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*College of Business and Economics*

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*Executive MBA Program*

*Assessment of Corporate Governance Practices in the  
Ethiopian Insurance Industry (The Case of Selected Four  
Insurance Companies)*

*Submitted To: Ethiopia Legesse (D.Sc.)*

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## Statement of Certification

This is to certify that the thesis prepared by Mr. Solomon Wolde entitled **Assessment of Corporate Governance Practices in the Ethiopian Insurance Industry: The Case of Selected Four Insurance Companies** and submitted in partial fulfilment of the requirements for the Masters Degree of **Executive Masters of Business Administration** complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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## **Statement of Declaration**

I, Solomon Wolde, have carried out independently a research work on the topic entitled “**Assessment of Corporate Governance Practices in the Ethiopian Insurance Industry**” in partial fulfilment of the requirement for the Masters Degree of **Executive Masters of Business Administration** with the guidance and support of the research advisor. This study is my own work that has not been submitted for any degree or diploma program in this or any other institutions.

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*Solomon Wolde*

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## *Abbreviation and Acronyms*

*BOD - Board of Directors*

*CEO - Chief Executive Officer*

*CFO - Chief Financial Officer*

*FRC - Financial Reporting Council*

*FRS - Financial Service Authority*

*IFRS - International Financial Reporting Standards*

*NBE - National Bank of Ethiopia*

*NED - Non Executive Directors*

*OECD - Organization for Economic Cooperation and Development*

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## **Abstract**

It is the separation of ownership and control that produced the concept of corporate governance. Since governance is the centre point for corporate success, it needs the attention of all stakeholders. Unless given a focus it deserves in managing a business, it may result undesirable long term consequences. In the current business set up, Insurance Companies are among the industries that are implementing the concept of corporate governance in the context of Ethiopia. Due to the sensitivity nature of the business and an irreplaceable role these companies play in the macro economy of a given country, poor corporate governance practice may have a macroeconomic impact that could potentially affect the whole economy. As a result, this research paper was prepared with the objective of assessing and understanding the level of corporate governance practice in Insurance Companies in Ethiopia in light of National bank of Ethiopia's Directive and OECD principles, so as to improve the understanding of various stakeholders and also to shed light on the adoption of best practices and principles into the country's corporate governance system. Major components like board of directors, shareholders, Executive directors, supervisory organ and disclosure, were taken as major assessment concepts. A questionnaire prepared addressing these concepts were distributed and related documents were also reviewed. The data collected were analysed using SPSS application. The results show that, Insurance Companies in Ethiopia are in good corporate governance foundation because of the regulatory organ strict supervision on each and every action of the market. However, some important and critical manifestations of good corporate governance are lacking both from regulatory side and from the Companies side that would promote the practice some steps higher. This will have impact on the existing knowledge of the practice and further policy measures should be updated and enhanced.

# Chapter One

## Introduction

### 1.1 Background of the Study

In this study, we are going to deal with the practice of corporate governance. Simply said, Corporate Governance is the administrative system of companies (Berle and Means, 1932). Organizations can be functioning in any form depending on the size and ownership. A company can be managed by one individual or few people only if it is a small one, like sole proprietorship or General Partnership. In this case, stewardship is in the hands of these people. Whereas, big corporations established by stock ownership are managed by professional managers who are usually not owners. That means big issues are decided by third parties. This might, ultimately, create agency problem.

Berle and Means (1932:47) explains how the corporate system has done more than evolve a norm by which business is carried on. They say that, within it there exists a centripetal attraction which draws wealth together into aggregations of constantly increasing size, at the same time throwing control into the hands of fewer and fewer men. Therefore, we can understand from these writers that putting in place appropriate form of corporate governance is crucial.

According to Monks and Minow (2011:XXI), the importance of corporate governance became dramatically clear in 2002 as a series of corporate meltdowns, frauds, and other catastrophes led to the destruction of billions of dollars of shareholder wealth, the loss of thousands of jobs, criminal investigation of dozens of executives, and record-breaking bankruptcy filings.

Jensen and Meckling (1976:309) also say that the existence of positive monitoring and bonding costs will result in the manager of a corporation possessing control over some resources which he can allocate (within certain constraints) to satisfy his own preferences. This kind of problem occurs especially when there is incomplete contracting occurs between Shareholders and Managers which these authors call it type one agency problem.

La Porta (1998:1) further elaborates by saying investor protection turns out to be crucial because, in many countries, expropriation of minority shareholders and creditors by the controlling shareholders is extensive. This is what (Jensen and Meckling 1976) call it a type two agency problem. On the other hand, Fama (1980) argue that the separation of security ownership and control, typical of large corporations, can be an efficient form of economic organization.

According to the Cadbury report of 1992, corporate governance is a system by which companies are directed and controlled. It includes directors of the companies and managers regarding how they relate and their responsibilities. As the report states: “Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community’’. Corporate governance is a term that is being considered in Ethiopian corporations starting just very recently. Most companies in Ethiopia regard corporate governance as an integral part of their success.

A directive, Insurance Corporation Governance Directive No. SIB/42/2015, issued by the National Bank of Ethiopia, ascertains that Corporate Governance gives way to balanced risk taking and enhances business prudence, prosperity and corporate accountability with ultimate objective of realizing long term shareholders' value, as well as customers' and other stakeholders interest (<https://www.google.com/search?ei=E384WqfDIarw6ATt1bFY&q=oeed+principles&oq=oeed>, Accessed on November 21, 2017).

In this research, corporate governance is going to be assessed in light of the six OECD principles. 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.

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

The corporate governance framework should protect and facilitate the exercise of shareholders' basic rights (Commercial Code).

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

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.

## **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.

## **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.

## **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.

## 1.2 Statement of the problem

Different studies show that one of the many challenges the business world is facing currently is installing sound and proper corporate governance system in an organization. This might lead to irreversible bankruptcies if not managed and addressed properly and timely. The messing up of big international organizations like WorldCom had provided concrete and costly lesson to the business world. The OECD principles on board responsibilities state that 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.

Insurance Companies represent a significant and influential sector of business and play crucial role in the global economy. Since these companies are complex institutions and may require employees with specialized skills (Philippon & Reshef, 2012), selecting the right executives could give them a significant competitive edge as well as contribute to the growth of the economy. Insurance business is a pool mobilization point where a person that is faced with financial loss due to accident may be compensated from that pool. By so doing this, the economy of one person ultimately that of a country, get balanced. Therefore, insurance companies play a significant role in stabilizing the economy of a nation. This happens when the companies are running smoothly especially in terms of governance. The practices of corporate governance are usually challenged. With these issues in view, it is important to undertake a study on the level of practice of corporate governance in an insurance company.

In connection with this, tight corporate governance requirements were imposed on publicly traded firms by regulators and other organizations in different periods. This is a reactive way of addressing the issue of corporate governance across the world; this can be evidenced by most of the guiding principles which have been enacted based on the incidents observed in the business world.

Studies conducted in the area of corporate governance in the context of Ethiopia have a wide professional range basically focused on the adequacy of legal framework rather than evaluating the practice of corporate governance principles and best practices. Most of the papers reviewed for this study deal with adequacy of legislative provisions on governance issues related to the separation of ownership and management responsibilities on the composition, independence and remuneration of

board of directors in share companies (Tura, 2012), and also on the overall corporate governance standard adequacy by identifying different factors such as limited legislative framework, inadequate shareholders protection law and ineffective judicial system, absence of an organized share market and discrimination on implementations of regulatory framework on Insurance Companies (Ayele, 2013).

Due to its legal formation, insurance companies are perceived to be prone to agency cost in the context of Ethiopia in which shareholders have no control of their investment on a daily basis. There may be challenges in the sector in terms of adhering to corporate governance rules and international best practices. In different magazines circulated in the country, concerns of malpractices in the industry have been observed and becoming public concern in previous as well as in recent period. There are instances where some of these institutions have been linked with major breaches of the rules and regulations when it comes to conflict of interest and unethical business conduct. Therefore, it is critical to assess the current level of practice and draw some lessons from the study in terms of applying good corporate governance practices in insurance companies. The discrepancies from the principles set by international organizations and National Bank of Ethiopia directive can be drawn to address the gap observed in the practice.

Thus, the focus of this paper is on major dimensions of corporate governance system which are Shareholders, Board of Directors, Executives, Supervisory Organs and other stakeholders, Risk management and internal control and Disclosure and Transparency. Based on these factors, the study comprehensively assesses corporate governance practice of privately owned insurance companies in the country in light of National Bank of Ethiopia Directives and OECD principles.

The current level of practice based on the country law and international standards and best practices will have a paramount importance in terms of identifying the gaps in practice. As a result this paper tries to assess the broad range of corporate governance practice based on OECD Principles and the country's laws and provisions. This will help stakeholders to take lesson from the assessment to strengthen their best practice and improve on the gaps identified and also point out areas which need further study.

### **1.3 Research Question**

1. What rights of the shareholders being protected?
2. How important is the role of stakeholders in the practice of corporate governance?
3. Is all material information regarding financial situation, performance, ownership, and governance of the company being disclosed?
4. How do the Board of Directors carry out their responsibility in light of corporate governance practice?
5. How do the composition in the Board of Directors influence corporate governance practices?

### **1.4 Objective of the Study**

#### **1.4.1 General Objective**

- The main objective of this research is to assess the practice of corporate governance in Ethiopian Insurance industry in light of The Country's National Bank Directives and OECD Principles.

#### **1.4.2 Specific Objectives**

The specific objectives of this research are:

1. To explore the division of responsibilities among different supervisory, regulatory and enforcement authorities.
2. To assess the extent of the basic rights of shareholders being protected and exercised.
3. To assess the extent of the rights of other stakeholders rather than the shareholders being recognized.
4. To examine whether timely and accurate disclosure is made on all material matters regarding the companies, including the financial situation, performance, ownership, and governance of the company.
5. To examine whether 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 is implemented.

## 1.5 Definition of Terms

The National Bank of Ethiopia has defined most of the terms that are going to be used in this paper under its Insurance Corporate Governance Directives No. SIB/42/2015. The terms are as follows:

**Board** – means board of directors of an insurer.

**Chief Executive Officer** – means a person, by whatever title that person may be referred to, who is primarily responsible for the day to day management of the affairs of an insurer.

**Corporate Governance** – means the process and structure used to direct and manage the business and affairs of an insurer towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long-term shareholders’ value, as well as customers’ and other stakeholders’ interest.

**Director** – means any member of the board of directors of an insurer, by whatever title he may be referred to.

**Employee** – means a chief executive officer, a senior executive officer or any other person who is appointed or hired by an insurer to carry out its day to day operations.

**Financial Institution** - means insurance company, bank, micro-financing institution, postal savings or such other similar institution as defined by the National Bank.

**Influential Shareholder** - means a person who holds directly or indirectly two percent or more of the total subscribed capital of an insurer.

**National Bank** - means the National Bank of Ethiopia.

**Non-influential shareholder** - means any person who holds directly or indirectly less than two percent of the total subscribed capital of an insurer.

**Person** - means any natural or juridical person.

**Remuneration** - means board compensation and allowance paid to directors.

**Risk management program** - means a program that clearly identifies and measures inherent and significant risks of an insurer and draws a strategy, policy and procedure to mitigate such risks.

**Senior management** - means chief executive officer, and any other officials, as may be defined by individual insurer, responsible for day-to-day running of the operation.

Any expression in the masculine gender includes the feminine and/or legal persons.

## **1.6 Significance of the Study**

This research paper is about corporate governance, by picking up some insurance companies in Ethiopia, and studies the practices of it using OECD principles and National Bank of Ethiopia Directives as a resource, thereby providing some insight on the issue for any interested party. In order to have some idea about Corporate Governance, we have referred some points regarding the issue from different literatures.

## **1.7 Delimitation or Scope of the study**

This study is quite new to our country that is why the research is focussing on assessment only. Further research on relationships can be done by any interested party. There is a time constraint in conducting this research in addition to short experience on the area. There is also quite a limited reading material in the field from the domestic perspective.

## **1.8 Organization of the Research Report**

This research paper composes of five chapters:

Chapter One – This chapter discusses the background or the Introduction part of the study.

Chapter Two – Relevant Literatures were discusses or reviewed under this chapter.

Chapter Three – Methods on how to approach the research were coined in this part of the study

Chapter Four – The data collected by the questionnaire were analysed using SPSS application and discussed under this chapter.

Chapter Five – Summary of the findings and Recommendations are forwarded under this chapter.

## **Chapter Two**

### **Literature Review**

This section covers what the previous studies or literatures such as books, journals and internet sites discussed on corporate governance and the qualities of it in order to further understand in depth the concept under the research. In order to understand the core point in this study, it is good to know the historical development of the term Corporate Governance and the definition of it.

#### **2.1 History of Corporate Governance**

The practice of corporate governance started as far back as 1612, when the world's first listed company was founded, though they didn't use the term directly at that time. The importance of corporate governance became dramatically clear in 2002 as a series of corporate meltdowns, frauds, and other catastrophes led to the destruction of billions of dollars of shareholder wealth, loss of thousands of jobs, criminal investigations of dozens of executives and record-breaking bankruptcy filings. Seven of the twelve largest bankruptcies in American history were filed in 2002 alone. The names Enron, Tyco, Adelphia, WorldCom, and Global Crossing have eclipsed past great scandals like National Student Marketing, Equity Funding, and ZZZZ Best. (Farrar: 1999) analysed Corporate Governance in light of Agency Problem. This problem is controlled by law and further supported by legislation.

#### **2.2 Definition of Corporate Governance**

Lots of definitions were delivered by different writers about corporate governance, even though; there is no universally proven water tight meaning for it. Some definitions have something in common like (Wheelen: 2006) corporate governance is defined as the relationship among shareholders, board of directors and the top management in determining the direction and performance of the corporation. In addition, (Shleifer: 1997) stated that corporate governance as the way in which contributors of the fund to share companies assure themselves of getting a return on their investment. (Melvin: 2005) mentioned the concept as referring to corporate decision making and control, particularly the structure of the board and its working procedures. Likewise, the OECD principles (2005) defined corporate governance as involving a set of relationships between a company's management, its board, its shareholders, and the other stakeholders.

### **2.3 Board Directors and Management Practices**

One of the points under consideration under the research questions is how the Board of Directors carry out their responsibility (Principle IV of OECD). The principles of corporate governance place a heavy responsibility on company boards, even though in practice, many boards do not take this responsibility seriously. The quality of a company can often be judged by its vigilant and quality of the board. The board of directors (BODs) plays the pivotal role in any system of corporate governance. It is accountable to the stakeholders and directs and controls the management. It stewards the company, sets its strategic aim and financial goals, and oversees their implementation, puts in place adequate internal controls and periodically reports the activities and progress of the company in a transparent manner to the stakeholders. (Nam: 2004) suggests some aspects that should be concerned in the internal mechanism of corporate governance, including its independency and structure, function and activity, compensation and other relevant responsibilities of BODs.

There is a relationship between proportion of independent board composition and firm performance. This issue is largely built around the agency theory and addresses the role of the board in shielding shareholders from manager's self-interest (Fama: 1983). Independent directors with no personal or professional relationship to the firm or firm management are more effective in protecting shareholders' interest, resulting in higher performance (Dalton: 1998). Moreover, determining the structure and level of compensation of top executives of the firm is among the task of the board of director.

It is known that the board of directors is in charge of representing shareholders' interest in ensuring that shareholders have reliable information regarding corporate performance, risks and prospects and that management undertake activities that enhance shareholders interest (Keasey: 2005). Thus it is the official first line of defence against managers, who would act contrary to shareholders' interest. The board composition is characterized by the relative proportion of independent outside directors. These independent directors are individuals with no connection to the company other than a seat of nine (9) people on the board and possibly ownership of share. The composition of board members is proposed to help reduce the agency problem (Hermalin: 2003). A positive relationship is expected between firm performance and the proportion of outside directors sitting on the board. Unlike inside directors, outside directors are better able to challenge the CEOs.

Empirical evidence has grown but the results as (Adams and Mehran: 2003) quoted by (Grove Hugh: 2009) report that banking firms have a larger board of directors in comparison to manufacturing firms and that a larger board of directors at insurance companies is positively associated with return on assets. This suggests that the performance of companies with a smaller board do not surpass their counterparts with larger boards. They speculate that insurance companies have larger boards due to their complex organizational structure and the requirement to have more committees and thus require more members. Most of “best code of practices” suggests that the typical corporate board is composed of 8 to 16 directors. Larger, more mature companies tend toward the higher end of the range, while smaller, growing companies leaned toward the lower end with appropriate board compositions. The purpose is to have a breadth of expertise in order to deal effectively with the issues confronting the business.

CEO Duality is when the chief executive officer of an organization concurrently serves as the chairman of the board. Agency theory would suggest that such centralized leadership authority will lead to management dominance of the board and result in poor performance (Shleifer: 1997). Despite there are many personal benefits for individual board members by sitting on different boards, serving multiple boards lowers the ability of independent directors to perform their duties effectively and reduce time commitment of members of board of directors.

Board meetings serve as key forums where executives and directors share information on company performance, plans, and policies. Frequent meetings allow for better communication between management and directors. The performance of a company generally reflects the quality of its directors and the effectiveness of its board considering the complexity of the business, the high dynamism and volatility of the markets in recent years and the responsibility of insurance boards in supervising and monitoring as a prerequisite for the sound and prudent management of financial intermediaries (OECD Principles: Principles of Corporate Governance, 2005).

(John: 1998) stress the role of committee structure as a means of increasing the independence of the board. They refer to the work of (Klein: 1998) and argue for the need to set up specialized committees on audit, remuneration and appointment. The nominations committee oversees the appointment of board members and ensures that the process is formalized and transparent.

The committee also oversees succession planning for the board and ensures that plans for senior executive succession planning are in place for orderly succession to the board and other senior management positions. The three main objectives of audit-committees are increasing public confidence in financial information, assisting directors (particularly non-executive directors-NEDs) in meeting their responsibilities in respect of financial reporting, and strengthen the independence position of a company's external auditor by providing an additional channel of communication. This result suggests that, on average, equity investors place greater reliance on earnings releases when the audit committee comprises a majority of independent directors. (Carey, 2008) suggests that companies must have an audit committee of at least three (two for smaller companies).

The main responsibilities and duties of the risk committee are to advise the full board on risk management, emphasize and demonstrate the benefits of a risk-based approach to internal control and reinforce control consciousness by setting appropriate internal control policies, seeking regular assurance that the system is functioning, reviewing the effectiveness of internal control, providing disclosures on internal controls in annual reports and accounts.

Klein (2002) found a positive relation between earnings management and presence of the CEO on the compensation committee. Similarly, (Newman and Mozes: 1999) cited by (Grove Hugh: 2009) found that CEOs receive preferential treatment, at the expense of shareholders, when insiders are members of the compensation committee. On the other hand, some research findings indicated that CEO compensation is typically comprised of a mix of salary and annual bonuses. However, since meeting a bonus puts an emphasis on the short-term, stock based incentive plans are used to emphasize long-term performance in order to align the interests of the CEO with that of the firm. Consistent with the argument that stock based incentives align the interest of the manager with the firm.

## **2.4 Financial Disclosure**

Principles number five of OECD talks about Disclosure and Transparency on material matters of companies. Financial disclosure is a very important matter in insurance companies. That is why it is picked and literature review is done on this core are of these companies. Prior research suggests that firm size is a key determinant of the extent of voluntary disclosure (Meek et al., 1995; Ahmed and Courtis, 1999).

Larger companies are associated to larger resources to allocate for the preparation of high quality information, and the costs involved are lesser due to the economies of scale. The accounting literature (Chow and Wong-Boren, 1987; Gul and Lang, 2004) has consistently confirmed the existence of a positive relationship between firm size and the extent of voluntary information disclosure.

Bujaki and McConomy (2002) also document the existence of a positive relationship between firm size and the extent of information provided by Toronto Stock Exchange listed companies regarding their corporate governance practices in 1997.

Large firms may adopt good Corporate Governance practices in order to mitigate the agency costs of free cash flow. Firms with large free cash flows may not use them in the best interest of all shareholders. Small firms may grow faster than large firms and will need more external financing. Both large and small firms could have incentives to adopt good Corporate Governance practices voluntarily (Klapper and Love, 2004).

Developed by societies to create order, institutions provide the rules of the game and organizations are the players that are bound by these rules (North, 1990). The institutional perspective emphasizes the influences of the context surrounding organizations that shape their behaviour (Scott, 1995). It suggests that one cannot understand business strategy if one cannot understand the context (Meyer and Nguyen, 2005). In most markets there exists a law that regulate and govern the disclosure of detailed information in annual reports on matters related to the nomination of directors, the formation and composition of board committees, the organization of board leadership structure and the remuneration of directors especially in publicly held corporations. These are aimed at protecting the interest of investors.

According to Harrison (1997) for a board of directors, its committee structure symbolizes its method of operation which itself is not readily observable. Boards are getting increasingly confronted by the need to generate more openness, transparency and openness. Despite the growing concern on board disclosure, annual reports still present a limited view of board practices. International developments in corporate governance increasingly force exchanges to set forth new corporate governance standards while they fight for a piece of the financial pie (Griffith, 1990). In essence, the principal characteristics of effective corporate governance transparency which entails full disclosure, protection and enforceability of the rights and prerogatives of all shareholders.

The board should not be involved in developing or implementing strategy unless it firmly believes that the proposed strategy or its execution is wrong (Zahra, 1990).

For disclosure purposes McMullen (1996) indicated that the existence of audit committees is associated with a lower number of shareholder law suits. Companies with unreliable financial reporting and disclosure were less likely to have audit committees than those not confronted with law suits. Effective monitoring and enhanced internal control following the adoption of high-quality audit committees should mitigate managers' incentives to make inefficient investments (Huang and Zhang 2012).

## **2.5 The Influence of Board Characteristics on Corporate Governance**

Board Size, Composition and Executives' expectation on remuneration are key influencing factors for the directors to execute their responsibilities. Literature is reviewed on these three points to further have a clear view of principle number six of OECD. The next three topics elaborate the detail.

### **2.5.1 Board Size**

From a sociological perspective, it has been argued that a larger board of directors is beneficial and will increase the collection of expertise and resources accessible to a firm (Dalton et al.,1999). Scholars have also illustrated that family owners often have a more traditional long term orientation and often act as "protective stewards" of a firm (Miller, Le Breton-Miller, & Lester, 2013). Yet, Hermalin and Weisbach (2003) argue that the consensus among the economic literature is that a larger board will impair firm performance. For instance, Jensen (1993) argues that as board size increases, boards' ability to monitor management decreases due to a greater ability to shirk and an increase in decision-making time. A larger board may also be indicative of a firm's attempt to satisfy independence requirements by diluting the concentration of insiders via appointment of independent directors.

Contrary to these statements, a study by Adams and Mehran (2003) report that banking (insurance) firms have a larger board of directors in comparison to manufacturing firms and Belkhir (2009) reports that a larger board of directors at insurance companies is positively associated with return on assets. This suggests that the performance of insurance companies with a smaller board do not surpass their counterparts with larger boards.

Adams and Mehran (2003) speculate that banks, insurance companies in our case, have larger boards due to their complex organizational structure and the requirement to have more committees and thus require more members. Our second determinant of code compliance is the size of the supervisory board. The decision making process on the supervisory board is likely to be affected by its size for at least two reasons. First, coordination problems are larger on a large board compared to a small board. Jensen (1993) and Lipton and Lorsch (1992) suggest that large boards can be less effective than small boards, presuming that the emphasis on politeness and courtesy in boardrooms is at the expense of truth and frankness.

Specifically, when boards become too big, agency problems (e.g., director free-riding) increase and the board becomes more symbolic and neglects its monitoring and control duties. Moreover, large boards may reflect an inadequate perception of the true executive function, particularly in firms with public involvement. Supporting this rather ad-hoc proposition, Yermack (1996) was the first to report empirical evidence for a negative relationship between board size and firm valuation (see also Eisenberg, Sundgren, and Wells (1998); Beiner, Drobetz, Schmid, and Zimmermann (2004)). Second, on a large board it is likely that more conflicting groups of stakeholders, such as representatives of large shareholders, employees, and creditors, are represented than on smaller boards. Third, many companies do have a (and if, at most one) representative of small shareholders. However, the larger the board the, less weight this representative has at a ballot.

## **2.5.2 Board Composition**

An outside director is a member of a company's board of directors who is neither an employee nor a stakeholder of the company. In most instances, they are paid a retainer, share option or other prescribed benefit. They are non-executive directors and are believed to have unbiased opinions. Outside directors bring a certain level of impartiality in evaluating management decisions (Baysinger and Hoskisson, 1990). Firms with lower profitability are more likely to increase the number of outside directors to their boards (Bhagat and Black, 2002). The careers of outside directors are not likely to be affected by the outcome of their decisions and are more objective (Rechner, Sundaramurthy and Dalton, 1993). Many countries worldwide have established the minimum standards for representation for outside directors on the boards of public quoted companies (Dahya and McConnell, 2002). Fama and Jensen (1983) indicated that outside directors are in a better position to monitor management because of their independence from the firm's management.

They advise management on operations and strategy based on their professional experience while monitoring the firm to ensure that management act in the sole interest of the shareholders. They are therefore likely to act without undue influence from management while providing third party oversight. Shareholders react positively to the appointment of outside directors (Rosenstein and Wyatt, 1990). Proponents of inside directors on the other hand advance the argument that outside directors are less informed about a company and may be less qualified and engaged. They may lack independence since they are co-opted by management and thus may make wrong decisions. Shareholders react negatively to the sudden death of an outside director especially when the director serves in a key role such as board chairperson and when the overall representation by outsiders is low (Nguyen and Nielsen, 2010).

As a result of recent corporate scandals, several rules have focused on the role played by Boards of Directors on the planning and monitoring of corporate codes of ethics. In theory, outside directors are in a better position than insiders to protect and further the interests of all stakeholders because of their experience and their sense of moral and legal obligations. Female directors also tend to be more sensitive to ethics according to several past studies which explain this affirmation by early gender socialization, the fact that women are thought to place a greater emphasis on harmonious relations and the fact that men and women use different ethical frameworks in their judgments (Luis Rodriguez Dominguez, Isabel Gallego-Alvarez & Isabel Maria Garcia-Sanchez, 2009).

The resource dependency theory explains how organizations reduce environmental interdependence and uncertainty. Pfeffer and Salancik (1978) proposed five options that firms can use to minimize environmental dependence which are mergers and vertical integration, joint ventures, board of directors, political action and executive succession. External factors influence organization behaviour but managers can act to reduce environmental uncertainty and dependence. One such way is the appointment of external directors to a company's board. Changes in the membership of a corporate board are a direct response to changes in the environment. Central to these actions is the urge to control power and reduce other people's power over them. Boards enable firms to gain resources and minimize dependence. Pfeffer (1978) found that board size relates to the firm's environmental needs and those firms with greater interdependence have a higher number of outside directors. He concluded that board composition and size are rational organization responses to the conditions of the external environment.

Director age may be related to more than one underlying construct considering that the board of directors are responsible in identifying the strategic direction and improving decision making (Hambrick & Mason, 1984). Top management characteristics influence the decisions that they make. This is because demographic characteristics such as age are associated with cognitive bases, values and perceptions that influence the decision making at the top (Marimuthu & Kolandaisamy, 2009). Goll and Rashid argued that the demographic characteristics of top management affects the decision making process.

Like old directors, it has been argued that busy directors are expected to be less active monitors relative to directors who sit on fewer boards. The number of busy directors is positively correlated with CEO pay and Beasley (1996) reports that the probability of committing accounting fraud is positively related to the number of directorships held by outside directors.

Despite the findings, which suggest that busy directors are a form of weak corporate governance, Ferris et al. (2003) find that serving on multiple boards does not impact the ability to carry out board member responsibilities.

As well, Harris and Shimizu (2004) find that busy directors are important sources of knowledge and improve acquisition performance. However, these studies do not negate the finding that busy directors may be too “busy” to challenge insiders such as the CEO.

Frequency of board meetings is suggested to indicate active monitoring by the board (Conger et al., 1998). Contrary to this perspective, Vafeas (1999) found that frequency of board meetings is negatively related to performance, which may be the result of boards meeting more often subsequent to poor performance. This finding suggests that board meetings are a reactive measure to performance rather than proactive measure (Jensen, 1993). In periods of financial distress such as the subprime crisis this view purports that boards would meet more frequently and may have met less frequently prior to the crisis.

As discussed previously, insurance companies are likely to have larger boards which may increase schedule conflicts and reduce the quantity of meetings. Adams and Mehran (2003) suggest that since this companies have more committees than others, it is necessary that the boards meet more frequently for effective operating purposes.

According to agency theory, the board should be more effective when composed of a majority of unrelated directors. Given that independent directors compete in the directors' labor market (Fama and Jensen, 1983), they have incentives to establish and keep a reputation of professional experts who effectively monitor managers and who look for the shareholders' best interests.

### **2.5.3 Executive Compensation and Remuneration**

Consistent with prior studies on director compensation (e.g., Core et al. 1999; Archambeault et al. 2008; Engel et al. 2010), a compensation package for each independent director include board meeting fees, annual cash retainer, value of stock awards (the market price of shares awarded to an independent director at the fiscal year-end preceding the proxy date), value of option grants (the market value of stock options awarded to an independent director at the fiscal year-end preceding the proxy date) and other miscellaneous rewards (e.g., loans to an independent director) Duchin et al. (2010), and Ahern and Dittmar (2012). There have been a lot of studies on CEO and executive compensation more so in the 1990s. The increase in academic papers on this subject seems to have outpaced even the remarkable increase in CEO pay itself (Murphy: 1999). Remuneration of board of directors and executives should reflect the interest and be consistent with the shareholders as well as safeguard a company's interests. Payment of incentives is allowed in certain companies but with clear guidelines.

Incentives may include share options and bonus payments. Part of the considerations made in setting the compensation level for member of the board of directors is comparability to other companies, the competencies and experience of board members, scope of work and number of meetings. A combination of fixed and performance based pay is given to many executive management to attract and retain key employees. (Denis and McConnell:2003) investigated the relationship between board composition, executive compensation and other corporate governance aspects.

Agency problem can be mitigated by the composition of a board and the existence of a remuneration committee (Pukthuanthong: 2004). Remuneration is meant to help solve the agency problem where the managers may use their influence for private interest in a variety of ways (Shleifer & Vishny:1977).It is also meant to enhance performance thus the reason some companies link incentives to performance.

However, some research based on different data sets have found weak or insignificant relationships between pay and performance (Jensen & Murphy: 1990). Outside directors to a company board are favoured because they are said to be more concerned with the company compensation structure in the interest of shareholders (Pukthuanthong: 2004). With the generally agreed role of the board of directors being the monitoring of management on behalf of shareholders and providing resources, effective monitoring can improve firm performance by reducing agency costs.

## **2.6 Theoretical Framework**

The framework on which this thesis is based is derived from the two frameworks of Insurance Corporate Governance Directives No.SIB/42/2015 and OECD principles discussed above.

Board effectiveness in this model is observed as the outcomes of the main tasks of the board of control, service, and strategy. The control role includes oversight of management activities and internal control; while the service role includes advice to management and providing resources to the firm such as information/data and generating business. The strategy role includes participating in strategy development and monitoring implementation by management.

Board size is the number of directors on the board and this will impact, positively or negatively, on the board processes of decision-making, cohesiveness and board operations. Board leadership in the framework is actually board duality and it is argued that separating the position of chairperson from that of the CEO will have a different impact on the board processes mentioned above from that of combining the positions. Board independence is achieved to some extent when the number of non-executive directors is more than that of executive directors on a board. Board diversity is an indication of the diverse backgrounds, education, professions, age and gender of directors on the board.

Frameworks of how boards work are central to corporate governance research and practice; they dictate the type of data collected, the analysis process employed and the action plan that is developed. There have also been some recent attempts to model board dynamics theoretically (Forbes and Milliken, 1999; Sundaramurthy and Lewis, 2003; Zona and Zattoni, 2007). Forbes and Milliken argue that the effectiveness of boards depends on socio-psychological processes, related to group participation and interaction, the exchange of information and critical discussion.

They define an effective board as one that can perform distinctive service and control activities successfully yielding task effectiveness, and yet continue working together, that is, cohesiveness. Sundaramurthy and Lewis (2003) propose a simultaneous need for control and collaboration in the working style and dynamic of boards. Zona and Zattoni relate group's social-psychological processes to different board tasks.

The aim of the thesis is to assess the corporate governance practice in light of the National Bank of Ethiopia Directive and OECD principles. Rather than relying on any single governance research agenda, such as agency theory, stewardship theory, resource dependence theory, etc, a general framework that conceptualises the board and the executive management as part of a governance system is outlined.

Board effectiveness may also be influenced by firm age; the older firms are likely to be more efficient than younger firms (Ang et al, 2000). Older firms may have proven processes that have been developed and tested over the years, while younger firms might still be experimenting with their processes. Studies have shown that as firms grow over the years, their capital structure will likely change with age (Berger and Udell, 1998), which puts much demand on the board in terms raising capital. New firms are expected to have smaller earnings than old ones because they have less experience in the market, are still building their market position, and might have a higher costs structure. Such new firms might not have the clout to attractive good directors and could lack resources to put good governance processes in place. Companies in this framework are insurance companies (service rendering ones).

## **Chapter Three**

### **Research Methodology**

#### **3.1 Research Design**

The research design is a survey research which employed descriptive and quantitative approach. Moreover, it is an insurance business based study and conducted in four selected companies in Addis Ababa, Capital City of Ethiopia. These insurance companies are Awash, Nib, Nyala and Africa. The way these companies are picked is explained under the sampling technique section.

#### **3.2 Data Source**

The Primary and Secondary sources of data are relied upon for conducting this research.

#### **3.4 Sampling Technique**

There are twenty (20) insurance companies in Ethiopia, including the state owned one. Out of these, only nine of them have existed for over ten years. Out of the nine, only five have been observed competing enough regarding market share and one of them is a state owned one. Therefore, the study focused on the top four privately owned insurance companies so that we will be comparing the comparable ones only. A Purposive Sampling technique is employed to pick the four insurance companies. The reason why this approached is selected is that, unless we do it in this subjective way, it will be difficult for comparison. Respondents from the insurance companies were selected randomly in proportion to the respective company employee size. Hence, a stratified random sampling was used in selecting employees who participated in the survey.

##### **3.4.1 Estimating the sample size based on a proportion**

The target population for this study are Shareholders, Board of Directors, CEOs, DCEOs, and the Executive Management of the selected insurance companies i.e Awash, Nib, Nyala, and Africa. In order to gather quantitative data that represent the total population, it is very important to determine the total number of population in those identified ones. The total population for this study is 1,353 out of which the sample size is 132.

The sample is determined using the following formula.

$$n = \frac{N}{1+N(e)^2} \quad n = \frac{1,353}{1+1,353(0.05)^2} \quad n = \frac{1.353}{10.235} = 132.19 \approx 132$$

Where:  $n$  = the sample size,  $N$  = the population size and,  $e$  = the level of precision which is ( $\pm 5\%$ )  
 Where Confidence Level is 95% and  $P = .05$ . (Yamane Taro, 1967)

As a result, the sample size 132 is about 10% of the total population. Therefore, as the sampling method is purposive random sampling, 10% of the population in each stratum were considered as a sample. In addition, for each stratum we considered 10% of the population in this study. Due to this reason, the sample size was increased to 138.

Target Popn	Awash		Nib		Nyala		Africa		Total Sample Size
	Total Number	Sample Size (5%)	Total Number	Sample Size (5%)	Total Number	Sample Size (5%)	Total Number	Sample Size (5%)	
Shareholders	603	NA	633	NA	28	NA	19	NA	NA
Majority Shareholders	33	3	41		7	1	5	1	11
Minority Shareholders	550	55	592	59	21	2	14	1	166
Board of Directors	9	1	9	1	9	1	9	1	4
CEO	1	1	1	1	1	1	1	1	4
DCEO	2	1	2	1	2	1	2	1	4
Exec Mgmt	15	1	11	1	8	1	8	1	4
<b>Total</b>	<b>610</b>	<b>62</b>	<b>656</b>	<b>63</b>	<b>48</b>	<b>7</b>	<b>39</b>	<b>6</b>	<b>138</b>

### 3.5 Procedures of Data Collection

A structured survey questionnaire is used in collecting the primary data. The questionnaire is prepared in English and distributed in person. The questionnaire is administered at least by twelfth grade completed data collectors.

## **Chapter Four**

### **Results and Discussion**

#### **4.1 Findings of Corporate Governance Practices in Ethiopian Insurance Industry**

In this part of the study, the National Bank of Ethiopia directives and the five pillars of OECD principles are used to assess corporate governance practices. The tools used on the questionnaire for the assessment was taken from the works of Mekonen and Mandefro (2017). The tools are picked for there are similarities with the principles mentioned under National Bank of Ethiopia Directives. Among the total 132 number of respondents, 120 of questionnaire were completed and returned. This amount to 91% of response rate. Based on the data collected from the survey participants, the data was entered and analysed using SPSS statistical package using mainly one sample t-test statistical technique.

##### **4.1.1 Basic Rights and Equitable Treatment of Shareholders**

Several characteristics are involved in assessing the basic rights and equitable treatment of shareholders. The table below presents the t-test results for each of the basic rights of shareholders. The respondents' agreement level, as to whether these rights were addressed or not, evaluated against the moderate level agreement. As one of the supposed rights, voting by mail however is found to be disagreed by the respondents, with the average level of  $M = 2.33$ . This is significantly a disagreement, with  $t\text{-value} = 13.38$  and  $p\text{-value} = 0.00 < 0.05$ , within the 95% Confidence Interval (CI) range of 2.33-2.58. Thus, it is found that the right in allowing shareholders to vote by mail is significantly disagreed showing that this right is not addressed. In contrary, the right of shareholders in voting by proxy is found to have been agreed with high average agreement level of  $M = 4.28$ , which is within the 95% CI range of 4.10-4.55.

Other rights of shareholders are also found to have been adequately respected. The top most respected right is that shareholders have the right to know the candidates for board membership. The right that board member candidates are disclosed to shareholders before shareholders meetings is acknowledged by the respondents with an average agreement level of 4.80, which is significantly above the moderate level agreement ( $t\text{-value} = 32.73$ ,  $p\text{-value} = 0.00 < 0.05$ ) within the 95% CI range of 4.69-4.91.

Another most respected right of shareholders is that shareholders are informed in advance the meeting date of general assembly. This right is found to have been respected with average level of agreement  $M=4.74$ ; which is within the 95% CI range of 4.59-4.90.

It is also found that respondents have significantly above moderate level of agreement,  $M=4.61$ , as to the respecting of voting right of non- influential shareholders, which found within the 95% CI range of 4.45-4.77. Moreover, Shareholders Priority Subscription Rights is found to have been exercised to the level high as witnessed by an average level of agreement with  $M=4.56$ , which is a right that shareholders enjoy within the 95% CI range of 4.38-4.73. Similarly, the right of equitable treatment of Shareholders is practiced with  $M=4.50$  average level of agreement. This equitable treatment is practiced among the corporations to high extent within the 95% CI range of 4.29-4.71.

Adequate time provision for questions during shareholders meetings, and the right of nomination committee to nominate candidates are both acknowledged with average level agreement of  $M=4.33$ . These rights are found to have been exercised within the 95% CI limits of 4.10-4.55.

It is found, therefore, that except the right of voting by mail, all other rights of shareholders are adequately exercised. Overall, the average level of agreement in the exercising of those rights is computed to the level  $M=4.27$ , which is mean difference (MD) =1.27 levels above the moderate level, and is a high level agreement within the 95% CI limits of 4.05-4.49.

The basic rights of shareholders	N	Mean	Std. Deviation	Test Value = 3					
				t-value	Df	p-value	Mean Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Voting by Mail allowed	120	2.33	.552	-13.38	119	0.00	-0.68	-0.77	-0.58
Voting by proxy allowed	120	4.28	1.202	11.62	119	0.00	1.28	1.06	1.49
Adequate time given for questions at Shareholders meetings	120	4.33	1.217	11.92	119	0.00	1.33	1.10	1.55
Shareholders Priority Subscription Rights protected	120	4.56	.977	17.47	119	0.00	1.56	1.38	1.73
Equitable treatment of Shareholders practiced	120	4.50	1.160	14.17	119	0.00	1.50	1.29	1.71
Candidates disclosed before shareholders meetings	120	4.80	.603	32.73	119	0.00	1.80	1.69	1.91
Nomination Committee nominate candidates present at AGM	120	4.33	1.182	12.28	119	0.00	1.33	1.11	1.54
voting right of non - influential shareholders excised	120	4.61	.901	19.56	119	0.00	1.61	1.45	1.77
Shareholders be informed in Advance the meeting date of general assembly	120	4.74	.865	22.06	119	0.00	1.74	1.59	1.90
Overall Rights	120	4.27	1.222	11.42	119	0.00	1.27	1.05	1.49

**Table 1 - Basic Rights and Equitable Treatment of Shareholders**

#### **4.1.2 The Role of Stakeholders in Corporate Governance**

Entities like Media, Chamber of Commerce, Professional Society, etc. have also stake in insurance companies from different perspective in addition to the shareholders or stock holders. These are the respondents under this title. In assessing the importance of this stakeholders role in practices of corporate governance, each respondents response is rated and presented in the table below. The average level of importance of each stakeholder is also computed to set the respective rank of relative importance.

The most important external stakeholder influencing corporate governance is financial regulatory and supervisory agencies, which has about 4.23 average level of importance influencing governance. Only 12.5% of the respondents felt the regulatory agency as least (not) important; whereas the majority of the respondents, 73.3%, found this stakeholder has a considerable impotence influencing corporate governance.

Institutional investors are found to be the second most important external stakeholder that has 4.19 average level of importance influencing governance. This stakeholder is favored by 58% of the respondents for its fairly important role in corporate governance. The Minority shareholders are also has crucial 4.08 level of importance in corporate governance. This stakeholder is found to have considerable importance according to about 69% of the respondents.

Labor Unions/Employees, and Institutional Investors are also found to have an average importance of 3.78 and 3.56 levels, respectively. Non-executive board of directors and the media assume the rank of 5th and 6th with 3.56 and 3.49 average levels of importance, respectively. Followed by the judiciary with 3.36 average level of importance, in influencing the corporate governance.

Among the least important external stakeholders are the legal system and chamber of commerce with 3.16 and 3.11 average level of importance. According to 50.8% of the respondents, the importance of chamber of commerce is least (or none) in influencing corporate governance.

Stakeholders such as professional society have only 3.01 average level of importance as the majority of the responses (about 66%) attributed this stakeholder for having no considerable importance in influencing corporate governance.

The insurance association is also found not to have considerable influencing importance with its average level of 2.63, which is mainly attributed to 16.7% of responses in favour of it compared to 56.7% of the respondents against it. The least significant stakeholder is executive board of directors that have found to have only 1.51 average level of importance in influencing corporate governance. Only 2.8% of the respondents observed its significant importance. However, the very majority of the respondents (about 88%) found it least (or not) an important stakeholder influencing insurance companies corporate governance.

Characteristics		Level of Importance						Average Level of Importance	Rank of Relative Importance
		(1) Not Important	(2) Least Important	(3) Slightly Important	(4) Important	(5) Fairly Important	(6) Most Important		
Media	Freq	17	16	24	25	30	8	3.49	6
	Perc.	14.2%	13.3%	20.0%	20.8%	25.0%	6.7%		
Chamber of Commerce	Freq	28	33	14	11	11	23	3.11	9
	Perc.	23.3%	27.5%	11.7%	9.2%	9.2%	19.2%		
Professional Society	Freq	22	28	29	18	14	9	3.01	10
	Perc.	18.3%	23.3%	24.2%	15.0%	11.7%	7.5%		
Financial Regulatory & Supervisory Agencies	Freq	7	8	17	31	32	25	4.23	1
	Perc.	5.8%	6.7%	14.2%	25.8%	26.7%	20.8%		
The Judiciary	Freq	8	22	44	22	13	11	3.36	7
	Perc.	6.7%	18.3%	36.7%	18.3%	10.8%	9.2%		
Executive Board of Directors	Freq	72	22	9	0	1	2	1.51	12
	Perc	67.9%	20.8%	8.5%	0.0%	0.9%	1.9%		
Others, Insurance Association	Freq	35	33	15	17	12	8	2.68	11
	Perc	29.2%	27.5%	12.5%	14.2%	10.0%	6.7%		
Minority Shareholders	Freq	11	13	14	23	35	24	4.08	3
	Perc	9.2%	10.8%	11.7%	19.2%	29.2%	20.0%		
Institutional Investors	Freq	8	7	13	20	70	2	4.19	2
	Perc	6.7%	5.8%	10.8%	16.7%	58.3%	1.7%		
Outside(Non - Executive) Board of Directors	Freq	16	15	23	30	24	12	3.56	5
	Perc.	13.3%	12.5%	19.2%	25.0%	20.0%	10.0%		
Labour Unions or Employees	Freq	12	19	9	24	55	1	3.78	4
	Perc	10.0%	15.8%	7.5%	20.0%	45.8%	0.8%		
The Legal System	Freq	11	35	27	24	11	10	3.16	8
	Perc	9.3%	29.7%	22.9%	20.3%	9.3%	8.5%		

**Table 2 - The Role of Stakeholders in Corporate Governance**

### 4.1.3 Disclosure and Transparency

Disclosure and Transparency in information are critical and key player in corporate governance as this is used as a tool to disseminate information to all stakeholders.

The respondents were asked for assuring if certain characteristics existed in their corporations. All the characteristics listed in figure /graph below are found to be favoured by the majority of respondents. Among all, 115 of the 120 respondents (i.e. 95% of the respondents) identified suitable resume/background of directors in their corporation. 92.5% of the total respondents also assured that vision, mission and values of their corporation are one of the distinguishing characteristics of their corporation.

Having audited annual financial reports of the corporation is identified by 91.7% of the respondents. Existing governance structure, explicit corporate governance rules, and financial performance of the corporations are said to be features exhibited in their corporations according to 77.5%, 75.8% and 72.5% of respondents, respectively.

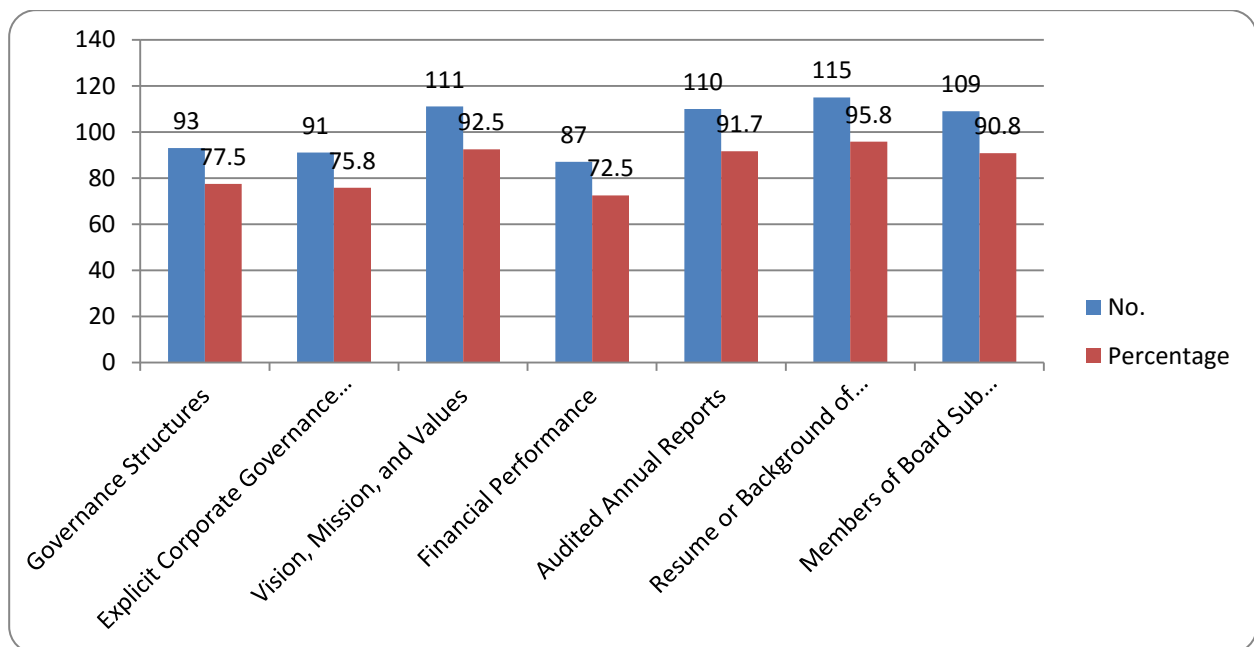


Figure 1 - Disclosure and Transparency

Characteristics	No.	Percentage	Rank
Governance Structures	93	77.5	5
Explicit Corporate Governance Rules	91	75.8	6
Vision, Mission, and Values	111	92.5	2
Financial Performance	87	72.5	7
Audited Annual Reports	110	91.7	3
Resume or Background of Directors	115	95.8	1
Members of Board Sub Committees	109	90.8	4

**Table 3 - Disclosure and Transparency**

#### **4.1.4 The Responsibilities of the Board**

The OECD (2004) principles on board responsibilities deals with the issue of board responsibilities that include the role of boards to ensure strategic guidance of a company, effective monitoring of management, and board's accountability to a company and shareholders. It specifically states that boards have the responsibility to act on informed basis, in good faith, with due care and in the best interest of the company and the shareholders. Board members were requested to rate the extent to which they carry out their responsibilities entrusted to them. The rate ranges from Strongly Disagree (1) to Strongly Agree (5).

Regarding their responsibilities as board members, respondents were asked to rate their agreement-disagreement to the five statements in the table below. The average level of agreement to each statement (responsibility) was tested for its significance against the test value, i.e. 3, which represents the moderate level agreement.

One area of the members' responsibility is that they are adequately informed and knowledgeable about their functions and responsibilities. Regarding this responsibility, board members' average level of agreement is  $M=4.45$ , with a slight variation,  $SD=0.759$ , among their responses. The resulting average agreement level is 1.45 levels above the moderate level agreement within the 95% CI of this difference in the range 1.09-1.81. Moreover, the  $p\text{-value}=0.00 < 0.05$  indicates significantly high level agreement by the board members towards the statement. From the analysis result for the first statement, it is found that board members' agreement level that they are informed and knowledgeable about their functions and responsibilities is within the 95% CI range of 4.09-4.81; which is a high level agreement.

As board members, they are also expected to feel responsible and pay a lot sufficient time in handling their responsibilities. As to this particular responsibility of the board members, the average level of agreement is  $M=4.4.0$ , with  $SD=0.883$ . The t-test result, with  $t\text{-value}=7.09$  and  $p\text{-value} = 0.00 < 0.05$  indicates that members have significantly high level agreement that they used to feel responsible and devote sufficient time to carry out their responsibilities. This is a high level agreement by the board members towards their responsibility within the 95% CI in the range 3.99-4.81.

As to the responsibility that, members consider fiduciary and stewardship responsibilities in discussions and decision making, their average level agreement is  $M=4.65$ , which is found to be within the 95% CI range 4.34-4.96. The t-test result with  $t\text{-value} =11.00$  and  $p\text{-value} =0.00 < 0.05$  indicated that members have significantly high level of agreement caring out this particular responsibility.

The fourth responsibility is that, members were responsible and take into account stakeholder interests in decisions and actions. The board members are found to have agreed to this responsibility with  $M=4.75$  average level of agreement; which is  $MD=1.75$  above the moderate level agreement.

The t-test result with  $p\text{-value} =0.000 < 0.05$  also indicated that members have significantly high level agreement towards this particular responsibility of them. Their agreement level is within the 95% CI range of 4.45-5.00.

It is also expected that members are willing to be accountable and responsible for situations that may cost them to the extent of relinquishing their position. As to this responsibility, board members have very high level agreement,  $M=4.95$  with  $SD =0.224$ , which is even relatively high level agreement compared to their agreement level to the pervious responsibilities. The 95% CI for board members willingness for being accountable and responsible is within the range of 4.85-5.00.

Aggregating the five responsibilities, the overall agreement level of board members to their entrusted responsibilities is  $M=4.64$ , which is  $MD=1.64$  levels above the moderate level of agreement towards recognizing all their responsibilities. The t-test result with  $t\text{-value} =10.42$  and  $p\text{-value} = 0.00 < 0.05$  indicates significantly high level agreement of board members' overall responsibilities; which is found to be within the 95% CI range of 4.31-4.97.

Responsibilities of member of the Board of Directors	N	Mean	Std. Deviation	Test Value = 3					
				t-value	Df	p-value	Mean Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Members were adequately informed and knowledgeable about my functions and responsibilities	20	4.45	.759	8.54	19	0.00	1.45	1.09	1.81
Members used to feel responsible and devote sufficient time to carry out my responsibilities	20	4.40	.883	7.09	19	0.00	1.40	0.99	1.81
Members consider fiduciary and stewardship responsibilities in discussions and decision making	20	4.65	.671	11.00	19	0.00	1.65	1.34	1.96
Members were responsible and take into account stakeholder interests in decisions and actions	20	4.75	.639	12.25	19	0.00	1.75	1.45	2.00
Members were willing to be accountable and responsible for situations that may cost me to the extent of relinquishing my position	20	4.95	.224	39.00	19	0.00	1.95	1.85	2.00
<b>Overall Responsibilities</b>	20	4.64	.704	10.42	19	0.00	1.64	1.31	1.97

**Table 4 - The Responsibilities of the Board**

#### 4.1.5 Some additional influencing factors of Corporate Governance Practices

Assessing the significance of certain factors that influence the practice of corporate governance, respondents had rated each factor for its level of influence, and t-tests were conducted to assess the significance of each factor. As indicated in the table below, the overall influence of these factors is rated with the level M=3.70 average agreement. This level of influence is tested for its significance beyond the average level agreement (t-value =6.23 and p-value =0.00< 0.05) and in the 95% CI range of 3.48-3.92.

Factors	N	Mean	Std. Deviation	Test Value = 3					
				t-value	df	p-value	Mean Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Number of Board Members	120	3.85	.904	10.30	119	0.00	0.85	0.69	1.01
Frequency of Board Meetings	120	3.35	1.447	2.65	119	0.01	0.35	0.09	0.61
Number of Board Members that have Experience in Insurance Business	120	3.63	1.310	5.23	119	0.00	0.63	0.39	0.86
Number of institutional members in the board	120	3.97	1.084	9.77	119	0.00	0.97	0.77	1.16
Overall influence	120	3.70	1.227	6.23	119	0.00	0.70	0.48	0.92

**Table 5 - Some additional influencing factors of Corporate Governance Practices**

Among the four factors, the number of institutional members in the board is relatively the foremost influencing factor to corporate governance with M=3.97 average agreement level of shareholders. In a scale of five, the significance level of this factor falls within the 95% CI range of 3.77-4.16. The next influential factor is Number of Board Members that were agreed to the level M=3.85 for its significance in corporate governance. The t-test result shows the significance of this factor for being beyond the moderate level within the range of 3.69-4.01 confidence intervals. Number of Board Members that have Experience in Insurance Business is another factor that could influence corporate governance. Regarding this factor respondents recognized its influence with M=3.63 average level of agreement. From the t-test result, the influence of this factor would amount to the level within the 95% range of 3.39-3.86. The frequency of board meeting was agreed to the level M=3.35, which is the least factor relative to the other three factors mentioned. This factor is slightly significantly above the moderate level and its level of impact falls within the range of 3.09-3.61 confidence interval.

## Chapter Five

### Summary of Findings, Conclusions and Recommendations

#### 5.1 Introduction

This chapter summarizes about the results of the study that have been presented in chapter 4. It also gives some conclusions from the result findings and discussions depending upon the research's questions and objectives. Finally, it suggests some future recommendations on important issues that should be done and taken into consideration by concerned bodies accordingly.

#### 5.2 Summary of Findings

The study attempted to assess the practice of corporate governance with respect to National Bank of Ethiopia Directives and OECD principles. In assessing the basic rights and equitable treatment of shareholders, it is found that except the right of voting by mail, all other rights of shareholders are adequately exercised. For these, the respondents average agreement level ranges above 4 points. The overall agreement to the governance practice adhering to the 2<sup>nd</sup> and 3<sup>rd</sup> OECD principle is with  $M=4.27$  which is within 4.05 to 4.49 range of 95% CI. In addition to the basic rights of shareholders the significance of other stakeholders were also studied. The most important external stakeholder influencing corporate governance is financial regulatory and supervisory agencies. Institutional investors are found to be the second most important external stakeholder. Labor Unions/Employees, and Institutional Investors are also found to have an average importance. Among the least important external stakeholders are the legal system and chamber of commerce. Stakeholders such as professional society have only 3.01 average level of importance as the majority of the responses (about 66%) attributed this stakeholder for having no considerable importance.

The insurance association is also found not to have considerable influencing importance, according to the recognition given by the majority of respondents (56.7%). Similarly, the recognition given to the importance of executive board of directors was the least ( $M=1.51$ ) indicating it has no or minimal impact in the governance of the insurance companies.

Overall, the insurance companies under consideration are found, in most cases adhering to the 4<sup>th</sup> principle of OECD; but also exhibited inadequate practices with regard to recognising the importance of the board directors and insurance associations' role.

Disclosure and Transparency in information is critical and a key player in corporate governance. Among all, 115 of the 120 respondents (i.e. 95% of the respondents) identified suitable resume/background of directors in their corporation. 92.5% of the total respondents also assured that vision, mission and values of their corporation are one of the distinguishing characteristics of their corporation. Having audited annual financial reports of the corporation is identified by 91.7% of the respondents. Existing governance structure, explicit corporate governance rules, and financial performance of the corporations are said to be features exhibited in their corporations. Such high level agreement rating by the respondents exhibited the governance practice was in accordance with the 5<sup>th</sup> OECD principle.

Moreover, in studying the responsibilities of the board (the 6<sup>th</sup> principle in OECD), it is found out that there is a significantly high level agreement of board members' regarding their overall responsibilities. The result, therefore, showed that optimal composition of board members; and appropriate meeting schedules were observed in the governance practice.

Some additional influencing factors of Corporate Governance Practices were also assessed. In doing so, it is found out that among the four factors, the number of institutional members in the board is relatively the foremost influencing factor. The frequency of board meeting was agreed that it is the least factor relative to the other three factors mentioned.

Regarding the 1<sup>st</sup> principle of OECD, which talks about ensuring the basis for an Effective Corporate Governance Framework, this study couldn't consider due to the time constraint. Therefore, further study could be done on this area.

### **5.3 Conclusion**

The study attempted to assess the governance practice of insurance companies; and made evaluation of the practice against National Bank of Ethiopia directives and OECD principles. In the process, the study basically addressed the research questions, and based on the results and findings, the following major conclusions are drawn.

The insurance companies are found to have operated in accordance with the National Bank of Ethiopia directives and OECD principles. The principles of observing the right of Shareholders (Principle II) and equitable treatment of shareholders (Principle III) were adequately addressed in the governance practice of the insurance companies. Hence, the shareholders are properly enjoying their right as a result of the governance practice which is consistent with the OECD principle.

The 4<sup>th</sup> principle, is found to be well practiced in the companies with certain limitations. The governance practice recognized the importance of several stakeholders. However, the recognition paid to insurance association and executive board members were too low. The results identified the gap in insurance companies corporate governance with regard to the role of some key stakeholders.

Insurance companies also have OECD consistent practice with regard to Disclosure and Transparency Principle, which is the 5<sup>th</sup> principle. Overall, with some limitations in the importance of insurance associations and executive board of directors; the governance framework of insurance companies is consistent with the principle.

## **5.4 Recommendations**

Based on the findings, the existing practices of companies need to ensure and improve their governance in line with OECD principles. To supplement the practice and address its gaps, the corporate governance framework of insurance companies are suggested with the following recommendations.

- Understand and fully adopt OECD practice in their governance framework.
- Give recognition for the importance of insurance association, and the respective board of directors.
- Have clear picture of external stakeholders that are found to have considerably high level influence in their corporate governance.
- Create and promote awareness on corporate governance in general and the boards' role and responsibilities in particular.

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## Appendices

### Appendix 1: Introduction Letter



**Addis Ababa University**

**College of Business and Economics**

**EMBA Program**

Dear Sir/ Madam,

I am a student at Addis Ababa University (AAU) in pursuit of a post graduate degree in Executive Masters of Business Administration (EMBA). In partial fulfilment of the requirement of this master's degree, I am conducting a research on Practices of Corporate Governance in Ethiopian Insurance Industry.

I Kindly request for your participation in this research by answering the questions in the attached questionnaire. Kindly be informed that any information received from you will be held with utmost confidentiality and remain anonymous and will only be used for the sole purpose of this project.

Your feedback will be highly appreciated. We are looking forward to your valued response.

Yours Faithfully,

Solomon Wolde

## Appendix 2: Research Questionnaire on Corporate Governance

### Part A: General Information

1. Gender      Male          Female
2. Age      Below 20          21 – 30          31-40      
              40-50          Above 50
3. Role in the Management        Board of Directors      
Organization  
      Others, please specify \_\_\_\_\_
4. Levels of Education    Secondary and below        TVET        College      
      University 1<sup>st</sup> degree        University 2<sup>nd</sup> degree and above
5. Do you have access to the company's audited financial reports?  
      Yes          No
6. Do you know the status of the company in regards to Financial Position?  
      Yes          No
7. Do you know the composition of the Board of Directors?  
      Yes          No

## PART B: Responsibilities of the Board

Please kindly answer the following questions. Please indicate your choice on the scale of 1–5, 1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, 5=Strongly Agree

Please use ✓ to indicate your choice

	<b>Board Responsibilities</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1	As a member of the Board of Directors, I was adequately informed and knowledgeable about my functions and responsibilities					
2	As a member of the Board of Directors, I used to feel responsible and devote sufficient time to carry out my responsibilities					
3	As a member of the Board of Directors, I consider fiduciary and stewardship responsibilities in discussions and decision making					
4	As a member of the Board of Directors, I was responsible and take into account stakeholder interests in decisions and actions					
5	As a member of the Board of Directors, I was willing to be accountable and responsible for situations that may cost me to the extent of relinquishing my position					

## Part C: The basic rights of shareholders?

9. Please kindly answer the following questions. Please indicate your choice on the scale of 1 – 5, 1= Strongly Disagree, 2 = Disagree, 3 = Neutral, 4= Agree, 5 = Strongly Agree

Please use ✓ to indicate your choice

	<b>Characteristics</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1	Voting by Mail Allowed					
2	Voting by Proxy Allowed					
3	Adequate time given for questions at Shareholders meetings					
4	Shareholders Priority Subscription Rights Protected					
5	Equitable treatment of Shareholders practiced					
6	Candidates disclosed before shareholders meetings					
7	Nomination Committee nominate candidates present at AGM					
8	Do the voting right of non-influential shareholders exercised					
9	Do all Share Holders be informed in advance the meeting date of general assembly					

**Part D: The Relative importance of other stakeholders' role rather than the shareholders in improving corporate governance**

10. How do you rate the following Stakeholders on the level of importance?

1 = Not important, 2 = Least Important, 3 = Slightly Important, 4 = Important , 5 = Fairly Important; 6 = Most Important. Please use ✓ to indicate your choice

No.	Characteristics	1	2	3	4	5	6
1	Media						
2	Chamber of Commerce						
3	Professional Society						
4	Financial Regulatory & Supervisory Agencies						
5	The Judiciary						
6	Non-Executive Board of Directors						
7	Others, Insurance Association						
8	Minority Shareholders						
9	Institutional Investors						
10	Outside (Non - Executive) Board of Directors						
11	Labour Unions or Employees						
12	The Legal System						

11. Do the following influence the practice of corporate governance at your company? **Please indicate your choice on the scale of 1 – 5, 1= Strongly Disagree, 2 = Disagree, 3 = Neutral, 4= Agree, 5 = Strongly Agree.** Please use ✓ to indicate your choice

	Factors	1	2	3	4	5
1	Number of Board Members					
2	Frequency of Board Meetings					
3	Number of Board Members that have Experience in Insurance Business					
4	Number of institutional members in the board					

**Part D: Please Tick 'Yes' if the characteristics exist in your company and tick 'no' otherwise.**

Characteristics	Yes	No
Governance Structures		
Explicit Corporate Governance Rules		
Vision, Mission, and Values		
Financial Performance		
Audited Annual Reports		
Resume or Background of Directors		
Members of Board Sub Committees		

**THANK YOU FOR TAKING PART IN THE STUDY**



