ADDIS ABABA UNIVERSITY

College of Business and Economics

THE IMPACT OF CORPORATE GOVERNANCE ON MICROFINANCE INSTITUTIONS FINANCIAL PERFORMANCE IN ETHIOPIA

A thesis submitted to the department of Accounting and Finance in partial fulfillment of the requirement of Master of Business Administration (MBA) Degree in Finance.

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Declaration

I, Belete Zegeye hereby declare that the thesis entitled *"The Impact of corporate governance on Microfinance Institution Financial Performance in Ethiopia"* in partial fulfillment of the requirements for the award of Master of Business Administration in Finance is a record of original research work done by me and supervision and guidance of Dr. Degefe Duressa.

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Certification

This is to certify that the thesis prepared by Belete Zegeye, entitled *"The Impact of corporate governance on Microfinance Institution Financial Performance in Ethiopia"* and submitted in partial fulfillment for Masters of Business Administration in Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

Approved by the examining committee

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Advisor: Dr. Degefe Duressa **Signature _____Date _____**

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Acronyms and Abbreviations

AdCSI	Addis Credit and Saving Institution
AVFS	Africa Village Financial Service
BOD	Board of Director
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poor
CMEF	Council of Microfinance Equity Funds
FEM	Fixed Effect Model
MFI	Micro-Finance Institution
NBE	National Bank of Ethiopia
NGO	Non-Governmental Organization
OSCCO	Oromia saving and Credit Institution
OLS	Ordinary Least Square
PEACE	Poverty Eradication and Community Empowerment
REM	Random Effect Model
ROA	Return on Asset
RUFIP	Rural Financial Intermediation program

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Abstract

The study focused on the impact of corporate governance on Microfinance Institutions financial Performance in Ethiopia over a period of seven years from 2007/08-2013/14. The study was necessitated by the lack of documented literature on the impact of corporate governance on the financial performance of Microfinance institutions in Ethiopia. The main objective of the study was to investigate the impact of corporate governance on Ethiopian Microfinance institutions sustainability. The relevant literature was reviewed for the purposes of this study. Explanatory research design was used in trying to establish the causal effect relationship between corporate governance variable (which were; board size, board gender composition, board competency, board experience in the finance sector, meeting frequency of , size of audit committee, CEO duality, and CEO gender) and the control variable (size of MFI) was added. The financial performance measure was Return on Asset. 10 MFIs was selected as a sample from 35 licensed MFI from NBE. Primary data was captured using structured questionnaires completed by the CEOs as they were in a better position to comment on corporate governance affairs. Secondary data was collected from the NBE. The study utilized panel data analysis methodology in drawing conclusions about the study. It was foundthat the average board size was 6 members, the average board member who had college degree or higher was 7 member, average female director was 1, average annual meeting was 7 and average size of audit committee was 1 with 20 % of the institutions having the CEO double up as the board, 20% of the institutions surveyed had a female CEO. Empirical findings confirmed that board size, board competency, board experience in the financial sector and meeting frequency of board has a significant impact on the financial performance of Microfinance Institutions. However, size of audit committee has a significant negative relationship with the financial performance of Microfinance Institutions. Board gender composition, CEO duality and CEO gender does not have significant impact on the financial performance of Microfinance Institutions.

Key terms:- *Corporate governance, Financial Performance, ROA, MFIs, Ethiopia.*

Chapter One

Introduction

1.1. Background of the Study

The concept of microfinance has gained grounds and has been regarded as a poverty reduction tool especially on account of the success story of the famous Grameen Bank in Bangladesh (Kyereboah-Coleman, December 2007)**.** While the concept has been used globally for centuries; it's Bangladesh's Muhammad Yunus who is credited with being the pioneer of the modern version of microfinance. While working at Chittagong University in the 1970s, Yunus began offering small loans to destitute basket weavers. Yunus carried on this mission for nearly a decade before forming the Grameen Bank in 1983 as a way to reach a much wider audience. The notation become known as microcredit, and as it spread to other countries, it is on the way of giving millions of people the opportunity to pull themselves out of abject poverty.

Microfinance comprises the provision of loans and other financial services to the productive poor who cannot access formal financial intermediation. Indeed, microfinance has evolved primarily as a consequence of the efforts of individuals and agencies committed to the idea of ensuring that the poor have access to some form of credit (Kyereboah-Coleman, December 2007). The microfinance industry is a new global industry that services the poorest market segments with banking services, mostly in developing and newly industrialized countries.

Ethiopia is a country that has been showing impressive performance in microfinance in Africa. Until 1996, the provision of microfinance services in Ethiopia has been carried out mostly by donor funded programs through NGOs and government institutions. This practice has undermined loan collection performance leading to huge default and hence weakened the development of self-sustaining MFIs. As a result; the first licensing & supervision of microfinance business was issued in 1996. This proclamation was again revised and replaced by Microfinance Business Proclamation no. 626/2009. MFIs provide wide range of services including lending, savings, money transfer, collecting taxes on behalf of tax authorities, paying pension payments etc.

The current regulatory framework requires microfinance institutions to be formed as share companies owned only by Ethiopian nationals (As defined under art. 304 of the commercial code and Microfinance business proclamation NO. 626/2009).Therefore, all MFIs in Ethiopia are share companies by law.

Since MFIs are to be formed as share companies they can raise capital by dividing the capital into shares and selling them to interested buyers. National Bank of Ethiopia Licenses MFIs upon fulfilling the requirements set by the MFI proclamation and directives. Most of MFIs has regional governments, individuals, commercial banks & NGOs as shareholders. The number of shareholders range from 6 to 2,805 shareholders. There are also MFIs like Agar, Dynamic, Lefayda, and Nisir MFIs that are purely established by private investors. The microfinance sector in Ethiopia is not yet proved to be a profitable venture than investing somewhere else. As a result, most of the shareholders of the MFIs are regional governments, associations and NGO's. The sector

has not yet been in a position to attract commercial conventional investors (Ebakeh, 2005).

The commercial code of Ethiopia (1960) incorporates provisions pertinent to the governance of Share Company. Moreover, NBE directive no. MFI/21/2012 put a minimum requirement for persons with significant influence in Microfinance Institution what the directive calls fit and proper criteria. The fit and proper criteria include knowledge, experience and age of Board of Directors (BODs) and Chief Executive Officer (CEO).

Corporate governance has become an important factor in managing organizations in the current global and complex environment. Corporate governance can be defined as a frame work that protect stakeholders rights by illustrating an effective board of directors, efficient internal control and audit in addition to reliable financial reporting and disclosure (Hassn, 2011). Melvin & Hirt (2005) described corporate governance as referring to corporate decision-making and control, particularly the structure of the board and its working procedures. Corporate governance is related to an institution's internal operating and control procedures. It plays a key role in providing strategic direction which helps the institutions in creating transparency and trust for investors and in attracting capital. Good corporate governance contributes to efficient management and to considering stakeholder interests, boosting the microfinance institution's reputation and integrity and fostering the customer trust. In last few years, Microfinance Industries significantly changes its shape, due to several reasons in which corporate governance also one of them which plays a pivot role to enhance the performance of Microfinance institutions. Effective Governance of these institutions is necessary due to its complex

business as it provides thrift, credit and other financial services and products of very small amounts mainly to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve a living standard which leads to socio and economic development of the country. Majority of MFIs have a dual mission, i.e. a social mission-to provide financial services to large numbers of low-income persons to improve their welfare, and a commercial mission -to provide those financial services in a financially viable manner. Maintaining and balancing both at the same time is very challenging and complex task for the board of directors and senior management who provides strategic vision to the institutions (Vishwakarma, 2015).

Therefore, Microfinance institutions are again adopting best corporate practices to increase the investors' confidence as well as other stakeholders. The improvement of corporate governance practices is widely recognized as one of the essential elements in strengthening the foundation for the long-term economic performance of countries and corporations.

During the last two decades, there is a tremendously development of the microfinance industry and its role in the economic growth of developing countries. This success can be attributed to their ability to grant small loans to those excluded from the formal banking sector due to lack of collateral.

The separation of ownership and control in modern corporations leads to an agency problem where the agent operates the firm in line with their own interests, instead of shareholders (Jensen & Meckling, 1976). The need for corporate governance arises from these potential conflicts of interest among stakeholders such as shareholders, board of

directors and managers in the corporate structure. According to Imam & Malik (2007)these conflicts of interest often arise from two main reasons. First, different participants have different objectives and preferences. Second, the participants have imperfect information as to each other's actions, knowledge, and preferences. Corporate governance is intended at reducing divergence of interest and monitoring of controlling interests of the firm, the absence of which firm value is declined (Nanka-Bruce, 2009).

Microfinance institutions are institutions that offer microfinance services to the poor. Corporate governance on the other hand is concerned with maintaining a balance between economic and social goals, and between individual and collective aims, while encouraging efficient use of resources and higher levels of accountability (Vishwakarma, 2015). Helms, (2006) stated that governance is about achieving corporate goals. For MFIs, multiple goals exist. The fundamental goal is to contribute to development which involves reaching more clients and poorer population strata. A second goal is to do this in a way that achieves financial sustainability, preferably independence from donors. While (Rhyne, 1998)considers these two main goal areas to be a 'win-win' situation, claiming that those MFI institutions that follow the principles of good banking will also be those that alleviate the most poverty. One must note that the key elements of an effective governance structure are ownership (this involves both institutional and managerial), board size, board composition and its structure, CEO characteristics and board members remuneration, auditing, information, and the market for corporate control (Keasey et al 1997 as sited on Vishwakarma, 2015). This study sought to investigate corporate governance in Ethiopian MFIs by studying the impact of corporate governance on financial performance.

1.2. Statement of the problem

Institutions that practice good corporate governance are more likely to achieve institutional objectives and goals. Good corporate governance should thus be of prime concern to owners and other stakeholders of those institutions. Governance issues in MFIs are not only essential but also an important variable in the bid to promote the well-being of the poor due to their increasing role in controlling significant resources. Resource provision is also significant as boards consist of people with different experiences, skills, and backgrounds. Board members bring different types of resources, such as advising, counseling, facilitating access to resources such as funding, and linking the organization to important stakeholders and/or other important entities.

In microfinance, governance refers to the mechanisms through which donors, equity investors and other providers of funds ensure themselves that their funds will be used according to the intended purposes. Studies have been conducted in Africa on impacts of corporate governance on MFI performance (like kyereboah-coleman, Joel,). However, the results will not be generally applicable to Ethiopia's Microfinance Institutions as most of the research conducted covering small period and the sample was from specific country. In addition to this, the peculiar nature of MFI in Ethiopia in terms of ownership structure and regulation makes Ethiopian MFIs different. Moreover, Ferede (2012) studied about the impact of Corporate Governance mechanisms on Bank's financial performance in Ethiopia. He concluded that banks with effective corporate governance mechanisms improve financial performance depending on the financial performance measure being used. However, Ferede(2012) suggest for future research that the relationship between corporate governance mechanisms and firms' financial performance

can also be further explained if future researchers conduct study including more corporate governance variables. In addition, Ethiopian MFIs have dual goal unlike bank.

Microfinance Institutions in Ethiopia have several kinds of fund sources and out of which Government, NGOs, Banks, and public Deposits are the major fund suppliers for Microfinance Institutions. Public deposit has necessitated the need for good corporate governance. Good corporate governance becomes even more important as there is no Deposit Insurance Scheme here in Ethiopia. Moreover, as the industry is growing it require governance who acts as a best interest of shareholders to minimize agency conflict. Owing such facts in Ethiopia, empirical studies on corporate governance on Microfinance Institutions (MFIs) were nonexistence and finding documented empirical literature on the topic is difficult. Therefore, the study was deemed at finding the impact of corporate governance elements on MFIs financial performance owning lack of empirical literature on the topic in Ethiopia.

1.3. Objectives of the research

The general objective of this study is to explain the effect of corporate governance variables on the MFI's financial performance in Ethiopia.

The specific objectives include;

- To examine the impacts of board size on MFI financial performance.
- To investigate the effect of board gender composition on MFI financial performance.
- To identify the influence of board competency on MFIs financial performance.

- To identify the effect of board experience in the Finance sector on MFI financial performance.
- To identify the negative or positive impacts of Board Meeting frequency on MFI financial performance.
- To ascertain whether size of audit committee has negative or positive effect on MFI financial performance.
- To investigate the effect of CEO gender on MFI financial performance.
- To examine the impacts of CEO duality on MFI financial performance.
- To suggest appropriate level of corporate governance mechanism to improve the Microfinance Institution's performance.

1.4. Significance of the study

There is some justification for the apparent lack of research on the effect of MFI governance on performance even though corporate governance has assumed an increasing importance for MFIs in Ethiopia. Corporate governance issue is paramount for MFIs to be sustainable. Thus, the researcher hopes that this paper will generally have some important contributions. Based on the above facts the result of this study will;

- Contribute to MFIs by identifying relevant corporate governance mechanisms and how these governance mechanisms affect financial performance.
- Provide empirical result for fund suppliers, government, shareholders and other stakeholders of MFIs both the negative and positive impacts of corporate governance variables on Performance.

- ❖ Provide information to understand the nature of the relationship that exists between institutional success and corporate governance especially for Ethiopia.
- ❖ Suggest possible recommendations to improve or revise the existing corporate governance practices for better performance of MFIs.
- ❖ Servesfor the future researchers as documented literature.

1.5. Hypothesis

In this study based on below conceptual framework following hypotheses are formulated to test:

H_0: corporate governance elements do not have significant impact on MFI Financial performance.

H_1: corporate governance elements have a significant impact on MFI Financial performance

- $H_{1a:}$ board size has a significant positive relationship with MFI financial performance.
- $H_{1b:}$ Board Gender composition has a significant positive impact on financial performance of Ethiopian MFIs.
- $H_{1c:}$ competence board members have a significant positive impact on financial performance of MFIs.
- $H_{1d:}$ There is a significant positive association between board members experience in the Finance sector and MFI financial performance.
- $H_{1e:}$ there is a significant positive association between board members meeting frequency and MFI financial performance.

- $H_{1f:}$ There is a significant negative relationship between size of audit committee and financial performance.
- H_{1g}: there is a significant negative relationship between CEO with dual responsibility and MFI financial performance.
- $H_{1h:}$ there is a significant positive relationship between women CEO and MFI financial performance.

1.6. Scope and Limitation

1.6.1. Scope of the study

To investigate the impact of corporate governance on performance of Microfinance Institutions, this study focus on 10 selected Microfinance Institutions which are licensed and supervised by National Bank of Ethiopia and operating in Ethiopia.

1.6.2. Limitation of the study

Other corporate governance variables may affect the performance of the MFI; however the variables the researcher selects to study are limited to Board size, Board gender composition, Board Competency, Board experience in the Finance sector, Meeting frequency, Audit committee size, CEO Duality, and CEO gender and their impact on ROA as in my review of literature they are the most influential variable.

The generalizability of the study may be limited due to other variables may affect the performance of MFIs and limitation of data on the governance elements. Moreover, the sample is limited to Ethiopian MFIs so that the generalizability for the developing countries may be limited.

1.7. Organization of the Paper

The thesis consists of Five Chapters. Chapter one provides introduction which contain background, problem statement, objectives, hypotheses, significance, scope and limitations of the study. Chapter Two provides theoretical and empirical reviews of the literature. In addition to literature, Chapter Two provides summary and research gap as well as conceptual framework relevant to the study. Chapter Three provides source of data, instrument, sampling, method of data analysis and variables included in the study. The Fourth Chapter presents the results and discussions of the study, based on data collected from secondary and primary sources. The results of the descriptive statistics, correlation analysis and regression analysis were also presented in the Fourth Chapter of this study. The last Chapter contains the conclusion and recommendations based on the result in the fourth chapter. Moreover, in the last chapter recommendation for future research was included.

Chapter Two

Literature review

2.1. General Literature

2.1.1. The concept of corporate governance

Governance is concerned with the manner in which rules and regulations are applied and followed, the relationships that these rules and regulations determine or create and the nature of those relationships (Otieku, 2010). Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission (Chenuos, Mohamed, & Bitok, 2014). It is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society.

Sound corporate governance encourages the efficient use of resources and provides for accountability for the stewardship of those resources by managers. Institutions that practice good corporate governance are more likely to achieve institutional objectives and goals. Good corporate governance should thus be of prime concern to owners and other stakeholders of these institutions. In fact, good corporate governance helps promote the general welfare of the society and should be of interest to the general public and

governments. Corporate Governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed.

“Good governance is the ability of the board members to monitor the status of the organization, make good strategic decisions, and hold executives accountable for their execution. Ultimately, that comes down to the quality of the board members, the culture and practice of the board, and the power relationships among board members and executives.” Elisabeth Rhyne, the Center for Financial Inclusion as sited on the CSFI survey of Microfinance Risk (2014).

A governance structure identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and includes the rules and procedures for making decisions in corporate affairs. Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. Governance mechanisms include monitoring the actions, policies and decisions of corporations and their agents. Corporate governance practices are affected by attempts to align the interests of stakeholders.

One must note that the key elements of an effective governance structure are ownership (this involves both institutional and managerial), board size, board composition and its structure, CEO characteristics and board members remuneration, auditing, information, and the market for corporate control (Keasey et al 1997 as sited on Vishwakarma, 2015)

2.1.2. The Concept of Microfinance

Microfinance has been variously defined in the literature. No single definition exists, variations are mostly a matter of emphasis Narrower definitions equate microfinance with microcredit, following early practice of NGO credit schemes. Microcredit is the provision of small loans to poor households and small business operators with or without guarantee (Obo, 2009)

Microfinance refers to the provision of formal financial services to poor and low-income (and, for credit, in particular, non-salaried) people, as well as others systematically excluded from the financial system. As noted, microfinance embraces not only a range of credit products (for business purposes, for consumption smoothing, to fund social obligations, for emergencies, etc.), but also savings, money transfers, and insurance (CGAP/World Bank, October 2012). Microfinance is defined as the provision of financial services, mostly savings and credit to the poor and low income households that otherwise don't have access to mainstream commercial banks. Microfinance industry is the primary source of credit and saving to low income earners (Chenuos, Mohamed, & Bitok, 2014).

Therefore, Microfinance institutions are a formal (i.e., legally registered) entity whose primary activity is microfinance. Licensing and supervision of Microfinance business Proclamation No. 626/2009 defines micro- financing business as the provision of financial services like accepting savings, extend credit, drawing and accepting drafts payable, providing money transfer services and others specified in the Article 3(2) of the proclamation(Government of Ethiopia, 2009). This definition of microfinance business does not confine microfinance business to only credit as done elsewhere in other countries. Therefore, it is in line with the best practice which defines Microfinance as the

provision of a wide range of financial services to the low income people and micro and small enterprises that usually lack access to formal financial institutions (Banks). Microfinance is not limited to borrowing but also includes other financial services such as savings, micro-insurance, local money transfer, capital goods leasing etc.

2.1.3. Agency Theory

The agency theory assumes that owners of an organization (principals) and those that manage the organization (agents) have different interests. Hence owners will face the problem that managers are likely to act according to their own interests rather than the owners' interests (Fama & Jensen., 1983). In this regard, boards are required to monitor managers on behalf of the owners. In performing this role, members are expected to be independent and monitor the actions of managers as agents of the owners to ensure they are acting in accordance with the owners' interests (Jensen & Meckling, 1976). The theory suggests that board composition is important for effectively monitoring top management. Boards have to be diverse in terms of skills, experience, and gender balance. This creates a balance on boards and leads to effective monitoring and subsequently to the successful performance of the organization.

The concept of corporate governance presumes a fundamental tension between shareholders and corporate managers (Jensen & Meckling, 1976). While the objective of a corporation's shareholders is a return on their investment, managers are likely to have other goals, such as the power and prestige of running a large and powerful organization, or entertainment and other perquisites of their position. Managers' superior access to inside information and the relatively powerless position of the numerous and dispersed

shareholders, mean that managers are likely to have the upper hand (Fama & Jensen., 1983).

Therefore, shareholders monitor and controls managers through their representatives such as board of directors. Boards of directors are considered as an important device to protect shareholders from being exploited by managers and help to effectively control managers when they try to maximize their self-interest at the expense of the company's profitability.

Fama and Jensen (1983) argues that in order to minimize agency problem that emanates from the separation of ownership and control the corporations need to have a mechanisms that enables to separate the authority of decision management from decision control. This would reduce agency costs and ensures maximization of shareholders wealth by effectively controlling the power and self-centered decisions of management.

From agency theory view point, corporate governance improves corporate performance by resolving agency problems through monitoring management activities, controlling self-centered behaviors of management and inspecting the financial reporting process (Habbash, 2010). Moreover, corporate governance is able to alleviate agency costs by aligning the conflicting interests of management and shareholders through monitoring management and using different corporate governance mechanisms. Therefore, corporate governance mechanism such as boards of directors and audit committees enables shareholders to closely monitor the activities of managers. Ineffective board and audit committee may give confidence for managers to pursue their own interests but effective

board and audit committee can reduce deceptive behavior of managers by detecting fraudulent financial report and actively monitoring.

According to the assumptions of agency theory corporate governance mechanisms affect financial performance. As a consequence, enhancing corporate governance mechanisms should result in improved financial performance. Taking agency theory into consideration, the study variables were identified with the aim of examining the relationships between corporate governance mechanisms and financial performance. Board structure has relied heavily on the concepts of agency theory, focusing on the controlling function of the board (Habbash, 2010). The corporate governance mechanisms considered in this research include Board Size, Board Composition, Board competency, Board experience in the sector, Meeting frequency of Board, Audit committee size, CEO duality and CEO gender.

2.1.4. Resource Dependency Theory

In addition to monitoring, board members are also required to provide organizations with resources (Hillman & Dalziel, 2003). The provision of resources is linked to the resource dependence theory. This theory holds that organizations are interdependent (Pfeffer & Salancik, 1978) in that they depend on each other and various actors for their survival as well as for resources. As a result, they need to find different ways of managing this dependence and ensuring they get the resources and information they need. From this perspective, the board is seen as one means of reducing uncertainty by creating influential links. Board members provide organizations with various resources through board members' skills, experience, and expertise. Pfeffer and Salancik (1978) also note that 'when an organization appoints an individual to a board, it expects the individual will

come to support the organization, will concern himself with its problems, will invariably present it to others, and will try to aid it'.

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm (Abdullah & Valentine, 2009). According to this theory the primary function of the board of directors is to provide resources to the firm. Directors are viewed as an important resource to the firm. When directors are considered as resource providers, various dimensions of director diversity clearly become important such as gender, experience, qualification and the like. According to Abdullah and Valentine, directors bring resources to the firm, such as information, skills, business expertise, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Boards of directors provide expertise, skills, information and potential linkage with environment for firms (Ayuso & Argandona, 2007).

The resource based approach notes that the board of directors could support the management in areas where in-firm knowledge is limited or lacking. The resource dependence model suggests that the board of directors could be used as a mechanism to form links with the external environment in order to support the management in the achievement of organizational goals (Wang, 2009).

Diversity in the composition of boards is important if boards are to effectively provide advice and resources. Board members with different skills and experience and of both genders contribute to effective resource provision and to the beneficial performance of

organizations. Moreover, qualified and skillful board members can be considered as a strategic resource to provide a strategic linkage to different external resources.

Both agency and resource dependency theories advocate that boards should have a diversity of competent members who are able to effectively monitor top managers and provide organizations with the resources they need. By performing these roles, board members are able to positively influence the performance of organizations.

2.1.5. Stakeholders theory

The stakeholder theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. Stakeholder theory extends the narrow focus of agency theory on shareholders interest to stakeholders to take into account the interests of many different groups and individuals, including interest groups related to social, environmental and ethical considerations (Freeman, Wicks, & Parmar, 2004). Therefore, stakeholder theory is an extension to Agency theory as the latter expects board of directors to protect only the interests of shareholders. According to (Freeman et al 2004), stakeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business. It asks managers to articulate the shared sense of the value they create, and what brings its core stakeholders together. It also pushes managers to be clear about how they want to do business, specifically what kinds of relationships they want and need to create with their stakeholders to deliver on their purpose. According to stakeholder theory the purpose of the firm is to serve and coordinate the interests of its various stakeholders such as shareholders, employees, creditors, customers, suppliers, government, and the community.

According to Habbash(2010), stakeholder refers to any one whose goals have direct or indirect connections with the firm and influenced by a firm or who exert influence on the firms goal achievement. These include management, employees, clients, suppliers, government, political parties and local community. Recently, stakeholder theory has received attention than earlier because 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 (Kyereboah-Coleman, 2007).

Generally, this study will draw on agency theory to test whether hypothesized relationships exist between corporate governance mechanisms and firms' financial performance. The agency theory framework has the ability to explain corporate governance mechanisms. It can also explain the expected association between corporate governance mechanisms and financial performance.

2.2. Empirical Literature

2.2.1. Corporate governance and Microfinance Institutions Performance

Governance in microfinance refers to the mechanisms which ensure donors, creditors and equity investors, that their funds will be used according to the intended purposes. Good governance in the Ethiopian deposit taking MFIs plays an important role in increasing outreach, improving transparency, accountability, sustainability, profitability, efficiency, effectiveness, responsibility and responsiveness to the changing environments (Amha, July 2-4, 2008).

The ultimate goal of microfinance industry is to contribute to development and alleviation of poverty through reaching for low income productive poor people. To achieve this goal MFI in Ethiopia should be financially strong enough. Therefore, MFI profitability is a paramount. There are factors that lead MFI financial performance either weak or strong. Various researches have been done on such factors. One of the focuses was corporate governance.

Even though many studies have been conducted to identify the relationship between corporate governance practices and firm performance, there are limited scholarly studies conducted for the microfinance industry in relation to corporate governance. The empirical analysis of good corporate governance practices in relation to MFIs is still at an immature stage and it is important to conduct more studies in this field to enhance MFIs' development (Thrikawala, 2013).

"The paramount risk facing the microfinance sector in Sub-Saharan Africa is that of governance, and more precisely risk governance. Within governance, there is a lack of appreciation and understanding of the role that risk management should play within a financial institution." (The CSFI survey of Microfinance Risk, 2014). According to (Thrikawala, 2013) there is need for further empirical research for MFIs using micro econometric techniques, such as regression analyses of panel data to support the conceptual literature currently available. His finding encourages MFIs to consider further significant governance factors which will improve and sustain the industry.

Chenuos et al (2014) found that good governance structure is important in the young and immature microfinance industry as it has an effect on the institution performance. The

researchers concluded that corporate governance practices have an influence on MFI performance in Kenya.

Ms.S.Danoshana et al (2013) documented that corporate governance practices of Board Size, Meeting Frequency and Audit Committee Size have significant impact on firm performance and Board Size and Audit Committee are positively related with firm's performance but Meeting Frequency has negative relation. Further, researcher concluded that, corporate governance can be improved in Sri Lanka by companies maintain their board size to nine directors, meetings to once a month and audit committees to four members.

The board of directors is an internal governance mechanism that helps resolve the agency problems between owners and managers. Board members are elected by shareholders to monitor and advice managers on behalf of owners. The degree of alignment of board composition and shareholders' objectives is measured in the empirical corporate governance literature by the proportion of outside/independent directors (Hartarska, 2004)

In MFI, board Members are the ultimate decision maker and stewards of the shareholders' investment with fiduciary responsibility as well as the duty to balance the social mission and financial objectives of MFIs (Obo, 2009). Effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, area of expertise, ethnicity and gender (Ayalew, 2007).

In spite of the generally accepted notion that effective corporate governance enhances MFI performance, other studies have reported a negative relationship between corporate governance and MFI performance (Hutchinson, 2002). The corporate governance elements considered in this research include Board Size, Board Composition, Board competency, Board experience in the sector, Meeting frequency of Board, Audit committee size, CEO duality and CEO gender.

2.2.2. Board Size and MFI Performance

Board size is the number of directors in a given Microfinance. A microfinance board should be large enough to incorporate the various skills, including audit skills, legal knowledge, knowledge of the target market and social perspective in order to complete their work effectively (without overburdening members), to provide continuity, and to ensure quorums for meetings (council of Microfinance Equity Fund, 2012). It was further stated by the Council of Microfinance Equity Funds (2012) that it is important to have people in the board that are politically influential so that they can assist with political issues, tap funding, and to enhance public image.

However, determining an ideal size of the board has being an ongoing and controversial debate in corporate governance literature (Lawal, 2012). Whether large or small board help improve firm performance it is debatable issue and researchers found mixed result about the relation between board size and firm performance.

The size of the board is measured by the number of board members as has been done by many authors such as Hermalin and Weisbach (1999, 2002), (Ferede, 2012), (Akpan, 2015) and (Jensen & Meckling, 1976). In their various studies, the size of the board has

been seen to have an inverse relationship with firm performance. Jensen M. (1993) argues that a larger board leads to less effective monitoring due to coordination and process problems inherent in large board size. Larger boards can be less participative, less cohesive, and less able to reach consensus. Small board size was favored to promote critical, genuine and intellectual deliberation and involvement among members which presumably might led to effective corporate decision making, monitoring and improved performance (Lawal, 2012). Moreover, Akpan (2015) found that board size and equity are also found to be negative and significant with company performance. Ferede (2012) also found that the numbers of board of directors' are negatively related with Ethiopian commercial banks' financial performance. His result indicates that small boards are more effective in monitoring and controlling banks management and it help to reduce agency costs. Thus, it is expected that the size of the board would have a direct correlation with performance.

In contrast, a number of scholars have contended that larger boards have their benefits and when board size increases firm performance also goes up as more board members provide greater monitoring, advice and make available better linkages to the external environment (Chenuos, Mohamed, & Bitok, 2014). Moreover, Klein (2002) suggested that larger boards able to promote effective monitoring due to their ability to distribute the work load over a greater number of observers. Moreover, Results from (Akpan & Amran, 2014) study showed that board size has positive significant influence on company performance. Therefore, our alternative hypothesis is that board size has a significant positive relationship with MFI financial performance.

2.2.3. Board Gender Composition and MFI Performance

Board gender composition refers male-female proportion of board of directors. Gender composition of the board of directors is one current governance issue facing corporate organization today. Greater female representation on boards provides some additional skills and perspectives that may not be possible with all-male boards (Boyle, 2011). Board diversity promotes more effective monitoring and problem-solving. He suggests that female board members will bring diverse viewpoints to the boardroom and will provoke lively boardroom discussions. It can be argued that the presence of women and men board leads to better board dynamics and improved institutional performance and that boards that are comprised of women show improved corporate governance attributes compared to boards dominated by men. Board composition is an important determinant of its effectiveness and the performance of an organization (Dalton, C. Daily, & Johnson, 1998).

There is an argument between scholars whether there is significant relationship between gender diversity on board and MFIs performance. Rose (2007) revealed insignificant association between number of women directors on the board and firm performance. In our country case, Ferede (2012) found that insignificant relation between Board gender composition and Ethiopian bank performance.

In contrast, Akpan et al (2014) found that board women had a negative significant influence on company performance. Many scholars now believe that an increase in board diversity leads to better boards and governance on the ground that diversity allows boards to tap on broader talent pools for the role of directors (Bathula, 2008). Representation from diverse groups will provide a balanced board so that no individual or group of

individuals can dominate the decision-making of the board (Erhardt, Werbel, & Shrader, 2003). Therefore, this study argues that MFI boards are likely to have a high level of diversity. Thus, alternative hypothesis is that MFIs which are gender balanced (have females on boards) have better financial performance than MFIs which are not.

2.2.4. Board competency and MFI performance

Board Competency refers to Educational Qualifications of individual board members. Qualifications of individual board members are important for decision making. Board members with higher qualifications benefit the firms through a mix of competencies and capabilities which helps in creating diverse perspectives to decision making. Presence of more qualified members would extend knowledge base, stimulate board members to consider other alternatives and enhance a more thoughtful processing of problems. Members with higher educational qualifications in general and research and analysis intensive qualification like PhDs in particular will provide a rich source of innovative ideas to develop policy initiatives with analytical depth and rigor that will provide for unique perspectives on strategic issues (Joel, 2012). Ayalew (2007) stated that in Ethiopia, Board members of most MFI do not have awareness and hence do not apply best practice corporate governance in their MFIS.

Several studies have found a positive relationship between competencies and firm performance. Directors' specialist knowledge will be valuable to the creation of a strong and informed board (Saat, Karbhari, Heravi, & Nassir, 2011). Board of directors is vested with the responsibility of ensuring that the shareholders' money is not wasted, shareholders have a serious interest in ensuring that the board is staffed with well-educated and experienced directors (Gantenbein & Volonte). They also found that

Educational qualification affects the oversight and monitoring role of boards of directors. Akpan (2015) found board education is positively significant impact on the firm performance. Moreover, Ferede (2012) found that the presence of qualified directors on the board plays an important role in carrying out the boards monitoring responsibility and in improving financial performance. Thus, board members educational qualification has a significant positive effect on Ethiopian banks financial performance. Therefore, the study argues there is a significant positive association between Board competencies and MFIs financial performance.

2.2.5. Board Experience in the Finance Sector and MFI performance

Board experience in the sector refers to board member who had any finance related work experience. Ayalew(2007) stated that in Ethiopia, Board members of most MFI do not have awareness and hence do not apply best practice corporate governance in their MFIS. Appointing directors with related and relevant skills and knowledge to perform task specific duties such as the firm's internal control and procedures will enhance the quality of information gathered and the solution to problems and of the views held and judgments made during the decision-making process (DeZoort, 1998 as cited by Saat et al 2011). Their paper claimed that experience of directors enables them to guide, steer and monitor the firm more effectively. In other words, their knowledge of the industry, its opportunities and threats and their connections to the industry participants based on their experience enables them to contribute substantively in the firm performance. Moreover, Ferede (2012) found that a positive association is found between industry specific experience and return on asset and return on equity in Ethiopian Banking Industry. Thus,

this paper argue that there is a significant positive association between board members experience in the sector and MFI financial performance.

2.2.6. Meeting frequency of Board and MFI Performance

Meeting frequency refers to how much time Board meet on a year. For board to effectively perform its oversight function and monitor management performance, the board must hold a regular meeting. Measuring the intensity and effectiveness of corporate monitoring and discharging is the frequency of board meetings (Jensen M. , 1993).

Empirical findings on the effect of frequent board meetings and corporate performance show mixed results.

Some studies concluded more meeting frequency has a negative impact on the performance of MFIs. Vefeas (1999) reported a statistical significance and negative association between frequency board meetings and corporate performance. He also finds that operating performance significantly improves following a year of abnormal board activity. Meeting Frequency has a significant negative impact on ROA and an increasing in meeting frequency will reduce the ROA. (Ms.S.Danoshana & Ms.T.Ravivathani, 2013). Moreover, Akpan (2015) found that board meetings negatively and significantly relate with company performance. Another study conducted on public listed companies in Malaysia using five years data 2003 to 2007 of 328 companies, shows that the higher the number of meetings the worse the firm performance (Amran, 2011).

Whereas, Karamanou et al (2005) found a positive association between frequency board meeting and management earnings forecasts, using a sample of 157 firms in Zimbabwe from 2001-2003; Mangena & Tauringana (2008) report a positive relationship

betweenboard meeting frequency and corporate performance. Similarly in a study of the sample of 169 listed corporations from 2002-2007 in South African, a statistical significant and positive association between the frequency of board meeting and corporate performance exist (Ntim & Osei, June 2011). This implies that the board of directors in South Africa that meet more frequently tend to generate higher financial performance. Moreover, Ntim & Osei (2011) found a statistically significant and positive association between the frequency of corporate board meetings and corporate performance, implying that South Africa boards that meet more frequently tend to generate higher financial performance.

Thus, it is expected that there is a significant positive association between board members meeting frequency and MFI financial performance.

2.2.7. Size of Board Audit committee

An audit committee is an operating committee of the board of directors charged with oversight of financial reporting and disclosure. Committee members are drawn from members of the company's board of directors, with a Chairperson selected from among the committee members. Its role includes choice and monitoring of accounting principles and policies, overseeing appointment, dismissal of external auditors, monitoring internal control process, discussing risk management policies and practice with management and overseeing the performance of internal audit function

Internationally, the audit committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of the independent auditor, and receipt of audit results both internal and external. The committee assists the board of

directors fulfill its corporate governance and overseeing responsibilities in relation to an entity's financial reporting, internal control system, risk management system and internal and external audit functions. Its role is to provide advice and recommendations to the board within the scope of its terms of reference / charter.

Empirical findings on the effect of size of audit committee and corporate performance show mixed results. Ms.S.Danoshana et al (2013) found that increasing Audit Committee Size will result high financial performance, because detailed discussion on the financial statement of the companies will lead to get more ideas regarding the reports and it will guide to increase the firm's performance.

However, in Ethiopia banking industry, Ferede (2012) found that large number of audit committee has a negative and significant effect on financial performance. He added that Limiting audit committee size to reasonable number improves audit committee effectiveness. Thus, it is expected that there is a significant Negative relationship between size of audit committee and financial performance.

2.2.8. CEO duality

Here, CEO duality, unlike most of literature define, implies when a Chief executive officers became a member of the board of director. It is usual for the CEO of an organization to be a board member as well.

If CEO is a member of the Board, CEO has higher credibility and authority with the board and community. However, it has its own drawback as it may create conflicts of interest, much influence on board decisions, board to rely too heavily on CEO's opinion,

and Board may not adequately supervise/evaluate one of its own (Council on Foundations., 2004; 2006.).

Good governance demands there are clear lines between the duties and responsibilities of board members and those of the CEO. A high performing CEO should not need to be a board member to influence the direction of the organization at the highest level. However, empirical studies examining the effect of CEO become a member of the board on MFIs financial performance is scarce in the literature. Therefore, it is expected that there is a significant negative relationship between CEO with dual responsibility and MFI financial performance.

2.2.9. CEO gender

CEO Gender refers to whether the CEO is man or woman. Several Studies suggested that Women CEOs enhance performance of microfinance institutions and improve sustainability. Hartarskaa et al (2013) found that in rural microfinance institutions, outreach efficiency is positively associated with female CEOs. They also added Female managers are more efficient than male managers when their institutions specialize in one type of market served.

Women, it is believed could add value by bringing different perspectives, experiences and opinions. Also it is believed that women generally have higher expectations in terms of responsibilities as directors which could influence the board's effectiveness towards productivity (Chenuos, Mohamed, & Bitok, 2014). They further added that MFI financial sustainability is enhanced when the CEO is a female this could be true as most of the MFIs customers in Kenya are women and the CEO being a woman is likely to attract

more women to invest in MFI, thus, allows the MFIs to increase its profitability. Moreover, Kyereboah-coleman (2007) study showed that having women CEOs on MFI boards enhances performance.

Strøm and his colleagues attempted to address whether women in senior positions are signify cant drivers of firm performance. Consistent with some prior research, the results showed that female CEOs enhance firm performance in MFIs, although, interestingly, having female directors and chairs also had a positive impact on firm performance. In effect, having female CEOs, directors, and chairs is associated with better firm performance in general, supporting the matching argument of leadership and tasks. Consequently, having women in top management improved overall performance at firm level(Strøma, D'Espallierb, & Merslandc, 2009).Therefore, it is expected that there is a significant positive relationship between women CEO and MFI financial performance.

2.3. Summary of literature and research gap

Mori (2014) explored the effect of board of directors' characteristics (age, gender, and education) on their ability to effectively perform their board roles (monitoring and resource provision). They used the agency theory and resource dependence theory by a survey conducted with 105 board directors representing 63 microfinance institutions from three East African countries (Kenya, Tanzania, and Uganda) to test the empirical relationship between directors' characteristics and boards' performance found that there is a positive relationship between directors' age and their ability to monitor and provide the board with resources. The study also revealed that the effect of directors' level of education on boards' performance is positive, while no evidence was found with regard to

the effect of female directors on boards. The findings imply that board directors need to be appointed based on their personal characteristics and their ability to perform their roles.

Anthony Kyereboah-Coleman and Kofi A. Osei (2007) examined how selected governance indicators impact on performance measures of outreach and profitability in microfinance institutions (MFIs). Further they found that governance plays a critical role in the performance of MFIs and that the independence of the board and a clear separation of the positions of a CEO and board chairperson have a positive correlation with both performance measures.

Roy Mersland and R. oystein Strom (2007) studied the effect of corporate governance in microfinance institutions (MFIs).They analyzed the relationship between performance and corporate governance in microfinance institutions (MFI) utilizing a self-constructed global data set on MFIs, collected from third-party rating agencies. Their results show that split roles of CEO and chairman, a female CEO, and competition are important explanations. They were not found any difference between non-profit organizations and shareholder firms in financial performance and outreach and MFIs need to improve top management characteristics just as much as ordinary firms. CEO/chairman duality is associated with a lower ROA and higher operational costs, but a female CEO with higher.

Chenuos et al (2014) found that good governance structure is important in the young and immature microfinance industry as it has an effect on the institution performance. The researchers concluded that corporate governance practices have an influence on MFI performance in Kenya. Ms.S.Danoshana et al (2013) documented that corporate

governance practices of Board Size, Meeting Frequency and Audit Committee Size have significant impact on firm performance and Board Size and Audit Committee are positively related with firm's performance but Meeting Frequency has negative relation. Further, researcher concluded that, corporate governance can be improved in Sri Lanka by companies maintain their board size to nine directors, meetings to once a month and audit committees to four members.

Ferede (2012) studied the impact of corporate governance Mechanism on Bank performance in Ethiopia and concluded that large size board and audit committee negatively influences financial performance; board members educational qualification positively associated with financial performance; industry specific experience of director positively related with return on asset but it has a negative effect on net interest margin; and the percentage of female directors and board members business management experience does not have a significant effect.

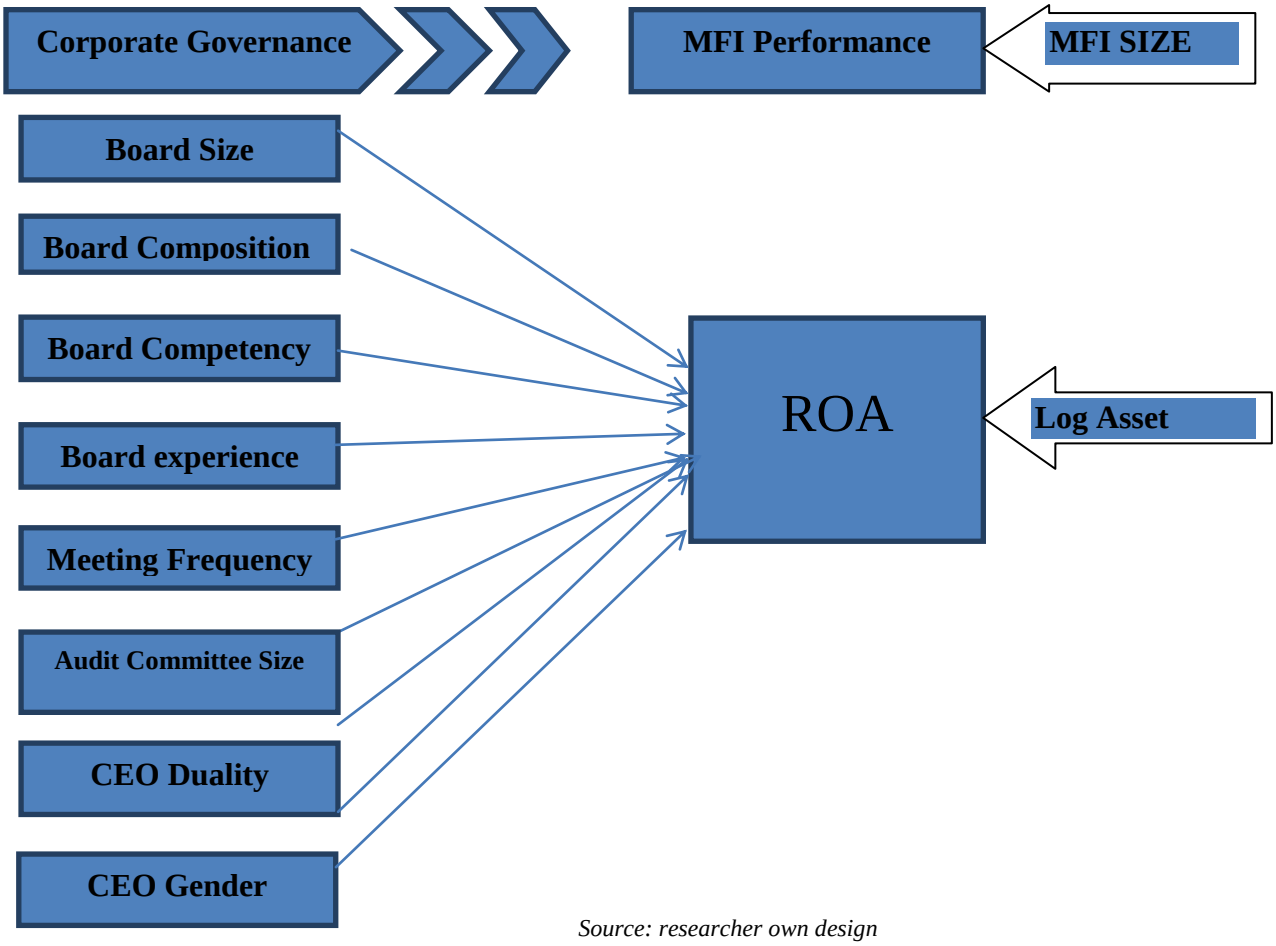
However, according to Thrikawala (2013) there is need for further empirical research for MFIs using micro econometric techniques, such as regression analyses of panel data to support the conceptual literature currently available. His finding encourages MFIs to consider further significant governance factors which will improve and sustain the industry. He added that empirical analysis of good corporate governance practices in relation to MFIs is still at an immature stage and it is important to conduct more studies in this field to enhance MFIs' development.

In addition, the results that the researcher discussed above will not be generally applicable to Ethiopia's Microfinance Institutions as most of the research conducted

covering small period and the sample was from specific country. In addition to this, the peculiar nature of MFI in Ethiopia in terms of ownership structure and regulation makes Ethiopian MFIs different. Further the banking sector in Ethiopia is different from that of Microfinance Institutions in such a way that majority of microfinance Institutions have dual mission (being sustainable and social mission).

2.4. Conceptual Framework

Based on empirical literature on corporate governance and MFI performance above the researcher developed conceptual model as shown below:



Source: researcher own design

Chapter Three

3. Methodology

3.1. Research Design

The study employed an explanatory survey design with a mixed approach, more of quantitative will employ. The explanatory type of research design helps to identify and evaluate the causal relationships between the different variables under consideration. Mixed methods research provides better (stronger) inferences. Therefore, by using a mixed approach it is able to capitalize the strength of quantitative and qualitative approach and remove any biases that exist in any single research method (Creswell, 2003).

This study utilized purposive cluster random sampling technique where a representative sample of ten MFIs was selected from the 35 MFIs in Ethiopia. This sampling method was used due to the distinctive nature of the MFIs operating in the country as they are Regional government backed; NGO backed; and purely privately owned MFIs. In addition to clustering them in to NGO, government and purely private MFIs, the researcher select based on the availability of seven year data purposively for the analysis purpose.

3.2. Source of Data

Both primary and secondary source were used to capture the data. Primary data was collected through structured questioners which were filled by CEO for capturing corporate governance variables while secondary data, which obtained from National

Bank of Ethiopia (NBE) used for computing Return on Asset of MFIs. Panel data covering a Seven-year period from 2007/08– 2013/14 was used for the study. The advantage of panel data analysis is that more reliable estimates of the parameters in the model can be obtained.

3.3. Sample population and sample design

There are 35 Microfinance Institutions which are licensed and operating in Ethiopia as of June 2014. The researcher used 10 MFIs as a sample which covers 35% of the total population. The sampling method the researcher used was purposive Cluster sampling random method.

The sapling is based on the ownership nature of MFIs and availability of seven year data for analysis purpose that the first two MFIs are majority of the shares were owned by government, the next five MFIs are NGO backed and the last three MFIs are established purely by private shareholders. The MFI which the researcher used for this study are Oromia saving and Credit Institution (OSCCO), Addis Saving and Credit Institution (AdSCI), Wasasa MFI, PEACE MFI, Eshet MFI, Metemamen MFI, Letta MFI, AVFS, Aggar Micro-financing, and Lefayda MFI.

3.4. Instrument

Structured questioners which capture corporate governance elements was prepared which were filled by CEO of the selected sample MFIs since they are in a better position to have all the information pertaining corporate governance in their organizations. Moreover, the qualitative data about corporate governance variables also collected by using questionnaire to support the quantitative data.

3.5. Method of Data Analysis

The method of analysis used in the study was descriptive statistics, correlation and linear regression methods. The descriptive statistics was used to quantitatively describe the important features of the variables using mean, maximum, minimum and standard deviations. The correlation analysis was used to identify the relationship between the independent, dependent and control variables using correlation analysis. The correlation analysis shows only the degree of association between variables and does not permit the researcher to make causal inferences regarding the relationship between variables. Therefore, multiple panel linear regression analysis was also used to test the hypothesis and to explain the relationship between corporate governance variables and financial performance measures by controlling the influence of some selected variables. Qualitative analysis was used for qualitative data collected through questionnaire. Eviews 7 software was used for analysis and the results were presented through tables.

Due to the combination of cross-sectional data and time-series data, the OLS regression technique is unsuitable for the analysis (Learner 1978). The appropriate method of analysis involves panel data regression techniques. The big advantage of working with panel data is that we will be able to control for individual- specific, time- invariant, unobserved heterogeneity, the presence of which could lead to bias in standard estimators like OLS.

There are two frequently used estimation techniques for panel data regression. These are the fixed effects model (FEM) and the random effects model (REM) (Gujarati, 2003). The Fixed effect model assumes that the slope coefficients of the explanatory variables are all identical for all firms. The intercept in the regression model is allowed to differ

among individual firms in recognition of the fact that each individual or cross-sectional unit may have some special characteristics of its own. To take into account the differing intercepts, dummy variables may be used. The fixed effect model using dummy variables is known as the least-squares dummy variable (LSDV) model (Gujarati, 2003). The Random effect model is sometimes known as the error component model (ECM). In ECM, it is assumed that the intercept of an individual unit is a random drawing from a much larger population with a constant mean value. The individual intercept is then expressed as a deviation from this constant mean value.

The Hausman test, a model specification test, can be used to decide between FEM and REM (Hausman, 1978). To test for the existence of any correlation between unobservable heterogeneity and the explanatory variables, we use the Hausman test. This test examines the equality of the coefficients of the fixed effect estimations and the random effect estimations.

Dependent Variable

Dependent variable (Financial Performance) was measured by annual Return on Assets (ROA) which is a standard finance literature measure of performance. It shows how management of an entity has been able to turnover assets of the organization over-one-year. To a large extent, ROA also deals with operational sustainability of these institutions.

$$\textbf{ROA} = \frac{\textbf{Profit after Tax}}{\textbf{Total Asset}}$$

Explanatory variables

The independent variables are variables that are used as a determinant of corporate governance of the sample Ethiopian microfinance institutions in this study. The independent variables of the study are board size, board gender composition, board competency, board experience in the Finance sector, meeting frequency of board, size of audit committee, CEO duality and CEO gender.

Board Size (B.S)

Board size is the number of board members for the MFIs during the period under review. In various studies, the size of the board has been seen to have a direct relationship with firm performance. Thus, it is expected that the size of the board would have a positive relation with performance.

Board gender Composition (BCPO)

Board Gender Composition is gender diversity of boards (male-female proportion in the board room) during the period under review. The researcher expects the presence of the female directors on board to have a positive correlation with financial performance of Ethiopian Microfinance Institution.

Board competence (BCPE)

Board competence is Qualifications of individual board members. The expertise, competence and quality of a firm's board inevitably impacts on performance. The higher the quality, the better will be the financial performance of the firm. The study used the number of board members who have received college degree education or above as a

proxy for board quality and competence. Hence, the researcher expects this variable to have a positive correlation with Microfinance Institutions performance.

Board Experience in the Finance Sector (BES)

It is the number of directors who had earlier work experience in other Microfinance institutions or any financial institutions. The researcher expects that there is a significant positive association between board members experience in the Finance sector and MFI financial performance.

Meeting frequency (M.F)

Meeting frequency how much time Board meets on a year during the period under review. The researcher expects the number of board meeting has a positive impact on Ethiopian Microfinance Institutions financial performance.

Size of audit committee (SAUD)

The audit committee is operating committee of the board of directors charged with oversight of financial reporting and disclosure. It is likely thatsmall sizeand effective audit committees effectively communicate in the financial reporting process and problems to be resolved easily.

CEO duality (CEOD)

This is a dummy variable which is equal to 1 if the CEO combines as the board member and zero if these positions are assigned to different people. The researcher expects that this will have a negative relationship with performance.

CEO gender (CEOG)

This is a dummy variable captured whether a CEO was a female or otherwise, it adopted a dummy variable where, 1 was if CEO was a female and 0 if otherwise for the MFIs under review.

Control Variable (Microfinance Institution size)

In this study MFI size (MFIS) is included to account its potential influence on Microfinance institutions' financial performance in order to know the selected explanatory variables effect on Microfinance Institutions' financial performance.

MFI size - measured as the natural logarithm of total assets at year-end. The control variable is selected based on previous studies. In most of the previous studies firm size was used as control variable.

The Model

The general regression model adopted by the researcher was outlined blow;

$$ROAit = \alpha it + \beta it\ GOV + \mu it$$

ROA is the proxy for MFIs performance (dependent variable) and represents Return on Assets (ROA) of the MFIs under study.

α is the intercept (y intercept), βit is slope coefficients of explanatory variables. Where subscript i denote the individual institutions characteristics across time dimension t.

GOV is vector of governance (independent) variables which are; board size, board composition, board competency, board experience, Meeting frequency, size of audit committee, CEO gender and CEO duality.

The above general empirical research model is changed into the study variables to find out the impact of corporate governance variables on Microfinance Institution financial performance as follows:

$$ROA_{it} = \beta_0 + \beta_{1a}(B.S_{it}) + \beta_{1b}(BCPO_{it}) + \beta_{1c}(BCPE_{it}) + \beta_{1d}(M.F_{it}) + B_{1e}(SAUD_{it}) + \beta_{1f}(CEOD_{it}) + \beta_{1g}(CEOG_{it}) + \beta_{1h}(MFIS) + \mu_{it}$$

μit was the error term (residual variable) and represents the unobservable MFIs characteristics not captured in the model. The error term was a two way error component model which is specified below and will be used to test the robustness of the estimation model.

$$\mu it = \alpha i + \gamma t + vit$$

Where; αi denotes the unobservable individual MFI specific effects, λt denotes the unobservable time effect and vit is the remainder stochastic disturbance term.

The robustness of the model was tested using the fixed effects and random effect two way error component models. Under the fixed effect model, the αi and the λt are assumed

to be fixed parameters to be estimated and the remainder disturbances stochastic with νit~ IID (0, σ 2ν). The Xi tare assumed independent of the νit for all i and t. The random effects model on the other hand the αi~ IID (0, σ 2α), λt~ IID (0, σ 2λ) and νit~IID (0, σ2 ν) are independent of each other. In addition, Xit is independent of μi, λt and νit for all i accordingly any correlations between the error term and the independent variables is taken care of.

Chapter four

4. Results and Discussion

This chapter presents the descriptive statistics, correlation analysis and multiple panel linear regression analysis of the study variables. It has three sections. The first section is the descriptive statistics which summarizes the main features of the study variable such as mean, maximum, minimum and standard deviation. The second section is the correlation analysis which shows the degree of association between the study variables. The third sections of the chapter, regression results report the OLS estimation output of the regression random effect model.

4.1. Descriptive Statistics of Variables

This section discussed the summery statistics of each variables of the study. The variables include the dependent, independent and control variables. The dependent variable used to study the financial performance of microfinance institution is Return on Asset (ROA). The explanatory variables were board size, board gender composition, board competency, board experience in the Finance sector, meeting frequency of board, size of audit committee, CEO duality and CEO gender. Whereas the control variable used in this study was firm size measured by asset of the MFIs.

Table 4.1. Descriptive statistics result summary

	ROA	B_S	BCPO	BCPE	BES	M_F	SAUD	CEOD	CEOG	MFIS
Mean	1.97458	5.67143	1.24286	5.18571	0.300	6.81429	0.74286	0.2000	0.2000	16.3945
Median	3.69086	5.500	1.000	5.000	0.000	6.500	0.000	0.000	0.000	16.2871
Maximum	14.1091	8.000	4.000	8.000	1.000	14.000	3.000	1.000	1.000	21.1521
Minimum	-16.500	3.000	0.000	2.000	0.000	4.000	0.000	0.000	0.000	12.0805
Std. Dev.	6.9026	1.85505	1.33445	2.03087	0.46157	2.76779	1.28182	0.40289	0.40289	2.1047
Obs.	**70**	**70**	**70**	**70**	**70**	**70**	**70**	**70**	**70**	**70**

Source: researcher's computation using Eviews 7

The mean values tell about the average size of board, female board, board competency, board experience in the finance sector, board meeting, size of audit committee, average female CEO, average CEO who is board member, size of microfinance institutions and ROA and standard deviation has been used to analyze the variations in explanatory variables, control variable as well as in ROA.

The average value of return on asset, which measures financial performances of MFI in this study, for the sample Ethiopian Microfinance Institution is 1.97 with a maximum and minimum value of 14.1 and -16.5, respectively as presented in the table 4.1 above. The standard deviation is 6.9 from the average value 1.87. The standard deviation of 6.9 suggests that there is wide dispersion in the return on asset of the sample Microfinance institutions.

In the explanatory variable the one to get first is Board size (B.S). The average size of board for Ethiopian MFIs is 6 members (mean=5.67143) with a minimum board members of 3 and maximum board member of 8. The standard deviation indicates that

for the sample MFIs board size varies by 1.85 from the average value of 5.67. The standard deviation of 1.85 suggests that there is no wide dispersion in the board size of the sample Microfinance Institutions.

Concerning gender composition, on average 1 board of director (mean= 1.2428) of MFIs are females with a minimum of null female director and maximum of 4 female directors. It suggests that the composition of gender of sample Ethiopian MFIs boards, as measured by proportion of directorship held by women, is low since its mean value is only 1.24during the last 7 years. The standard deviation indicates that for the sample MFIs female directors vary by 1.33 from the average value of 1.24.

From table 4.1, the competency of Ethiopian MFIs board members, as measured by holding college degree or higher, has a mean value of 5.18 with a minimum of 2 members and maximum of 8 members. This shows that board members are competent and educated. The standard deviation is 2.03 from the mean value of 5.18. The standard deviation of 2.03 suggests that there is no wide dispersion in the board competency of the sample Microfinance Institutions.

The other explanatory variable is board of directors' experience in the finance sector. The board of sample MFIs has a mean of 0.3 with a minimum of null and maximum of 1 as measured by the proportion of directors who had experience in the sector. This shows that Ethiopian MFIs board of directors' experience in the finance sector is low for the last 7 years. The standard deviation is 0.46 from the mean value of 0.3.

Moreover, all the MFIs Board of directors conducts a minimum of 4boards of director meeting per year as required. The number of meeting held by board of directors (BODs)

of Ethiopian MFIs for the last seven years has a mean of 7 minutes per year (mean= 6.81) with a minimum of 4 minutes and maximum of 15 minutes held per annum. The standard deviation is 2.76 from the mean of 6.8.

The audit committee of the sample MFIs has a mean value of 0.74with a minimum of null audit committee and a maximum of 3 audit committee members. The standard deviation is 1.28 from the mean. This shows that in Ethiopia there are Microfinance institutions which do not have an audit committee.

The table also examined the effects of gender as proxy for corporate board diversity on performance of MFIs. The gender of CEO was a dummy variable which was allocated 1 when CEO was a woman and 0 when otherwise. The table 4.1 shows that 80% of MFIs were led by male CEOs this is despite the fact that their target clientele were mainly women. This left only 20% of selected MFIs led by women in Ethiopian sample Microfinance Institutions. MFIs perform better when CEO is a woman because she able to connects well with clients who are mostly women (Mersland& Strom, 2007).

The study showed that 20% of sample Ethiopian MFIs had CEOs who also became as the board member which generated a lot of conflict since the management could not check itself especially when decision control and decision management functions were embedded in one position. On the other hand 80% of sample Ethiopian MFIs CEO did not sit on the board which gave the board enough power to make independent decision and also act as oversight body for the management. CEO duality was a dummy variable which was allocated 1 when CEO combined as the board chairperson and 0 if otherwise.

When we see the control variable, the mean value of MFI size as measured by the natural logarithm of total asset is 16.4 with having a maximum value of 21.2 and minimum values of 12.1. The standard deviation of MFI size among the sample MFI is 2.1.

4.2. Correlation analysis of ROA and corporate governance elements

This section of the study presents the results and discussions of the correlation analysis. To identify the relationship among the variables of corporate governance and financial performance correlation coefficients were used.

Below in table 4.2, the correlation matrix which shows the relationship of the return on asset with board size, board gender composition, board competency, board experience in the finance sector, meeting frequency of board, audit committee size, CEO duality, CEO gender and Microfinance Institutions size. This table also shows the linear relationships between each independent variables and control variables used in this study.

Based on the correlation matrix independent variables; board size, board composition, board competency, board experience in the sector, meeting frequency and audit committee size are positively and significantly correlated with Return on Asset. However, CEO gender and CEO duality are negatively and significantly correlated with return on asset.

Whereas, control variable (Firm size) measured by natural logarithm of total asset of MFI has a positive and significant correlation with return on asset in this study.

The correlation analysis shows only the direction and degree of association between variables and it does not permit the researcher to make causal inferences regarding the relationship between the identified variables. Therefore, it is not possible to explain the

relationship between corporate governance variables and performance measure by controlling the influence of some selected variables using correlation analysis. As a result the main analysis is left for regression analysis that overcomes the shortcomings of correlation analysis.

Table 4.2. Correlation Matrix

	ROA	B_S	BCPO	BCPE	BES	M_F	SAUD	CEOD	CEOG	MFIS
ROA	1									
B_S	0.85215	1								
BCPO	0.133	0.11467	1							
BCPE	0.83698	0.91277	0.29328	1						
BES	0.40295	0.38761	0.23294	0.38807	1					
M_F	0.67996	0.64281	0.03201	0.61213	0.3392	1				
SAUD	0.40738	0.55516	0.38442	0.59761	0.5977	0.49697	1			
CEOD	-0.2842	-0.2986	0.28574	-0.2055	-0.0935	-0.1742	-0.0393	1		
CEOG	-0.0959	-0.1435	0.66313	0.04251	0.21822	-0.2391	0.07297	0.375	1	
MFIS	0.66216	0.56066	-0.1121	0.50962	0.12173	0.4295	0.34262	-0.3229	-0.4347	1

Source: researcher's computation using Eviews 7

4.3. Regression Results and Discussion

This section of the study presents the results and discussions of the regression output. In order to examine the impact of corporate governance elements on sample Ethiopian Microfinance institutions financial performance panel linear regression model was estimated. The regression analysis enables the researcher to empirically test the proposed hypothesis and to achieve the research objective. The method of least squares has some very attractive statistical properties that have made it one of the most powerful and popular methods of regression analysis (Gujarati, 2003). Thus, by conducting the appropriate diagnosis tests Random-effect Model estimation was used in the model.

4.3.1. Diagnostic tests of the data set

The data sets were tested for the classical linear regression model assumptions before running the model. Brooks (2008) suggests four critical assumptions that must be met before utilizing OLS estimation in order to validly test the hypothesis and estimate the coefficient. The classical linear regression model assumptions and their diagnostic tests are discussed below.

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

B) **The assumption of homoscedasticity:** This assumption requires that the variance of the errors to be constant. If the errors do not have a constant

variance, we say that they are heteroscedastic. To check this assumption White test was conducted for the model (See table 4.3). In the model there is no problem of heteroscedasticity or the error variance is constant since the p-value is not significant, meaning that p-value is 0.17 which is greater than 0.05. This means the null hypothesis was not rejected which says that the error variance is constant.

Table 4.3.Heteroscedasticity test

H_0: The variance of the error is Homoscedastic

H_1: The variance of the error is Heteroscedastic

Heteroskedasticity Test: White			
F-statistic	1.455067	Prob. F(48,21)	0.1759
Obs*R-squared	53.81828	Prob. Chi-Square(48)	0.2615
Scaled explained SS	38.13044	Prob. Chi-Square(48)	0.8453

Source: Eviews 7 test result summary

C. **The errors are uncorrelated with one another:** If the errors are correlated with one another, it would be stated that they are 'serially correlated'. A test of this assumption is therefore conducted. The first test was Durbin-Watson which is shown in the regression output of the model. As per this test the value of Durbin--Watson for the model is 1.69which is near to 2.Thus, the null hypotheses were not rejected for the model so there is no problem of autocorrelation. However, Durbin-Watson is a test for first orders autocorrelation. It tests only for a relationship between an error and its immediate previous value. Therefore, in addition to DW test it is desirable to conduct. Breusch-Godfrey Serial Correlation LM test to

examine a joint test for autocorrelation that will allow examination of the relationship between error term and several of its lagged values at the same time. Thus, Breusch-Godfrey test was also conducted for the model (see below table 4.4) and found no problem of autocorrelation for the model, meaning that p-value of the test resulted 0.11 which is greater than 0.05.

Table 4.4. Autocorrelation test

H_0: The errors are uncorrelated with one another

H_1: The errors are correlated with one another

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	2.568303	Prob. F(1,59)	0.1144
Obs*R-squared	2.920029	Prob. Chi-Square(1)	0.1875

Source: Eviews 7 test result summary

D. **Model misspecification error:** With regard to model misspecification error Ramsey reset test was conducted for the model (See table 4.5). The Ramsey regression specification error test result for the model is insignificant, (i.e. test statistics probability is 0.12). The researcher fails to reject the null hypothesis. Thus, the result indicates no model specification error in the model of the study. Therefore, in this study appropriate functional form has been used.

Table 4.4.Model specification error (linearity) test

H_0: The model functional form is appropriate

H_1: The model functional form is inappropriate

Ramsey RESET Test			
	Value	df	Probability
t-statistic	1.579168	59	0.1196
F-statistic	2.493772	(1, 59)	0.1196
Likelihood ratio	2.897891	1	0.0887

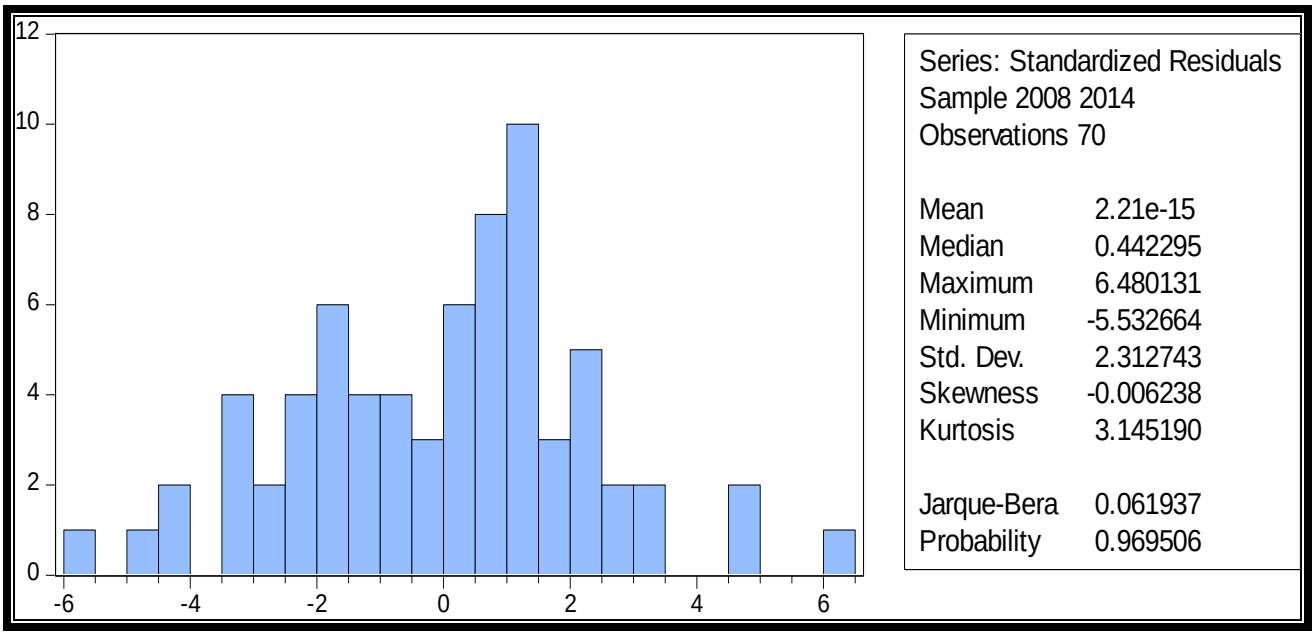
Source: Eviews7 test result summary

E. **The disturbances are normally distributed:** Bera-Jarqu normality test which is the most commonly used normality test was conducted for the model after estimating the regression (see table 4.5). The p-value is0.96 which is insignificant for the model and the researcher failed to reject the null hypothesis, which says the residual value is normally distributed. Moreover, kurtosis is 3.1, which is near to 3. Therefore, there is no normality problem on the data used for this study.

Table 4.5.Normality test

H_0: Residuals are normally distributed

H_1: Residuals are not normally distributed



Source: Eviews 7 test result summary

Fixed effect Versus Random effect

The pooled OLS estimator ignores the panel structure of the data and simply estimates. The major problem with the Pooled model is that it does not distinguish varies MFIs that we have. In other words, by combining 10 MFIs by pooling, we deny the heterogeneity or individuality that may exist among 10 MFIs. Here the assumption is that the coefficients including the intercept are the same for all MFIs.

Fixed effect model allows for heterogeneity or individuality among 10 MFIs by allowing having its own intercept value, but the intercept does not vary over time. In Random effect model the 10 MFIs have a common mean value for the intercept. Therefore, it is

necessary to determine whether the fixed effect or random effect approach is appropriate. A common practice in corporate governance research is to make the choice between both approaches by running a Hausman test.

The hausman test result shows (See Table 4.6.) that the p-value of the test summary is 47.5 percent meaning that the null hypothesis is accepted that the Random Effect Model is appropriate.

Table 4.6.Random Vs Fixed effect Model test summary

H_0: Random effect model is appropriate
H_1: Fixed effect model is appropriate

Correlated Random Effects - Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	6.558737	7	0.4762

Source: Eviews 7 test result summary

All the above tests of basic classical linear regression model assumptions for OLS estimation prove that, the results obtained from the regression model in this study are consistent, free from bias and efficient since the assumption holds and the next step is analyzing and discussing the outputs of the regression. The results of the regression model that has been estimated to examine the impact of corporate governance variables on the financial performance of selected Ethiopian Microfinance Institutions are shown below in table 4.7.

As it is summarized in the table 4.7 below, the R^2 for the model is 88.8percent while adjusted $R^2$is 87.1percent.Which means that 88.8 percent of the variation in return on asset was explained by the independent and control variables used in this study, only 11.2 percent of variation in return on asset is due to other factor that are not included in this study.

The adjusted R^2 measures how well the model fits the data by taking into account the loss of degrees of freedom associated with adding extra variables. Therefore, the model best fits the data.

In addition, the F-statistic shows the overall significance of variables in other words the significance of each models slope parameters jointly. The F-statistics of the model is 52.7 and the null hypothesis of the model was rejected. Therefore, the model variables are significant. The model adequately describes the data. Here one can infer from the results of R-squared and F-statistics that the implemented model of this research is well fitted that corporate governance elements have a significant effect on MFIs' financial performance.

Table 4.7 Random effect Regression Result

Dependent Variable: ROA
Method: Panel EGLS (Cross-section random effects)
Date: 05/28/15 Time: 14:40
Sample: 2008 2014
Periods included: 7
Cross-sections included: 10
Total panel (balanced) observations: 70
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-34.05565	2.188310	-15.56254	0.0000
B_S	1.253183	0.326590	3.837177	0.0003
BCPO	0.368854	0.248437	1.484698	0.1429
BCPE	1.038228	0.306947	3.382439	0.0013
BES	3.078563	0.624300	4.931227	0.0000
M_F	0.637622	0.108044	5.901512	0.0000
SAUD	-1.982355	0.262383	-7.555185	0.0000
CEOD	-0.221057	0.607243	-0.364034	0.7171
CEOG	1.606604	0.912114	1.761407	0.0833
MFIS	1.159381	0.139865	8.289274	0.0000

Effects Specification	S.D.	Rho
Cross-section random	0.000000	0.0000
Idiosyncratic random	1.762851	1.0000

Weighted Statistics

R-squared	0.887739	Mean dependent var	1.974576
Adjusted R-squared	0.870900	S.D. dependent var	6.902603
S.E. of regression	2.480141	Sum squared resid	369.0659
F-statistic	52.71873	Durbin-Watson stat	1.697359
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.887739	Mean dependent var	1.974576
Sum squared resid	369.0659	Durbin-Watson stat	1.697359

Source: researcher's computation using Eviews 7

4.3.2. Corporate governance: Results and Discussion

Board size

As shown above, table 4.7, this study found a positive (coefficient = 1.25) and statistically significant (p-value of 0.0003> 0.05) association between boards size (B.S) and return on Asset at 1 percent level of significance level. It implies that the numbers of board of directors' have significant impact on the financial performance of sample Ethiopian Microfinance Institutions. Thus, the alternative hypothesis (H_{1a}) is accepted that the size of the board have a significant impact on the performance of MFIs. The result support the view that large boards are more effective in monitoring and controlling MFIs management and it help to reduce agency costs.

The finding supports the argument that an increase in board size leads to effective monitoring of the activities of management. The result is consistent with prior studies which argue that larger boards have their benefits and when board size increases firm performance also goes up as more board members provide greater monitoring, advice and make available better linkages to the external environment (Akpan & Amran, 2014); Chenuos et.al (2014); and (Klein, 2002). Therefore, the result shows that board size has positive significant influence on company performance.

Subjective question was also asked whether respondents believe the number of board size affects Microfinance Institutions Financial performance (Question Number 6, see appendix I). Majority of the respondents (90 percent) said "yes" and they have justified that large size is appropriate to run the responsibility of the board. One said that as the board size increase it create an opportunity to generate more new idea, there will be

different committees like Asset Liability management committee, risk management committee, fund rising committee, etc. Microfinance Institutions need to have reasonable numbers of directors in order to perform the board task effectively. National bank of Ethiopia set the minimum number of director to be 7. The outcome of the analysis of both quantitative and qualitative data indicates that there is a positive relationship between board size and financial performance of sample Microfinance Institutions in Ethiopia.

Board gender Composition

The relationship between board gender composition (BCPO) and Return on Asset has a positive coefficient (0.36) which is insignificant (p-value of 0.1429> 0.05).

Hypothesis H_{1b} predicts that the number of women directors on the board is positively associated with financial performance. The positive and insignificant coefficient of the percentage of women directors does not support this hypothesis. Meaning that the null hypothesis which states the composition of board in terms of gender does not have a significant impact on Microfinance Institutions Financial Performance is accepted.

Therefore, this study does not support the view that gender diversity composition leads to superior Microfinance Institutions financial performance. So the result is consistent with (Ferede, 2012) , (Rose, 2007) and (Habbash, 2010) that all found insignificant relationship between board gender composition and firm performance. This may be due to the fact that there are small proportion of board members who are women compared to proportion of board members who are men as shown in the descriptive analysis section, which does not permit them to be powerful enough to make a difference to monitoring. This result does not necessarily contradict the notion that women's presence on boards

may be useful and positive in general. Nevertheless, the low number of women on the boards of sample Ethiopian MFIs does not give them sufficient monitoring power.

In the qualitative question (see appendix II) majority of respondents (70 percent) said "yes "andmost of them justified that it help to enhance gender balance. In addition one respond that females are critical thinkers and they take care of minor think that affect operation. One respondent added that due to most of their clients are women, women board members contribute vital to develop product that meet women clients. On the other hand, one respondent justified that in microfinance board the matter is qualification and experience of board, not gender composition. Whether gender diversity help improve MFIs operation and performance it depends on factors such as experience, education and assertiveness of female directors.

Board competency

Board competency (BCPE) has a positive coefficient (C=1.038)and statistically significant effect (p- value of 0.0013<0.05) on Return on Asset of Ethiopian Microfinance Institutions at 1 percent significant level.

The result indicate that the increase in the proportions of directors who had college degree or higher have a significant positive influence on the financial performance of Microfinance Institution and vice versa. In other words the higher the number of directors who had college degree or above sitting on the board the higher the financial performance of sample MFIs in Ethiopia and vice versa. This suggests that the presence of qualified directors on the board plays an important role in carrying out the boards monitoring responsibility and in improving financial performance.

Hypothesis H_{1c} predicts that there is a significant positive relation between board competencies and Microfinance Institutions financial performance. Since the null hypothesis is rejected in the financial performance measure the result is in line with the proposed alternate hypothesis. Thus, there is a significant positive relationship between board members educational qualification and financial performance of Microfinance Institutions in Ethiopia. This result supports the finding revealed by (Amran, 2011). Moreover, the result is in line with the finding revealed by (Ferede, 2012) in Ethiopian Commercial banks. They argues that directors with higher education are better in managing the business operation and controlling agency problem than less educated counterparts this reduce agency cost. Educational competency affects the oversight and monitoring role of boards of directors. The result support the view that educational competency is potentially important since the ability to seek and interpret appropriate information is essential for the efficient operation of MFIs and the effective control or guidance of management by boards of directors. The qualification of directors as measured by the percentage of directors who had college degree or higher significantly influences Microfinance Institutions performance.

Respondents were asked to reflect their view as to whether they feel that competency of directors have any significant effect on their monitoring and controlling efficiency (Annex II). All of the respondents (100 percent) said "yes". The best justification given is that directors need to have a minimum of college degree in order to read and interpret the financial statements given by the Microfinance Institution management, give right direction properly, and able to give strategic leadership. Boards of directors make decision after analyzing and carefully understanding the technical documents submitted

by management as a report. In addition, they stated that education plays a key role not only in the finance sector but also in any other sector of the economy. Thus, educational qualifications of directors play a great role in board decision making. Both the regression result and the qualitative analysis indicate that educational qualification of directors is important factor to improve financial performance of MFIs in Ethiopia. Thus, there is a significant positive relation between board competencies and Microfinance Institutions financial performance.

Board Experience in the Finance Sector

Hypothesis H_{1d} expected that Board Experience in the Finance Sector (BES) is positively and significantly associated with MFIs financial performance. As expected, a positive (Coefficient = 3.07) and significant (p-value of 0.0000<0.05) association is found between board experience in the sector and return on asset. It means the higher the proportions of directors who had earlier working experience in the financial sector the higher the financial performance (as measured by return on asset) of sample MFIs in Ethiopia and vice versa.

Respondents were asked a subjective question (Q. No. 9 appendix I) about directors' prior experience in the financial sector. The respondents in which the board consists directors who had prior experience in financial sector said "yes" and justified that board of directors who had an experience in the financial sector is highly important because they share the experience they had, challenges they faced and actions they took in their previous job. The qualitative result and regression result based on return on asset performance measures support the alternative hypothesis of Board Experience in the

Finance Sector (BES) is positively and significantly associated with MFIs financial performance.

Meeting Frequency

Return on Asset with Meeting Frequency (M.F), coefficient is 0.63, test of p-value is 0.0000< 0.05. This result depicts that, Meeting Frequency has a significant positive impact on ROA and an increasing in meeting frequency will improve the financial performance of Ethiopian Microfinance Institutions by63percent. So meeting frequency has significant positive impact on the firm performance of Microfinance institutions.

The result is consistent with previous studies such as (Karamanou & Vefeas, 2005); (Mangena & Tauringana, April 2008); and (Ntim & Osei, June 2011) in a way that the frequency of board meetings is a measure of board activities and effectiveness of its monitoring ability. Frequent board meetings can result in higher qualities of management monitoring that in turn impact positively on corporate financial performance. Therefore, alternative hypothesis, $H_{1e}$is accepted and means that, increasing Meeting Frequency will result high financial performance that Board who meet frequently generate new idea and follow up the institution.

Respondents asked about the impact of board meeting frequency on the performance of Ethiopian Microfinance Institutions (Question no. 10 appendix I) that half of the respondents said high meeting frequency generate high performance while the rest said the reverse. 10 percent of the respondents said that it depends on the agenda and quality of the meeting not the frequency. The best justification given by respondent was Board that at least meet monthly can better follow up the performance, challenges of the

Microfinance Institutions and monitor their decision implementations. Therefore, by having a good agenda board who meet most frequently will generate higher financial performance.

Size of Audit Committee

Size of audit Committee (SAUD) on Microfinance Institutions financial performance is negative and significant in the measure under study with a coefficient of -1.98 and p-value of 0.0000> 0.05 for return on asset. Which means that the larger the audit committee is the lower will be the financial performance of Microfinance Institutions as measured by return on asset. Therefore, the alternative hypothesis that states size of audit committee has a significant negative impact on MFI financial performance is accepted.

The result is consistent studies conducted previously (Jensen & Meckling, 1976) ; and (Kyereboah-coleman, December 2007). Kyereboah-coleman (2007) found that the size of the audit committee negatively influences performance. This study result supports the notion that a certain minimum number of audit committee members may be relevant to the quality of financial reporting and to enhance financial performance. Free-riding and difficulty to reach in consensus in large groups inversely affect financial performance. Therefore, the outcome of this variable is in line with the proposed alternate hypothesis, when financial performance is measured by return on asset.

For the subjective question (Question no. 11 appendix I) majority of the respondents (60 percent) said "no" meaning that increasing the size of audit committee will not improve performance. The respondents justified that it not the size, but having an effective board audit committee will improve the performance of the institutions. They added that size is

not an issue in audit committee but their experiences and commitment to review an internal and external audit report. So the alternative hypothesis is supported.

CEO duality

The study predicted that CEO with dual duties (CEOD) had a negative insignificant effect on Ethiopia's Microfinance institutions financial performance. The null hypothesis was accepted by the results of the study where CEO duality was found does not have a significant effect on the financial sustainability of MFIs. In the table 4.7 above, the random effect model of the regression results indicates that CEO duality coefficient has -0.52 was insignificant p-value of 0.32> 0.05 in determining the financial performance of the Ethiopian MFIs.

This different from previous studies that our expectation was if CEO is a member of the board there may be conflict of interest and agency problem may happen. This may be in the Ethiopian young and immature microfinance industry it requires to work together board and management so as to achieve better financial performance. Therefore, the null hypothesis is supported.

However, it may create conflicts of interest, much influence on board decisions, board to rely too heavily on CEO's opinion, and Board may not adequately supervise/evaluate one of its own when the industry is matured and when Microfinance Institutions attract more private investors.

CEO gender

The relationship between board CEO Gender (CEOG) and Return on Asset has a positive coefficient (1.6) which is insignificant (p-value of 0.0833> 0.05).

The study found that CEO gender (CEOG) had no significant effect on Ethiopia's Microfinance Institutions financial sustainability. The results of the study accept the null hypothesis that CEO gender has no significant impact on the financial performance of Ethiopian Microfinance institution. The alternative predicts that the female CEO has positive association with financial performance. The positive and insignificant coefficient CEO gender does not support this hypothesis. Meaning that the null hypothesis which states the CEO gender does not have a significant impact on Microfinance Institutions Financial Performance is accepted.

Moreover, in the qualitative analysis majority of respondents said "no" and they justify that it is not the gender of CEO, rather CEO competency and experience that lead superior financial performance. So, competent and experienced female CEO enhances performance. Thus, this study supports the null hypothesis.

4.3.3 Control variable (MFI size): Results and Discussion

Microfinance Institution size which was measured by Logarithm of Total asset has a statistically significant (p-value of 0.0000< 0.05) positive (C=1.15) relationship with the financial performance of Microfinance Institutions measured by Return on Asset. The result can be explained as Microfinance Institution which is large has an advantage of economics of scope and scale. The result implies size of MFI measured by its asset enhance financial performance. Therefore, sample Ethiopian Microfinance Institutions are utilizing their size to enhance their financial performance.

Chapter Five

5. Conclusion and Recommendations

It is important to determine those corporate governance practices that have the greatest impact on the MFI performance and accordingly afford the potential to contribute the greatest significant impact on improving MFIs' performance in long run. In this chapter, the conclusion of the study was made followed by recommendations. In addition recommendation for future research was included.

5.1. Conclusion

From this research, it is found that all the corporate governance elements do not affect the performance of MFIs in the same way. Based on the results of the descriptive statistics, correlation and regression analysis the researcher made the following conclusions.

Based on the descriptive statistics the financial performance of sample Microfinance Institution are 2.56 percent as measured by return on asset. The sample Microfinance Institutions board is characterized by the presence of competence directors that majority of the directors have college degree and above. However, the board is dominated by male and consists of low numbers of directors who had prior experience in the finance sector. Moreover, Ethiopian Microfinance institutions Board of directors on average conduct 7 minutes per year. Concerning CEO duality, 20 percent of CEOs are members of board of directors. Moreover, 20 percent of sample Microfinance Institutions have a female CEO.

The correlation analysis indicates that board size, board composition, board competency, board experience in the sector, meeting frequency, and audit committee size are

positively and significantly correlated with Return on Asset. However, CEO duality and CEO gender are negatively significantly correlated with return on asset

The regression result shows that Board size has a significant Positive effect on return on asset. The finding supports the argument of (Akpan & Amran, 2014); Chenuos et.al (2014); and (Klein, 2002) that an increase in board size leads to effective monitoring of the activities of management. Accordingly, the researcher concludes that board size has significant effect on the Microfinance Institutions performance.

The researcher found no statistically significant relation between board gender composition and financial performance of Microfinance Institutions in Ethiopia. However, it may be due to small representation of female directors in Ethiopian Microfinance institution. . The result is consistent with (Ferede, 2012) , (Rose, 2007) and (Habbash, 2010).

Board competency significantly and positively influences the financial performance of sample Microfinance Institutions. The presence of competence and qualified directors on the board plays an important role in carrying out the boards monitoring responsibility and in improving financial performance. The result supports the finding revealed by (Amran, 2011); and (Ferede, 2012). Therefore, the researcher concludes that board members competency has a significant positive effect on Microfinance Institutions financial performance.

From the regression result, Board Experience in the Finance sector positively and significantly influence return on asset. Moreover, from the qualitative analysis, respondent justified that board of directors who had an experience in the financial sector

is highly important because they share the experience they had, challenges they faced and actions they took in their previous job.

Meeting Frequency has a significant positive impact on ROA and an increasing in meeting frequency will improve the financial performance of Ethiopian Microfinance Institutions. The result is consistent with previous studies such as (Karamanou & Vefeas, 2005);(Mangena & Tauringana, April 2008); and (Ntim & Osei, June 2011) in a way that the frequency of board meetings is a measure of board activities and effectiveness of its monitoring ability.

Size of audit Committee has a negative and statistically significant relation with the financial performance of Microfinance Institutions. Thus, audit committee size has significant negative impact on the financial performance of Ethiopian Microfinance Institutions.

The study found that CEO with dual responsibilities had insignificant negative effect on Ethiopia's Microfinance institutions financial performance. Moreover, the study found that CEO gender (CEOG) had no significant effect on Ethiopia's Microfinance Institutions financial sustainability, even though it has appositive coefficient.

Generally, the findings suggest that Microfinance Institutions with effective corporate governance elements improve financial performance which measured by Return on Asset of Microfinance Institution in Ethiopia. The study has achieved its objective by identifying the attributes that help to test the research hypothesis.

5.2. Recommendations

This study examined the impact of corporate governance on Microfinance Institution' financial performance by taking evidence from selected Microfinance Institutions in Ethiopia. On the basis of the findings and conclusions reached, the following recommendations were forwarded.

- Microfinance Institutions board size should be large enough with better competency to monitor managers through establishing different sub-committees and in turn help to improve financial performance of the institutions.
- Microfinance Institutions should include qualified and competence female directors to enhance gender balance and to develop new product line for female clients of Microfinance Institutions as researcher found Microfinance institutions board was dominated by males.
- This research found that there are limited numbers of experienced board of directors in MFIs. But the experience of board of directors in the finance sector is positively and significantly affects the performance of Microfinance Institution. Therefore, the researcher recommends that Ethiopian Microfinance institutions should include experienced board in other finance related area to improve their financial performance.
- From the descriptive statistics, the research found that there are Microfinance institutions that do not have their audit committee. The researcher recommends that Ethiopian Microfinance institutions should have their audit committee with small size and committed members to improve their financial performance.

- This research found that Meeting Frequency has a significant positive impact on ROA of MFI. Therefore, board of directors should meet frequently by having a good agenda to generate superior financial performance.
- Moreover, it has found that CEO duality has no significant impact on performance. However, it may create conflict of interest when the industry is growing and attract more private investors. Therefore, Good governance should have clear lines between the duties and responsibilities of board members and those of the CEO.

5.3. Recommendation for future Research

The relationship between corporate governance mechanisms and MFIs' financial performance can also be further explained and the result will be more robust by increasing the sample size and number of year of observation. Moreover, the researcher recommend for future researchers to conduct study by including more corporate governance variables focusing on Board of directors and CEO characteristics.

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Appendixes

Appendix I
Questionnaires for the study

BeleteZegeye

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College of Business and Economics

MBA-in Finance

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RESEARCH QUESTIONNAIRE

Dear respondents,

I am a final year student currently pursuing my Master of Business Administration in Finance at Addis Ababa University. This questionnaire is designed to gather data for research to be conducted on the **"Impact of Corporate Governance on Microfinance Institutions Financial Performance in Ethiopia**" for the partial fulfillment of my MBA in Finance. Therefore, its aim is only for educational value. So you are highly requested to respond genuinely.

Thank you in advance for your cooperation!!!

Part I: Personal information

1. Educational qualification

   Diploma ☐ College Degree ☐ asterDegree ☐ above ☐

2. Gender: Male ☐ Female ☐

3. Do you sit on Board as a member?

   Yes ☐ No ☐

Part II: General Question

4. Do you think that CEO gender affect MFIs performance?
   Yes ☐ No ☐
   Please give your justification?
   ……
   ……
   ……
5. Does the presence of CEO on the board affect MFI performance?
   Yes ☐ No ☐
   Please justify how it affects?
   ……
   ……
   ……
6. Do you think that board size affects MFIs performance?
   Yes ☐ No ☐

   Please justify how it affects?
   ……
   ……
   ……

7. Does the presence of female board of directors' in terms of board diversity helps improve the MFIs operation and performances?

   Yes ☐ No ☐
   Why?……
   ……
   ……
8. Does the educational qualification of directors have any significant effect on their monitoring and controlling efficiency?
   Yes ☐ No ☐

   Please give your reason?
   ……
   ……
   ……

9. Are there any board members who had earlier working experience on Microfinance area or Financial Institutions like bank, now in your company?

   Yes ☐ No ☐

   In what ways do these members contribute better than other directors?

   ……
   ……
   ……

10. Do you think boards that meet more frequently tend to generate higher financial performance?

    Yes ☐ No ☐

    Please justify it?

    .....
    .....
    .....

11. Do you believe that increasing the size of audit committee improve effectiveness?

    Yes ☐ No ☐

    How?.....
    .....
    .....

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

No Items	Fiscal Year in Gregorian Calendar						
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
1. Total number of directors sitting on the board.							
2. Total number of Female Board of Directors.							
3. Number of board members who had College Degree or higher.							
4. Number of board members who work as a Board of Directors in other Microfinance/ Other financial Institutions earlier.							
5. Total Number of meeting held by Board Per Annum.							
6. Total number of audit committee members.							

Appendix II

Respondents view about corporate governance elements

Respondents View	total respondents	Yes	%tage	No	%tage	It depends	%tage
CEO gender affect MFIs performance	10	3	30	7	70	0	0
The presence of CEO on the board affect MFI performance	10	5	50	5	50	0	0
Board size affect MFI performance	10	9	90	1	10	0	0
Gender composition of board improve MFI performance	10	7	70	1	10	2	20
Board competency affect monitoring and controlling efficiency	10	10	100	0	0	0	0
Existence of board earlier working experience on Finance sector	10	5	50	5	50	0	0
High meeting frequency generate high performance	10	5	50	4	40	1	10
Increasing the size of audit committee improve effectiveness	10	5	50	4	40	1	10