50

Internal Corporate Governance Structure and Financial Performance of Microfinance Institution in Ethiopia

By

Ayelu Beyene Gerbi

A Thesis Submitted to

School of Business and Public Administration

Department of Accounting and Finance

Post Graduate Program

For Partial Fulfillment of the Requirements for the Masters of Science Degree in Accounting and Finance

Addis Ababa University

February 2012

Addis Ababa

DECLARATION

I declare that this thesis is an output of my own research activities. In pursuant of this research work, concerted efforts were made to duly acknowledge references, bibliography and all sources of data and information used.

Ayelu Beyene Gerbi 

Internal Corporate Governance structure and Financial Performance of Microfinance Institution in Ethiopia

By

Ayelu Beyene Gerbi

A thesis Submitted to
Addis Ababa University
School of Business and Public Administration
Department of Accounting and Finance
Post Graduate Program

Approved by:

Dr S. Uganathan

Advisor Signature

Internal Examiner Signature

External Examiner Signature

Certificate

This is to certify that **Ayelu Beyene Gerbi** has carried out her research work on the topic entitled **"Internal Corporate Governance structure and Financial Performance of Microfinance institutions in Ethiopia"**. The work is original in nature and is suitable for submission for the reward of the Masters of Science degree in accounting and finance.

Advisor:Ulaganathan.(PhD): _____

ABSTRACT

This thesis contains the findings of an examination of the relationship between internal corporate governance structures and the financial performance of Ethiopian microfinance institutions, using a sample of 11 microfinance institutions from the year 2006 to 2009 (a total of 44 microfinance institutions-year observations). The corporate governance data was collected directly from the microfinance institutions chief executive officer, a secretary of board, and other board members, while the financial performance data was collected from the association of Ethiopian microfinance institution's financial analysis report. The thesis seeks to determine whether better-governed microfinance institutions tend to be associated with higher financial returns than their poorly-governed counterparts. The internal corporate governance-financial performance relation is investigated by applying the panel data regression analysis model. The results based on this regression analysis are mixed. First board diversity in gender, the frequency of board meeting and the existence of board committee has statistically significant negative impact on financial performance of microfinance institutions which was measured by return on asset (ROA). Second, board diversity in professional back ground, percentage of share held by board members, board size and percentage of nonexecutive directors have no statistically significant impact on financial performance of microfinance institutions which was measured by return on asset (ROA).

Acknowledgements

First and foremost I wish to express my deepest heartfelt gratitude to the Almighty God for seeing me through this course successfully and all my life. I would like to extend my sincere thanks to my advisor Dr. Ulanganathan for his valuable advice, guidance and constructive comments, without which this thesis would never have been completed. Also, I would like to thank all the staff of the Addis Ababa University, School of Business and Business Administration, as well as my fellow students for their respective support and encouragement during my studies.

Second, I would like to thank the staffs of the MFIs in Ethiopia and the AEMFI who voluntarily offered me with all the necessary data required for this research. This study would not have been possible without the support of this institutions' staff support by giving required data to me.

Finally, I would like to express my deepest gratitude to my family for their support in completing this goal. I especially thank my husband Tadesse Gemechu for his regular support, devotion, and encouragement in fulfilling this aspiration. I thank my son Ankawak Tadesse, my daughter Bontu Tadesse and Genet Abaraya for their patience and understanding when I absent for long during my studies at the Addis Ababa University. I am also indebted to Tashome Gemechu, Dessaleng Werkineh, Negassa Abewa, Birehane Abdena, Gemechu Gerba, Dr.Gemechu Beyene and all other who contributed their part in this endeavors. May God richly bless all of them and their family!!

Table of Contents

Contents

List of Figures and Table

Page

Definition of Key Terms and Abbreviations

ADCSI- Addis Credit and Savings Institution

Agar- Agar Microfinance Institution

AVFS- Africa Village Financial Services

Buussa- Buussa Gonofa Microfinance

CEO- Chief executive officer

Digaf- Digaf Microfinance Institution

Gasha- Gasha Micro-Financing

Harbu- Harbu Microfinance Institution

MFIs- microfinance institutions

NBE- National bank of Ethiopia

NED-Nonexecutive directors

OCSSCO- Oromia Credit & Savings share company

PEACE- poverty eradication and community empowerment

ROE- return on equity

ROI - return on investment

SFPI- Specialized Financial & Promotional Institution

Wisdom- Wisdom Micro-Financing Institution

ROA –return on asset: This indicator calculates the adjusted net income of the microfinance activity to average assets. It measures how well the institution's assets are utilized, or its ability to generate earnings with a given asset base.

CHAPTER I

1. 1. INTRODUCTION

The term 'corporate governance' has been developed with noticeable expansion with a number of definitions. For instance, Sheikh and Chatterjee (1995) define corporate governance as a system whereby board of directors is entrusted with responsibilities and duties in relation to the direction of a company's affairs. Similarly, Rock *et al.* (1998) define corporate governance as, a process by which a board of directors, through management, guides an institution in fulfilling its corporate mission and protects the institution's assets. Furthermore, corporate governance is a ways of ensuring that corporate actions, agents and assets are directed at achieving the corporate objective established by the corporation's shareholders (Sternberg, 2004). In its broadest sense, corporate governance refers to principles and rules regulating organizational operations to ensure that it achieves it goals (Recoletos, 2011).

Rock *et al.* (1998) argued that, good corporate governance is a key factor to strengthen the financial performance of microfinance institutions (MFIs) and increase outreach of microfinance services. Also they state that effective governance depends primarily on the skills and characteristics of the individual directors, like a diverse set of experiences, backgrounds, areas of expertise, ethnicity, and gender.

However, in the context of Ethiopia, the influence of corporate governance on the MFIs' performance has rarely been thoroughly investigated except limited reports that treat performance and governance of MFIs separately (e.g. Ayalew, 2006; Befekadu, 2007; Wolday, 2008; Letenah, 2009). For instance, Befekadu (2007), has identified that "microfinance institutions(MFIs) are operationally sustainable as measured by return on asset, return on equity and the industry's profit performance with little say on the role of corporate governance on financial performance". Befekadu's argument holds true when seen from financial sustainability point of view but with little regards to the role of corporate governance on financial performance.

With respect to corporate governance, in Ethiopia, Ayalew (2006) also argued that, "ownership composition, effectiveness of board composition, functions and responsibilities are not in line with best microfinance governance practices". The existing empirical gap on the relationship between good corporate governance and financial performance of MFIs in Ethiopia hence initiated this research.

Therefore, this research aims (1) to fill the existing gap and (2) to provide recommendations that would shape the relationship between good internal corporate governance structure and financial performance of microfinance institutions operating in Ethiopia.

The study also, is believed to contribute towards the efforts made yet to ensure all-encompassing good internal governance structure in the microfinance institutions. As almost all microfinance institutions in Ethiopia are in their early growth/expansion stage ensuring good corporate governance will be imperative even to survive and attain their maturity stage. Thus, to identify the currently existing governance problems and come up with possible recommendation in this young economic arena; is meant to contribute to the goal of stakeholder's value maximization which in turn contributes to the wellbeing of the society at large as a package of the institutions social responsibility. It is also believed that this study will serve as a stepping stone for future research in this buffer zone.

To this end, this thesis organized into five sections. The first section is an introductory part, the second is literature review, the third is research design, the fourth is data presentation, result and discussion and the last section is summary of findings, conclusions and recommendations.

1.2. Statement of the problem

As it is expressed above, corporate governance in the broadest sense refers to principles and rules regulating organizational operations to ensure that it achieves its goals. And, a Board of Director is a key player in an institution's governance structure because it is responsible for the strategic management, control and monitoring regarding the

institution's achievement of its objectives. Good internal corporate governance also contributes to efficient management considering stakeholder interests, and boosting institutional reputation, integrity as well as fostering customer trust (Recoletos, 2011).

Good governance means that an organization has a system of processes and rules that guarantee fulfillment of its mission and the efficient use of resources. A good internal corporate governance structure is efficient if it generates maximum reward for all of the parties involved, including shareholders, creditors, employees, customers, authorities and other third parties affected by the institution's activities. So, for microfinance institution (MFI) to be successful in the implementation of good internal corporate governance program there is a need for a strong and independent Board of Directors to lead the process. In this regards, in Ethiopia, Ayalew (2006) however argued that, "ownership composition, effectiveness of board composition, functions and responsibilities are not in line with best microfinance governance practices''.

Similarly, in the case of Ethiopia, Derk *et al*, (2009) have identified the existence of major gap in the area of board size, board composition and election, board tenure, board committees, board documents, conflicts of interest and board performance and evaluation, all with its implication on the performance of microfinance institutions (MFIs). The existing gap on the relationship between good internal corporate governance and financial performance of MFIs in Ethiopia hence is an area that needs to be researched. This research hence aims to identify the relationship between internal corporate governance structure and the financial performances of microfinance institutions in Ethiopia, and come up with feasible recommendations that would shape the relationship between good internal corporate governance and financial performance of MFIs operating in Ethiopia.

1.3. General Objective of the Study

The objective of the study is to identify the relationship between internal corporate governance structure and financial performance of microfinance institutions in Ethiopia

1.4. Specific Objectives of the Study

To achieve the above indicated general objective, the study is designed to achieve the following specific objectives:

- To identify the impact of board size on financial performance of MFIs.
- To assess the impact of board diversity in gender on financial performance of microfinance institutions (MFIs).
- To assess the impact of board diversity in professional backgrounds on financial performance of microfinance institutions (MFIs).
- To assess the impact of frequency of board meeting has on financial performance of microfinance institutions (MFIs).
- To assess the impact of the existence of board committee on financial performance of microfinance institutions (MFIs).
- To assess the impact of percentage of shares held by board members on financial performance of microfinance institutions (MFIs).
- To assess the impact of percentage of executive directors in board members on financial performance of microfinance institutions (MFIs).

1.5 Hypotheses

Based on the review of the scientific literatures, the following research hypotheses (null and alternative hypothesis) were formulated for this study..

Hypothesis #1

Ho: There is no statistically significant relationship between the presence of internal board committees and MFIs financial performance, as measured by Return on Asset (ROA).

H1: There is a statistically significant relationship between the presence of internal board committees and MFIs financial performance, as measured by Return on Asset (ROA).

Hypothesis #2

Ho: *There is no statistically significant relationship between board diversity in gender and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant relationship between board diversity in gender and MFIs financial performance, as measured by ROA.*

Hypothesis #3

Ho: *There is no statistically significant relationship between board diversity in professional backgrounds and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant relationship between board diversity in professional backgrounds and MFIs financial performance, as measured by ROA.*

Hypothesis #4

Ho: *There is no statistically significant relationship between percentage of shares held by board members and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant relationship between percentage of shares held by board members and MFIs financial performance, as measured by ROA.*

Hypothesis #5

Ho: *There is no statistically significant relationship between board size and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant relationship between board size and MFIs financial performance, as measured by ROA.*

Hypothesis #6

Ho: *There is no statistically significant relationship between the frequency of board meetings and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant positive relationship between the frequency of board meetings and MFIs financial performance, as measured by ROA.*

Hypothesis #7

Ho: *There is no statistically significant relationship between the percentage of executive board and MFIs financial performance, as measured by ROA.*

H1: *There is a statistically significant relationship between the percentage of executive board and MFIs financial performance, as measured by ROA.*

1.6. Significance of the Study

The study is believed to contribute towards the efforts made to ensure all-encompassing good governance in the microfinance institutions economic sector in Ethiopia. As almost all microfinance institutions in Ethiopia are in their early stage, ensuring good internal corporate governance will be imperative for their sustainable development. Thus, identifying the existing good corporate governance in this economic sector is meant to contribute towards enhancing financial performance of the MFIs, the shareholder's value maximization and satisfaction of stakeholders. Additionally, this study is believed to provide relevant data for further research on corporate governance of microfinance institutions in Ethiopia.

1.7. Scope of the Study

The study is delimited to address the existing relationship of good internal corporate governance structure and financial performance of the currently existing thirty one microfinance institutions in Ethiopia. This shall be done by taking eleven of the thirty-one MFIs as a representative sample (six from the larges, four from the mediums and one from the smalls), based on their gross loan portfolios. To this end, this study shall base on data of the past four years (2006-2009).

1.8. Organization of the Thesis

The thesis is managed under five chapters. Under chapter one, introductory issues including; the objectives of the study, statement of the Problem, research questions and hypothesis, scope, and significance of the study are included. Chapter two accommodates the theoretical framework and review of related literature. Chapter three outlines the research methods and techniques, whilst chapter four deals with the main (finding) section of the paper. The last chapter (chapter5) provides conclusions for the research findings.

CHAPTER II

2. LITERATURE REVIEW

2.1. Definitions and Concepts

2.1.1. Governance

As it is expressed above, Good internal corporate governance is deified as a system whereby board of directors is entrusted with responsibilities and duties in relation to the direction of a company's affairs (Sheikh and Chatterjee, 1995). It also defined as a process by which a board of directors, through its management guides an institution in fulfilling its corporate mission and protects the institution's assets over time (Rock *et al.*, 1998). Similarly, Sternberg (2004) define corporate governance as a ways of ensuring that corporate actions, agents and assets are directed at achieving the corporate objective established by the corporation's shareholders. In its broadest sense it also refers to principles and rules regulating organizational operations to ensure that it achieves its goals (Recoletos, 2011).

2.1.2 Financial Performance

As it is cited in the Amha &kifle (2011), financial performance of MFIs is reviewed based on four financial performance measurement indicators. Which includes, return on asset, Return on equity, operational self-sufficiency and financial self-sufficiency.

The operational self-sufficiency considers the extent that financial revenue covers financial expense, loan impairment charge and operating expense without making adjustment for no lending activities or other income such as donations.

Financial self-sufficiency is similar to operational self-sufficiency; however the ratio includes inflation and other adjustments. The effect of adjustment increases financial expenses, impaired loan loss provision and operating expenses. The difference between financial self-sufficiency and operational self-sufficiency is that, the financial self-sufficiency measures only an institutions ability to cover its operating cost but also its

ability to maintain the value of its equivalent to inflation and to operate and expand without subsidies.

Return on equity and return on asset are the most commonly used indicators to measure a MFIs ability to continue operating in the future. Return on equity measures, net operating income less taxes as a percentage of total equity.

Return on asset is an indicator that calculates the adjusted net income of the microfinance activity to average assets. It measures how well the institution's assets are utilized, or its ability to generate earnings with a given asset base (Saltzman and Salinger, 1998).

2.1.3. Board of Directors Composition

Recolatos (2011) states that, Board of directors can be formed by internal and external Directors, who can be independent or not. The total number of independent Directors should represent at least one third of the total number of Board members. The inclusion of External Directors is considered a good governance practice because it increases the Board's independence and objectivity. Similarly Baysinger & Butler (1985) argues a mix of insiders and outsiders on the board and find empirical support that this approach enhances firm performance. Also John and Senbet (1998) argue that a board is more independent if it has more non-executive directors (NEDs).

In addition Rock *et al.* (1998) indicates relevant skills to any MFI board include business sense, microfinance experience, financial markets expertise, legal and regulatory expertise, marketing expertise, public relations, technology expertise, and fundraising. The same author also states that, effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, areas of expertise, ethnicity, and gender (Rock *et al.* 1998, p, 32).

Also Recolatos (2011) states that, Board must have members with the necessary technical knowledge to fulfill the institution's strategic priorities. In a MFI, usually the Board is formed by people with broad financial knowledge, social awareness, good public relations, ability to liaise with investors and contributors, legal knowledge and familiar

with the microfinance sector. Not everyone who sits on the Board has to have knowledge in all of these areas, but it does as a group. The same author also states that, Promoting diversity in terms of gender, ethnicity and country of origin is considered a good practice because it encourages policies that consider different points of view and enriches the decision-making process (Recolatos 2011, p, 25).

2.1.3. Board of Directors Size

Lipton & Lorsch (1992) argue that large boards are less effective and are easier for the CEO to control. The same author also suggests an optimal board size between seven and nine directors.

Also, Rock *et al.* (1998) states that, the capacity of the board to function effectively partly depends on its size. Although there is no optimum number of board members, extremes of size should be avoided. A microfinance board should be big enough to incorporate the various skills and perspectives as outlined above. However, it must be small enough to accommodate the need for frequent meetings, given the characteristics of microfinance.

Similarly, Vafeas (1999) argued that, as board size increases board activity is expected to increase to compensate for increasing process losses. The argument is that large boards are less effective and are easier for a CEO to control. The cost of coordination and processing problems is also high in large boards and this makes decision-taking difficult. On the other hand, smaller boards reduce the possibility of free-riding and therefore have the tendency of enhancing firm performance.

In addition, Recoletos (2011) states that, the right number of Directors must be established to allow productive discussions and proper decisions. In larger MFIs, the Board's size must allow the work of the different committees to be managed properly. There is no rule as to the right size for a Board of Directors because it depends to a large extent on each institution's situation. The Board needs to be large enough to cover all of the skills necessary to efficiently guide and supervise the institution. The number of Directors also needs to be small enough to ensure a high level of participation and involvement for a streamlined and effective decision-making process.

The same author also states that, there is no ideal number, but a Board with between 5 and 9 members is usually sufficient for most MFIs to run smoothly. Boards with less than 5 members pose problems because the necessary diversity and skills are not usually found in such a small group and a group of less than 5 will have difficulties finding the quorum required to take decisions. Boards with more than 9 members, unless they are very large institutions with lots of committees, are usually difficult to manage and do not have the right level of cohesion for the Board to reach a consensus.

2.2. Fundamental Corporate Governance Theories

As it is cited in Kyereboah (2007) literature there is different corporate governance theories, includes agency theory, stewardship theory, stakeholder theory, and resource dependency theory.

2.2.1 Agency Theory

It is an acknowledged fact that the principal-agent theory is generally considered the starting point for any debate on the issue of corporate governance emanating from the classical thesis on Berle and Means (1932). Modern firms are seen to suffer from separation of ownership and control and therefore are run by professional managers (agents) who cannot be held accountable by dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? The principals are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem: they must give agents (managers) the right incentives to make decisions aligned with shareholder interests

The following represent the key issues towards addressing opportunistic behavior from managers within the agency theory:

- **Composition of board of directors:** The board of directors is expected to be made up of more non-executive directors (NEDs) for effective control. It is argued that this

reduces conflict of interest and ensures a board's independence in monitoring and passing fair and unbiased judgment on management.

• **CEO duality**: It is expected also that different individuals occupy the positions of CEO and board chairperson as this reduces the concentration of power in one individual and thus greatly reduces undue influence of particular management and board members.

2.2.2 Stakeholder Theory

One argument against the strict agency theory is its narrowness, by identifying shareholders as the only interest group of a corporate entity necessitating further exploration. By expanding the spectrum of interested parties, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). The stakeholder theory is therefore appears better in explaining the role of corporate governance than the agency theory by highlighting the various constituents of a firm. Thus, creditors, customers, employees, banks, governments, and society are regarded as relevant stakeholders. Related to the above discussion, John and Senbet (1998) provide a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm. They also emphasize the role of non-market mechanisms such as the size of the board, committee structure as important to firm performance.

Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, McDonald and Puxty (1979) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, has responsibilities to that society. One must however point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic

value is created by people who voluntarily come together and cooperate to improve everyone's position (Freeman *et al.*, 2004).

Jenson (2001) critique the Stakeholders theory for assuming a single-valued objective (gains that accrue to a firm's constituencies). The argument of Jensen (2001) suggests that the performance of a firm is not and should not be measured only by gains to its stakeholders. Other key issues such as flow of information from senior management to lower ranks, inter-personal relations, working environment, etc. are all critical issues that should be considered. Some of these other issues provided a platform for other arguments as discussed later. An extension of the theory called an enlightened stakeholder theory was proposed. However, problems relating to empirical testing of the extension have limited its relevance (Sanda *et al.*, 2005).

2.2.3 Stewardship Theory

This theory, arguing against the agency theory posits that managerial opportunism is not relevant (Donaldson and Davis, 1991; Davis, Schoorman and Donaldson, 1997; Muth and Donaldson, 1998). According to the stewardship theory, a manager's objective is primarily to maximize the firm's performance because a manager's need of achievement and success are satisfied when the firm is performing well. One key distinguishing feature of the theory of stewardship is that it replaces the lack of trust to which agency theory refers with respect for authority and inclination to ethical behavior. The stewardship theory considers the following summary as essential for ensuring effective corporate governance in any entity:

• **Board of directors:** The involvement of non-executive directors (NEDs) is viewed as critical to enhance the effectiveness of the board's activities because executive directors have full knowledge of the firm's operations. Thus, it is believed that the appointment of NEDs will enhance decision-making and ensure the sustainability of the business.

• **Leadership:** Contrary to the agency theory, the stewardship theory stipulates that the positions of CEO and board chair should be concentrated in the same individual. The reason behind is that, it affords the CEO the opportunity to carry through decision

quickly without the hindrance of undue bureaucracy. We must rather point out that this position has been found to create higher agency costs. The argument is that when governance structures are effectively working, there should not be undue bureaucratic delays in any decision-making.

Finally, it is argued that small board sizes should be encouraged to promote effective communication and decision-making. However, the theory does not stipulate a rule for determining the optimal board size and for that matter what constitutes small?

2.2.4 Resource Dependency Theory

This theory introduces accessibility to resources, in addition to the separation of ownership and control, as a critical dimension to the debate on corporate governance. Again, the theory points out those organizations usually tend to reduce the uncertainty of external influences by ensuring that resources are available for their survival and development. By implication, this theory seems to suggest that the issue of dichotomy between executive and non-executive directors is actually irrelevant. How then does a firm operate efficiently? To resolve this problem, the theory indicates that what is relevant is the firm's presence on the boards of directors of other organizations to establish relationships in order to have access to resources in the form of information which could then be utilized to the firm's advantage. Hence, this theory shows that the strength of a corporate organization lies in the amount of relevant information it has at its disposal.

The next subsections will review literatures on a set of internal corporate board structure variables which includes, board diversity, corporate board size, role or CEO duality, the percentage of non-executive directors, the frequency of board meetings, the presence of key internal board committees (namely, audit, nomination, and remuneration committees), and director share ownership, that have been found to influence performance of institutions.

2.3. Empirical Literatures on Corporate Board Structure and Financial Performances

Brennan (2006) argued that, to be able to protect shareholders' interests, corporate boards must be effective and efficient in performing their functions, like giving direction, executive action (strategy), service and resource support (resource mobilization), supervision (monitoring), and accountability. And, Effective and efficient board performance is influenced by several factors, such as board diversity, composition, and size, amongst others (Baranchuk and Dybvig, 2009).

Also Fillatotchev and Boyd (2009) argued that, corporate board of directors is seen as a central part of any internal corporate governance structure.

2.3.1. Board Committees and Financial Performance

Prior literature suggests that board committees help to improve the effectiveness and efficiency of corporate boards (Jiraporn *et al.*, 2009, p.820). According to Harrison (1987, p.109), there are two generic types of board committees: monitoring or oversight and management supporting or operating. Operating board committees advise management and the board on major business decision. Their monitoring counterparts are intended to protect shareholder interests by providing objective, independent review of corporate executives and affairs.

There are conflicting theoretical suggestions as to the relationship between monitoring board committees and financial performance. One line of the theoretical literature suggests that the establishment of these committees can impact positively on performance because of different reasons. For instance, Harrison (1987) argued that, by their composition, board committees help in bringing individual director's specialist knowledge and expertise to bear on the board decision-making process (Harrison, 1987, p.111). This also allows the main board to devote attention to specific areas of strategic interests and responsibility.

Also Klein (1998) argued that, unlike the main board or operating committees monitoring board committees are usually entirely composed of independent NEDs, making them

better placed to protect shareholders' interests by effectively scrutinizing managerial actions. And Vefeas and Theodorou (1998) also argued that, the nomination committee is responsible for nominating candidates for appointment to the board. This minimizes the agency conflict by improving board independence and the quality of appointed directors (Vefeas and Theodorou, 1998, p.390).

Klein (1998) also argued that, the principal function of the audit committee, for example, is to meet regularly with the firm's external and internal auditors to review the company's financial statements, audit process and internal accounting controls. This helps reduce agency costs and information asymmetry by facilitating timely release of unbiased accounting information by managers to shareholders (Klein, 1998, p.279). Also, effective monitoring by the audit committee may help minimize financial fraud and increase firm value.

Additionally, Weir and Laing (2000) argued that, the remuneration committee determines and reviews the nature and amount of all compensation for directors and senior officers of the firm. This also helps in reducing the agency problem by constructing and implementing remuneration schemes and incentives designed to better align the interests of managers and shareholders (Klein, 1998, p.279; Weir and Laing, 2000, p.268). Weir *et al.* (2002) also argued that, board committees enhance corporate accountability, legitimacy and credibility by performing specialist functions (Weir et al., 2002, p.585).

Furthermore, Karamanou and Vefeas (2005) argued that, by their relative small size, board committees are able to meet more frequently. This provides sufficient time for meaningful dialogue and in reaching consensus decisions quicker (Karamanou and Vefeas, 2005, p.458)

In line with the theoretical literature, a part of the empirical literature suggests a positive board committees-performance relationship. For instance, Wild (1994) examines market reaction before and after the establishment of audit committees by a sample of 260 US firms. He reports a statistically significant improvement in share returns following the establishment of audit committees, which suggests that the presence of audit committees

can enhance managerial accountability to shareholders. Also, evidence by Vefeas and Karamanous (2005) in 275 Fortune 500 firms is consistent with prior research that the presence of audit committees is positively associated with firm financial performance.

Similarly, by using a sample of 606 large US listed firms; Vefeas (1999b) reports a positive relationship between the establishment of nomination committees and the quality of new director appointments. This implies that nomination committees can improve board quality, which may ultimately improve the effectiveness with which the board carries out its monitoring and advisory roles.

Also Mangena and Chamisa (2008) find in a sample of 81 South African listed firms that the presence of an audit committee significantly reduces the possibility of a firm being suspended from the stock exchange. This indicates that the presence of audit committees improve internal monitoring, reduce internal fraud and enhance compliance with corporate regulations.

Additionally, by using samples of US listed firms, Chaochharia and Grinstein (2009) and Sun and Cahan (2009) report a significant decrease in CEO compensation for US firms with independent compensation committees compared with those without compensation committees. This suggests that the establishment of independent compensation committees is associated with better monitoring of managerial compensation.

By contrast, others suggest board committees can impact negatively on performance because of various reasons. For instance, Goodstein, *et al.* (1994) and Conger *et al.* (1998) argued that, board committee can result in excessive managerial supervision, which can inhibit executive initiative and vision. Also, it may result in duplicating corporate board duties and responsibilities. This will have additional costs implications for firms. Additionally, by creating generalists and specialists among board members, board committees have the potential of generating conflicts in ideas and impairing boardroom cohesion.

Also, Vefeas (1999a) argued that, the establishment of board committees imposes extra costs in terms of managerial time, travel expenses and additional remuneration for the members of the committees (Vefeas, 1999a, and p.118).

In line with the theoretical literature, a constituent of the empirical literature suggests a negative board committees-performance relationship. In a sample of 220 large British listed firms, Main and Johnston (1993) examined the role of remuneration committees in British boardrooms. They reported that the presence of a remuneration committee is associated with higher executive pay, which reduces shareholder value. Similarly, using 307 US listed firms from 1990 to1994, Vefeas (1999a) found a negative relationship between the establishment of board committees (namely, audit, remuneration, and nomination) and firm value.

The other stream of the empirical literature suggests no empirical relationship between board committees and performance. For instance, by using a sample of 486 US firms over the period 1992-1993, Klein (1998) examines the association between the presence of audit, compensation, and nomination committees and financial performance, but finds no statistically significant relationship. Also, Vafeas and Theodorou (1998) investigate the impact of audit, remuneration and nomination committees on the performance of 250 UK listed firms in 1994. They find no evidence in favor of the idea that the existence of the three board committees significantly affected firm financial performance. Similarly, Weir and Laing (2000), Weir *et al.* (2002), Dulewicz and Herbert (2004), and Bozec (2005) provide evidence, which shows that the establishment of the three board committees has no significant impact on financial performance.

2.3.2. Board Diversity and Financial Performance

Board diversity has broadly been defined as the various attributes that may be represented among directors in the boardroom in relation to board process and decision-making, including age, gender, ethnicity, culture, religion, constituency representation, independence, knowledge, educational and professional background, technical skills and expertise, commercial and industry experience, career and life experience (Van der Walt and Ingley, 2003, p.219).

Cox & Blake (1991) show how managing cultural diversity can create a competitive advantage for firms in six areas. There are cost, resource acquisition, marketing, creativity, problem-solving, and organizational flexibility. Robinson & Dechant (1997) also present three business reasons for diversity. There are cost savings, winning competition and driving business growth.

Similarly Rock *et al.*1998, states that Effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, areas of expertise, ethnicity, and gender (Rock *et al.*1998, p.31). Also Recoletos, 2011, states that In addition to the necessary technical training, the Board members should contribute with different points of view, experiences and values. Promoting diversity in terms of gender, ethnicity and country of origin is considered a good practice because it encourages policies that consider different points of view and enriches the decision-making process (Recoletos, 2011, p.25).

Goodstein *et al.*, (1994, p.241) argued that, board diversity helps to link a firm to its external environment and secure critical resources, including skills, business contacts, prestige and legitimacy. Also Shrader *et al.*, (1997,p.355) states that corporate boards of qualified individuals of diverse backgrounds and constituencies can help to provide a better link with a firm's stakeholders, such as consumers and the local community. This can improve a firm's reputation and commercial opportunities. Also VanderWalt and Ingley, (2003, p.219) suggests that boards of diverse backgrounds rather than homogenous selected groups with similar socio-economic backgrounds, increases board independence and improves executive monitoring. Similarly Carter *et al.* (2003, p.36) argued that, diversified boards can also increase creativity and innovation in boardrooms due to diversity in cognitive abilities, which can also facilitate effective decision-making. In addition Rose (2007, p.405) argues that a higher degree of board diversity may serve as a positive signal to potential job applicants. This will help to attract well qualified persons outside the circles where board candidates are usually recruited from. This can also generate healthy competition within the firm's internal labor market. Furthermore,

Baranchuk and Dybvig, (2009, p.715) argued that, it brings diversity in ideas, perspectives, experience, and business knowledge to the decision-making process in boardrooms.

Empirically, one stream of the empirical literature suggests positive empirical relationship between board diversity and performance.

For instance, Adler (2001) finds a positive correlation between firms that employ higher percentage of women in top management and a raft of accounting measures of performance, including ROA. Similarly, Carter *et al.* (2003) also report a positive relationship between board diversity (measured by gender and ethnicity) and market measure of performance. Also Hiratsuka (2004) examined governance and performance of microfinance institutions in central and Eastern Europe and the newly independent states and she report that Board diversity improves both outreach and sustainability of MFIs. In addition, Armendariz *et al.* (2005) also reported that, having a female CEO or a high fraction of women on the board would help the MFI understand its customers better. Thus, this better customer knowledge should influence both the MFI's operational costs as well as its overall profitability. Consistent with prior evidence, Francoeur *et al.* (2008) examine whether the participation of women in a firm's board and senior management enhances financial performance in a sample of 230 of the 500 largest Canadian listed firms. Applying Fama and French three factor model, they report that firms operating in complex environments do generate positive and significant abnormal returns when they have a higher proportion of women officers.

The other stream of the empirical literature suggests negative empirical relationship between board diversity and performance. For instance, Shrader *et al.* (1997) examine the association between the percentage of female board members and two accounting measures of financial performance (ROA and ROE) for a sample of 200 American Fortune 500 firms in 1992 and argued a statistically significant and negative relationship between the percentage of women on the board and firm performance.

The third stream of the empirical literature suggests no empirical relationship between board diversity and performance. For instance, Rose (2007) investigates whether female board representation influence firm performance using a sample of Danish listed firms and argued the absence of significant link between firm performance and female board representation.

2.3.3. Director Share Ownership and Financial Performance

Different authors suggest that director share ownership helps in reducing the conflicts of interest that exists between shareholders and managers. This convergence-of-interests model maintains that as the proportion of equity owned by directors increases, their interests and those of shareholders become more aligned and the incentive to indulge in opportunistic behavior diminishes. This is because the greater their financial stake in the form of share ownership, the greater the costs they will incur for not maximizing shareholders wealth. Consequently, directors who own large blocks of shares have additional incentive to actively monitor managerial actions that can help reduce agency costs and increase firm financial performance (Jensen and Meckling, 1976; Fama, 1980; Jensen, 1993).

However, another strand of the literatures suggests director entrenchment as an alternative hypothesis to convergence-of-interests .The entrenchment hypothesis proposes that at low levels of director share ownership, the competitive internal and external market forces can help align the interests of directors with those of shareholders. However, it contends that at high levels of shareholding, directors may hold sufficient voting power to protect themselves against such disciplinary forces, and as such directors will prefer to pursue non-wealth maximizing goals. This is because the private benefits in the form of perquisites consumption, such as guaranteed employment with an attractive salary that will accrue to directors are greater than the utility that they will obtain from pursuing optimal projects that will increase the wealth of all shareholders. This results in director entrenchment in which other shareholders are unable to remove or influence the actions of the managing directors, even in the face of serious under performance or misbehavior. In this case, the director share ownership-performance relationship is

expected to be negative (Morck et al., 1988; McConnell and Servaes, 1990; Short and Keasey, 1999).

Empirically, by using a sample of 87 European firms, Krivogorsky (2006) argued a positive association between director share ownership and financial performance, as measured by ROA. Similarly Kapopoulos and Lazaretou (2007) have supported the positive relationship for a sample of 175 Greek listed firms. In addition, by using a sample of 72 listed Zimbabwean firms over the period 2002-2004, Mangena and Tauringana (2008) argued a positive association between director share ownership and financial performance, as measured by ROA.

In contrast, Ho and Williams (2003) find that director ownership is negatively related to a firm's physical and intellectual capital performance in a sample of 84 South African listed firms. Similarly, Sanda *et al.* (2005) report an inverse relationship between director share ownership and financial performance measures, including ROA, ROE, in a sample of 93 Nigerian listed firms from 1996 to 1999 and argued the negative relationship between director share ownership and financial performance. In addition, Haniffa and Hudaib (2006) argued the inverse relationship between director share ownership and financial performance measures by using a sample of 347 Malaysian listed firms.

2.3.4. Corporate Board size and Financial Performance

Lipton and Lorsch (1992) suggest that corporate board size must preferably fall between eight and nine directors. They argued the reason behind that is, as corporate board size goes beyond a maximum number of ten directors, additional costs of having larger boards typically associated with slow decision-making are higher than any marginal gains from intense monitoring of management's activities. Also, it is contended that smaller boards are more likely to be cohesive, and to have more effective discussions. This is because all directors are able to candidly contribute and express their ideas and opinions within the limited time available (Lipton and Lorsch, 1992, p.67-68).

Similarly, Jensen (1993) argued that when a board gets too big, it does not only become difficult to co-ordinate, but also comparatively easier to control by a dominant CEO due

to associated director shirking and free-riding (Jensen (1993, p.865) . In addition, Sonnenfeld (2002) argued that, larger boards are bad, while smaller boards are good and effective at improving financial performance (Sonnenfeld , 2002, p.108) . This is because while they plan, organize, direct and control the business of the organization, the size of the board has also got financial costs implications. That is, larger boards consume more pecuniary and no pecuniary company resources in the form of remuneration and perquisites than smaller boards. Furthermore, Yawson (2006) argued that larger boards suffer from higher agency problems and are far less effective than smaller boards. Thus, limiting corporate board size may improve efficiency (Yawson, 2006, p.77). Also, the Board needs to be large enough to cover all of the skills necessary to efficiently guide and supervise the institution (Recoletos, 2011, P.24).

Empirically, Yermack, (1996) investigated the relationship between board size and financial performance in a sample of 452 large US industrial corporations. Generally, he found out an inverse relationship between corporate board size and financial performance. Similarly, Eisenberg *et al.* (1998) examined the association between board size and performance in a sample of 879 small and medium size Finnish firms. Consistent with Yermack (1996), they argued a negative correlation between firms' profitability, measured by industry-adjusted return on assets (ROA) and board size.

Also, Bohren and Strom (2005) report that larger boards are associated with lower firm performance, measured as ROA. And Hartarska (2005) adds the same negative result in ROA. In addition, by using a large sample of 2,746 UK listed firms, Guest (2009) argued a statistically significant and negative relationship between board size and performance, as measured by ROA, and share returns.

On contrary, Pearce and Zahra (1992) and Goodstein *et al.*, (1994) argued that, larger boards offer greater access to their firm's external environment, which reduces uncertainties and also facilitates securing critical resources, such as finance, raw materials, and contracts. Also, Dalton *et al* (1999) argued that large boards may be beneficial because they increase the pool of expertise and resources available to the organization. Consistent with this, Kiel and Nicholson (2003) suggested that, a larger

number of people with varied expertise will be better placed to subject managerial decisions to greater scrutiny and monitoring (Kiel and Nicholson, 2003, p.194).

In addition, Haniffa and Hudaib, (2006) argued that larger boards may possibly be better for corporate financial performance because of its association with diversity in skills, business contacts, and experience that smaller boards may not have, which offers greater opportunity to secure critical resources Haniffa and Hudaib, (2006, p.1038).

John and Senbet (1998) also argued that, a corporate board's monitoring capacity is demonstrated to be positively related with board size (John and Senbet, 1998, p.385). Consistent with this Sanda *et al.* (2005) find a positive correlation between board size and profitability, as measured by return on equity (ROE).

Furthermore, Haniffa and Hudaib (2006), employing an accounting measure of performance, as measured by ROA, find a positive relationship between board size and performance. Similarly, Mangena and Tauringana (2008) report a positive relationship between board size and performance in an environment of severe political and economic uncertainty.

2.3.5. Board Meetings and Financial Performance

The association between the frequency of board meetings and financial performance is another internal corporate governance issue that gives rise to concern for policy-makers and researchers. There are two theoretical views on this issue: those who are in favor of higher frequency of board meetings and those who are not.

Consistent with findings of Conger *et al.*, (1998, p.142),Vefeas (1999a, p.116) argued that, the frequency of board meetings measures the intensity of a board's activities, and the quality or effectiveness of its monitoring. Also Vefeas (1999a) suggested that, all else equal, a higher frequency of board meetings will result in a higher quality of managerial monitoring, which can impact positively on financial performance. It has been contended that regular meetings allow directors more time to confer, set strategy, and to appraise managerial performance (Vafeas 1999a, p.118). Also, Mangena and Tauringana, (2006, p.12) states that, frequency of board meeting can help directors to remain informed and

knowledgeable about important developments within the firm. This will place the directors in a better position to timely address emerging critical problems (Mangena and Tauringana, 2006, p.12).

In contrast, Lipton and Lorsch, (1992, p.64) suggest that, 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.

Jensen (1993, p.866) opposes 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. Consistent with Jensen's (1993), Vafeas (1999a) 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. Also board meetings are costly in the form of managerial time, travel expenses, refreshments and directors' meeting fees (Vafeas 1999a, p.118).

Empirically, Vafeas (1999a) reports a statistically significant and negative association between the frequency of board meetings and financial performance. By contrast, he finds that operating performance significantly improves following a year of abnormal board activity. This suggests that while directors who confer more regularly can make better decisions and engage in active monitoring, the potential benefits of such intense monitoring are expected to reflect in future years' performance. That is, board decisions may have gestation period within which their full benefits may be realized.

Also, Carcello et al. (2002) establish a positive relationship between the amount of audit fees paid and the frequency of audit committee meetings. This means that audit committees that meet more frequently pay higher audit fees, which reduces financial performance. Fich and Shivdasani (2006) also offer evidence, which is in line with the results of prior research that boards that meet more frequently are, valued less by the market. .

On the contrary, Karamanou and Vafeas (2005) find a positive association between board meeting frequency and the accuracy of management earnings forecasts. Also, Mangena and Tauringana (2006) report a positive relationship between the frequency of board meetings and firm performance for a sample of 157 Zimbabwean listed firms. Their results support the proposition that monitoring becomes more intense in periods of crisis, and companies whose board meet more frequently perform better.

The third stream of empirical literatures argued that, that the frequency of board meetings has no association with economic performance in a small sample of 24 Tunisian listed firms and he suggests that financial performance, which is tied most closely to the quality of the day-to-day management of the company, is likely to be less affected by the frequency of board meetings (El Mehdi 2007).

2.3.6. Non-executive Directors (NEDs) and Financial Performance

Baysinger & Butler (1985) argue a mix of insiders and outsiders on the board and find empirical support that this approach enhances firm performance. Similarly, Weisbach (1988) and Cotter *et al.* (1997) support this view emphasizing the important role of outside directors in protecting shareholders' interest through effective decision control. Also, John and Senbet (1998) argue that a board is more independent if it has more non-executive directors (NEDs). In addition, Bhagat & Black (2002) argues that, firms with more independent directors achieved improved firm profitability. Furthermore, Hiratsuka (2004) argued that, less independent boards are characterized by lower sustainability of micro-finance institutions. Consistently, Sonnenfeld (2002, p.108) puts that boards dominated by executive directors (insiders) are less accountable for an institution.

On the other hand Fama (1980) and Fama and Jensen (1983a, p.313) argue that once top internal management gains control of the corporate board, they are more likely to connive and collude among themselves to expropriate shareholders' wealth. It also reduces healthy competition among managers for improved performance.

In line with the above view, Fama (1980, p.293) argues that the possibility of such internal managerial connivance might be reduced, and the viability of the board as a

market induced mechanism for low-cost transfer of control might be enhanced, by the addition of NEDs. Also Jensen (1993, p.863) suggests that their independence help NEDs to avoid politeness and courtesy at the expense of truth, frankness, and constructive criticisms of executive management in the boardroom without fear of victimization.

Finally, it has been argued that the appointment of independent NEDs helps in reducing information asymmetry by credibly signaling insiders' intent to treat outside or potential shareholders fairly, and by implication, the safety of their investment (Black *et al.*, 2006a, p.184). It also signals to the market insiders' intent to rely on decision experts, as well as their appreciation of the importance of separating the decision-making and control functions (Fama and Jensen, 1983a, p.315).

On contrary, Weir and Laing (2000, p.267) argued that NEDs often command less knowledge about the business and find it too difficult to understand the complexities of the company. Also, Nicholson and Kiel, (2003, p.588) argued that, high levels of executive directors are associated with high access to information, which leads to high quality decision-making. This can impact positively on financial performance. Crucially, outside directors would usually not have the same access to informal sources of information and knowledge within the firm. As a result, decisions made by a board dominated by NEDs would be of a lower quality, and this would in turn lead to low firm performance.

In addition, Bozec, 2005 and Jiraporn *et al.* 2009 argued that, outside directors are usually part-timers who normally also sit on boards of other companies. This leaves them with too little time to devote to their monitoring and advisory duties (Bozec, 2005, p.1927; Jiraporn *et al.*, 2009, p.819). Furthermore, it has been argued that corporate boards dominated by outside directors tend to stifle managerial initiative and strategic actions, which arise from excessive managerial supervision (Haniffa and Hudaib, 2006, p.1039).

Also, in a sample of 25 Canadian firms, Bozec (2005) finds that the relationship between the percentage of NEDs and performance is negative. Similarly, Sanda *et al.* (2005)

report that Nigerian firms with a low percentage of outside directors performed better than those with more NEDs. This suggests that whilst NEDs can bring independence, objectivity and experience to bear upon board decisions.

The third stream of empirical literatures states that there is no significant relationship between proportion of NEDs and firm performance. For instance, Hermalin and Weisbach (1991) report no link between board composition and performance for a sample of 142 US listed firms.). Similarly, Agrawal & Knoeber (1996) argues that, boards expanded for political reasons often result in too many outsiders on the board, which does not help performance. Also, Vafeas and Theodorou (1998) and Weir and Laing (2000) argued that, the wealth effects of outside directors are statistically insignificant. Further, Haniffa and Hudaib (2006) report a statistically not significant relationship between the percentage of NEDs and performance for a sample of 347 Malaysian listed firms.

2.3.7. Chief Executive Officer Duality and Financial Performance

Chief executive officer duality refers to a board leadership structure in which one person undertakes the combined roles of chief executive officer (CEO – management) and chairman (control) of the board. The chairman of the board is responsible for managing the board. These may typically include nominating new board members, reviewing the performance of senior management, setting agenda for board meetings, and settling conflicts which may arise within the board. In contrast, the CEO is responsible for the day-to-day management of the company, including the implementation of board decisions (Laing and Weir, 1999, p.458).

Weir *et al.* (2002) argued that role duality can have a positive impact on firm financial performance because; the CEO tends to have greater knowledge, understanding and experience of the strategic challenges and opportunities, which the company faces, than a non-executive chairman (Weir *et al.* 2002, p.585). Also, Haniffa and Hudaib (2006) argued that role duality grants a charismatic CEO the opportunity to have a sharper focus on firm objectives (Haniffa and Hudaib, 2006, p.1040). Similarly, Haniffa and Cooke, (2002, p.321) argued that, a visionary CEO will have the chance to shape the long-term

fortunes of a firm with minimum board interference. Role duality lead to improved performance due to the rapid management decision-making that arises from the provision of clear and unambiguous corporate leadership (Haniffa and Hudaib, 2006, p.1040). Further, Vafeas and Theodorou (1998, p.389) put that role duality avoids extra compensation to the chairman, which can results in a reduction in managerial remuneration. Finally, Bozec (2005, p.1927) argues that unified firm leadership associated with role duality improves managerial accountability as it makes it easier to charge the blame for poor performance.

Similarly, a group of researchers argued that CEO duality impacts positively on firm financial performance (Donaldson and Davis, 1991; Boyd, 1995; Kiel and Nicholson, 2003). Firstly, Donaldson and Davis (1991) examined the effects of CEO duality on shareholder returns in a sample of 321 US firms. Accordingly, they reported that 'companies' with CEO duality have superior financial performance to those that separate the two roles.

Consistently, Boyd (1995) investigates the association between role or CEO duality and financial performance, as measured by five year average returns on investment (ROI) in a sample of 192 American firms selected from 12 industries. Consistent with the evidence of Donaldson and Davis (1991), he reports that firms with role or CEO duality consistently outperformed their counterparts with independent board leadership structure. This is consistent with the view that role or CEO duality enhances decision-making by permitting a sharper focus on company objectives. Finally, using a sample of 348 of Australia's largest publicly listed firms in 1996, Kiel and Nicholson (2003) investigate the CEO duality performance relationship. They report that CEO duality impacts positively on the financial performance of Australian listed firms.

Another stream of theoretical literature suggests that CEO duality can impact negatively on firm performance. (Lipton and Lorsch, 1992; Jensen, 1993). According to Jensen (1993, p.866), the function of the chairman is to run board meetings and oversee the process of hiring, firing, evaluating and remunerating the Chief executive officer. Due to this, Jensen (1993) contends that role or CEO duality increases agency problems by

compromising the board's effectiveness in monitoring the CEO. As a corollary, agency theorists argue that separating the two roles will help increase board independence by providing effective checks and balances over managerial behavior (Lipton and Lorsch, 1992, p.72; Haniffa and Cooke, 2002, p.321). It has been suggested, for example, that separating the two roles will make it easier for the board to remove a non-performing CEO (Jensen, 1993, p.866; Monks and Minow, 2001, p.208). This can help in preventing managers from pursuing goals that advance their self-interests to the disadvantage of shareholders.

Also, Rechner and Dalton (1991), investigated that the relationship between CEO duality and three accounting measures of financial performance (ROE, return on investment and profit margin) of 141 large American corporations (Fortune 500 firms) from 1978 to 1983. They found that companies with separate board chairpersons consistently outperformed those with CEO duality.

Dahya *et al.* (1996) investigate whether the stock market prefers companies to combine or split the roles of company chairman and CEO. Consistent with the evidence of Rechner and Dalton (1991), their results suggest that the market responds favorably to the separation of the two roles and unfavorably to their fusion.

Using a sample of 84 South African listed firms, Ho and Williams (2003) put a statistically significant and negative link between a firm's physical and intellectual capital performance and CEO duality. This indicates that the role or CEO duality-financial performance nexus is also likely to be negative among South African listed firms. Similarly, in a sample of 347 Malaysian listed firms, Haniffa and Hudaib (2006) reported that; firms that separated the two roles performed financially (ROA) better than those that vested the two roles in one person. This indicates that monitoring by the board improves when the roles of CEO and chairman are split. Also, Merslan and storm (2007), examined Performance and corporate governance in microfinance institutions and report that financial performance is improved when the roles of CEO and chairman are split.

However some others authors argued that CEO duality has no impact on performance. For instance, Brickley *et al.* (1997) did not find that firms with a CEO- Chairman split out performed those with a CEO-chairman duality. Similarly by using a small sample of 25 Canadian firms, Bozec (2005) reports that role or CEO duality has no impact on return on sales, sales efficiency and assets turnover.

2.4. Ownership, Board Structure and the Requirement to be appointed as Executive Director in Ethiopian MFIs cases

2.4.1. Ownership of MFIs

Proclamation No.84/1994 clearly states that financial institutions including MFIs should be owned by Ethiopian nationals. MFIs in Ethiopia should be established as share companies as defined under Article 304 of the Commercial Code, the capital thereof owned fully by Ethiopian Nationals and/or organizations wholly owned and having its head office in Ethiopia. The Commercial Code of Ethiopia indicates that a share company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. The members shall be liable only to the extent of their shareholding. Only members of a company may manage the company. A company shall have not less than three or more than twelve directors who shall form a board of directors. The microfinance law and directives of the NBE has the intention of creating business like shareholders and board of directors who control, guide and monitor the activities of the MFIs as a private share company.

Year of Establishment and Ownership Structure of sample MFIS

Microfinance Institutions	Year of Establishment	Regional Government	Associations and NGOs	Individuals	Total
Oromia Credit & Savings Institution	1997	25	70	5	100
Specialized Financial & Promotional Institution	1997	-	80	20	100
Gasha Micro-Financing	1998	-	61.9	38.1	100
Wisdom Micro-Financing Institution	1998	-	-	100	100
Africa Village Financial Services	1998	-	-	100	100
BuussaGonofa Microfinance	1999	-	19.6	80.4	100
PEACE Microfinance Institution	2000	-	16	84	100
Addis Credit and Savings Institution	2000	96.7	3.3	-	100
Agar Microfinance Institution	2004	0	0.2	99.8	100
Digaf Microfinance Institution	2005	-	81.4	19.6	100
Harbu Microfinance Institution	2005	-	-	100	100

Source: *National Bank of Ethiopia,* Addis Ababa. Cited (Amaha, 2008)

The shareholders in the Ethiopian MFIs are individuals, regional government and local NGOs (see Table 1). Although Proclamation (40/96) clearly indicates that the shareholders are investors who buy shares from their own resources, in reality, with few exceptional cases, the shareholders in MFIs are nominal shareholders who are not

investing their own money in the institutions (without real stake). As a result, the nominal shareholders of MFIs may not have sufficient interest to seriously oversee the activities of the MFIs. Moreover, many of the MFIs, through their Memorandum of Association, have made it clear that shareholders will not receive any dividend from the profits of MFIs. We believe that, the ownership structure of MFIs should create true stakeholders.

2.4.2. Board Structure and the Requirement to be appointed as Executive Director

As it is clearly indicates in the Directive No. MFI/03/96 issued by the National Bank of Ethiopia (NBE) the criteria for selection of board of directors and officers of MFIs; which states that the chief executive director of a MFI should have first degree in the field of social science or equivalent in relevant field, minimum of three years' work experience in a senior post in a financial institution and the director should not be less than 30 years of age. Board members of MFIs should be at least high school complete with preferably adequate managerial experience and with a minimum age of 25 years.

CHAPTER III

3. RESEARCH DESIGN

This chapter attempts to provide a comprehensive description of the research methodology (methods and techniques) applied in this research work.

3.1. Nature of Data, Source and Methodology

The method employed in this research is the survey method. This method was chosen because; it is low cost, allows observation of several cases at a time, and helps to see association between different variables (Bhandakar1987; 265-301),cited in Workineh (2005).Two main types of data was used in examining the relationship between internal corporate governance structure and financial performance of Ethiopian micro finance institutions. The first category consists of internal corporate governance variables. These include: board size; the frequency of board meetings; board diversity; the presence of internal board committees, director share ownership and percentage of nonexecutive directors. Mainly the internal corporate governance variables were collected from board and top management of institutions through structured self-administered questionnaires, interviews and also some data was collected by document analysis.

The second category consists of financial performance indicator variables, which includes return on asset (ROA) of microfinance institutions. All the data for financial performance indicator variables (ROA) were collected from secondary source of data. This includes financial statements of microfinance institutions, other relevant website and documents, like microfinance institutions performance analysis report by an association of Ethiopian microfinance institutions.

In general both qualitative and quantitative data were used in this study. The data includes both secondary and primary data.

3.2. Sampling Frame, Sample Size and Sampling Procedures

Individual microfinance institutions were the unit of study, in which, board and management body was contacted for the fill-up of self-administered questionnaires. The

sampling frame, the total list of micro-finance institutions in the country-Ethiopia (31), was obtained from the Association of Ethiopian microfinance institutions. Out of the total thirty-one, twenty-seven microfinance institutions were included in the sample frame. Out of this eleven (40.74%) microfinance institutions were included in the study Sample. The sample microfinance institutions were drawn using the following procedures. First, of the thirty-one currently existing, twenty-seven microfinance institutions were selected based on their age, because the study includes the data from 2006 to 2009. Next, twenty-seven MFIs were further categorized in to small, medium and large based on their scale of operation (gross loan portfolio). Then after, the sample size of one from small, four from medium and six from large MFIs is selected judgmentally based on the availability of data on time.

3.3. Instruments of Data Gathering and Analysis Methods

As indicated above, multiple data gathering instruments were employed to collect the data used in this study. Structured questionnaires and document analysis were the principal means of gathering the data used in this study. In collecting the primary data, self-administered questionnaires were distributed to the board and management of the sampled institutions for feedback. The questionnaire was designed fifteen questions in English language. After gathering the data, editing, coding and data entry was done an input for regression analysis.

Model

The model used in this study for regression analysis was:

$$ROA_{it}=\beta_1+\beta_2 Bsize_{it}+\beta_3 BdiversityG_{it}+\beta_4 BdivesityP_{it}+\beta_5 FOBM_{it}+\beta_6 Bcommittee_{it}+\beta_7 PSHHB_{it}+\beta_8 PNED_{it}+E$$

Where:

- β_1 is constant,
- β_2, β_3, β_4, β_5, β_6 represents coefficients of corresponding variables,
- ROA represents return on asset,

- B size represents board size,
- B diversity. G represents board diversity in gender,
- B diversity .P represents board diversity in professional backgrounds
- FOBM represents frequency of board meeting
- B committee represents board committee
- PSHHB represents percentage of share held by board and
- PNED represents percentage of non-executive directors.
- E – error term

The explanatory variables in this regression consist of individual internal corporate governance which indicated above.

These variables were measured in accordance with prior researchers. Board size was measured as the total number of directors serving on an institution's board at the end of its financial year. Director share ownership was measured by the total number of ordinary shares held by all directors divided by the total number of ordinary shares. Board diversity in gender is a binary variable which takes the value of "1" if a company's board is constituted by 40: 60 percent, male to female or females to male ratio otherwise zero. Board diversity in professional back ground was also a binary variable which takes the value of "1" if a company's board was constituted at least fifty percent of the required professional skills for microfinance institutions (Rock *et al.*, 1998) otherwise zero.

Similarly and consistent with prior literature board committee is measured as dummy variables that takes a value of "1" if any of the committee is established at the end a firm's financial year, otherwise zero. In addition percentage of non-executive director is a binary variable takes a value of "1" if the board members are mixed (executive and non-executive), otherwise zero. On the other hand, explained variable here is financial performance which was measured by return on asset. Finally, statistical tools like; ratios, percentage, means, standard deviation, adjusted R^2, coefficient, p-value etc. are employed in condensing the data for interpretation.

CHAPTER IV

4. DATA PRESENTATIONS, RESULTS AND DICUSSIONS

4.1. Data presentations

The results of the statistical analysis are presented in the following figures and tables. First, the results indicated in the figure one below shows that the percentage of shares held by board members for over all samples ranges from 9.7% to 100% with an average and standard deviation of 57.1 %and 27.2% respectively (figure 1& table 3).

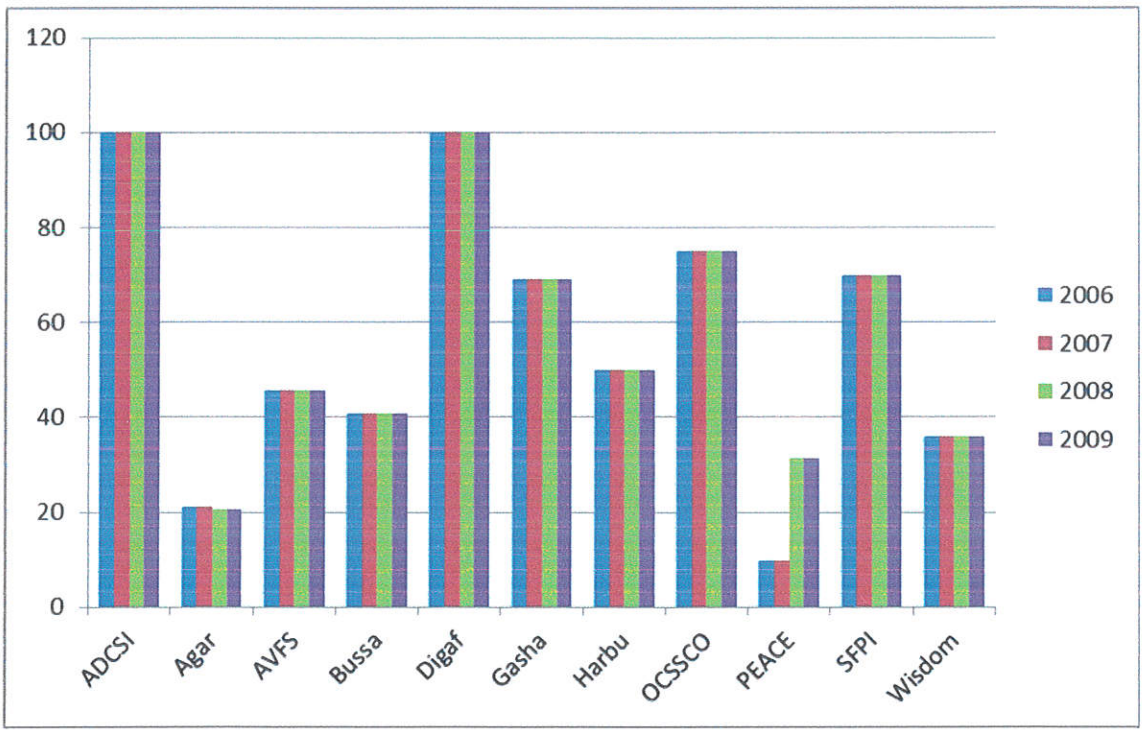


Figure1: percentage of shares held by board members of microfinance institutions

Secondly, the results shown in the figure two below shows that, the frequency of board meeting for over all samples ranges from two to twenty with an average and standard deviation of 7.66 and 4.92 respectively (figure 2 & table 3).

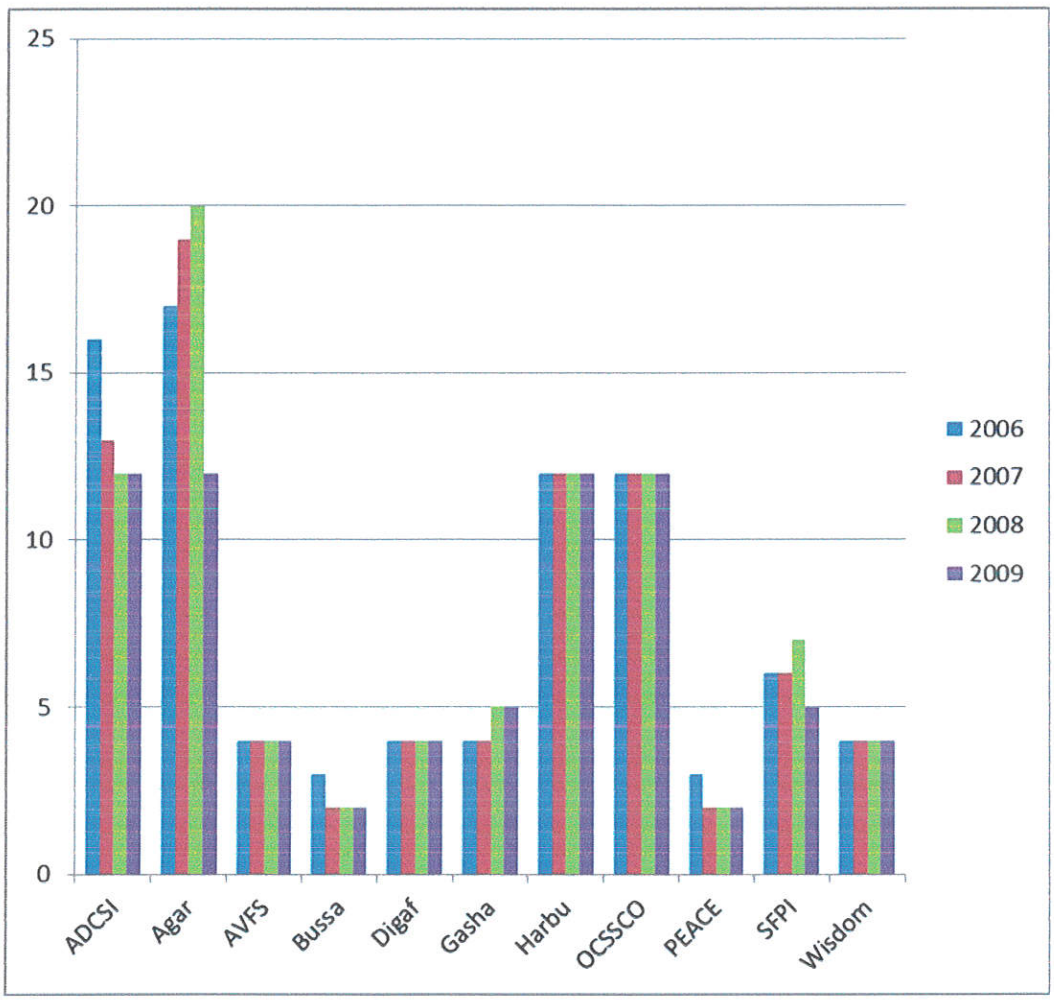
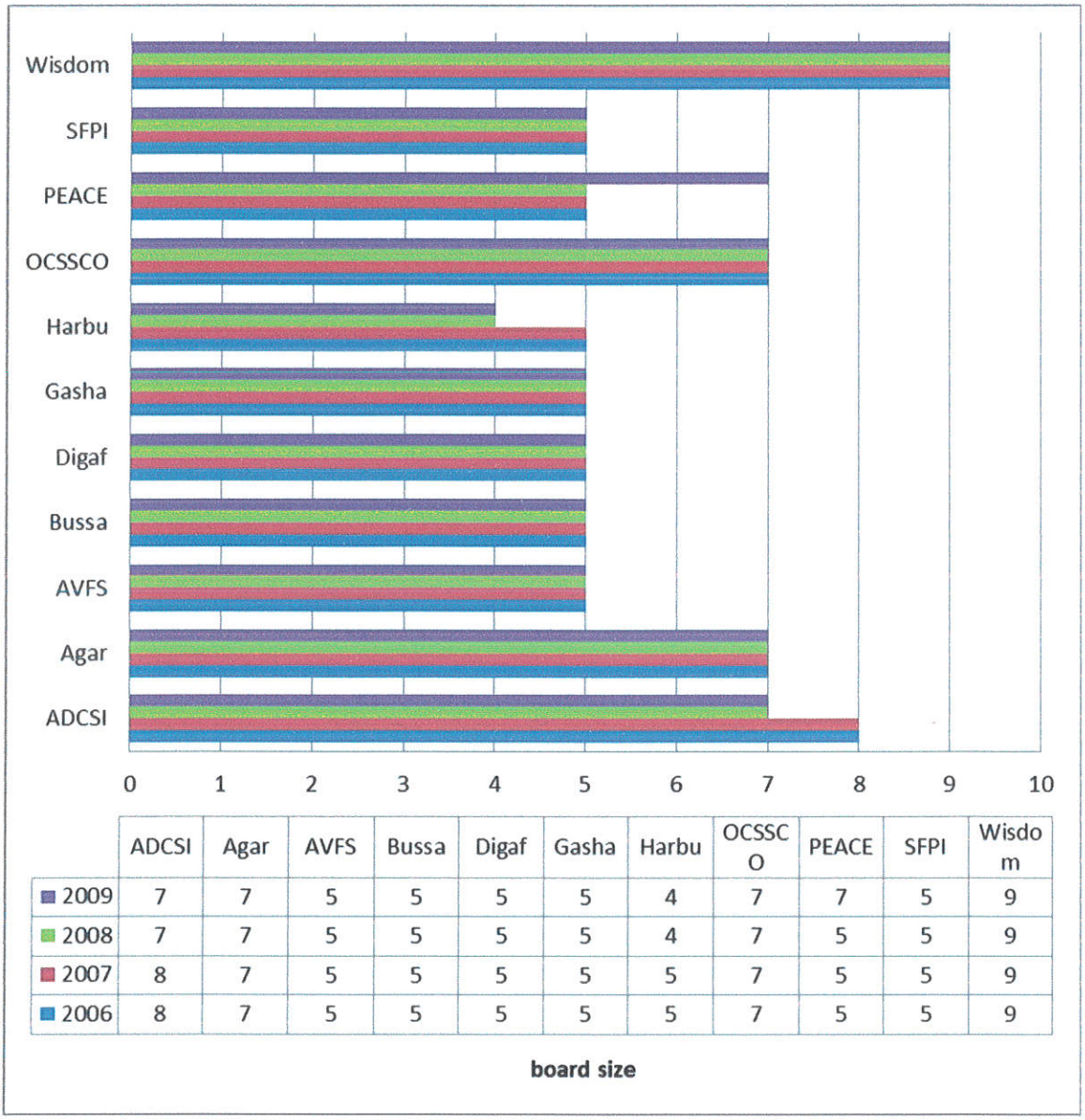


Figure 2: Frequency of board meeting of microfinance institutions board

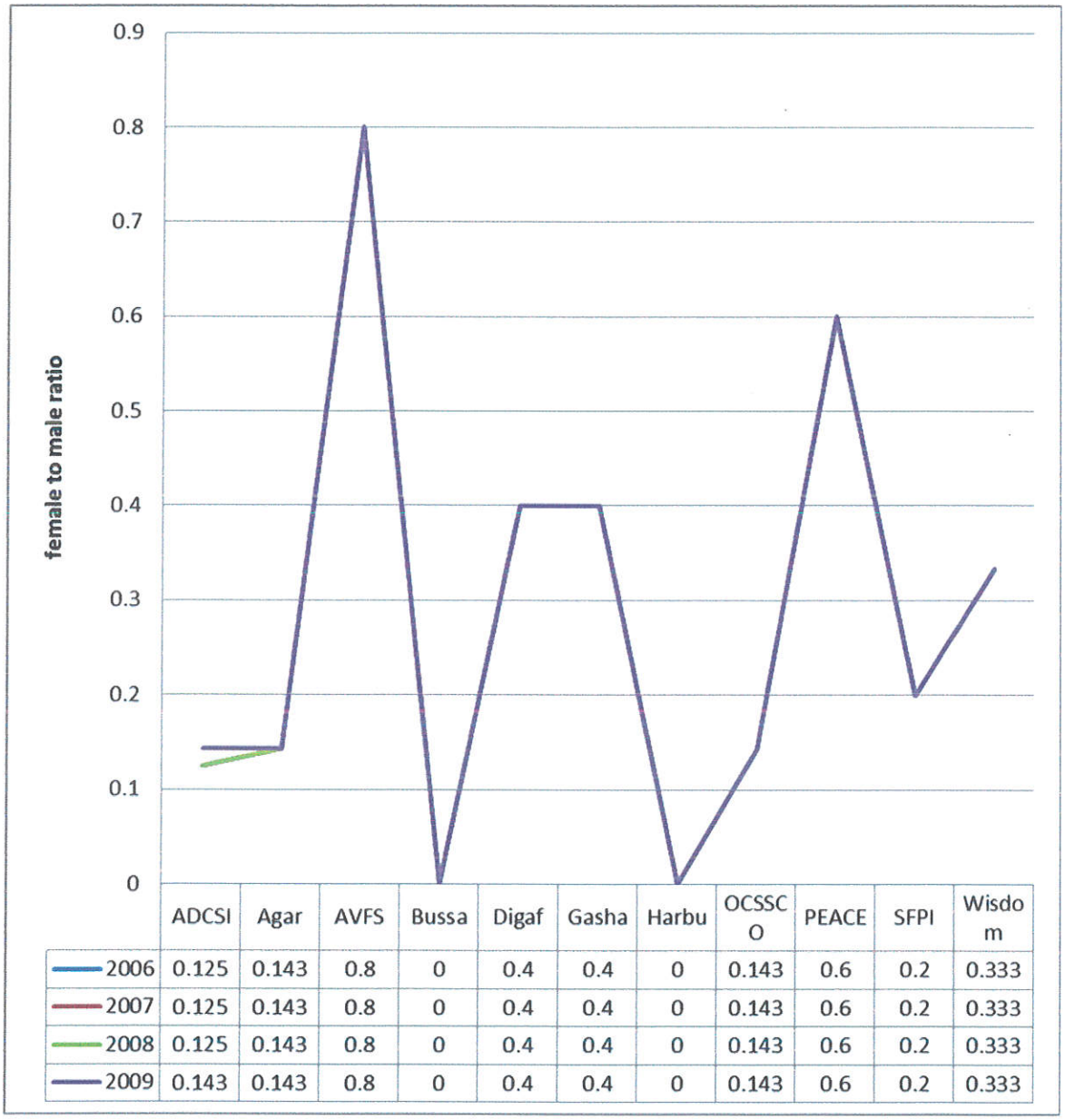
Thirdly, the results shown in the figure three below shows that, the board size for over all samples ranges from four to nine with an average and standard deviation of 5.95 and 1.43 respectively (figure 3 & table 3). In addition, all boards are nonexecutive directors and also the role of board chair person and the institutions CEO are performed by different persons, respectively.



	ADCSI	Agar	AVFS	Bussa	Digaf	Gasha	Harbu	OCSSCO	PEACE	SFPI	Wisdom
2009	7	7	5	5	5	5	4	7	7	5	9
2008	7	7	5	5	5	5	4	7	5	5	9
2007	8	7	5	5	5	5	5	7	5	5	9
2006	8	7	5	5	5	5	5	7	5	5	9

Figure 3: Board size of microfinance institutions

Fourthly, the results shown in the figure four below shows that, the female to male ratio for over all samples ranges from 0 to 0.8(figure 4)



	ADCSI	Agar	AVFS	Bussa	Digaf	Gasha	Harbu	OCSSCO	PEACE	SFPI	Wisdom
2006	0.125	0.143	0.8	0	0.4	0.4	0	0.143	0.6	0.2	0.333
2007	0.125	0.143	0.8	0	0.4	0.4	0	0.143	0.6	0.2	0.333
2008	0.125	0.143	0.8	0	0.4	0.4	0	0.143	0.6	0.2	0.333
2009	0.143	0.143	0.8	0	0.4	0.4	0	0.143	0.6	0.2	0.333

Figure 4: Female to male ratio of microfinance institutions board

Fifthly, the results in the table1below shows that, professional background of board members in each sample microfinance institutions for over all samples ranges from four to nine with an average and standard deviation of 5.6 and 1.65 respectively (table1 & table 3).

Table 1: Professional back ground of the total sampled MFIs board members.

MFIs Name & Qualification	Frequency	MFIs Name & Qualification	Frequency	MFIs Name & Qualification	Frequency
ADCSI		**Agar**		**Buusaa Gonofa**	
Commerce	1	Industrial technology	1	History	1
Economics	2	Business administration &commerce	1	Law	1
Microfinance	1	Accounting & finance	3	Accounting	1
Management	1	12 complete	1	Economics	2
Biology	1	Development study	1	**Total**	**5**
Law	**2**	Economics	1	**AVFS**	
Sociology	**1**	Social work	1	Political science	1
Geography	1	Public health	1	Home economics	1
Civil engineering	1	**Av. Total**	**8**	Management	1
Av .Total	6	**Gasha**		Accounting	1
Degaf		Economics	1	Nursing & radio journalism	1
Economics	2	Marketing	1	**Total**	6

Technology	1	Business education	1	**Harbu**	
MIS	1	Geography	1	Agriculture	1
Nurse	1	Accounting	**1**	Mathematics &auditing	1
Total	4	**Total**	**5**	Psychology	1
OCSSCO		**PEACE**		Mathematics & development	1
LLB	2	Development	1	Political science	1
Organizational leadership	2	Microfinance	2	Sociology& entrepreneurship	**1**
Forestry	2	Agriculture	1	**Total**	**9**
Economics	1	Other	1	**SFPI**	
Accounting	1	**Total**	**4**	Accounting	1
Total	**5**			Banking	1
				Law	**1**
				Agriculture	**1**
				Economics	1
				Total	**5**

Sixthly, the Table 2 below shows that there was no internal board committee for majority of sampled MFIs, except for Wisdom, Digaf and AVFS MFIs. This is 27.3% of sampled MFIs.

Table 2: Existence of board committee by MFIs

MFIs name	Response	
	Yes	No
ADCSI		√
Agar		√
AVFS	√	
Buussa		√
Digaf	√	
Gasha		√
Harbu		√
OCSSCO		√
PEACE		√
SFPI		√
Wisdom	√	

Seventhly, based on the data collected from microfinance institutions performance analysis report of the association of Ethiopian microfinance institution Bulletin number 5, 6 and 7, the results shown in the figure five below show that, the return on asset for over all samples ranges from -25% to 7% with an average and standard deviation of -1.92% and 6.65% respectively (figure5& table 3).

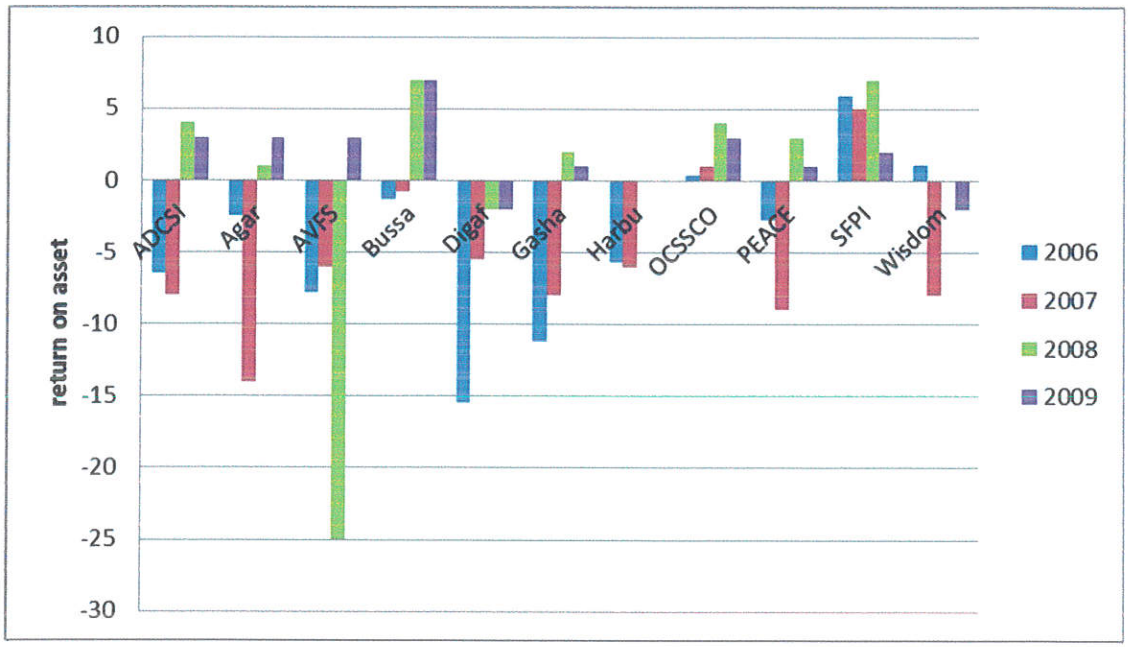


Figure5: Return on Asset (ROA)

Lastly the table 3 below presents the mean, maximum, Minimum and standard deviations of the data presented under above figures and tables.

Table 3: Descriptive Statics

Dependent/ independent variables	Mean	Maximum	Minimum	Std. Dev.
ROA Percentage	-1.92	7	-25	6.65
Board size	5.95	9	4	1.43
diversity in profession	5.6	9	4	1.65
% of shares held by board members	57.1	100	9.7	27.2
Frequency of board meeting	7.66	20	2	4.92

4.2. Empirical Results

This section presents the main regression results to test hypotheses one to seven. Table 4 contains panel data regression results based on return on asset (ROA). To facilitate comparison and easy, following Table 5 presents a summary of all seven hypotheses and results based on all MFIs years for the ROA. The variables selected in this regression are the seven corporate governance variables described above, includes, board size, board diversity in gender and professional backgrounds, frequency of board meeting, the existence of board committee and the percentage of nonexecutive directors in board members. Table 4 presents the results of multivariate regression of ROA on the seven corporate governance variables.

Table 4: Regression Results

Variables	Coefficient	Std. Error	t-Statistic	*p*-value
C	0.752853	4.859423	0.154926	0.8777
Board committee	-7.246249	2.452882	-2.954177	0.0055
Board diversity in gender	-5.070230	2.385515	-2.125423	0.0405
Board diversity in professional type	2.680872	2.608298	1.027825	0.3109
Percentage of share held by board member	1.764127	3.998792	0.441165	0.6617
Board size	0.259549	0.837726	0.309826	0.7585
Frequency of board meeting	-0.530070	0.238357	-2.223848	0.0325
Nonexecutive directors	3.771858	6.144584	0.613851	0.5432
Weighted Statistics				
R-squared	0.308961	Mean dependent var	-1.934091	
Adjusted R-squared	0.174592	S.D. dependent var	6.573341	
S.E. of regression	5.972008	Sum squared resid	1283.936	
F-statistic	2.299354	Durbin-Watson stat	2.338988	
Prob (F-statistic)	0.048044			

Table 5: A Summary Table of All Hypotheses and Results

Independent Variable	Hypothesis No.	Actual Sign of Result	Statistical Significance of Result	Decisions / Hypothesis
Board committee	1	-	Significant at (0.0055)	Rejected
Board diversity in gender	2	-	Significant at (0.0405)	Rejected
Board diversity in professional type	3	+	Not significant (0.3109)	Fail to reject
Percentage of share held by board member	4		Not significant (0.6617)	Fail to reject
Board size	5	+	Not significant (0.7585)	Fail to reject
Frequency of board meeting	6	-	Significant at (0.0325)	Rejected
Executive directors	7	+	Not significant (0.5432)	Fail to reject

4.3. Discussions

From the last row of table 4 it is suggested that the F-value of F-statistic is statistically significant at the (0.048044) or 5% significance level. Therefore, the null hypothesis that the coefficients of the seven corporate governance variables are jointly equal to zero can be rejected. It suggests that the coefficients on the seven corporate governance variables can jointly explain significant variations in the sampled microfinance institutions'

financial performance that are measured by return on asset (ROA). The adjusted R^2 is approximately 17.5%. This means that at least 17.5% of the variations in the sampled microfinance institutions' (MFIs') accounting returns (ROA) can be explained jointly by the seven corporate governance variables.

The coefficients on the existence of Board committee, Board diversity in gender and frequency of board meeting are statistically significant, whereas the coefficients on board size, Board diversity in professional back ground, Percentage of share held by board members and the non-executive directors are not statistically significant. The positive coefficient on board diversity in professional back grounds, Board size, Percentage of share held by board members and percentage of non-executive directors are consistent with hypothesized relationship. However, the negative coefficients on Board committee, Board diversity in gender, and Frequency of board meeting are inconsistent with hypothesized relationship. With reference to the seven corporate governance variables, the estimated coefficients are discussed further.

To start with, the coefficient on the first corporate governance variable, the existence of board committee, is negative and significant over the entire sample. This rejects hypothesis one, that there is no statistically significant relationship between existence of board committee and financial performance of MFIs, as measured by ROA. In contrast, it supports the results of prior studies from international evidences which argued that the presence of board committees impact negatively on performance (Main and Johnston, 1993; Vefeas, 1999a). For instance in a sample of 220 large British listed firms, Main and Johnston (1993) examined the role of remuneration committees in British boardrooms and argued that the presence of a remuneration committee is associated with higher executive pay, which reduces shareholder value. Similarly, using 307 US listed firms, Vefeas (1999a) found a negative relationship between the establishment of board committees and firm value.

However, the results differ from prior studies that argues a statistically significant and positive link between board committee and accounting returns (e.g., Wild, 1994;

Chhaochharia and Grinstein, 2009; Sun and Cahan, 2009; Vefeas and Karamanous, 2005; Vefeas; 1999b).

The second coefficient on the corporate governance variable, Board diversity in gender, is negative and statistically significant. This rejects hypothesis two, that there is no statistically significant relationship between board diversity in gender and financial performance of MFIs, as measured by return on asset. It supports the results of prior studies who argued a statistically significant and negative relationship between the percentage of women on the board and firm performance. For instance, Shrader *et al.* (1997) examined the association between the percentage of female board members and two accounting measures of financial performance (ROA and ROE) for a sample of 200 American Fortune 500 firms in 1992 and reported a statistically significant and negative relationship between the percentage of women on the board and firm performance.

However, the results differ from prior studies that argue a statistically significant and positive link between board diversity in gender and accounting returns (e.g., Adler, 2001; Carter *et al.*, 2003; Armendariz, Aghion and Morduch, 2005; Francoeur *et al.*, 2008).

For instance, Adler (2001) finds a positive correlation between firms that employ higher percentage of women in top management and amount of accounting measures of performance, including ROA, ROE, ROI and ROS. Armendariz, Aghion and Morduch, (2005) also reported that, having a female CEO or a high fraction of women on the board would help the MFI understand its customers better. Thus, this better customer knowledge should influence both the MFI's operational costs as well as its overall profitability. In addition, Carter *et al.* (2003) also report a positive relationship between board diversity (measured by gender and ethnicity) and market measure of performance.

Consistent with prior evidence, Francoeur *et al.* (2008) examine whether the participation of women in a firm's board and senior management enhances financial performance in a sample of 230 of the 500 largest Canadian listed firms. Applying Fama and French three factor model, they report that firms operating in complex environments do generate

positive and significant abnormal returns when they have a higher proportion of women officers.

Thirdly the statistically not significant and positive coefficient on board diversity in professional back ground supports hypothesis three that, the board diversity in different professional backgrounds have no relation with financial performance of MFIs as measured by return on asset.

Empirically, it is not supports the results of Hiratsuka (2004) examined governance and performance of microfinance institutions in central and Eastern Europe and the newly independent states and reports that, Board diversity improves both outreach and sustainability of MFIs. Also it is not supports the arguments of Cox & Blake (1991) and Robinson & Dechant (1997). For instance Cox & Blake (1991) argues that, diversity can create a competitive advantage for firms in six areas. There are cost, resource acquisition, marketing, creativity, problem-solving, and organizational flexibility. Robinson & Dechant (1997) also present three business reasons for diversity. There are cost savings, winning competition and driving business growth. However the empirical result for this study shows positive but not statistically significant. This implies board diversity in professional back ground of microfinance institutions in Ethiopia has no impact on financial performance of them when measured by return on asset (ROA).

The coefficient on the fourth corporate governance variable, Percentage of share held by board member is positive but not significant. This failed to reject hypothesis four that, there is no relationship between percentage of share held by board members and financial performance of MFIs, as measured by ROA. It not supports the results of some of prior studies from international evidences. For instance Ho and Williams (2003) find that director ownership is negatively related to a firm's physical and intellectual capital performance in a sample of 84 South African listed firms. Similarly Sanda et al. (2005) report an inverse relationship between director share ownership and a financial performance measures, including ROA, ROE, in a sample of 93 Nigerian listed firms from 1996 to 1999. The negative relationship between director share ownership and

financial performance has also been supported by the findings of Haniffa and Hudaib (2006) in a sample of 347 Malaysian listed firms.

Similarly, the results differ from prior studies that argues a statistically significant and positive link between percentage of share held by board members and accounting returns (e.g., Morck et al., 1988; McConnell and Servaes, 1990; Owusu-Ansah 1998; Mangena and Tauringana 2008; Krivogorsky 2006; and Kapopoulos and Lazaretou 2007).

For instance, by using a sample of 49 listed Zimbabwean firms, Owusu-Ansah (1998) report that director share ownership impacts positively on mandatory disclosure. Consistent with the evidence of Owusu-Ansah (1998), Mangena and Tauringana (2008) report a positive association between director share ownership and financial performance, as measured by ROA in a sample of 72 Zimbabwean listed firms over the period 2002-2004. Similarly, the results of studies by Krivogorsky (2006), and Kapopoulos and Lazaretou (2007) have supported the positive relationship for a sample of 87 European and 175 Greek listed firms, respectively.

The coefficient on the fifth corporate governance variable, board size, is positive, but not significant. This fails to reject hypothesis five that there is no a statistically significant relationship between board size and financial performance of MFIs, as measured by return on asset. Empirically, the results differ from prior studies that argues a statistically significant and positive link between board size and accounting returns (Dalton et al., 1999; Sanda *et al.*, 2005; Haniffa and Hudaib ,2006; Mangena and Tauringana ,2008), from international evidences. For instance Dalton et al. (1999) argue that large boards may be beneficial because they increase the pool of expertise and resources available to the organization. Consistent with this, Sanda *et al.* (2005) find a positive correlation between board size and profitability. Similarly, Haniffa and Hudaib (2006), employing an accounting measure of performance, as measured by return on aseet, find a positive relationship between board size and financial performance. Mangena and Tauringana (2008) also report a positive relationship between board size and performance.

Similarly, the results differ from prior studies that argues a statistically significant and negative link between board size and accounting returns (e.g., Eisenberg et al., 1998; Bohren and Strom, 2005; Kiel and Nicholson, 2003; Shabbir and Padget, 2005; Guest, 2009).

For instance, Bohren and Strom (2005) argued that larger boards are associated with lower firm performance, measured as ROA, and Hartarska (2005) adds the same negative result in ROA regressions for microfinance institutions. Additionally, Yermack, (1996) investigated the relationship between board size and financial performance in a sample of 452 large US industrial corporations. Generally, he found out an inverse relationship between corporate board size and financial performance. Similarly, Eisenberg et al. (1998) examined the association between board size and performance in a sample of 879 small and medium size Finnish firms. Consistent with Yermack (1996), they argued a negative correlation between firms' profitability, measured by industry-adjusted return on assets (ROA) and board size. Similarly, using a large sample of 2,746 UK listed firms, Guest (2009) argued a statistically significant and negative relationship between board size and performance, as measured by ROA. In addition, Haniffa and Hudaib (2006) put a negative relationship between board size and financial performance.

The coefficient on the sixth corporate governance variable, frequency of board meeting is negative and statistically significant. This rejects hypothesis six that, there is no a statistically significant relationship between the frequency of board meeting and financial performance of microfinance institutions (MFIs), as measured by return on asset (ROA). Empirically, this finding is consistent with the result of (Vafeas, 1999a; Carcello et al., 2002) who reports a statistically significant and negative association between the frequency of board meetings and financial performance. However it is not in line with the result of Mangena and Tauringana, 2006; who argued a positive relationship between the frequency of board meetings and firm performance. Also it is not in line with the findings of prior studies that suggest that the frequency of board meeting has no impact (e.g. Mehdi, 2007). For instance El Mehdi (2007) argued that the frequency of board meetings has no association with financial performance in a small sample of 24 Tunisian listed

firms. He suggests that financial performance, which is tied most closely to the quality of the day-to-day management of the company, is likely to be less affected by the frequency of board meetings.

The coefficient on the last and seventh corporate governance variable, executive director is positive, but not statistically significant. This fails to reject hypothesis seven that, there is a statistically significant and positive relationship between the executive directors and financial performance of microfinance institutions (MFIs), when it is measured by return on asset (ROA).

In contrast, it supports the results of prior studies from international evidences which show that the percentage of non-executive directors has no impact on performance (Agrawal & Knoeber 1996;, Vafeas and Theodorou 1998; Weir and Laing 2000; Haniffa and Hudaib 2006; and Hermalin and Weisbach 1991). For instance, Hermalin and Weisbach (1991) argued no link between board composition and performance for a sample of 142 US listed firms. Also, Vafeas and Theodorou (1998) and Weir and Laing (2000) argued that, the wealth effects of outside directors are statistically insignificant. Further, Haniffa and Hudaib (2006) report a statistically insignificant relationship between the percentage of NEDs and performance for a sample of 347 Malaysian listed firms.

However it is not in line with the result of authors who argued a negative relationship between the percentage of non-executive directors and firm performance. For instance, in a sample of 25 Canadian firms, Bozec (2005) finds that the relationship between the percentage of NEDs and performance is negative. Similarly, Sanda *et al.* (2005) report that Nigerian firms with a low percentage of outside directors performed better than those with more NEDs. This suggests that whilst NEDs can bring independence, objectivity and experience to bear upon board decisions.

Also it is not consistent with the findings of prior studies that suggest that the percentage of non-executive directors has positive impact on financial performance. For instance, Nicholson and Kiel, (2003, p.58 argued that high levels of executive directorships are

associated with high access to information, which leads to high quality decision-making. This can impact positively on financial performance. Crucially, outside directors would usually not have the same access to informal sources of information and knowledge within the firm. As a result, decisions made by a board dominated by NEDs would be of a lower quality, and this would in turn lead to low firm performance.

CHAPTER V

5. SUMMARY OF FINDINGS, CONCLUSIONS, RECOMMENDATIONS AND LIMITATION OF THE STUDYT

This chapter seeks to achieve four main objectives. First, it summarizes the research findings. Second, conclusions, and third, where applicable, makes appropriate recommendations and finally give some limitations of this research.

5.1. Summary of Findings

As has been discussed in subsection 1.5 of chapter one and reported in subsection 4.2 of chapter four, seven main hypotheses are tested. These hypotheses relate to board diversity (in gender and in professional back grounds), board size, the frequency of board meetings, the presence of board committees, percentage of share held by board members and percentage of non-executive directors. From this statistically significant negative relationships were observed between three of the seven variables selected for use. The variables in which statically significant negative relationships observed were between: 1) The presence of internal board committees and MFIs financial performance, as measured by Return on Asset (ROA), 2) Board diversity in gender and MFIs financial performance, as measured by ROA, and 3) The frequency of board meetings and MFIs financial performance, as measured by ROA. Whilst statistically significant relationships were not observed between: 1) Board diversity in professional backgrounds and MFIs financial performance, as measured by ROA. 2) Percentage of shares held by board members and MFIs financial performance, as measured by ROA and 3) Board size and MFIs financial performance, as measured by ROA, and 4) Percentage of executive board and MFIs financial performance, as measured by ROA.

5.2. Conclusion

The relevance of corporate governance cannot be over-emphasized since it constitutes the organizational climate for the internal activities of a company. Corporate governance brings new outlook and enhances microfinance's corporate competitiveness. The study examined the relationship between internal corporate governance structure and financial

performance of microfinance institutions in Ethiopia, as measured by return on asset. The regression results shows that board committee, board diversity in gender and frequency of board meeting have a negative effect on microfinance institutions financial performance, as measured by return on asset (ROA). Whilst, board size, board diversity in professional back ground, percentage of share held by board members and percentage of executive directors have positive but not significant impact on financial performance of microfinance institutions, as measured by return on asset (ROA). Further the regression result shows that the p-value of F-statistic is statistically significant at the (0.048044) or 5% significance level. It implies that the coefficients on the seven corporate governance variables can jointly explain variations in the sampled microfinance institutions' (MFIs') financial performance that is measured by return on asset (ROA). Also, the adjusted R^2 is approximately 17.5%. This means that at least 17.5% of the variations in the sampled microfinance institutions' (MFIs') financial performance can be explained jointly by the seven corporate governance variables. From this it is concluded that, there is a relationship between financial performance and internal corporate governance structure of microfinance institutions in Ethiopia.

5.3. Recommendations

There are several implications of the findings. First, the findings indicate that microfinance institutions (MFIs) that have established board committees tend to be associated with lower financial performance, as measured by return on asset. Since MFIs that have established board committees tend to be associated with lower financial performance, it is recommended that it may not necessarily needed to have an independent board committee

Second, the findings are mixed when it comes to board composition. The findings indicate that microfinance institutions that have well diversified in gender tend to be associated with negative impact on financial performance, as measured by return on asset.

By contrast, the findings suggest that microfinance institutions' board with high diversified board members in professional backgrounds and high percentage of non-

executive directors have no impact on financial performance, as measured by return on asset (ROA). Similarly, the findings suggest that, bard size have no impact on financial performance, as measured by return on asset (ROA).

This may imply that the board composition may not be well in line with the required (relevant) profession for microfinance institutions (MFIs) service. As it is expressed under chapter four, in the case of sample microfinance institutions in Ethiopia, majority of institutions board members profession is concentrated to specific field of study. In addition, majorities' board professional diversification is not in line with the relevant field to microfinance institutions service. Also, all board members are non-executive directors.

This appears to recommend that board diversity may need to be meaningfully improved. This may be done by significantly increasing the number of board members from diverse relevant professional backgrounds which is relevant for microfinance institutions (MFIs) service. Additionally, mixing executive directors to board members may facilitate effective contribution of diverse board members.

Third, the findings suggest that the frequency of board meeting has statistically significant negative impact on microfinance institutions (MFIs) financial performance, as measure by return on asset (ROA). As it is discussed under chapter four above, it is noted that, there is a frequent meeting up to twenty per year. This appears to suggest 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.

5.4. Limitations of the Study

This research may encounter some limitations which need to be acknowledged. The major limitation recognized in this study is using judgmental sampling method. Like any other empirical research, which may suffer mainly from the problems with the use of judgmental sampling method, using this method for this study may make the sample less representative unlike the random sampling method.

In addition, the corporate governance variables were collected through self-administered questioners which might be susceptible to the human error emanating from the respondents ways of understanding of the questions. Whilst the financial performance variables data were obtained from the yearly financial analysis report of third party, the Association of Ethiopian Microfinance Institutions (AEMFI), which might be susceptible to the typing error.

Finally, analyzing the relationship between financial performance and internal corporate governance structure only by using return on asset as a measurement may not sufficient to generalize the relationships between internal corporate governance and financial performance of MFIs. Therefore, all the above mentioned limitations call for further detail research in this arena.

REFERENCES

Ayalew.F, 2006. "Governance Practices of Ethiopian Microfinance Institutions - A Study of Selected Units", National Bank of Ethiopia.

Alemayehu Y. 2008. "The performance of Micro Finance Institutions in Ethiopia: A case of six microfinance institutions, Addis Ababa University

Agrawal, A. and Knoeber, C. R. (1996). "Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders", Journal of Financial and Quantitative Analysis, Vol. 31, Pp.377-389.

Adams, R. B. and Mehran, H. (2005). "Corporate Governance, board structure and its Determinants in the Banking Industry", Working Paper.

Adler, R. D. (2001)." Women in the Executive Suite Correlate to High Profits"

Amha.w &kifle.A (2011), "Ethiopian microfinance institutions performance analysis report", bulletin 7, association of Ethiopia microfinance institution.

Befekadu B. 2007." Outreach and Financial Performance Analysis of Microfinance Institutions in Ethiopia", National Bank of Ethiopia,

Barry and Tacneng, 2011. "Governance and Performance: Evidence from African Microfinance Institutions", Universite de Limoges.

Baranchuk, N. and Dybvig, P. (2009). "Consensus in Diverse Corporate Boards, The Review of Financial Studies, Vol. 22, No. 2, Pp.715-747.

Baysinger, B. D. and Butler, H. N. (1985). "Corporate Governance and Board of Directors: Performance Effects of Changes in Board Composition", Journal of Law, Economics and Organisation, Vol. 1, Pp.101-124.

Baysinger, B. D. and Hookisson, R. E. (1990). "The Composition of Boards of Directors: Performance Effects of Changes in Board Composition", Journal of Law, Economics and Organisation', Vol. 1, Pp.101-124.

Black, B. S., Jang, H. and Kim, W. (2006a). "Does Corporate Governance Predict Firm's Market Values? Evidence from Korea", Journal of Law, Economics and Organization, Vol. 22, No. 2, Pp.366-413.

Boyd, B. K. (1995). "CEO Duality and Firm Performance": A Contingency Model, Strategic Management Journal, Vol. 16, Pp.301-312.

Bozec, R. (2005). "Boards of Directors, Market Discipline and Firm Performance", Journal of Business Finance & Accounting, Vol. 32, No. 9 & 10, Pp.1921-1960.

Brammer, S., Millington, A. and Pavelin, S. (2007)." Gender and Ethnic Diversity Among UK

Corporate Boards". Corporate Governance: An International Review, Vol. 15, No. 2, Pp.393-403.

Brennan, N. (2006). "Boards of Directors and Firm Performance: is there an expectation gap?", Corporate Governance, Vol. 14, No. 6, Pp.577-593.

Brickley, J. A., Coles, L. and Jarrell, G. (1997). "Corporate Leadership Structure: On the Separation of the Positions of CEO and Chairman of the Board", Journal of Corporate Finance, Vol. 3, Pp.189-220.

Bohren, and Strom (2005). "The value-creating board: Theory and evidence". Research Report no. 8 2005, BI, Norwegian School of Management.

Carcello, J. V., Hermanson, D. R., Neal, T. L. and Riley, R. A. (2002). "Board Characteristics and Audit Fees", Contemporary Accounting Research, Vol. 19, No. 2, Pp.365-384.

Carter, D. A., Simkins, B. J. and Simpson, W. G. (2003). "Corporate Governance, Board Diversity, and Firm Value", Financial Review, Vol. 38, No. 1, Pp.33-53.

Chahine, S. and Tohmé, N. S. (2009). "Is CEO Duality Always Negative? An Exploration of CEO Duality and Ownership Structure in the Arab IPO Context", Corporate Governance: An International Review, Vol. 17, No. 2, Pp.123-141.

Cheng, S. (2008). "Board Size and the Variability of Corporate Performance", Journal of Financial Economics, Vol. 87, No. 1, Pp.157-176.

Cheng, S., Evans, J. H. and Nagarajan, N. J. (2008). "Board Size and Firm Performance: Moderating Effects of the Market for Corporate Control", Review of Quantitative Financial Accounting, Vol. 31, Pp.121-145.

Cox, T. H. & Blake, S. 1991, "Managing cultural diversity: implications for organizational competitiveness", Academy of Management Executive, vol. 5, no. 3, pp. 45-56.

Chhaochharia, V. and Grinstein, Y. (2009). "CEO Compensation and Board Structure", The Journal of Finance, Vol. 64, No. 1, Pp.231-261.

Coles, J. L., Daniel, N. D. and Naveen, L. (2008). "Boards: Does One Size Fit All", Journal of Financial Economics, Vol. 87, No. 2, Pp.329-356.

Conger, J. A., Finegold, D. and Lawler, E. E. III (1998). "Appraising Boardroom Performance", Harvard Business Review, Vol. 76, No. 1, Pp.136-148.

Dahya, J. and McConnell, J. J. (2005). "Outside Directors and Corporate Board Decisions", Journal of Corporate Finance, Vol. 11, Pp.37-60.

Dahya, J., Lonie, A. A. and Power, D. M. (1996). "The Case for Separating the Roles of Chairman and CEO: An Analysis of Stock Market and Accounting Data", Corporate Governance: An International Review, Vol. 4, No. 2, Pp.71-77.

Derk B.,Ageba G.,Haftu B.and Milion H.(2009)."Ethiopian Micro finance Ownership and governance", AEMFI,Occasional paper No. 27.

Daily, C., Dalton, D. R. and Cannella, A. A. (2003). "Corporate Governance: The Impact of Board Composition and Structure", Academy of Management Journal, Vol. 28, Pp.371- 382.

Dalton, D. R., Daily, C. M., Ellstrand, A. E. and Johnson, J. L. (1998)." Meta-Analytic Review Board Composition, Leadership Structure and Financial Performance", Strategic Management Journal, Vol. 19, No. 3, Pp.269-290.

Denis, K. D. and McConnell, J. J. (2003). "International Corporate Governance", Journal of Financial and Quantitative Analysis, Vol. 38, No. 1, Pp1-36.

Donaldson, L. and Davis, (1991). "Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns", Australian Journal of Management, Vol. 16, No. 1, Pp.49-64.

Donaldson, L. and Davis, J. H. (1994). "Boards and Company Performance" – Research Challenges the Conventional Wisdom, Corporate Governance: An International Review, Vol. 2, Pp.151-160.

Dulewicz, V. and Herbert, P. (2004)." Does the Composition and Practice of Boards of Directors Bear Any Relationship to the Performance of their Companies?, Corporate Governance'': An International Review, Vol. 12, No. 3, Pp.263-280.

Eisenberg, T., Sundregen, S. and Wells, M. (1998). "Larger Board Size and Decreasing Firm Value in Small Firms'', Journal of Financial Economics, Vol. 48, Pp.35-54.

El Mehdi, I. K. (2007). "Empirical Evidence on Corporate Governance and Corporate Performance in Tunisia, Corporate Governance'': An International Review, Vol. 15, No. 6, pp.1429-1441.

Fama E. F. and Jensen, M. C. (1983a). "Separation of Ownership and Control'', Journal of Law and Economics, Vol. 26, No. 2, Pp.301-325.

Fama, E. F. (1980)." Agency Problems and the Theory of the Firm'', Journal of Political Economy, Vol. 88, No. 2, Pp288-307.

Fich, E. M. and Shivdasani, A. (2006). "Are Busy Boards Effective Monitors, Journal of Finance, Vol. LXI, No. 2, Pp.689-724.

Filatotchev, I. and Boyd, B. K. (2009). "Taking Stock of Corporate Governance Research While Looking to the Future, Corporate Governance'': An International Review, Vol. 17, No. 3, pp.257-265.

Francoeur C., Labelle, R. and Sinclair-Desgagné, B. (2008). "Gender Diversity in Corporate Governance and Top Management, Journal of Business Ethics, Vol. 81, Pp.83-95.

Guest, P. M. (2009). "The Impact of Board Size on Firm Performance: Evidence from the UK''',The European Journal of Finance, Vol. 15, No. 4, Pp.385-404.

Goodstein, J., Gautum, M. E. and Boeker, W. (1994). "The Effect of Board Size and Diversity on Strategic Change'', Strategic Management Journal, Vol. 15, Pp.241-250.

Haniffa, R. and Hudaib, M. (2006). "Corporate Governance Structure and Performance of Malaysian Listed Companies'', Journal of Business, Finance and Accounting, Vol. 33, No. 7 & 8, Pp.1034-1062.

Haniffa, R. M. and Cooke, T. E. (2002). "Culture, Corporate Governance and Disclosure in Malaysian Corporations", Abacus, Vol. 38, No. 3, Pp.317-349.

Harrison, J. R. (1987). "The Strategic Use of Corporate Board Committees", California Management Review, Vol. 30, No. 1, Pp.109-125.

Hermalin B. E. and Weisbach M. S. (1991). "The Effect of Board Composition and Direct Incentives on Firm Performance", Financial Management, Vol. 21, No. 4, Pp.101-112.

Ho, C-A. and Williams, S. M. (2003). "International Comparative Analysis of the Association between Board Structure and the Efficiency of Value Added by a Firm from its Physical Capital and Intellectual Capital Resources", The International Journal of Accounting, Vol. 38, Pp.465 491.

Hartarska, V. (2005). "Governance and performance of microfinance institutions in central and eastern Europe and the newly independent states". World Development 33, 1627{1648.

Jensen, M. C. and Meckling, W. H. (1976). "Theory of the Firm: Managerial Behaviour, Agency costs and Ownership Structure", Journal of Financial Economics, Vol. 3, Pp.305-360.

Jensen, M.C. (1993). "The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems", Journal of Finance, Vol. 48, Pp.831-880.

Jiraporn, P., Singh. C. and Lee, C. I. (2009). "Ineffective Corporate Governance": Director Busyness and Board Committee Memberships, Journal of Banking and Finance, Vol. 33, Pp.819-828.

John, K. and Senbet, L. W. (1998). Corporate and Board Effectiveness", Journal of Banking

and Finance. Vol. 22, No. 3, Pp.371-403.

Jansson, T. R. R. and G.Westley (2004). Principles and practices for regulating and supervising Micro fiancé". Inter-American Development Bank, Washington, D.C.

Kapopoulos, P. and Lazaretou, S. (2007). Corporate Ownership Structure and Firm Performance: Evidence from Greek Firms, Corporate Governance'': An International Perspective, Vol. 15, No. 2, Pp.144-158.

Karamanou, I. and Vefeas, N. (2005). The Association between Corporate Boards, Audit Committees, and Management Earnings Forecasts'': An Empirical Analysis, Journal of Accounting Research, Vol. 43, No. 3, Pp.453-486.

Kiel, G. C. and Nicholson, G. J. (2003). Board Composition and Corporate Performance: How the Austrian Experience Informs Contrasting Theories of Corporate Governance'', Corporate Governance: An International Review, Vol. 11, No. 3, Pp.189-205.

Klein, A. (1998). Firm Performance and Board Committee Structure'', Journal of Law and Economics, Vol. 41, No. 1, Pp.275-303.

Kyereboah.C(2007)Corporate Governance And Firm Performance In Africa: A Dynamic Panel Data Analysis'',A Paper Prepared for the "International Conference on Corporate Governance in Emerging Markets"

Krivogorsky, V. (2006). "Ownership, Board Structure, and Performance in Continental Europe'', The International Journal of Accounting, Vol. 14, Pp.176-197.

Laing, D. and Weir, C. M. (1999). "Governance Structures, Size and Corporate Performance inUK Firms'', Management Decisions, Vol. 37, No. 5, Pp.457-464

Lipton, M. and Lorsch, J. (1992). "A Modest Proposal for Improved Corporate Governance'', Business Lawyer, Vol. 48, Pp.59-77.

Letenah E.(2009). "Performance analysis of a sample microfinance institutions of Ethiopi''a, International NGO Journal Vol. 4 (5), pp. 287-298,

Main, B. G. M. and Johnston, J. (1993). "Remuneration Committees and Corporate Governance'', Accounting and Business Research, Vol. 23, 91A, Pp.351-362.

Mangena, M. and Chamisa, E. (2008). "Corporate Governance and Incidences of Listings Suspension by the JSE Securities Exchange of South Africa: An Empirical Analysis'', The International Journal of Accounting, Vol. 43, Pp.28-44.

Mangena, M. and Tauringana, V. (2008). "Corporate Boards, Ownership Structure and Firm Performance in an Environment of Severe Political and Economic

Uncertainty'', Paper Presented at the British Accounting Association Conference, April 2008.

McConnell, J. and Servaes, H. (1990). "Additional Evidence on Equity Ownership and Corporate Value'', Journal of Financial Economics, Vol. 27, No. 1, Pp.595-612.

Monks, R. A. G. and Minow, N. (2001). "Corporate Governance'', 2nd Edition, Blackwell Publishers Ltd, UK.

Morck, R., Shleifer, A. and Vishny, R. W. (1988). "Management Ownership and Market Valuation: An Empirical Analysis'', Journal of Financial Economics, Vol. 20, No.1, Pp.293-315

Mersland, Roy and Strom, Oystein(2007)."Performance and corporate governance in Micro finance institutions'', Agder University, Norway.

Netter, J., Poulsen, A. and Stegemoller, M. (2009). "The Rise of Corporate Governance in Corporate Control Research, Journal of Corporate Finance, Vol. 15, Pp.1-9.

Nicholson, G. J. and Geoffrey, K. C. (2003). "Can Directors Impact Performance? A CasebasedTest of Three Theories of Corporate Governance'', Corporate Governance: An International Perspective, Vol. 15, No. 4, Pp.585-608.

Oxelheim, L. and T. Rand¿y (2003). "The impact of foreign board membership on firm value''.Journal of Banking & Finance 27 (12), 2369{2392.

Owusu-Ansah, S. (1998). "The Impact of Corporate Attributes on the Extent of Mandatory Disclosure and Reporting by Listed Companies in Zimbabwe'', The International Journal of Accounting, Vol. 33, No. 5, Pp.505-631.

Pearce, J. H. and Zahra, S. A. (1992). "Board Composition from a Strategic Contingency Perspective''. Journal of Management Studies, Vol. 29, Pp.411-438.

Rechner, P. L. and Dalton, D. R. (1991). "CEO Duality and Organizational Performance: A Longitudinal Analysis'', Strategic Management Journal, Vol. 12, No. 2, Pp.155-160.

Rose, C. (2007). "Does Female Board Representation Influence Firm Performance? The Danish Evidence'', Corporate Governance: An International Review, Vol. 15, No. 2, Pp.404-413.

Ross, S. A., Westerfield, R. W. and Jaffe, J. F. (2002). "Corporate Finance", 6th Edition, McGraw-Hill Companies Inc., New York, USA.

Rock, R., M. Otero, and S. Saltzman (1998). "Principles and practices of microfinance governance. Microenterprise Best Practices.

Recoletos,2011. Guide for the Adoption of good Governance principles in microfinance institutions", 1st edition

Robinson, G. & Dechant, K. 1997, "Building a business case for diversity", The Academy of Management Executive, vol. 11, no. 3, pp. 21-31.

Sanda, A., Mikailu, A. S. and Garba, T. (2005). "Corporate Governance Mechanisms and Firm Financial Performance in Nigeria", AERC Research Paper 149, Nairobi, Kenya.

Sheikh S. and Chatterjee, C. (1995) Corporate Goveranance in Sheikh, S. and Rees, W. (Ed.). Corporate Governance & Control, Routledge Cavendish, London, UK.

Short, H. and Keasey, K. (1999). "Managerial Ownership and the Performance of Firms: Evidence from the UK", Journal of Corporate Finance, Vol. 5, Pp79-101.

Shrader, C. B., Blackburn, V. B. and Iles, P. (1997). "Women in Management and Firm Financial Performance": An Exploratory Study, Vol. 9, No. 3, Pp.355-372.

Sonnenfeld, J. A. (2002). What Makes Great Boards", Harvard Business Review, Vol. 80, No. 9, Pp.106-113.

Sternberg, E. (2004). "Corporate Governance: Accountability in the Marketplace", 2nd Edition, The Institute of Economic Affairs, London, UK.

Sun, J. and Cahan, S. (2009). "The Effect of Compensation Committee Quality on the Association between CEO Cash Compensation and Accounting Performance". Corporate Governance: An International Review, Vol. 17, No. 2, Pp.193-207.

Saltzman and Salinger, (1998). "The ACCION CAMEL Technical Note"

Van der Walt, N. and Ingley, C. (2003)". Board Dynamics and the Influence of Professional Background, Gender and Ethnic Diversity of Directors, Corporate Governance: An International Review", Vol. 11, No. 3, Pp.218-234.

Vafeas, N. and Theodorou, E. (1998). "The Relationship between Board Structure and Firm Performance in the UK", British Accounting Review, Vol. 30, Pp.383-407.

Vefeas, N. (1999a). "Board Meeting Frequency and Firm Performance", Journal of Financial Economics, Vol. 53, Pp.113-142.

Vefeas, N. (1999b). "The Nature of Board Nominating Committees and Their Role in Corporate Governance", Journal of Business Finance & Accounting, Vol. 26, No. 1 & 2, Pp.199-225.

Weir C., Laing, D. and McKnight, P. J. (2002). "Internal and External Governance Mechanisms: Their Impact on the Performance of Large UK Public Companies", Journal of Business Finance and Accounting, Vol. 29, No. 5, Pp.579-611.

Weir, C. and Laing, D. (2000). "The Performance-Governance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies", Journal of Management and Governance, Vol. 4, Pp.265-281.

Wild, J. J. (1994). "Managerial Accountability to Shareholders: Audit Committees and the Explanatory Power of Earnings for Returns", British Accounting Review, Vol. 26,

Wolday A.(2008). "Corporate Governance of deposit taking MFIs", AEMFI Occasional paper No.23.

Workineh 2005."The Challenges And Prospects Of The Post 1991 Resetelement Program In The Quest For Food Security": The Case Of Kenaf Site, Western Oromia Region.

Yawson, A. (2006)." Evaluating the Characteristics of Corporate Boards Associated with Layoff Decisions, Corporate Governance": An International Review, Vol. 14, No. 2, Pp.75-84.

Yermack, D. (1996). "Higher Market Valuation of Companies with a Small Board of Directors", Journal of Financial Economics, Vol. 40, Pp.185-2.

Appendix: 1

ADDIS ABABA UNIVERSITY

SCHOOL OF BUSSINESS AND PUBLIC ADMNISTRATION

DEPARTMENT OF ACCOUNTING AND FINANCE

The questions are to be administered to individual sample, Ethiopian Microfinance Institution's (MFIs) board members, CEO, and the top management members.

Objective:-The objective behind administering this questionnaire is to collect data on the internal corporate governance and financial performance of microfinance institutions in Ethiopia. Enhanced access to this data is expected to help the researcher fulfill her academic requirements in accounting and finance. In light of this objective, you are kindly requested to provide correct information for the following questions. Note also that your privacy is maintained for your response.

- ❖ Directions: -
- There is no need of writing your name.
- Fill the blanks in brief & use tick mark while responding to the questions with choice.
- All responses are required to be managed by board members or institutions' executives.

❖ Demographic Characteristics

- Age_____ Sex_____ Educational level _____Profession _____ Occupation_____ Designation _____.

A. Questions Related to Board of Directors' Structure:

1. What is the total number of the institution's board of directors in each of the following fiscal year? 2005_____2006 _____, 2007 _____, 2008 _____, 2009_____, 2010_____, 2011____

2. Is there a year/s in which the role CEO and the board chairman performed by CEO? Yes □ no □

3. If your answer for Q No.2 is yes, please mark the year/s with the tick mark:

2005 _____, 2006 ____, 2007_____, 2008_____, 2009_____,

2010_____, 2011 ____

4. Do the board members comprise both male and female? Yes □ no □

5. If your answer for Q No. 4 is yes, what is female to male ratio? , female_____,

male _____

6. Is the institution's board composed of different professional back grounds?

Yes □ no □

7. If your answer for Q No.6 is yes, please list each of their educational qualification (professional back ground of each board member) for the subsequent years in the space provided below.

2006_____

_____

2007_____

_____

2008_____

_____

2009_____

_____

2010_____

_____

2011_____

_____

8. Does the institution compose non executive directors? Yes □ no □

9. If your answer for question no 7is yes, please indicate the number of the independent directors in the space provided below under the respective years.

2006_____2007_____2008_____2009_____2010_____2011_____

___

10. Are there any clearly set roles and responsibilities between the board and the management? □ No □ Yes

B. **Question Related to Frequency of Board Meetings:**

11. What is the total number of board of directors meetings held during each of the following fiscal year? 2005 _____2006_____, 2007 _____, 2008, ____, 2009____, 2010_____,2011 _____

C. **Questions Related to the types of Internal Board Committees:**

12. Does the institution have various board committees? Yes □ no□,

13.If your answer for QNo.13 is yes, please mention the type with their respective year of establishment on the space provided. Compliance/ corporate governance committee _____, Audit committee _____, Remuneration committee _____, Nomination committee _____, Risk management committee _____, others if any_____ _____.

D. **Questions Related to Director Share Ownership Structure:**

14.Does board members have shares in the institution? Yes □ no □

15. If your answer for question number 14 is yes, please specify the total number of the institutions shares and the total number of shares held by board members, respectively: 2006___:___2007_____:____2008____:____2009____:___2010___:__ 2011___:____

Appendix :2

Variables Definitions and Measurements

Variable	Acronym/Code	Measurement
Return on Assets (%)	ROA	Adjusted Net operating income, net of tax/adjusted average total asset
Board size	BSIZE	*The* total number of directors on the board of a MFI at the end of its financial Year.
Non-executive directors	NED	*A* binary number that takes the value of 1 if the board members are mixed end of its Financial year, 0 otherwise.
Board diversity in gender	BDIVERSITY_ G_	*A* binary number that takes the value of 1 if a MFI board is composed of 40:60 ratio at the end of its financial year, 0 otherwise.
Board diversity in professional back ground	BDIVERSITY_ P_	*A* binary number that takes the value of 1 if a MFI's board is composed at least 50% of the relevant profession for MFIs service at the end of its financial year, 0 otherwise.
Frequency of board meetings	FOBM	The total number of meetings held by a firm's board of directors over a full financial year.
Board committee	BCOMITEE	*A* binary number that takes the value of 1 if a MFI has any board committee established at the end of its financial year, 0 otherwise.
Percentage of shares held by board members	BSHARE	*The* total number of ordinary shares held by all directors of the board of scaled by the total number of ordinary shares of a firm at the end of its financial Year.

Regression Results

Dependent Variable: ROA

Method: Panel EGLS (Cross-section random effects)

Date: 02/18/12 Time: 16:11

Sample: 2006 2009

Periods included: 4

Cross-sections included: 11

Total panel (balanced) observations: 44

Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.752853	4.859423	0.154926	0.8777
BCOMITEE	-7.246249	2.452882	-2.954177	0.0055
BDIVERSITY_G_	-5.070230	2.385515	-2.125423	0.0405
BDIVERSITY_P_	2.680872	2.608298	1.027825	0.3109
BSHARE	1.764127	3.998792	0.441165	0.6617
BSIZE	0.259549	0.837726	0.309826	0.7585
FOBM	-0.530070	0.238357	-2.223848	0.0325
NED	3.771858	6.144584	0.613851	0.5432

Effects Specification

	S.D.	Rho
Cross-section random	0.000000	0.0000
Idiosyncratic random	5.797601	1.0000

Weighted Statistics

R-squared	0.308961	Mean dependent var	-1.934091

Adjusted R-squared	0.174592	S.D. dependent var	6.573341
S.E. of regression	5.972008	Sum squared resid	1283.936
F-statistic	2.299354	Durbin-Watson stat	2.338988
Prob(F-statistic)	0.048044		

Unweighted Statistics			
R-squared	0.308961	Mean dependent var	-1.934091
Sum squared resid	1283.936	Durbin-Watson stat	2.338988

Appendix: 4

Test of the model

Correlated Random Effects - Hausman Test

Equation: EQ01

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	7.121188	4	0.1296