and Two Vice-Presidents, Eighteen Departments, 10 districts and Three hundred eighteen branches. From the entire branches one hundred fifty branches are located in Addis Ababa city and the rest are outlying branches. The geographic coverage of the study included Head Office organs and selected Addis Ababa branches from east, west, and central Addis Districts.

In terms of the content scope, this study specifically seek to determine the relationship between accountability and organizational performance, transparency and organizational performance, and board composition and organizational performance at Bank of Abyssinia.

## **1.9. Structure of the study**

The thesis consists of five chapters. The first chapter introduces what the study is about, the problem to be examined, the objectives, hypotheses, significance and delimitation of the study. Chapter two provides a highlight of pertinent theoretical and empirical reviews of the literature and conceptual framework relevant to the study. The third chapter provides description about the methodology and the variables used in this study. The fourth chapter presents the results and discussions of the study, based on data collected from secondary and primary sources. The results of the descriptive statistics, correlation analysis and regression analysis were also presented in the fourth chapter of this study. The study ends with chapter five by the conclusion and recommendations parts that brings to light the major findings of the study and possible recommendations in a manner that relates to the topic, namely the impact of corporate governance practices on organizational performance of Bank of Abyssinia.

## **Chapter Two**

### **Literature Review**

#### **2.1. History of corporate governance**

The story of corporate governance begins with the foundation of the first listed company in 1612. Adam Smith is the one who understood the issues corporate governance in 1776. He in fact did not use the phrase corporate governance Steier, (2005). The first recognized academic work on the issue of corporate governance was Means, (1932), followed by Coase, (1937) as they recognized ownership/performance issues arising from the growing separation of power between executive management of major public companies and their increasingly remote and diverse shareholders.

The term “Corporate Governance” first surfaced in the 1970s in the USA to describe the role, functions and responsibilities of the board and management but did not appear in print until 1983 (Earl, 1983). A lack of transparency meant that shareholders had no idea what managers were doing. In fact, it turned out that many of them were using company funds to run their own private businesses buying spices and selling them privately. The result was the first ideas on how to exercise more control through additional disclosure and the appointment of supervisory directors, who had better access to the detail of what the company was actually doing and who could stop transactions going forward.

Corporate governance and principal-agent problems were further highlighted by (Farrar, 1999) who traces the development of corporate governance with the appearance of managerial capitalism and the need to raise capital from the public. Farrar’s view is that in the absence of a countervailing power, management has a tendency to pursue own self-interest at the expense of the corporation.

This situation justifies the need of monitoring the management so as to prevent it from opportunistic behavior. The corporate governance issues were controlled by both fiduciary restraints developed in the law and supplemented by legislation so that modern directors’ duties are an amalgam of law, equity and statute (Brown, 2004). The market for corporate control

rewards good performance. A company with poor practice of corporate governance confronts under-performance that could be manifested by fall in share prices or business failure.

## **2.2 Definition of Corporate Governance**

There are different definitions for corporate governance. The most widely used definition is the one given by OECD, which states that:

“Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means through which those objectives and monitoring performance are attained” (OECD, 1999, p.76).

In its 2004 update, the OECD describes what corporate governance involves and provides:

“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth (OECD, 2004, p.11)”.

Shleifer and Vishny (1997, p. 737) also state that “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.”

The International Chamber of Commerce also provides a corporate-specific definition of corporate governance: “Corporate governance is the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives. And the corporation itself conforms to the law and regulation” (ICCWBO,).

## **2.3. Literature Review**

### **2.3.1. Agency Theory**

Firms are assumed to exist for the benefit of its owners who are assumed to be solely interested in the maximization of their wealth. Managers, on the other hand, are the decision-makers in an organization and they are implicitly assumed to automatically act in the best interests of the owners. Agency theory recognizes that people are unlikely to ignore their own self-interest in making decisions. The theory provides a means of establishing a contract between the principal and the agent which will lead to optimal performance by the agent on behalf of the principal (Crowther & Seifi, 2011).

According to Alchian and Demsetz (1972); if every stock owner participated in each decision in a corporation, not only would large bureaucratic costs be incurred, but many would shirk the task of becoming well informed on the issue to be decided, since the losses associated with unexpectedly bad decisions will be borne in large part by the many other corporate shareholders. More effective control of corporate activity is achieved for most purposes by transferring decision authority to a smaller group, whose main function is to negotiate with and manage (renegotiate with) the other inputs of the team. The corporate stockholders retain the authority to revise the membership of the management group and over major decisions that affect the structure of the corporation or its dissolution.

Jensen and Meckling (1976) state that an agency relationship is a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs

designed to limit the aberrant activities of the agent. Agency costs are the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss.

In the theory of the firm, Jensen and Meckling state that the relationship between the stockholders and the managers of a corporation fits the definition of a pure agency relationship. Corporations are associated with the general problem of agency as there is separation of ownership and control. The problem of inducing an “agent” to behave as if it was maximizing the “principal’s” welfare is quite general.

Fama (1980) stated that the board is viewed as a market-induced institution, the ultimate internal monitor of the set of contracts called a firm, whose most important role is to scrutinize the highest decision makers within the firm.

A key issue in the agency view of corporate governance is how to align the interests of the agent with those of the principal. Other important issues include the timely minimization of any divergences, and how to balance the need for and the cost of monitoring with the benefits that arise from the separation of control and ownership (Marnet, 2008).

### **2.3.2. Stakeholder Theory**

According to Abrams’s article of 1951 (cited in Yusoff&Alhaji, 2012) this theory centers on the issues concerning the stakeholders in an institution. It stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction.

Stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity. Stakeholder theory intends to explain and to guide the structure and operation of the established corporation. The ultimate managerial implication of the stakeholder theory is that managers should acknowledge the validity of diverse stakeholder interests and should attempt to respond to them within a mutually supportive framework, because that is a moral requirement for the legitimacy of the management function (Donaldson & Preston, 1995).

Wang and Dewhirst (1992) state that stakeholder theory can best explain how members of governing boards think about the interests of corporate constituencies and thus how organizations are actually managed.

### **2.3.3. Stewardship Theory**

Davis, Schoorman, and Donaldson (1997) define stewardship theory as situations in which managers are not motivated by individual goals, but rather are stewards whose motives are aligned with the objectives of their principals. In the theory, the model of man is based on a steward whose behavior is ordered such that pro-organizational, collectivistic behaviors have higher utility than individualistic, self-serving behaviors. Where the interests of the steward and the principal are not aligned, the steward place higher value on cooperation and seeks to attain the objectives of the organization. This behavior in turn will benefit principals. Stewardship theorists assume a strong relationship between the success of the organization and the principal's satisfaction. A steward who successfully improves the performance of the organization generally satisfies most groups, because most stakeholder groups have interests that are well served by increasing organizational wealth. The steward realizes the trade-off between personal needs and organizational objectives and believes that by working towards organizational, collective ends, personal needs are met.

### **2.3.4. Resource Dependency Theory**

Resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy (Abdullah &Valentine, 2009).

Pfeffer and Salancik (2003) state that organizations are constrained and affected by their environments and they act to attempt to manage resource dependencies. Pfeffer (1972) asserts that boards enable firms to minimize dependence or gain resources. Pfeffer (1972) finds that board size relates to the firm's environmental needs and those with greater interdependence require a higher ratio of outside directors. He concludes "that board size and composition are not random or independent factors, but are, rather, rational organizational responses to the conditions of the external environment".

### **2.3.5. Transaction Cost Theory**

The main advantage that transaction cost economics brings to the study of corporate governance is that it provides a robust framework to investigate contracting problems such as those occurring between the management of the firm and its shareholders. The unit of analysis in transaction cost theory is the transaction. Therefore, the combination of people with transaction suggests that in transaction cost theory managers are opportunists and arrange firms' transactions to their interests (Williamson 1996, cited in Abdullah & Valentine, 2009).

According to the theory, the equity governance structure has three important properties; first, shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm's management, including the review and monitoring of management's investment policy (Williamson, 1988 cited in Saravia& Chen, 2008).

## **2.4. Principles of Corporate Governance**

### **2.4.1 Basel Committee on Banking Supervision- Principles**

The Basel Committee on Banking Supervision (The Basel Committee) published guidance in 1999 to assist banking supervisors in promoting the adoption of sound corporate governance practices by banking organizations in their countries, and revised it in 2006, and prepared a consulting document on Enhancing Corporate governance for Banking Organizations. The following are the principles put forward in that document;

**Principle 1. Establishing strategic objectives and a set of corporate values that are communicated throughout the banking organizations.**

The board should establish the strategic objectives and ethical standards that will direct the ongoing activities of the bank, taking into account the interests of stakeholders. The board should take the lead in establishing the "tone at the top" and approving ethical standards and corporate values for itself, senior management and other employees. It is especially important that the standards address corruption (including bribery), self-dealing and other unethical or illegal behavior in banks' internal and external activities.

**Principle 2. Setting and enforcing clear lines of responsibility and accountability**

**throughout the organization.**

Effective BODs clearly define the authorities and key responsibilities for themselves, as well as for senior management. They also recognize that unspecified line of accountability or confusing, multiple lines of responsibility may aggravate a problem through slow or diluted response. The BODs is responsible for overseeing management's actions and consistency with board policies as part of the checks and balances embodied in sound corporate governance.

**Principle 3. Ensuring that board members are qualified for their positions have a clear understanding of their role in corporate governance and are able to exercise sound independent judgment about the affairs of the bank.**

The board of directors is ultimately responsible for the operations and financial soundness of the bank. BODs and their individual members add strength to the corporate governance of a bank when they understand their oversight role and their fiduciary "duty of loyalty" and "duty of care", avoid conflicts of interest, are able to commit sufficient time and energy to fulfilling their responsibilities.

**Principle 4. Ensuring that there is appropriate oversight by senior management**

Senior management consists of a core group of individuals (for example, the chief financial officer and division heads) responsible, under the guidance of the board of directors, for the day-to-day management of the bank such as the establishment of effective system of internal controls. These individuals should have the necessary skills to manage the business under their supervision as well as have appropriate control over the key individuals in these areas.

**Principle 5. Effectively utilizing the work conducted by internal and external auditors, as well as other control functions, in recognition of their critical contribution to sound corporate governance.**

The role of independent, competent and qualified auditors and other control functions (including the compliance and legal functions) is vital to the corporate governance process in order to achieve a number of important objectives. It is a sound practice to consider direct reporting of the internal audit function to the board of directors through an audit committee as well as direct (but not exclusive) reporting from the compliance and legal staff to the boards. It may be beneficial for independent directors to meet in the absence of bank management at least annually with the external auditor and the head of the internal audit, compliance and legal functions. This can strengthen the ability of a bank's BODs to oversee management's implementation of the

board's policies and to ensure that a bank's business strategies and risk exposures are consistent with risk parameters established by the bank's board of directors.

**Principle 6. Ensuring that compensation policies and practices are consistent with the bank's ethical values, objectives, strategy and control environment**

The board of directors should determine or approve, where appropriate subject to prior shareholders' approval, the compensation of members of the board, senior management and other key personnel, and should ensure that such compensation is consistent with the bank's culture, control environment, and long-term objectives and strategy.

**Principle 7. Conducting corporate governance in a transparent manner**

Transparency is essential for sound and effective corporate governance. It is difficult for shareholders, other stakeholders and market participants to effectively monitor and properly held accountable the BODs and senior management when there is a lack to transparency. That is when stakeholders do not receive sufficient information on the structure and objectives of the bank to judge the effectiveness of the board and senior management in governing the bank. Both publicly-traded and privately-traded and privately-held banks should be required to provide full, accurate and timely disclosure of material information to investors, supervisors, and as appropriate under national law, to other stakeholders.

**Principle 8. Maintaining and understanding of the bank's operational structure including operating jurisdictions, or through structures, that impede transparency (i.e "know-your-structure").**

Corporate governance challenges arise where bank operate through structures that lack or impair transparency. Banks may choose to operate in a particular jurisdiction or may establish complex structures e.g. special purpose vehicles or corporate trusts, often for legitimate and appropriate business purposes. Operating in such jurisdictions or through such structures may, however, pose financial, legal, and reputational risks to the banking organization, impede the ability of the board of directors and senior management to conduct appropriate business oversight; and hinder effective banking supervision. Consequently, banks' board of directors should have in place policies and procedures to ensure that such structures or activities comply with relevant law and regulations, that the board considers appropriate.

## **2.4.2 OECD Principles of Corporate Governance**

The organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance were originally developed in response to a call by OECD Ministers in 1999 to develop a set of corporate governance standards and guidelines. Since then become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. The principles are intended to assist governments in their effort to evaluate and improve the legal, institutional and regulatory framework in their countries. “The OECD has identified the following corporate governance principles built on some common elements.

### **I. Ensuring the Basis for an Effective Corporate Governance Framework**

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

### **II. The Rights of Shareholders and Key ownership Functions**

The corporate governance framework should protect and facilitate the exercise of shareholders’ basic rights. Equity investors have certain property rights such as to sell, buy or transfer an equity share in a publicly traded company. Shareholders are also entitled to participate in the profits of the corporation, with liability limited to the amount of the investment. They should have the opportunity to participate effectively and vote in shareholders general meetings and should be informed of the rule, including voting procedures that govern the general shareholder meetings. In addition, all shareholders including institutional investors have to exercise their ownership right to influence the corporation and its management.

### **III. The Equitable Treatment of Shareholders.**

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same series of a class should be treated equally. Investors’ confidence that the capital they provide will be protected

from misuse or misappropriation by corporate managers, board members or controlling shareholders is important factor in the capital markets.

#### **IV. The Role of Stakeholders in Corporate Governance**

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. It is, therefore, in the long-term interest of corporations to foster wealth-creating cooperation among stakeholders. The governance framework should recognize that the interests of the corporation are served by recognizing the interests of stakeholders and their contribution to the long-term success of the corporation.

#### **V. Disclosure and Transparency**

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. Public disclosure is considered as a minimum requirement at certain intervals preferably on an annual basis. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and nonfinancial disclosure. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

#### **VI. The Responsibilities of the Board**

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. The board should fulfill certain key functions, including reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestments (if any).

## **2.5. Corporate Governance Mechanisms**

Corporate governance generally refers to the process or mechanism by which the affairs of businesses and institutions are directed and managed, with a view to improve long term value of shareholders while taking into account the interests of other stakeholders interested in the wellbeing of an entity. Corporate governance is divided into external and internal corporate governance. Internal corporate governance covers public's interest, employees' interest, and owners' interest. While external corporate governance is defined as a mechanism through which governments' responsibility to control the operations of banks are exercised based on the prevailing bank regulations (Ben, Patrick & Caleb, 2015).

Researchers often categorize corporate governance mechanisms into two categories, i.e. internal and external corporate mechanisms. The internal mechanism is divided into five basic categories, they are: the board of commissioners (roles, structures and incentives), managerial incentives, capital structure, constitutions and corporate regulations, and internal control system. Whereas external mechanism is divided into five categories, they are: law and regulations, market, capital market information and analysis, accounting market, finance and law, and special sources of external control (Gillan, 2006 cited in Dharmastuti&Wahyudi, 2013).

### **2.5.1. Internal Governance Mechanisms**

A well governed corporation needs to balance the roles of three groups of players: shareholders, boards of directors, and managers, while meeting all of its financial commitments and other obligations to a broad array of stakeholders. The board of directors represents the interests of shareholders and may have obligation to other stakeholders under various statutory and voluntary provisions. An independent board of directors, the core internal governance mechanism, is the bridge between management and owners, other stakeholders, and the outside world (Babatunde & Olaniran, 2009).

Good corporate governance requires a board of directors to fulfill its statutory duty to oversee the management of its company, to guard the interests of shareholders and to ensure conformity with regulatory requirements (Salim, Arjomandi, &Seufert, 2016).

Several characteristics of the board of directors (size, composition or functioning) might reflect directors' motivation and their ability to effectively monitor and advise managers. Banks with

boards that are more effective in monitoring and advisory terms are better governed, and that better governance creates shareholder value (Andres &Vallelado, 2008).

Four major roles and responsibilities of the board have been widely recognized by researchers: (1) the control role; (2) the strategic role; (3) the service or resource provision role and (4) the advice and counsel role. The control role of the board implies its legal duty of monitoring and supervising the firm's operations, current as well as preventive, i.e. the monitoring of business decisions and firm's plans as well as monitoring and controlling top management. The strategic role of the board relates to supporting and leading the management in realizing the firm's mission and its goals by advising, improving and enhancing the discussion on strategic issues, in particular the strategic problem solving and decision-making. The service or resource provision role of the board is primarily concerned with providing the access to networks and resources and maintaining the formal and informal relationships with firm's stakeholders and overcoming the inherent conflict between them.

Boards' ability to fulfill their functions of advising and monitoring management is affected by the choices of board characteristics. Hence, the following governance mechanisms have been selected based on their significance in context of reviewed governance theories, in relation to framework of banking industry in the country, and studies conducted in Ethiopia and abroad. National Bank of Ethiopia under its directive No SBB/62/2015 has set characteristics and requirements to be fulfilled by board members to maintain safety and soundness of financial system.

#### **a) Board Size**

Board size represents number of directors on a board. Boards having too many directors could be unproductive with ineffective communication that results directors free riding problem (Alam&Akhter, 2017). While the board's capacity for monitoring increases as more directors are added, the benefit may be outweighed by the incremental cost of poorer communication and decision making associated with larger groups (John & Lemma, 1998). Jensen (1993) cited in Liang, Xu, &Jiraporn, (2013) argues that large corporate boards are less effective due to the problems of coordination, control, and flexibility in decision-making and give excessive control to CEOs.

Board size can have either a positive or negative effect on corporation performance. On one hand, a large board makes coordination and communication difficult triggering the agency issue and reducing company performance. On the other hand, resource-dependent theory suggests that a larger board allows for more specialists from different fields and therefore facilitates high quality decision making (Eisenberg et al., 1998 & Kiel & Nicholson, 2003 cited in Salim et al.2016).

### **b) Board Gender Diversity**

According to Adams and Mehran (2003) cited in Fernandes et al. (2017) the rationale behind the view of diversity as a positive force within boards builds on the assumption that the existence of multiple and divergent viewpoints within a board will decrease the likelihood that the agenda and initiatives will be dominated by management thus improving the monitoring role of the board.

According to Daily & Dalton (2003) and Julizaerma and Sori, (2012) cited in Wagana and Nzulwa (2016), female board directors provide unique perspectives, experiences, and work styles as opposed to their male counterparts, which can greatly enhance deliberations of the board. These attributes will lead to better performance when combined with female characteristics such as communication and listening skills. Bart and McQueen (2013) state female directors can make significant contributions to the board due to their higher quality decision-making capability, which helps better explain the higher rates of return, more effective risk management and even lower rates of bankruptcy.

However, according to Eisenberg (1998), cited in Bussoli, Gigante, and Tritto (2015) increasing of gender differentiation could lead to the reduction of harmony within the “team” of directors, since it can affect the confidence among members of different genders and their willingness to cooperate. Kilic (2015) state gender diversity in boardrooms can be a disadvantage, especially in terms of group performance. Different styles, attitudes, and perspectives may increase conflict, reduce cohesion, and hinder communication and coordination within the team.

Gallego-Álvarez et al., (2010), Adams & Ferreira (2004, 2009) Randøy et al. (2006) cited in Kilic (2015) state that the conflict arising from gender diverse board may slow the decision-

making process, gender diversity may entail costs in digesting different viewpoints and resolving disagreement. Board diversity may increase the probability of ambiguities, misunderstandings, and decision errors.

#### **c) Industry Related Qualification of Board**

Higher education of directors in organizational contexts is positively related to receptivity to innovation, creativity, and better strategic decision-making. Existence of qualified directors increases banks performance as they promote corporate image, and demonstrate accountability and credibility within the management team (Olani&Berhanu, 2015).

By bringing expertise and knowledge, the board plays an important role in formulating and implementing business strategy. Academic papers emphasize experience rather than qualifications (Fernandes et al. 2017).

A board should consist of directors with diverse business experiences relevant to the firm's existing and future businesses (Madden, 2007).

#### **d) Board Ownership**

Efficient monitoring hypothesis (EMH) argues that greater ownership concentration can eliminate the agency conflict between owners and management and decrease the costs of management monitoring and leads to improved performance and productivity (Al-Amarneh, 2014). Levine (2004) states that one corporate governance mechanism for preventing managers from deviating too far from the interests of owners is concentrated ownership. Large investors have the incentives to acquire information and monitor managers. Furthermore, large shareholders can elect their representatives to the board of directors and thwart managerial control of the board of directors. Jensen and Meckling (1978) state that minority shareholders realize that the manager's interests will diverge somewhat from theirs; hence the price which they will pay for shares will reflect the monitoring costs and the effect of the divergence between the manager's interest and theirs.

#### **e) Number of Board Meetings**

In the agency framework, the intensity of board activity, measured by the frequency of board meetings, may indicate an active monitoring role of corporate boards and so, influence corporate performance (Fernandes et al. 2017).

Meetings provide board members with the chance to come together, and to discuss and exchange ideas on how they wish to monitor managers and bank strategy. Hence, the more frequent the meetings, the closer the control over managers, the more relevant the advisory role, factors that lead to a positive impact on performance (proactive boards). By contrast, frequent meetings might also be a result of board reaction to poor performance (reactive boards). Therefore, any hypothesis concerning the influence of board activity on firm performance is an empirical question, possibly yielding either proactive or reactive results (Andres &Vallelado, 2008).

#### **f) Number of Board Committees**

According to Fama and Jensen (1983), committees exist to manage agency problems among partners and to study and determine major policy issues in a manner that is less costly than when performed jointly by all partner.

The effectiveness of the board is influenced by board committees. The regulatory recommendations and the complexity of bank activities place emphasis on the importance of board committees in banks (John et al.2016).

The importance of committees is underpinned as the main influence on boards' most important decisions for the control over management (Salim et al. 2016). Boards use committee structures to facilitate, evaluate, and ratify long-term investment decisions and to monitor the performance of senior management (John & Lemma, 1998). Klein (1995, cited in John & Lemma, 1998) proposes a committee with specialized roles to enhance the board's performance in its productivity and monitoring. That is, each board committee should specialize in either productivity or monitoring issues.

Functional effectiveness to a large extent is connected to the inner workings of the board by various standing board committees which support and complement board's decision-making and supervisory functions (Puni, 2015).

### **g) Management Efficiency**

Efficient management is an important factor behind the performance of all banks. It is important for ensuring bank stability and strength. Management efficiency includes administrative ability to react in diverse circumstances. The term management efficiency involves the capability of management in generating business and maximizing profits. It indicates the capacity of a bank to increase benefits or minimize costs. The two main questions, “what drives performance” and “what contribute to performance” are headed in the minds of managers. Finding or highlighting the source of better performance and adoption of right management strategies is very important to the managers. The performance of the management based upon the availability of useful information for decision making and measuring the performance gives input as to what current performance level is and what can be done to enhance performance (Ishaq, Karim, Ahmed, & Zaheer, 2016).

Management efficiency is used to assess administration’s quality; it involves analysis of efficiency of management in generating business and in maximizing profits. High cost income ratio is equal to low productivity and low efficiency (Ishaq et al. 2016).

### **2.5.2. External Governance Mechanisms**

Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability, and responsibility to protect shareholders, consumers, workers, the environment, and even competitors from abusive practices. A good legal and regulatory framework efficiently addresses the entry, operations, and exists of firms (Babatunde&Olaniran, 2009).

Financial sector works as the backbone of the economy that controls the money supply. Banking is a very important sector because the development of the finance, and particularly the banking system, promotes economic growth. Hence, it is important to control and regulate bank processes by an apex bank to ensure customers’ safety, strengthen and promote soundness, stability and efficiency of the banking system. Assessment of financial performance of the banking sector is a powerful measure and pointer to check the soundness of economic activities of an economy. Parameters are used to evaluate the operating soundness, financial performance, financial condition and regulatory compliance of the banking organization (Ishaq et al.2016).

Bank examination is a basic foundation of the bank supervisory process. It is done to assess the soundness of commercial banks' operations, and to ensure that commercial banks comply with rules and regulatory requirements. The supervisory central bank has the power to set rules and guidelines for commercial banks to ensure that they operate in a safe and sound manner. Such regulations might range from the banks' corporate governance and risk management practices to capital and reserve adequacy requirements. For a central bank, capital requirements (the minimum capital that each bank needs to have to buffer against unexpected losses) and reserve requirements (the minimum reserves that each bank needs to hold against deposits to meet liquidity demand) are among the key regulations it can use to ensure the safety and soundness of commercial banks' operations (Moenjak, 2014).

#### **a) Capital Adequacy Ratio**

The concepts of asymmetric information, adverse selection, and moral hazard are factors why governments choose the form of banking regulation. Moral hazard in equity contracts is known as the principal-agent problem, because managers (the agents) have less incentive to maximize profits than stockholders (the principals). Bank regulations that restrict bank capital requirements are directed at minimizing moral hazard. Risk-based capital requirement is one form of bank capital requirements (Mishkin, 2004).

Capital adequacy or sometimes regulatory capital determines how well banks or other depository institutions can have enough capital equal to their asset in order to sustain operational losses and to show whether those institutions are not participating in investments that increase risk to default (Yonas, Hamdu, & W/Michael, 2015).

The capital structure of banks is highly regulated. This is because capital plays a crucial role in reducing the number of bank failures and losses to the stakeholders (Echekoba, Egbunike, & Ezu, 2014). Capital is one of the factors that influence the level of bank profitability. It is the amount of funds available to support the bank's business and act as buffer in case of adverse situations. The adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. The ratio is directly proportional to the resilience of the bank to crisis situations. (Ongore&Gemechu, 2013).

National Bank of Ethiopia under its directive no SBB/50/2011 has set a minimum capital to risk weighted asset ratio of 8% to be maintained by all licensed banks to enable withstand adverse operational results.

**b) Liquidity**

Bank deals in funds belonging to the public. Hence, bank should always be on its guard in handling these funds. Banks should always have enough cash to meet the demands of the depositors. The success of a bank depends to a considerable extent upon the degree of confidence it can instill in the minds of its depositors. So, it should always be prepared to meet the claims of the depositors by having enough cash (Somashekar, 2009).

Liquidity is defined as the capacity of financial institutions to finance increases in their assets and comply with their liabilities as these mature (Yonas et al. 2015).

The theory of asset management states that banks must seek high returns, reduce risk and make adequate provisions by holding liquid assets. Achieving high returns while holding a large portion of liquid assets at a low risk can be difficult as liquid assets are costly and have the tendency of reducing profits. The more liquid a bank is, the greater is its capability to meet its obligations as they fall due. According to the tradeoff theory, banks target an optimal level of liquidity to balance the benefit and cost of holding cash. The cost of holding cash includes low rate of return due to liquidity premium. The benefits of holding cash are saving of transaction costs to raise funds in which assets are liquidated to make payments and using of liquid assets to finance its activities and investment where other sources of funding are not available or very expensive (Edem, 2017).

National Bank of Ethiopia under its directive no SBB/57/2014 has set a minimum liquid asset of 15% of net current liabilities for licensed commercial banks to enable maintain public trust and confidence.

**c) Legal Reserve**

The supervisory central bank has the power to set rules and guidelines for commercial banks to ensure that they operate in a safe and sound manner. Central bank sets legal reserve requirements- the minimum reserves that each bank needs to hold against deposits to meet liquidity to ensure safety and soundness of bank's operations. The requirement is used to enable regulate the flow and the amount of money in the economy.

Reserves are traditionally held in the form of cash, or deposits at the central bank, and thus banks can easily turn to them to meet liquidity demand. Cash kept as reserves do not provide returns, and can incur a cost of safekeeping. Deposits held at the central bank might also not earn interest or earn considerably less than could be gained from lending to customers. Historically, reserve requirements have also been used as a tool of monetary policy. When reserve requirements are raised, banks have to keep more reserves as cash or deposits at the central bank rather than lending them out as loans. With fewer loans being provided in the economy—all other things being equal—economic activity will slow down. When reserve requirements are lowered, banks are able to provide more loans, as they are required to hold less cash and deposits at the central bank as reserves (Moenjak, 2014).

National Bank of Ethiopia under its directive no SBB/55/2013 has set that any bank at all times shall maintain in its reserve account 5% of its net deposit balance as a form of monetary policy instrument and prudential regulation tool.

## **2.6. Organizational Performance**

The ultimate goal of a business organization is higher financial performance or maximization of wealth for stakeholders (Joseph and Dai, 2009). Nonetheless, attaining the organization's goals depends upon the extent to which its organizational performance is reached (Katou and Budhwar, 2007). Organizational performance is generally indicated by effectiveness, efficiency, satisfaction of employees and customers, innovation, quality of products or services, and ability to maintain a unique human pool. The organizational performance variables of the present study included features such as product quality, customer satisfaction, new product development, ability to attract employees, ability to retain employees, and relationship between management and employees.

According to Kaplan and Norton (1993), organizational performance means the transformation of inputs into outputs for achieving certain outcomes. With regard to its content, performance informs about the relation between minimal and effective cost (economy), between effective cost and realized output (efficiency) and between output and achieved outcome (effectiveness). Sales performance can be explained as all the activities or investment carried out in the firm in the given period of time. It can be measured by total amount of revenue collected for the goods sold. Growth revenue is defined as total amount of money collected by the company for the goods

they sold in a specific time and this amount is calculated before any expenses are subtracted. Effectiveness of the organization depends on the three basic performance determinants which include efficiency and process reliability; human resource and relations; and innovation and adaptation to environment (Joseph and Dai, 2009).

Finally, in order for an organization to remain viable over time, it must be both financially viable and relevant to its stakeholders and their changing needs. In the framework, these four aspects of performance are the key dimensions to organizational performance. Organizations exist within certain external contexts or environments that facilitate or impede their performance. Key factors in the policy or regulatory environment, and in the economic, political, socio-cultural, environmental and technological contexts, affect how the organization does its work. (Kaplan and Norton, 1993). Internally, performance is driven by the organization's motivation to perform, which refers to the organizational culture, history, mission, values and incentive systems. These factors affect the quality of work, the nature of how the organization competes, and the degree of involvement of internal stakeholders in decision-making processes. Performance is driven, in part, by organizational capacity, which we now understand as existing in seven basic areas: strategic leadership, human resources, financial resources, infrastructure, programming and process management, and inter-institutional linkages (Usha, 2009).

Each of these seven capacity areas may be described in sub-components as, for example, in the organization's strategic leadership capacity which is understood as its structure, governance, leadership, strategic plans and niche management. Human resources, financial resources and infrastructure are seen as resources as well as the management of these resources (Katou and Budwar, 2007). Organizations also have capacities that result from the relations, partnerships and alliances they have established with other organizations referred to as inter-institutional linkages. Kaplan and Norton (1992) explain balanced scorecard methodology as a comprehensive approach that analyzes an organization's overall performance in four ways, based on the idea that assessing performance through financial returns only provides information about how well the organization did prior to the assessment, so that future performance can be predicted and proper actions taken to create the desired future.

The methodology examines performance in four areas: cost analysis in terms of procurement is the most traditionally used performance indicator, which includes assessments of measures such

as operating costs and return on investment; customer analysis looks at customer satisfaction and retention; internal analysis looks at production and innovation, measuring performance in terms of maximizing profit from current products and following indicators for future productivity; and finally, learning and growth analysis explores the effectiveness of management in terms of measures of employee satisfaction and retention and information system performance (Joseph and Dai, 2009). As a structure, balanced scorecard methodology breaks broad goals down successively into vision, strategies, tactical activities, and metrics.

## **2.7. Accountability and Organizational Performance**

Awio, Lawrence and Northcote (2007) posit that accountability is concerned with giving explanations through a credible story of what happened, and a calculation and balancing of competing obligations, including moral ones. Accountability ranges more freely over time and space, focusing as much on future potential as on past accomplishment, connecting and consolidating performance reports to plans and forecasts. Accountability is concerned with giving explanations through a credible story of what happened, and a calculation and balancing of competing obligations, including moral ones. Broadbent and Laughlin (2003) contend that the provision of more detailed information does not automatically lead to greater accountability. According to Barton (2006), accountability requires openness, transparency and the provision of information. Accountability ranges more freely over time and space, focusing as much on future potential as on past accomplishment, connecting and consolidating to plans and forecasts.

Cheffins (2009) proposed two aspects of accountability thus: public accountability, which involves the public as principals and is concerned with issues of democracy; and trust, and managerial accountability that is concerned with day-to-day operations of the organization. Under managerial accountability the provision of detailed information is not directed to being more accountable to the public but that rather, it is an attempt by the principals to control the agents (managers) and legitimize past decisions and actions. Therefore, Goddard (2005) revealed that greater accountability is often presumed to provide more visibility and transparency for organizational activity, enabling appropriate organizational behavior and ultimately impact on organizational performance. It is increasingly used in political discourse and policy documents because it conveys an image of transparency and trustworthiness. Mulgan (2008) contends that an accounting system is a way of keeping a written record of transactions. Receipts are given for

all money that is received by an organization and receipts are asked for every time money is spent. According to Core, Holthausen and Larcker (1999) an accounting system consists of business papers, records, reports and procedures that are used by an organization in recording transactions and reporting their effects. Goddard (2005) said that an accounting system, regardless of the size of the organization is designed to collect, process and report periodic financial information about the entity.

In the case of and more especially, the idea of accountability is practiced as a way of effectively managing resource utilization in relation to set financial internal controls. However, it should also be noted that the reviewed literature draws a lot of attention on accountability and financial performance of organizations in the financial sector leaving scanty literature on the effect of accountability on organizational performance in the financial sector and more especially . This provides a gap in literature which this study intended to bridge so as to provide information on the effect of accountability on organizational performance in the financial institutions such as BOA.

## **2.8. Transparency and Organizational Performance**

Transparency is integral to corporate governance, higher transparency reduces the information asymmetry between a firm's management and financial stakeholder's (equity and bondholders), mitigating the agency problem in corporate governance (Barbu, 2005). In Ethiopia, lack of transparency is attributed to the closures of commercial banks. The concept of bank transparency is broad in scope; it refers to the quality and quantity of public information on a bank's risk profile and to the timing of its disclosure, including the bank's past and current decisions and actions as well as its plans for the future. The transparency of the banking sector as a whole also includes public information on bank regulations and on safety net operations of the central bank (Brown and Caylor, 2004).

Weak transparency makes banks' asset risks opaque. Stock market participants including professional analysts such as Moody's encounter difficulties in measuring banks credit worthiness and risk exposures (Chiang, 2005). Rogers (2006) argues that timely incorporation of economic losses in the published financial statements increases the effectiveness of corporate governance, compensation systems, and debt agreements in motivating and monitoring managers. For instance, improved governance can manifest in a reduction of the private benefits

that managers can extract from the company or in a reduction of the legal and auditing costs that shareholders must bear to prevent managerial opportunism (Abor and Biekpe, 2007). Governance research in accounting exploits the role of accounting information as a source of credible information variables that support the existence of enforceable contracts, such as compensation contracts with payoffs to managers contingent on realized measures of performance, the monitoring of managers by boards of directors and outside investors and regulators, and the exercise of investor rights granted by existing securities laws (Barbu, 2005). There are a number of issues to consider in this regard.

Brown (2004) asserts that transparency is integral to corporate governance, higher transparency reduces the information asymmetry between a firm's management and stakeholder's, mitigating the agency problem in corporate governance. Today, after many scandals and financial crises, the transparency in corporate governance is the debate du jour. Transparency lies at the intersection between the public's right to know and corporation's right to privacy. The public's right to know, means the stakeholders interest in obtaining corporation information about management and strategy. According to Leblanc and Gillies (2005), stakeholders includes employees, unions, and governments at various levels, media, customers, suppliers, financial institutions, various non-governmental corporations with broad or narrow agendas, and even the public at large. The stakeholders have a legitimate claim to know vast quantities of information about corporations' actions and intents.

The corporation's right to privacy means the corporation's right to control the collection, use and disclosure of all information and management strategies related of the corporation (Agrawal and Chadha, 2005). Financial reports include filings and documents required by law, as well as those expected by lenders, investors, employees, donors, or board members. Much as the idea of transparency is been extensively studies in the financial sector; little attention has been focused on commercial banks. Similarly, much of the existing literature focuses on transparency and financial performance causing gaps in the literature on transparency and organizational performance in the financial sector and more especially commercial banks in developing countries where the procedures followed during transparency are still underdeveloped to support the organizational performance of commercial banks. This explains why in there are still lapses in organizational performance. This literature deficiency provides a research gap which will be bridged by this study.

## **2.9. Board Composition and Organizational Performance**

According to the Gavin and Geoffrey (2004) the board composition allows for effective decision making and supervision of the management. Further to this, the board size should give room to fruitful discussions and appropriate, swift and prudent decisions. There is no perfect number of board members due to the different factors that may influence the board size, e.g. corporation's size, the business environment and special characteristics. The board should include outside directors in order to maintain practical independence and the appointment of board members should be through a transparent procedure that reflects broadly the diverse opinions of shareholders (Abor and Biekpe, 2007). Board members should also be competent and professional. Board size is one of the well-recognized dimensions of board composition examined in the literature.

Karamanou and Kyereboah (2007) analyzed the composition of the board of directors and concluded that the size of the board does not enhance the returns of the company. As shown, most of the studies examining board size effect on financial performance have confirmed Gompers, Ishii and Metrick's (2004) findings that board size and financial performance of a firm were negatively correlated. This idea suggests that as the size of the group increases, communication and coordination problems increases, assert Karamanou and Kyereboah (2007). Anderson, Mansi and Reeb (2004) reveal that although many of the studies suggest a positive relationship between outsider-dominated boards and the performance of the company, some studies found no significant relationship between the proportion of inside/outside directors and company performance. Moreover, some studies support a negative relationship between the previously mentioned variables. For example, Gavin and Geoffrey (2004) findings, which depended on a two-tier board structure proposed that the proportion of inside directors has an inverse relationship with financial performance. For a successful decision-making process, stewardship theory claims that a significant proportion of dependent directors is required in managerial boards. Matama (2008) posits that the rationale of this claim is based on the idea that dependent directors can better understand not only the business processes but also the environmental factors. Therefore, they can govern their businesses more successfully than independent directors.

The reviewed literature puts a lot of emphasis on board composition and financial performance. Similarly, there is much attention drawn by researchers of board composition and financial performance which provided inadequate literature on the association between board compositions as a measure of corporate governance on bank performance in financial organizations such as BOA. On the other hand, much of the available literature is centered on developed economies and little or no research has been conducted on the subject in developing economies such as Ethiopia. This has left a literature gap which the study intends to close by carrying out a study on the effect of board composition on organizational performance in financial institutions such as.

## **2.10. Basic Features of Bank Corporate Governance in Ethiopia**

According to Ayele, A.G. (2013) ‘revisiting the Ethiopian Bank Corporate Governance system: A Glimpse of the Operation of Private Bans’, 2013(1) Law, and Social Justice & Global Development Journal (LGD).

The overall climate of corporate governance in the n banking sector was critically assessed through the lens of principles of good corporate governance. She highlighted that the issue of corporate governance in the banking sector stands out as one of the problematic areas. The blending of politics and business, absence of share markets, inadequate shareholder protection laws, and an ineffective court system are the defining elements of the Ethiopian banking sector.

Active involvement of political parties in business through endowment companies, which were originally intended to conduct non-trade development activities, creates a gloomy condition for the growth of the private sector since party affiliated competitive advantages over private companies.

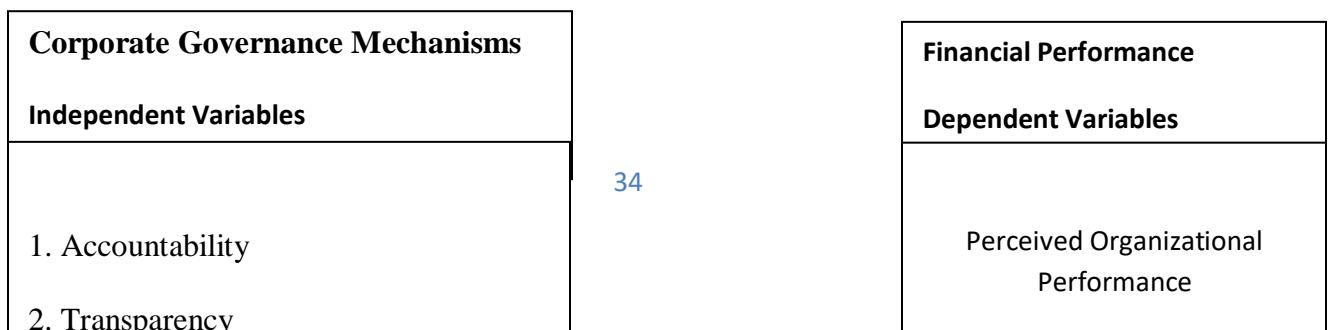
The absence of an organized and well-regulated share market makes valuation and price discovery of banks problematic and thereby inhibits share markets from being sound corporate governance mechanisms (Negash, M.2008. Supra Note 104). In adequate shareholder protection laws and the ineffective court system affects investor confidence and discourages investors to put their capital in business.

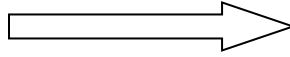
As far as the poor competitive environment is concerned, banks can offer higher interest rate to attract customers provided it is not below the minimum rate set by NBE. However, there is no

competition among private banks since they merely follow interest rate fixed by CBE. Unfortunately, this has helped private banks to carve out the market among them, and make exorbitant profits year after year in the absence of proper and strong corporate governance. She finally emphasized the need to draw up a code whereby the sector could compete in a fair and balanced environment and that NBE has this responsibility to shoulder.

### 2.11. Conceptual Framework

The conceptual framework is developed after review of literature discussed above. Hence, the study is based on the presumption that corporate governance mechanisms (board size, gender diversity of board, industry related qualification, board ownership, number of meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity position, and management efficiency) have impact on banks' financial performance but this effect is intervened by control variables. The variables have been selected after assessing that these proxies are frequently used as measures of corporate governance and are in line with theories.





## **Chapter Three**

### **Research Design and Methodology**

#### **3.1. Research Design**

The primary aim of this study is to examine the impact of corporate governance on organizational performance of Bank of Abyssinia. The study adopted a single-case study to help in studying the impact of corporate governance and organizational performance and to analyze the inherent problem. The case study research approach was used to investigate a contemporary phenomenon in its real-life context, most especially when the boundaries between the phenomenon and context are not clearly evident (Yin, 2011). A case study was therefore adopted for this study because its approach provides a holistic and in-depth investigation of the phenomena (Yin, 2011) and is compatible with a critical interpretive research paradigm. The design was descriptive and analytical in nature employing both quantitative and qualitative approaches. Quantitative approach allowed the researcher to

solicit information that was quantified, while the qualitative approach allowed the researcher to solicit information that could not be quantified as observed by Mugenda and Mugenda (1999). Thus quantitative research design comprised correlations and descriptive designs. The qualitative method described variables that could not be measured in quantitative terms such as personal variables, organizational and other qualitative variables. Combining numerical and textual information helped the researcher to have an in-depth analysis of the procedures of organizational development.

### **3.2. Sampling design**

Mugenda and Mugenda (2003) define sampling as a formulation of a procedure of selecting the subjects or cases to be included in the sample. This study will use simple random sampling and purposive sampling methods to select the sample. According to Mugenda and Mugenda (2003), simple random sampling involves allocating equal chance to the selected elements in the population. This method involved giving a number to every respondent in the accessible population, placing the numbers in a container and then picking any number at random. This was used during the selection of Head office managers, Branch Managers, team leaders and relationship managers. Purposive sampling is a sampling technique that allows a researcher to use cases that have required information with respect to the objectives of one's study. Cases of subjects are therefore handpicked because they possess the required information. Purposive sampling was employed to select the Executive Management members and Department Directors who possessed a lot of information and are knowledgeable about corporate governance and bank performance.

The population of the study included all Executives, Department Directors, Head Office Managers, and branch Managers operating in Addis Ababa. In the sample, all executive management, Selected Department Directors. Branch Managers and Head office managers were included.

### **3.3. Source of data and collection methods**

The necessary data for this study was collected from both primary and secondary sources. The secondary source of data was obtained from the audited financial statements of the bank. The primary data was collected through structured questionnaires. Data on corporate governance variables was collected by distributing 116 questionnaire to all Executive Management Members, Department Directors, Branch Managers, Head Office Managers and other work units.

### **3.4.Data Collection Instruments**

The tools that the researcher used for collecting data included a self-administered questionnaire and interview guide.

#### **3.4.1 Structured Questionnaire**

Self-administered questionnaires were used for the Executive Managements, Directors of departments, Branch and Head Office Managers and team leaders. Structured questions arranged per objective were used for Managers because this is the most appropriate instrument for a big sample. The questionnaire used a 5- point Likert scale ranging from 5 (strongly agree) to 1 (strongly disagree), in order to provide consistent responses. The questionnaire was systematically organized to include demographic characteristics of the respondents, corporate governance and organizational performance.

#### **3.4.2 Interview Guide**

Interview guide was used for the executive members at the managerial level in order to obtain in-depth information. Interviews were opted because of seniority of the Executive Management participation. An interview guide was used to supplement the questionnaire and get first-hand narrative vital while meeting Executive Management members.

### **3.5. Validity and Reliability Tests**

In order to make sure that quality and relevant data is collected, the research instruments were tested for validity and reliability as follows;

#### **3.5.1 Validity test**

The validity of the study is concerned with the extent to which data collection instruments accurately measure what they intend to. Validity is an important concept in the acceptability of the use of an instrument. Validity refers to the appropriateness of the instrument in collecting the data that is supposed to be collected, while reliability refers to its consistency in measuring whatever it is intended to measure (Amin 2005). Validity was measured by both content and faces validity. To ensure validity the researcher consulted the thesis advisor who helped him in constructing a data collection instrument and made sure that each item has a link to the objectives of the study and ensure all items cover a full range of issues being measured. Face validity was established where tools and questions were

chosen rationally, an appropriate way to find out what is being measured, content validity focused on the extent to which the contents of an instrument corresponds to contents of the theoretical concept designed to measure according to Amin (2005).

The instruments were discussed with the advisor and later pre-tested using a sample of 12 respondents within the study population which was asked to fill them and later give comments on their accuracy and clarity, and after pre-testing ambiguous questions were reconstructed. To measure validity of variables and measures of dimensions of corporate governance and bank performance, a validity test was carried out using content validity index (CVI) formula prior to the administration of the research instruments. This was intended to find out whether the questions were capable of capturing the intended data that was stated in research objectives and questions.

**Table 3.1: Validity Tests**

<b>Variable</b>	<b>Number of items</b>	<b>Content Validity Index (CVI)</b>
Transparency	<b>19</b>	<b>.789</b>
Accountability	<b>20</b>	<b>.772</b>
Board Composition	<b>21</b>	<b>.854</b>
Organizational Performance	<b>13</b>	<b>.898</b>

**Source: Primary data**

### **3.5.2 Reliability test**

To test reliability of instruments the researcher administered, pre-tested for consistency and checked logical flow of questionnaires. Prior to actual data collection all data collection tools

and items were subjected to a pre-test or pilot study at on a small sample of 12 staff to check for the clarity of the questions asked and the time required for data collection. The researcher constructed research instruments and analyzed the pre-test results using computer program SPSS and Cronbach's Alpha split the questions on the instrument in a possible way and computed correlation values for them all.

**Table 3.2: Reliability Tests**

<b>Variable</b>	<b>Number of items</b>	<b>Content Validity Index (CVI)</b>
Transparency	<b>19</b>	<b>0.807</b>
Accountability	<b>20</b>	<b>0.890</b>
Board Composition	<b>21</b>	<b>0.842</b>
Organizational Performance	<b>13</b>	<b>0.793</b>

**Source:** primary data

The table above displays the reliability indices / coefficients for all constructs used in the study. All alpha reliabilities ( $\alpha$ ) for all scales were above 0.7, ranging from 0.793 to 0.890, therefore meeting acceptance standards for research (Nunnally, 1978).

### **3.6. Data Collection Procedure**

The researcher submitted his proposal to the University for Approval. Upon successful defense of the proposal, the researcher will obtain a cover letter from AAU authoring him to conduct the research. Questionnaires were hand-delivered to the respondents assuring them of voluntary, confidentiality and anonymity, completed questionnaires were collected after 5 days. The researcher contacted key informants and provided them with the necessary details of the study, seeking their consent to participate in the study and requesting for a date on which the interview could be conducted.

### **3.7. Data Analysis**

After participants responding to the questionnaires and interviews, raw data were cleaned, sorted and entered using statistical data entry form designed in Statistical Package for Social Sciences (SPSS) software for analysis according to the objectives of the study. Data will be organized and analyzed using a 5-point Likert scale. Questionnaire data will be obtained from questionnaires. Each questionnaire will be given a unique serial number. Using soft number coding, categorizing

data, sorting and filling was carried out. Statistical package for the social sciences (SPSS) student version of 18.0 was used to aid the processing and summarizing of information got from the questionnaires.

Qualitative data collection was sorted out and interpreted manually from respondents each interview was analyzed and interpreted using content analysis to appropriate the nature of the collected data before emerging themes are identified using “Template analysis” approach. Analysis of qualitative data was done to identify similarities across several accounts as well as direction. Data was categorized into recurrent themes that seem relevant to answer the research questions. Descriptive analysis was made from information obtained from the questionnaires and interviews. Key categorical variables such as gender, education of respondents were presented in a table form. Triangulation is one of the several rationales for multi-method research and also offers the prospect of enhanced confidence. The researcher used data triangulation, which entailed gathering data through several sampling strategies, so that segments of data at different times, as well as on a variety of people were gathered. This provided invaluable information and gave the evaluation heightened status within the area of study.

### **3.8. Measurement of Variables**

The variables were measured by defining concepts. For instance, the questionnaire was designed to ask for responses about corporate governance and organizational performance. These were translated into observable and measurable elements so as to develop index of the concepts. The researcher categorized the data collected in an orderly form using the 5-point Likert scale used on the questionnaire as indicated below where; 1= Strongly agree, 2= Agree, 3= Undecided, 4= Strongly disagree, 5= Disagree. Socio-economic attributes like age, sex, employment period/duration of service, academic levels were measured at nominal and ordinal scales depending on the variables.

Following review of theoretical and empirical literature, presented are the selected variables used as proxies to study the effect of corporate governance on bank performance. Operational definitions of the constructs have been included.

Agency theory, stakeholder theory, resource dependency theory, transaction cost theory are used as base to select the variables. Moreover, empirical studies reviewed have used the variables as proxies for governance mechanism. Ashenafi et al. (2013); Manini and Abdillahi (2015); Bussoli

et al. (2015); Olani and Berhanu (2015); Ben et al. (2015); Rao and Kidane (2016); Assefa and Megbaru (2014); Andres and Vallelado (2008); Kilic (2015); Halidu and Kuutol (2015); Salim et al. (2016); Yonas et al. (2015) are to site few of the reviewed empirical literature that have used the variables as proxies for corporate governance.

### **Dependent Variable**

#### **Organizational performance**

Organizational performance is generally indicated by effectiveness, efficiency, satisfaction of employees and customers, innovation, quality of products or services, and ability to maintain a unique human pool.

### **Independent Variables**

#### **Accountability**

Accountability is concerned with giving explanations through a credible story of what happened and calculation and balancing of competing obligations including moral ones

#### **Transparency**

Transparency is integral to corporate governance, higher transparency reduces the information asymmetry between a firm's management and financial stake holders (equity and bond holders), mitigating the agency problem in corporate governance (Barbu, 2005).

#### **Board composition**

Board composition allows for effective decision making and supervision of the management. Further to this, the board size should give room to fruitful discussions and appropriate swift and prudent decisions'.

## **Chapter Four**

### **Presentation Analysis and Discussion of Findings**

This chapter provides a presentation, analysis and discussion of the empirical findings according to the purpose and objectives of the study. The chapter comprises five sections. Section one presents the introduction, section two represents the response rate, section three deals with the demographic characteristics which include gender, age group, tenure of employment, level of education and position held using frequency tabulations. Section four deals with empirical findings on the study objectives using item mean analysis and correlations. Section five deals with multiple regressions which present the results on the combined effect of the dimensions of corporate governance on organizational performance using regression analysis.

#### 4.1. Response Rate

The study targeted 116 respondents to provide the information of the study and 116 questionnaires were distributed to the respondents who composed the sample size of the study. Out of the 116 distributed questionnaires, 97 usable questionnaires were returned giving a response rate of 83.6% which was acceptable for the study according to Sekaran (2003).

#### 4.2. Background Data of Respondents

This section of the study discusses the characteristics of the respondents at BOA such as gender, age group, tenure of employment, level of education and position held. The researcher adopted frequency tabulations to present and discuss the results of the sample characteristics below. The rationale of using frequency tabulation and figures was to ascertain the categories of the different characteristics in relation to the responses of the respondents. In order to summarize the results, figures were used by the researcher because it was another way of presenting the results in a summarized manner.

##### 4.2.1 Respondent Category by Gender

In order to present the respondent category and gender distribution categories of the respondents, frequency tabulation was used by the researcher. Table 4.1 below presents the results:

**Table 4.1: Gender Distribution**

<b>Gender</b>	<b>Frequency</b>	<b>Percentage</b>
Male	61	62.9
Female	36	37.1
<b>Total</b>	97	100

**Source:** Primary data (2019)

##### 4.2.2 Respondent Category by Age Group

Frequency tabulation was used by the researcher to present the age distribution of the respondents. Table 4.2 below presents the results:

**Table 4.2: Age Distribution**

<b>Age</b>	<b>Frequency</b>	<b>Percentage</b>
------------	------------------	-------------------

20-25 years	2	2.0
26-30 years	28	28.5
31-35 years	21	21.5
36-40 Years	16	16.5
40 years and above	30	30.5
<b>Total</b>	97	100

**Source:** Primary data (2019)

#### **4.2.3 Tenure of Employment**

Frequency tabulation was used by the researcher to present the tenure of employment distribution of the respondents. Table 4.3 below presents the results:

**Table 4.3: Tenure of Employment Distribution**

<b>Tenure</b>	<b>Frequency</b>	<b>Percentage</b>
Less than 1 year	11	11.3
2 – 3 yrs	22	22.7
4 – 5 yrs	10	10.3
6 – 10 yrs	35	36.1
Above 10 yrs	19	19.6
<b>Total</b>	97	100

**Source:** Primary data (2019)

#### **4.2.4 Respondent Category by Level of Education**

Frequency tabulation was used to present the level of education distribution of the respondents.

**Table 4.4: Level of Education**

<b>Level of Education</b>	<b>Frequency</b>	<b>Percentage</b>
Diploma	0	0.0
Postgraduate diploma	22	22.7
Degree	38	39.2
Masters	29	30.0
Professional qualification	8	8.1
Others	0	0.0

<b>Total</b>	97	100
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**Source:** Primary data (2019)

#### **4.2.5 Distribution According to Position Held**

Frequency tabulation was used by the researcher to present the distribution according to position held of the respondents. Table 4.5 below presents the results:

**Table 4.5: Position Held**

<b>Designation</b>	<b>Frequency</b>	<b>Percentage</b>
Top management	11	11.3
Middle management	39	40.2
Supervisor	47	48.5
<b>Total</b>	97	100

**Source:** Primary data (2019)

### **4.3. Assumption Tests**

Assumptions are made relating to the classical linear regression model (CLRM). This is required to show that the estimation technique has a number of desirable properties and that hypothesis tests regarding the coefficient estimates could validly be conducted (Brooks, 2008). Hence diagnostic tests have been conducted to ascertain fulfillment of underlying assumptions.

#### **4.3.1. Linearity**

The assumption requires the mean of the disturbances to be zero. Brooks (2008) states that if a constant term is included in the regression equation, this assumption will never be violated. The model used for the study includes a constant term, hence the assumption has not been violated.

#### **4.3.2. Assumption of Homoscedasticity**

The assumption assumes that the variance of the errors is constant. This is known as the assumption of homoscedasticity. If the errors do not have a constant variance, they are said to be heteroscedastic (Brooks, 2008). To test for fulfillment of the assumption, Koenker test; which is the student zed/generalized statistics of Lagrange Multiplier test (LM)-Breusch-Pagan test (BP)

was used. Result of the test below indicates that the probability value (p-value) of the test statistics is 0.165 which is greater than 0.05. Hence, the null hypothesis of homoscedasticity is not rejected. The assumption of homoscedasticity is valid.

**TABLE 4.6: Test of Output for Homoscedasticity**

-----Koenker test statistics and sig-values -----

	LM	Sig
Koenker	14.170.	.165

Null hypothesis: heteroscedasticity not present (homoscedasticity); if sig-value less than 0.05, reject the null hypothesis.

Source: SPSS result, 2019

#### 4.3.3. Assumption of No Autocorrelation

Brooks (2008) states that the assumption will be fulfilled when covariance between the error terms over time or cross-sectionally is zero. It is assumed that the errors are uncorrelated with one another. Durbin-Watson (DW) test statistic of 2 and close to 2 results a no autocorrelation in the residuals. Hence, DW test has been conducted to verify that the assumption has not been violated. Result is as follows;

**TABLE 4.7: Test Output for No Autocorrelation**

<b>Model Summary <sup>b</sup></b>	
<u>Model</u>	<u>Durbin-Watson</u>
<u>1</u>	<u>1.826</u>

a. Predictors: (Constant), Transparency, accountability, and board composition

b. Dependent Variable: Firm performance

Source: SPSS result, 2019

DW for the model is 1.826 a value close to 2. The null hypothesis of no autocorrelation has not been rejected, hence the model has not violated the assumption.

#### 4.3.4. Multicollinearity Test

Assumption made when using the OLS estimation method is that the explanatory variables are not correlated with one another (Brooks, 2008). The larger the value of Variance Inflation Factor (VIF) the more “troublesome” or collinear the variable X. As a rule of thumb, if the VIF of a variable exceeds 10, that variable is said to be highly collinear (Gujarati, 2004). Variance Inflation Factor (VIF) for the independent variables has been computed using SPSS. The result is as follows;

**TABLE 4.8: Multicollinearity Test**

**Coefficients <sup>a</sup>**

##### Collinearity Statistics

<b>Model</b>	<b>Tolerance</b>	<b>VIF</b>
Transparency	.581	1.723
Accountability	.530	1.887
Board composition	.539	1.854

Dependent Variable: Firm performance

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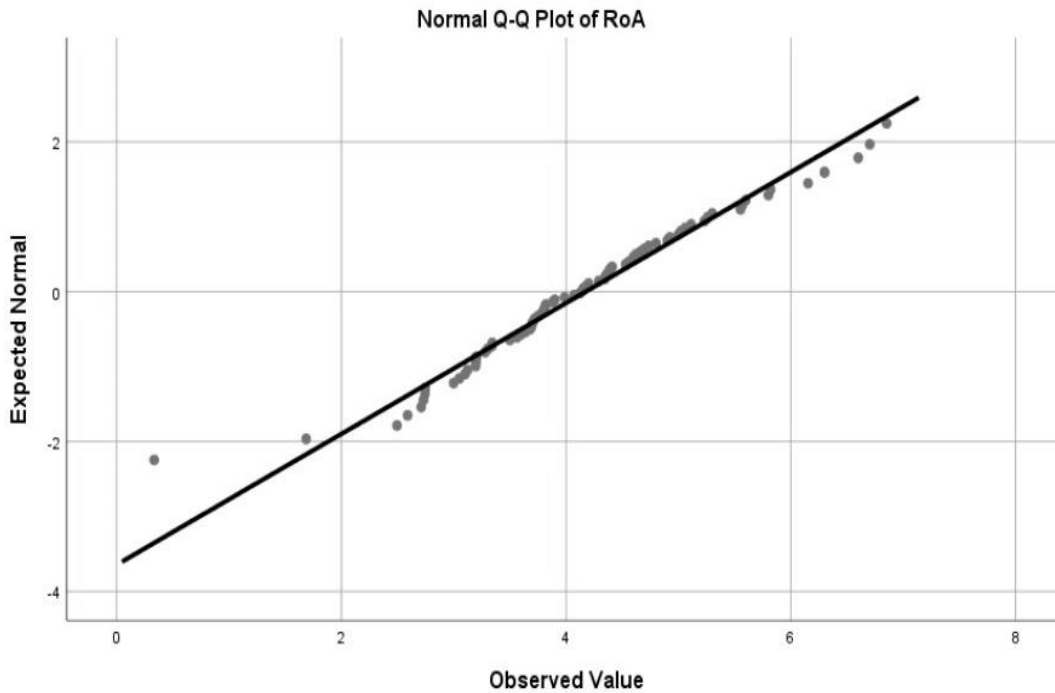
Source: SPSS result, 2019

VIF for all the variables is below 10, hence there is no multicollinearity among the independent variables.

**FIGURE 4.1: Normality Tests**

**4.3.5. Normality Assumption**

Normality test investigates whether the error term follows the normal distribution with zero mean and constant variance (Gujarati, 2004). Normal probability plot with tests have been conducted to check for normality. Output results are;



**TABLE 4.9: Normality Tests**

**Tests of Normality**

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistic	df	sig.	Statistic	df	sig.

<b>Firm performance</b>	.059	80	.200*	.978	80	.175
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\*. This is a lower bound of the true significance.

#### a. Lilliefors Significance Correction

Source: SPSS result, 2019

If the variable is from a normal population, the probability plot will assume an approximate straight line (Gujarati, 2004). The plot of the residuals of the study shows that the fitted line is approximately a straight line, hence the variable of the study is normally distributed. Moreover, probability value (p-value) of the test statistics of Kolmogorov-Smirnov and Shapiro-Wilk should be greater than 0.05 to not reject the null hypothesis- distribution is normal at 5% level. Significance levels of both tests are above 0.05 indicating the residuals are normally distributed.

### **4.4. Empirical Findings**

The findings in this study are based on the study objectives which included the effect of transparency on organizational performance; the contribution of accountability on organizational performance; and the effect of board composition on organizational performance. The variables are measured using a five-point Likert scale and the results are presented in descriptive tables, showing percentages and item means of responses under each variable. The results are further explained using the Pearson correlation matrix in order to show relationships between the study variables, whereas to study the predictive power of the dimensions of corporate governance (transparency, accountability and board composition) on organizational performance, a regression analysis was carried out. The results from the quantitative source are compared with qualitative ones. Statistical tables were used for easier understanding and interpretations.

#### **4.4.1. Effect of Transparency on Organizational Performance**

This section gives a description of research objective one which was assessed using a variety of questions as per Section I of the Instrument (Appendix I): How does transparency affect organizational performance? This research objective was conceptualized using 19 questions which required each respondent to do self-rating on training practices. Responses were based on

Likert scale ranging from one which represented strongly disagree to five which reflected strongly agree, although these were thereafter categorized into agree and disagree sections. The resulting summary statistics are in Table 4.6;

**Table 4.10: Transparency**

<b>Items</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>	<b>Std dev</b>
<b>Information access</b>				
At the bank, all public information is published	1	5	3.95	0.999
There is no falsification of information at the bank	1	5	3.49	0.798
All relevant documents/reports/statements of the bank are available for access	1	5	2.98	0.737
The information provided to the public is complete	1	5	2.98	0.812
Dissemination of bank information is done in a timely manner	1	5	2.54	0.925
The bank provides regular progress reports about its performance to statutory bodies	1	5	3.34	0.938
<b>Independent verification</b>				
At the bank, management ensures that certification of agency records is carried	1	5	3.56	0.941
The bank financial statement are authenticated by statutory bodies	1	5	4.07	0.827
All bank reports submitted to statutory bodies are verified	1	5	3.90	0.700
The bank regularly under goes an audit process to verify its performance	1	5	3.62	0.812
An assessment of the bank's financial statements is carried out on a terminal basis	1	5	3.71	0.783
During the verification process, the issues raised are addressed amicably	1	5	3.46	0.901
Proof of bank expenditures and revenue is ascertained by statutory bodies	1	5	3.34	0.938

<b>Disclosure</b>				
The bank responds to audit queries raised by statutory bodies	1	5	3.69	0.702
The bank facilitates understandability and interpretation of the published information	1	5	3.56	0.805
The information that is disclosed by the bank is a reflection of its performance	1	5	3.08	0.829
Due to the bank's level of openness it is trusted by the public	1	5	3.30	0.744
The audited accounts of the bank are available for public access	1	5	3.71	0.809
The information provided by the bank is error free	1	5	3.39	0.702

**Source:** Primary data (2019)

The results on information access as a component of transparency in Table 4.6 showed that there was agreement that the bank published all public information (mean=3.95) whereas, the respondents disagreed that all relevant documents/reports/statements of the bank were available for access (mean=2.98), the information provided to the public was complete (mean=2.98) and dissemination of bank information was done in a timely manner (mean=2.54). This was evidence that there was some level of information access by the public on the bank much more needed to be done to enhance the accessibility of the required information about the bank by the public.

In regard to independent verification in order to enhance transparency, the majority of the respondents again agreed that the bank's financial statements were authenticated by statutory bodies (mean=4.07), all bank reports submitted to statutory bodies were verified (mean=3.90), an assessment of the bank's financial statements was carried out on a terminal basis (mean=3.71), the bank regularly underwent audit processes to verify its performance (mean=3.62) and management ensured that certification of bank records was carried (mean=3.56). The results point to the fact that the bank carried out independent verification of its financial records by statutory organs so as to promote transparency.

The results on disclosure as a component of transparency showed that the audited accounts of the bank were available for public access (mean=3.71), the bank responded to audit queries raised by

statutory bodies (mean=3.69) and the bank facilitated understandability and interpretation of the published information (mean=3.56). From the results, the standard deviation result of less than 1 is proof that transparency determined bank performance. Likewise, the standard deviation results provided evidence that the results obtained information access, independent verification and disclosure could be applied to BOA and therefore could be generalized for other commercial banks in Ethiopia.

The qualitative results from management staff who were the key informants were in form of responses, one of which said: “to a moderate extent, the bank allowed information access by different stakeholders, allowed independent verification by statutory bodies and always disclosed their information to the public”.

The general view is that the results on transparency as a means of corporate governance at the bank provided confirmation that information access, independent verification and disclosure as avenues of promoting efficient corporate governance was effective and had benefited the public and staff. This implies that continued information access, independent verification and disclosure will go a long way in helping management become more transparent to the public and in turn foster the required corporate governance at the bank.

➤ **Financial Transparency and Organizational Performance**

To assess the association between transparency and organizational performance, correlation was done whereby all responses for each variable, transparency and organizational performance, were aggregated and then Pearson’s Correlation Co-efficient (r) technique was used to assess the nature and magnitude of the relationship. Table 4.7 gives Pearson’s Correlation Coefficient for the two variables which include transparency and organizational performance.

**Table 4.11. Financial Transparency and Organizational Performance**

<b>Variables</b>		<b>Transparency</b>	<b>Organizational Performance</b>
<b>Transparency</b>	Pearson Correlation	1	0.633**
	Sig. (2-tailed)		0.000

<b>Organizational Performance</b>	Pearson Correlation	0.633**	1
	Sig. (2-tailed)	0.000	
**. Correlation is significant at the 0.01 level (2-tailed).			

**Source:** Primary data (2019)

Table 4.7 shows that Pearson’s Correlation Coefficient for transparency and organizational performance was  $r = 0.633$ , which was positive with probability value ( $p = 0.000$ ) that is less than  $\alpha = 0.01$  level of significance, showing a positive relationship between transparency and organizational performance at the one per cent level of significance. This implied that in order for the bank to enhance its corporate governance, it had to be more transparent so as to have a positive influence on the organizational performance at the bank. This position was also shared by top executives such as the executive committee members, top managers and heads of department who revealed that transparency at BOA was paramount in promoting profitability, cost reduction, growth and liquidity. The correlation results between financial transparency and organizational performance are supported by the multiple regression results in Table 9, Beta=.390 which revealed that financial transparency determined a change in organizational performance. The results provide confirmation that availability of transparency with regard to information access, independent verification and disclosure will enhance the effectiveness, efficiency and service delivery of BOA to the tune of 63.6%.

#### 4.4.2. Effect of Accountability on Organizational Performance

This section gives a description of research objective two which was examined using a variety of questions as per Section II of the research tool (Appendix I): What is the contribution of accountability on organizational performance? This research objective was conceptualized using nine questions which required each respondent to do self-rating on accountability. Responses were based on Likert scale ranging from strongly disagree (1) to strongly agree (5), although these were subsequently categorized into agree and disagree sections. The resulting summary statistics are in Table 4.12;

**Table 4.12: Respondents’ Views on Accountability**

Items	Min	Max	Mean	Std dev
<b>Participation</b>				
Management provides adequate information when making	1	5	3.39	0.692

accountability				
Management adheres to accountability procedures set by law	1	5	3.56	0.705
There is stakeholder participation during accountability	1	5	3.78	0.729
The degree of participation during the accountability process leads to compliance	1	5	3.90	0.844
The accountability process is used as a means of assessing resource allocation	1	5	3.71	0.709
The management of the bank is committed to the accountability process	1	5	3.95	0.671
<b>Evaluation</b>				
At the bank, there is resource monitoring	1	5	3.63	0.719
Significant departures from accountability set targets are reported	1	5	3.46	0.951
At the bank a lot of emphasis is put on timely provision of accountability	1	5	4.37	0.813
The availability of monitoring frameworks enhances accountability	1	5	3.78	0.788
Management provides for tracking variances and backlash	1	5	3.06	0.638
There is a clear methodology of tracking accountability	1	5	4.05	0.817
There is identification of the risky areas likely to affect the accountability process	1	5	3.80	0.789
There are well set internal controls to check the accountability process	1	5	3.59	0.795
Independent financial reviews are carried out at the bank	1	5	3.09	0.895
<b>Fiscal compliance</b>				
The bank adheres to set financial sector policies, rules and regulations	1	5	3.62	0.932
The bank adheres to accountability procedures governing the banking sector	1	5	3.65	0.882

The right priorities are usually set during the budgeting process at the bank	1	5	3.32	0.714
There are effective internal controls used to monitor the operations of the bank	1	5	3.25	0.795
Staff are aware of the policies, laws and regulations	1	5	3.61	0.881

**Source:** Primary data (2019)

Basing on the study results in Table 4.8 with regard to participation as a component of accountability, the majority of the respondents revealed that management was committed to the accountability process (mean=3.95), the degree of participation during the accountability process led to compliance (mean=3.90), there was stakeholder participation during accountability (mean=3.78), the accountability process was used as a means of assessing resource allocation (mean=3.71) and management adhered to accountability procedures set by law (mean=3.56) which was indication that the work processes were determined by their line managers or according to set guidelines and policies.

Regarding evaluation as a component of corporate governance, the respondents showed that a lot of emphasis was put on timely provision of accountability (mean=4.37), there was a clear methodology of tracking accountability (mean=4.05), there was identification of the risky areas likely to affect the accountability process (mean=3.80), the availability of monitoring frameworks enhanced accountability (mean=3.78), there was resource monitoring (mean=3.63) and there were well set internal controls to check the accountability process (mean=3.59).

On the other hand, the results on fiscal compliance showed that the bank adhered to set financial sector policies, rules and regulations (mean=3.62), the bank adhered to accountability procedures governing the banking sector (mean=3.65) and staff were aware of the policies, laws and regulations (mean=3.61). From the results, the standard deviation result of less than 1 is proof that accountability determined organizational performance at BOA. Likewise, the standard deviation results provided evidence that the results obtained on participation, evaluation and fiscal compliance could be applied to the bank and therefore could be generalized on other commercial banks in Ethiopia.

In line with the quantities results on accountability above, the results from the interviews affirmed that: “the bank exhibited a high level of accountability in regard to participation, evaluation and fiscal compliance through adherence to set procedures and policies, monitoring frameworks and stakeholder participation”.

Various studies have shown that accountability influences organizational performance. From the results of the study, one can deduce that accountability was paramount in promoting organizational performance. Therefore, the management of the bank should endeavor to adhere to the set procedures, guidelines and policies so as to promote improvement in governance structures which will in turn boost bank performance.

➤ **Accountability and Organizational Performance**

To verify this hypothesis, correlation was done whereby all responses for each variable; accountability and organizational performance were aggregated into a single index and then Pearson’s Correlation Co-efficient (r) technique was used to assess the nature and magnitude of the relationship. Table 4.9 gives Pearson’s Correlation Coefficient for the two variables which include accountability and organizational performance.

**Table 4.13: Relationship between Accountability and Organizational Performance**

<b>Variables</b>		<b>Accountability</b>	<b>Organizational Performance</b>
<b>Accountability</b>	Pearson Correlation	1	0.579**
	Sig. (2-tailed)		0.000
<b>Organizational Performance</b>	Pearson Correlation	0.579**	1
	Sig. (2-tailed)	0.000	
**. Correlation is significant at the 0.01 level (2-tailed).			

**Source:** Primary data (2019)

Correlation results indicated a significant and positive relationship between accountability and organizational performance ( $r = 0.579^{**}$ ,  $p < .01$ ). The results in the above table indicate that there is a very strong and statistically significant positive correlation between accountability and organizational performance at  $0.579^{**}$  with a significance of 0.000 at the level of 0.01. The correlation results between accountability and organizational performance are supported by the multiple regression results (Beta=.246) which revealed that accountability predicated a change in organizational performance. This implies that accountability positively contributes to organizational performance at the bank. The results

provide justification that when there is stakeholder participation, evaluation and fiscal compliance in the bank, this would enhance the performance of the bank in terms of profitability, cost reduction, growth and liquidity to the tune of 57%.

#### 4.4.3. Effect of Board Composition on Organizational Performance

In order to examine the effect of board composition on Organizational performance, item mean results were developed to show the average response of the respondents on each item. The items were anchored on a 5-point Likert scale ranging from strongly disagree, to disagree, neither agree nor disagree, agree and strongly agree. The findings are shown in Table 4.14 below:

**Table 4.14: Respondents view on Board Composition**

Items	Min	Max	Mean	Std dev
<b>Competencies</b>				
I demonstrates self-confidence by getting involved in decision making	1	5	4.02	0.772
Board members possess the required knowledge and skills required to perform their roles	1	5	3.67	0.813
Board members provides mutual support and monitor the operations of the bank	1	5	3.48	0.688
Board members have the capability of assessing monetary and financial documents	1	5	3.52	0.772
Board members have the capacity to develop policies and procedures	1	5	3.65	0.817
The management committee of the bank is competent to handle the operations of the bank	1	5	3.70	0.789
The management committee is independent during decision making	1	5	3.49	0.895
Board composition is diversified in regard to skills and competences	1	5	3.59	0.695
<b>Composition</b>				
The boards are composed of competent members	1	5	3.61	0.781
During board formation, representation of all stakeholders	1	5	3.55	0.882

is considered				
The integrity of board members is considered during board composition	1	5	4.02	0.614
When appointing board member, there is gender balance	1	5	3.05	0.795
During board composition, members' track record is considered	1	5	3.61	0.781
The board co-opts members with expert knowledge and skill in particular fields.	1	5	3.06	0.757
<b>Independence</b>				
The board has the mandate to carry out resource allocation	1	5	3.72	0.832
The board takes decisions independently	1	5	3.34	0.735
The board of the bank is autonomous	1	5	3.02	0.832
The board decides on the internal controls to be instituted at the bank	1	5	3.95	0.782
The bank has administrative and financial autonomy	1	5	3.62	0.814
The bank is at liberty to carry our policy reviews	1	5	3.75	0.795
The board delegates some of its responsibilities to sub-committees or subordinates	1	5	3.51	0.881

**Source:** Primary data (2019)

From the results on competences as a component of board composition, the majority of the respondents were in agreement that board members demonstrated self-confidence by getting involved in decision making (mean=4.02), the management committee members were competent to handle the operations of the bank (mean=3.70), board members possessed the required knowledge and skills required to perform their roles (mean=3.67), board members had the capacity to develop policies and procedures (mean=3.65), board composition was diversified in regard to skills and competences (mean=3.59) and board members had the capability of assessing monetary and financial documents (mean=3.52).

On the other hand, the results on composition as a dimension of board composition revealed that integrity of board members was considered during board composition (mean=4.02), boards were

composed of competent members (mean=3.61), during board composition, members' track record was considered (mean=3.61) and during board formation, representation of all stakeholders was considered (mean=3.55). The responses on independence as a construct of board composition revealed that the board decided on the internal controls to be instituted at the bank (mean=3.95), the bank was at liberty to carry out policy reviews (mean=3.75), the board had the mandate to carry out resource allocation (mean=3.72) and the bank had administrative and financial autonomy (mean=3.62).

This is justification that the management of BOA ensured that the boards were composed of competent people who were independent in their decision making. From the results, the standard deviation results of less than 1 provided evidence that the results obtained on board composition applied to the bank and therefore could be generalized on other commercial banks in Ethiopia. Various studies have shown that board composition influences organizational performance. From the results of the study, one can deduce that board composition was paramount in promoting organizational performance.

➤ **Board Composition and Organizational Performance**

To verify this hypothesis, correlation was done whereby all responses for each variable, board composition and organizational performance, were aggregated into a single index and then Pearson's Correlation Co-efficient (r) technique was used to assess the nature and magnitude of the relationship. Table 4.11 gives Pearson's Correlation Coefficient for the two variables which include; board composition and organizational performance.

**Table 4.15: Board Composition and Organizational Performance**

<b>Variables</b>		<b>Board Composition</b>	<b>Organizational Performance</b>
<b>Board Composition</b>	Pearson Correlation	1	0.530**
	Sig. (2-tailed)		0.000
<b>Organizational Performance</b>	Pearson Correlation	0.530**	1
	Sig. (2-tailed)	0.000	
**. Correlation is significant at the 0.01 level (2-tailed).			

**Source:** Primary data (2019)

Correlation results indicated a significant and positive relationship between board composition and organizational performance ( $r = 0.530^{**}$ ,  $p < .01$ ). The results indicate that there is a strong and highly significant positive correlation between board composition and organizational performance at  $0.530^{**}$  with a significance of 0.000 at the level of 0.01. The correlation results between board composition and organizational performance are supported by the multiple regression results of  $Beta = .130$  which revealed that board composition influenced the change in organizational performance. This implies that board composition positively contributes to the performance of bank and, therefore, the hypothesis that board composition significantly influences organizational performance in BOA is substantiated.

#### **4.5. Multiple Regression Model**

Regression analysis includes any techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent variable and one or more independent variables. More specifically, regression analysis helps understand how the typical value of the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed. Most commonly, regression analysis estimates the conditional expectation of the dependent variable given the independent variables. Regression analysis is widely used for prediction and forecasting, where its use has substantial overlap with the field of machine learning.

Regression analysis is also used to understand which among the independent variables are related to the dependent variable, and to explore the forms of these relationships. In restricted circumstances, regression analysis can be used to infer causal relationships between the independent and dependent variables. A regression analysis was carried out to examine the extent to which study variables (transparency, accountability and board composition) predict firm performance at the bank. The results are presented in Table 4.14 below.

**Table 4.16: Regression Model**

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.863	0.437		1.976	0.052
	Board Composition	0.165	0.148	0.130	1.112	0.269
	Accountability	0.239	0.115	0.246	2.085	0.040
	Transparency	0.372	0.115	0.390	3.221	0.002
<b>Dependent Variable:</b> Firm performance						
R Square = .458						
Adjusted R Square = .437						

**Source:** Primary data (2019)

According to Table 4.12, accountability, transparency and board composition predict 43.7% of organizational performance (Adjusted R Square = .437). The regression model was significant and thus reliable for making conclusions and recommendations. The most significant predictor of organizational firm performance was transparency (Beta= 0.390, t= 3.221, Sig. = .002) followed by accountability (Beta= .246, t= 2.085, Sig. = .040) and then board composition (Beta= 0.130, t= 1.112, Sig. = 0.269). The findings revealed that accountability and transparency were strong predictors of organizational performance, whereas board composition did not register a significant effect on firm performance.

#### **4.6. Discussion of the Findings**

A discussion of the findings is presented in this section according to the study objectives. Here the researcher assesses how the findings of the study are in agreement or disagreement with extant literature that was reviewed.

##### **4.6.1. Financial Transparency and firm performance**

The findings revealed that there was a strong and statistically significant positive correlation between financial transparency and firm performance which was implication that financial transparency positively affects organizational performance of BOA. The findings were further supported by the multiple regression results which revealed that financial

transparency determined a change in organizational performance. In support of the findings of the study, Abor (2007) asserts that transparency may not lead to immediate success, but lack of transparency can lead to a quick failure of an organization. While increasing transparency means that organizational mechanisms operate closer and closer to true efficiency, shareholders and stakeholders have more power, the privacy right of corporations slips slowly away. Organizational transparency is essentially about trust. Assuming the information that is transparently provided by an organization is accurate, true and non-selective, it is likely that the public will trust a transparent organization over a non-transparent one. According to Batra, Kaur and Dangwal (2007), transparent and consistent reporting will promote sound decision-making, which can improve organizational performance and attract additional capital.

#### **4.6.2. Accountability and Organizational Performance**

From the findings, there was a very strong and statistically significant positive correlation between accountability and organizational performance. This was supported by the multiple regression results which revealed that accountability predicated a change in organizational performance of BOA. In agreement with the findings, Chen, Chen and He (2008) revealed that accounting exploits the role of accounting information as a source of credible information variables that support the existence of enforceable contracts, such as compensation contracts with payoffs to managers contingent on realized measures of performance, the monitoring of managers by board of directors and outside investors and regulators, and the exercise of investor rights granted by existing securities laws.

They posit that the existence of a strong financial accounting regime is likely a precondition for the existence of a vibrant organization and in its absence the notions of equity-based pay and diffuse ownership of firms become debatable (Jandik and Rennie, 2008). Alexander (2006) suggests that corporate audiences rate the performance of firms on the basis of the quality of their disclosures as well as market and accounting signals such as asset size, market returns and ROA. If companies are to reap the benefits of good corporate governance, they need to communicate such information to the various groups of stakeholders (Mashayekhi and Mohammad, 2008).

### **4.6.3. Board Composition and Organizational Performance**

The findings revealed a strong and highly significant positive correlation between board composition and organizational performance which was supported by the multiple regression results which revealed that board composition influenced the change in organizational performance. In line with the findings, Mohd, et. al. (2008) are of the view that the size of the group increases, communication and coordination problems increases in the organizational environment. According to Alexander (2006) greater independence of board members led to better financial decisions and thereby better financial performance.

The findings further revealed that, the board of directors be constituted of at least two independent members and that at least one third of the members fulfill the criteria for independence. For a successful decision making process, stewardship theory claims that a significant proportion of dependent directors is required in managerial boards. The rationale of this claim is based on the idea that dependent directors can better understand not only the business processes but also the environmental factors. Therefore, they can govern their businesses more successfully than independent directors (Abor and Biekpe, 2007).

### **4.7. Summary of the Findings**

The study sought to investigate the effect of corporate governance on firm performance in BOA. This was carried out by way of unpacking the factor components of corporate governance and thereafter relating them to organizational performance. Data was collected by way of a self-administered questionnaire and interview guide which were both open and closed ended and the data was analyzed with the use of Statistical Package for Social Scientists which presented results in tabulations of frequencies, correlations and regression analysis. From the findings on the demographic characteristics, the majority of the respondents were male. According to the results, middle managers were more responsive in comparison with other positions. A sizeable number of respondents had accumulated experience of over 2 years. The majority of the respondents belonged to the 26-35 years age group and the highest level of education possessed by the majority of the respondents was degree level of education.

#### **4.7.1. Financial Transparency and firm performance**

The findings on the effect of transparency and firm performance revealed a significant relationship. This is confirmation that information access, independent verification, and disclosure were paramount in influencing firm performance positively. The correlation findings were also supported by regression analysis results which showed that transparency was a significant predictor of firm performance

#### **4.7.2. Accountability and firm performance**

According to the correlation findings on the effect of accountability and firm performance, a significant relationship was observed. This is confirmation that through participation, evaluation and fiscal compliance, this had a positive effect on firm performance. The correlation results are in line with the regression analysis which revealed that accountability predicted firm performance

#### **4.7.3. Board Composition and firm performance**

Similarly, the association between board composition and firm performance revealed a significant relationship between the study variables. The findings posit that board competences, composition and independence were important in promoting firm performance. The correlation results are in agreement with the regression analysis findings which revealed that board composition predicted firm performance.

## **Chapter Five**

### **Conclusion and Recommendations**

#### **5.1. Conclusion**

The conclusions were drawn based on the research objectives of the study as presented below:

- a) From the findings, transparency was an integral in promoting the performance of the bank. This implies that when the bank provides information that accurate, true and non-selective, this will lead to the public having trust in the organizations, hence improving their performance. This is justification that transparency was paramount in improving bank performance.
- b) The findings on objective two revealed that accountability in relation to participation, evaluation and fiscal compliance had a positive significant effect on bank performance. The positive significant relationship between accountability on organizational performance is justification that to promote effectiveness, efficiency and service delivery of the bank, there was need to have bank managers and employees appreciate the role of accountability as this would in turn improve performance.
- c) The findings confirmed that board composition was a determining factor of bank performance which is implication that board competences, independence and composition were paramount in promoting bank performance. As a result this would promote idea generation as a result of board independence which would in turn lead to better financial decision making and thereby better bank performance.

#### **5.2. Recommendations**

In the light of the research findings, the following recommendations are made:

- a) According to the findings, transparency was found to be the major predictor of bank performance. Therefore, the management of the bank should put a lot of emphasis on information access, independent verification and disclosure so as to enhance bank performance. This can be carried out through the bank websites, publications and through electronic media which will have a positive effect on the effectiveness and efficiency of the bank in the delivery of services to the public.
- b) According to the regression analysis results, accountability was found to be predictor of bank performance. Therefore, the management of the bank should ensure

that the generated financial reports are accurate, relevant and reliable so as to enhance decision making at the bank which would in turn have a positive effect on the performance of the bank. This could be realized through ensuring that effective and efficient financial reporting systems are put in place to promote participation, effective evaluation and adherence to financial policies set by the bank as this will have a positive influence on bank performance. There should also be continuous reviews of accounting internal controls of the bank through monitoring and evaluation of accounting processes as this will ensure checks and balances and also help identify the gaps that are still eminent in the accounting processes of the bank and address them.

- c) The findings revealed that board composition was a determinant of bank performance. For this reason, the management of the bank should ensure that the members appointed on the different boards and committees possess the required competences, promote gender balance and are independent during decision making. This could be achieved through talent management by promoting succession planning, career guidance, workplace diversity and staff development where the bank should offer the required training for staff. Management should provide guidance on training opportunities which are relevant to their professions.

### **5.3. Limitation of the Study**

- i) The case study analysis used by the study undermined the quality of information that was collected to represent the views of all the other commercial banks. Here the researcher carried in-depth interviews with senior staff who had a long tenure with the bank so as to gather data that was representative for all the commercial banks.
- ii) The time horizon used (cross sectional) in the study only collected data at a point in time, therefore providing views as of when the study was carried out. However, the research encouraged staff to provide as much information as possible; and to bridge this gap, he pointed out that a longitudinal study was more appropriate for the study so as to gain a clear understanding about commercial banks regarding the association between corporate governance and bank performance.

#### **5.4. Contribution of the Study**

- i) According to the findings on transparency and bank performance, the study was able to provide insight in the role of financial transparency with regard to information access, independent verification and disclosure in promoting profitability, cost reduction, growth and liquidity at the bank.
- ii) Regarding the findings on the association between accountability and bank performance, the study was able to articulate the importance of accountability relative to participation, evaluation and fiscal compliance which were key in promoting profitability, cost reduction, growth and liquidity at the bank.
- iii) The findings on the association between board composition and bank performance revealed that the role played by composition with regard to competences, independence and composition were key determinants of bank profitability, cost reduction, growth and liquidity.

#### **5.5. Recommendation for Further Research**

- i) This study concentrated on transparency, accountability and board composition and organizational performance at BOA. Future research should attempt to widen the scope of the study to cover other regions other than Addis Ababa district to ascertain the findings.
- ii) The study adopted a cross sectional design which studied the state of affairs at the bank at a point in time. To study the true nature and quality of the effect of transparency, accountability and board composition on organizational performance, a longitudinal study is more appropriate.
- iii) From the findings, the regression analysis revealed that the model could only explain 43.7% in variance of organizational performance; a study should be carried out comprising other factors which were not part of the model.

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## QUESTIONNAIRE

Dear Respondent,

This questionnaire is aimed at collecting data to undertake a study on **the impact of Corporate Governance on performance of Bank of Abyssinia**. The research is in partial fulfillment of the requirements for the award of a Master of Business Administration of Addis Ababa University. All information provided will be treated with utmost confidentiality and will be used for purely for academic purposes.

SECTION I: General Information (Please tick in the appropriate option)

1. What is your gender?

MALE	FEMALE

2. What is your age bracket?

20-25 years	26-30 years	31-35 years	36-40 years	40 years and above

3. How long have you worked at the BOA?

Less than 1 year	2 – 3 yrs.	4 – 5 yrs.	6 – 10 yrs.	Above 10 yrs.

4. What is the highest level of education you have attained?

Diploma	Degree	Postgraduate Diploma	Professional Qualification	Masters	other

5. What is your level of management?

Top management (1)	Middle Management (2)	Supervisor (3)	Officer (4)

### SECTION II: Board Composition

Please indicate the extents of your agreement with statements listed below ranging from 5- strongly agree (SA), 4- agree (A), 3 not certain (NC), 2 disagree (D), 1- strongly disagree (SD).

<b>Items</b>	<b>SD</b>	<b>D</b>	<b>NC</b>	<b>A</b>	<b>SA</b>
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<b>Competencies</b>					
I demonstrate self-confidence by getting involved in decision making	1	2	3	4	5
Board members possess the required knowledge and skills required to perform their roles	1	2	3	4	5
Board members provides mutual support and monitor the operations of the bank	1	2	3	4	5
Board members have the capability of assessing monetary and financial documents	1	2	3	4	5
Board members have the capacity to develop policies and procedures	1	2	3	4	5
The management committee of the bank is competent to handle the operations of the bank	1	2	3	4	5
The management committee is independent during decision making	1	2	3	4	5
Board composition is diversified in regard to skills and competences	1	2	3	4	5
<b>Composition</b>					
The boards are composed of competent members	1	2	3	4	5
During board formation, representation of all stakeholders is considered	1	2	3	4	5
The integrity of board members is considered during board composition	1	2	3	4	5
When appointing board members, there is gender balance	1	2	3	4	5
During board composition, members' track record is considered	1	2	3	4	5
The board co-opts members with expert knowledge and skill in particular fields.	1	2	3	4	5
<b>Independence</b>					
The board has the mandate to carry out resource allocation	1	2	3	4	5
The board takes decisions independently	1	2	3	4	5
The board of the bank is autonomous	1	2	3	4	5
The board decides on the internal controls to be instituted at the bank	1	2	3	4	5
The bank has administrative and financial autonomy	1	2	3	4	5
The bank is at liberty to carry our policy reviews	1	2	3	4	5
The board delegates some of its responsibilities to sub-committees or subordinates	1	2	3	4	5

### **Section III: Accountability**

Please indicate the extent of your agreement with statements listed below ranging from 5- strongly agrees (SA), 4- agree (A), 3 not certain (NC), 2 disagree (D), 1- strongly disagree (SD).

<b>Items</b>	<b>SD</b>	<b>D</b>	<b>NC</b>	<b>A</b>	<b>SA</b>
<b>Participation</b>					
Management provides adequate information when making accountability	1	2	3	4	5
Management adheres to accountability procedures set by law	1	2	3	4	5
There is stakeholder participation during accountability	1	2	3	4	5
The degree of participation during the accountability process leads to compliance	1	2	3	4	5
The accountability process is used as a means of assessing resource allocation	1	2	3	4	5
The management of the bank is committed to the accountability process	1	2	3	4	5

<b>Evaluation</b>					
At the bank, there is resource monitoring	1	2	3	4	5
Significant departures from accountability set targets are reported	1	2	3	4	5
At the bank a lot of emphasis is put on timely provision of accountability	1	2	3	4	5
The availability of monitoring frameworks enhances accountability	1	2	3	4	5
Management provides tools for tracking variances and backlashes	1	2	3	4	5
There is a clear methodology of tracking accountability	1	2	3	4	5
There is identification of the risky areas likely to affect the accountability process	1	2	3	4	5
There are well set internal controls to check the accountability process	1	2	3	4	5
Independent financial reviews are carried out at the bank	1	2	3	4	5
<b>Fiscal compliance</b>					
The bank adheres to set financial sector policies, rules and regulations	1	2	3	4	5
The bank adheres to accountability procedures governing the banking sector	1	2	3	4	5
The right priorities are usually set during the budgeting process at the bank	1	2	3	4	5
There are effective internal controls used to monitor the operations of the bank	1	2	3	4	5
Staffs are aware of the policies, laws and regulations of the bank	1	2	3	4	5

#### **Section IV: Transparency**

Please indicate the extent of your agreement with statements listed below ranging from 5- strongly agrees (SA), 4- agree (A), 3 not certain (NC), 2 disagree (D), 1- strongly disagree (SD).

<b>Items</b>	<b>SD</b>	<b>D</b>	<b>NS</b>	<b>A</b>	<b>SA</b>
<b>Information access</b>					
Financial information is published as per the financial sector regulation	1	2	3	4	5
There is no falsification of information at the bank	1	2	3	4	5
All relevant documents/reports/statements of the bank are available for access	1	2	3	4	5
The information provided to the public is complete	1	2	3	4	5
Dissemination of bank information is done in a timely manner	1	2	3	4	5
The bank provides regular progress reports about its performance to statutory bodies	1	2	3	4	5
<b>Independent verification</b>					
Management ensures that certification of agency records is carried	1	2	3	4	5
The bank's financial statement are authenticated by statutory bodies	1	2	3	4	5
All bank reports submitted to statutory bodies are verified	1	2	3	4	5
The bank regularly under goes an audit process to verify its performance	1	2	3	4	5
An assessment of the bank's financial statements is carried out on a regular basis	1	2	3	4	5
During the verification process, the issues raised are addressed amicably	1	2	3	4	5
Proof of bank expenditures and revenue is ascertained by statutory bodies	1	2	3	4	5
<b>Disclosure</b>					

The bank responds to audit queries raised by statutory bodies	1	2	3	4	5
The bank understandability facilitates the interpretation of the published information	1	2	3	4	5
The information that is disclosed by the bank is a reflection of its performance	1	2	3	4	5
Due to the bank's level of openness it is trusted by the public	1	2	3	4	5
The audited accounts of the bank are available for public access	1	2	3	4	5
The information provided by the bank is error free	1	2	3	4	5

**Section V: Organizational Performance**

Please indicate the extent of your agreement with statements listed below ranging from 5- strongly agrees (SA), 4- agree (A), 3 not certain (NC), 2 disagree (D), 1- strongly disagree (SD).

Items	SD	D	NC	A	SA
The bank is highly productive and values its customers	1	2	3	4	5
The bank is highly productive	1	2	3	4	5
The bank is one of the fastest growing financial institution in the country	1	2	3	4	5
The bank's deposit volumes have been growing for the last 3 years	1	2	3	4	5
The bank's transactions turnover has grown	1	2	3	4	5
The bank's return on investment has been growing over the years	1	2	3	4	5
The bank has grown in the number of branches	1	2	3	4	5
The asset base of the bank has grown	1	2	3	4	5
The bank competes favorably in the financial sector	1	2	3	4	5
The bank's customer base has grown over the years	1	2	3	4	5
The profits of the bank have been steadily increasing	1	2	3	4	5
The profit margins of the bank have growth	1	2	3	4	5
At the bank, the total costs of operation have continued to reduce	1	2	3	4	5

**Thank you for your cooperation**

## **Interview Guide for Employees**

The researcher will be guided by the following questions in carrying out the interview for bank employees

1. In your view, is there easy information access and disclosure at the bank?
2. Does the management of the bank encourage participation during accountability?
3. Is board independence and diversity encouraged on the different boards/committees at the bank?
4. Does the management of the bank appoint competent board members?
5. Is the profitability and growth of the bank satisfactory?
6. Is the bank's level of liquidity adequate to enable it carry out its activities well?
7. What are the corporate governance challenges faced the bank?
8. What strategies have been put in place to mitigate the above challenges?
9. In your view, does corporate governance enhance bank performance?