



Corporate Governance and its Effect on Financial Performance of the Ethiopian Private Commercial Banks

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This is to certify that the thesis prepared by Abdurazak Harun, entitled “Corporate Governance and Its Effect on Financial Performance of the Ethiopian Private Commercial Banks” and submitted in partial fulfillment for Masters of Accounting and Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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Abstract

The paper takes a look at the effects of corporate governance on the financial performance of private commercial banks in Ethiopia. This exploratory study seeks to analyze the effect of different corporate governance mechanisms, particularly board gender diversity, directors' educational qualification, variety number of internal board sub-committee, meeting frequency of board, board ownership, regulations of legal reserve and liquidity and depositor influence, on the financial performance of 8 privately owned commercial banks of Ethiopia. And the study also controls the effect of private commercial banks size. The financial performance measure was Return on Asset (ROA). In order to achieve this objective, the study uses mixed research approach that is by adopting quantitative method research approach by combining documentary analysis of secondary data which was collected from the National Bank of Ethiopia (NBE). And capturing and administrating primary data using structured questionnaire which were completed by board secretary and delegated staffs as he/she is in a better position to comment on corporate governance affairs. Panel data covering 11 year period from 2005-2015 was analyzed and regression result with recommendation are displayed for the selected 8 private commercial banks. The cross section fixed effect technique has been applied to find out the most significant variables from considered corporate governance variables. The findings indicated that board gender diversity and liquidity ratio does not have a significant effect on the financial performance of selected private commercial banks. Board members educational qualification is positively but insignificantly related with the financial performance. Similarly, variety number of internal board sub-committee, meeting frequency of board, and board ownership had statistically insignificant positive effect on private commercial bank financial performance. In addition private commercial bank size had statistically significant positive effect on private commercial bank financial performance. Legal reserve ratio and depositor influence have negative significance at 5% level and positive significance at 10% level effect on the financial performance of selected private commercial banks.

Keywords: *Banking Sector, Private Commercial Bank Financial Performance, Corporate Governance Mechanisms.*

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Acronyms and Abbreviations

<i>AIB</i>	<i>Awash International Bank</i>
<i>ALCO</i>	<i>Asset and Liability Management Committee</i>
<i>BGD</i>	<i>Board Gender Diversity</i>
<i>BOA</i>	<i>Bank of Abyssinia</i>
<i>BOD</i>	<i>Board of Directors</i>
<i>BSC</i>	<i>Board Sub-Committee</i>
<i>BSZ</i>	<i>Bank Size</i>
<i>CBO</i>	<i>Cooperative Bank of Oromia</i>
<i>CEO</i>	<i>Chief Executive Officer</i>
<i>CLRM</i>	<i>Classical Linear Regression Model</i>
<i>DB</i>	<i>Dashen Bank</i>
<i>DLV</i>	<i>Disclosure Level</i>
<i>EQD</i>	<i>Educational Qualification of Directors</i>
<i>LIB</i>	<i>Lion International Bank</i>
<i>MFB</i>	<i>Meeting Frequency of Board</i>
<i>NBE</i>	<i>National Bank of Ethiopia</i>
<i>NIB</i>	<i>Nib International Bank</i>
<i>OECD</i>	<i>Organization for Economic Cooperation and Development</i>
<i>OLS</i>	<i>Ordinary Least Square</i>
<i>PAT</i>	<i>Profit after Tax</i>
<i>ROA</i>	<i>Return on Asset</i>
<i>SBB</i>	<i>Supervision of Banking Business</i>
<i>TA</i>	<i>Total Asset</i>
<i>TE</i>	<i>Total Equity</i>
<i>UB</i>	<i>United Bank</i>
<i>WB</i>	<i>Wegagen Bank</i>

CHAPTER ONE

1. Introduction

1.1. Background of the Study

Corporate governance can be defined as the process and structure used to manage the organizations and it can be referred to as how those organizations are directed, controlled; how policies, laws are designed; and how control environment affect the overall performance of entrepreneurial activities in an economy. Effective and good corporate governance is important to the proper functioning of the corporation and it improves economic efficiency and growth as well as enhances investor confidence (Alem, 2011). But poor corporate governance can be brought by lack of integrity on the selection criteria for choosing leaders and managers who run corporations, lack adequate remuneration system to the management, inappropriate balance between executive and non-executive members of the board. These leaders may lack experience, appropriate training and proper qualifications. Recent change in ownership structure results in increasing ownership of equity shares by institutional investors in forming corporation or share companies (Jensen and Meckling 1976).

The standards of corporate governance set the nature of the relationship among shareholders, members of board of directors, managers, employees and other corporations and persons with whom the company has business links. It mainly protects the rights of the company and its participant groups and specifies their obligations (Massie, 2000).

According to Shleifer and Vishny (1997), effective corporate governance control the awards given by the stakeholders and creditors and increase the profitability of the firm by investing in a positive net present value projects. It also increases access to external financing by firms, lowers cost of capital and increases operational performance also indicated that investors are willing to pay large premiums for companies with effective corporate governance. Hence, it can be argued that good corporate governance will lead to increase in firm value as well as better firm performance (ibid, 1997).

Many researchers like Kalifa (2012), Kibrysfaw (2013), Hlanganipai Ngirande (2014), and Godfrey Ndlovu (2014), have studied based on a number of corporate governance mechanisms including board size, board remuneration, and size of audit committee and board ownership which are frequently used. They have studied the impact of corporate governance mechanisms on firms' financial performance from different perspectives in different environments using the aforementioned and other related variables. The researchers found mixed results on the relationship between corporate governance mechanisms and firms' financial performance.

Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole and it enhances the confidence of investors in the companies and positively contributes towards the overall business environment (Tura AH., 2012). It has received new urgency because of global financial crisis and major corporate failures that shock major financial centers of the world (Imam and Malik, 2007). Hence, corporate governance has become an important factor in managing organizations in the current global and complex environment. Financial institution especially banks are the most important source of finance for the majority of

firms in developing economies. As it is said by different researchers, performance of banks is affected by good corporate governance practice and policies. And also if the banks are profitable and adequately capitalized, it has an effect on soundness of the financial system in a country. In this aspect, little attention has been paid to the research of corporate governance mechanisms in less developed economies in general and particularly in Ethiopia. The aim behind this effort was to aware the banking industry of Ethiopia about the benefits of good corporate governance and its effect on financial performance. So, they can avail opportunities to struggle not only at national level but also at international level as well.

Financial services organizations are very important factor for growth and success of projects in developing countries (Tarawneh, 2006). Banks are the important component of any financial system and they play important role of channeling the savings of surplus sectors to deficit sectors. The Ethiopian financial sector is more of dominated by the banking sector. Banks play a vital role in the process of economic growth and transformation of Ethiopia since the efficiency and competitiveness of banking system defines the strength of any economy. The Ethiopian banking sector comprises of one development bank, and seventeen commercial banks out of which sixteen banks are privately owned commercial banks. According to Mulugeta (2010) the key regulatory features were interest rate regulation, credit restrictions, equity market controls and foreign exchange controls.

According to Mulugeta (2010), Ethiopia has established strategic framework for the financial sector, and emphasize the importance of further strengthening corporate governance and accountability of financial institutions, and improving the capacity of financial sector

professionals. Ensuring better corporate governance of corporations, financial institutions and markets is increasingly recognized as a pre-condition for the countries development and it is directed and supervised by the NBE. The NBE monitors and controls the banking business and functions as regulators of the country's money supply.

This research aims to look the corporate governance mechanisms effect to the banks' financial performance of 8 Ethiopian private commercial banks.

1.2. Statement of the Problem

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 its participant groups which are mentioned above and specifies their obligations. Therefore, corporate governance principles are important in terms of setting the rights and obligations of the said groups and ensuring investor confidence.

The private commercial banks are corporations that have a dominant position in developing economic financial systems, and they are important engines of economic growth of a country (Levine, 1997). Banking failure would affect the entire financial system and economy of a country. Therefore, in order to ensure the improvement of the company performance, economic efficiency and growth, and to enhance investors' confidence; strong, effective and good corporate governance has to be developed and implemented.

Most previous studies like conducted by Yasser (2011), Al-Manaseer et al. (2012), and Kyereboah Coleman (2007) have been undertaken on large firms operating within well-organized corporate governance mechanisms in developed economic system and in countries where there are capital markets. When we see developing countries specifically in Ethiopia some studies on corporate governance have been conducted previously. But corporate governance mechanisms were not covered sufficiently by those studies. And the number of observations was limited in those studies. To mention some of the observations' limitations: Using narrow period or number of years and small sampling size. Methodology of data gathering and analyzing focused by some of the studies were limited only on secondary data. In addition, this study focuses on the privately owned commercial banks since majority of banks in Ethiopia are those banks and they are significantly differs on some aspects as compared to the government owned commercial banks. And most of our private commercial banks are almost at the same size, level or category and may help in order to reach on reasonable results. This also could help to see their linkage with the corporate governance mechanisms. Previously there were no any studies conducted by focusing only on privately owned commercial banks. Therefore, it is difficult to generalize the same result from the findings of the studies that were done in developed countries, for relatively small size Ethiopian private commercial banks governance mechanisms. Ethiopian banking sector's corporate governance is characterized by the absence of an organized share market and the country has different rules, regulations, practices, and economic features which needs to conduct a separate study using various perspectives, meaning they were concentrated on agency theory which is the central need to cooperate governance are to protect the interest of shareholders only have not been conducted within a well-organized corporate governance mechanism. This study has been conducted to provide empirical evidence particularly on the

effect of corporate governance mechanisms on privately owned commercial bank's financial performance.

To come up with a better insight; this study covers by assessing and including selected corporate governance mechanisms major areas of board of director characteristics, regulation aspects, shareholder and depositor related issues (specifically the independent variables: board gender diversity, directors educational qualification, number of board sub-committee, meeting frequency of board, board ownership, regulations of legal reserve and liquidity and depositor influence). Hence this paper sought to determine the relationship between selected corporate governance mechanisms, which have been sufficiently uncovered variables in the previous studies in order to further be explained and financial performance of the private commercial banks with in the given period of time which was measured by the return on asset (ROA).

This study fills the gaps and serves as points of reference for further research in corporate governance and provides empirical evidence on the effect of corporate governance mechanisms on financial performance of the banks by taking in to consideration the variables, observations and sampling methodologies related to the realities of the banks governance mechanism in Ethiopia.

1.3. Objective of the Study

1.3.1. General Objectives of the Study

The main objective of this study seeks to examine the relationship between corporate governance and financial performance of banking sector by taking evidence from selected private commercial banks in Ethiopia.

1.3.2. Specific Objectives of the Study

The specific objectives of the study include:

- ❖ Examine the association between board gender diversity and private commercial bank financial performance.
- ❖ Ascertain the influence of the directors' educational qualification on private commercial bank financial performance.
- ❖ Identify whether availability of board sub-committees affect private commercial bank financial performance.
- ❖ Explain the relationship between meeting frequency of board and private commercial bank financial performance.
- ❖ Investigate the relationship between board ownership and the financial performance of the private commercial banks in Ethiopia.
- ❖ Investigate the relationship between the ratio of total deposit to total asset and the private commercial bank financial performance.

- ❖ Examine the association between regulation of legal reserve and private commercial bank financial performance.
- ❖ Examine the association between regulation of liquidity and private commercial bank financial performance.

1.4. Research Hypothesis

The following research hypotheses were formulated to guide the researcher in finding answers to the research questions:

- ❖ **Ha1:** There is a significant positive association between gender diversity on board and private commercial banks financial performance.
- ❖ **Ha2:** There is a significant positive association between educational qualification of directors and private commercial banks financial performance.
- ❖ **Ha3:** There is a significant positive association between numbers of board sub-committees and private commercial banks financial performance.
- ❖ **Ha4:** There is a significant negative relationship between meeting frequency of board and private commercial banks financial performance.
- ❖ **Ha5:** There is positive and significant relationship between board ownership and private commercial banks financial performance.
- ❖ **Ha6:** There is positive and significant relationship between deposit to asset ratio and private commercial banks financial performance.

- ❖ **Ha7:** There is significant and negative relationship between private commercial banks financial performance and legal reserve.
- ❖ **Ha8:** There is significant and negative relationship between liquidity and private commercial banks financial performance.

Note: Ha: stands for alternative hypothesis.

1.5. Significance and Scope of the Study

As mentioned above in the main objective of the research, the aim is to examine the relationship between corporate governance mechanisms and financial performance of private commercial banks and it will contribute to commercial banking firms by identifying relevant corporate governance mechanisms and how these governance mechanisms affect financial performance of the selected private commercial banks in Ethiopia. The effect of board gender diversity, directors educational qualification, availability of board sub-committee, meeting frequency of board, board ownership, and different regulations set by regulators and depositors on private commercial bank financial performance are some of these valuable inputs to sound corporate governance. The result of this study contributes to the existing literature by providing evidence on the relation between corporate governance mechanisms and private commercial banks financial performance. The empirical results would also be the general indicators of corporate governance mechanisms useful for regulators, policy makers, managers and business people in making policies and decisions. The study may serve as a reference material for other researchers who need to make a research on this area at larger scale to carry out comparison among other banks. And also, this study may contribute to practitioners by providing proper responses to the

questions such as: to what extent the regulation set by government can enhance financial institutions' performance? How the financial performance of private banks can be affected by depositors?

1.6. Limitation of the Study

Regarding the limitation of the study it is well known that any study is not completely free from limitations. As a result, the researcher assumes that there are some sorts of limitations. In this study the financial performance of private commercial banks in Ethiopia is only measured by using accounting based measures. Therefore, only the accounting measure of bank performance was used. These may limit the findings of this study. The conceptual framework of the study was therefore, limited to examine the effect of corporate governance on firms' financial performance of banking sector. In addition the corporate governance variables that are selected to study are limited to board gender diversity, directors' educational qualification, number of board sub-committee, meeting frequency of board, board ownership, depositor influence regulations of legal reserve and liquidity. Therefore, the researcher tried to overcome the limitation of the corporate governance variables by using the primary data in addition to the secondary data.

1.7. Organization of the Study

This study is organized in to five chapters. The first chapter deals with the statement of problem, the objectives, hypotheses, significance and scope and limitations of the study. The second chapter focuses on the literature review followed by the third chapter focus on the methodology and the variables used. The fourth chapter that deals with data presentation and analysis based on

the collected data. The last chapter presents the conclusion and recommendation part of the study.

CHAPTER TWO

2. Literature Review

This part, chapter two, discusses on issues regarding to the related literatures on the corporate governance which covered the following two aspects: the theoretical aspects and the empirical parts. On the theoretical part, it covers the discussion about the meaning of corporate governance and other related issues which have been said by different scholars whereas, the empirical part discusses about the outcome of the former study on corporate governance and other related issues.

2.1. Corporate Governance Theories

According to Imam and Malik (2007), the corporate governance theoretical framework is the widest control mechanism of corporate factors to support the efficient use of corporate resources. It will certainly not be the same for all organizations, but will take into account the expectations of all the key stakeholders. Corporate governance is the relationship among shareholders, board of directors and the top management in determining the direction and performance of the corporation.

There are a lot of company failures of governance in the world. Corporate governance history can be interrupted by a lot of different corporate failures; the Maxwell Group raid on the pension fund of the Mirror Group of newspapers, the collapse of the Bank of Credit and Commerce International, and also naked Bank. Those corporate failures that are the result of incompetency, fraud, and abuse were led to develop and implement new elements of an action for improved system of corporate governance (Magdi and Naderech, 2000). Corporate governance system

needs to develop and implement in a company not only to solve such kind of corporate failures and inconsistency but also risks and hazards that led the company to failures.

According to Nganga, Jain and Artivor (2003:4), corporate governance was defined as “the set of mechanisms through which outside investors are protected from expropriation by insiders”. Nganga survey covered Botswana, Egypt, Ghana, Mauritius, Morocco, Nigeria, Tunisia and Zimbabwe. The key principles to good corporate governance must be prioritized to enhance the firm’s level of competitiveness. These include; transparency, honesty, trustworthy, openness, integrity, responsibility and accountability.

The term corporate governance has been identified to mean different things to different people. As a result it has been defined differently in different ways: Corporate governance is about commitment to values and about ethical business conduct. It is about how an organization is managed. This includes its corporate and other structures, its culture, policies and manner in which it deals with various stakeholders. Corporate governance is primarily the responsibility of the board. The board performs its duties with the support of managerial staff (La Porta, Lopez-de-Silance, and Shleifer, 2002).

Melvin and Hirt (2005) described the concept of corporate governance as referring to corporate decision-making and control, particularly the structure of the board and its working procedures. And they add that corporate governance is also sometimes used widely, embracing a company's relations with a wide range of stakeholders or very narrowly referring to a company's compliance with the provisions of best practice codes.

Since the late 1980's, the relationship of financial structures of companies with respect to corporate governance, and the susceptible economic effects caused consequently began to be examined. Corporate governance principles make available a control instrument of the corporation operations and thus give confidence the managers to be more and more successful and encourage the company's performance with long-term strategies (Claessens, 2006). Banks differ from other institutions because of the collapse of banks affect a wider circle of stakeholders resulting in a weak financial system itself which lead to adverse effects on the economy as a whole. Due to this, it is important in placing a special responsibility to the members of the board of directors. Corporate governance in banks as the methods and approaches used to manage banks through the board of directors and senior management which determine how to put the bank's objectives, operation and protect the interests of shareholders and stakeholders with a commitment to act in accordance with existing laws and regulations and to achieve the protection of the interests of depositors (Ibid, 2006).

Various corporate governance theories have been developed concerning the nature and significance of corporate governance. The most important corporate governance theories are the agency theory, stakeholders' theory and resource dependency theory. According to Agency and stakeholder theories, corporate governance is associated with the principal-agent or agency problem. Both theories dictate that corporate governance is a mechanism designed to minimize agency conflict in the business environment. And resource dependency theory corporate governance is a mechanism to interact the business organization with different resources in the

environment. Under this subject matter, the three dominant theories to the corporate governance are discussed.

2.1.1. Agency Theory

According to Habbash (2010) agency theory is a theory which is based on the principal-agent relationships. The separation of ownership from management in modern corporations provides the context for the functioning of the agency theory. In modern corporations the shareholders (principals) are widely dispersed and they are not normally involved in the day to day operations and management of their companies rather they hire managers to manage the corporation on behalf of them (Habbash, 2010). The agents are appointed to manage the day to day operations of the corporation. However, conflict of interest between the agent and the principal may occur when the agent fails to act in the best interest of the principal, and instead act to maximize their own value. Such conflict of interest occurs due to difference in their preferred level of managerial effort, and their attitude towards risk, which in turn may lead to divergence in the goals of managers and shareholders. Consequently, different control mechanisms either internal or external to the firm should be put in place in order to align the interests of managers and shareholders and/or to solve the agency problem.

According to agency theory, much of corporate governance deals with the limits on managers' discretion and accountability. Agency theorists typically take the maximization of shareholder wealth as the primary standard for evaluating corporate performance and ask how the board can serve to further corporate performance. The theory offers many useful ways to examine the relationship between owners and managers and verify how the final objective of maximizing the

returns to the owners is achieved, particularly when the managers do not own the corporation's resources. Agency theory identifies the role of the monitoring mechanism of corporate governance to decrease agency or controlling costs and to solve the conflict of interest between managers and owners. It is clear that the principal-agent theory is generally considered as the starting point for any debate on the issue of corporate governance. Boards of directors are expected to be independent, diverse and monitor the actions of managers as agents of the owners to ensure they are acting in accordance with the owners' interests. The theory suggests that board composition is important for effectively monitoring top management. Boards have to be diverse in terms of skills, qualifications, experience, and gender balance. This creates a balance on boards and leads to effective monitoring and subsequently to the successful performance of the organization. Therefore, boards of directors are considered as an important device to protect shareholders from being exploited by managers and help to effectively control managers.

2.1.2. Stakeholders Theory

The other popular theory of corporate governance is the stakeholder theory. The stakeholder theory originated from the management discipline and gradually developed to include corporate accountability to a broad range of stakeholders. Stakeholder theory is an extension of the agency theory, where the agency theory expects board of directors to protect only the interests of shareholders. However, stakeholder theory extends the narrow focus of agency theory on shareholders' interest to stakeholders to take into account the interests of many different groups and individuals, including interest groups related to social, environmental and ethical considerations like suppliers, employees, business partners and soon (Freeman et al., 2004).

According to stakeholder theory, decisions made regarding the company affect and are affected by different parties in addition to stock-holders of the company. Hence, the managers should on the one hand manage the company to benefit its stakeholders in firm to safeguard the long term stakes of each group. Consequently, whether corporate governance should focus exclusively on protecting the interests of equity holders in the corporation, or should expand its focus to deal with the problems of other stakeholders (Asenafi, Kelifaand Yodit, 2013).

2.1.3. Resource Dependency Theory

According to Abdullah & Valentine (2009), resource dependency theory concentrates on the role of board of directors in providing access to resources needed by the firm. According to this theory the primary function of board of directors is to provide resources to the firm and they are viewed as an important resource to the firm. Directors are considered as a provider of resources to the firm, such as information, skills, business expertise, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy.

The resource dependence model suggests that the board of directors could be used as a mechanism to form links with the external environment in order to support the management in the areas where knowledge gap is occurred to ensure the achievement of organizational goals (Wang, 2009). The agency theory concentrated on the monitoring and controlling role of board of directors whereas the resource dependency theory focus on the advisory and counseling role of directors to a firm management. The dual role of boards is recognized. However, board structure has relied heavily on agency theory concepts, focusing on the control function of the board (Habbash, 2010).

2.2. Corporate Governance and the Nature of Banking Sector

Banks play a key role for industrial expansion, the corporate governance of firms, and capital allocation. When there is a proper functioning of the private commercial banks, it has implications for the operations of firms and the prosperity of countries. If sound corporate governance mechanisms is designed and implemented, the bank can allocate capital efficiently and improve its financial performance. And also effective corporate governance protects the interests of shareholders as well as other stakeholders (Levine, 2003).

On the other way it is less likely to allocate capital efficiently, if the banks face poor corporate governance mechanisms. In this case the bank manager will mainly enjoy acting in his/her own interest rather than in the interests of shareholders or other stakeholders. This leads to banking failures and crises that promote the massive consequences and can pose significant public costs of poor governance of banks (Levine, 2004). Therefore, effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole.

According to Levine (2003), banks have two characteristics that are related to the corporate governance of banks. First, even though information asymmetries exist in all sectors it is larger in banking industry than non-financial firms due to the opaqueness of their assets and activities. Loan quality can be hidden easily for long periods in banking industry. In addition to this, banks can modify the risk composition of their assets more immediately than most of the non-financial

industries, and bank managers can hide problems by extending loans to clients that cannot service previous debt obligations. The greater information asymmetry between insiders and outsiders and relatively severe difficulties in acquiring information about bank activities and monitor continuing bank activities intensifies the agency problem. Second, governments impose heavy regulation on banks which are usually regulated very seriously since banks are important for the economy of countries.

According to Basel Committee on Banking Supervision (2006), banking sector corporate governance has a greater importance to the international financial system and has advantages for the stakeholders and countries due to the financial intermediation role of banks in an economy, and high degree of sensitivity of the sector to potential difficulties arising from ineffective corporate governance and the need to safeguard depositors' funds. The other special nature of banking requires not only a broader view of corporate governance i.e. the methods by which suppliers of finance to control managers in order to ensure that they earn appropriate return on their investment, but also government intervention in order to control the opportunistic behavior of bank management (Arun & Turner, 2004). Since the uniqueness nature of the banking firms, sound corporate governance can be beneficial for both shareholders and depositors if it is being adopted and implemented properly for the banks.

2.3. Corporate Governance Tools and Firm Financial Performance

Corporate governance mechanisms are essential tools needed in managing any corporation including banks. There are different mechanisms that reduce agency cost whereby corporate

governance can be measured in an organization. Management and its board of directors are internal corporate governance instruments. The existence of regulation is one of the external governance forces, in addition to the market, with the power to discipline the agent. In the corporate governance literature board size, diversity of board sub-committees, board gender diversity and experience and audit committee size were used as corporate governance mechanisms. And some of the characteristics improved firms' financial performance. International organizations such as Organization for Economic Cooperation and Development (OECD) have developed corporate governance principles which stressed on the role of boards. So that it is important to adopt sound corporate governance mechanism in order to reduce information asymmetry problem and to improve controlling of management.

A strong board can play an important role in improving firm financial performance and can help the firm to achieve better performance by effectively undertaking their monitoring duties (Bathula, 2008).

Boards of directors are the agent of the shareholders and perform their task of monitoring and controlling the activities of firms' top management on behalf of shareholders to reduce agency problem (Jensen and Meckling, 1976). According to agency theory, boards have played critical role in solving the agency problems. When the board is effective it is expected to drive the company towards better financial achievement (Andres and Vallelado, 2008).

The board of directors is highly significant for shareholders as an internal control mechanism and its financial performance can be affected by board composition and quality, size of board, board

diversity, and board committee effectiveness such as audit committee and information asymmetries (Uadiale, 2010). However, the effectiveness of the board of directors can only be efficient if bounded with appropriate size, composition and sub-committee (Lawal, 2012).

Audit committee is one of the sub-committee of the board of directors and its primary role is to monitor and review financial statements (Yammeesriand Herath, 2010). It also ensures the interests of shareholders are properly protected in relation to financial reporting and internal control (Habbash, 2010). Monitoring is performed by external audit and audit committees. The existence of an audit committee improves the monitoring of corporate financial reporting and internal control, it uses as a decision control system and it helps to promote good corporate governance in turn this improves firms' financial performance by reducing agency cost (Al – Sa'eedand Al-Mahamid, 2011). This study examined the relationship between both external and internal corporate governance mechanism and private commercial bank financial performance.

2.3.1. Board Gender Diversity

According to Enobakhare (2010), board diversity is the mixture of men and women, people from different age groups, people with different ethnic groups and racial backgrounds. The topic is highly debatable that puts more emphasis on, gender diversity, i.e. the inclusion of women on corporate boards of directors, considered as an instrument to improve board variety and thus discussions. It is computed as the total number of women in the board over the board size over a period. According to OECD principles of corporate governance (2004), one of the responsibilities of board of directors is ensuring the integrity of the corporation's accounting and

financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards. In order to fulfill their responsibilities; there is a need for gender diversity in the composition of the board.

Boards are concerned with having right composition to provide diverse perspectives. Women representation on boards provides some additional skills and perspectives that may not be possible with all-male boards (Boyle and Jane, 2011).The management may be less able to manipulate a more heterogeneous board to achieve their personal interests. Gender diversity is associated with effectiveness in the oversight function of boards of directors which may be more effective if there is gender diversity on board.

Gender diversity in the boards is supported by different theoretical perspectives. Agency theory is mainly concerned about monitoring role of directors and emphasize that representation from diverse groups will provide a balanced board so that no individual or group of individuals can dominate the decision making of the board (Erhardt et al., 2003). According to the stakeholders' theory, diversity also provides representation for different stakeholders of the firm for equity and fairness (Keasey et al., 1997). From resource dependency perspective, the board is a strategic resource, which provides a linkage to various external resources (Walt and Ingley, 2003). These all are facilitated by board diversity.

On the other hand, Rose (2007) revealed insignificant association between numbers of women directors on the board and firm performance. However, many scholars now believe that an

increase in board diversity leads to better boards and governance on the ground that diversity allows boards to tap on broader talent pools for the role of directors (Bathula, 2008). Belete Zegeye (2015) also found that board gender composition does not have significant effect on the financial performance of Microfinance Institutions.

2.3.2. Educational Qualification of Directors

Educational Qualification refers to Board Competency of individual board members. Qualifications of individual board members are important for decision making. Board members with higher qualifications benefit the firms through a mix of competencies and capabilities which helps in creating diverse perspectives to decision making. Presence of more qualified members would extend knowledge base, stimulate board members to consider other alternatives and enhance a more thoughtful processing of problems. It is measured by the proportion of board members who had at least college degree to the total number of board members. Higher the number of educated directors in organizational contexts is positively related to receptivity to innovation, creativity, and better strategic decision making. Director's educational qualifications are central to effectively interpret and utilize the information generated by the management.

Educational qualification is important since the ability to seek and interpret appropriate information is essential for the efficient operation of the modern corporation and the effective control or guidance of management by boards of directors. It affects the oversight and monitoring role of boards of directors (Gantenbeinand Volonte, 2011). The human capital provided by its board of directors is very important given the corporate board is one of the

mechanisms for overseeing the firm and it can arguably provide the knowledge needed to function in the new environment. Poon, Heong and Lee (2013) find that there is positive relationship between performance and the qualifications of directors. Their finding supports the belief that top management teams who have qualifications in business-related disciplines such as banking, auditing, legal, accounting, business administration, information technology, investment management or finance, improved higher firms performance. These qualified directors chose to increase firm performance to promote corporate image, and demonstrate accountability and credibility within the management team.

Personal profile factors of directors such as education and experience is important for board efficiency. Hence, less qualified directors are possibly less effective than directors with business qualifications (Ferreira, 2010).

2.3.3. Availability of Variety Number of Board Sub-committee

Board committees are internal regulatory and supervision board which oversees the effective operation and acts of the board of directors. They are calculated as the total number of internal sub-committees serving on the board the private commercial bank has at the end of the period. The total minimum required number of internal board committees means the central/national bank and international corporate governance codes requirements established for a bank that is at least three committees: audits and risk sub-committee, remuneration sub-committee and main board management sub-committee.

Romano et al. (2012) argued that board sub-committees are critical that help to monitor corporate activities and protection of shareholder value. Most of the countries requires all banks to have an internal control, risk and compliance committee, remuneration committee, and nomination committee; among other committees (Bank of Italy, 2008). Audit committee and risk and compliance sub-committees mainly focus on the examination of the financial conditions, on the assessment of internal controls and on the monitoring of bank performance and also review the findings of the internal auditors will be reported to the board with some recommended. The sub-committees should be independent and transparent from the board and clearly communicate to all employees the risk strategy and risk tolerance of the company (Enobakhare, 2010). Nomination committee is one of the most important committee, which appoint in new committed directors and fire uncommitted (Sierra et al., 2006). Remuneration and nomination sub-committee should be comprised only with non-executive directors, of whom the majority should be independent, and chaired by the board chairperson. This committee is a relevant tool to align managers and shareholders' interests, mitigating agency costs and providing a link between managerial actions and performance (Romano et al, 2012). Asset and liability management committee (ALCO) is required to better perform its role, as it requires more discussions and assures more skills, backgrounds and competences (Alkdaiand Hanefak, 2012). ALCO is the most appropriate strategy in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and foreign exchange exposure and capital adequacy (Romano and Guerrini, 2012).

In the Ethiopian directives on bank corporate governance there are at least three committees that are allowed to establish but not limited to: audit sub-committee, risk and compliance sub-

committee and human resource affairs sub-committee. Those are the total minimum required number of internal board committees that are established by NBE codes of requirements.

According to Bussoli (2013), the board sub-committees are the measurements for better functioning of private commercial banks, as the number of board committees is statistically significant to banks financial performance. Hlanganipai Ngirande and Godfrey Ndlovu (2014) positive relationship between board composition, board diversity and commercial bank performance, although a negative relationship appears between board sizes, board committees. Rajendran Kajanathan (2012) positive relationship for separate leadership, board composition, board committees. Most of the previous studies concluded that availability of variety number of board committee is positively related to the financial performance by reasoning different variety board committee could provide the diversity that would help companies get critical resources and increase monitoring and controlling capacity of the board.

2.3.4. Meeting Frequency of Board

For board to effectively perform its function and monitor management performance, the board must hold a regular meeting. Meeting frequency of board refers to how much time the board meets on a year. There are two theoretical views on this issue: those who are in favor of higher frequency of board meetings and those who are not (e.g. Lipton and Lorsch, 1992; Jensen, 1993).

A higher frequency of board meetings will result in a higher quality of managerial monitoring. This will implies that there is a positive relationship between frequency of board meetings and

financial performance. Regular meetings allow directors more time to confer set strategy and to appraise managerial performance (Vafeas 1999, p.118). It can help directors to remain well informed about important developments within the firm. This will place the directors in a better position to timely address critical problems. In fact, there was a suggestion that frequent meetings intermingled with informal sideline interactions can create and strengthen cohesive bonds among directors (Lipton and Lorsch 1992, p.69).

An opposing theoretical view is that board meetings are not necessarily beneficial to shareholders. Firstly, Vafeas (1999, p.114) argues that normally the limited time directors spend together is not used for the meaningful exchange of ideas among themselves. Instead, routine tasks, such as presentation of management reports and various formalities absorb much of the meetings. This reduces the amount of time that outside directors would have to effectively monitor management (Lipton and Lorsch 1992 p.64). Secondly, board meetings are costly in the form of managerial time, travel expenses, refreshments and directors' meeting fees (Vafeas 1999, p.118).

Empirical findings on the effect of frequent board meetings and corporate performance show mixed results. Some studies concluded more meeting frequency has a negative effect on the performance of banks. Akpan (2015) found that board meetings negatively and significantly related with company financial performance. And also the higher the number of meetings has a significant negative effect on ROA and an increasing in meeting frequency will reduce the ROA (Ms.S. Danoshana and Ms.T.Ravivathani, 2013). Vafeas (1999) reported a statistical significance and negative association between frequency of board meetings and corporate performance.

But Karamano et al (2005) found a positive association between frequency of board meeting and management earnings forecasts, using a sample of 157 firms in Zimbabwe from the year 2001-2003; report a positive relationship between board meeting frequency and corporate performance. Similarly in a study of the sample of 169 listed corporations from 2002-2007 in South African, a statistical significant and positive association between the frequency of board meeting and corporate performance exist (Ntimand Osei, 2011). Belete Zegeye (2015) also found that meeting frequency of board has a significant effect on the financial performance of Microfinance Institutions. This implies that the board of directors in South Africa that meet more frequently tend to generate higher financial performance.

In fact, Jensen (1976, p.866) contends that boards in well-functioning companies should be relatively inactive and exhibit little conflicts. He suggests that rather than necessarily organizing frequent board meetings, it will be more profitable for corporate boards to establish a system that is responsive to their specific challenges. For example, directors can increase the frequency of meetings during crisis or when shareholders' interests are visibly in danger, such as when replacing the CEO or fighting hostile takeovers. Consistent with Jensen's (1993) suggestions, Vafeas (1999, p.118) argues that companies that are efficient in setting the right frequency of board meetings, depending on its operating context, will enjoy economies of scale in agency costs.

2.3.5. Board Ownership

The review of the empirical evidence on the effect of ownership of board on the financial performance shows mixed results. Some studies concluded that there is significant relationship between board ownership and private commercial bank financial performance. The board of directors, as internal mechanism of governance, is appointed by the shareholders in order to control the activities of managers in the company. Their main responsibility is to support the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its shareholders, authorities and other stakeholders. The board ownership reduces manager-shareholder conflicts in share ownership by both executive and non-executive board members. To the extent that executive board members own part of the firm, they develop shareholder-like interests and are less likely to engage in behavior that is unfavorable to shareholder, (Uadiale 2010). Therefore, board ownership is inversely related to agency conflicts between managers and shareholders.

In contrast Kibrysfaw Getahun (2013) found insignificant relationship between board ownership and private commercial bank financial performance. On the other way according to agency and stakeholder theory, as board ownership increases, the boards' inducement to monitor the opportunistic and risk taking behavior of manager will be high and this enhances the financial performance of private commercial banks.

2.3.6. Influence of Depositor (Total Deposit to Total Asset Ratio)

According to Tandelilin et al. (2007), it was important to use a total deposit to total asset ratio as a measurement for depositors' influence. Therefore, this study also used this measurement tools. A lower value of this ratio indicates reduced depositor support for investment probably because of perceived higher risk. The capability of depositors to control private commercial bank risk-taking is another mechanism of corporate governance. The depositors might withdraw their deposits from or require high deposit interests from risky private commercial banks. If the private commercial banks know that deposit withdrawal or high funding costs put in danger their survival, they will avoid excessive risk-taking and engage in far-sighted management, (Hosono 2007).

The total deposit to total asset ratio shows the proportion of public contribution as a source of capital to finance the private commercial banks' asset. Accordingly if this ratio is smaller and smaller, the total deposit to total asset ratio number indicates that public provides smaller and smaller proportion to support the private commercial banks' activity. For the above reason, the ratio represents a good proxy for external corporate governance mechanism, (Tandelilin et al. 2007). The theory of risk return tradeoff says that as corporation use extra debt to finance their asset their return will be exaggerated. In addition to this when a private commercial bank's deposit to total asset ratio is higher and higher, the more money it can earn in terms of lending revenue. There are many empirical results which supports this hypothesis. Ebiad (2009), indicates that higher levels of debt in the firm's capital structure is directly, associated with higher performance levels. Similarly, Modigliani and Miller (1963) in existence of corporate

taxes suggested that firms should use as much debt capital as possible in order to maximize their value by maximizing the interest tax shield. Therefore, because of the above reason the researcher expects positive relationship between total deposit to total asset ratio and private commercial bank financial performance.

2.3.7. Legal Reserve

The other important external government policy to control excessive risk taking behavior of managers is the reserve ratio. The cash reserve ratio is the minimum reserve that the national (central) bank requires each bank to hold from the total deposit liabilities held by the private commercial banks. This serves two purposes. First, to be able to meet sudden and unexpected cash withdrawal demands of depositors, but more importantly, a rise in this ratio may be used to restrict the amount of loans that the private commercial banks can make. Second, the purpose of regulation is not only maximizing profitmaking but also protecting the whole public by minimizing the risk taking behavior of managers for example; Private commercial banks have to keep funds in their accounts at the Federal Reserve that pays no interest.

A high cash reserve ratio reduces the cash for lending and a low cash reserve ratio increases the funds for lending. A reduction in money supply affects the ability of private commercial banks to create new money through giving loans to their customers. Since extending loan is the main source of income for private commercial banks and cash reserve ratio do not earn any income for the private commercial banks, it drains on the profitability of private commercial bank.

Kibrysfaw (2013), Tandelilin et al. (2007), Kwee and Rasiah (2010) also used this variable as corporate governance proxy.

2.3.8. Liquidity

The liquidity ratio is the other type of regulation used by NBE to protect private commercial bank stakeholders. Through the financial inter-mediation role; the private commercial banks reactivate the idle funds borrowed from the lenders by investing such funds in different classes of portfolios. Such business activity of the private commercial bank may face a problem since the deposits from these fund savers which have been invested by the private commercial banks for profit maximization, can be recalled or demanded when the latter is not in position to meet their financial obligations. There are two conflicting views as to the effect of liquidity on private commercial bank financial performance. The first view is that liquidity has a positive effect on private commercial bank financial performance. According to this view, when a private commercial bank has adequate liquidity, it can obtain sufficient funds, either by increasing liabilities or by converting assets promptly, at a reasonable cost, thereby affecting profitability positively. The second view is that since investment in liquid asset has relatively lower income than investment in non-liquid assets, keeping more liquid asset affects the profitability negatively.

Referring to previous empirical findings, the results concerning liquidity are mixed. Molyneux and Thornton (1992) and Guru et al. (2002) find a negative relationship between liquidity and

commercial bank profitability. In contrast, Pasiouras and Kosmidou (2007) found a significant positive relationship between liquidity and commercial bank Profit.

2.4. Review of Previous Empirical Studies

This section of literature review concentrates on previous studies that have been conducted in relation to this study. In the context of Ethiopia, even if there is limited number of research work on the evaluation of the effect of corporate governance on private commercial bank financial performance, there were mixed results concluded by previous studies pertaining to the relationship between corporate governance mechanisms and financial performance. The important empirical studies are summarized below in this section.

Kyereboah Coleman (2007) examined the effort of corporate governance on the performance of firms in Africa by using both market and accounting based performance measure. The study used unique data from 103 listed firms drawn from Ghana, South Africa, Nigeria and Kenya covering the five year period 1997-2001. The analysis was carried out within the dynamic panel data framework. Their results indicate that the direction and the extent of effect of governance is dependent on the performance measure being examined. Specifically, the findings show that large and independent boards enhance firm value and that combining the positions of CEO and board chair has a negative effect on corporate performance. The study also finds that CEO's occupancy in office enhances a firm's profitability while board activity intensity affects profitability negatively. The size of audit committees and the frequency of their meetings have positive influence on market based performance measures and that institutional shareholding

enhances market valuation of firms. Finally, the results pointed out that sector characteristics influence the effect of governance on corporate performance. For enhance performance of corporate entities, the study recommended a clear separation of the positions of CEO and board chair and relatively independent audit committees should be maintained. It needs to study further in the area by using long period of year's data.

Yasser (2011) provide evidence on the effect of corporate governance on firm performance using 792 companies listed on Karachi Stock Exchange from 2003 to 2008 in Pakistani. Tobin's Q, return on assets, operating cash flow has been used as a measure of firms' performance; dummy variable for family-controlled firm, Board composition, director's educational qualification, directors professional qualification, leadership structure and frequency of board meetings were the independent variables of the study. Moreover, debt, firm age and firm size were the control variables of the study. The study revealed that there are significant difference between family and non-family controlled firms' performance when measured by Tobin Q, return on asset and operating cash flow. For non-family controlled companies, the board governance variables such as board composition, director's educational qualification, director's professional qualification, leadership structure have improved the firm performance. In addition, debt, firm size and firm age affect a firm's performance. It was evidenced that corporate governance does play a vital role in influencing Pakistani companies' financial performance.

Hlanganipai Ngirande and Godfrey Ndlovu (2014) investigated the effect of corporate governance on the performance of Commercial Banks in Zimbabwe. Using data gathered from 2009-2012, for a sample of five commercial banks, it applies multi-regression model, to assess

the causal relationship between corporate governance measures (board size, board composition, internal board committees and board diversity) and bank performance. He found that the results indicate unidirectional causal relationship from corporate governance to bank performance. In addition, there a positive relationship between board composition, board diversity and commercial bank performance, although a negative relationship appears between board size, board committees and bank performance. Therefore, in order to improve performance in commercial banks good corporate governance practices must implemented, this includes improving the board structures, information disclosure, and fiduciary duties of directors.

Al-Manaseer et al. (2012) empirically investigated the effect of corporate governance on performance using 15 Jordanian banks from the year 2007 to 2009 with a total of 45 bank observation. The study employed pooled data, and OLS estimation method with panel methodology. Return on asset, return on equity, profit margin and earnings per share were the dependent variables of the study and board size, board composition, CEO status, foreign ownership and bank size were the independent variables of the study. The study revealed a significant negative relation between board size and banks performance as measured by ROE and earnings per share but insignificant negative association of board size with ROA and profit margin was found. Bank size was negatively related with ROA, ROE and profit margin but only significant with profit margin. The study also reveals a positive association between board composition and foreign ownership and bank performance. In addition, CEO status has a negative influence. Finally, the researchers suggest extending the study period. Due to this recommendation by the researcher it needs to study further in the area by using long period of year's data.

Rajendran Kajanathan(2012) investigated the relationship between corporate governance practices & firm performance; to examine the effect of corporate governance on firm performance in listed banks, Sri Lanka in the years of 2006, 2007, 2008, 2009, and 2010. Leadership structure, board composition, board committees, board size and board meeting in the corporate governance dimensions to predict the firm performance were examined. A sample of 11 listed banks was selected from database of Colombo stock exchange for the period of 5years from 2006 to 2010. The selection was determined by the availability of data for years. Data was obtained from annual reports. The data was analyzed with SPSS to obtain quantitative measures of descriptive statistics, Spearman's correlation, regression analysis and analysis of variance. He found that this study provided evidence in support of a positive relationship for separate leadership, board composition, board committees and firm performance. In this study, the positive relationship between corporate governance structures, separate leadership, board composition, board committees and firm performance indicated that firms had implemented corporate governance strategies, which had resulted in higher profitability. Further the corporate governance practices have a significant effect on firm performance. And he concluded that this study has significant implications for the corporate sector, investors, policy makers, international agencies, government and stakeholders, due to the importance of the corporate success to the economy of the country.

Ajala Odinga, Amuda and Arulogun Lawren (2012) provided evidence on the effect of Corporate Governance on the performance of Nigerian Banking Sector the secondary source of data was sought from published annual reports of the quoted banks. In examining the level of disclosure of

the sampled banks, a disclosure index was developed and guided by the Central Bank of Nigeria code of governance. The Pearson Correlation and the regression analysis were used to find out whether there is a relationship between the corporate governance variables and firms performance. The study revealed that a negative but significant relationship exists between board size and the financial performance of these banks while a positive and significant relationship was also observed between directors' equity interest, level of corporate governance disclosure index and performance of the sampled banks.

Belete Zegeye (2015) examined the relationship between corporate governance mechanisms and Microfinance Institutions financial Performance in Ethiopia as measured by ROE and ROA using OLS regression analysis for a sample of seven years from 2007/08-2013/14. Explanatory research design was used in trying to establish the causal effect relationship between corporate governance variable (which were; board size, board gender composition, board competency, board experience in the finance sector, meeting frequency of , size of audit committee, CEO duality, and CEO gender) and the control variable (size of MFI) was added. The financial performance measure was Return on Asset. Firms were selected as a sample from 35 licensed MFI from NBE. The study points out that board size, board educational qualification, board experience in the financial sector and meeting frequency of board has a significant effect on the financial performance of Microfinance Institutions. However, size of audit committee has a significant negative relationship with the financial performance of Microfinance Institutions. Board gender composition, CEO duality and CEO gender does not have significant effect on the financial performance of Microfinance Institutions.

Habtamu (2012) examined the effect of corporate governance on the performance of banks. The study applied panel data of seven Ethiopian commercial banks that covered for the period of 2004/05 to 2009/10. The paper used independent sample t-test and pooled OLS panel data regression models to investigate the effect of some internal corporate governance variables on major profitability indicator i.e., ROA and ROE. The estimation results showed that, board size, gender diversity in boardroom and CEO experience are found to have negative effect on the financial performance of banks measured using ROA and ROE. Audit committee and board meeting frequency are found to positively affect ROE, with no effect on ROA. Finally board composition is found to have no effect on both financial performance measures.

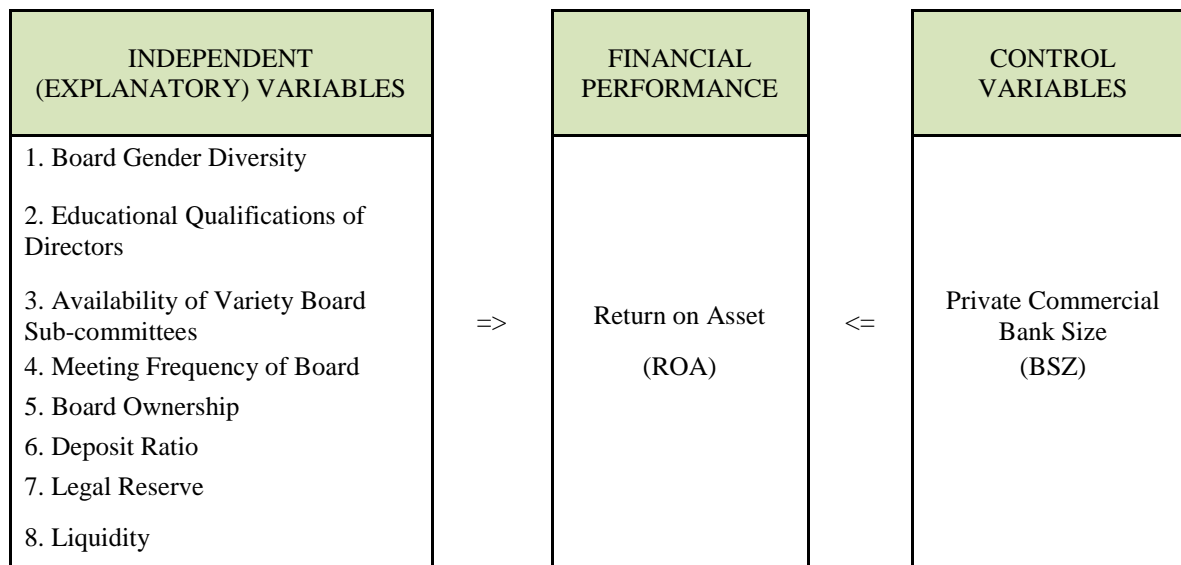
Kalifa (2012) examined the relationship between corporate governance mechanisms and firm financial performance as measured by ROE and ROA using OLS regression analysis for a sample of 9 banks for the period 2005-2011. The researcher used ROE and ROA as performance measure and existence of audit committee in the board, board size, capital adequacy ratio, ownership type, loan loss provision and loan to deposit ratio as explanatory variables. The study points out that existence of audit committee in the board, board size had negatively and significantly influence on firm performance in terms of both ROA and ROE. Capital adequacy ratio had statistically significant positive effect on bank performance. The remaining variables such as ownership type, loan loss provision and loan to deposit ratio did not have statistically significant effect on bank performance.

Kibrysfaw (2013) provided evidence on the effect of different corporate governance mechanisms on the performance of nine commercial banks of Ethiopia covering the period of 2005-2012. He

has employed panel data regression analysis to test whether the selected corporate governance variables have an impact on firms' financial performance. The results of the study showed that the board ownership and liquidity ratio have negative but insignificant effect on the firm performance; similarly board size has negative but insignificant impact on ROA. In case of composition, there is negative and significant effect of proportion of non-executive board on bank performance. Similarly, CAR and reserve requirement from regulation proxies had negative and significant effect on the performance of Ethiopian commercial banks. Availability of audit committee on board and deposit ratio has positive and significant effect on ROA. The regression result also shows that positive and significant effect of concentrated ownership on the performance of banks. Lastly, the result shows positive and significant impact of deposit to total asset ratio on the performance of banks by using market mechanism. The study was also recommends further research could be possible to come up with a better insight and several extensions to this study are possible. So, it can be more robust, if future researchers conduct a study on this area by increasing the number of observations through the use of large sample size and long year's data, and by incorporating other corporate governance variables. Even if the researcher covers from both internal and external corporate governance variables the relationship between internal corporate governance mechanisms and firms' financial performance needs also be further explained.

2.5. Conceptual Framework of the Study

The following diagrammatic framework is developed.

Figure 2.1: Researcher Design

2.6. Research Gap

As per the review of the literature most of the empirical studies that have been conducted with the purpose of examining the relationship between corporate governance mechanism and bank financial performance belong to the companies outside Ethiopia. Even if the topic is boldly researched the above literature review revealed the existence of controversial conclusions that results from different studies made so far. The empirical analysis of good corporate governance practices in relation to banks is still at young stage and it is important to conduct more studies in this field to enhance private commercial banks' development.

In case of Ethiopia, very small work has been done with the aim of examining the effect of corporate governance mechanism. The study conducted by Habtamu (2012), tests the relationship between some internal corporate governance mechanism and bank performance. The

research used only some of the board characteristics as corporate governance proxies and established relationship between those board proxies and bank financial performance. And the agency theory was used by the study as a model which is less relevant when there is regulation or government intervention and imperfect market which is an environment on which banks operates.

Even if a research conducted by Kelifa (2012) tried to address the issue in a better way as compared to the previous work of Habtamu (2012), he overlooked major and important corporate governance variables like frequency of board meeting, board qualification, sub-committees in the board, level of disclosure, ownership structure, legal reserve, board ownership, board composition and liquidity. On the other way the research conducted by Kibrysfaw (2013) covers both internal and external corporate governance variables. But some of the corporate governance variables were not covered. He recommend for future research should incorporate other variables like, gender diversity on the board and availability of different sub-committees on the board. Consequently this research needs to study by including more corporate governance variables which were not studied sufficiently and broad sampling size and period of years data. Furthermore, the contradictory conclusions that results from the three previous researches call for a detailed investigation to be conducted in the area.

In general, most of the previous studies have some gap like there was insufficiency in sampling and limited number of observations and corporate governance variables, and they have concentrate on both governmental and privately owned commercial banks. The lack of sufficient research on the effect of internal corporate governance mechanism on bank financial

performance in the context of Ethiopia and the existence of knowledge gap in the area are the causes for undertaking this study. As far as the researcher's knowledge concerned there is no sufficient and robust research that has been conducted to provide empirical evidence particularly on the effect of corporate governance mechanisms on firm's financial performance of private commercial banks in Ethiopia. Furthermore, most previous studies were made in countries where there are capital markets and the findings may not apply to country such as Ethiopia where there is no organized stock exchange market.

To come up with a better insight and be more robust; this study covers by assessing and including selected internal corporate governance mechanisms, by increasing the number of observations through the use of large sample size and broad year data. And this study also uses sufficiently uncovered variables; concentrates only on privately owned commercial banks; and uses recently generated data. Therefore, the relationship between corporate governance mechanisms and firms' financial performance can also be further explained.

Finally, this study has a contribution to the literature and provides empirical evidence on the effect of corporate governance mechanisms on financial performance of private commercial banks in Ethiopia by taking in to consideration the variables, observations, sampling data and methodology related to the realities of the private commercial banks governance mechanism in Ethiopia.

CHAPTER THREE

3. Methodology

This section presents the methods used to carrying out this study. In particular, this study is employed in order to examine the relationship between corporate governance and financial performance of banking sector by taking evidence from selected private commercial banks in Ethiopia. It presents the research design, procedures of data collection, the sampling procedure and method of data analysis and the variables measurements.

3.1. Research Design

The type of research which is appropriate to be employed for the purpose of this study is explanatory survey design in nature. With a mixed approach, more of quantitative and qualitative methods will be applied. The explanatory type of research design helps to identify and evaluate the causal relationships between the different variables. Mixed methods research can provide better inferences. Therefore, by using a mixed approach it is able to capitalize the strength of quantitative and qualitative approach and remove any biases that exist in any single research method (Creswell, 2003).

3.2. Data Collection and Sampling Procedures

There are 16 private commercial banks which are licensed and operating in Ethiopia as of June 2016. The sampling method or the cutoff the researcher to use was purposive sampling. The data for the study was collected from both primary and secondary sources. The secondary source of data is the audited financial statements of 8 private commercial banks as a sample over a period

of 11 years (2005 to 2015) except Lion International Bank which has only 9 years data; so 86 firm year data, which has been obtained from NBE. The most important use of this secondary data source is to confirm and augment evidence from other sources (Yin, 1989; pp. 86). Thus, the document examination helps to corroborate the patterns that evolved from the data collected via questionnaires, so that the validity of the findings could be enhanced.

The primary data was collected through the use of a structured questionnaire from the target banks. In addition, the qualitative data also collected by using questionnaire to support the quantitative data. And it was needed for further addressing the objectives of the study. Therefore the questionnaires which capture corporate governance variables was prepared, distributed and filled by vice president or board secretary of the selected sample banks. A panel data study design which combines the attributes of cross-sectional and time series data has been used. The advantage of panel data analysis is that more reliable estimates of the parameters in the model can be obtained (Gujarati, 2004).

3.3. Data Analysis Technique and Variables Measurement

The data collected through the aforementioned tools has been analyzed using the method known as descriptive statistics, correlation and multiple panel linear regression methods. The descriptive statistics has been used to quantitatively describe the important features of the variables using mean, maximum, minimum and standard deviations. Pearson correlation analysis has been used to identify the relationship among the variables. But it does not allow the researcher to make causal inferences regarding the relationship between variables (Marczyk et al., 2005). That is why

a multiple panel linear regression analysis was also used to test the hypothesis and to explain the relationship between corporate governance variables and financial performance measures by controlling the influence of selected variable. Qualitative analysis was used for qualitative data collected through questionnaire. The least square is conducted using Eviews8 econometric software package has been used for analysis and the results are presented in tables and figures.

The variables were selected based on alternative theories agency and stakeholder theories and previous empirical studies related to corporate governance and firm performance. Accordingly, the theory and empirical studies, the independent, dependent and control variable of the study were identified in order to examine the effect of corporate governance mechanisms on private commercial banks' financial performance.

Dependent Variable:

Return on Assets (ROA): a dependent variable or a proxy for the private commercial banks financial performance which measures a firm's financial performance annually. It shows how management of an entity has been able to turnover assets of the organization over-one-year. To a large extent, ROA also deals with operational sustainability of these institutions.

$$\text{Return on Asset (ROA)} = \frac{\text{Profit after Tax (PAT)}}{\text{Total Asset (TA)}}$$

Independent Variables:

Board Gender Diversity: It is one of the proxies used for the corporate governance and it was measured as the percentage of number of female directors divided by the total number of board members. Board gender diversity is considered to improve company performance since it provides new insights and perspectives (Bathula, 2008; Erhardt et al., 2003). Female board members will bring diverse viewpoints to the boardroom that is not possible with all male directors. The researcher expects that there is a significant positive association between board gender diversity and the private commercial bank financial performance.

Educational Qualifications of Directors: It is measured by the proportion of board members who had college degree or higher to the total number of board members. Educational qualification is an important determinant of board effectiveness. According to Rose (2007) as long as board members have a university degree or equivalent skills, board members have sufficient human capital in order to understand and analyze information that is provided by management. Educational qualifications of individual board members are very important for board decision making (Amran 2011; Yasser; 2011). The monitoring role expected to be effectively implemented if the board members are qualified and experienced. The researcher expects that there is a significant positive association between directors' educational qualifications and the private commercial bank financial performance.

Availability Variety Number of Board Sub-committees: It is the various numbers of sub-committees in a private commercial bank. It was calculated as the total number of internal board sub-committees the private commercial bank has at the end of the period. The researcher expects

that there is a significant positive association between number of internal board sub-committees and the private commercial bank financial performance.

Meeting Frequency of Board: Refers the number of meeting how much time board meets on a year during the period under review. The researcher expects the number of board meeting has a negative effect on the Ethiopian private commercial banks financial performance.

Board Ownership: It is measured as in terms of the total percentage shareholding by board members. The researcher expects that there is a significant positive association between board ownership and the private commercial bank financial performance.

Influence of Depositors: Among various disciplining devices, the ability of private agents to control private commercial bank risk-taking, i.e., market discipline, is attracting more and more attention by both policy-makers and economists, (Tandelilin et al. 2007). Depositors (and creditors) may withdraw deposits, or require high deposit interests from risky private commercial banks. If the private commercial banks recognize that deposit withdrawal or high funding costs endanger their survival, they will avoid excessive risk taking and engage in prudential management, (Hosono, 2007). To measure depositors' influence, similar with Tandelilin et al. (2007), the total deposit to asset ratio is used. The researcher expects that there is a significant positive association between total deposit to asset ratio and the private commercial bank financial performance.

$$\text{Deposit to TA Ratio} = \frac{\text{Total Deposit}}{\text{TA}}$$

TA

Legal Reserve: Another central bank regulation proxy which is used by this research is the total Reserve ratio. This ratio is calculated by dividing total reserve kept by each private commercial bank to their respective total asset. The researcher expects that there is a significant negative association between legal reserve and the private commercial bank financial performance.

Liquidity: Other tool used as governance mechanism by National Bank of Ethiopia (NBE) is liquidity ratio. And for this research purpose liquidity is calculated as follows:

$$\text{Liquidity Ratio} = \frac{\text{Liquid Asset}}{\text{TA}}$$

The researcher expects that there is a significant negative association between liquidity ratio and the private commercial bank financial performance.

Control Variable:

Private Commercial Bank Size: In this study private commercial bank size (BSZ) was included to account its potential influence on private commercial banks' financial performance in order to know the selected explanatory variables effect on the banks' financial performance. The private commercial bank size - measured as the natural logarithm of total assets at year-end. The control variable was selected based on previous studies. In most of the previous studies firm size was used as control variable.

Table 3.1: Summary for Terms of Measurement

Variables	Acronym	Terms of Measurement
Return on Asset	ROA	Amount of profit after tax as a percentage of total asset
Board Gender Diversity	BGD	Percentage of number of female directors divided by the total number of board members
Educational Qualifications of Directors	EQD	Proportion of board members who had college degree or higher to total number of board members
Availability of variety number of board Sub-committees	BSC	Number of sub-committees serving on the board
Meeting Frequency of Board	MFB	Number of meeting how much time board meets on a year during the period
Board Ownership	BOH	Percentage of shareholding by board members
Total Deposit to Total Asset ratio	DRI	Total deposit to total asset
Reserve ratio	LRS	Total reserve divided by total asset
Liquidity ratio	LIQ	Liquid assets divided by total asset
Private Commercial Bank Size	BSZ	The natural logarithm of total assets at year end

Source: financial statements of the private commercial banks

Accordingly, to estimate the effect of corporate governance on private commercial bank's financial performance in Ethiopia the following general panel data regression or research model was developed.

$$Y_{it} = \alpha + \sum \beta KX_{it} + \epsilon_{it} \text{-----} (1)$$

The above general research model was converted into the study variable to find out the effect of corporate governance mechanisms on private commercial bank's financial performance as follows:

$$ROA_{it} = \alpha + \beta_1 BGD_{it} + \beta_2 EQD_{it} + \beta_3 BSC_{it} + \beta_4 MFB_{it} + \beta_5 BOH_{it} + \beta_6 DRI_{it} + \beta_7 RES_{it} + \beta_8 LIQ_{it} + \beta_9 BSZ_{it} + \epsilon_{it} \text{-----}(2)$$

Where:

- Y_{it} represents the dependent variable (ROA) of the sample bank i for time period t
- α is the intercept of the model
- β_K represents the coefficients of the X_{it} variables
- X_{it} represents the independent or explanatory and control variables (BGD, EQD, BSC, MFB, BOH, DRI, RES, LIQ and BSZ) of the private commercial bank i for time period t
- ϵ_{it} is the error term
- ROA_{it} is measures of financial performance for the sample bank i in time t
- BGD_{it} represents female directors on the board for the sample bank i in time t
- EQD_{it} represents educational qualifications of the board for the sample bank i in time t
- BSC_{it} represents the size of internal board sub-committee in a sample bank i in time t
- MFB_{it} represents the meeting frequency of the board in a sample bank i in time t
- BOH_{it} represents the total holdings of board members in the sample bank i in time t
- DRI_{it} represents loan to deposit ratio of the sample bank i in time t
- RES_{it} represents total reserve ratio kept by the sample bank i in time t
- LIQ_{it} represents the ratios of liquid asset to total asset for the sample bank i in time t
- BSZ_{it} represents the size of the private commercial bank

CHAPTER FOUR

4. Results and Discussion

This chapter presents the results and analysis of the findings of the different methods used. The chapter is organized to have 3 sections. The first section presents test for classical linear regression model (CLRM) assumptions. The second section presents the results of questionnaires and correlation. Then in the last section results obtained under these different methods are jointly analyzed, discussed and presented.

4.1. Test Results for the Regression Assumptions

This section presents the test for the assumptions of classical linear regression model (CLRM).

Assumption 1: The Mean of the Disturbances is Zero ($E(\epsilon) = 0$)

The mean of the disturbances will always be zero provided that there is a constant term in the regression. If a constant term is included in the regression equation, this assumption will never be violated. So that in the models of this study a constant term is included. As a result this assumption was not violated.

Assumption 2: Homoscedasticity (Variance of the Errors is Constant)

If the errors do not have a constant variance, they are said to be heteroscedasticity. To test for heteroscedasticity, the researcher used Breusch-Pagan-Godfrey's test. Eviews 8 presents three different types of tests for heteroscedasticity. According to Brooks (2008), if F , X square and normalized version of the explained sum of squares from the auxiliary regression ('Scaled

explained SS') statistic have a p-value of more than 0.05, the test statistic give conclusion that there is no evidence for the inconsistency of variance of the errors. As per the table 4.1 below, the F-statistic shows as there was no evidence for presence of heteroscedasticity since the p-values were greater than 0.05.

Table 4.1.: Heteroskedasticity Test-Breusch-Pagan-Godfrey

F-statistic	1.526774	Prob. F(9,76)	0.1539
Obs*R-squared	13.16816	Prob. Chi-Square(9)	0.1551
Scaled explained SS	14.45775	Prob. Chi-Square(9)	0.1069

Source: Eviews 8 test result summary

Assumption 3: Covariance Between the Error Terms over Time is Zero

This assumption test will be conducted when the errors are linearly independent of one another or uncorrelated with one another. If the errors are correlated with one another, it would be stated that they are auto correlated (serially correlated). Therefore to conduct test of this assumption, the first test was Durbin-Watson (D-W) which is shown in the regression output of the model. As per this test the value of Durbin-Watson (D-W) for the model is 2.2 which is near to 2 (see below table 4.6). Thus, the null hypotheses were not rejected for the model so there is no problem of autocorrelation. However, D-W tests only for a relationship between an error and its immediate previous value. Therefore, in addition to D-W test it is desirable to conduct Breusch Godfrey Serial Correlation LM test to examine a joint test for autocorrelation that will allow examination of the relationship between error term and several of its lagged values at the same time. Thus, Breusch-Godfrey test was also conducted for the model (see below table 4.2) and found no problem of autocorrelation for the model, meaning that p-value of the test resulted 0.63 which is greater than 0.05.

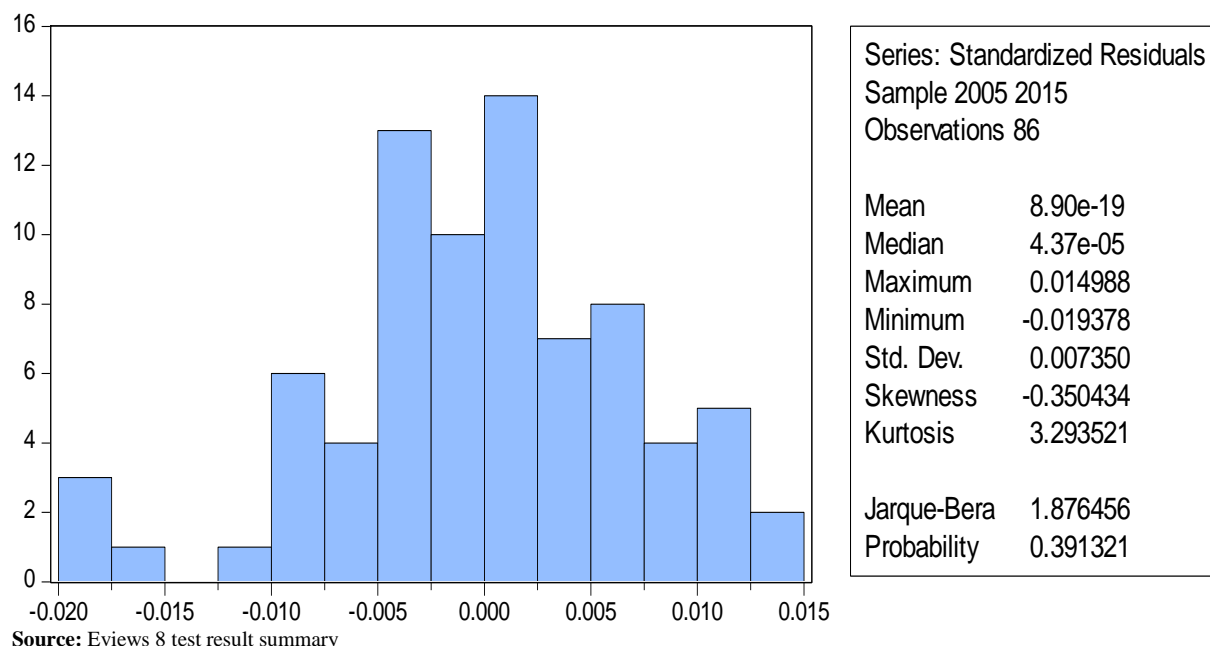
Table 4.2: Autocorrelation Test - Breusch-Godfrey Serial Correlation LM

F-statistic	0.463969	Prob. F(2,86)	0.6306
Obs*R-squared	1.065060	Prob. Chi-Square(2)	0.5871

Source: Eviews 8 test result summary

Assumption 4: Normality Test (Errors are Normally Distributed)

This test is performed to confirm the assumption of CLRM which states that the disturbances terms are normally distributed. One of the most commonly applied tests for normality is the Bera-Jarque (BJ) test. According to Brooks (2008), if the residuals are normally distributed, the histogram should be bell-shaped and the Jarque Bera statistic would not be significant. This means that the p-value given at the bottom of the normality test screen should be greater than 0.05 to support the null hypothesis of presence of normal distribution at the 5% level or the null hypothesis of normality should not be rejected at 5% level.

Figure 4.1: Normality Test Result

Source: Eviews 8 test result summary

As we can see in the figure 4.1, p-value of 0.39 (greater than 0.05) which is insignificant for the model and the researcher failed to reject the null hypothesis, which says the residual value is normally distributed. Therefore, there is no normality problem on the data used for this study. Also, it implies that the inferences made about the population parameters from the sample parameters tend to be valid.

Assumption 5: Multicollinearity Test

The other Assumption of the CLRM is that there is no multicollinearity among the regressors included in the regression model. When the explanatory variables are highly correlated with each other there is a problem known as multicollinearity. Multicollinearity in the regression model suggests substantial correlations among independent variables. Hair et al. (2006) argued that correlation coefficient below 0.9 may not cause serious multicollinearity problem. Also, Cooper and Schendler (2009) suggested that a correlation above 0.8 should be corrected for. In addition, Malhotra (2007) stated that multicollinearity problems exist when the correlation coefficient among variables should be greater than 0.75.

The method used in this study to test the existence of multicollinearity was by checking the Pearson correlation between the independent variables. The correlations between the independent variables are shown in table 4.3 below. Accordingly, all correlation results are below 0.75, which indicates that multicollinearity is not a potential problem for this study.

Table 4.3: Correlation Matrix between Independent Variables

Balanced sample (listwise missing value deletion)

Correlation	BGD	EQD	BSC	MFB	BOH	DRI	LRS	LIQ	BSZ
BGD	1								
EQD	-0.041468	1							
BSC	0.473887	0.057965	1						
MFB	-0.218799	0.040221	0.349951	1					
BOH	0.034338	-0.07442	0.32213	0.198381	1				
DRI	-0.146805	-0.115369	-0.223831	-0.009379	-0.117235	1			
LRS	0.20171	0.100887	0.10658	-0.189858	-0.028628	-0.441032	1		
LIQ	0.036739	0.143684	0.005884	0.10247	-0.096079	-0.422733	0.588697	1	
BSZ	-0.109493	0.105607	-0.093385	0.236756	-0.2279	0.492288	-0.159374	0.052842	1

Source: Eviews 8 test result summary

Fixed Effect versus Random Effect

There are two broad classes of panel estimator approaches that can be employed in financial research: fixed effects models (FEM) and random effects models (REM) (Brooks 2008). Fixed effect model allows for heterogeneity or individuality among 8 private commercial banks by allowing having its own intercept value, but the intercept does not vary over time. In random effect model the 8 private commercial banks have a common mean value for the intercept. Therefore, it is necessary to determine whether the fixed effect or random effect approach is appropriate. A common practice in corporate governance research is to make the choice between both approaches by running a Hausman test. According to Brooks (2008), to use random effect method the sample must be selected by using random sampling technique but in this research the samples are selected based on availability and age of data. In addition to use random panel effect or to conduct a Hausman test the number of cross section should be greater than the number of coefficients to be estimated. But in this research the coefficient of the variables number was

greater than the number of cross section. Because of the above reasons, a redundant fixed effects test (see below table 4.4) was conducted to determine whether the fixed effect is appropriate. Hence, with cross section fixed effects, the intercept is allowed to vary across entities (private commercial banks). It captures private commercial bank specific heterogeneity. To run the regression the fixed cross- section (panel) effect method was used.

Table 4.4: Random Vs. Fixed Effect Model Test Summary

Redundant Fixed Effects Tests
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.662473	(7,69)	0.1329
Cross-section Chi-square	13.403529	7	0.0629

Source: Eviews 8 test result summary

All the above tests of basic classical linear regression model (CLRM) assumptions for OLS estimation prove that, the results obtained from the regression model in this study are consistent, free from bias and efficient since the assumption holds.

4.2. Results and Analysis

In this paper the necessary data were collected mainly through review of documents and questionnaire. The data is used to examine the existing relationship between the governance mechanism variable and private commercial banks financial performance. Consequently, both governance mechanism and financial performance data were collected from all the private

commercial banks that have been in operation from the year 2005 up to 2015 in Ethiopia. This data results in 86 observations. The corporate governance mechanism data and financial performance data were accessed from NBE and private commercial banks head offices. Finally, the data were extracted from audited annual financial statement. With regard to the questionnaires, the study conducted by collecting from 2 board secretary and 6 delegated staffs, totally 8 people were contacted.

4.2.1. Descriptive Statistics

This section discussed the summary statistics of each variable in the study based on panel data of the private commercial banks from the year 2005 to 2015. The table 4.5 below presents the mean, standard deviation, minimum and maximum values of regression variables. The variables include the dependent, independent and control variables. The dependent variables used in this study in order to measure the private commercial banks financial performance are return on asset and the explanatory variables are the board gender diversity, directors educational qualification, availability of variety number of board sub-committees, meeting frequency of board, board ownership, depositor influence, regulations of legal reserve and liquidity. In addition to the explanatory variables a control variable i.e. private commercial bank size was included. Accordingly, the descriptive statistics for all variables are presented below in table 4.5.

Table 4.5: Descriptive Statistics Results

	ROA	BGD	EQD	BSC	MFB	BOH	DRI	LRS	LIQ	BSZ
Mean	0.026859	0.099081	0.990890	3.244186	31.01163	0.069963	0.733991	0.194558	0.449310	22.26179
Median	0.029322	0.105556	1.000000	3.000000	24.00000	0.076650	0.739600	0.184486	0.435500	22.49887
Maxim.	0.064868	0.250000	1.000000	4.000000	52.00000	0.331180	0.983800	0.891473	0.937984	24.77251
Minim.	-0.061110	0.000000	0.909091	3.000000	24.00000	0.005900	0.116279	0.050303	0.214000	18.67532
Std. Dev.	0.016115	0.075969	0.023247	0.432123	12.03963	0.056090	0.098680	0.108519	0.126966	1.130093
Observation	86	86	86	86	86	86	86	86	86	86

Source: Eviews 8 test result summary

As presented in table 4.5 above, the average mean value of return on asset for the sample Ethiopian private commercial banks is 2.69% or mean value of 0.026859 with a maximum and minimum value of 6.49% and -6.11% respectively. Meaning, among the sampled private commercial banks the most profitable private commercial bank achieved a profit of 6.49 cent per a birr invested in the assets. On other side, the least profitable private commercial bank incurred a loss of 6 cent per one birr investment. The standard deviation of return on asset is 1.61% from the average value or from the mean value of the sample private commercial banks.

The above table also examined the effects of gender as proxy for internal corporate governance mechanism on financial performance of sample private commercial banks. On average 9.9% or mean value of 0.099081 of the sample private commercial banks directors are female as measured by percentage of female directors divided by total number of directors, which is considerably unsatisfactory figure. It suggests that the diversity of sample Ethiopian private commercial bank' boards, as measured by proportion of directors held by women, is low since its mean value is only 0.099081 during the last 11 years. The percentage of female directors in the sample private

commercial banks is range from 0 to 25% representation of women on the private commercial banks' boards with a standard deviation of 0.075969.

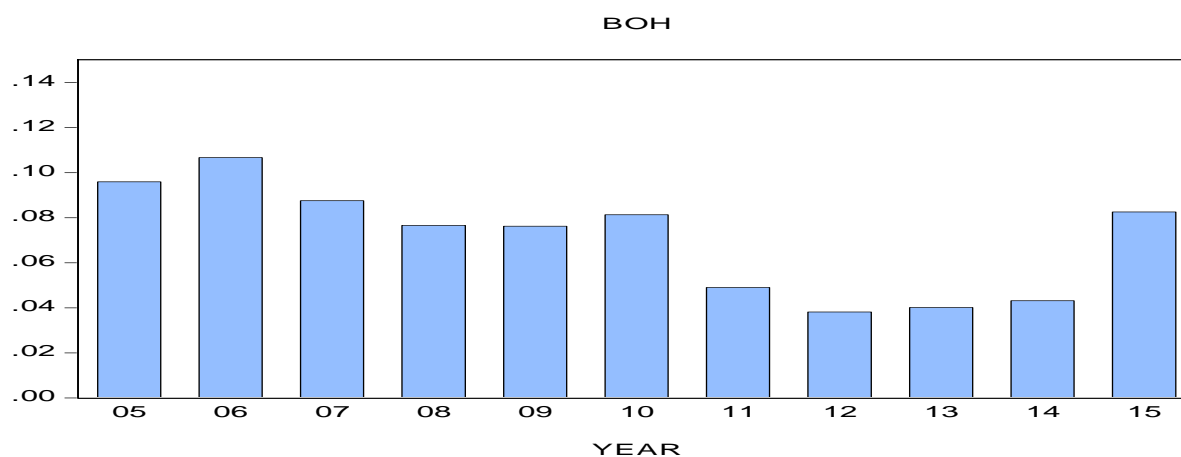
It could also be seen that the mean value of board members educational qualifications, as measured by proportions of directors holding college degree or higher, is about 99.1% which implies that directors of the sample private commercial banks possess the necessary educational qualifications. The proportions of board members educational qualifications shows 2.32% standard deviation which is more or less low as evidenced by a maximum and minimum values of 100 and 90.9%.

When we see the availability of variety board sub-committee, on average the sample private commercial banks have board sub-committee (BSC) about 3 (mean = 3.244186). A maximum of 4 shows that there are private commercial banks with 4 board sub-committee and a minimum of 3 shows that there are private commercial banks with 3 board sub-committee. In case of Ethiopian private commercial banks, even if the practice of having variety size of board sub-committee on the board is improving the effective monitoring and control of the private commercial banks activity. Table 4.5 show that the practice of having 4 number of board sub-committee is improving from time to time which shows improvement in corporate governance practice of private commercial banks. This should be strengthening by those banks. The standard deviation indicates that for the sample private commercial banks board committee size varies by 0.432123 from the average value of 3.244186. Since increasing variety number of board increases the monitoring as well as controlling ability of board. It also enhances the quality of corporate governance.

Moreover, as it can be seen in the table above that the mean value of meeting frequency of board, as measured by the number of board meeting conducted by board of directors (BODs) for the past 11 years has (a mean value of 31.01163)31 minutes per year, with a maximum of 52 minutes held per annum and a minimum of 24 minutes held per annum. The standard deviation is 12.03963 from the mean of 31.01163.

It is confirmed in the table above that the average mean value of board ownership for the sample private commercial banks is about 0.069963 as measured by the percentage of shareholding by board members with a maximum of 0.331180 and a minimum of 0.005900board ownership. The standard deviation indicates that for the sample private commercial banks board ownership varies by 5.6% from the average value of 0.069963. If we see the trend from the figure 4.2, there is no consistency as to the board ownership of sample private commercial banks i.e., one year increases and then the next year decreases. So we cannot infer that whether governance practice in this aspect is improving or not.

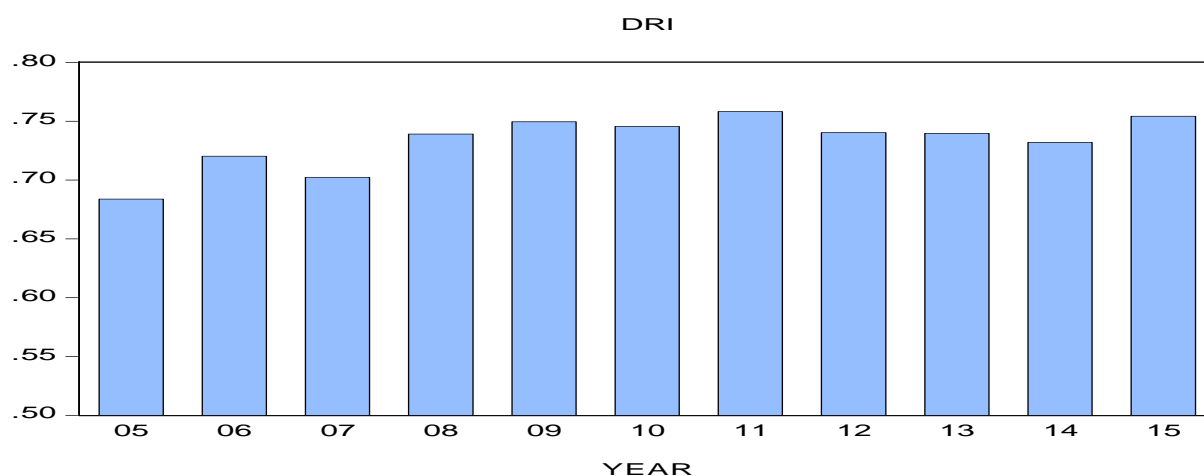
Figure 4.2: Past Trend of board ownership



Source: Eviews 8 test result summary

On average, during the given period, sample private commercial banks of Ethiopia finances 73% (mean = 0.733991) of their asset through deposits as measured by total deposit to asset ratio, a maximum of 0.983800 and a minimum of 0.116279. The standard deviation indicates that for the sample private commercial banks deposits varies by 0.098680 from the average value of 0.733991. The trend in figure 4.3 shows that the deposit mobilization of the private commercial banks was continuously increasing except in year 2007/12/13 and 2014. It is known that increasing the deposit raising capacity is a signal to improved corporate governance. Financing most of private commercial bank asset using deposits gave depositors a chance to govern the behavior of private commercial bank managers by withdrawing their deposits from riskier private commercial bank and depositing their money in less risky private commercial banks. In addition, using more deposit to finance their assets by private commercial banks may create riskier environment to the depositor since if the private commercial banks face sudden crashes, the chance of losing their money will be high. Therefore, in case the private commercial banks face unexpected disaster, the disaster level to be faced by depositor will be minimized, since there are different regulations set by the central bank.

Figure 4.3: Past Trend of depositor influence (total deposit to total asset ratio)



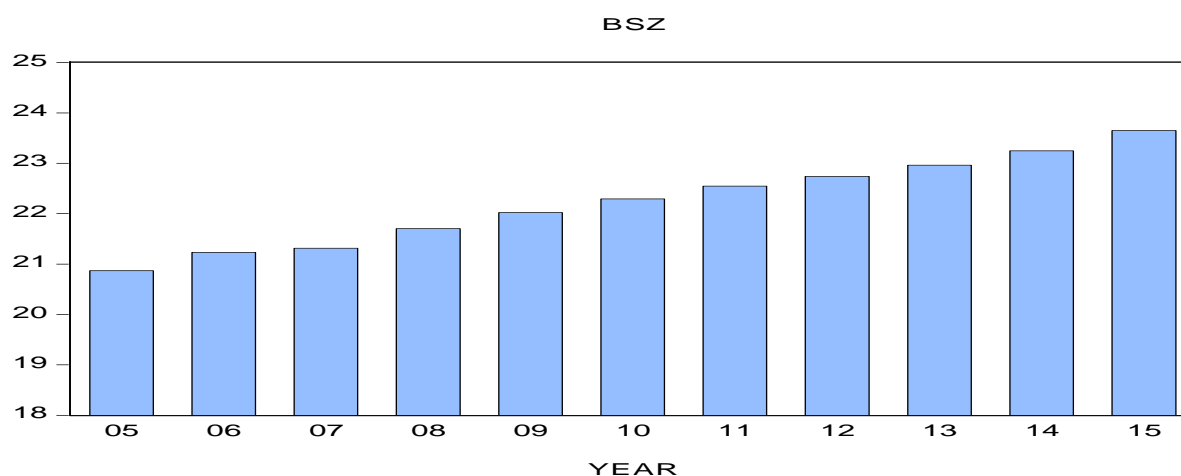
Source: Eviews 8 test result summary

The average reserve ratio maintained by sample private commercial banks was by far more than reserve ratio required by the regulation. As to reserve ratio, during the sample period, on average, Ethiopian private commercial banks kept their 19.45% asset as a reserve in National Bank of Ethiopia. The standard deviation is 10.8% from the mean of 0.194558.

On average, Ethiopian private commercial banks invest 44.9% of their money on liquid asset which is by far higher than the legal requirement of 20%. Of the total 44.9% liquidity ratio around 19% is kept at NBE as deposit reserve, payment and settlement account. The remaining amount (around 25.9%) is invested on other liquid assets.

When we see the control variable, the mean value of private commercial bank size as measured by the natural logarithm of total asset is 22.3 with having a maximum value of 24.8 and minimum values of 18.7. The trend in Figure 4.4 also shows that the private commercial bank size has increased slightly from year to year. The standard deviation of private commercial bank size among the sample private commercial bank is 1.13.

Figure 4.4: Past Trend of private commercial bank size



Source: Eviews 8 test result summary

4.2.2. Correlation Analysis of ROA and Corporate Governance Mechanisms

The table 4.6 below was run by taking ROA as a dependent variable and other governance and control variables as an independent variable. The correlation coefficient shows the extent and direction of the linear relationship between considered corporate governance variables and financial performance proxy by ROA of the sample private commercial banks in Ethiopia during study period. The correlation matrix which shows the relationship of the ROA with board gender diversity, directors educational qualification, number of board sub-committee, meeting frequency of board, board ownership, regulations of legal reserve and liquidity, depositor influence and the private commercial bank size. And the probability is shown in parenthesis with the correlation coefficient in the correlation matrix below in table 4.6.

As might be seen from table 4.5 below, the correlation matrix independent variables; such as meeting frequency of board and depositor influence are positively and significantly correlated at 5% and 1% significance level with ROA respectively. However, board gender diversity (at 10% significance level), number of board sub-committee and liquidity ratio (at 5% significance level) and legal reserve ratio (at 1% significance level) are negatively correlated with ROA. Even though directors educational qualification and board ownership are insignificantly correlated directors' educational qualification shows a positive coefficient and board ownership shows a negative coefficient. Whereas, control variable (private commercial bank size) measured by natural logarithm of total asset of the private commercial banks has a positive and significant correlation at 5% with ROA in this study.

Table 4.6: Correlation Matrix of Dependent and Independent Variables

Correlation Probability	ROA	BGD	EQD	BSC	MFB	BOH	DRI	LRS	LIQ	BSZ
ROA	1 -----									
BGD	-0.19874 0.06660	1 -----								
EQD	0.06402 0.55810	-0.04147 0.70460	1 -----							
BSC	-0.22261 0.03940	0.47389 0.00000	0.05797 0.59600	1 -----						
MFB	0.23668 0.02820	-0.21880 0.04300	0.04022 0.71310	0.34995 0.00100	1 -----					
BOH	-0.08330 0.44580	0.03434 0.75360	-0.07442 0.49590	0.32213 0.00250	0.19838 0.06710	1 -----				
DRI	0.56453 0.00000	-0.14681 0.17740	-0.11537 0.29020	-0.22383 0.03830	-0.00938 0.93170	-0.11724 0.28240	1 -----			
LRS	-0.48572 0.00000	0.20171 0.06250	0.10089 0.35540	0.10658 0.32870	-0.18986 0.08000	-0.02863 0.79360	-0.44103 0.00000	1 -----		
LIQ	-0.22612 0.03630	0.03674 0.73700	0.14368 0.18690	0.00588 0.95710	0.10247 0.34780	-0.09608 0.37890	-0.42273 0.00010	0.58870 0.00000	1 -----	
BSZ	0.69897 0.00000	-0.10949 0.31560	0.10561 0.33320	-0.09339 0.39240	0.23676 0.02820	-0.22790 0.03480	0.49229 0.00000	-0.15937 0.14270	0.05284 0.62900	1 -----

Source: Eviews 8 test result summary

In addition, the correlation coefficient of -0.22612 of liquidity variable shows that as private commercial banks hold more money in most liquid assets, their return on asset diminishes significantly. From the correlation coefficient of -0.19874 board genders diversity variable we can conclude that there was negative relationship between number of board sub-committee and private commercial bank profitability of return on asset. In addition from the correlation coefficient of -0.22261 variety number of board sub-committee variable we can conclude that there was negative relationship between number of board sub-committee and private commercial

bank profitability of return on asset. From the correlation coefficient of -0.48572 reserves variable we can conclude that there was negative relationship between reserve ratio and private commercial bank profitability of return on asset. This means as the private commercial bank put more money in reserve fund, the profitability of private commercial bank will move in opposite direction. In contrast meeting frequency of board in private commercial banks was directly correlated with ROA. In addition private commercial bank size was directly correlated with ROA. And total deposit to asset ratio of private commercial banks was directly correlated with ROA. This means as the total debt to total asset of private commercial banks increases, the return generated from total asset changes in the same direction.

In general, the correlation analysis shows that the degree and directions of association of some corporate governance mechanisms and financial performance differ depending on the financial performance measure used. The correlation analysis shows only the direction and degree of association between variables and it does not permit the researcher to make causal inferences regarding the relationship between the identified variables.

4.3. Regression Results Analysis and Discussion

This section of the chapter discusses some of the main implications of the results. The analysis is based on the results of the regression between the dependent variable and the independent variables and the questionnaire. The results obtained under these different methods are jointly analyzed and discussed. As it is summarized in the table 4.7 below, the R square for the model is 72.4% while adjusted R square is 66%. Which means that 72.4% of the variation in ROA was

explained by the independent and control variables used in this study. The remaining 27.6% of changes was explained by other factors which are not included in the model. The adjusted R square measures how well the model fits the data by taking into account the loss of degrees of freedom associated with adding extra variables. Therefore, the model best fits the data. The F-statistic of 11.3 is also significant with p-value of zero indicating that the null hypothesis, that all the coefficients are jointly zero is rejected and the models do not suffer from specification bias. In other word, the null hypothesis of the model was rejected. So, the variation in the dependent variable is well explained by the regresses in the model. The following table 4.6 below shows the regression result for the model.

Table 4.7: Regression Result for the Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.3553	0.0994	-3.5742	0.0006
BGD	-0.0104	0.0307	-0.3379	0.7364
EQD	0.0460	0.0503	0.9141	0.3638
BSC	0.0117	0.0107	1.0962	0.2768
MFB	0.0034	0.0026	1.2909	0.2010
BOH	0.0043	0.0252	0.1691	0.8662
DRI	0.0291	0.0165	1.7697	0.0812
LRS	-0.0367	0.0143	-2.5665	0.0124**
LIQ	-0.0192	0.0130	-1.4796	0.1435
BSZ	0.0085	0.0015	5.8115	0.0000***
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.72383	Mean dependent var	0.026859	
Adjusted R-squared	0.659791	S.D. dependent var	0.016115	
S.E. of regression	0.009399	Akaike info criterion	-6.32124	
Sum squared resid	0.006096	Schwarz criterion	-5.83608	
Log likelihood	288.8134	Hannan-Quinn criter.	-6.12599	
F-statistic	11.3029	Durbin-Watson stat	2.286216	
Prob(F-statistic)	0.000000			

Source: Eviews 8 Output

Note: ***, **, * significant at 1% and 5% level of significance respectively.

As per the results shown in the above table 4.7, the significance level that is *** and ** for 1%, and 5% level respectively. The correlation coefficients are checked for the presence of high collinearity among regressors. Accordingly the corporate governance variables like, legal reserve ratio and private commercial bank size had statistically significant at 5% and 1% effect on financial performance of private commercial banks respectively. While, the effect of other governance variables like board gender diversity, directors' educational qualification, availability of variety number of board sub-committee, meeting frequency of board, board ownership, and liquidity, on ROA are insignificant.

In addition, the coefficient (-0.0367) of legal reserve was negative. This implies that the increase of the aforementioned variable will lead to decrease in financial performance of the private commercial banks. In contrast, governance variable namely depositor influence and the control variable namely the private commercial bank size had a positive relationship with the private commercial bank financial performance, ROA, as indicated by their coefficient of (0.0291) and (0.0085) respectively. This shows that an increase on the aforementioned two variables will affect the private commercial bank financial performance positively as depositor influence and private commercial bank size increases, the financial performance of private commercial bank increases too.

In this study, to check the relationship between the 9 variables of corporate governance which are the board gender diversity, directors educational qualification, number of board sub-committee, meeting frequency of board, board ownership, depositor influence or total deposit to asset ratio, legal reserve ratio, liquidity ratio, private commercial bank size and the proxy of

private commercial bank financial performance i.e. after tax return on asset 8 hypotheses were developed. The regression results of each governance variables' effect on financial performance of private commercial banks are analyzed based on the theoretical framework and previous empirical results as follows.

4.3.1. Board Gender Diversity

Hypothesis Ha1 predicts that the number of women directors on the board is positively associated with financial performance. But the relationship between board gender diversity (BGD) and Return on Asset has a negative coefficient (-0.0104) which is insignificant (p-value of $0.7364 > 0.05$). The negative and insignificant coefficient of the percentage of women directors does not support this hypothesis. Meaning that the null hypothesis which states the composition of board in terms of gender does not have a significant effect on private commercial banks financial performance is accepted. Therefore, this study does not support the view that gender diversity composition leads to superior private commercial banks financial performance. So the result is consistent with (Belete Zegeye (2015), Ferede, 2012), (Rose, 2007) and (Habbash, 2010) that all found insignificant relationship between board gender diversity and firm performance. This may be due to the fact that there are small proportion of board members who are women compared to proportion of board members who are men as shown in the descriptive analysis section, which does not permit them to be powerful enough to make a difference to monitoring. Nevertheless, the low number of women on the boards of sample Ethiopian private commercial banks does not have effect on the financial performance.

In the qualitative question majority of respondents said 'yes' and justified as board gender diversity is important since almost half of the country's population is female, they can represent this significant potential customers and help private commercial banks to have links with this potential customers. But, simply the presence of female directors will not improve private commercial banks operation and performance unless they are experienced and knowledgeable. Whether gender diversity help improve private commercial banks operation and performance it depends on factors such as experience, education and assertiveness of female directors.

4.3.2. Educational Qualification of Directors

Hypothesis Ha2 predicts that there is a significant positive relation between board competencies and private commercial banks financial performance. Board members educational qualification (EQD) explains the variations of the financial performance of private commercial banks with a positive coefficient of (0.0460) and statistically insignificant (p -value of $0.3638 > 0.05$) for return on asset. Thus, there is an insignificant positive relationship between board members educational qualification and financial performance of private commercial banks in Ethiopia. The positive and insignificant coefficient of the proportions of directors who had college degree or higher sitting on the board does not support this hypothesis. Meaning that the null hypothesis which states the proportions of directors who had college degree or above sitting on the board does not have a significant effect on sample private commercial banks financial performance is accepted.

So the result is inconsistent with the finding revealed by (Amran, 2011), Yasser (2011), and (BeleteZegeye2015). Moreover, the result is not in line with the finding revealed by (Ferede, 2012) in Ethiopian Commercial banks. They argues that directors with higher education are better in managing the business operation and controlling agency problem than less educated counterparts this reduce agency cost. This result does not necessarily contradict the notion that directors' educational competency sitting on the board may be useful and positive in general. The qualification of directors as measured by the percentage of directors who had college degree or higher positive insignificantly influences private commercial banks financial performance.

Respondents were asked to reflect their view as to whether they feel that competency of directors have any significant effect on their monitoring and controlling efficiency. All of the respondents (100 %) said "yes". The best justification given is that directors need to have a minimum of college degree in order to read and interpret the financial statements given by the private commercial banks management, give right direction properly, and able to give strategic leadership. Boards of directors make decision after analyzing and carefully understanding the technical documents submitted by management as a report. In addition, they stated that education plays a key role not only in the finance sector but also in any other sector of the economy. But only qualification by itself may not contribute a lot. So it should be supported with practical experience. Thus, educational qualifications of directors play a great role in board decision making. Even if the regression result shows insignificance, it has positive relation and the qualitative analysis also indicates that educational qualification of directors is important factor to improve financial performance of private commercial banks in Ethiopia. Thus, there is a positive relation between board competencies and private commercial banks financial performance.

4.3.3. Availability of Variety Number of Board Sub-committees

Hypothesis Ha3 predicts that there is a significant positive association between variety number of internal board sub-committees and private commercial banks financial performance. As shown above, table 4.7, this study found a positive (coefficient = 0.0117) and statistically insignificant (p-value of $0.2768 > 0.05$) association between availability of variety number of internal board sub-committees (BSC) and return on asset. It implies that the numbers of board sub-committees' have insignificant but positive effect on the financial performance of sample Ethiopian private commercial banks. In other words, the higher or the lower the number of variety board sub-committees' of private commercial banks, does not have effect on financial performance achievement. The effect of availability of variety internal board sub-committees on the financial performance of Ethiopian private commercial banks is negligible. Thus, the null hypothesis which states the number of board sub-committee which is available on the board does not have a significant effect on private commercial banks financial performance is accepted. The result is inconsistent with prior studies which argue that the positive and significant relationship was observed by (Hlanganipai Ngirande 2014) and (Godfrey Ndlovu 2014), (RajendranKajananthan2012), and (Bussoli 2013), between variety number of board committees and the private commercial banks financial performance.

Subjective question was also asked to qualitatively check as to whether respondents believe the availability of variety number of board sub-committee affects private commercial banks financial performance. 65% of the respondents said "yes" but the rest of the respondents said "no" and

they also have justified that too large or too small number of board sub-committee is not appropriate to run the responsibility of the board sub-committee. So that the private commercial banks need to have reasonable numbers of sub-committees in order to perform the board task effectively. National bank of Ethiopia set the maximum number of sub-committees to be 3. The outcome of the analysis of both quantitative and qualitative data indicates that even if the regression result show insignificance, it has positive relation and the qualitative analysis also indicates that having reasonable number of board sub-committee is important factor to improve financial performance of private commercial banks in Ethiopia. Thus, there is a positive relation between reasonable number of board sub-committee and private commercial banks financial performance.

4.3.4. Meeting Frequency of Board

Hypothesis Ha4 predicts that there is a significant negative relationship between meeting frequency of board and private commercial banks financial performance. Return on Asset (ROA) with Meeting Frequency of Board (MFB), coefficient is 0.0034, test of p-value is $0.2010 > 0.05$. This result depicts that, meeting frequency has an insignificant and positive effect on ROA and the effect of meeting frequency of board on the financial performance of Ethiopian private commercial banks is negligible. Therefore, the null hypothesis which states the meeting frequency of board does not have a significant and negative effect on private commercial banks financial performance is accepted.

The result is consistent with previous studies and the theoretical view that (Vefeeas 1999, p.114 & 118), and (Lipton and Lorsch 1992, p.64). On the other hand there is inconsistency with previous studies Kyereboah Coleman (2007) and Yasser (2011) since the dependent variable used by those researchers had been a market based performance. But in this study the researcher used accounting based performance. In addition some theoretical views results were inconsistent with this study. The frequency of board meetings is a measure of board activities and effectiveness of its monitoring ability. Frequent board meetings can result in higher qualities of management monitoring that in turn effect positively on corporate financial performance.

Respondents asked about the effect of board meeting frequency on the financial performance of Ethiopian private commercial banks that half (50%) of the respondents said high meeting frequency generate high financial performance while 40% of the respondent said the reverse. 10% of the respondents said that it depends on the agenda and quality of the meeting not the frequency. The best justification given by respondent was board that at least meet monthly can better follow up the overall performance, challenges of the private commercial banks and monitor their decision implementations. Therefore, by having a good agenda board who meet most frequently will generate higher financial performance.

4.3.5. Board Ownership

Hypothesis Ha5 predicts that there is a significant positive association between the board ownership and private commercial banks financial performance. The result showed that the positive correlation at 0.0043 is observed between the percentage of directors' ownership in the

private commercial banks and return on asset which is the proxy for financial performance. The regression result further disclosed that a positive but insignificant relationship with a p-value of 0.8662 occurs between the dependent and the independent variables. The effect of percentage of directors' ownership on the financial performance of Ethiopian private commercial banks is negligible. Based on these findings, we therefore accept the null hypothesis and reject the alternative hypothesis. This result may be attributed to the reason that, on average, the ownership percentage of board members in Ethiopian private commercial banks is very small but this may increase their incentive to control the opportunistic behavior of private commercial banks managers.

For the subjective question majority of the respondents (90%) said "yes" and the rest 10% said "no". Therefore, the proposed hypothesis is supported.

4.3.6. Deposit to Total Asset Ratio

Hypothesis Ha6 predicts that there is positive and insignificant relationship between deposit to asset ratio and private commercial banks financial performance. It is well known that the depositors can monitor or control the risk taking behavior of managements through manipulating their deposits. As predicted the coefficient sign of deposit ratio is positive and it is insignificant. Both the t- value of 1.77 and p- value of 0.0812 show that deposit to total asset ratio can affect the profitability of private commercial banks significantly. Deposit is the main source of debt financing of private commercial banks and according to risk-return trade of theory, as corporation finances their asset from more of debt source their income will be magnified. So, this

study is consistent with risk-return trade of theory. From the regression result the researcher can say that in Ethiopian private commercial banks, the distress cost incurred by using more debt is outshined by the benefit generated through using more debts. Even though using more of deposit by private commercial banks create more risk by side depositors, by withdrawing their deposit from private commercial banks which are relatively more risky, depositors can drain the profitability of private commercial bank and this will put restriction on private commercial bank manager show to use their fund. From this we can conclude that depositors cannot influence the financial performance of Ethiopian private commercial banks by manipulating their deposit to loan ratio through market mechanism. This result is inconsistent with the finding of Kibryisfaw Getahun (2012) and this supports the above hypothesis.

Respondents asked about the effect of deposit to asset ratio on the financial performance of Ethiopian private commercial banks that almost all of the respondents said high deposit to asset ratio generate high financial performance and the depositors can control their money by depositing their money in less risky private commercial banks and withdrawing their money from high risky private commercial banks.

4.3.7. Legal Reserve

Hypothesis Ha7 predicts that there is significant and negative relationship between private commercial banks financial performance and legal reserve. Therefore the result is as expected, that is the effect of reserve ratio on private commercial bank financial performance is negative

and significant. The coefficient parameter of -0.0367 shows that as one percent of their asset is kept in NBE as a reserve balance, the private commercial bank tends to loss 3.7% from its ROA.

The empirical result is consistent with expectation in this research. The negative relationship exhibited may be due to high reserve balance reduces the cash for lending and this reduction in money supply affects the ability of private commercial banks to create new money through giving loans to their customers. The private commercial banks pay interest in raising these funds but they do not earn any income from these fund. So the result supports the expectation and for this reason the study failed to reject the hypothesis saying there is significant negative relationship between private commercial bank profitability and legal reserve. This result is consistent with the finding of Kibryisfaw Getahun (2012).

In the qualitative question 75% of respondents said 'yes' and justified as private commercial banks asset that kept in NBE as a reserve balance increased, the private commercial bank tends to loss. The rest of the respondent said “no”.

4.3.8. Liquidity

Hypothesis Ha8 predicts that there is significant and negative relationship between liquidity and private commercial banks financial performance. A private commercial bank liquidity which is measured in terms of liquid asset to total asset does not have any significant effect on Ethiopian sampled private commercial bank profitability. Even though the sign of the coefficient parameter is negative, a p- value of 0.1435 shows that liquidity is not a determinant of profitability of

Ethiopian private commercial banks. Since holding liquid assets imposes an opportunity cost on the private commercial bank given their low return relative to other assets; it has a negative effect on profitability. Nevertheless the empirical result of this study does not support. This may be due that the opportunity cost of holding liquid asset is compensated by the marginal benefit of holding them. Thus the hypothesis that states there is a negative significant relationship between liquidity and profitability is rejected. This result is supported by the finding of Kibryisfaw Getahun (2012).

Respondents asked about the effect of holding liquid asset on the financial performance of Ethiopian private commercial banks that half of the respondents said holding high liquid asset has positive effect on financial performance while the rest said the reverse.

4.3.9. Control variables (Private Commercial Bank Size):

In addition to what has been discussed above, table 4.6 depicts the result of the regression analysis between the control variable (bank size) and financial performance indicator (return on asset) of sample Ethiopian private commercial banks, which is interpreted below.

Bank size (BSZ) has a positive effect on the private commercial bank financial performance, return on asset (ROA), implying large private commercial banks enjoy better profits than smaller private commercial banks. This benefit is likely to be due to economies of scale and larger market share possessed by the larger private commercial banks and this is consistent with the findings of Yasser (2011).

In conclusion, results indicate that the direction and the extent of effect of some corporate governance mechanisms are dependent on the financial performance measure being examined. All corporate governance variables do not influence the financial performance indicator in the same direction and their degrees of association may also differ. Here in this study the researcher used return on asset that indicates the overall efficiency of management and reflects whether the private commercial bank uses assets effectively in order to produce its income.

Table 4.8: Summary of the Hypothesis Result

Hypothesis	Relationship	Result	Actual Relationship
Ha1	Board gender diversity and ROA	Insignificant	Negative
Ha2	Educational Qualifications of Directors and ROA	Insignificant	Positive
Ha3	Availability of Board Sub-committees and ROA	Insignificant	Positive
Ha4	Meeting Frequency of Board and ROA	Insignificant	Positive
Ha5	Board Ownership and ROA	Insignificant	Positive
Ha6	Deposit ratio and ROA	Insignificant	Positive
Ha7	Legal reserve ratio and ROA	Significant at 5%	Negative
Ha8	Liquidity ratio and ROA	Insignificant	Negative

Source: Computed from Eviews 8.

CHAPTER FIVE

Conclusion and Recommendation

5.1. Summary of Finding

The result shows that board gender diversity as a proxy of corporate governance has negative but insignificant relationship with the private commercial bank financial performance. Similarly liquidity ratio and ROA has negative but insignificant effect on ROA. Educational qualifications of directors, variety number of board sub-committees, meeting frequency of board, and board ownership have positive but insignificant relationship with the profitability of the private commercial bank. The legal reserve ratio has negative and significant effect on ROA. Similarly, depositor influence has positive and significant effect on ROA, while the size of the private commercial bank is an important factor with a positive contribution to its profitability.

5.2. Conclusion

The intention of this study was to empirically examine the effect of corporate governance mechanisms on financial performance of Ethiopian private commercial banks. In order to achieve this objective 8 research hypothesis have been developed. To get information about the selected variables the researcher applied mixed research approach. Specifically, reviewing the private commercial bank documents and structured questionnaire.

In doing so, all private commercial banks operating for the past 11 years (2005-2015) and except 9 years data of lion international bank were included in the sample for review of documents resulting in 86 observations. Fixed cross - section (panel) effect model was used to estimate the regression equation. The researcher used the following independent variables: board gender diversity, directors educational qualification, number of board sub-committee, meeting frequency of board, board ownership (which were used as a proxy for board characteristics), and there were two proxy of regulations i.e. legal reserve and liquidity ratio, and depositors influence was measured in terms of total deposit to asset ratio. The dependent variable, financial performance, is measured in terms of ROA. Regarding the structured questionnaire, the study has been conducted by collecting questionnaire from 2 board secretary and 6 delegated staffs of selected private commercial banks.

The result shows that board gender diversity as a proxy of corporate governance has negative but insignificant relationship with the private commercial bank financial performance. Similarly liquidity ratio and ROA has negative but insignificant effect on ROA. On the other hand, educational qualifications of directors, variety number of board sub-committees, meeting frequency of board, depositor influence, and board ownership have positive but insignificant relationship with the profitability of the private commercial bank. These findings were implying that according to this result there was no statistically significant relation found between percentage of female directors and financial performance. However, this is due to very small numbers of female directors which does not permit them to be powerful enough to make a difference to monitoring; the more or the less the number and variety of sub-committees in the board, there was no effect on profitability of private commercial bank. So that reasonable

number of board sub-committee is important factor to improve financial performance of private commercial banks in Ethiopia. Even if the effect of meeting frequently of board on ROA is negligible, by having a good agenda board who meet most frequently will generate higher financial performance; even if the sign is in line with agency theory but the effect of board ownership variable on ROA is negligible.

The legal reserve ratio has negative and significant effect on ROA. This negative effect of reserve may attribute to that reserve amounts at NBE has no interest income and it limits the fund available to loan and this may drain the profitability of banks. Similarly, the size of the private commercial bank is an important factor with a positive contribution to its profitability.

5.3. Recommendations

This study examined the effect of corporate governance mechanisms on private commercial banks' financial performance by taking evidence from selected private commercial banks in Ethiopia. On the basis of the findings and conclusions reached, the following recommendations were forwarded.

- Attention should be given for legal reserve ratio of private commercial banks. The legal reserve requirement is crating control on the activity of private commercial banks. Meaning the regulation is crating money with zero earning power and this affects the financial performance of the banks negatively. Consequently by reducing the ratio of this reserve requirement and by developing different mechanism to protect the depositor like

by establishing deposit insurance, National Bank of Ethiopia need rules on money holdings by the private commercial banks.

- Private commercial banks should increase their branches as well as their size in order to improve profitability due to economies of scale.

In general, mandatory compliance with code of corporate governance and related directives should be adhered. Also the legal framework that specifies the rights and obligations of an Ethiopian private commercial bank, its directors, and shareholders, specifies disclosure requirements and provide for effective enforcement of the law should be practiced very well and should be ensured. The government, financial institutions and the business community in general should work towards the establishment of a formal capital market institutions especially stock exchange which enhances corporate governance and competition among businesses and helps to rate each of the private commercial banks in the country. In the future research should focus on assessing corporate governance mechanisms and firm financial performance from the perspective of different stakeholders such as employees, management and depositors of private commercial banks.

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APPENDICES***Annex I: List of Sample Ethiopian Private Commercial Banks***

S/No.	Name of Sample Bank	Number of Observations
<i>1</i>	Awash International Bank	<i>11</i>
<i>2</i>	Dashen Bank	<i>11</i>
<i>3</i>	Wegagen Bank	<i>11</i>
<i>4</i>	Bank of Abyssinia	<i>11</i>
<i>5</i>	United Bank	<i>11</i>
<i>6</i>	Nib International Bank	<i>11</i>
<i>7</i>	Cooperative Bank of Oromia	<i>11</i>
<i>8</i>	Lion International Bank	<i>9</i>

Source :< www.nbe.gov.et>

Part II: General Questions

1. Does the presence of female board of directors (in terms of board diversity) helps improve the banks operation and performances?

Yes / No

Why? -----
-----.

2. Does the educational qualification of directors have any significant effect on their monitoring and controlling efficiency?

Yes / No

Please give your reasons-----
-----.

3. Do you believe that number of internal board sub-committees affects banks financial performance?

Yes / No

How? Please justify it-----
-----.

4. Do you believe that increasing the frequency of the board meeting has impact on bank financial performance?

Yes / No

How? -----
-----.

5. Does high liquidity asset has effect on private bank financial performance?

Yes / No

How? -----
-----.

6. Does increasing the percentage of holding by board members has significant effect on their monitoring and controlling efficiency?

Yes / No

Please give your reasons-----

-----.

7. Do you believe that depositors can influence the private banks financial performance?

Yes / No

How? Please justify it-----

-----.

8. Do you believe that high legal reserve deposit has effect on bank financial performance?

Yes / No

How? -----

-----.

Part III: Please fill the number for each period for questions listed below.

S/N	Questions	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
1	Does gender diversity exist in board? If yes, how many female directors exist in the board?											
2	Number of board members who had college degree or higher?											
3	Numbers of sub-committees exist under the board of the bank?											
4	The actual total number of board meetings held per year?											

Thank You Once Again!!!

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