

**Corporate Governance Policy and Its Effects on the Performance of Private
Banks in Ethiopia - A Comparative Analysis**

**A Thesis Submitted to the Department of Management in partial fulfilment of the
requirements for the degree of Executive Masters of Business Administration**

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Statement of Declaration

I, Yohannes Tesemma, declare that this thesis entitled “*Corporate governance policy and its effects on the performance of private banks in Ethiopia - A Comparative Analysis*” is the outcome of my own effort and study in which all sources of materials used for the study have been duly acknowledged. I have produced it independently except for the guidance and suggestion of the thesis Advisor.

To the best of my knowledge, this study has not been submitted for any degree in this University or any other University. It is offered for the partial fulfilment of the degree of Executive Masters of Business Administration.

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Statement of Certification

This is to certify that the thesis entitled, “*Corporate governance policy and its effects on the performance of private banks in Ethiopia - A Comparative Analysis*”, undertaken by Yohannes Tesemma for the partial fulfilment of degree of Executive Master of Business Administration at the Addis Ababa University, to the best of my knowledge, is an original work and not submitted earlier for any degree either at this University or any other University.

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This is to certify that the thesis prepared by Yohannes Tesemma, entitled “*Corporate governance policy and its effects on the performance of private banks in Ethiopia-A Comparative Analysis*” and submitted in partial fulfilment of the requirements for the of Degree of Executive Master of Business Administration complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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Abbreviations

CBB	Construction and Business Bank
CBE	Commercial Bank of Ethiopia
DBE	Development Bank of Ethiopia
G20	Group Twenty Countries
IMF	International Monetary Fund
NBE	National Bank of Ethiopia
OECD	The Organization for Economic Cooperation and Development
SEC	Security Exchange Commission
SOEs	State Owned Enterprises
SPSS	Statistical Software Package for Social Sciences
UN-ECA	United Nations-Economic Commission for Africa
WB	World Bank

Definition of key terms

Corporate Governance: is the process and structure used to direct and manage the business affairs of a bank towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long-term shareholders' value, as well as other stakeholders' interest (SBB/62/2015). In this study, it represents both board structure and corporate reporting (disclosure) as mechanisms/means to be used for the execution of the corporate governance policy.

Corporate Reporting (Disclosure): is a part of the bank governance mechanisms and is related with the provision of both financial and non-financial information by banks to shareholders and/or concerned stakeholders,

Board Structure: is a part of the bank governance mechanisms and encompasses factors such as board size, board composition, minority representation and board committees,

Bank Performance: in this study it is approximated by return on assets (**ROA**) which is the ratio of after tax net profit to the total assets owned by banks.

Abstract

It is apparent that nowadays the issue of corporate governance has got due attention from various stakeholders such as the general public, academia and government policy makers. This may be due to the recognition of either the multifaceted benefits derived from its effective implementation or the severe consequences it poses otherwise. For this reason the objective of this research is to analyze the effects of the corporate governance policy enforced by the NBE on the performance of the private commercial banks operating in Ethiopia. Thus both primary and secondary data are collected from 14 (fourteen) private banks operating in the country and in order to address the objectives of the study, a deductive research approach and various statistical techniques such as Descriptive Statistics, T- test, Spearman's Rank Correlation and Analysis of Variance (ANOVA) were employed so as to make comparative analyses among the corporate governance and performance variables during the periods 2011-15 and 2016 respectively. Taking in to account the expected outcome of implementing the policy effectively and the empirical findings of previously done researches, this study has made five hypotheses asserting that the corporate governance variables could have significant effects on bank performance. The analyses result from descriptive statistics depicts the existence of improvements in the implementation of most of the requirements of the policy relatively. However, analytical results from t-tests show that the changes were significant for some variables, but not for others. Spearman's correlation results also demonstrate the existence of low correlation in general, except for board size and board composition in 2011-15. The results obtained using ANOVA on the other hand show that the mean variance of all corporate governance variables and bank performance are found not-significant during the study periods. Hence, all the hypotheses, except related to Board size, were supported. Based on the results obtained from the analyses some recommendations such as the determination of optimal board size by the banks , enhancing board composition through the participation of executives and/or non-executive professional personnel in boards' and others are made that are thought to enhance the effectiveness of the policy through safekeeping the interests of both shareholders and other stakeholders and hence improving the performances of the banks accordingly; for that the proactive engagements of all the concerned such as the supervisory organ, the respective banks and others will have a remarkable impact on the effectiveness of the policy under consideration.

Key words: Corporate Governance, Corporate Governance Policy, Bank Performance, Board Structure.

Chapter One

Introduction

1.1 Background of the study

The issue of corporate governance nowadays has become one of the critical subject matters that get due attention among governments, scholars and general public as problems emanated from fraud activities, failure and bankruptcy are becoming apparent and widely manifested in today's ever complex world (Rezaee 2009). Hearing the news about the collapse of the one-time giant corporate entities, the recurrent waves of business failures and/or the bail-out actions taken by governments have been no more a surprise for the general public-even if disappointing, as most of the corporate companies are established and run from the resources acquired from individuals and/or corporate investors in one way or another.

When we look at the new century's corporate scandals that terribly affected major American firms, such as Enron, WorldCom and Arthur Andersen, and the resulting loss of confidence of the public on the stock market led to dramatic declines in share prices and resulted in substantial financial losses to millions of individual investors and for that both the public and experts have identified failed corporate governance as a principal cause for the scandals (Fernando, 1997). Furthermore, many researchers have also found that the recent global financial crisis is mostly attributed to failures in corporate governance such as oversights, failure of risk analysis and unfair compensation (David, Mingyi, and Pedro, 2009)

On top of that the very recent manifestations on the collapse of such large corporate entities and financial institutions around the World have left people and concerned bodies to feel that the system for regulation was not satisfactory, and provoked the need for making appropriate rules of conduct and practices with substantial external regulations and controls (Fernando, 2006). Thus since recent past, the issue of corporate governance has been emerged as a subject of profound and enduring significance (Clarke & Dela Rama, 2008).

So nowadays in business policy and practice, corporate governance is widely accepted as an essential discipline which managers must understand and apply to achieve accountability and performance. In company law, the issues of corporate governance are becoming increasingly prominent as directorial duties and responsibilities are called into question. Leading international

agencies such as the G20, OECD, IMF and WB have seized upon higher standards of corporate governance not only as the means of managing the risk of corporate failure but also as a route to improving economic performance, facilitating access to capital, decreasing market volatility and enhancing of the overall investment climate (OECD, 2004).

Even if corporate governance is considered to have significant implications for the growth of an economy, regarded as important means in reducing potential risks for investors, attracting investment capital and improving the performances of companies, however, the way in which the system of corporate governance is run differs among countries depending on the economic, political and social situations that exist in the respective countries.

When we look at the situation in Ethiopia, following the mushrooming of activities to establish corporate businesses, it was constantly heard about the occurrences of some malpractices possibly emanated due to the gap seen on the commercial code of the country which is inconclusive, not go with the contemporary business complexities and exacerbated with the absence of institutional set-ups needed to enforce them (Hussein, 2012). According to Minga (2008), the Commercial Code of the 1960 does not provide adequate legislative response to the complex governance issues of the time.

So contrary to this fact, considering the susceptibility of the sector and the potential problems that could crop-up either from the financial industry of the country or from other parts of the world, the National Bank of Ethiopia (NBE) took a solitary action in the promulgation of a corporate governance law for banks in 2015 for the stricter implementation by all private financial institutions in the country (NBE, 2015) in view of addressing the under listed major purposes.

1. To maintain the safety and soundness of financial system in general and the respective institutions (sectors) under its supervision in particular;
2. To give way to balanced risk taking and enhance business prudence, prosperity and corporate accountability with ultimate objective of realizing long term shareholders value and other stakeholders interest; and
3. To ensure whether banks are soundly and prudently managed and directed;

Hence the core purpose of this study is, therefore, to examine the implementation of the corporate governance policy by the private banks operating in the country and make analyses in light of its effects on the performance of the banks under consideration.

1.2 Statement of the Problem

Many literatures on corporate governance show that the theories of corporate governance and the issues they tried to deal with ranges from endorsing the actions to be taken to keep and safeguard the interest(s) of shareholders (agency and stewardship theories) to securing the interests of a certain groups (stakeholder theory) or the whole society in general (as represented by social contract theory).

As clearly stipulated in the corporate governance policy for banks, one of the very reasons for having this law is to give ways to balanced risk taking, to enhance business prudence and promote prosperity and corporate accountability, with the ultimate objective of realizing the long- term **shareholders** value and maximize the interests of other **stakeholders**.

Theoretical and empirical evidences from previously done researches (shown in chapter 2) proved that, apart from the assumed benefits corporate governance policies would bring about to the economy in general and to shareholders and other stakeholders in particular, it is not a surprise, however, to observe various effects-either positive or negative or no effects at all- that such policies could potentially pose on the performances of corporate entities in a given economy.

Hence, taking such facts in to account, this study tries to empirically analyze the effects of the newly introduced corporate governance policy on the performance of the private commercial banks operating in the country, mainly for the reasons:

1. The unavailability of works (comparative analysis) specifically done in light of the newly introduced corporate governance policy for banks yet, and
2. To test empirically the effects of the bank corporate governance policy on the performance of private commercial banks operating in the country by using appropriate statistical methods that address this objective.

Hence taking both the agency and stakeholder theories along with the corporate governance policy as a theoretical foundation for the establishment of the conceptual framework for the study, this research mainly tries to empirically show the effects of the corporate governance policy on the performance of private commercial banks, so as to deal with the under listed general and specific objectives of the study.

1.3. Objectives of the study

1.3.1. General Objective of the study

The main objective of this study is to analyze the effects of the corporate governance policy on the performance of private commercial banks in Ethiopia.

1.3.2. Specific Objectives of the study

This study has the following specific objectives:

1. To analyze the effects of the board structures of the banks on bank performance,
2. To examine the effects of corporate reporting on bank performance,
3. To examine the level of implementation and compliance in the execution of the corporate governance policy by the banks, and
4. To provide, suggest and recommend alternative practices so as to make the existing policy become more effective and hence improve the performance of the private banks accordingly.

1.4. Significance of the study

The study is thought to have the following theoretical and practical significances:

1. Due to the unavailability of empirical studies conducted to test the effects of the corporate governance policy on the performance of the private banks in Ethiopia in light of the **newly** introduced corporate governance policy, for that the research is thought to have some kind of contribution in the area,
2. The outcomes of the study will be expected to provide some relevant information to policy makers, researchers and commercial law makers, and

3. It is expected that the research shall also serve as a basis and reference material for other related studies to be conducted using similar analyses techniques in future.

1.5 Scope of the Study

Compared with the applicability of the concepts of corporate governance, the scope of this paper is limited (to):

1. In terms of the target group, as the study only deals on the private commercial banks in the country and excludes other non-financial institutions and state owned banks,
2. In terms of time wise, as the research is a comparative analysis it will only consider the time periods which are thought relevant for the purpose of this research by considering the age of the newly introduced corporate governance policy, and
3. Considering the scope and the issues that corporate governance addresses, the variables considered in this study are mainly based and extracted from the newly introduced corporate governance policy and hence its scope of applicability could be contained in the context of the private commercial banks only.

1.6 Limitations of the Study

Limitations could be occurred in defining and measurements of the variables since variables identification is mainly done based on the corporate governance policy of the NBE and hence this may not lead to a perfect representation and generalization as compared to the theoretical and conceptual span that corporate governance encompasses. Hence the findings are assumed to have limited applicability only to privately owned banks in the country.

1.7 Outline of the Study

This Paper is organized in seven chapters. Chapter one is about general introduction on corporate governance and background of the study. Chapter two deals with review of literatures on theoretical and empirical evidences and concepts related to corporate governance, board structure, corporate reporting and performance. Chapter three try to give highlight on corporate governance in the context of Ethiopia and briefly look at the performance of private commercial banks in Ethiopia, using some general performance indicators. Chapter four of this study deals with the conceptual framework and hypotheses development. Chapter five of the paper is on the

research methodology employed for data analysis and testing of the hypotheses made in Chapter 4. Chapter six deals with data presentation and analysis; and the last chapter is dedicated for discussion on the research findings, conclusion and recommendation.

Chapter Two

Literature Review on Corporate governance

2.1. Introduction

Literature on corporate governance in Africa is just emerging. While scholars in the developed economies have developed a large body of literature on the subject, that on Africa is still very thin. The Dearth of literature is partly due to the fact that the separation of management and ownership of modern corporations is a fairly recent development in large segments of Africa, as most economies were dominated by SOEs whose ownership and management structures derived from a single source-government (UN-ECA, 2007).

Even if the issue of corporate governance is not well advanced in developing countries yet, nowadays it has however, attracted a great deal of public and government attention because of its importance to the economic health of companies and its effect on society in general (Rezaee 2009). Since it has significant implications for the growth and prospects of an economy, numerous recent corporate failures around the world have alerted regulators the importance of sound corporate governance for efficient operations of capital markets, in reducing risk for investors, attract investment capital and improve corporate performance (Rezaee 2009).

Regarding the concepts and issues raised in governance, it is very broad. Corporate governance, however, is specific to business practices in private and public institutions. Although in the literature the discussion seems to center on the relationships that develop within a firm, it also encompasses the relationship created between the corporation with its shareholders, the workforce and the society at large. Corporate governance also encompasses the setting of an appropriate legal, economic and institutional environment that allows companies to pursue long-term shareholder value and maximum human-centered development, while remaining conscious of their other responsibilities to stakeholders, the environment and society in general (Akinboade and Okeahalam 2003).

Hence in light of such general and specific concepts on corporate governance practices; the current chapter is organized to validate the researchable problem of this study. The various

definitions given for corporate governance from different perspectives, contextual and theoretical backgrounds, the governance mechanisms such as board structure and corporate reporting, corporate performance and other pertinent concepts which have significance for the conceptual framework development of this study are also addressed in this chapter.

2.2. Corporate Governance

2.2.1 Definition of Corporate Governance

Corporate governance is not easy to define, as a result of the perpetually expanding boundaries of the subject (Roche 2005). Definitions vary according to the context and the cultural situations (Armstrong & Sweeney 2002) and perspectives of different researchers.

Some schools of researchers argue that a firm's responsibility is primarily towards maximizing the wealth of the shareholders (Friedman 1970; Sundaram & Inkpen 2004), whereas other schools argue that a firm has an obligation, not only to its shareholders, but to all stakeholders whose contribution is necessary for the success of the firm (Donaldson 1983; Freeman 1984).

The OECD paper defines corporate governance as a system by which business corporations are directed and controlled. The corporate governance structures specify the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which company's objectives are set, and the means of attaining those objectives and monitoring of performances (OECD 1999). The Basel Committee on Banking Supervision also used this definition of corporate governance (Basel, 2014).

However, corporate governance is also considered to have wider implications, which are critical to economic and social well-being and stability and equity of a society. This is captured in the broader definition stated by Adrian Cadbury who defines corporate governance in line with the stakeholder approach:

Corporate governance is concerned with holding the balance between economic and social goals, and between individual and communal goals. The governance framework is there to encourage efficient use of resources and

equally to require accountability for the stewardship of those resources. The aim is to align nearly as possible the interest of individuals, corporations and society. The incentive to corporations is to achieve their corporate aims and to attract investment. The incentive for the state is to strengthen their economies and discourage fraud and mismanagement (Cadbury 2000).

According to the corporate governance directive of the NBE, corporate governance is defined as the process and structure used to direct and manage the business and affairs of a bank towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long term shareholders value and other stakeholders interest (NBE, 2015).

Even though, the definition of „corporate governance“ is not provided under the Ethiopian company law, the Commercial Code of Ethiopia incorporates provisions pertinent to the governance of share companies. However, the provisions are inadequate to address specific issues in corporate governance (Hussien, 2012). From this we can infer about the deficiency and gaps observed on the existing commercial code of Ethiopia (which is under revision) to clearly and convincingly address issues and problems aroused in connection with corporate governance.

2.2.2. Benefits of Corporate Governance

The effectiveness of corporate governance depends on the application of the laid down principles and mechanisms in a manner which benefits stakeholders, as well as broader industries and economic sectors.

Corporate governance promotes efficient use of resources within the firm and the larger economy. It also helps firm's to attract low cost investment capital through improved investor and creditor confidence, both nationally and internationally. It also increases the firms' responsiveness to the need of the society and results in improving long-term performance (Gregory & Simms 1999). According to (Banks, 2004), Companies that are properly governed promote financial and economic stability and increases national and global growth rates, whereas poorly governed companies do the opposite. Good corporate governance also brings better management and prudent allocation of the company's resources, and enhances corporate performance which would significantly contribute to the company's share price and increasing the values of shareholders (Keong 2002).

2.3. Theoretical Perspectives of Corporate Governance

2.3.1 Review of Theoretical Literature

Literatures reveal about the existence of wide varieties of corporate governance theories that has been developed with respect to the nature and significance of corporate governance. These, among others include agency theory, stewardship theory, stakeholder theory, resource dependency theory, social contract theory and legitimacy theory as described in the subsequent paragraphs. Out of these theories, we shall draw concepts relevant for this study such as the accountability of board of directors and corporate reporting (disclosure) practices that are assumed to have effects on the performance of corporate entities respectively.

2.3.1.1. Agency Theory

Much of the research in corporate governance derives from agency theory. Since the early work of Berle and Means (1932), corporate governance has focused upon the separation of ownership and controls which results in principal-agent problems arising from the dispersed ownership in the modern corporation. This theory viewed corporate governance as a mechanism where a board of directors is an essential monitoring device to minimize the problems brought about by the principal-agent relationship. In this context, agents are the managers, principals are the owners and the board of directors acts as monitoring mechanism (Mallin 2004).

The focus of agency theory is on the principal and agent relationship (for example shareholders and corporate managers) which created uncertainty, due to various information asymmetries (Deegan 2004). Hence a monitoring mechanism is designed so as to protect the interests of shareholders (Jensen & Meckling, 1976).

The agency model assumes that individuals have access to complete information and investors possess significant knowledge of whether or not governance activities confirm to their preferences and the board has knowledge of investors' preferences (Smallman 2004). Therefore according to the view of the agency theorists, an efficient market is also considered as a solution to mitigate the agency problem, which includes an efficient market for corporate control, management of labor and corporate information (Clarke 2004).

Various governance mechanisms have also been proposed by theorists in relation to protecting the interests of shareholders, such as (Jensen and Meckling, 1976) explore the ownership structure of the corporation, including how equity ownership by managers aligns managers' interests with those of owners. Fama (1980) proposed the possible role of efficient capital and labor markets as information mechanisms that are used to control the self-serving behavior of top executives. (Fama and Jensen, 1983) also described the important roles of the board of directors as an information system that the stockholders within large corporations could use it in order to monitor the opportunism behavior of top executives.

Even though agency theory provides a valuable insights into corporate governance, however, it is not free from critics and according to (Johanson and Ostergen, 2010) the theory's applicability to less developed countries fall in question due to some of its assumption and its more reliance on the existence of efficient markets for its effectiveness, as presence of such markets in less developed countries is practically not real.

2.3.1.2 Stewardship Theory

In contrast to agency theory, stewardship theory presents a different model of management, where managers are considered as good stewards who will act in the best interest of the owners (Donaldson & Davis 1991). The steward's behavior is pro-organizational and collectivistic, and the steward's behavior will not depart from the interest of the organization (Davis, Schoorman & Donaldson 1997). Thus the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control (Ibid).

Therefore stewardship theory takes a more relaxed view and also supports appointment of a single person for the position of chairman and CEO and a majority of specialist executive directors rather than non-executive directors (Clarke 2004). Hence, according to this theory, the need for board of director is to advise and support management rather than to discipline and monitoring of management, a view which entirely opposes with the agency theory.

2.7.1.3 Stakeholder Theory

Unlike the agency theory, the stakeholder theorists argue that rather than running the firm to primarily maximize the wealth of shareholders, the firm should equally serve the interests of a

wider stakeholder group (Freeman and Reed 1983, Hummels, 1998, Freeman 1984). And a stakeholder is relevant if their investment, in some form, is subject to risk from the activities of the organization (Clarkson 1995). According to Ansoff (1965), a firm's objective could be achieved through balancing the conflicting interests of the various stakeholders.

Corporate governance systems are in a state of transition due to internationalization of capital markets, resulting in convergence of the shareholder value-based approach to corporate governance and the stakeholder concept of corporate governance towards sustainable business systems (Clarke 1998, Smallman 2004). Therefore, a narrow focus on shareholders has undergone a change and is expected to take into account a broader group of stakeholders such as those interest groups linked to social, environmental and ethical considerations (Donaldson & Preston 1995; Freeman 1984; Freeman, Wicks & Parmar 2004).

On the other hand critiques that focus on stakeholder theory identify the problem of who constitutes genuine stakeholders. One argument is that meeting stakeholders interest also opens up a path for corruption, as it offers agents the opportunity to divert the wealth away from the shareholders to others (Smallman 2004).

2.7.1.4 Resource Dependency Theory

Lawrence and Lorsch (1967) link the resource dependency theory to corporate governance. They state that successful organizations possess internal structures that match environmental demand; Pfeffer's (1972) also argued that both board size and composition is a rational organizational response to the conditions of the external environment. Furthermore, directors may serve to connect the external resources with the firm to overcome uncertainty (Hillman et al.2000, Gales & Kesner 1994), because coping effectively with uncertainty is essential for the survival of the company.

Hence in this theory, diversity of corporate board members has been found to be an important element since it can lead to broader corporate networks and improve financial performance, (Waddock and Graves 1997).

2.7.1.5 Social Contract Theory

Social contract theory considered society as a series of social contracts between members of society and society itself (Gray, Owen & Adams 1996). There is a school of thought which sees social responsibility as a contractual obligation the firm owes to society (Donaldson 1983).

Integrated social contract theory was developed by Donaldson and Dunfee (1999) as a way for managers to make ethical decision making, which refers to macro-social and micro-social contracts. The former refers to the communities and the expectation from the business to provide support to the local community, and the latter refers to a specific form of involvement.

2.7.1.6 Legitimacy Theory

Legitimacy theory is defined as a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate with some socially constructed systems of norms, values, beliefs and definitions (Suchman 1995). Similar to social contract theory, legitimacy theory is based upon the notion that there is a social contract between the society and an organization. A firm receives permission to operate from the society and is ultimately accountable to the society for how it operates and what it does, because society provides corporations the authority to own and use natural resources and to hire employees (Deegan 2004). Failure to comply with societal expectations may result in sanctions being imposed in the form of restrictions on firms operations, resources and demand for its products (Ibid).

In general there also exist theories of corporate governance such as institutional theory, political economy theory and others but for the purpose of constructing the conceptual framework of this study and being in line with the assumptions made by the NBE on its corporate governance policy, the study shall take in to account and apply a few of the above mentioned theories that have relevance with the purpose of this research.

2.4. Board Structure

Boards can be structured in many different ways to meet the needs of the organization. The variation in governance structures reflects two competing views. On one hand, it is believed that boards are formed to maximize the managerial control of the firm through adopting structures that will allow for control of the board by management, resulting in superior performance due to

the inside information and better understanding of the needs of the firm than is possible with outside independent directors (Berle & Means 1932; Mace 1971). The other view is that boards are formed to minimize agency costs through adoption of structures that require ratification and monitoring of management behavior by outside directors, thus reducing the difference between shareholders and management interest (Fama, 1980; Fama & Jensen 1983).

In this study, however, as one of the governance mechanisms which are thought to manifest and characterize board structure and as clearly stipulated in the corporate governance policy of the NBE include instruments such as board size, board composition, minority representation in board and board committees are discussed in detail below.

2.4.1. Board Size

According to Marte (2010), the size of board is considered to be crucial characteristics of board structure. Regarding the relationship between the size of a board and a firm's performance, there are two distinct schools of thoughts. The first school of thought argues that a smaller board size will contribute more to the success of a firm (Lipton and Lorsch, 1992; Jensen, 1993; Yermack, 1996). However, the second school of thought considers that a large board size will improve a firm's performance (Pfeffer, 1972; Klein, 1998). These studies indicate that a large board will support and advise firm management more effectively because of a complex of business environment and an organizational culture (Klein, 1998). Moreover, a large board size will gather much more information. As a result, a large board size appears to be better for firm performance (Dalton et al, 1999, Haniffa and Hudaib, 2006, Vanden, Berghe and Levrau, 2004, Goodstein et al., 1994, Kiel and Nicholson, 2003). The outcome of the studies done by Nicholson & Geoffrey (2003), Sunday (2008), Dehaene et al (2001), Jackling and Johl (2009) and Dalton et al.(1998) also show the positive impact of large board size on the performance of corporates.

On the other hand, a research done by Olubukunola (2011) concluded that banks with large board size record a profit lower than those with smaller board size. Other researches done by Almanseer et al (2012), Gill and Mathur (2011), Bennedsen et al, 2004; Sanda, Mukaila & Garba, 2003; Van den Berghe and Levrau, 2004; and Yermack 1996 show a negative relationships between board size and corporate performance.

From the two contradictory views on board size, it can be witnessed the existence of empirical evidences showing mixed results.

2.4.2. Board Composition

Board composition refers to, for instance, the number of independent non-executive directors on the board relative to the total size of directors (note that there might be other elements to be considered depending up on the respective country's governance requirement). An independent non-executive director is independent director who has no affiliation with the firm except for their directorship (Clifford and Evans 1997). The argument for the board composition is that the skills and the knowledge base they will bring to the firm are of importance to firm performance (Bonn, Yoshikawa & Phan 2004).

Some studies found that there is a positive link between firm performance and board composition. Lee et al. (1992), Rosentein and Wyatt (1990) state that boards dominated by independent outside directors are associated with substantially higher abnormal returns (Barnhart, Marr & Rosenstein 1994; Daily & Dalton 1992; Schellenger, Wood & Tashakori 1989, Pfeffer 1972, Valenti et al, 2011).

Alternatively, there are also studies which show a negative relationship between the proportion of outside directors and corporate performance (Bhagat & Black 1998, Weir and Lang, 2001).

On the other hand other studies suggest that there is no link between outside independent directors and firm performance. For instance, MacAvoyet el. (1983) did not find any support for the hypothesis that a board's composition affects firm performance. The studies made by Fosberg (1989) and Molz (1988) also show similar results.

In this study, however, board structure constitutes the number of non-executive directors in the bank's board, representation of females in the board and availability of the mixture of core competencies in the board, as per what the corporate governance policy of the NBE dictates.

In general regarding the relationship between board composition and firm performance, as witnessed from the reviews of various empirical evidences, show mixed results.

2.4.3. Minority Representation

La Porta et al. (1999) argue that, in countries with weaker legal and institutional protection of minority shareholder rights, the agency conflict between large and small shareholders may increase in importance to the point where it rivals the impact of the managers–shareholder conflict. This suggests that, based on the balance between the two agency conflicts, concentrated ownership is less beneficial to minority shareholders where the institutional structure is weaker. Consistent with this view, Maury (2006) provides evidence that, in Western Europe at least, the firm valuation benefits from family control and only where minority shareholders enjoy stronger legal protection.

Some literatures stress the role of controlling shareholders as the main monitors of managers and, therefore, as key determinants of firm value (Holmstrom and Tirole, 1993; Bolton and von Thadden, 1998a, 1998b; Kahn and Winton, 1998; Noe, 2002; Faure-Grimaud and Gromb, 2004).

Admati and Pfleiderer (2009), show that a large minority shareholder could wield a certain amount of power over the manager due to the right to exit the company and depress its stock price (Edmans, 2009, Edmans and Manso, 2011). According to Marisela et al (2009) as the number of directors serving in boards increase through the inclusion of additional independent outside directors, the potential for expropriation of minority shareholders’ rights is decreased.

Santiago and Brown (2007), state that the ownership structure, board size and CEO ownership are positively related with the expropriation of minority shareholders’ rights. However, Claessens et al. (1999) found that there is no significant evidence of expropriation for state control and control by widely held corporations.

Cravens and Wallace (2001) found that the percentage of independent directors on the board and the size of the board have both been positively associated with levels of expropriation of minority shareholder (Janggi and Leung, 2004). However, negative relationship is found by Santiago and Brown (2007), between the measures of board independence and the expropriation of minority shareholders’ rights.

A study by Berkman et al. (2009) indicates that expropriation is more likely at firm with poor growth opportunities. The result from Akhtaruddin and Hossain (2008) also indicates that growth

reduced expropriation activities. Due to this, they concluded about a negative relation between growth opportunity and expropriation.

In general protecting minority shareholders has various advantages that go beyond the individual investors and to the economy as a whole. It is from this reason that the World Bank views the absence of an adequate protection system for minority shareholders impact negatively the capacity of the country to attract more foreign investors.

2.4.4. Board Committees

Board committees are also an important mechanism of the board structure providing independent professional oversight of corporate activities to protect shareholders interests (Harrison 1987). Corporate failures in the past focused criticism on the inadequacy of governance structures to take corrective actions by the boards of failed firms. The importance of these committees was espoused by the business world (Petra 2007). Shareholders are also able to have greater confidence in boards when there are named committees to address the key responsibilities and disclose their existence to the investors (Davis 2002).

The corporate governance policy issued by the NBE imposes the responsibility for the establishment and ensuring of effective functioning of the various committees to bank boards such as Audit committee, Risk and Compliance committee and Human Resource Affairs Committee.

In general, empirical evidences regarding the relationship between audit committees and the reliability of financial information have shown mixed results. Firms with audit committee are more likely to have reliable financial information. In contrast, Beasley (1996) reports that firms with audit committees do not increase the reliability of information. Audit committees with a greater percentage of non-independent directors reported lower probability of issuing going concern reports by the auditor (Carcello & Neal 2000). However, evidences indicated that there is a positive effect on the quality of financial statements with the presence of independent audit committees (Petra 2007).

2.5. Corporate Reporting (Disclosure)

The contents of a disclosure rule are those having the nature of both financial and non-financial information. Disclosure of information is meant to prevent the monopolization of information and expanded investment requirements. The main aim of corporate disclosure is to communicate firm performance and governance to outside investors (Haely and Palepu, 2001), to those stakeholders who have an active interest in the organization (Zairi & Letza 1994), to provide the society-at-large with information about the extent to which the organization has met the responsibilities imposed upon it (Gary, Owen & Maunders 1991).

According to the policy of the NBE, the board and senior management of banks are obliged at a minimum to disclose, without breaching the necessary confidentiality, information such as related party loans, to exhibit audited annual reports with due assurance in a newspaper of wide circulation, about its board, its mandate, qualification, experience, board sub-committees and so on.

Healy and Palepu (2001) identify three types of capital market effects for firms that make voluntary disclosures: improved liquidity of stocks in the capital market; reduced cost of capital; and increased analysis. Empirical studies on voluntary disclosure also suggest that managers voluntarily enhance the visibility of their firms' financial profiles to: (1) reduce agency costs or contracting costs (Chow and Wong-Boren, 1987); (2) reduce their cost of capital (Sengupta, 1998), and (3) enhance the value of the firm (King et al., 1990; Frankel et al., 1995; Balabanis, Philips & Lyall 1998).

Most of the studies show that the increase in disclosure creates value for shareholders. This is true whatever the way disclosure is enhanced (Goncharov et al, 2006; Patel and Dallas, 2002; Akhigbe & Martin, 2006, Marquardt & Wiedman, 2007, Ferrell, 2007). On the other hand, for instance Zhang (2007) shows the existence of negative returns (meaning destruction of value).

It appears that banking crises are less likely to happen in financial systems producing comprehensive financial reports characterized by disclosure. Tadesse (2005) shows that market discipline ensures the stability of the financial systems and markets, in countries that adopt such reports. Giannetti (2007) and Nier (2005) come to the same conclusions that banks that communicate more information on their assets are less likely to see their financing costs

increasing. However, Cordella and Yeyati (1998) show that transparency may increase the banking sector sensitivity to systemic shocks if banks in difficulty have suffered an exogenous shock, and more information generates market reaction which can worsen the bank's situation. Hasman and Samartin (2008) also bring to light the potential negative role of disclosure during a banking crisis.

Previous researches (Hossain, 2000; Inchausti, 1997; Karim, 1996; Owusu-Ansah, 1998; Wallace & Naser, 1995; Wallace et al., 1994) used profitability as a determinant of disclosure in corporate annual reports. Findings of Wallace et al. (1994), Karim (1996), Owusu-Ansah (1998), and Hossain (2000) suggest that companies having higher profitability disclose more information than those with lower profitability. In general, empirical evidences of various researches in this regard show the existence of mixed results.

2.6. Firm Performance

So as to evaluate performance, it is necessary to determine the constituents of good performance using performance indicators. To be useful, a performance indicator must be measurable, relevant and important to the performance of the organization, it must be meaningful and the cost of obtaining the information must not outweigh its value (Oakland 1989).

There are many measures of firm performance. Financial measures of firm performance used in empirical research on corporate governance fit into both accounting-based measures and market-based measures (Kiel & Nicholson 2003).

Most commonly used accounting based-measures are return on assets (ROA) (Kiel & Nicholson 2003) and return on equity (ROE) (Baysinger & Butler 1985). The most commonly used market-based measures are market to book value ratio and Tobin's Q (Barnhart, Marr & Rosenstein 1994).

There is much debate regarding the most reliable measures. However, in a meta-analytic review of corporate governance literature there appears to be no consensus regarding the efficacy and about reliability of one measure over another (Dalton et al. 1998).

However this study uses the accounting-based measure of performance mainly the Return on Assets (ROA) over the market-based one as the later one in general requires market data which is difficult to use and apply due to the absence of stock or equity markets in Ethiopia.

2.6.1 Return on Assets (ROA)

Return on assets (ROA) is also a measure of performance widely used in the governance literature for accounting-based measures (Finkelstein & D'Aveni 1994; Kiel & Nicholson 2003; Weir & Laing 2001). It is a measure which assesses the efficiency of assets employed (Bonn, Yoshikawa & Phan 2004) and shows to investors the earnings the firm has generated from its investment in capital assets (Epps & Cereola 2008).

Efficient use of a firm's assets is best reflected by its rate of return on its assets. ROA is an indicator of performance which is calculated as after tax income divided by total assets (Finkelstein & D'Aveni 1994). Since managers are responsible for the operation of the business and utilization of the firm's assets, ROA is a measure that allows users to assess how well a firm's corporate governance system is working in securing and motivating efficiency of the firm's management (Epps & Cereola 2008).

2.7. Corporate governance related to Financial Institutions

In this section of the study attempt is made to summarize the empirical findings on the effects of the various governance mechanisms on bank performance that are thought to have relevance with the financial sector.

2.7.1 Board structure and Performance

Reviews of various researches that addressed board structure argued that board structure can influence a variety of organizational outcomes (Dalton et al. 1998; Donaldson & Davis 1991; Laing & Weir 1999). Corporate reform efforts by institutional investors and shareholder activists are the results of these governance issues (Davis & Thompson 1994).

2.7.1.1. Board Size and Bank Performance

When we look at cases regarding the size boards should possess, we found mixed results, according to the studies conducted by various scholars and researchers. For banks, the same

holds true and various studies present a positive relation, concave relation or no relation between board size and performance (Andres and Vallelado (2008); Adams and Mehran, (2012).

Sunday (2008), Kiel & Nicholson (2003), Yung (2009) examined the effect of corporate governance on bank performance and found that board size has positive effect on performance.

Al-Manaseer et al. (2012) empirically investigated the impact of corporate governance on performance and the study revealed a significant negative relation between board size and banks performance as measured by return on equity and earnings per share but found insignificant negative association of board size on return on asset and profit margin. Qi Liang et al, (2011), Shams Pathan and Robert Faff (2011) also found that board size has a significant negative impact on bank performance.

The study made by Pablo and Eleuterio (2008) found an inverted U-shaped relation between board size and bank performance. Thus, the inclusion of more directors would benefit the monitoring and advisory functions, improve governance, and raise returns. However, there is a limit beyond which the coordination, control, and decision-making problems outweigh the benefit.

According to the study made by Ashenafi et al (2013) the size of board negatively affects the profitability of banks in Ethiopia, implying that the less the number of directors in the board, the better profitable banks become.

2.7.1.2.Board Composition and Bank Performance

Like the studies conducted on non-financial sectors, empirical evidences and findings regarding the relationship between board compositions and performance show mixed results in the financial sectors too.

Qi Liang et al (2011) explore a comprehensive set of board characteristics (size, composition and functioning of the board) and analyze their impacts on bank performance and bank asset quality respectively. They found that the number of board meetings and the proportion of independent directors have a significant positive impact on both bank performance and asset quality.

However the study of Shams and Robert (2011) revealed that both board size and independent directors decrease bank performance.

Pablo and Eleuterio (2008) based on the data of large commercial banks showed an inverted U-shaped relation between proportion of outside directors and performance. Thus, they advised an optimum combination of executive and non-executive directors is more adequate to create value for the firm than excessively independent boards.

For the purpose of this study, board composition constitutes the number of non-executive board members, gender representation in the board and mixtures of core competencies as taken from the corporate governance policy of the NBE.

2.7.1.3.Minority Representation and Bank Performance

Protection of minority shareholders is an important aspect of good corporate governance. This is because the mechanical application of the majority rule, without restrictions, as the cornerstone of modern company law has serious detrimental effects to the interests of minority shareholders such as reduce their overall investments and such actions could lead to the collapse of the firm and end the perpetual existence of an entity (Sam 2003).

Coffee (1999a) and Stulz (1999) argue that firms wishing to raise capital respond by bonding themselves to protect the interests of their minority stockholders.

Kenneth et al (2007) examined ownership concentration and bank risk of Japanese commercial banks and a positive relation is exhibited between bank risks and ownership concentration and a stronger relation between ownership concentration and bank performance (accounting profits) (Hong, Kubik and Stein, 2004).

However, some literatures stress the role of controlling shareholders as the main monitors of managers and, therefore, key determinants of firm value (Holmstrom and Tirole, 1993; Bolton and von Thadden, 1998a, Kahn and Winton, 1998; Noe, 2002; Faure-Grimaud and Gromb, 2004).

In general as the results of various studies made on the non-financial firms show mixed results, it is however expected that same might holds true in the case of financial firms too, as the attempts

made to look for specific researches done in this regard has resulted in evidences not in sufficient level.

2.7.1.4. Board Committee and Performance

Board committees are also an important mechanism of the board structure providing independent professional oversight of corporate activities to protect shareholders interests (Harrison 1987).

The Cadbury Committee report (1992), recommended that boards should nominate sub-committees to address the following three functions:

- Audit committees to oversee the accounting procedures and external audits;
- Remuneration committees to decide the pay of corporate executives; and
- Nominating committees to nominate directors and officers to the board;

According to the corporate governance policy of the NBE, one of the major responsibilities of the board of directors of banks is establishing and ensuring of the functioning of various board sub-committees including, but not limited to:

- Audit committee,
- Risk and Compliance committee, and
- Human Resource Affairs committee

Studies by Lorsch and MacIver (1989), Daily (1996) and Kesner (1988) explain that most critical processes and decisions are derived from a board sub-committee and this will enable boards to cope with the limited time factor and the complexity of information that they need to deal with (Dalton et al. 1998).

Empirical evidence regarding the relationship between audit committees and the reliability of financial information shows mixed result in general. According to Keyerboah-Coleman (2007), the availability of audit committee on the board has a positive impact on return on asset. Similarly Chan and Li (2008) found significant and positive relationship between the existence of audit committee in the board and firm performance. However, Klein (2002) found a negative relationship between earning manipulation and existence of audit committee in the board of

directors. On the other hand, Sunday (2008) did not find significant relationship between availability of audit committee and bank performance.

2.7.2. Corporate Reporting (Disclosure) and Performance

Information disclosure is seen as a means to improve marketability of shares, to enhance corporate image, and to reduce the cost of capital (Meek, Roberts, & Gray, 1995). Companies provide information on the ground that such disclosure will not respond to the negative impact on the company image (Choi, 1973). It is seen that a company discloses information in line with legislative frameworks (Alam, 1989). Brownlee et al. (1990) argue that regulatory agencies should be more concerned with the full and fair disclosure of information than with the specific accounting methods used to measure or report economic transactions.

Financial companies, whether domestic or international, are required to have appropriate levels of corporate governance standards owing to their sensitive role in the economy to maintain credibility in the marketplace (Abraham, Deo, & Irvine, 2008), to secure their extensive dependence on depositors for capital (Bookey & Thomas, 2010), and to maintain depositors' confidence (Hossain & Reaz, 2007).

Proponents of agency theory theorized a positive correlation between profitability and disclosure (Gallagher, Cooper, & Sweeting, 2008), which was also confirmed by some researchers (Aerts, Cormier, & Magnan, 2007; Akhtaruddin et al., 2009; El-Gazzar, Fornaro, & Jacob, 2008; Li, Pike, & Haniffa, 2008; Narendra Sharma (2014); Hossain and Reaz (2007). But, on the other hand, Ho and Taylor (2007) reported a negative relation between disclosure and profitability. Furthermore, an insignificant impact of profitability on the levels of disclosure is found by (Aljifri, 2008; Ferrer & Ferrer, 2011; Mia & Al-Mamun, 2011).

Hence, from these it is clear to see the existence of mixed results regarding the relationship between bank performance and disclosure in general.

Chapter Three

Corporate Governance and Performance of Private Banks in Ethiopia

3.1 Corporate Governance in Ethiopia

As mentioned in the earlier chapters, the existence of good corporate governance is one of the pillars for the existence of an efficient market in the economy and also possibly shall raise the confidence of both local and international investors, especially for countries like Ethiopia where availability of capital for investment activities is scant. On top of that it has also become the order of the day to have an effective governance system together with an efficient and organized institutional set-ups in order to be competent in the global financial resource acquisition both at county level in general and/or corporate level in particular.

It is also known that developing countries somehow rely on foreign investment and trade for economic growth. The top criteria used by international investors in evaluating the investment potential include the legal and accounting infrastructure, fraud risk and corporate governance of a given country. Therefore, to build investors confidence developing countries need to undertake reforms of corporate governance, financial reporting and related laws (Abhayawansa & Johnson 2007).

However when we look at the existing Ethiopian commercial law (even if it is under revision), according to Hussien (2012) it is neither go with the time and complexities of the economic activities and interdependencies that the current global business atmosphere demands, nor contain acts, legislative provisions and mechanisms related to governance issues especially when we look at it in light of internationally recognized best practices, principles and mechanisms of corporate governance.

As (Hussien, 2012) described, even if the Commercial Code of Ethiopia incorporates provisions pertinent to the governance of share companies, however, such provisions are inadequate to address specific issues of corporate governance related with board of directors such as on the separate roles of non-executive directors and CEOs, on the composition and independence of

boards as well as remuneration of directors. And even the definition of „corporate governance“ is not provided in the Ethiopian company law (Ibid).

Even if the gap in the commercial code is known and the process of revising the existing commercial code is under process, currently there are a number of companies that are being established through the sales of shares to the wider public (Addis Fortune, 2011). Hence the emergence of publicly held share companies in Ethiopia gave rise to a multitude of issues on corporate governance (Tewodros, 2011) typically related to agency problem where agents (managers) may misappropriate the principals“ (shareholders“) investments and there also exist block-holders so that minority shareholders could be exploited.

The agency problems that could occur between dispersed shareholders and managers and/or block-holders of share companies in Ethiopia, therefore, necessitate the need for good corporate governance laws and institutions. Issues related to the existing gap was also raised and addressed in many literatures by academicians and others (Minga, 2008, Fekadu, 2010, Gabor and Zekrie 2009).

According to (Hussien, 2012) there were attempts made and studies conducted to introduce a voluntary code of corporate governance by the Addis Ababa and Ethiopia Chamber of Commerce and Sectorial Associations in collaboration with the Government of Ethiopia through the support of the Swedish International Development Agency (SIDA), to launch an ambitious private sector led initiative (a voluntary code of corporate governance) so as to institutionalize corporate governance in Ethiopia in 2011(Gabor and Zekrie, 2009).

3.2 Significance of Corporate Governance to Ethiopia’s Economy

Good corporate governance is recognized for all the benefits and significance it has in countries peaceful economic activities and long term growth through uplifting of investors“ confidence and capital inflows.

Hence it is apparent that the existence of good governance law and practice to developing countries like Ethiopia have enormous benefits in smoothening their economic growth and development which is a prerequisite for reducing poverty, minimize the effects of mal-management practices and on top of that in enhancing investors“ confidence and which in turn

lowers the cost of capital mobilization and encourages the involvement of the private sector in the economic development endeavors of the country.

3.3 Corporate Governance of Financial Sectors in Ethiopia

Publicly held companies are referred to as “share companies” in Ethiopia’s Commercial Code. Even though all companies (including financial institutions) have to adhere to the provisions of the commercial code to operate in the country, financial institutions are also expected to comply with proclamations , policies and subsidiary directives exclusively issued by the NBE (Hussien, 2012).

3.3.1 Corporate Governance directive of the NBE

As stated in the previous chapters, the establishment of publicly held companies in Ethiopia has been soaring from time to time, even if the existing corporate law of the country could not be able to address and provide solution to all the contemporary problems investors has been facing in connection with the establishment and running of such business entities. For that it has been long heard that the process of revising the existing commercial law of the country has been underway.

However taking various local and international developments in to account, the critical roles financial institutions play in the economy of the country, the recent global financial crisis & the profound adverse effects it posed on the global economic performance, as a requirement to be fulfilled to work with the rest of the world and to safeguard the interests of the stakeholders and investors in the financial sector, the supervisory organ of financial institutions of the country, the NBE, had taken the initiative to declare a policy for corporate governance for banks (SBB/62/2015), due to the absence of an all-inclusive corporate governance provision in the commercial code of the country.

As stated in the governance policy, the following are the main reasons for having the policy:

- 1) Sound corporate governance plays a vital role in maintaining the safety and soundness of financial system in general and banking/insurance/microfinance sector in particular;

- 2) Corporate governance gives way to balanced risk taking and enhances business prudence, prosperity and corporate accountability with ultimate objective of realizing long term shareholders value and other stakeholders interest;
- 3) To ensure whether banks/insurers/microfinance institutions are soundly and prudently managed and directed;

Accordingly, share companies engaged in the banking sector have to comply with the Banking Business Proclamation No.592/2008 and all the directives and procedures issued by the National Bank of Ethiopia (NBE), one of which is the Corporate Governance for banks directive No SBB/62/2015 that came in to force effective 2015, which is the main issue and center of analysis of this research paper.

The following are the major points extracted from the corporate governance policy for banks that are found relevant for the purpose of this research.

- 1) Article 5, states about the size and composition of the board members where;
 - i. Sub article 5.1 states that the bank's board should AT LEAST have Nine directors,
 - ii. Sub article 5.2 states about the board may comprise a mixture of gender and core competencies,
 - iii. Sub articles 5.3 states about the composition of non-influential (minority) shareholders and the board should comprise of non-influential shareholders whose number shall not be less than:
 - a. One-third ($1/3^{\text{rd}}$) of the total board members elected separately by the non-influential shareholders provided such shareholders hold at least 30% and above of the subscribed capital,
 - b. One-fourth ($1/4^{\text{th}}$) of the total board members elected separately by the non-influential shareholders provided such shareholders hold less than 30% of the subscribed capital of the bank,
- 2) Article 6 is about the general meeting of shareholders and sub article 6.1 under sub article 6.1.3 states that the ordinary meeting of a bank shall ensure that the board is held accountable and responsible for the inefficient and ineffective governance,

- 3) Article 6, sub article 6.1 under 6.1.4 and through 6.7 states that the General Meeting of Shareholders shall nominate not less than Five members of Board Standing Nomination Committee for recruiting potential candidates for a seat on the board,
- 4) Article 8 sub article 8.2, sub article 8.2.6 states that the nomination committee shall ensure that two-third ($2/3^{\text{rd}}$) of the candidates for board memberships are nominated by all participating shareholders and one-third ($1/3^{\text{rd}}$) solely by non-influential shareholders,
According to Article 2, sub article 2.6 non-influential (minority) shareholders is defined as any shareholder who holds directly or indirectly less than 2% (Two Percent) of the subscribed capital of the bank.
- 5) Article 10, sub article 10.1 is about appointment of directors and states that it is subject to approval by the National Bank of Ethiopia,
 - i. Article 10, sub article 10.4 states in detail about the responsibilities of board of banks, of which sub article 10.4.10 puts that the board should establish and also ensure the effective function of board sub-committees including, but not limited to, Audit Committee, Risk and Compliance Committee and Human Resource Affairs Committee.
- 6) Article 11, and sub articles runs from 11.1 through 11.9 state about the minimum responsibilities of a chief executive officer (CEO) of the bank without prejudice to the duties and responsibilities stated in any applicable laws, National Bank directives and policies and procedures of the bank,
 - i. Article 12 of the directive is about disclosures where the board and senior management of the bank should be transparent to any shareholder, depositors and any other relevant stakeholders without breaching the law of the country and the National Bank.

3.4 Performance of private banks in Ethiopia

According to the annual report made by the NBE for the year 2014/15, major economic indicators show that Ethiopia has recorded a rapid growth where industry grew by 21.6 percent, services by 10.2 percent and agriculture 6.2 percent. Their contribution to the annual growth was 3.0 percent, 4.7 percent and 2.5 percent respectively (NBE, 2015).

3.4.1 Developments in the Financial Sector

Banks, insurance companies and microfinance institutions are the major financial institutions operating in Ethiopia. The number of banks stood at 19 of which 16 were private and the remaining three are state-owned (even if the CBE and CBB are currently merged).

3.4.1.1 Branch Outreach

With respect to financial sector performance, Ethiopia has made progress. Commercial banks opened 485 (of which 359 were private) new branches which increased the total numbers of branches to 2,693 up from 2,208 a year ago as a result bank branch to population ratio is declined from 1:39,833.8 people to 1:33,448.2 in 2014/15.

Despite aggressive branch expansion by public banks, their share in total branches slightly went down to 41.9 percent from 45.4 percent last year and about 35.5 percent of bank branches are found in Addis Ababa during the fiscal year under review.

3.4.1.2 Expansion of Capital

The total capital of the banking industry increased by 19.0 percent and reached Birr 31.5 billion by the end of June 2015 as the result of a number of banks injected more capital. For that, the share of private banks in total capital marginally increased to 56.5 percent from 55.4 percent last year, while that of CBE remained at 34.0 percent.

3.4.1.3 Resource Mobilization

Commercial banks on their part have stepped up their deposit mobilization which saw a 25.5 percent annual growth. Their loan collection exhibited a 16.0 percent increase and new loan disbursement was expanded by about 26 percent. Of the total loan disbursement, about 68 percent went to finance private sector. Moreover all indicators showed that commercial banks were well capitalized and their return on equity and assets were above the required level, and their non-performing loans were kept within the prudential requirement (Ibid).

The rise in saving deposits indicates the steady growth in financial intermediation of banks. The share of private banks in deposit mobilization increased only marginally to 32.2 percent from 31.5 percent last year despite their opening of 359 new branches. CBE alone mobilized 66.1 percent of the total deposits which is largely due to its branch network.

3.4.1.4 New Lending Activities

Commercial Banks and DBE disbursed Birr 75.5 billion new loans to various economic sectors during the review fiscal year witnessing a 25.9 percent annual increase in line with higher deposit mobilization and collection of loans. Of the total new loans disbursed, about 44.5 percent was by private banks, and the rest by public banks.

3.4.1.5 Sectorial Distribution of Loans

Sectorial distribution of outstanding loans (excluding central government) indicated that credit to industry accounted for 39.7 percent followed by international trade (19.9 percent), domestic trade (11.7 percent), housing and construction (10.4 percent) and agriculture (8.5 percent). The share of private sector including cooperatives in outstanding credit stood at Birr 147.4 billion or 67.9 percent reflecting a 28.7 percent growth over last year.

3.4.1.6 Developments in Interbank Financial Markets

Although there is no secondary market in Ethiopia, government bonds are occasionally issued to finance government expenditures and/or to absorb excess liquidity in the banking system.

A) Treasury Bills Market

The transaction in the Treasury-bills market on weekly basis constituted throughout the fiscal year. At the end of 2014/15, the total outstanding T-bills stood at Birr 41.7 billion, 29.0 percent up from a year ago. The banks' participation in the T-bill market showed not a marked improvement and the dominance of non-bank institutions continued in the review year. Accordingly, the non-bank institutions account for the entire amount of the total outstanding T-bills.

B) NBE Bill Market

NBE-Bill was introduced in April 4, 2011 so as to mobilize resources from commercial banks to finance priority sectors identified by the government as key for long-term growth of the economy. Since their introduction until end of June 2015, NBE bills to the tune of Birr 37.4 billion were sold to the banking sector.

C) Inter-Bank Money Market

The interbank money market remained inactive in Ethiopia due to the existence of excess reserves in the banking system. Accordingly, no inter-bank money since its introduction in September 1998; merely twenty three transactions worth Birr 259.2 million were transacted with interest rates ranging between 7 to 11 percent per year. The maturity period of these loans widely spanned from overnight to 5 years.

From the above information we can observe how the cumulative performances and roles of the private commercial banks constitute key part in the overall economic activities and development of the county. Not only the employment opportunities created along with the expansion of branches throughout the country, their contribution to the government coffer in the form of profit and income tax and the significant role they are playing both in the social and economic activities of the county and the voluntary participation to discharge their corporate social responsibilities are also something worth mentioning.

Chapter Four

Hypothesis and Conceptual Framework

A conceptual framework developed in this chapter provides a framework to understand the effects of the newly introduced governance policy on bank performance using comparative analysis techniques, and identifies the hypotheses regarding the relationship of corporate governance variables with bank performance in the context and with respect to private commercial banks in Ethiopia.

4.1. Theoretical Perspective on Corporate Governance and Firm Performance

Corporate governance structure and hence the role and effect of boards as studied by various scholars from a variety of theoretical perspectives has resulted in a number of competing theories (Kiel & Nicholson 2003). As stated in chapter two, various governance theories have emerged from different disciplines such as the agency theory, stewardship theory, resource dependency theory, stakeholder theory, social contract theory and legitimacy theory.

The major theories mainly applied for the purpose of this study are agency theory and stakeholder theories as the corporate governance policy of the NBE clearly shows that, one of the reasons to have such policy is to maximize the long term shareholders' value as well as to enhance the interests of other stakeholders (NBE, 2015).

Agency Theory

Agency theory is concerned with ensuring that managers act in the interest of the shareholders. It is based on the premise of inherent conflict of interest between the owners and management (Fama & Jensen 1983).

According to agency theory, adequate monitoring or control mechanisms are needed to protect the shareholders and management from conflicts of interest (Fama & Jensen 1983). The argument is that managers may be involved in empire building or other pursuits that may not improve the value of the firm. Hence Initiatives such as the appointment and establishment of board structure (Board size, Board composition, Minority representation, Board Committee) to control management, are designed to address the issue of agency problem and its related costs.

Stakeholder Theory

Stakeholder theory explains the accountability of the board beyond the shareholders, and includes those who can affect or are affected by the achievement of the firm's objectives (Freeman 1984). If the achievement of a firm's objectives can be affected by stakeholders, then a firm's decisions, and hence its performance, can be affected by the stakeholder activities, and in turn the firm's decisions may affect the well-being of its stakeholders (Berkman et al. 1999).

It is unlikely that managers can maximize the value of a firm to its owners by completely ignoring the interest of other stakeholders. Therefore according to the stakeholder theory, managers must consider the impact of their decisions on a broad spectrum of stakeholders and evaluate their decisions based on the impact it has on the market value of their firm (Bird, Ron. et al. 2007).

Stakeholder theory also supports the practice of corporate disclosure. Hence the disclosure practice by firms can be considered as one of the governance mechanisms to make stakeholders have the right information about the firm and enable them to make informed decisions.

4.2. Hypothesis Development

The hypotheses made in this study are emanated from the corporate governance policy and also based on previously stated theories of corporate governance that encompasses mechanisms such as board structure and corporate disclosure and their effect on the performance of private banks in Ethiopia, as the framework developed for the purpose of this research depicts (Figure 4.1).

Hypotheses

The hypotheses made in this study are based on the argument that good corporate governance practices, namely board structure and corporate disclosure practices, as stated in the corporate governance policy of the NBE, are assumed to have effects on the performance of private banks in Ethiopia.

The core function of the board is to monitor and control the top managers and is also accountable to shareholders and other stakeholders who are affected by the activities of the banks. The monitoring and control mechanism of the board through its size (**H1**), board composition (**H2**), minority representation in board (**H3**) and board committee (**H4**) is represented to investigate the

boards' accountability to shareholders through bank performance while the corporate reporting (disclosure) (H5) indicates the board's accountability to other stakeholders and similarly expected to have effects on the performance of the respective private banks too.

Board size and bank performance

As discussed in chapter 2, regarding the relationship between the size of board and performance, there are two distinct schools of thoughts. The first school of thought argues that a smaller board size will contribute more to the success of a firm (Lipton and Lorsch, 1992; Jensen, 1993; Yermack, 1996). However, the second school of thought considers that a large board size will improve a firm's performance (Pfeffer, 1972; Klein, 1998). These studies indicate that a large board will support and advise firm management more effectively because of a complex of business environment and an organizational culture (Klein, 1998). Moreover, a large board size will gather much more information. As a result, a large board size appears to be better for firm performance (Dalton and et al, 1999).

In general the relationship between the size of the board and firm performance, as witnessed from various researches show mixed results and same also holds true regarding the size of board on the performance of financial institutions, as discussed in chapter 2 in detail.

Therefore unlike what is suggested by some proponents of the agency theory and the corporate governance policy for banks in Ethiopia, this study claims the insignificance of board size in affecting bank performance. To test the above argument in relation to Ethiopia's context, the understated hypotheses (null and alternative) are suggested, assuming that it is an optimal size specific to the respective banks context matters most, than the numbers of board size stated on the policy to have effects on banks' performance.

H1: Board size is not significantly associated with bank performance.

H1a: Boars size is significantly associated with bank performance.

Board composition and bank performance

As discussed in detail in chapter 2, some studies find that there is a positive link between firm performance and board composition. Lee et al. (1992), Rosentein and Wyatt (1990) state that boards dominated by independent outside directors are associated with substantially higher abnormal returns. (Barnhart, Marr & Rosenstein 1994; Daily & Dalton 1992; Schellenger, Wood & Tashakori 1989)

Alternatively, there are studies which show a negative relationship between the proportion of outside directors and corporate performance (Bhagat & Black 1998, Weir and Lang (2001). On the other hand other studies suggest that, there is no link between outside independent directors and firm performance (MacAvoyet el. (1983), Fosberg (1989) and Molz (1988).

In general the relationship between board composition and performance, as witnessed from the review of empirical evidences, show mixed results and same also expected to hold true in the case of financial institutions.

In this study, board composition encompasses the size of non-executive boards out of the total board numbers, gender representation and existence of core competencies by board members as derived from the corporate governance policy of the NBE.

Therefore as suggested by the agency theory and stated on the governance policy of banks, this study considers the significance of board composition in affecting bank performance. To test the above argument in relation to Ethiopia's context the under mentioned hypotheses (null and alternative) are suggested.

H2: Board composition is significantly associated with bank performance.

H2a: Board composition is not significantly associated with bank performance.

Minority representation in board and bank performance

As discussed in chapter 2, some literatures gave emphasis on the role of controlling shareholders as the main monitors of managers and, therefore, key determinants of firm value (Holmstrom and

Tirole, 1993; Bolton and von Thadden, 1998a, 1998b; Kahn and Winton, 1998; Noe, 2002; Faure-Grimaud and Gromb, 2004).

On the other hand the result from Akhtaruddin and Hossain (2008) also indicates that growth reduced expropriation activities. Due to this result, they summarized the existence of negative relation between growth opportunity and expropriation. Firms that have high growth opportunity are more likely to avoid the expropriation activities, especially towards minority shareholders' rights compared to firms that have low growth opportunity. Also Coffee (1999a) and Stulz (1999) argue that firms wishing to raise capital respond by bonding themselves to protect the interests of their minority stockholders.

Though it became hard to get sufficient empirical studies and evidences conducted on this specific area related to financial firms, works done on other non-financial sectors revealed mixed results.

Others like (Thomas, 2014) stated that protecting minority shareholders has various advantages that go beyond the individual investors and to the economy as a whole. It is for this reason that the World Bank views the absence of adequate protection regime for minority shareholders as impacting negatively on the capacity of the country to attract even more foreign investors.

Therefore based on relevant theories and the assumptions of the corporate governance policy for banks in Ethiopia, this study considers the significance of minority representation in affecting banks' performance. To test the above argument in relation to Ethiopia's context, the under stated hypotheses (null and alternative) are suggested.

H3: Minority representation in board is significantly associated with bank performance.

H3a: Minority representation in board is not significantly associated with bank performance.

Board Committees and bank performance

Literatures and empirical evidences regarding board sub-committees are found scanty, however according to (Harrison 1987), board committees are also an important mechanism of the board structure providing independent professional oversight of corporate activities to protect shareholders interests. Corporate failures in the past focused criticism on the inadequacy of

governance structures to take corrective actions by the boards of failed firms and the importance of these committees was espoused by the business world (Petra 2007). And regarding the benefits of nomination committees, (Byrd & Hickman, 1992) state the committee will appoint individuals who will act as advocates and to the benefit of shareholder" interest.

In general, as described in chapter 2, shareholders are able to have greater confidence in boards when there are named committees to address the key responsibilities and disclose their existence to the investors (Davis 2002). As a result most countries are moving towards including these committees to enhance independence and satisfy their regulatory requirements.

Like other firms, empirical evidence regarding the impact of the existence of various committees in boards, show mixed results. According to Keyerboah-Coleman (2007), the availability of audit committee on the board has a positive impact on return on asset. Similarly Chan and Li (2008) found significant and positive relationship between the existence of audit committee in the board and firm performance. Furthermore, Klein (2002) found a negative relationship between earning manipulation and existence of audit committee in the board of directors. On the other hand, Sunday (2008) did not found significant relationship between availability of audit committee and bank performance.

Therefore based on what is suggested by the agency theory, the corporate governance policy of banks in Ethiopia and conceptual framework of this study, the monitoring functions of board sub-committees is found an important mechanism of corporate governance and this study expect that the impact of various committees on bank performance is significant. To test this argument in relation to Ethiopia's context, the following hypotheses (null and alternative) are suggested.

H4: Board committee structure composed of audit, risk & compliance and/or human resource affairs committees are significantly associated with bank performance.

H4a: Board committee structure composed of audit, risk & compliance and/or human resource affairs committees are not significantly associated with bank performance.

Corporate disclosure and bank Performance

The contents of a disclosure include both financial and non-financial information. As stated in chapter 2, disclosure creates shareholder value by allowing a firm to reduce the cost of capital.

The majority of the studies show the existence of positive impact (Botosan, 1997, Cheng et al., 2006). Some studies arrive at less conclusive results. For instance Botosan (2000) finds that an increased disclosure only benefits to companies that are followed by few financial analysts. Botosan and Plumlee (2002) show that a more transparent annual report decreases the cost of capital but that more frequent information given during the year increase it. Similarly, Utrero-Gonzalès (2006) finds that a strong regulatory requirement for disclosure leads to lower debt levels: greater disclosure would allow firms to raise equity capital more easily.

The same holds true regarding the relationship between disclosure and performance in the financial sector too i.e. Proponents of stakeholder theory theorized a positive correlation between profitability and disclosure (Gallery, Cooper, & Sweeting, 2008), which were confirmed by some researchers (Aerts, Cormier, & Magnan, 2007; Akhtaruddin et al., 2009; El-Gazzar, Fornaro, & Jacob, 2008; Li, Pike, & Haniffa, 2008).

On the other hand, Ho and Taylor (2007) reported a negative relation between disclosure and profitability. Furthermore, an insignificant impact of profitability on the levels of disclosure was found (Aljifri, 2008; Ferrer & Ferrer, 2011; Mia & Al-Mamun, 2011). Hence, various studies show the existence of different perspectives and mixed results in this regard.

Hence taking the stakeholder theory and the corporate governance policy for banks in to account, the disclosure practice of banks is expected to affect the performance of the bank positively. Hence, to test this argument in relation to Ethiopia's context, the following hypotheses (null and alternative) are suggested:

H5: Corporate reporting (disclosure) is significantly associated with bank performance.

H5a: corporate reporting (disclosure) is not significantly associated with bank performance.

Table 4.1 Summary of the Research Hypotheses

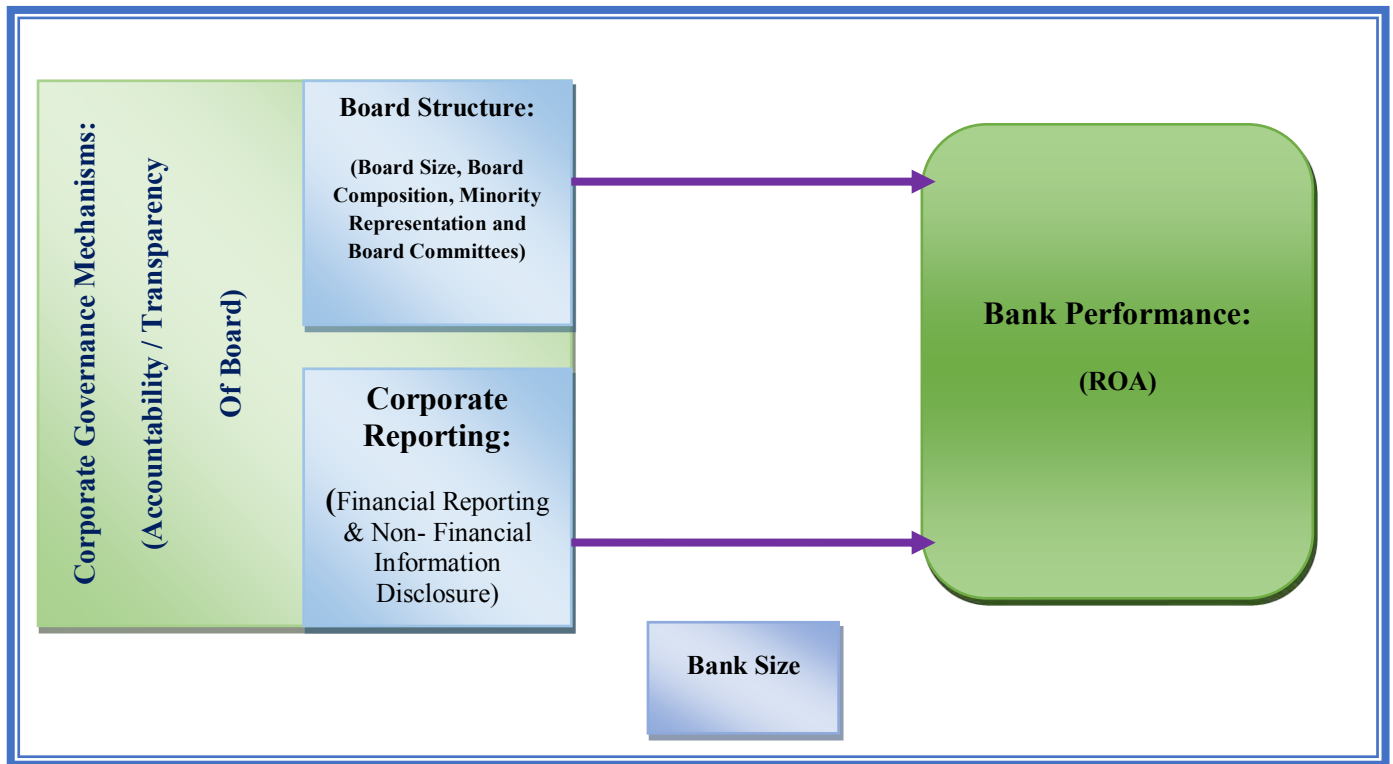
Variables	Null-hypothesis	Alternative-hypothesis
Board Size	Board size is not significantly associated with bank performance.	Board size is significantly associated with bank performance.
Board Composition	Board Composition is significantly associated with bank performance.	Board Composition is not significantly associated with bank performance.
Minority representation in board	Minority representation in board is significantly associated with bank performance.	Minority representation in board is not significantly associated with bank performance.
Board Committee	Board committees composed of audit, risk and compliance and/or human resource affairs committees are significantly associated with bank performance.	Board committees composed of audit, risk and compliance and/or human resource affairs committees are not significantly associated with bank performance.
Corporate Disclosure	Corporate reporting (disclosure) is significantly associated with higher firm performance.	Corporate reporting (disclosure) is not significantly associated with higher firm performance.

4.3. Conceptual Framework Development

A framework drawn taking in to account the agency theory, stakeholder theory and corporate governance policy is shown in the figure below. It suggests that in this study board structure is represented using the variables such as board size, board composition, minority representation and board Committees.

The review of stakeholder theory and researches suggest that different forms of accountability are due to shareholders and the wider group of other stakeholders. In this study accountability of the board and management of the bank to stakeholders is assumed to be via corporate reporting (disclosure).

Figure 4.1: Conceptual Framework of Corporate Governance and Bank Performance



Sources: A conceptual framework developed based on agency theory, stakeholder theory and the corporate governance policy for private banks of the NBE.

The conceptual framework illustrated in figure 4.1 emanate from the theoretical background and the operationalization of the corporate governance variables and bank performance variable that are investigated in this study.

This study examines the relationship between corporate governance and bank performance. The conceptual framework comprises of corporate governance variables such as board structure and corporate reporting practices that are considered important mechanisms in affecting bank performance. Bank performance variable used in this study is represented by the accounting measure of performance called the return on asset–ROA.

Hence the variables considered in affecting performance i.e. **independent variables** shown in the conceptual framework above are comprised of board size, board composition, minority representation, board committee and the corporate reporting that are found in support of the

agency and stakeholder theories respectively. The variable that represents the **dependent variable** i.e. the bank performance is approximated by return on asset (**ROA**) and Bank size is considered as a **controlling variable**, which is estimated by the total value of assets of the banks considered in this study.

Chapter Five

Research Methodology

5.1 Introduction

This chapter explains the methodology employed in this study such as the sample and data collection method, the variables used to measure, conceptualize and operationalize variables including the discussions on the statistical techniques adopted to analyze the data.

5.2. Research Approach

The two main research paradigms used in social research are referred to as *phenomenological* or *positivist*.

In the phenomenological paradigm, researchers are seen as a part of the research process rather than being independent. It relies on people being studied to provide their own explanation on the situation or behavior. The phenomenological approach is referred to as hermeneutic, qualitative, phenomenological, interpretive, reflective, inductive ethnographic or action research (Veal 2005). On the other hand, the positivist paradigm takes the view that researchers are seen as independent of the research they are conducting. The normal process for the positivist approach is to study the literature to establish a relevant theory and develop the hypotheses or propositions, which can be tested for association or causality by deducing logical consequences that are tested against empirical evidence. The positivist paradigm is also referred to as scientific, empiricist, *quantitative* or *deductive*.

The reason guiding a research design can be deductive or inductive. If the research process begins with examining of literature, developing the theoretical / conceptual structure, which is tested by empirical observation it is a deductive study, whereas in an inductive process, a theory is developed from empirical observations (Collis & Hussey 2003).

Hence this study adopted a *deductive* approach in order to determine the relationship between determinants and test the hypotheses stated in Chapter 4 in light of the respective theories and the corporate governance policy under consideration.

5.3 Research Methodology

The methodology used in this study was based on the general and specific objectives of the study. The study is made based on *quantitative* research methodology by employing statistical techniques such as descriptive and inferential methods such as Spearman's correlation, T-test and ANOVA so as to conduct comparative analyses between the respective years (2011-15 and 2016) using SPSS-V.20 software package.

5.4 Data Type and Data Source

The study was conducted using primary and secondary data. Data concerning board structure and corporate reporting are collected using a simple questionnaire designed for the purpose, while data related to performance are taken from the annual reports and/or finance departments of the respective private banks.

5.5 Target Population and Sample Size

The targets population of the study are all the 16 (sixteen) private commercial banks in the Ethiopia and the sample size of this study is 14 (fourteen) private banks in the country. However, 2(two) of the banks are excluded from the list due to the acquisition of incomplete information per the requirement of this study.

5.6 Data Analysis Techniques

Both descriptive and inferential analysis techniques that include *Spearman's correlation* (to test the level of correlation between variables), *t-test* (to check the level of significance) and *ANOVA* (to test the research hypotheses) are used to conduct the analyses.

5.7 Unit of Analysis

This study was on private commercial banks operating in Ethiopia. Accordingly, the units of analysis are these banks.

5.8 Definition and measurement of variables

A) Corporate governance variables

1. The board of directors

As previously mentioned the board of directors is the ultimate governing organ of banks. As stated in the governance policy of the NBE, the duties and responsibilities of bank's board includes exercising the monitoring, advising and guiding roles over the top management of the bank, setting the "tone on the top" and being found exemplary in practicing of good governance process in banks. Based on the policy document, this study has used four proxies to measure the board characteristics of banks. These include:

- i. **Board Size:** measured by the number of board members in each bank.
- ii. **Board Composition:** measured by the numbers of non-executive/executive board of directors relative to the total number of directors, representation of gender and the mixtures of core competencies among board members in the bank, as stated in the policy. It is measured by giving equal weights (i.e. 33.33%) for each factor only for the availability and proper practicality of each of the factors in the bank's board during the years under analyses.
- iii. **Minority Representation in Board:** is to investigate whether 1/3 of the total number of directors in the board represented the non-influential shareholders of the bank or not as mentioned in the NBE's policy. And takes a dummy variable 0 if 1/3 minority representation not exist in banks' board while 1 if there is 1/3 representation in the board.
- iv. **Board Committee:** one of the best practices stated in the corporate governance directive is the establishment of sub-committees in the bank's board as it is believed, it will enhance the monitoring and controlling role of the board. Hence committees such as audit, risk and compliance and human resource affairs committee are the least recommended committees the board is expected to establish as per the directive. It is measured by giving equal weights (i.e. 33.33%) for the availability of each committee in the bank's board during the years under analyses.

2. Corporate Reporting (Disclosure)

It is expected that transparency of banks to their shareholders and stakeholders is the requirement of banks in providing financial and non-financial information as stated on the policy. It is measured by giving equal weights (i.e. 25%) for each of the four factors (stated on the questionnaire) as per what the policy requires and for the practicality of each of the stated factors by the respective banks during the periods under analyses.

B) Bank Performance- Return on Assets (ROA)

Due to the absence of stock market in the country, this study takes the accounting-based measure of performance-ROA which is used as proxy variable to represent the performance of private commercial banks in Ethiopia. ROA is measured by the ratio of after tax net income to total assets of the sample banks. Return on assets shows the profitability of the company's assets in generating profits. It also indicates the effectiveness of the company's assets in increasing shareholders economic interests and the efficiency of management in using its asset to generate earnings.

C) Bank Size

Firm size may be related to corporate governance characteristics and could also have correlation with bank performance. Bank size can be represented by market capitalization and book values of total assets of the firm. But for the same reason stated above due to the absence of such markets in Ethiopia, in this study bank size is represented and measured by the book values of total assets of the banks.

5.9 Operationalization and Measurement of Variables

Specified below are the variables used to operationalize the constructs discussed in chapter 4. These include the corporate governance variables related to board structure such as board size, board composition, minority representation in board, board committees and corporate reporting, bank performance and the controlling variable-bank size.

Table 5.1 Corporate governance and bank performance variables

Variables	Measures	Symbols
Corporate Governance (Board Structure)		
Board Size	The number of board members in each bank	BZ
Board Composition	The number of non-executive/executive directors from the total numbers of directors in the board, representation of gender and core competencies of board members. An equal weight is given for each (33.33%) for the implementation of these factors in the board.	BCP
Minority Representation in Board	Dummy variables 0 if 1/3 minority representation not exist in banks' board and 1 if there is 1/3 representation exist in the board	MRB
Board Committee	The number of committees found in the bank's board as stated in the directive such as audit, risk & compliance and human resource affairs committees. An equal weight is given for each (33.33%) for the availability of such committee in the board.	BC
Corporate Reporting (Disclosure)	Provision of both financial and non-financial information about the bank as per the requirement is related with corporate disclosures. As per the policy, four factors are considered here and for that an equal weight is given for each (25%) for the implementation of them by the respective bank.	CRD
Bank Performance		
Return on total assets	Profit after tax/ book value of total assets	ROA
Others		
Bank Size	The total assets of banks	BZ

5.10. Statistical Analysis

Preliminary analysis of the data was carried out for the selected years. Hence the years 2011-15 and 2016 are selected for the purpose of comparison in order to see the effects of the corporate governance mechanisms on the performance of the private commercial banks in Ethiopia. Hence comparative statistical analyses techniques are employed to address the objective of this study.

As this is a comparative study, same banks are analyzed on the respective time periods i.e. both in 2011-15 and 2016.

5.10.1. Descriptive Statistics

Descriptive statistics measures the central tendency and dispersion. The most commonly used measures of central tendencies are mean, mode and median, however the mean is the most important measure of central tendency. The descriptive statistics used in this study consists of mean, maximum and minimum. Hence in this study mean is calculated to measure the central tendency of the variables for the years 2011-15 and 2016 respectively.

Descriptive statistics are also useful to make general observations about the data collected. They report on the trends and patterns of data and provide the basis for comparisons between variables. In this study descriptive statistics provide a comparison of changes in the period 2011-15 and 2016 related with corporate governance and performance variables during the stated periods. The maximum is used to compare the highest value and the minimum is used to compare the lowest values of the variables during 2011-15 and 2016.

5.10.2 T-Test

T-tests can be used to determine whether there is a significant difference between two sets of means. Conducting the t-tests require that normality of the data is not violated (i.e. the disturbance terms are normally distributed). In such case, the histogram will be bell-shaped and p-value is bigger than 0.05, hence normality should not be rejected at 5% level.

However to measure the changes in the mean, the change is considered as significant if the p-value is less than 0.05 and the opposite holds true if the p-value is greater than 0.05.

5.10.3 Spearman's Rank Correlation

The study also uses the correlation coefficients which measure the strength of the linear association between two variables. When the data are not normal and may include ordinal data and the researcher suspects and wants to measure the strength of the linear relationship between corporate governance and performance variables, non-parametric measures such as Spearman's correlation can be used to measure the strength of association. *According to Spearman, a*

correlation is small if value is between 0.10 and 0.29, medium if value is between 0.3 and 0.49 and, large/significant if value equals or greater than 0.5.

5.10.4 Analysis of Variance

In order to test the hypotheses about the relationships between the corporate governance variables and firm performance variables, an analysis of variance (ANOVA) was conducted. This procedure compares the mean of dependent variables for groups defined by the factor variables and whether there is an interaction between two variables in this study.

ANOVA is an exploratory analysis, which tests the differences among sets of means grouped by more than one classifying variable or factor. It examines the cross-tabulation of means and determines whether the *differences* revealed are significant. Analysis of variance uses F statistics to compute the probability, p . The F ratio is the mechanism used to test the null hypotheses, which tests that the means of group do not differ significantly. *If p is less than a pre-determined threshold (for example, .50) the null hypotheses is rejected and the factors are deemed to have a significant effect* (Doncaster & Darvey 2007).

Summary

In this chapter the research methodology and relevant statistical techniques employed for the purpose of analyzing the relationship between the corporate governance mechanisms and bank performance have been dealt with. Descriptive statistics is used to make overall observation; T-tests are to be used to see the significance of the changes in the means of related variables, Spearman's correlation is applied to assess the linear correlation between the variables and an analysis of variance (ANOVA) is employed in order to test the research hypotheses stated in chapter 4.

Chapter Six

Data Presentation and Analysis

This chapter shall focus on the analysis of the relationship of corporate governance and bank performance variables based on the results obtained from data analyses by employing the statistical techniques illustrated in the previous chapter.

6.1. Descriptive Statistics

Descriptive statistics for the periods 2011-15 and 2016 is calculated for corporate governance and bank performance variables respectively. It is used to compare and see whether compliance is made by the banks on the applicability of the corporate governance policy required by the NBE during the periods under consideration.

It also describes the characteristics of the board structure and corporate reporting practices of the private banks and their overall performance in terms of the variables selected to address such issues. A summary of the descriptive statistics is presented in the Table 6.1 below.

Table 6.1 Descriptive statistics for the years 2011-15 and 2016

Variables	2011-15			2016		
	Minimum	Maximum	Mean	Minimum	Maximum	Mean
Board Size	7	12	10	8	12	9.9
Board Composition (%)	67	100	89	67	100	93
Minority Representation (%)	0	1	57	0	1	71
Board Committee (%)	54	100	72	67	100	95
Corporate Reporting (%)	50	100	75	50	100	85
Return on Assets (%)	10	40	25	20	50	28
Bank Size	800	19,720	6,875	1,294	33,000	12,405

6.1.1 Board Size

As shown above (Table 6.1), the average size of the boards of private banks during the respective periods does not show significant difference. The period 2011-15 shows a minimum of 7, while during 2016 the minimum was 8. For both periods the maximum board size stood at 12. And the average size of a board during both periods is approximately, 10, which in turn signifies the existence of no changes during the periods under analyses in terms of absolute figures.

6.1.2 Board Composition

Board composition includes the number of non-executive boards in the bank's board, female representation in the board and the existence of a mixture of core competencies in board as per what the corporate governance policy dictates.

The minimum and maximum for the periods 2011-15 and 2016 show similar figures i.e. 67% and 100% respectively. However the mean proportion of the board composition increased from 89% in 2011-15 to 93% in 2016 which shows that the number of banks that complied with the policy has improved in a smaller proportion in terms of percentage figures.

6.1.3 Minority Representation

Minority representation, which is expressed as the representation of those shareholders having smaller proportion in their share value in the respective bank's equity and hence 1/3 of the total board members should constitute directors that represent minority shareholders, as the corporate governance policy dictates.

Analysis of the representation of smaller shareholders in bank's board during the periods show a relatively higher increment from the level of 57% in 2011-15 to 71% in the year 2016 (Table 6.1). This implies that the level of minority representation has shown improvement and progress in this regard has been made by the banks as the percentage figures show.

6.1.4 Board Committees

The various committees such as audit, risk & compliance and human resource affairs committees are some as recommended by the policy to be established with in bank boards. Hence during 2011-15 the minimum figure shows 54% and a maximum of 100% but, in 2016 the minimum figure rise to 67% while the maximum figure stood as of the previous periods. However the average figure shows an increment from its level of 72% in the years 2011-15 to 95% in 2016, which showed that the number of banks establishing the various committees in their boards has increased and compliance is relatively managed by the banks in this regard.

6.1.5 Corporate Reporting (Disclosure)

The corporate reporting (disclosure) practice as stated on the corporate governance directive includes the disclosure of related party loans and foreign transactions, reporting transactions having material natures to the controlling body, information about the board members, their qualification, experience and sub-committees in the board, the posting of latest audited financial statements and others.

The corporate reporting (disclosure) practice by the banks show an improvement from its level of 75% in the year 2011-15 to 85% in the year 2016.

6.1.6 Return on Assets

The mean value for ROA was 25%, with a maximum of 40% and minimum of 10% during the period 2011-15. But in 2016 the mean value for ROA showed not as such significant change i.e. 28%, with maximum and minimum values of 50% and 20% respectively. Hence results of the analysis in this regard shows that the profitability of the banks based on total assets did not show significant improvements between the two periods in terms of percentage values.

6.1.7 Bank Size

The bank size is represented by the total assets of the banks, which is taken as a controlling variable in this study. By the size, it is assumed that it shall directly or indirectly represent the organizational structure of the banks, the level of human capital held and its management competency to run the bank etc, all in turn will have effects on the performance of the respective banks.

The minimum and maximum values of the assets employed by the banks during the period 2011-15 are 800 and 19,720 million respectively and in 2016 the figure shows a minimum and maximum value of 1,294 and 33,000 million. Hence the average total assets of the banks rise from 6,875 million in the year 2011-15 to a mean value of 12,405 million in the year 2016. So the descriptive statistics show that the total assets of the banks have shown improvements in terms of value during the periods under analyses.

6.2 Two- Related– Sample T-test

Comparisons of the mean values of the corporate governance and performance variables of the banks for the periods 2011-15 and 2016 using a two-related-sample t-test are presented in the Tables 6.2 and 6.3 respectively. The details of the results are also shown below.

Table 6.2 Corporate governance variables –Comparison of Mean Value for 2011-15 and 2016

Governance Variables	2011-15	2016	t-value	Sig.(2-tailed)
Board Size	10	9.9	.715	0.487
Board Composition (%)	89	93	-1.812	0.093
Minority Representation (%)	57	71	-1.472	0.165
Board Committee (%)	72	95	-5.288	0.000
Corporate Reporting (%)	75	85	-2.442	0.030

6.2.1 Board Size

The t-test conducted to compare the average figures of the mean values related to board size is found not-significant (t-value 0.715, $p > 0.05$) which is reported by the fall from 10 in 2011-15 to 9.9 in the year 2016. Even if the figure is still above the minimum level required by the law, comparison of the number of board members for the two periods shows regress on average even though it is not a major turn down in terms of absolute figure.

6.2.2 Board Composition

Related to the board composition of the banks, the result shows that the changes made in compliance to what the policy dictates between the periods 2011-15 and 2016, was found not significant (t-value -1.812, $p > 0.05$), which in turn shows that the banks under consideration are not comply increasingly as witnessed from the small changes seen in this regard i.e. from 89% to 93% during the stated periods.

6.2.3 Minority Representation

Comparison of the mean difference between the periods 2011-15 and 2016 related to minority representation is found not-significant (t-value -1.472, $p > 0.05$) even if the mean values in terms of percentage during the periods rise from 57 to 71 respectively. This is probably attributed due to the partial implementation of the code by some of the banks as the policy provides the chance for the banks to buy time to abide in full, at least until the time the next board election is made.

6.2.4. Board Committee

Compliance by the banks regarding the establishment of various board committees, as per what the corporate governance policy demands is found significant (t-value -5.288, $p < 0.000$) as the analysis result shows. This shows that there is a significant change in the establishment of audit, risk & compliance and human resource affairs committees by the banks during the stated periods.

6.2.5 Corporate Reporting (Disclosure)

The Corporate reporting (disclosure) practices of the banks show improvements. The change in the mean values for corporate reporting practices (disclosure) between 2011-15 and 2016 is also found significant (t-value - 2.442, $p < 0.05$). The t-test result confirmed that the banks are found in compliance with as per what the code for corporate governance dictates.

6.2.6 Return on Assets

Comparison of the mean values of the performance indicator, ROA, for the respective years, however, is found not-significant (t-value -0.414, $p > 0.05$) showing that the performance of the private banks do not show as such a significant change during the periods 2011-15 and 2016 as depicted in the Table 6.3 below.

Table 6.3 Bank Performance - Comparison of mean value for 2011-15 and 2016

Variables	2011-15	2016	t-value	Sig.(2-tailed)
Return on Assets (%)	25	27	-0.414	0.686

6.3 Spearman's Correlation

Table 6.4 depicts the results of Spearman's correlation for all the variables considered in the study. It examined the association between the corporate governance and bank performance variables for the periods under analyses.

In the case of Spearman's correlation a correlation value between 0.10 and 0.29 signifies the existence of small correlation, a value between 0.30 and 0.49 shows medium relationship and the relationship is considered as larger/significant if a correlation value equals or greater than 0.50.

Correlation results show that the values are more or less low during the years 2011-15 and 2016 in general. But a few statistically significant correlations are also found. The analysis results show that the size of the board was largely correlated only with the board composition, the size of the bank with corporate reporting and ROA in the years 2011-2015. However, the correlation for same variables was found not significant during the year 2016. For the rest of the variables the result shows the existence of small correlation among the variables in the year 2011-15.

The result shows the existence of large correlation between bank size and ROA during the year 2016 like the period 2011-15. However the correlation result shows the existence of small correlations for the rest of the variables during the year 2016.

In general, overall correlation results in both periods show that the problem of multicollinearity does not exist and such problems are considered to occur when correlations among variables have a value of 0.80 or more.

Table 6.4 Spearman's Correlation

Spearman's Correlations for the Period 2011-15

	BZ-2011-15	BCP-2011-15	MRB-2011-15	BC-2011-15	CRD-2011-15	BKZ-2011-15	ROA-2011-15
Spearman's rho	1.000						
	.553*	1.000					
	0.000	.100	1.000				
	.082	.343	-.292	1.000			
	-.034	.148	-.040	.085	1.000		
	-.414	-.287	-.143	-.138	-.583*	1.000	
	-.233	.121	.118	.212	-.059	.489*	1.000

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

Spearman's Correlations for the year 2016

	BZ-2016	BCP-2016	MRB-2016	BC-2016	CRD-2016	BKZ-2016	ROA-16
Spearman's rho	1.000						
	.267	1.000					
	.182	.055	1.000				
	.391	-.213	.194	1.000			
	.015	.121	-.329	-.396	1.000		
	-.054	-.194	-.078	.152	-.061	1.000	
	-.154	-.071	-.172	-.166	.293	-.580*	1.000

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

6.4 Analysis of Variance (ANOVA)

When we perform a t-test, we test the hypothesis that the two samples have the same mean. Similarly, ANOVA tells us whether three or more means are the same and hence it tests the null hypothesis that all group means are equal. ANOVA is an omnibus (compilation) test, which means that it tests for an overall experimental effect.

ANOVA is a way of comparing the ratio of systematic variance to unsystematic variance in an experimental study. The ratio of these variances is known as the F-ratio. A p-value is a probability that provides a measure of the evidence against the null hypothesis provided by the sample. Smaller p-values indicate more evidence against H_0 . After computing the p-value, we must then decide whether it is small enough to reject the null hypothesis and as we see later on, this decision involves *comparing the p-value to the level of significance*.

In this study ANOVA is used to analyze the variance. Hence in order to test the hypotheses made in chapter 4, analysis of variance (Univariate) is applied and it examines the interaction between board structure which includes board size, board composition, minority representation and board committees, and corporate reporting (disclosure) with bank performance.

Univariate analysis, using F statistics indicated that the mean variances among corporate governance and bank performance variables are found not statistically significant, implying that the hypotheses, except for the variable board size (H_1), assumed in this study are not rejected as the details of which are shown below.

6.4.1 Board Size and Bank Performance

The result on the analysis of the mean variance conducted to find the interaction between board size and bank performance are found not-significant for both years 2011-15 (F-statistics .184 ($p=.941 > 0.05$)) and 2016 (F-statistics .490 ($p=.744 > 0.05$)) respectively (Table 6.5).

This implies that there exist no significant variance in the means of the variables and hence the alternate hypothesis (**H1a**) made in Chapter 4 is accepted accordingly, and this in turn implies that there is a significant relationship between board size and private bank performance in Ethiopia.

Table 6.5 Analysis of Variance for Board Size and Bank Performance

Bank Performance Variable	Corporate Governance Var.	2011-15		2016	
		F	Sig.	F	Sig.
Return on Asset	Board Size	.184	.941	.490	.744

6.4.2 Board Composition and Bank Performance

Analysis of variance was conducted to check the interaction between board composition and bank performance as shown in the Table 6.6 below. The result shows the existence of not significant variation between the mean of the variables under consideration during the year 2011-15 (F-statistics 1.973 ($p = .182 > 0.05$)) and year 2016 (F-statistics .010 ($p = .924 > 0.05$)) respectively. Hence, the hypothesis (**H2**) is not rejected accordingly.

Table 6.6 Analysis of Variance for Board Composition and Bank Performance

Bank Performance Variable	Corporate Governance Var.	2011-15		2016	
		F	Sig.	F	Sig.
Return on Asset	Board Composition	1.973	.182	.010	.924

6.4.3 Minority Representation and Bank Performance

Analysis of variance also reported an interaction between minority representation and bank performance (Table 6.7). The result did not show any significant variances between the means of both minority representation and bank performance during the year 2011-15 (F-statistics .087 ($p = .773 > 0.05$)) and 2016 (F-statistics .008 ($p = .931 > 0.05$)) respectively. Hence hypothesis (**H3**) is not rejected since the result from the analysis shows the existence of not significant mean variances between the variables under consideration during the respective periods.

Table 6.7 Analysis of Variance for Minority Representation and Bank Performance

Bank Performance Variable	Corporate Governance Var.	2011-15		2016	
		F	Sig.	F	Sig.
Return on Asset	Minority Representation	.087	.773	.008	.931

6.4.4 Board Committee and Bank Performance

The result of the analysis of variance is shown in Table 6.8 is meant to see the interaction between board committee and bank performance. It shows that the mean variances were found not-significant for the year 2011-15 (F-statistics .536 ($p = .668 > 0.05$) and 2016 (F-statistics 1.836 ($p = .200 > 0.05$) respectively. Hence, the hypothesis (**H4**) is not rejected accordingly.

Table 6.8 Analysis of Variance for Board Committee and Bank Performance

Bank Performance Variable	Corporate Governance Var.	2011-15		2016	
		F	Sig.	F	Sig.
Return on Asset	Board Committee	.536	.668	1.836	.200

6.4.5 Corporate Reporting and Bank Performance

Lastly, the analysis of variance result between corporate reporting and bank performance is shown in Table 6.8. For both periods, F-statistics results show the existence of not significant variances between the means of corporate reporting (disclosure) and bank performance variables i.e. F-statistics 1.169 ($p = .370 > 0.05$) for the year 2011-15 and F-statistics .786 ($p = .480 > 0.05$). Hence the hypothesis made regarding the relationship between corporate reporting (disclosure) and bank performance (**H5**) is not rejected accordingly.

Table 6.9 Analysis of Variance for Corporate Reporting and Bank Performance

Bank Performance Variable	Corporate Governance Var.	2011-15		2016	
		F	Sig.	F	Sig.
Return on Asset	Corporate Reporting	1.169	.370	.786	.480

Finally total assets are included in the analysis of variance to test whether the size of the bank had effect on board structure and corporate reporting variables. Hence the analysis result shows that the size of the bank as a variable is found having no significant effect on both variables. However these are not considered for further analyses in the study.

6.5 Hypotheses testing result summary

Table 6.10 Summary of hypotheses testing result

Variables	Null-Hypotheses	Conclusion
Board Size And Performance	Board size is not significantly Associated with Bank Performance.	Alternate hypothesis (H1a) Accepted.
Board Composition and Performance	Board Composition is significantly Associated with Bank Performance.	Null hypothesis (H2) is accepted.
Minority representation in board and Performance	Minority representation in board is significantly Associated with Bank Performance.	Null hypothesis (H3) is accepted.
Board Committee and Performance	Board committee structure composed of audit, risk and compliance and/or human resource affairs committees are significantly Associated with firm performance.	Null hypothesis (H4) is accepted.
Corporate Disclosure and Performance	Corporate reporting (disclosure) is significantly Associated with higher firm performance.	Null hypothesis (H5) is accepted.

Summary

All the above statistical analyses provide evidences to test the respective hypothesis made in Chapter 4. The data collected from the private commercial banks operating in Ethiopia for the periods 2011-15 and 2016 have been used for the analyses. Hence conclusions and recommendations based on the results and findings of the analyses will be discussed in detail in the next chapter.

Chapter Seven

Discussions on Findings, Conclusion and Recommendation

Taking in to account the various theories and empirical evidences related to corporate governance as discussed in chapter two and the statistical results obtained in the previous chapter, discussions on the findings and the implications of the relationships among the variables under consideration are shown in this chapter and hence conclusions and recommendations are also made so as to address the general and specific objectives of the study accordingly.

7.1. Discussions on Findings

In this part of the study the findings on the effects of the corporate governance mechanisms on bank performance are discussed in light of the theoretical and empirical evidences related with the variables under analyses.

7.1.1 Board size

Board size is one of the important governance mechanisms of corporate governance, as stipulated on the governance policy of the NBE. The findings on the relationship between the size of board and bank performance shows that it is significant, which is found contrary to what is hypothesized during the inception of this study. Here the size of board was tested against the accounting based measures of bank performance (ROA).

Hence the hypothesis, banks' board size is not significantly associated with bank performance, made in this research is rejected as the statistical analyses results of Spearman's correlation for association presented in Table 6.4 and ANOVA in Table 6.5 reported the existence of insignificant mean variance with respect to ROA in both periods. Therefore it may be concluded that profitability of banks could be attributed and related with the size of the board possibly due to the betterment in management capability created in the banks.

As discussed in chapter 2 regarding the relationship between the size of board and performance, there are two distinct schools of thoughts. The first school of thought argues that a smaller board size will contribute more to the success of a firm (Lipton and Lorsch, 1992; Jensen, 1993;

Yermack, 1996). However, the second school of thought considers that a large board size will improve a firm's performance (Pfeffer, 1972; Klein, 1998). These studies indicate that a large board will support and advise firm management more effectively because of a complex of business environment and an organizational culture (Klein, 1998). Moreover, a large board size will gather much more information. As a result, they assumed that a larger board size appears to be better for firm performance (Dalton and ct, 1999).

According to the corporate governance policy, each bank is expected to have at least a board composed of nine members. For that, during the periods under analyses the average number of boards was ten, which is above the requirement set in the policy. Consequently due to this fact the hypothesis made in this study which stated that the rise in the size of the board may not have significant effect on bank performance is therefore rejected and hence the alternative hypothesis is accepted consequently.

7.1.2 Board Composition

Another important constituent of corporate governance dealt in this study is the composition of the board of directors. For the sake of this study, composition of board constitutes the numbers of non-executive members in the board, the presence of female representation in board and the existence of the mixture of core competencies in the board as required in the policy while the performance of banks is measured using the accounting-based measure of performance-ROA.

The hypothesis, banks' board composition is significantly associated with bank performance made in advance in this research, is not rejected. The results of the descriptive statistics presented in Table 6.1 reveals the existence of improvements in board compositions during the periods under analyses, even though the change is not as such significant, as measured using t-test (Table 6.2). The statistical analysis results of Spearman's correlation for association presented in Table 6.4 shows the existence of high correlation with respect to bank size in the period 2011-15. The result of ANOVA in Table 6.6 depicts that the variation in means between board composition and ROA in both periods is also found not significant.

Hence the above results suggest that the composition of the board of directors in banks have impact on the performance of the banks and this probably is go with the overall efficiency created in the management of the banks due to the various beneficial talents acquired through the

board members results in the generation of profits and which in turn create values to the respective banks.

Generally the relationship between board composition and corporate performance, as witnessed from the reviews of previously done researches shows mixed results. However theories made by Lee et al. (1992), Rosentein and Wyatt (1990) state that boards dominated by independent outside directors are associated with substantially higher abnormal returns. (Barnhart, Marr & Rosenstein 1994; Daily & Dalton 1992; Schellenger, Wood & Tashakori 1989)

The results of this study can also be seen in relation to one of the predominant theory of corporate governance, agency theory, which supports the existence of independent (non-executive) board members so as to arrest the conflict of interest between the shareholders and management, alleviating or minimizing the agency costs and maximizing of shareholders wealth (Fama 1980; Fama & Jensen 1983). This in turn might show that board's accountability to shareholders has resulted in an increased profit performance of the banks and hence it can be suggested that board composition, as one of the most important components of board structure could possibly increase the performance of banks.

Therefore it may be concluded that profitability of banks is attributed to the composition of the board due to the resultant betterment created in the management of the bank, the acquisition of knowledge and critical information beneficial to make informed decisions and this in turn enhances the profitability and corporate values of the banks.

7.1.3 Minority Representation

The existence of minority shareholders representation in the bank's board is considered as one of the important corporate governance mechanisms stated on the corporate governance policy of the NBE. The results of the relationship between minority representation in boards and bank performance, as the later one is measured by the net-income after tax return of assets of the banks (ROA), is shown in chapter 6.

The hypothesis, which stated that minority representation in banks' board is significantly associated with bank performance, is not rejected.

Descriptive statistics presented in Table 6.1 shows an increase in the number of banks that incorporate small shareholders representatives in their respective boards has reached to the extent of 71% in 2016 from its average level of 57% during the period 2011-15. But the result of t-test in Table 6.2 shows that the change is found not significant. The result from Spearman's correlation in Table 6.4 also shows the existence of small and/or medium relationship with other variables. However, ANOVA result in Table 6.6 shows that the variation in means between minority representation in boards and ROA in both periods is found not significant.

Though it became hard to get sufficient empirical studies and evidences conducted on this specific area related with financial firms, researches done in other non-financial sectors reveal the existence of mixed results, however.

Results from Akhtaruddin and Hossain (2008) indicated that growth reduced expropriation activities and concluded about the existence of negative relation between growth opportunity and expropriation. Coffee (1999a) and Stulz (1999) also argue that firms wishing to raise capital respond by bonding themselves to protect the interests of their minority stockholders. Alternatively other results, however, support the role of the majority/controlling shareholders as key determinants of firm values (Holmstrom and Tirole, 1993; Bolton and von Thadden, 1998a, 1998b; Kahn and Winton, 1998; Noe, 2002; Faure-Grimaud and Gromb, 2004).

The results of this study however imply that the existence of minority representation in the banks' board could resulted in a positive effect on the performance of the banks and this might be highly attributed due to the active role and the mount in commitment shown by the boards to protect the interests of the banks.

Therefore it may be concluded that profitability of banks is attributed due to the representation of the minority shareholders in boards due to the enhancement of commitment of board members and that in turn could be beneficial to improve the profitability, value and public image of the respective banks.

7.1.4 Board Committees

The establishment of various board committees is one of the important constituents of the corporate governance mechanisms and elements of the board structure. The analysis of the relationship between board committees with bank performance, which the later is measured by the net profit return of assets owned by the banks (ROA) is shown in chapter 6.

According to the results, the hypothesis made in this study which states the existence of various committees in boards is significantly associated with bank performance, is not rejected. Descriptive statistics presented in Table 6.1 reveals about a significant increase (from its level of 72% during the period 2011-15 to 95% in the year 2016) in the number of banks complying with the establishment of various committees in their boards. The result from t-test (Table 6.2) also shows the existence of significant change between the two periods. Spearman's correlation (Table 6.4) on the other hand shows the existence of small and/or medium associations between board committee and other variables. ANOVA (Table 6.7) value, however, shows that the mean variance is not significant and hence the null hypothesis is not rejected accordingly.

Even though prior research in support of board committees and performance is scarce, the study made by Laing and Weir (1999) is found in support of the above stated relationship. In their study, they found that firms which had introduced board committees performed better than those without them and the presence of such committees is expected to have a positive influence on the performance of corporates. Hence the finding of this study in this regard shows that performance of banks could be related with board committees and that would also go with the agency theory ,which backs the prevalence of strong corporate boards in order to protect the interests of corporate shareholders.

Therefore it may be concluded that profitability of banks could be related with the existence of various sub-committees in the banks' board and that in turn may be the result of improvements and prudence in the management of the banks due to the prevalence of such committees in the respective banks' board.

7.1.5 Corporate Reporting (Disclosure)

The results on the relationship between corporate reporting and bank performance, as the later is measured by the net profit return of assets of banks (ROA) is shown in chapter 6.

Descriptive statistics (Table 6.1) shows that there is a rise in the numbers of banks disclosing both financial and non-financial information to the concerned stakeholders during the periods under consideration. The results of the t-test (Table 6.2) also show that the change was significant. The Spearman's correlation (Table 6.4) reported about the existence of high correlation with bank size in the period 2011-15 and the later in turn also has a significant effect on ROA on same period. However, the correlations with the rest of the variables show the existence of small and/or medium association. Analysis of variance value (Table 6.9) shows the non existence of significant difference between the mean variances in both periods and hence the hypothesis made in chapter 4, in this regard is accepted accordingly.

Researches done in this regard suggested about the existence of positive relationships between corporate reporting and financial performance (Clarkson 1995; Donaldson & Preston 1995; Freeman 1984), as the satisfaction of various stakeholder groups is instrumental for organizational performance (Donaldson & Preston 1995; Jones 1995, Orlitzky et al. (2003). OECD principles (1999) also emphasized the importance of reporting to other stakeholders in order to achieve both social and economic sustainability.

In general results of the various analysis made in this regard are found in conformity with what the stakeholder theory suggests, and hence as the more banks are in compliance with the provision of relevant financial and non-financial information, it is expected that it reflected the transparency of the management of the banks and which in turn is also expected to improve the performances of the banks since the general public's confidence to do more businesses with such banks could be enhanced.

Table 7.1. Summary of the Research Hypotheses and Test Results Obtained (Based on ANOVA)

Corporate Governance Variables	Bank Performance Variable	Null Hypothesis (H ₀)	Alternate Hypothesis (H _a)	Hypothesis Testing Result (ANOVA)
Board Size	ROA	Not Significant	Significant	H_a Accepted
Board composition	ROA	Significant	Not significant	H₀ Accepted
Minority Representation	ROA	significant	Not significant	H₀ Accepted
Board committees	ROA	Significant	Not significant	H₀ Accepted
Corporate Reporting	ROA	Significant	Not significant	H₀ Accepted

7.2. Conclusion

As explained in the introductory chapter of this study, it has been found that the prevalence and active engagements in the implementation of corporate governance practices in full will have multifaceted advantages such as the uplifting of both local and international investors' confidence in a given country and also smoothens the inflows of low cost capital resources to developing countries like Ethiopia where such resources are scanty.

On the other hand being found indifferent to such facts and on conditions that a country doesn't have the policy that enforce governance practices, the potential damages possibly emanated from malpractices are obvious, as can easily be witnessed from the global economic turndown following the 2009 financial crises where the impacts the crisis had left on the global economy has not yet resolved convincingly. As stated earlier the main cause of the problem was emanated from the lack of proper governance of the financial institutions, existence of board oversights, lack of the proper implementation of controlling and monitoring organizational activities and the unethical tone created at the top are a few of the reasons to mention, which all are related with the issue of corporate governance.

Taking such global facts and the occurrence of possible incidents having similar nature along with the absence of the appropriate corporate governance policy for both financial and non-financial institution in Ethiopia in to account, the NBE had put in place the corporate governance

policy for banks for a strict execution in 2015 by all the concerned parties, including the private commercial banks.

Based on this policy, the under listed are the general and specific objectives that this study has tried to address:

- To analyze the effects of board structures on bank performance, and
- To examine the effects of corporate reporting practices on bank performance and others as stated in chapter one.

In the effort to deal with the subject matter, attempts are made to exhaustively go through all the theories related to corporate governance for both financial and non-financial sectors, by giving due emphasis to the former one as shown in detail in chapter two of this study.

About the corporate governance and related issues with the context of Ethiopia especially to the banking sector, overview on the main articles of the corporate governance policy, their implications and significance to the Ethiopian economy and the overall performance and roles that private banks have been playing in the Ethiopian economy are also addressed in chapter three of this study.

Consequently so as to deal with the above stated objectives of this study, reviews of the theories and literatures related to corporate governance are conducted and attempt was also made to develop a conceptual framework that goes with the corporate governance policy of the NBE as described in chapter four of the study.

The research hypotheses are also emanated from the theoretical framework which is in turn was developed from the agency theory, stakeholder theory and the governance policy of the NBE. Variables on board structure that constitutes board size, composition of the board, minority representation in board, board committees and the corporate reporting (disclosure) practices are also established based on the theoretical framework of the study. On the other hand proxy variable for performance was represented by the after tax profit return of the assets of the banks (ROA).

The type of research approach used in this study is a deductive one in order to determine the relationship among the various corporate governance and performance variables and to test the

research hypotheses. Statistical analysis methods such as descriptive statistics is applied to see the overall implementation of the corporate governance mechanisms, t-test to measure the level and significance of the changes made in the implementation of the governance mechanisms between the stated periods, Spearman's correlation was applied to measure the degree of correlation among the variables and ANOVA was used in order to test the research hypotheses as mentioned in detail in chapter five of this study.

Both primary and secondary data are collected using a questionnaire developed for the purpose and from the annual reports of all private banks in the country respectively. Out of the 16 banks, the responses from 14 (fourteen) banks are found in full to make the analyses. However, the data received from 2 (two) banks was not considered, as the information obtained is incomplete for the purpose of the research. The results obtained by employing the various statistical analyses techniques together with the discussions and implications of the results in light of the theoretical and empirical evidences of previously done researches was summarized under Chapter six of the study.

Findings of the study and hypothesis testing results using ANOVA, show that the effects of the corporate governance mechanisms on the performance of private banks before and after the implementation of the policy are found not-significant and hence the hypotheses made in advance in this research could not be rejected accordingly except for the variable-Board Size. Hence, testing results are almost found in line with the assumptions made by the policy; which its aim is to implant the good corporate governance practices and culture in the private banks without compromising the interests of the shareholders and various stakeholders and without affecting their performance negatively.

But it should be noted that taking in to account the dynamic nature of the corporate governance mechanisms and the factors affecting it, the results obtained here could not be taken as a conclusive one and a similar research done by others, even by employing a similar analysis technique may reveal a different result than what is obtained in this study.

7.3. Recommendations

As stated in the conclusion part of this chapter, the results obtained from this study shows that during the periods under analyses the implementation of the corporate governance mechanisms

by the private banks has resulted in not-significant effects on the performances of banks, negatively. It is also recalled that the major aim of the corporate governance policy is to safeguard and enhance the interests of both the shareholders and various stakeholders in particular and securing the safety and soundness of the financial system of the country in general.

Hence so as to make the policy attain its broader and other pertinent objectives, the under mentioned points on the policy that are assumed to bring about and further enhance the performance of private banks through effective implementation of the policy are suggested.

1. Concerning the number of board size, it is better to be determined by the respective banks based on their overall capacity, volume of work and entry to the industry, than putting a minimum floor on the numbers of directors that the bank's board should possess (at least NINE, as the policy dictates). Hence it is suggested for the policy to be liberal and give the mandate to the respective banks in the determination of the optimal number of their board size based on their context and other factors as mentioned above, for instance.
2. Regarding the composition of board members, it is better for the policy be considerate enough in opening room for the inclusion of executive members or else to have them some restricted dual roles to play than making the whole composition of bank board's emanate from non-executive personnel only. Hence allowing for the boards to have a proportionate mixture in this regard might enhance the board's capacity in making informed decision and strengthening the monitoring and controlling roles of the board.
3. The attempt made by some banks to involve females in their board was found a good practice. However, it is better for the policy to be more elaborative in this regard in order to enhance the number of females in bank boards in particular and in the industry in general, as empirical evidences show that, on average stability is significantly higher in banks with higher fraction of women in the board. According to (Laura et al., 2016) during the financial crisis, bank-holding companies with at least three female directors braved the crisis better, and significantly outperforming bank holding companies with fewer female directors, as measured by Tobin's Q.
4. The policy also put in place a fixed amount of fee for board members, about the remuneration process and criteria for entitlement of it. However relative to the responsibilities and sensitive nature of the sector the directors are engaged in, it is better to revise the fees based on the

performance and achievements the boards accomplish, and this will in turn uplift the board members to engage in more productive activities and enhance their commitment for a better result.

5. As stated in the introductory part of the corporate directive, safeguarding the interests of stakeholder is one of the main reasons for the issuance of the policy. However it does not state the mechanisms how this will make those parties to be part of the governance activities than merely stating how the banks disclose financial and non-financial information to some of the stakeholders and the general public. Hence mechanisms should be in place in how to make the concerned stakeholders like employees, customers, creditors and others could play their role in the respective banks endeavor to implement good corporate governance in a more transparent and accountable manner and in a way that will improve the performances of the respective banks accordingly.

In general based on best practices related to corporate governance, the following summary points are recommended to be included in the corporate governance policy that are assumed to make the policy to be more flexibility and enhance the performances of the banks at same time:-

1. It is suggested the policy to open room for the participation of executives in bank boards for the major reasons stated above,
2. It is suggested the policy to be more elaborative one and clearly show the roles of the various stakeholders to make the governance issue becomes the concern of all stakeholders and this potentially will create overall consensus on the governance issues for its proper functionality and achievements of the ultimate objectives of the policy,
3. It is suggested the policy to clearly put the consequences of breaching the directive and develop rewarding and/or recognition mechanisms for those banks found in compliance with the policy. For that it is advised for the supervisory organ to put in place rating and rewarding systems accordingly.
4. Lastly, taking in to consideration the sensitivity of the issue of corporate governance, especially in the financial industry, it is better for the supervisory body to establish an independent body, like SEC, solely responsible for the supervision and close follow-up of the proper implementation of the governance policy by the concerned banks in order to realize the ultimate objectives of the policy.

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Research Questionnaire

-----Bank S.Co,

Dear respondent,

Good day to you!

My name is Yohannes Tesemma, a post-graduate student pursuing an Executive Master Degree in Business Administration in the College of Business and Economics and Department of Management at the Addis Ababa University. Currently, I am conducting a thesis for the partial fulfillment of a master's degree entitled "*Corporate governance policy and its effects on the performance of private banks in Ethiopia - A Comparative Analysis*".

The purpose of the study is to examine and make a comparative analysis on the effect(s) of the bank corporate governance mechanisms on the performance of the Ethiopian private Commercial banks.

To achieve this objective, your genuine and timely response of the questionnaire designed for the purpose will have a tremendous impact. It is assumed that the questionnaire will take only a few of your time to complete.

All information provided will be used for academic purpose ONLY and will be treated in strict CONFIDENTIALITY. I kindly request your utmost cooperation in filling the questionnaire and return it as soon as possible in a weak time. I am grateful for your kind cooperation and would like to extend my heartfelt appreciation, in advance, for providing me all the relevant information regarding your respective bank.

If you would like further clarification and information about the study, or have any problem in completing the questionnaire please contact me via **xxxx**.

Best regards.

This questionnaire has **THREE** parts. Part **A** is related to corporate governance variables such as board structure and corporate reporting (disclosure), part **B** is on variable that indicate performance of banks and part **C** is a controlling variable denoted by bank size and approximated by the banks' total asset. Please kindly write **YES** or **NO** for the questions of such types, on the corresponding space provided under the respective years.

(A) Corporate Governance	Descriptions	Answer Type	Fiscal Years					
			As of June 30,2011	As of June 30, 2012	As of June 30, 2013	As of June 30,2014	As of June 30,2015	As of June 30,2016
1) Board Size	The total numbers of board of directors in the bank	In number						
2) Board Composition	(a) The numbers of Non-executive board from the total number of board members *	In number						
	(b) Does female representation exist in the board?	Yes / No						
	(c) Mixture of core competencies exist in board as per what the corporate governance directive demands?	Yes/ No						
3) Non-influential (Minority) shareholders representation in board	Does 1/3 of the total board members are represented by the non-influential (minority) shareholders of the bank? **	Yes / No						
4) Board Committee	(a) Is audit committee available in the board?	Yes / No						
	(b) Is risk and compliance committee available in the board?	Yes / No						
	(c) Is human resource affairs committee available in the board?	Yes / No						
5) Corporate	(a) Is the bank discloses related party Loans/Fcy	Yes / No						

Reporting (Disclosure)	transactions & others having material nature to NBE?							
	(b) Does the bank post on the bank's website information about the board members, their qualification, experience and the sub-committees in the board?	Yes / No						
	(c) Does the bank exhibit its latest audited financial statements (Balance sheet, Comprehensive income and expense and cash flow reports) at every work station, branches and sub-branches in a conspicuous place?	Yes / No						
	(d) Does the bank make its audited reports be publicized in a newspaper of wider circulation and post same on the bank's website within a month after the annual shareholders meeting?	Yes / No						
(B)			Fiscal Years					
Bank Performance	Descriptions	Answer Type	As of June 30,2011	As of June 30, 2012	As of June 30, 2013	As of June 30,2014	As of June 30,2015	As of June 30,2016
Return on Asset (ROA)	(a) Net Income of the Bank after tax	In Amount						
	(b) Total Assets of the bank	In Amount						
(C)			Fiscal Years					
Bank Size	Descriptions	Answer Type	As of June 30,2011	As of June 30, 2012	As of June 30, 2013	As of June 30,2014	As of June 30,2015	As of June 30,2016
Bank Size	The Assets of the bank	In Amount						

* **Non-executive directors** are those members of the board of the bank who are not the management and/or employee of the bank at the same time.

** **Non-influential (Minority) shareholders** mean any person who holds directly or indirectly less than two percent (2%) of the total subscribed capital of the bank, according to the bank corporate governance directive.

Thanks Again!

Appendices

Appendix 1

Descriptive statistics of corporate governance and bank performance variables

Descriptive Statistics-For the years 2011-2015

Variables	N	Minimum	Maximum	Mean
BZ-2011-15	14	7	12	10.14
BCP-2011-15(%)	14	67	100	89.29
MRB-2011-15	14	0	1	.57
BC-2011-15(%)	14	54	100	72.21
CRD-2011-15(%)	14	50	100	75.36
BKZ-2011-15	14	800.00	19720.00	6874.9286
ROA-Before 2015	14	.01	.04	.0257
Valid N (list wise)	14			

Descriptive Statistics-For the year 2016

Variables	N	Minimum	Maximum	Mean
BZ- 2016	14	8	12	9.93
BCP- 2016(%)	14	67	100	92.93
MRB- 2016	14	0	1	.71
BC- 2016(%)	14	67	100	95.29
CRD- 2016(%)	14	50	100	85.71
BKZ- 2016	14	1294.00	33000.00	12405.3571
ROA- 2016	14	.02	.05	.0271
Valid N (list wise)	14			

Appendix 2

Results of T-test of Corporate Governance and Firm Performance Variables

Paired Samples Test

Variables	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 BZ-2011-15 - BZ-2016	.214	1.122	.300	-.433	.862	.715	13	.487
Pair 2 BCP-2011-15(%) - BCP-2016(%)	-3.643	7.520	2.010	-7.985	.699	-1.812	13	.093
Pair 3 MRB-2011-15 - MRB- 2016	-.143	.363	.097	-.353	.067	-1.472	13	.165
Pair 4 BC-2011-15(%) - BC-2016(%)	-23.071	16.513	4.413	-32.606	-13.537	-5.228	13	.000
Pair 5 CRD-2011-15 - CRD- 2016	-10.357	15.868	4.241	-19.519	-1.195	-2.442	13	.030
Pair 6 BKZ-2011-15 - BKZ- 2016	-5530.42857	4179.73103	1117.08011	-7943.73342	-3117.12372	-4.951	13	.000
Pair 7 ROA-2011-15 - ROA- 2016	-.00143	.01292	.00345	-.00889	.00603	-.414	13	.686

Appendix 3

Spearman's Correlation for the period 2011-15

		Correlations						
		BZ-2011-15	BCP-2011-15(%)	MRB-2011-15	BC-2011-15(%)	CRD-2011-15	BKZ-2011-5	ROA-2011-15
BZ-2011-15	Correlation	1.000	.553*	.000	.082	-.034	-.414	-.233
	Coefficient							
	Sig. (1-tailed)		.020	.500	.391	.454	.071	.212
BCP-2011-15(%)	Correlation	.553*	1.000	.100	.343	.148	-.287	.121
	Coefficient							
	Sig. (1-tailed)	.020		.367	.115	.307	.160	.340
MRB-2011-15	Correlation	.000	.100	1.000	-.292	-.040	-.143	.118
	Coefficient							
	Sig. (1-tailed)	.500	.367		.156	.446	.313	.344
BC-2011-15(%)	Correlation	.082	.343	-.292	1.000	.085	-.138	.212
	Coefficient							
	Sig. (1-tailed)	.391	.115	.156		.387	.319	.234
CRD-2011-15(%)	Correlation	-.034	.148	-.040	.085	1.000	-.583*	-.059
	Coefficient							
	Sig. (1-tailed)	.454	.307	.446	.387		.014	.421
BKZ-2011-15	Correlation	-.414	-.287	-.143	-.138	-.583*	1.000	.489*
	Coefficient							
	Sig. (1-tailed)	.071	.160	.313	.319	.014		.038
ROA-2011-15	Correlation	-.233	.121	.118	.212	-.059	.489*	1.000
	Coefficient							
	Sig. (1-tailed)	.212	.340	.344	.234	.421	.038	

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

Spearman's Correlation for the period 2016

Correlations

		BZ- 2016	BCP- 2016(%)	MRB- 2016	BC- 2016(%)	CRD- 2016(%)	BKZ- 2016	ROA- 2016
BZ- 2016	Correlation Coefficient	1.000	.267	.182	.391	.015	-.054	-.154
	Sig. (1-tailed)	.	.179	.267	.084	.479	.427	.300
BCP- 2016(%)	Correlation Coefficient	.267	1.000	.055	-.213	.121	-.194	-.071
	Sig. (1-tailed)	.179	.	.426	.232	.341	.253	.405
MRB- 2016	Correlation Coefficient	.182	.055	1.000	.194	-.329	-.078	-.172
	Sig. (1-tailed)	.267	.426	.	.254	.125	.395	.278
BC- 2016(%)	Correlation Coefficient	.391	-.213	.194	1.000	-.396	.152	-.166
	Sig. (1-tailed)	.084	.232	.254	.	.080	.302	.285
CRD- 2016(%)	Correlation Coefficient	.015	.121	-.329	-.396	1.000	-.061	.293
	Sig. (1-tailed)	.479	.341	.125	.080	.	.417	.154
BKZ- 2016	Correlation Coefficient	-.054	-.194	-.078	.152	-.061	1.000	-.580
	Sig. (1-tailed)	.427	.253	.395	.302	.417	.	.015
ROA- 2016	Correlation Coefficient	-.154	-.071	-.172	-.166	.293	-.580	1.000
	Sig. (1-tailed)	.300	.405	.278	.285	.154	.015	.

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

Appendix 4

Analysis of variance for the periods 2011-15

ANOVA-ROA-2011-15 with BZ-2011-15

ROA_2011-2015 BY BZ_2011-2015

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	4	.000	.184	.941
Within Groups	.001	9	.000		
Total	.001	13			

ANOVA-ROA-2011-15 with BCP-2011-15

ROA_2011-2015 BY BCP_2011-2015

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	3	.000	1.973	.182
Within Groups	.000	10	.000		
Total	.001	13			

ANOVA-ROA-2011-15 with MRB-2011-15

ROA_2011-2015 BY MRB_2011-2015

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	1	.000	.087	.773
Within Groups	.001	12	.000		
Total	.001	13			

ANOVA-ROA-2011-15 with BC-2011-15

ROA_2011-2015 BY BC_2011-2015

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	3	.000	.536	.668
Within Groups	.001	10	.000		
Total	.001	13			

ANOVA-ROA-2011-15 with CRD-2011-15

ROA_2011-2015 BY CRD_2011-2015

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	3	.000	1.169	.370
Within Groups	.001	10	.000		
Total	.001	13			

Appendix 5

Analysis of variance for the year 2016

ANOVA-ROA-2016 with BZ-2016

ROA_2016 BY BZ_2016

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	4	.000	.490	.744
Within Groups	.001	9	.000		
Total	.001	13			

ANOVA-ROA-2016 with BCP-2016

ROA_2016 BY BCP_2016

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	1	.000	.010	.924
Within Groups	.001	12	.000		
Total	.001	13			

ANOVA-ROA-2016 with MRB-2016

ROA_2016 BY MRB_2016

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	1	.000	.008	.931
Within Groups	.001	12	.000		
Total	.001	13			

ANOVA-ROA-2016 with BC-2016

ROA_2016 BY BC_2016

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	1	.000	1.836	.200
Within Groups	.001	12	.000		
Total	.001	13			

ANOVA-ROA-2016 with CRD-2016

ROA_2016 BY CRD_2016

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.000	2	.000	.786	.480
Within Groups	.001	11	.000		
Total	.001	13			