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EFFECT OF CORPORATE GOVERNANCE ON FINANCIALPERFOMANCE OF INSURANCE COMPANIES IN ETHIOPIA

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

By: Tolera Temesgen

Advisor: Dr. Ethiopia Legesse

**Addis Ababa University
College of Business and Economics
Addis Ababa
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Declaration

I, Tolera Temesgen, hereby declare that the thesis entitled ***Effect of corporate Governance on Financial performance of Insurance Companies in Ethiopia*** is my own original work and has not been submitted for any degree in any other University. It is offered for the award of the degree of Executive Master of Business Administration from Addis Ababa University.

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Advisor Name: **Dr. Ethiopia Legesse**

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Signature: _____

STATEMENT OF CERTIFICATION

This is to certify that Tolera Temesgen has carried out his research project work on the topic entitled “Effect of corporate governance on financial performance of insurance company in Ethiopia”. This work is original in nature and it is sufficient for submission for the partial fulfillment for the award of Executive Masters of Business Administration.

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Advisor: Dr. Ethiopia Legesse Signature _____ Date _____

Chair of Department or Graduate Program Coordinator

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List of Figures

Fig 2. 1: Conceptual framework of the study	21
Fig 4. 1: Histogram	28
Fig 4. 2: P-P plot of Standardized Residuals	29
Fig 4. 3: Scatter plot of standardized residuals	31

List of Tables

Table 4. 1: Descriptive statistics	25
Table 4. 2: Coefficient range	26
Table 4. 3: Correlation	26
Table 4. 4: Collinearity Test.....	30
Table 4. 5: ANOVA model fit	32
Table 4. 6: Model summary.....	33
Table 4. 7: Beta Coefficient.....	34
Table 4. 8: Hypotheses test summary	35

ACRONYMS AND ABBREVIATIONS

NBE – National Bank of Ethiopia

BOD – Board of Directors

GDP – Gross Domestic product

CEO – Chief Executive Officer

ROA – Return on Assets

OECD– Organization for Economic Cooperation and Development

ABSTRACT

*This study examines the relationship between **corporate governance and financial performance of insurance companies in Ethiopia**. Good corporate governance enhances ethical behavior of those that wield corporate power. Specifically, this study examined Board diversity, Board meetings, Board committee, Board size, and Board independence and their relationship with financial performance, as measured by return on assets, of insurance companies in Ethiopia. The study comprised of 13 insurance companies out of 17 licensed companies by Regulatory Authority, NBE during the period 2015 to 2018. The four insurance companies left over were stagnant in their growth and considered less important to influence the study. The study employed multiple linear regression analysis. The data is collected from secondary sources as it is obtained from the firm's financial reports and NBE. The data is cleaned for completeness, coded and analyzed by the use of Statistical Package for Social Sciences (SPSS) for analysis.*

Overall multiple linear regression models were tested using ANOVA and the result obtained from the model is significant at 95% significance level. To increase overall performance of the insurance industry in Ethiopia, the study recommends that stakeholders of the industry should take into account the board size, frequency of board meeting, board committees and board independency when forming board of directors as they are significant determinants of financial performance. Further recommendations and future studies are forwarded.

Key Words: Corporate Governance, Board of Directors, Insurance Companies, Firm Performance, Ethiopia

Table of Contents

ACKNOWLEDGEMENT	v
List of Figures	vi
List of Tables	vii
ACRONYMS AND ABBREVIATIONS	vii
ABSTRACT	viii
CHAPTER ONE	1
1.1. Background of the Research	1
1.1.1. Introduction	1
1.1.2. Corporate Governance.....	1
1.1.3. Financial performance of Insurance Company	2
1.1.4. Corporate Governance and Financial Performance of Insurance Companies.....	2
1.1.5. Corporate Governance in Insurance Industry in Ethiopia.....	3
1.1.5.1. Board of Directors Size and Composition	4
1.1.5.2. Role and Responsibility of Board of Directors	4
1.2. Statement of the Problem	5
1.3. Research Questions	6
1.4. Objectives of the study	7
1.4.1. General Objective	7
1.4.2. Specific Objective	7
1.5. Research Hypotheses.....	8
1.6. Significance of the Study.....	8
1.7. Delimitation/Scope of the Study.....	8

1.8. Organization of the Thesis Report	9
CHAPTER TWO.....	10
2. LITRATURE REVIEW.....	10
2.1. Introduction	10
2.2. Corporate Governance.....	10
2.2.1. Agency Theory.....	11
2.2.2. The Stewardship Theory	12
2.2.3. The Stakeholder Theory	13
2.2.4. Resource Dependency Theory	13
2.3. Corporate Governance Practice in Ethiopian Insurance.....	14
2.4. Empirical Review.....	14
CHAPTER THREE	22
3. Research Design and Methodology	22
3.1. Research Design.....	22
3.2. Population.....	22
3.3. Data Collection.....	22
3.4. Data Validity.....	23
3.5. Method of Data Analysis.....	23
CHAPTER FOUR.....	25
4. DATA ANALYSIS, FINDINGS AND DISCUSSION	25
4.1. Introduction	25
4.2. Descriptive Statistics	25
4.3. Correlation analysis.....	26
4.4. Multiple Linear Regression Analysis and Hypothesis Test.....	27
4.4.1. Normality Distribution Test	27
4.4.2. Linearity Test.....	28
4.4.3. Multicollinearity Test	29
4.4.4. Homoscedasticity	30
4.4.5. Auto-correlation /Durbin-Watson Test/	31
4.4. ANOVA Model Fit.....	32
4.5. Model Summary.....	33
4.6. Beta Coefficient.....	34

4.7. Hypothesis Test Result	35
CHAPTER FIVE.....	37
5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS.....	37
5.1. Introduction	37
5.2. Summary of Findings.....	37
5.3. Conclusion.....	37
5.4. Recommendations	40
5.5. Limitations of the Study	40
5.6. Suggestion for Further Research.....	41
REFERENCES	42
APPENDIX 1:.....	46

CHAPTER ONE

1.1. Background of the Research

1.1.1. Introduction

The modern business environment poses a number of challenges that require sound decision making and appropriate corporate governance practices. According to Edwards & Clough (2005) recent failures in corporate governance have led to the proliferation of corporate governance codes which emphasize, in particular, accountability and conformance measures in organizations. The essence of these codes is to determine what entails good corporate governance in an organization. For any organization to succeed in achieving good performance, it must be able to embrace conventional good corporate governance attributes as stipulated in codes such as the Cadbury code in the United Kingdom (UK) (Edwards & Clough, 2005).

This chapter entails the overview of the topic under study corporate governance, financial performance and their relationship in it, it also contains the statement of the problem, research objective and at the same time, it looks at the value of the study in general.

1.1.2. Corporate Governance

Corporate governance refers to generally accepted norms, customs, laws, habits and regulations determining the manner of running the company (Mohan and Marimuthu, 2015). The corporate governance is one of the concepts that has been discussed and applied throughout the world in recent years. Corporate governance is the body of applications that demand the restructuring of the firms observing the principles of transparency, fairness and responsibility, and guard the interests of its members. The improvement of corporate governance practices is widely recognized as one of the essential elements in strengthening the foundation for the long-term economic performance of countries and corporations (Ibrahim et al., 2010).

The development has forced national government and regional economic organizations to come up with various guidelines and codes to get businesses to behave decently. One of such institutions is the Organization for Economic Cooperation and Development (OECD), which has undertaken much work on corporate governance for a number of years. Corporate governance arrangements and institutions vary from one country to another. There is no single framework

that is appropriate for all countries (Okoi, Ochenand John, 2014).In financial institute like the case under study, compliance of corporate governance practices with the business nature as well as the composition of the structure within the company is an issue these days. In Ethiopian financial institute, the concept by itself is new and becoming a challenge to comply corporate governance with the trends and business practices which is customized before. Most of the time the practice on the ground is much far from the framework set for the institute to practice corporate governance (NBE, Insurance Corporate Governance Directive No. SIB/42/2015).

1.1.3. Financial performance of Insurance Company

Financial performance is defined as the extent to which financial objectives is being or has been achieved. It can also refer to the means by which the firm's policies and operations results are measured in monetary terms. The firm's overall financial health is measured over time and the obtained results are thereafter used for comparison by firms in the same industry or to compare companies in different industries or sectors, (Kwaning &Mahama, 2015)

Burca and Batrinca (2014), notes that actuaries use financial data analyzed by a company as an important tool during the insurance company's decision making on underwriting and investment. The insurance companies financial performance is crucial for an economy since the industry forms one of the financial system 'components that foster growth and stability however internal and external factors are factors that affect the insurance' companies performance. Internal factors can be represented by specific characteristics that are mostly unique to a particular company while external factors on the other side extends beyond one company and includes those factors that affect connected institutions as well as the overall macroeconomic environment.

1.1.4. Corporate Governance and Financial Performance of Insurance Companies

Corporate governance entails ensuring there is legal compliance with legal obligations and protection of shareholders' funds against fraud or organizational failure. This involves having a board in place to direct and control managers who may not to manage in a manner that represents the shareholders' interests. A board comprises of inside directors who normally are picked from among employees at the executive level of the firm and directors from outside the firm but who are affiliated to the firm by the virtue of their directorship. (Rouf, 2011).The roles of independent

director are to effectively monitor and control the activities of the firm as well as to reduce managerial behaviors that may be opportunistic and thereby resulting resources of the firm being expropriated.

Board size is considered as an important variable while undertaking the study of corporate governance as it is believed to influence the value of the firm in that while larger boards may have the benefit of increased monitoring, they may be surpassed by the poorer communication and decision making that results from coordinating larger groups. Mak and Kusnadi (2005), noted boards that smaller, tend to have high performance while on the other hand larger boards maybe less effective since the resources associated with coordinating and processing problems maybe high making decision making difficult. Small boards on the other side, reduces the problem of free riding thereby enhancing the efficiency of the firm. An optimal board as suggested by Lipton and Lorsch (1992) should consist of between seven to nine directors.

Agrawal and Knoeber (1996) assert that the number and percentage of independent directors is correlated positively to the firm's performance. Mehran (1995) noted that in instances where the number of proportion of independent directors is increased, it simultaneously increases the performance of the firm as managers are monitored effectively. However, Yermack (1996), observed that there is a negative relationship exists between the proportion of the firm and value of the firm. Hermalin and Weisbach (1991), didn't observe any relationship between the proportion of the firm and its performance.

1.1.5. Corporate Governance in Insurance Industry in Ethiopia

In Ethiopia where the financial sector is closed and subject to stringent regulatory system, exploring impact of corporate governance mechanisms on the performance of insurance industries is quite interesting. The extant literatures explain only the effect of corporate governance on the performance of firms (Matama, 2005; Joan, et.al, 2010; Rashid, 2011; David and Tobias 2013). These studies attempted to explain the effect of corporate governance on the performance firms in relatively liberalized economy where the board of directors has more discretionary power to exercise their power and to make decisions that they felt are more worthy to their firms.

National Bank of Ethiopia, which is a regulatory body for all insurance company, has set a directive on corporate governance and dispatch to all insurance company in 2015. But there is a

big challenge in evaluating all companies according to this directive. Therefore, this paper will try to assess the effect corporate governance on firm's performance in this sector.

1.1.5.1. Board of Directors Size and Composition

The company board shall be of sufficient size and expertise to oversee adequately the operations of the company. Accordingly, in line to this objective and based on the regulatory requirement and the governing commercial code, the company shall have at least nine directors that are elected from the shareholders;

The Board of Directors possibly shall have a capacity to understand the operational structure of the company and preferably comprise of directors who as a group provide a mixture of gender and core competencies such as insurance, accounting, legal, business administration, auditing information technology and investment management;

The Board shall comprise of non-influential shareholders whose number shall not be less than 1/3rd of the total board members elected separately by such shareholders provided that such shareholders hold at least 30% and above of the subscribed capital of the company and 1/4th of the total board members elected separately by such shareholders provided that such shareholders hold less than 30% of the subscribed capital of the company no matter what the proportion of their shareholding in the company.(Directive No SIB/42/2015.)

Fit and proper criteria for the purposes of this guidelines means the criteria that should be taken into account in determining whether one is suitable for appointment to a particular position and broadly include honesty, integrity, reputation, competence and capacity and financial soundness demonstrated in personal behavior and business conduct.

1.1.5.2. Role and Responsibility of Board of Directors

In general, the company directors, appointee of shareholders, shall act as the agent & trustee of the company and shareholders to look after their interest and besides this, the interest of different stakeholder groups such as customers, employees, intermediaries, government and the public at large. And also ensure that the management and Board functions are clearly separated to enable the Board to exercise its oversight function over the management.

BODs give overall direction of the business of the company, including projections on the capital requirements, revenue streams, expenses and the profitability. While laying down the projections, the Board must address the expectations of the shareholders and the policyholders.

Another responsibility of the board is ensuring proper compliance with the Insurance regulation, directives and laws framed there under, and other statutory requirements applicable to it and also sets out its responsibilities in committing to the specific corporate governance principles, policies and procedures and ensuring that they are applied in sound and prudent manner and for approving and overseeing the implementation of the company's business objectives and strategies. (Directive No SIB/42/2015)

In addition, to the Audit, Risk & Compliance and Human Resource Affairs board committees, which are mandatory requirement by National Bank, the Board can establish other board committees to assist it in discharging its duties and responsibilities. However, the board remains accountable and shall retain responsibility for monitoring and oversight of its sub-committees and external service providers. There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation, to enable the board to properly discharge its duties and responsibilities and to effectively execute its decision making process. Board committees should be free to take independent professional advice as and when necessary, and to invite Senior Management to provide technical advice when needed.

As a general principle there should be transparency and full disclosure from the board committee to the board, except where the committee has been mandated otherwise by the Board. (Directive No SIB/42/2015)

1.2. Statement of the Problem

According to (Miller C.A., 2010; Bourne & Franco, 2003), existing studies on firms with good corporate governance practices have been observed to have an impact that is positive to their performance. It's paramount for companies to embrace good practices of corporate governance as this helps in preventing scandals, fraud as well as enhancing the image of an organization in the eyes of the public as one that is worthy of shareholder and debt capital holder. It also becomes essential for companies to improve firm performance, ensures investor rights, enhances investment atmosphere as well as encourages economic development (Braga & Shastri, 2011). One of the contributions that led to poor performance of insurance companies in Ethiopia can be attributed to poor corporate governance. Ethiopian insurance industry is said to be under developed which stood at low insurance penetration rate, in terms of percentage of insurance premium to GDP which is 0.5% penetration as of 2017/18 budget year. One of the reasons for this poor penetration could be attributed to poor corporate governance.

Locally, the study of Corporate governance effect's on financial performance of insurance companies in Ethiopia has not been conducted well but there is one notably done: Fekadu, (2015), who undertook a study on the relationship between corporate governance and financial performance of 10 insurance companies that are major in Ethiopia, in which he noted that there exists a relationship that is insignificant between corporate governance mechanism with Return on Asset due to the closely regulated financial sector by the regulatory body which limited boards discretionary power. However, my study was conducted; how corporate governance practices on financial performance of insurance companies in Ethiopia by having a look at the following variables: board size, board diversity, board meetings, board committee, board independency and board members educational qualification. All except one variable were considered by Fekadu, (2015), but the business environment, number of Insurance companies and many regulations to relax board discretionary power are different during this time. And also the data collected by Fikadu was from web site of National bank of Ethiopia which I have checked that some data on web site is different from what on the ground during my preliminary survey at National Bank of Ethiopia. Therefore, this study challenged the result found on Fikadu's study on same variables and one additional variable which is board members educational qualification was considered as independent variable. But Board committee independency is totally irrelevant for this study since none of the company has this independent committee member during my preliminary survey.

1.3. Research Questions

The board of directors is accountable for acting in the best interests of shareholders and managers. Accordingly, an effective and independent board is more likely to monitor the top management to align the interests of the shareholders and managers. Thus, if interests are aligned, it reduces the conflict between managers and the shareholders leading to better firm performance. To end up with assessment of the use of corporate governance theory in the case insurance, the research was opting to get adequate and reliable data that satisfy in answering the points hereunder.

- What is the effect of board size on financial performance of insurance in Ethiopia?

- What is the effect of gender mix in boards on financial performance of insurance in Ethiopia?
- What is the effect of number of board meeting on financial performance of insurance in Ethiopia?
- What is the effect of board committee size on financial performance of insurance in Ethiopia?
- What is the effect of independent board member on financial performance of insurance in Ethiopia?
- What is the effect of member of board educational qualification have on financial performance of insurance in Ethiopia?

1.4. Objectives of the study

1.4.1. General Objective

The objective of the study was to determine the effect of corporate governance on financial performance of insurance companies in Ethiopia.

1.4.2. Specific Objective

Given the overall objective of examining the effect of corporate governance on financial performance of insurance industry in Ethiopia, this study had several specific objectives.

Specifically, the study wanted to:

- To examine the effect of board size on financial performance insurance industry in Ethiopia.
- To investigate the effect of board member gender composition on financial performance of insurance industry in Ethiopia.
- To examine number of board meeting on financial performance of insurance industry in Ethiopia.
- To examine number of board committee size on financial performance of insurance industry in Ethiopia.
- To identify the influence of board independency on financial performance of insurance industry in Ethiopia.

- To identify the influence of board member educational qualification (core competency) on financial performance of insurance industry in Ethiopia

1.5. Research Hypotheses

The study was tested based on following hypotheses.

Ha- alternative hypothesis

Ha1: There is a negative relationship between board size and financial performance of insurance industry.

Ha2: There is a positive relationship between board diversity and financial performance of insurance industry.

Ha3: There is a positive relationship between frequency of board meeting and financial performance of insurance industry.

Ha4: There is a positive relationship between size of board committee and financial performance of insurance industry.

Ha5: There is a positive relationship between board independency and financial performance of insurance industry.

Ha6: There is a positive relationship between board members educational qualifications and financial performance of insurance industry.

1.6. Significance of the Study

The result of this study helps insurance industry by identifying relevant corporate governance and how these corporate governance Characteristics affect their financial performance. The result found by this study may contribute to the existing literature by providing evidence on the relation between corporate governance characteristics and insurances financial performance and also to be the indicators of corporate governance characteristics useful for regulators, managers and business people in making policies and decisions.

1.7. Delimitation/Scope of the Study

The study was delimited to examining the effect of internal corporate governance on firms' financial performance by taking evidence from Insurances in Ethiopia for the period of four years, from 2015 to 2018. The reason for using this range of period is that the previous studies which was undertaken in Ethiopian related to this topic (Gardachew, 2015) were conducted by almost same number of years but the situations and regulations in which he conducted the study

is quite different now. Therefore this study will argue on his finding which states that all corporate governance mechanisms he used are insignificant on performance of insurance companies in Ethiopia. It will also use one additional corporate governance mechanism which is educational qualification of board members to be utilized other than the researcher used. The dependent variable was delimited to return on asset. The independent variables were delimited to some corporate governance mechanisms such as board size, board diversity, frequent of board meeting, board committee size, board independence and board member educational qualification. The study area of this research was delimited to Insurance industry in Ethiopia which has available data for the specified period of time.

1.8. Organization of the Thesis Report

This research paper was organized in to five chapters which include Introduction, Literature review, Methods of the study, Results and discussion; and the final chapter is Conclusion and Recommendation.

In introduction part the paper covers background of the study, statement of the problem, basic research questions, objective of the study, hypothesis, definition of terms, significance of the study and delimitation or scope of the study. The second chapter consists of literature review part and deals with literature related to this study. The third chapter, which is methods of the study, covers the type and design of the study; conceptual frame work, source of data, data collection techniques and method used for data analysis. The fourth chapter deals with finding of the study and its interpretation with the hypothesis set. The final chapter deals with conclusion and recommendation and includes summary of the finding, conclusion from the finding, limitation of the study and recommendation.

CHAPTER TWO

2. LITRATURE REVIEW

2.1. Introduction

This chapter deal with a theoretical conceptual framework on what corporate governance involves an overview of board structure, board committee, the relationship that exists between executive compensation and financial performance of organizations. There are various theories that explain more about corporate governance conventions (Rashid, 2011). These theories include the agency theory, stakeholder theory, stewardship theory and resource Dependency theory (Sanda and Garba, 2005; David and Tobias 2013).These four theories as the main and most significant theories of corporate governance are explained further respectively below. It also reviews empirical literature on past studies in this area of corporate governance and how this relationship affects the performance of insurance companies as well as identifying the research gaps to be filled.

2.2. Corporate Governance

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees. There are many different models of corporate

governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or multi-stakeholder model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. (Sreeti Raut, Research Scholar with Institute of Directors, India)

The board of directors is the primary direct stakeholder influencing corporate governance. Directors are elected by shareholders or appointed by other board members, and they represent shareholders of the company. The board is tasked with making important decisions, such as corporate officer appointments, executive compensation and dividend policy. In some instances, board obligations stretch beyond financial optimization, when shareholder resolutions call for certain social or environmental concerns to be prioritized. Boards are often comprised of inside and independent members. Insiders are major shareholders, founders and executives. Independent directors do not share the ties of the insiders, but they are chosen because of their experience managing or directing other large companies. Independents are considered helpful for governance; because they dilute the concentration of power and help align shareholder interest with those of the insiders.

The wide range of literature reflects a strong diversity of theoretical grids. These theories attempt to explain how managers in an organization are governed and not how they govern (Gerard, 2004). There are three main theories that describe corporate governance in institutions. They include: The Agency Theory; The stewardship Theory and the Stakeholder Theory.

2.2.1. Agency Theory

The Agency theory was first proposed by Jensen and Meckling (1976) in a theory of the firm based upon conflicts of interest between various contracting parties such as shareholders, corporate managers and debtors. In such a way that, the managers (agents) are hired to work and make decision on behalf of the owners (principals) in order to maximize return to the shareholders. However, the managers (agent) who are put in control of the affairs of the organization may not always consider the best interest of the owners and may pursue their self-activities to the detriment of the welfare of the principals (David and Tobias 2013). The Agency theory indicates that agency problems arise because of the impossibility of perfectly contracting for every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal, Brennan (1995b).

As a result of these agency problems, the principal might end up incurring costs known as Agency costs. This Agency cost is a value loss to the shareholders and usually involves the cost of monitoring the activities of managers so that goal congruence can be achieved between shareholders and managers. The effect of this agency theory is that one can only try to mitigate against this agency problem when the board is composed largely by non-executive directors (independent and dependent) who will be able to control the activities of managers and thereby maximize shareholders 'wealth. The governance structures suggested by the agency theory involve size of the board, composition of the board, remuneration to CEO, directors 'shareholding and shareholder right (Luan & Tang, 2007; Rashid, 2011). Jensen and Meckling (1976) suggest that this can be achieved through incentive schemes for managers which reward them financially for maximizing shareholder interests. Such schemes typically include plans whereby senior executives obtain shares, perhaps at a reduced price, thus aligning financial interests of executives with those of shareholders.

2.2.2. The Stewardship Theory

A steward is defined by Davis, Schoorman & Donaldson (1997) as one whose aim is to shield and maximizes shareholders wealth through the efficient running of the firm. By doing so, the steward's value are enhanced in an organization, stewards are the managers and executives working for shareholders. In this perspective, stewards are company executives and managers working for the shareholders protect and make profits for the shareholder (cited in David and Tobias 2013). This theory is a contrast or a direct opposite to the agency theory and this theory adopts a more idealistic view of humans. This theory is based on a belief that the agent is not self-opportunist but a steward that perceives greater utility in the interest of the principal and the organization as a whole. The theory assumes that a significant correlation exist between the firm's success and the manager's satisfaction. This trade-off is achieved by the steward admitting that working towards achieving company's and collective goals will lead to self actualization. The theory argues for the post of Chief Executive Officer and Chairman to be held by the same person. Therefore, control lowers the motivation of steward and weakens motivational attitude (Davis et al., 1997).

Executives and directors will work in such a manner as to maximize financial performance by increasing the wealth and profits of the shareholders so as to ensure their reputation is protected

as organizations decision makers of (Daily et al, 2003). In doing this, they aim at being seen as stewards who are effective of their organization thereby protecting their careers (Fama, 1980).

2.2.3. The Stakeholder Theory

The stakeholder theory is based on the argument that other than shareholders there are several agents with an interest in the actions and decisions of companies. Stakeholders are groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by corporate actions. In addition to shareholders, stakeholders include creditors, employees, customers, suppliers, and the communities at large. Stakeholder theory asserts that companies have a social responsibility that requires them to consider the interests of all parties affected by their actions. Management should not only consider its shareholders in the decision making process, but also anyone who is affected by business decisions. In contrast to the classical view, the stakeholder view holds that “the goal of any company is or should be the flourishing of the company and all its principal stakeholders (Freeman et al., 2004).

According to stakeholder theory decisions made regarding the company affect and affected by different parties in addition to stockholders of the company. Hence, the managers should on the one hand manage the company to benefit its stakeholders in order to ensure their rights and their participation in decision making and on the other hand the management must act as the stockholder’s agent to ensure the survival of the firm to safeguard the long term stakes of each group (Fontain et al., 2006).

2.2.4. Resource Dependency Theory

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm while the stakeholder theory focuses on relationships with many groups for individual benefits. Hillman et al. (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. It has been argued that the provision of resources enhances organizational functioning, firm’s performance and its survival (Daily et al, 2003).

2.3. Corporate Governance Practice in Ethiopian Insurance

In case of Ethiopian Insurance Companies, Corporate governance issues are more addresses in maintaining the safety and soundness of financial system in insurance sector in particular in such a way to balanced risk taking and enhances business prudence, prosperity and corporate accountability with ultimate objective of realizing long term shareholders' value, as well as customers' and other stakeholders interest (Insurance Corporate Governance Directives No.SIB/42/2015)

2.4. Empirical Review

The studies of the effect of corporate governance mechanism on the financial performance of Insurance companies in developing countries are dealt insufficiently and with poor conclusion as per Joan, (et.al, 2010). But many researchers argued that the board of directors as the top of the internal control mechanism in an organization in which they are responsible for monitoring the activities of managers and improving the performance of firms(Jensen (1993; Hillman et al. 2000; Joan, et.al, 2010).

In the study conducted by Fekadu, G.W.(2015). on effects of Corporate Governance on Financial Performance of Insurance Companies listed as top ten which are closely regulated in Ethiopia, He noted that Board size, board independence and board diversity have negative and insignificant effect on the performance of insurance companies while size and independence of audit committee and frequency of board meetings have positive but insignificant effect on the performance of insurance companies in Ethiopia. His study concluded that all corporate governance mechanisms have insignificant effect on the performance of insurance companies measured by return on asset. This vividly affirms that the role of board of directors in closely regulated financial sector is dismal and insignificant for they have limited discretionary power to exercise as board of directors.

2.4.1. Board dynamics

There have being a strong presumption that the effective use of board as internal governance mechanism is crucial to improved firm performance and profitability (Bhagat and Black, 1999; Weisbach, 1988, Brickley et al., 1994; Johnson et al., 1996; Rosenstein and Wyatt, 1990; Zahra and Pearce, 1989). While talk they said is cheap, more than two decades of empirical

investigation, is yet to justify the above assumption as ambiguous findings continue to dominate empirical studies on the relationship between corporate governance and firm performance.

It is highly debatable that the right mix of governance structure should be and how a company performance is dependent on these governance structures (Das and Gosh, 2004). Al-Hawary, S (2011) investigated the effect of some governance mechanisms on Jordanian commercial banks as measured by Tobin's Q and found that CEO duality, and percentage of nonexecutive directors had statistically significant positive effect on performance; whereas leverage had statistically significant negative effect on performance. In case of Ethiopia the regulatory body (NBE) has already prohibited the duality of the CEO in contrary to what is common in the boards of some firms in some countries that allow the CEO to be a board chairman. This CEO-Chairman split in the Ethiopian case is a positive move towards more independent boards to discharge their oversight and monitoring role and this variable could not be an issue and the study was not consider. The empirical review of the literature has focused on more relevant explanatory variables that are deemed to have effect on the performance of Ethiopian Insurance companies.

Some of the board dynamics reviewed here includes board composition, CEO duality, board size, board diversity, frequent of board meeting, board committee size, board independence and board member educational qualification.

Board Composition denotes the fraction of non executive directors on the board as compared to their executive Counter parts. This is the proportion of inside directors who participate directly in the day to day management of the firm to outside directors who provide check and balances in ensuring that the shareholders interest are protected (O'Sullivan and Wong, 1998; Donaldson and Muth, 1998; Petrovic, 2008; Wan and Ong, 2005; Klien 2002). The board independent that is, the extent to which board members are reliant on the CEO/Management is determined by its composition. From the empirical point, a board is said to be independent if made up of more non-executive directors that share no material connection such as family ties, financial relationship, employment, professional services, and interlocked directorship amongst others with the management (Ayuso and Argandoña, 2007; Shivdasani and Zenner,2002). In the face of ownership and control dispersion, outside non-executive directors are more reliable and also effective in representing shareholders interest (Byrd and Hickman, 1992; Kaplan and Reishus, 1990; John and senbet, 1998), Laing and Weir (1999) argued that non executive directors are much more likely to oppose to corporate strategy they believe are not in the best interest of shareholders. The board monitoring and control function becomes difficult with insider

dominated board since they cannot provide appropriate monitoring against itself (Fama, 1980). The independent outside director brings to bear the much needed neutrality and objectivity in the board discuss.

While most of codes for best practices have emphasized the need for mix directorship with greater non executive representation, empirical evidences remained conflicting with respect to whether such inclusion significantly induce firm performance. Some researchers found positive relationship (Shleifer and Vishny, 1997; Perry and Shivdasani, 2005; Rhoades et al., 2000; Rosenstein and Wyatt, 1990; Jackling and Johl, 2009), others report either negative or no relationship between the board configuration and firm performance (Yermack, 1996; Dulewicz and Herbert, 2004; Dalton et al., 1998; Erickson et al., 2005; Bhagat and Black, 2000; Weir and Laing, 2001; Shivdasani and Zenner, 2002; Heracleous, 2001; Hsu, 2010; Daily and Dalton, 1992). Bhagat and Black (2000) conducted a financial performance study on 934 largest US firms covering 10 year period and questioned the empirical validity of the need for board independence. They reported that while firm suffering from decline financial performance, increase proportion of outside directors on the board, no clear evidence that such addition were compensated by improved performance. For this study this is not an issue since managements are prohibited to be directors.

CEO duality is defined in respect of one person heading both the Management and the Board (Chien, 2008; Finkelstein and D'Aveni, 1994; Weir and Laing, 2000). According to the Agency theorists, CEO Duality creates imbalance in corporate power distribution as heavy concentration of management and control resides with one person which tend to jeopardized board effectiveness (Eisenhardt, 1989). This imbalance makes it inevitably difficult for the corporate board to provide appropriate monitoring or even institute punitive measure against erring CEO due to absence of independence (Jensen and Fama, 1983; Brickley et al., 1997; Keller et al., 2006; Dalton and Kesner, 1987; Shivdasani and Yermack, 1999; Goyal and Park, 2002; Wan and Ong, 2005; Morck et al., 1987; Dayton, 1984). The integrity of information available to board is compromised with CEO duality due to asymmetric as CEO determines what kinds of information are brought to board attention. Agency theorists thus, argued that the separation of the two positions will reduce the agency cost and promote corporate transparency and accountability (Weir and Laing, 2001).

Empirical evidences have been divergence in respect of CEO Duality and how it affects firm performance. The reported evidences ranges from positive (Peel and O'Donnell, 1995; Pi, and

Timme, 1993; Coles et al., 2001; Brickley et al., 1997; Boyd, 1995; Rechner and Dalton, 1991) to negative and mix findings (Adams et al., 2005; Heracleous, 2001). However, despite the inconsistencies in previous findings, support for agency theory still remained vibrant as the call for the separation of the position of CEO and that of Board Chair by far dominated recommendations in most corporate governance guidelines around the world (e.g. Cadbury Report, 1992; & Nigeria SEC Codes, 2003 etc.). In case of Ethiopia the regulatory body (NBE) has already prohibited the duality of the CEO in contrary to what is common in the boards of some firms in some countries that allow the CEO to be a board chairman. Therefore it is not an issue to be studied in this paper.

Board members industry specific experiences is measured as the number of directors who served in any insurance earlier in the same capacity as board members. It is important for insurance companies to have skilled and experienced directors on board particularly prior experience in the same sector and position. The effectiveness of board members monitoring role depends on their expertise to fully understand a firm's business situation (Kroll et al., 2008). Thus, industry specific experience of board members expected to improve insurance's performance by helping boards effectively reducing agency problem. Appointing directors with related and relevant skills and knowledge to perform task specific duties such as the firm's internal control and procedures will enhance the quality of information gathered and the solution to problems and of the views held and judgments made during the decision-making process (DeZoort, 1998 as cited by Saat, et al, 2011). Directors' specialist knowledge will be valuable to the creation of a strong and informed board (Saat et al., 2011). He claimed that experience of directors enables them to guide, steer and monitor the firm more effectively. In other words, their knowledge of the industry, its opportunities and threats and their connections to the industry participants based on their experience enables them to contribute substantively in the firm performance. But in this study this variable was not considered since there is much overlap with their educational background.

Board size is defined as the number of directors on the board. In some views, the higher the number of the directors the better firm value because they have a range of expertise to make better decisions, and are harder for a powerful CEO to dominate. According to Kiel and Nicholson (2003) board size is crucial to achieving the board effectiveness and improved firm performance. According to Lawal (2012), board size affects the quality of deliberation among members and ability of board to arrived at an optimal corporate decisions. Therefore, identifying

the appropriate board size is essential because size can be detrimental to corporate governance effectiveness beyond optimal level. Dallas, G (2004), states that the size of the board has positive effect and is an important governance consideration. However, some authors have advocated for smaller boards Lipton and Lorsch (1992) and Yermack (1996) argued that boards that were smaller were more productive and effective compared to larger boards. They attributed the lack of effective performance of large boards to free rider challenges that decreases the board's capacity to monitor effectively and efficiently.

When a board gets too big, it becomes difficult to coordinate, encourages free riding and poses problems. Smaller boards however can manage to look over the firm and reduce the possibility of free riding, and increase the accountability of individual directors. Hence there will be a positive or negative relationship between board size and firm value. Adetunji and Olawoye (2009) argue that board size determines the number of directors in a board and the board should be of reasonable size, and the terms of its directors should be fixed and advocates for optimal size of board of directors for good corporate governance as well as performance in the firm. Of course the National bank of Ethiopia (2014) has stated the minimum number of board size of an insurer to be nine. The question "what would be the optimum board size remains debatable and inconclusive (Musa et al., 2013; SaileshTanna, FotiosPasiouras & Matthias Nnadi,2011). The aforementioned empirical review of the literature leads to develop the hypothesis that board size has positive and significant effect on the performance of insurance company.

Board gender diversity: Gender diversity is part of the broader concept of board diversity. Boards are concerned with having right composition to provide diverse perspectives. Greater female representation on boards provides some additional skills and perspectives that may not be possible with all-male boards (Boyle & Jane, 2011). Board diversity promotes more effective monitoring and problem-solving. He suggests that female board members will bring diverse viewpoints to the boardroom and will provoke lively boardroom discussions.

Gender diversity in the boards is supported by different theoretical perspectives. Agency theory is mainly concerned about monitoring role of directors. 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). 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. The oversight function may be

more effective if there is gender diversity in board which allows for a broader range of opinions to be considered.

According to Erhardt et al. (2003), diversity of the Board of Directors and the subsequent conflict that is considered to commonly occur with diverse group dynamics is likely to have a positive impact on the controlling function and could be one of several tools used to minimize potential agency issues.

From 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 & Ingley, 2003). This is facilitated by board diversity.

On the other hand, Rose (2007) revealed insignificant association between number 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). However, as he stated in corporate world women representation on boards is very limited. Thus paper has hypothesized as board diversity has positive effect on the financial performance of insurance company

Frequency of board meetings: frequency of board meeting as corporate governance are considered as important proxies for the time directors spend monitoring managerial performance and also as an important resource in improving the effectiveness of a board (Funmi, 2014). When boards hold regular meetings, they are more likely to remain informed and knowledgeable about relevant performance of the company leading them to take or influence and direct the appropriate action to address the issue (Adams, 2000; Funmi, 2014). Indeed Jensen (1993) found negative relationship and suggests that board meetings were a reactive response and not a proactive measure.

Board Committee size: Literature shows that independent, different and competent committees have positive effect on firm performance (Anthony, 2007; Cassandra et al., 2009). Different committees within the board help to ensure that operation of the company is going well, handling of human and property resources are managed well and accounting policies are sound and financial statements are properly prepared and audited. Moreover, the existence of audit committee composed of external board members in the firm will create a transparent and credible environment between management, external auditors and the board members. The evidence

suggests that existence of different committee improves governance quality and financial performance of firms (Defond, et al., (2005; Green, 2005). This research hypothesize board committee size has positive relationship with financial performance of insurance company.

Board independency: is the ratio of independent (external) board members to the total number of board members. Many empirical evidences showing that the higher proportion of outsiders on a board can better over see and control the opportunistic behavior of the incumbent management, thus, minimizing the agency problem and maximizing shareholders' wealth (Martin and Sebastian, 2013; Anthony, 2007;Cassandra et;al., 2009; Lorne and Jun , 2012; Adeusi et al.,2013; Musa et al., 2013).Of course negative association between board composition and firm performance was presented by Agrawal and Knoeber (1996), who find that more outsiders on the board negatively affect the performance and conclude that outsiders are added on boards for political reasons. With such questionable findings in this study it has been hypothesized as the board independence has positive effect on financial performance of insurance company

Board educational qualification: Director's educational qualifications are central to effectively interpret and utilize the information generated by the management of particular types of business enterprise. Educational qualification is potentially 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. Educational qualification affects the oversight and monitoring role of boards of directors (Gantenbein & Volonte, 2011).

Board of directors is vested with the responsibility of ensuring that the shareholders' money is not wasted, shareholders have a serious interest in ensuring that the board is staffed with well educated and experienced directors (Gantenbein & Volonte, 2011). The human capital provided by its board of directors is vital 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. Personal profile factors of directors such as education and experience is important for board efficiency. Thus it could be hypothesized that board's educational qualification has a positive effect on performance of insurance company.

2.4.2. Control Variables

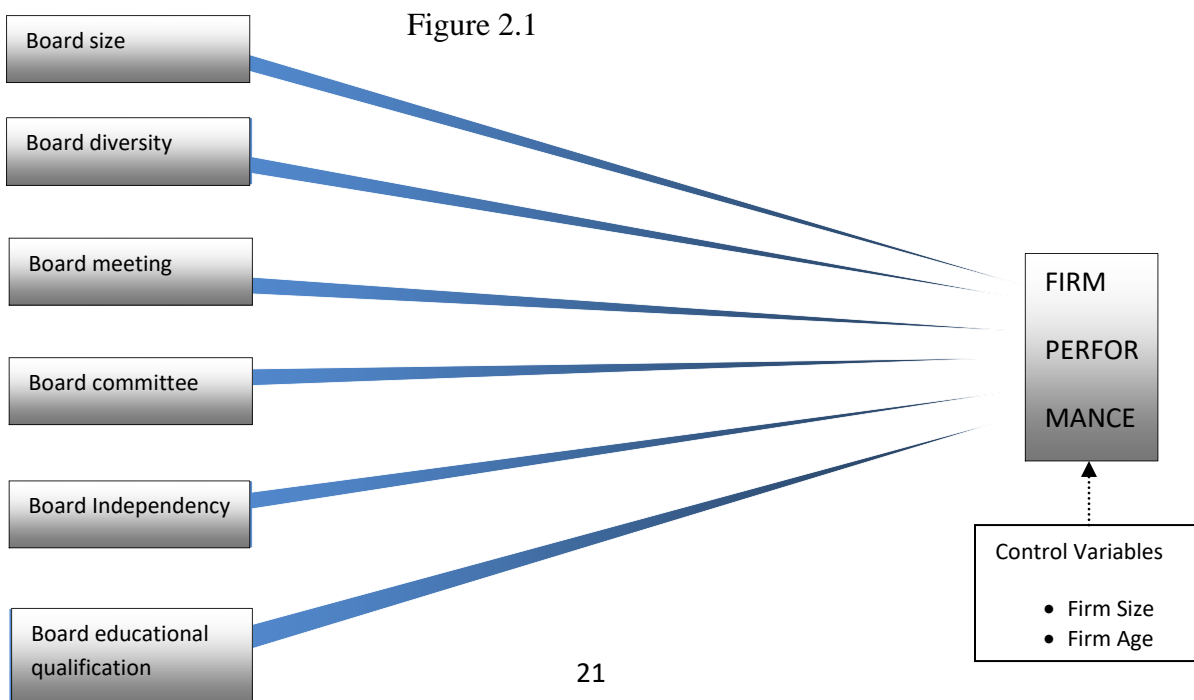
In this study two control variables, namely, Firm size (FS) and firm age (FG) included to account its potential influence on insurances' financial performance in order to know the selected explanatory variables effect on insurances' financial performance.

Firm size which is explained in this study is that the total asset of the firm. Burca and Batrinca (2014), asserts that the relationship existing between size and financial performance is positive in the sense that more resources are available in larger firms, better risk diversification strategies, complex information systems and are able to manage expenses well compared to small firms. This may have an impact on the financial performance of insurance companies in different ways for example large firms may be advantaged compared to smaller firms as they can be able to exploit economies of scale and scope and as such they are more efficient in their operations and as a result reap higher level of profits.

Firm age is explained as the total age of a firm. According to Sorensen and Stuart (2000), company’s age may have an effect on firms’ performance. They further noted that older firms may have organizational inertia which tends to make them inflexible which may result to their inability to appreciate the changes that occurring in changing environment. However, Liargovas and Skandalis (2008), noted that older firms may have more skills because they have been in operation longer thus have more experience having enjoyed the benefits that come from learning and aren’t prone easily to the liabilities that result from newness therefore they tend to have performance that is superior as compared to newer firms.

2.4.3. Conceptual Frame work

From the theoretical and empirical literature reviews, it is hypothesized that corporate governance mechanisms has positive or negative relationship with firms’ performance. Therefore, for this study the following conceptual frame work was utilized.



CHAPTER THREE

3. Research Design and Methodology

This chapter contains information about the design of the research, population and sample that will be selected for the study. Data collection, data analysis and presentation techniques that were used in the study were highlighted in this chapter.

3.1. Research Design

The methodology for this research was based on the objectives of the paper and the availability of relevant information. To conform to the objective of this research, the primary aim of this study was to examine the effect of corporate governance on Insurance Industry's financial performance. To achieve this objective the study adopted a descriptive and inferential research design. This research design is that process of collecting data in order to test hypothesis to answer questions regarding the current status of the subjects in the study. Mixed methods research provides better (stronger) 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. Population

According to Ngechu (2004), population can be defined as a set of people, households, services, events and group of things that are under investigation. This study was look at the 13Insurance (Appendix1) companies out of 17 Insurance companies in Ethiopia due to stagnant growth of the 4 insurance companies left over.

3.3. Data Collection

The required data was a secondary data collected from audited financial statements of the companies for the period of 2015-2018 of the selected insurance companies. These financial statements were obtained from the websites of the selected companies and collected print out annual report collected in person from many insurance company. Some other data's like directors educational back ground, frequency of board meeting, board independency and committee size were collected in person from the 13 Insurance Company.

3.4. Data Validity

Data for this study is secondary data obtained from audited annual financial statements of the respective insurance companies and internal sources of the company; therefore, reliability test is not necessary. The study included 13 Insurance companies. The study used panel data of 13 Insurance companies that covers the period 2015 to 2018 (4 years)(52 observation).

The data collected from insurance companies' annual financial reports and their internal resources was cross checked for errors to test the validity of the data sources. The research assumed a 95 percent confidence interval or 5 percent significance level (both leading to identical conclusions) for the data used. These values helped to verify the truth or the falsity of the data. Thus, the closer to 100 percent the confidence interval (and thus, the closer to 0 percent the significance level), the higher the accuracy of the data used and analyzed is assumed to be.

3.5. Method of Data Analysis

Multiple Regressions analysis was used to analyze whether there was a relationship that exists between one dependent variable and one or more independent variables. Corporate governance mechanisms such as board size, board diversity, frequent of board meeting, board committee size and independence, board independence and board member educational qualification were selected as independent variables in the study. Age and size of the insurance companies were also incorporated as control variables. ROA was considered as dependent variables.

The multiple regression mode used is as represented below.

$$ROA = \alpha_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + e$$

Where;

ROA= the Financial performance of Insurance companies in Ethiopia measured by ROA

α_0 = Intercept

β_i = Beta Coefficient of variable i which measures whether there is responsiveness of Y to change in i

X_1 = Board size representing number directors sitting in the board

X_2 = Board diversity, percentage or proportion of women in the board

X_3 = frequent of board meeting, Number of meetings held annually

X_4 = Board committee size, Number of Committee in boards

X_5 =Board Independence, the percentage of external board members to the total number of board members

X_6 =board member educational qualification, proportion of directors holding degree and above

X_7 =Firm size, total assets of an insurance company

X_8 =Firm age, age of the company in years

e =Error term

CHAPTER FOUR

4. DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1. Introduction

This chapter focused on the analysis of the collected data from the insurance company's financial statements. The objective was to establish the effect of corporate governance structures on financial performance of insurance companies in Ethiopia. Descriptive statistics was used to analyze, tabulate and graphically present results as shown in the following section

4.2. Descriptive Statistics

Table 4.1.

Variables	Observation	Mean	Std. deviation	Min	Max
ROA	52	.0727	.04529	-.04	.21
BSIZE	52	8.1923	1.20519	4	9
BIND	52	.0263	.06175	.00	.22
BDIV	52	.1167	.11409	.00	.44
BCOM	52	.9018	.16712	.00	1
BEDUQ	52	2.8077	1.12090	.00	5
BMET	52	13.7885	2.86518	12	24
FSIZE	52	10.47	10.23	1.40	54.00
FAGE	52	15.1923	10.71198	1	42

This section presents the descriptive results of this study including measures of central tendency, the trends analysis, maximum and minimum and standard deviation. From the analysis of descriptive statistics table 4.1, the finding clearly reveals that return on asset has a mean of 0.0727 with a maximum of .21 and minimum of -.04 and standard deviation of .0452, board size has a weighed mean of 8.19 maximum of 9.0 and minimum of 4.0, number of board committee weighed mean of 2.81 maximum of 5 and minimum of 0 and standard deviation of 1.12, board gender diversity weighed mean 0.12 maximum of 0.44 and minimum of 0 and standard deviation of 0.11, board independency weighed mean 0.0263.

4.3. Correlation analysis

Correlation analysis is used to establish if there exists a relationship between two variables which lies between (-) strong negative correlation and (+) perfect positive correlation.

Table 4.2: Coefficient Range

Coefficient Range	Strength / Are said to be
±0.91 to ±1.00	Very strong
±0.71 to ±0.90	High
±0.41 to ±0.70	Moderate
±0.21 to ±0.40	Small but definite relationship
±0.00 to ±0.20	Slight, almost negligible

Source: Hair, J. F. Jr., Money, A. H., Samouel, P. & Page, M. (2007). Research methods for business Chichester. West Sussex: John Wiley & Sons, Inc.

The correlation of six variables with return on asset were generated using SPSS (Board size(X1), board diversity(X2), frequency of board meeting(X3), Board committee's size(X4), board independence(X5) and directors holding degree and up(X6).

Table 4.3 Correlation table

		ROA	X1	X2	X3	X4	X5	X6	X7	X8
ROA	Pearson correlation	1								
X1	Pearson correlation	-.009	1							
X2	Pearson correlation	.084	.163	1						
X3	Pearson correlation	-.246*	-.300*	-.070	1					
X4	Pearson correlation	.197	.638**	.175	-.300*	1				
X5	Pearson correlation	.611**	.040	.277*	.173	.043	1			
X6	Pearson correlation	-.146	.125	-.027	-.021	.103	.078	1		
X7	Pearson correlation	.634**	.201	.438**	-.208	.194	.730**	-.034	1	
	Sig(1-tailed)	.000	.077	.001	.069	.084	.000	.404		
X8	Pearson correlation	.621**	.082	.360**	-.064	.119	.627**	-.294*	.874	1
N		52	52	52	52	52	52	52	52	52

*. Correlation is significant at the 0.05 level (1-tailed).

From the analysis of the correlation, it was observed that there exist negative slight correlation between return on assets and board size ($r = -.009$, $p > 0.05$). The relationship between return on

assets and board diversity was found to be insignificant and slight positive ($r = .084$, $p > 0.05$). The study also indicate that there exist a small but definite negative correlation between board meeting and return on assets ($r = -0.246$, $p < 0.05$). This study also found that there exist slight positive correlation between return on assets and committee's size ($r = .197$, $p > 0.05$). The relationship between return on assets and board independency was found to be moderate positive ($p = .611$, $p < 0.05$). The study also showed that there exist a slight negative correlation between return on asset and number of directors holding degree and above.

4.4. Multiple Linear Regression Analysis and Hypothesis Test

Regression Analysis is a statistical tool to deal with the formulation of mathematical model depicting relationship along with variables which can be used for the purpose of prediction of the value of dependent variable, given the value of the independent variable(s) (Kothari, 2004). Multiple regression analysis is an analysis of association in which the effects of two or more independent variables on a single, interval-scaled dependent variable are investigated simultaneously William and Barry (2010).

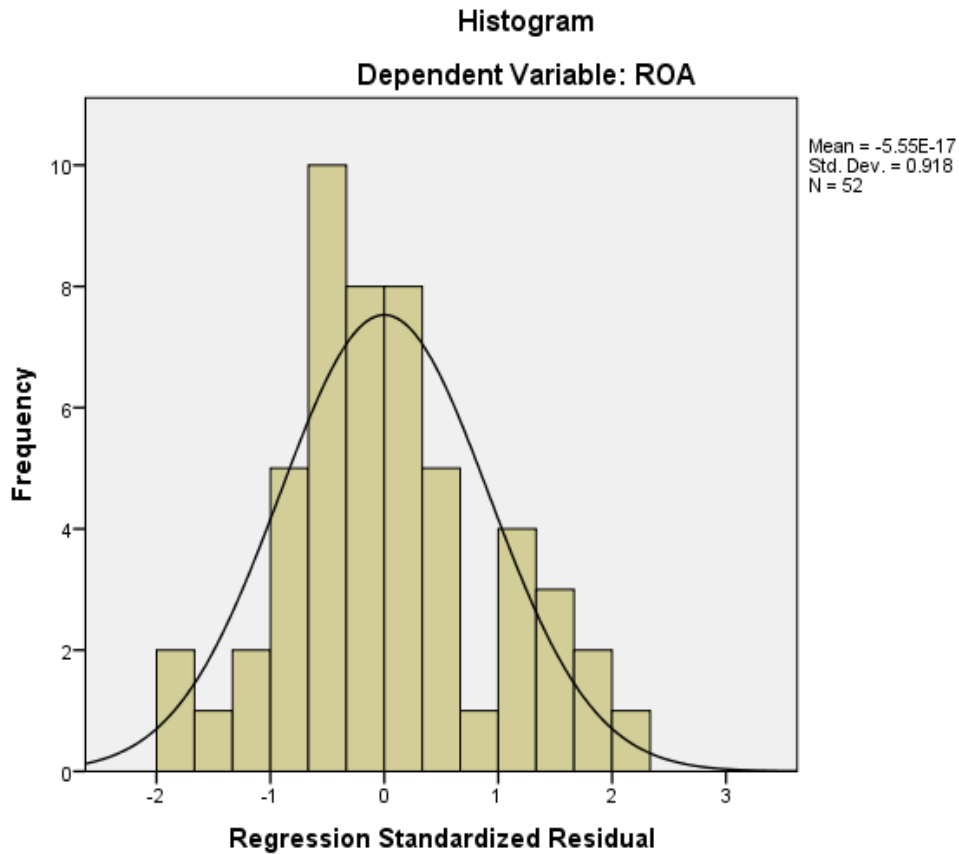
Before running multiple linear regression analysis, the researcher conducted basic assumption tests for the model. These are statistical assumption tests of normality distribution, linearity of the relationship between the independent and dependent variables, multicollinearity, homoscedacity and auto-correlation/DurbinWatson/. Each test is explained below:

4.4.1. Normality Distribution Test

Multiple regressions require the independent variables to be normally distributed. Normality test helps to determine whether the data used is normal or not, and this assumption is met for statistical tests.

Frequency distribution comes in many different shapes and sizes. Therefore, it is quite important, to have some general description for common types of distributions. In an ideal world our data would be distributed symmetrically around the center of all scores. As such, if we draw a vertical line through the center of the distribution then it should look the same on both sides. This is known as a normal distribution and is characterized by bell-shaped curve. This shape basically implies that the majority of scores lie around the center of the distribution Field (2006). The normal distribution graph was shown on figure 1 below.

Figure 4.1: Histogram

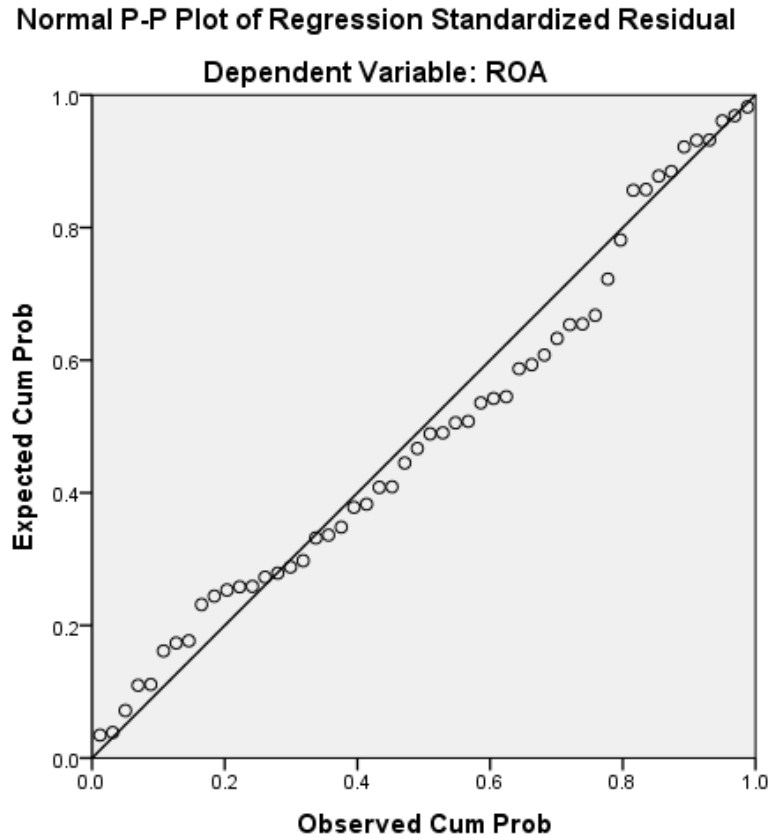


Source: Own Survey (2019).

4.4.2. Linearity Test

The second assumption for computing multiple linear regressions is test of the linearity of the relationships between dependent and the independent variables. As depicted in the below graph of the visual inspections of the p-p plot there exist the linear relationship between the Corporate governance mechanisms and Return on asset

Figure 4.2: **Linearity of the relationship**



Source: Own Survey (2019).

4.4.3. Multicollinearity Test

Multicollinearity exists when there is strong correlation between two or more predictors in a regression model Saunders et.al (2007). There should be no perfect linear relationship between two or more of the predictors. So, the predictor's variables should not correlate to highly Field, (2006). If there is perfect collinearity between predictors, it becomes impossible to obtain unique estimates of the regression coefficients because there are an infinite number of combinations of coefficients that would work equally well. If there is a high degree of correlation between independent variables, we have a problem of what is commonly described as the “problem of multicollinearity” Kothari, (2004); Field, (2006).

This study data multicollinearity assumption is checked by the Pearson correlation coefficient and collinearity statistics.

Checking the multicollinearity assumption is that by looking SPSS analysis output regression table of colinearity statistics value of Tolerance and Variance Inflation Factor /VIF (Field, 2006). The tolerance column value below 0.2 and VIF value above 10 create a multicollinearity problem. Having this, the Tolerance and VIF value is shown in the below table 4.4 and the analysis indicates that there is a minimum tolerance value of 0.403 which is above 0.2 and the maximum VIF value is 2.482 which is below 10. Therefore, the predictors don't significantly correlate each other; hence, there is no multicollinearity problem.

Table 4.4 : Collinearity Statistics value

Model	Collinearity statistics	
	Tolerance	VIF
BSIZE	.563	1.775
BIND	.336	2.976
BDIV	.784	1.275
BCOM	.570	1.756
BEDUQ	.673	1.486
BMET	.621	1.611
FSIZE	.221	4.525
FAGE	.249	4.016

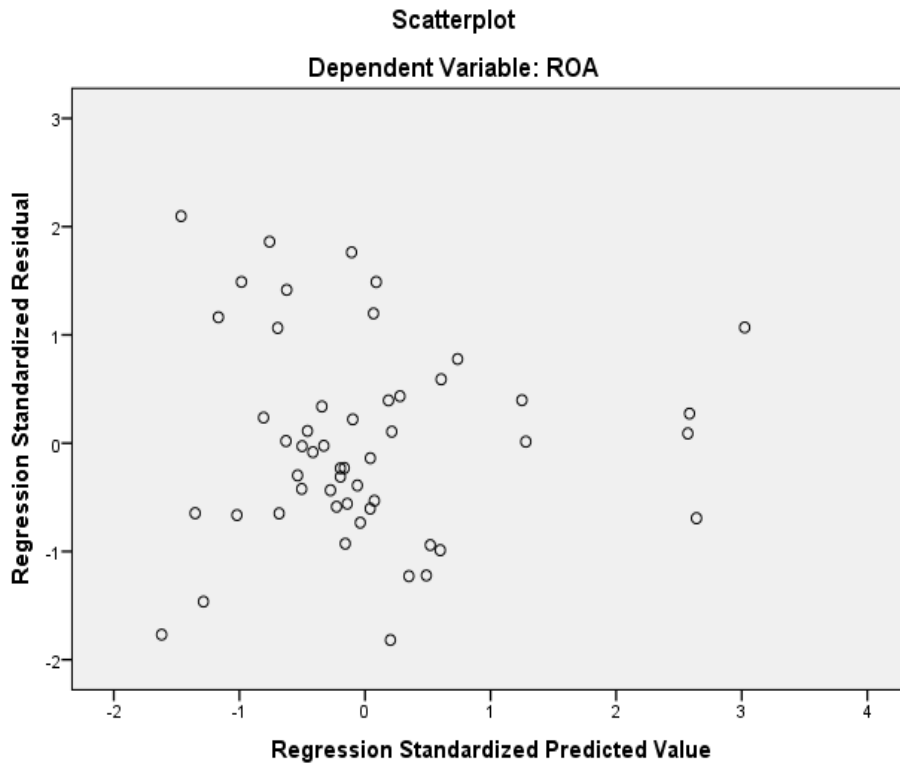
Source: Own Survey (2019).

4.4.4. **Homoscedasticity**

This assumption requires even distribution of residual terms or homogeneity of error terms throughout the data. Homoscedasticity can be checked by visual examination of a plot of the standardized residuals by the regression standardized predicted value (Osborn & Waters, 2002). If the error terms are distributed randomly with no certain pattern then the problem is not

detrimental for analyses. Figure 4.3 below shows that the standardized residuals in this research are distributed evenly indicating heteroscedasticity is not a serious problem for this data.

Figure 4.3: scatter plot



Source: Own Survey (2019).

4.4.5. *Auto-correlation /Durbin-Watson Test/*

It is the assumption of independent error acceptable or reasonable test. Durbin-Watson used to test for serial correlation between errors. The Durbin-Watson statistic test can vary between 0 and 4. A value of 2 meaning residual statistics are uncorrelated Field, (2006). A value greater than 2 indicates a negative correlation between adjacent residuals, whereas a value below 2 indicates a positive correlation. Similarly, Ott and Longnecker (2001), defines when there is no serial correlation, the expected value of Durbin-Watson test statistics d is approximately 2.0; positive serial correlation makes $d < 2.0$ and negative serial correlation makes $d > 2.0$. Although, values of d less than approximately 1.5 (or greater than approximately 2.5) lead one to suspect positive (or negative) serial correlation. If serial correlation is suspected, then the proposed multiple linear regression models are inappropriate.

Referring this and the model summary table 4.6 below; the Durbin-Watson value of this study is 1.708. Therefore, the auto-correlation test met the requirement, since it falls between 1.5 and 2.5, and we can conclude that our model is free of serial correlation.

The five assumptions test of multiple regressions are met and the next step was processing the regression analysis to determine the values of the model fit (ANOVA), model summary (R and R²), and the Beta coefficients. Accordingly, the relative effect of corporate governance mechanism on return on asset was identified.

4.4. ANOVA Model Fit

Table 4.5: ANOVA Model Fit

ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.068	8	.009	10.126	.000 ^b
	Residual	.036	43	.001		
	Total	.105	51			
a. Dependent Variable: ROA						
b. Predictors: (Constant), proportion of directors holding degree and up, frequency of board meeting, percentage of women in board, percentage of independent board , number of board committee, number of board member						

Source: Own Survey (2019).

The regression model overall fit can be examined with the help of ANOVA. Accordingly, the overall significance of the model presented in ANOVA table 4.5 above, the total variance (10.126) was the difference in to the variance which can be explained by the independent Variables (Model) and the variance which was not explained by the independent variables (error). The study established that there existed a significant goodness of fit between variables as F-test $F(8, 43) = 10.126$, at $P=0.000 < 0.05$). This indicated that the model formed between effect of corporate governance mechanisms and return on asset was a good fit for the data.

4.5. Model Summary

Table 4.6 : Model Summary

Model Summary					
Model	R	R ²	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.808 ^a	.653	.589	.02905	1.708
<p>a. Predictors: (Constant), proportion of directors holding degree and up, frequency of board meeting, percentage of women in board, percentage of independent board , number of board committee, number of board member.</p> <p>b. Dependent Variable: Return on Asset.</p>					

Source: Own Survey (2019).

In the model summary above (table 4.6), the multiple regression coefficients R, indicates a very strong correlation of 0.808 between return on asset and the six independent variables of corporate governance mechanisms which are Board size, Board diversity, Frequency of Meeting, Board committee size, Board independency, and Board educational qualification. The R² =0.653 reveals that the model accounts for 65.3% of the variation in the return on asset and is explained by the linear combination of all the six independent variables of corporate governance mechanisms that affect return on asset (i.e. Board size, Board diversity, Frequency of Meeting, Board committee size, Board independency, and Board educational qualification). The remaining 34.7% is explained by other factors giving room for further study to investigate other factors which affect return on asset.

4.6. Beta Coefficient

Table 4.7: Multiple Regression Beta Coefficient Result

Model		Unstandardized Coefficients		Standardized Coefficients	Sig.
		Beta	Std.Error	Beta	
1	(Constant)	.212	.050		.000
	BFSIZE	-.010	.004	-.276	.026
	BDIV	-.079	.040	-.198	.057
	BMET	-.006	.002	-.349	.004
	BCOM	.010	.005	.259	.035
	BIND	.414	.114	.565	.001
	BEDUQ	-.030	.030	-.112	.311
	FSIZE	.000	.000	-.013	.963
	FAGE	.001	.001	.286	.226

Source: Own Survey (2019).

As it is defined in chapter three, the unstandardized coefficients (β_1 to β_8) are the coefficients of the estimated regression model. Hence, by including the error term (ε), the model for return on asset can be written as;

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + \varepsilon$$

$$Y = .212 - .01X_1 - .079X_2 - .006X_3 + .01X_4 + .414X_5 - .030X_6 + .001X_8$$

The intercept (β_0) is the point on the vertical axis where the regression line crosses the Y axis. The value of β_0 is .212 which means the expected value of return on asset is .212 when all the eight independent variables of corporate governance mechanisms assume zero value.

As it can be seen from table 4.7 above, the unstandardized coefficients of board independency is the largest value followed by size of board committee, board diversity, board educational qualification, board meeting and board size ranks from one to six respectively. The larger the standardized coefficient, the higher is the relative effect of the factors to the return on asset.

The significance test of the six explanatory variables indicate that four of the explanatory variables are significant with p-value ($p < 0.05$) for predicting return on asset and the remaining two from corporate governance mechanisms variable is insignificant with p-value ($p > 0.05$) for predicting return on asset and also both control variables are insignificant with p-value ($p > 0.05$) for predicting return on asset.

All the four independent variables board size, board meeting, size of board committee and board independency are found to be statistically significant. The beta coefficients of these factors indicate that a one unit increase in corporate governance will result increase or decrease in return on asset.

4.7. Hypothesis Test Result

According to Weiers (2008), if P value is less than the specified level of significance (α), reject the null hypothesis; otherwise, do not reject the null hypothesis. The hypothesis result of organizational culture practices which are shown below in table 4.8, ANOVA and table 4.7 regression unstandardized beta coefficients, for four alternative hypotheses P value is less than 0.05, and this means reject the null hypothesis and accept for other two null hypothesis p value is greater than 0.05. Therefore, the regression analysis agreed to accept four alternative hypotheses, and reject two alternative hypotheses. Hence, corporate governance mechanisms (Board size, board meeting) have a negative effect on return on asset and size of board committee and board independency have a positive effect on return on asset.

Table 4.8: Hypothesis Test Result

Hypothesis No.	Hypothesis	P-value	Relationship Direction	Result
Ha	Board Size affect return on asset	.026	Negative	Reject H_0
Ha	Board diversity affect return on asset	.057	Negative	Accept H_0
Ha	Board meeting affect return on asset.	.004	Negative	Reject H_0

Ha	Board committee size affect return on asset	.035	positive	Reject H ₀
Ha	Board independency affect return	.001	Positive	Reject H ₀
Ha	Board educational qualification affect return on asset.	.311	Negative	Accept H ₀

In general, the two alternative hypotheses are automatically rejected and four alternative hypotheses are accepted. These shows the shareholders have to work in these four factors to increase return on asset.

CHAPTER FIVE

5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The chapter provides the findings summary from chapter four as well as gives the conclusions and recommendations of the study based on the study's objectives. The objective of the study was to determine the effect of corporate governance on financial performance of insurance companies in Ethiopia. The study limitations and suggestions for further research have also been presented.

5.2. Summary of Findings

The objective of this study was to establish the effect of corporate governance on financial performance of insurance companies in Ethiopia. The study found out that board size and frequency of board meeting have negative and significant effect on the performance of insurance companies in Ethiopia. Board diversity and board's educational qualification have negative and insignificant while board committee size and board independency have positive and significant effect on the performance of insurance industry in Ethiopia

The study in general found that all except board diversity and board educational qualification, other corporate governance mechanisms considered for investigation have significant effect on the performances of insurance companies.

5.3. Conclusion

The effects of corporate governance on firm performance found on different study show that general conclusion on the topic are difficult and continue to be arguable. The finding of this study was also different from that of Fekadu, (2015) which concluded that all corporate governance mechanism considered in his study was insignificant effect on the performance of insurance company's in Ethiopia which showed that director's discretionary power was very minimal due to stringent set up of regulatory body.

Four years panel data of 13 insurance companies' was used for the study. Average ROA of the sampled insurance companies was to be 7.3% with average board size of 8 which is less by one from NBE minimum number set. The study shows that board size has negative and significant effect on the performance of the insurance companies leading to the support of this research hypothesis. This finding contradict with findings of Dallas (2004) who states that the size the

board has positive effect on firm's performance where as consistent with findings of Lipton and Lorsch (1992) and Yermack (1996) who argued that boards that were smaller were more productive and effective, which means that board size has negative effect on the performance. Even though the optimum size of board is debatable and inconclusive, this study shows that board size has adverse effect on the performance of insurance company's in Ethiopia.

Average board committee size found was 3 which are similar with the minimum committee to be established set by NBE and almost 89% of the board members were male while the remaining 11% were female. Of the total board members, only 3% are outsider board members and average number of meeting attended by board per year was 13 which is more than the number set by regulatory (NBE) 12.

Board diversity in respect of gender which is measured as the ratio of women in the board to the total number of board members has negative and insignificant effect on the performance of insurance companies leading for rejection of research hypothesis. This finding contradicts with many empirical finding which advocate gender diversity has a positive effect on firm performance, Boyle & Jane, (2011) finding said that Greater women representation on boards provides some additional skills and perspectives that may not be possible with all-male boards. He suggests that female board members will bring diverse viewpoints to the boardroom and will provoke lively boardroom discussions. On the other hand, Rose (2007) revealed insignificant association between number of women directors on the board and firm performance. This study's finding argued that women representation has adverse but insignificant effect on the performance of the insurance industry in Ethiopia. This is not a surprise for many Ethiopian companies due to the hangover of suppressed culture on women to influence male's decision. And also there is poor regulation from NBE to bring figure and decision making women in the board members.

From this result, frequency of board meetings which is considered as the time that directors spend in monitoring managerial performance has negative and significant effect on the performances of insurance companies which rejects the hypothesis. This is the same with the findings of (Jensen (1993 Karamanou and Vafeas, 2005) who reported negative relationship between number of meetings and firm performances where as contradicts with (Adams, 2000; Abbott et al., 2003; Funmi, 2014). This finding argues that too many meetings would indicate adverse effect on the organization as Priyanka, (2013) found in his study.

Size of board committee has positive and significant effect on the performances of insurance companies supporting the research hypothesis. This finding is consistent with the finding which says that independent, different and competent committees have positive effect on firm performance (Anthony, 2007; Cassandra et al., 2009). Therefore, diversified and different committees in boards can significantly affect the performance of insurance company in Ethiopia.

Board independence which is measured as the ratio of external board members (non share holders) to the total number of board members has positive and significant effect on the performance of insurance companies supporting the research hypothesis. This finding is consistent with the finding of Anthony, 2007; Musa et al., 2013).

Board educational qualification which is described as proportion of directors holding degree and above has a negative and insignificant effect on performance of insurance industries proving the rejection of the hypothesis. This finding contradicts with Gantenbein & Volonte, (2011), which argues that educational qualification affects the oversight and monitoring role of boards of directors and brings positive effect on the performance of insurance companies. Board educational qualification has no effect on the performance of the company as such.

The control variables firm size has negative and firm age have got positive relationship with the performances of the insurance companies. In general, board sizes, frequency of board meeting, size of board committee and board independency have significant effect on the performance of insurance companies in Ethiopia. Board diversity and board educational qualification have insignificant effect on the performance of insurance companies in Ethiopia.

In general, board size and frequency of board meeting have negative and significant effect on the performance of insurance companies in Ethiopia. Board committee size and board independency have positive and significant while board diversity and board's educational qualification have negative and insignificant effect on the performance of insurance industry in Ethiopia. Therefore, it could be concluded that contrary to the prior study by Fekadu,(2015) many of corporate governance mechanisms like board size, frequency of board meeting, board committee size and board independency have significant effect on performance of insurance company in which all stake holders need to give attention in nominating directors of insurance company in Ethiopia. This change was come from the relaxing of some regulation from NBE and change of business environment of Ethiopian insurance industry. This vibrantly shows that the role of directors in

closely regulated financial sector in Ethiopia is getting relaxed even if there are many areas to be improved.

5.4. Recommendations

According to the research findings and the concluded notions, the following main recommendations are forwarded:

- Stakeholders in Ethiopian insurance industry should take into account the board size, frequency of their meeting, size of board committee and board independency when forming board of directors as they are significant determinants of financial performance. That is the board should be organized in a way that will help the insurance companies improve their overall performance.
- The regulatory body, NBE has to amend some regulations related to board size and frequency of meeting since they have adverse effect on the performance of the companies.
- In forming board, even if the representation of women has insignificant effect, it is recommended to involve women not only be for simply representing them rather strong and influential women should be selected by share holders who can influence males decision in board room..
- According to this study board educational qualification is insignificant when it comes to determining listed firms' financial performance, thus it is not a priority for a moment but it is highly recommendable if the regulatory body (NBE) still relaxes more to increase the engagement and discretionary power of the directors in insurance companies so that the insignificant effect of some mechanisms would be changed.

5.5. Limitations of the Study

The study was based on a four year study period from the year 2015 to 2018 since this is the latest period and thus availability of data that is more applicable to the current business environment. However, if a longer duration of the study was used, it would have captured periods which was considered by prior study and also captured booms and recessions that the industry broadly experienced. This would have probably given a longer time focus thus a broader dimension to the problem.

This study applied secondary data in meeting its mandate. A review of the same case using primary data sources involving the experts in the insurance industry might bring out different

outcomes. The researcher decided to use secondary data because it is information from combined effort by experts to the public and is also easily obtained compared to primary data where in some cases the required data may not be easily obtained in instances where primary data is used.

5.6. Suggestion for Further Research

Similar studies to this can be carried out in future using both primary and secondary data to capture some significant information that this study was not able to capture due to the shortcomings associated with secondary data. For instance, women representation in the board has been found to be negative and insignificant in this study but the reason for this may strength of women represented in board which intentionally influenced by men, such finding can be captured through primary data. The study concentrated on the last four years since it was the most recent data available. Future studies may use a range of many years e.g. from 2000 to date and this can be helpful to confirm or disapprove the findings of this study.

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APPENDIX 1:

LIST OF INSURANCE COMPANIES IN ETHIOPIA CONSIDERED IN STUDY

S.No	Name	Remark
1	Abay Insurance S.C	
2	Anbesa Insurance S.C	
3	Africa Insurance S.C	
4	Awash Insurance S.C	
5	Buna Insurance S.C	
6	Ethiopian Insurance cooperation(EIC)	
7	Lucy Insurance S.C	
8	Nib Insurance S.C	
9	Nile Insurance S.C	
10	Nyala Insurance S.C	
11	Oromia Insurance S.C	
12	Tsehay Insurance S.C	
13	United Insurance S.C	