

**Corporate Governance Mechanisms and their Impact on
Performance of Commercial Banks in Ethiopia**

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This is to certify that the thesis prepared by Kelifa Srmolo, entitled: *Corporate Governance Mechanisms and their Impact on the Performance of Commercial Banks in Ethiopia and* submitted in partial fulfillment of the requirements for the degree of Degree of Masters of Science in Accounting and Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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Abstract

The purpose of this research is to study the corporate governance mechanisms and their impact on performance of commercial banks in Ethiopia. The study examined the relationship between selected internal and external corporate governance mechanisms, and bank performance as measured by ROE and ROA. Accordingly, the study used mixed methods approach, particularly structured review of documents and in depth interviews were used. Both financial and non financial data were collected from all commercial banks that were in operation from the year 2005 to 2011 in Ethiopia.

The findings indicated that board size and existence of audit committee in the board had statistically significant negative effect on bank performance in terms of both ROE and ROA; whereas bank size had statistically significant positive effect on bank performance in terms of both ROE and ROA. Similarly, capital adequacy ratio as a measure of external corporate governance mechanism had statistically significant positive effect on bank performance. On the other hand the remaining variables such as loan loss provision, loan to deposit ratio, and ownership type did not have statistically significant effect on bank performance.

The study also indicated the various challenges of corporate governance mechanism in Ethiopian commercial banks that have adverse effect on bank performance, which include absence of organized stock exchange, high government intervention and involvement in business activities leading to unfair competition, lack of corporate governance awareness, absence of nationally implemented code of corporate governance, absence of nationally implemented accounting as well as auditing standards, and weak legal framework to protect minority shareholder rights.

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Table of Contents

Abstract.....	iii
Acknowledgments.....	iv
Table of contents.....	v
List of tables.....	vii
List of figure.....	viii
List of acronyms.....	ix
Chapter 1: Introduction	1
1.1 Background of the Study.....	1
1.2 Statement of the problem.....	4
1.3 General Objective of the study	7
1.4 Specific objectives.....	7
1.5 Hypotheses.....	7
1.6 Scope and limitation of the study	8
1.7 Significance of the study	8
1.8 Structure of the study.....	9
Chapter 2: Literature Review	10
2.1 Nature and importance of corporate governance	10
2.2 Conceptual framework and hypothesis development	13
2.2.1 Proxies of corporate governance in banks.....	13
2.2.2 Proxies of bank performance	18
2.3 Empirical studies on corporate governance and bank performance.....	20
2.4 The OECD principles of corporate governance.....	23
2.5 Corporate governance in Ethiopian context	24
2.6 Summary	26

Chapter 3: Research Methodology	28
3.1 Research approaches.....	28
3.2. Methods adopted.....	30
3.2.1 Survey design.....	30
3.2.2. Sample frame, Sample size, and Sampling method.....	31
3.2.3 Structured review of documents.....	32
3.2.4 In – depth interview.....	33
3.2.5 Data analysis method.....	35
Chapter 4: Results and Discussions	37
4.1 Results.....	37
4. 1.1 Profiles of sample banks.....	37
4.1.2 Descriptive statistics.....	39
4.1.3 Correlation analysis.....	41
4.1.4 Tests for the classical linear regression model (CLRM) assumptions....	42
4.1.5 Regression results	45
4.1.6 In-depth interview results.....	49
4.2 Discussion of results.....	52
Chapter 5: Conclusion and Recommendation	57
5.1 Conclusions.....	57
5.2 Recommendation.....	58
References	60
Appendix	66

List of Tables

Table 3.1: Link between research objective, hypotheses, variables and the different data sources.....	34
Table 4.1 Profiles of sample banks.....	38
Table 4.2 Descriptive Statistics of regression variables.....	39
Table 4.3 Pearson's Correlation Matrix.....	41
Table 4.4 Heteroskedasticity Test: White.....	43
Table 4.5 Correlated Random Effects - Hausman Test.....	45
Table 4.6 Regression Result for Model 1.....	46
Table 4.7 Regression Result for Model 2.....	48
Table 4.8 Summary of the expected and actual relationships.....	56

List of Figures

Figure 2.1 Conceptual Frame works of corporate governance and performance in banks...	19
Figure 4.1 Rejection and non-rejection regions.....	43
Figure 4.2 Bera-Jarque normality tests.....	44

List of Acronyms

CAR – Capital Adequacy Ratio

CIPE – Center for International Private Enterprise

FDRE – Federal Democratic Republic of Ethiopia

NBE – National Bank of Ethiopia

OECD – Organization for Economic Co-operation and Development

USAID – United States Agency for International Development

AACCSA – Addis Ababa Chamber of Commerce and Sectoral Associations

OFAG – Office of the Federal Auditor General

EPAAA – Ethiopian Professional Association of Accountants and Auditors

Chapter One

1. Introduction

“The wide wake of damage and disenfranchisement caused by recent corporate governance failures like Enron and WorldCom; has made corporate governance not only a concern for financial markets but also an issue of political economy on a global basis”
(Dalas 2004, p. 2).

1.1. Background of the Study

Corporate governance has been defined as “the set of processes, customs, policies, laws, and institutions affecting the way a company is directed, and administered” (WAMA 2009, p.3). It is also concerned with the relationships among the many stakeholders involved in corporations and the goals for which the corporation is governed (Claessens 2003). However, more narrowly corporate governance can be defined as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer and Vishny, 1996).

The original need for corporate governance arises due to the separation of ownership and control in publicly held companies. Investors seek to invest their capital in profit-making firms. Yet many investors lack the time and expertise necessary to operate a firm and insure that it provides investment return (CIPE 2002; Jensen 2000). As a result they hire managers. In corporations, shareholders (principals) delegate decision making rights to management (agents), expecting management to act in the best interests of shareholders (principals) (Jensen & Meckling 1976). However, the “agency problem” arises when the agents do not make their decision to the best interest of the principal or the agents are engaged in self-interest at the expense of shareholders interest (Jensen & Meckling 1976; Shleifer & Vishny 1996; Abdulla & Valentine 2009). Therefore, instituting good corporate governance is primarily aimed at minimizing the potential loss of shareholders due to conflict of interest between shareholders and management (Bozec & Bozec 2007). As a primary means of reducing this conflict of interest, the shareholders of corporations elect and appoint members of board of directors in order to monitor the actions of

management and make strategic decisions about the corporation on behalf of the shareholders.

As stated in the “OECD principles of corporate governance”, good corporate governance improves economic efficiency and growth as well as enhances investor confidence (OECD 2004). Besides corporate governance increases access to external financing by firms, lowers cost of capital and increases operational performance (Claesses 2003). The survey conducted by Coombes and Watson (2000) also indicated that, investors from all over the world are willing to pay large premiums for companies with effective corporate governance. Hence, it can be argued that good corporate governance will lead to increase in firm value as well as better firm performance.

Oman et al. (2003) on their part argue that corporate governance is important for the success in long-term development in developing, transition and emerging- market economies. Furthermore, Okeahalam and Akinboade (2003) maintain that, establishing good corporate governance is a precondition for Africa in order to: (1) attract both local and foreign investors and assure them that their investments will be secured and efficiently managed, (2) create competitive and efficient companies, (3) enhance the accountability and performance of managers and (4) promote efficient and effective use of limited resources.

In a study conducted by OECD (2009), it was concluded that the financial crisis of 2007-2008 could be to a large extent attributed to failures and weaknesses in corporate governance mechanisms which did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies, besides the accounting standards and regulatory requirements that were insufficient in some areas. Good corporate governance principles apply to corporations such as financial institutions that provide credit as well as to corporations that seek credit from these financial institutions (Cooper 2007). In the banking sector particularly, effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which is critical to the proper functioning of the banking sector and the economy as a whole (Basel Committee on Banking Supervision 2006). The stakeholders of banks are

more diverse than other business enterprises which include shareholders, depositors, employees, government, creditors, other companies and the public at large, which demands implementing a broader view of corporate governance in the case of the banking Organizations (Macey & O'Hara 2003). This is because, the failure of corporate governance in banks may cause adverse effect on a relatively wider range of stakeholders than in the case of firms in other sectors.

As stated by Tandelilin et al. (2007), there are internal and external corporate governance mechanisms designed to monitor the proper functioning and performance of banks. Internal corporate governance mechanisms are concerned with the structure of board of directors and their roll in monitoring the management of the bank, and these are firm specific governance characteristics. External corporate governance mechanisms on the other hand, are external forces with the power to discipline the management of banks (Weir, Laing and McKnight 2000). They include: the government regulations and supervisions, and the market for corporate control. This implies that, good corporate governance is the result of both internal and external corporate governance mechanisms.

As mentioned above, corporate governance is a critical issue for the success of businesses and economies. It, therefore, deserves thorough investigation. While scholars in developed economies have developed a fairly sizeable literature on corporate governance, in developing countries there have not been many studies on this topic (Dahawy 2007; Okpara 2010). Developing countries differ from developed countries in a wide variety of ways; hence, there is need for developing countries to develop their own corporate governance models that consider the cultural, political and technological conditions found in each country (Mulili & Wong 2010). In the case of Ethiopia, there are very few studies conducted on corporate governance mechanisms, in general, and its practice in the banking sector, in particular. Therefore, this paper is aimed at studying corporate governance mechanisms and their impact on performance of commercial banks in Ethiopia.

1.2. Statement of the problem

Basel Committee on Banking Supervision (2005) states that, because of (1) the important financial intermediation role of banks in an economy, (2) their high degree of sensitivity to potential difficulties arising from ineffective corporate governance, and (3) the need to safeguard depositors' funds, corporate governance for banking organizations is of great importance. Similarly, Tandelilin et al. (2007) mentioned four reasons for the government's interest and intervention to implement good corporate governance especially in the banking sector. These are (1) bank depositors cannot effectively protect themselves because they do not have adequate information, nor are they in a position to coordinate with each other, (2) bank assets are usually opaque, and lack transparency as well as liquidity, (3) bank instability will lead to contagion effect, which would affect a class of banks or even the entire financial system and economy and (4) banks have a dominant position in developing economy's financial systems, and are important engines of economic growth. Dahawy (2007) also argues that corporate governance helps developing nations like Ethiopia to realize high and sustainable rates of growth, increase confidence in the national economy, and deepen financial markets and increase its ability to mobilize savings.

The legal foundation for corporate governance in Ethiopia emanates from the company law. However, this company law is part of the commercial code which has remained unchanged since its enactment in Imperial times (1960) (USAID 2007). Thus, the company law does not provide adequate legislative framework, and key international conventions and standards are not ratified in Ethiopia (Minga 2008). The number of share companies is significantly increasing from time to time in Ethiopia. Fekadu (2010) noted that the years 2008 and 2009 in Ethiopia have seen unprecedented growth in the number of share companies under formation through initial public offering (IPOs). As a result the companies are able to mobilize large amount of capital from the public. However, this growth is likely to demand the adoption of better corporate governance mechanisms. Similarly according to Asnakech (2011), the standard of corporate governance in Ethiopia is very poor. For example, the absence of an adequate legislative framework to regulate modern complex bank governance issues, political parties' involvement in banks

and other business enterprises, and the absence of an organized share market are among the characteristics of bank corporate governance in Ethiopia. Asnakech (2011) also maintains that there is major credibility problem in the Ethiopian banking regulatory organ, which enforced rules that discriminate between state and private banks. The problem of corporate governance is exacerbated further in Ethiopia by the absence of regulatory requirement for compliance with the accounting and auditing standards both in the commercial law and other laws and regulations for specific sector entities except for some laws such as the Income Tax Law which explicitly requires compliance with the generally accepted accounting principles and generally accepted auditing standards, however, these standards are not defined (World Bank 2007).

Corporate governance have been a growing area of enquiry and debate, and produced relatively large body of knowledge. However, those studies were primarily concentrated in Europe and North America. Hence there is an urgent need to embark on meaningful analysis of corporate governance in Africa (Okeahalam and Akinboade 2003). Because, as stated in Rebelo and Vascelos (2002), corporate governance practices in developing economies may be significantly different from that found in developed nations due to the fact that in developing economies: firms pass through major transformation, less developed financial markets, and government intervention. Consequently, corporate governance practices of developing economies like Ethiopia have to be studied apart from studies made in developed economies.

Similarly Larcker et al. (2004) state that although prior studies have provided insights in to the role of corporate governance, the results of similar studies are frequently contradictory and a consistent set of results has yet to emerge regarding corporate governance. This point is also supported by Babatunde and Olaniran (2009) who stated that despite the fact that, previous empirical studies have provided the nexus between corporate governance and firm performance, there is still no consensus on the impact of corporate governance on firm performance. Consequently, this lack of consensus has produced a variety of ideas on how corporate governance influence firm performance. Hence further research is needed to get better understanding of the impact of corporate governance on firm performance.

Corporate governance may be different in case of Ethiopia from other countries, because of the fact that, there is no organized stock exchange market; which is an important institution in order to establish good corporate governance in a country. Prior studies conducted in the area of corporate governance in Ethiopia are very few. Minga (2008) studied the legal and other external institutional frameworks of corporate governance in Ethiopia and concluded that the overall standard of corporate governance was disappointing in the country. Another study conducted by Fekadu (2010) analyzed the ownership structure of corporations in the country and determined that the separation between ownership and control (or shareholders and management of the corporations) is growing in Ethiopia, however, there are weaknesses in the Commercial Code to protect minority shareholder rights.

Accordingly, none of the aforementioned studies made in Ethiopia attempts to see the relationship between corporate governance mechanisms of firms and their performance. They also did not investigate internal corporate governance structures such as board characteristics. Furthermore, they have focused on the corporate governance of companies, in general, not that of banks in particular. Nevertheless, corporate governance in banks could be different from that in other firms due to the existence of depositors in addition to shareholders, and the fact that banks are subject to high government regulation (Tandelilin et al. 2007). Another unpublished case study conducted by Gebremedine (2010) tried to see the application of corporate governance principles in the Lion International Bank Share Company and came up with evidence that corporate governance principles are implemented to some degree in the case bank. Nevertheless, his study was restricted to a single bank and cannot be generalized to all banks in Ethiopia. Hence, to the extent of the researcher's knowledge there has been no study which has systematically investigated the corporate governance mechanisms and their impact on the performance of Commercial Banks in Ethiopia.

Therefore, unlike prior researches, this study is aimed at assessing corporate governance mechanisms and their impact on performance of commercial banks in Ethiopia by using data on internal and external corporate governance mechanisms of all commercial banks which have been operating in Ethiopia from the year 2005 up to 2011.

1.3. General Objective of the study

The general objective of this research is to study the corporate governance mechanisms and their impact on performance of Commercial Banks in Ethiopia. The mixed methods research approach was adopted; particularly structured review of documents and in depth interview were used to collect data.

1.4. Specific objectives

In order to achieve the general objective stated above, the following specific objectives were developed for the study.

- To analyze the relationship between internal and external corporate governance mechanisms, and performance of commercial banks.
- To explore the current status of major corporate governance mechanisms in Ethiopian commercial banks.

1.5. Hypotheses

Based on the review of the related literature, the following hypotheses were developed to be tested by the study.

- H1: There is positive relationship between Board size and bank performance.
- H2: There is positive relationship between existence of audit committee in the board and bank performance.
- H3: There is positive relationship between external corporate governance mechanisms as measured by CAR and bank performance.
- H4: There is negative relationship between loan loss provision and bank performance.
- H5: There is positive relationship between capital ratio and bank performance.
- H6: There is negative relationship between loan to deposit ratio and bank performance.

1.6. Scope and limitation of the study

This research assesses corporate governance mechanisms and their impact on the performance of commercial banks. The study used various proxy variables of corporate governance and bank performance using mainly structured review of documents held by banks, and in depth-interview with bank board members. Nevertheless, the researcher believes that investigating the topic from the view points of different stakeholders such as: shareholders, depositors, managers, and employees using large sample size could provide better understanding of the problem. But due to time and budget constraint the topic was not studied from such diverse perspectives. Furthermore, banks that were established after the year 2005 were excluded from the sample because they do not have at least 7 years operating data. As a result the number of banks included in the sample is limited to 9 banks. Finally, increasing the number of years under study would reduce the number of banks from the sample due to their establishment date; hence only 7 years data were used.

1.7. Significance of the study

Okeahalam and Akinboade (2003) argue that even though corporate governance have been an issue of growing enquiry and debate, and have produced fairly sizeable literature, most of the studies were concentrated in developed economies. Hence there is an urgent need to embark on meaningful analysis of corporate governance in Africa. Furthermore, the results of prior studies on the topic were inconclusive (Larker et al. 2004). Accordingly, this study tries to fill the gap in the literature of corporate governance in developing countries in general and Ethiopia in particular and contributes to the corporate governance debate. Besides, the results of this research may be utilized by among others, policy makers, bank regulatory bodies, the business community, academicians in the area, and other stakeholders of corporations. Finally, the study will show areas of future research on the subject.

1.8. Structure of the paper

This paper is organized in five chapters. Chapter one presents introductions of the study. Chapter two presents the literature review. Chapter three presents the research methodology. Chapter four presents the results and discussion. Finally, chapter five presents the conclusions and recommendations.

Chapter Two

2. Literature Review

In this chapter of the paper the researcher reviews prior literature related to this study. Thus, the nature and importance of corporate governance is discussed first in section 2.1. Then the conceptual framework and hypothesis development for the study is presented in section 2.2. The empirical evidence on corporate governance and bank performance is discussed in section 2.3. The summary of the *OECD Principles of Corporate Governance* are also presented in section 2.4. Finally, issues related to corporate governance in Ethiopian context are presented from prior literature and other secondary data in section 2.5.

2.1 Nature and Importance of Corporate Governance

Good corporate governance helps to prevent corporate scandals, fraud, and potential legal liabilities of the organization. It also enhances the reputation of the organization and makes it more attractive to investors and minimizes cost of capital (Lipman and Lipman 2006). Especially corporate governance is an issue of growing importance in developing economies as many firms pass through significant transformations due to the combined forces of sociopolitical changes, technological progress and economic trends towards globalization (Rabelo and Vascoceles 2002)

According to WAMA (2009) corporate governance is concerned with the set of processes, customs, policies, laws, and institutions affecting the way a company is directed and administered. It also deals with the relationships among the stakeholders of a corporation (Miller et al. 2009). However corporate governance can narrowly be defined as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer and Vishny 1996).

Kostyuk et al. (2007) argues that the issue of corporate governance arises due to separation of ownership – shareholders, and control – management in large corporations. They further argue that, corporate governance is aimed at solving the agency problem between shareholders and their management; between majority and minority shareholders; as well as between shareholders and other stakeholders. To achieve this

objective, however, monitoring institutions which range from supervisory boards to external monitors such as government regulations and the market for corporate control are important.

Agency theory is used as a framework for dealing with most corporate governance issues. The agency theory originates in the economics discipline. The essence of the theory is based on the existence of separation of ownership and control in large corporations. In such corporations, the managers (agents) are hired to work and make decision on behalf of the owners (principals) in order to maximize return to the shareholders (Jensen and Meckling 1976). However, according to agency theory conflict of interest between the agent and the principal inevitably occurs when the agent do not act in the best interest of the principal. Instead the agent tries to maximize his/her own value. Such conflict of interest occurs due to difference in their preferred level of managerial effort, their attitude towards risk, and their time horizons. Because, unlike shareholders, managers may prefer to expand their firm for more satisfaction, power, prestige, and pay (Bozec and Bozec 2007). This may lead to divergence in the goals of managers and shareholders.

Similarly, Shleifer and Vishny (1996, p. 7) argue that the “agency problem” arises when the financiers (shareholders and creditors) face difficulties in ensuring their funds are not expropriated or wasted on unattractive projects. Consequently, different control mechanisms either internal or external to the firm are put in place in order to align the interests of managers and shareholders (Bozec and Bozec 2007) Thus, corporate governance is basically a set of mechanisms through which outside investors protect themselves against expropriation by the insiders- managers and controlling shareholders (Laporta et al. 1998). According to Laporta et al. (1998) expropriation may take different forms. Sometimes the insiders steal the profits and at other times they may sell the assets, the outputs, or additional securities in the firm they control to another firm they own at below market price. Nevertheless, Davis, Schoorman and Donaldson (1997) argue that, assumptions made in agency theory about individualistic utility motivation resulting in principal-agent interest divergence may not hold for all managers; and therefore, exclusive reliance on agency theory is undesirable, because, the complexities of organizational life are ignored in agency theory.

The stewardship theory on the other hand originates from sociology and psychology. The stewardship theory maintains that managers are not motivated by individual goals but rather they are stewards, whose motives are aligned with the objectives of their principals- shareholders (Davis, Schoorman and Donaldson 1997); as opposed to the agency theory which claims that conflict of interest between managers and shareholders is inevitable unless appropriate structures of control are put in place to align the interests of managers and shareholders (Jensen and Meckling 1976). The stewardship perspective suggests that stewards (managers) are satisfied and motivated when organizational success is attained even at the expense of the stewards' personal goals (Abdullah and Valentine 2009). Furthermore, agency theory suggests that shareholder interests will be protected by separating the posts of board chair and CEO but Stewardship theory argues that shareholder interests will be maximized by assigning the same person to the posts of board chair and CEO to give more responsibility and autonomy to the CEO as a steward in the organization (Donaldson and Davis 1991). Donaldson and Davis (1991, p. 12) further state that, "the question might not be whether agency theory or stewardship theory is more valid. Each may be valid for some phenomena but not for others. Then the question is what the switching rules between agency and stewardship theory are".

The other popular theory of corporate governance is the Stakeholder theory. The stakeholder theory originated from the management discipline and gradually developed to include corporate accountability to a broad range of stakeholders (Abdullah & Valentine 2009). Unlike the agency theory, where by managers are predominantly responsible for satisfying the interests of shareholders, stakeholder theory maintains that managers in organizations are not only responsible for the interests of shareholders but also for a network of relationships to serve which includes the suppliers, employees and business partners (Abdullah & Valentine 2009). According to stakeholder theory decisions made regarding the company affect and affected by different parties in addition to stockholders of the company. Hence, the managers should on the one hand manage the company to benefit its stakeholders in order to ensure their rights and their participation in decision making and on the other hand the management must act as the stockholder's agent to ensure the survival of the firm to safeguard the long term stakes of each group (Fontaine, Haarman and Schmid 2006).

Consequently, the debate in corporate governance focuses on two very different issues. These two concerns are as to whether corporate governance should focus exclusively on protecting the interests of equity holders in the corporation, or whether corporate governance should instead expand its focus to deal with the problems of other stakeholders or non shareholder constituencies. In other words, the first one is relatively the narrower view and the second is the broader view of corporate governance (Macey & O'Hara 2001).

2.2 Conceptual Framework and Hypothesis development

Previous literature on corporate governance and bank performance focuses on both internal, and external corporate governance mechanisms and their association with bank performance by taking proxy variables for corporate governance, and bank performance. In this section of the paper various measures of corporate governance and bank performance are discussed.

2.2.1 Proxies of Corporate Governance in Banks

Corporate governance of banks could be different from corporate governance of other business enterprises due to the existence of depositors in addition to shareholders, and high government regulation in banks (Tandelilin et al. 2007). Similarly Macey and O'Hara (2001) maintain that because of the peculiar contractual form of banking, corporate governance mechanisms for banks should encapsulate depositors as well as shareholders. Thus, Macey and O'Hara (2003) suggest that a broader perspective of corporate governance ought to be implemented in the case of banks. Bank corporate governance involves internal and external corporate governance mechanisms. Internal corporate governance mechanisms include but not limited to: the structure of board of directors and their effectiveness in monitoring the management of the bank. External corporate governance mechanisms on the other hand include: the government regulations and supervisions, and the market for corporate control (Tandelilin et al. 2007; Weir, Laing and McKnight 2000).

With regard to internal corporate governance, Shil (2008) argues that corporate governance is primarily the responsibility of the board of directors of a company as a group. And the board performs its duties with the help of management. Therefore, an analysis of board structure and effectiveness addresses the role of the board and its ability to provide independent oversight towards management (Dallas 2004). Thus, the optimal size and composition of board of directors is likely to lead to effective board of directors and better corporate governance in the firm; which in turn leads to better financial performance in the firm. Hence, previous literature on internal corporate governance has focused on analyzing different aspects of board of directors including its size, independence, structure, activity, and compensation (e.g. Kiel and Nicholson 2003; Adams and Mehran 2011; Sunday 2008). Babatunde and Olaniran (2009) also noted that internal mechanisms of corporate governance work to check and balance the power of managers, shareholders, directors and stakeholders.

According to Dallas (2004) the size of the board can be an important governance consideration, as boards with too many directors can be unwieldy, with ineffective communication among directors and boards with too few directors may lack the appropriate skills and backgrounds or may be dominated by management. Consequently, the optimal size of board of directors needs to be established for good corporate governance as well as performance in the firm. The empirical evidence regarding the effect of board size on bank performance is inconclusive. Some found positive effect of board size on bank performance (e.g. Kiel and Nicholson 2003; Adams and Mehran 2011; and Yung 2009) and others came up with negative effect of board size on bank performance (e.g. Samuel and Ranti 2012). Therefore, the first hypothesis is stated as:

H1: There is positive relationship between Board size and bank performance.

As stated in Waweru, Kamau & Uliana (2008, p. 2) “market regulators, commissions and accountancy bodies have recommended the establishment of audit committees as an important step in improving corporate governance”. The audit committee assists the board in fulfilling its oversight responsibilities by reviewing the financial information and internal control systems (Bean 1999, cited in Waweru, Kamau & Uliana 2008). In doing so, the audit committee will help the board become more effective in the governance of

the firm and improve the performance of the firm. Klein (2002) also reported a negative relationship between earnings manipulation and existence of independent audit committee in the board of directors, indicating that, the audit committee improves the quality of corporate financial reporting. Chan and Li (2008) also found significant positive relationship between existence of majority expert-independent directors in the audit committee, and firm performance. The second hypothesis is, therefore, stated as:

H2: There is positive relationship between existence of audit committee in the board and bank performance.

Good corporate governance is not the result of only internal corporate governance mechanisms, but there are also external corporate governance mechanisms which are important in reducing the agency problem in banks. Macey and O'Hara (2003) argue that commercial banks pose unique corporate governance problems for managers and regulators, as well as for claimants on the firms' cash flows such as investors and depositors. In commercial banks the shareholders contribute only a small portion (not more than 15%) of the assets of the bank and the remainder is contributed by mainly depositors; although those depositors cannot effectively protect themselves against abuse by bank managers and shareholders. Therefore, in the banking sector the government establishes relatively higher regulation to save the interests of the depositors as well as the general public. In such context the market for corporate control potentially fails to discipline the managers and owners of banks and the government takes over the role of market to control the banks (Tandelilin et al. 2007).

In countries like Ethiopia, where there is no organized secondary capital market, the effect of the market for corporate control on corporate governance will be minimal. Rather the government's regulation and supervision as an external corporate governance mechanism plays major role in the governance of banks. But in countries where there is developed secondary capital market, the market for corporate control plays major role in disciplining company managers. Because firms that perform poorly will be susceptible for hostile takeover by other firms; and management teams which perform poorly will likely be replaced by management teams which perform better after the takeover takes

place. To avoid loss of their job due to takeover, managers tend to perform better (Weir, Laing & McKnight 2000).

Accordingly, external corporate governance is considered as a mechanism, which places the government's responsibility to control the operations of banks through prevailing bank regulations (Tandelilin et al. 2007, p. 29). National Bank of Ethiopia (NBE) is the Major institution which regulates the corporate governance and operation of commercial banks in Ethiopia. It is stated in Proclamation no. 592/2008 of FDRE (2008) that, NBE is given the authority to regulate and supervise other banks in Ethiopia by issuing the necessary directives. One means of NBE's bank regulation is through the use of various financial ratios of individual banks. These ratios include capital adequacy ratio (CAR), loan loss provision (LLP), loan to deposit (LTD), liquid asset to total asset and others. Based on these ratios, NBE classifies the banks' health level as "Strong", "Satisfactory", "Fair", "Marginal", and "Unsatisfactory". Then the NBE takes the necessary measure on banks which do not satisfy the regulatory requirement. Among the above ratios, particularly the capital adequacy ratio (CAR) is used by many bank regulatory bodies to evaluate the financial health of banks in different countries.

CAR is computed as year-end capital of the bank divided by risk-weighted assets of the bank. According to Tandelilin et al. (2007) the CAR of individual banks, is a good indicator of the implementation of good corporate governance practice in the bank. Tandelilin et al. (2007) further argue that the CAR number represents the degree of bank's obedient function toward the rules, which serves and protects the public interest. The larger CAR number in banks represents the higher banks' sensitivity toward public interest; and in such banks, the public will be interested to deposit their money as well as buy the shares of the bank, leading to profitability of the bank.

Bank regulators can alleviate deterioration of bank performance by implementing the minimum CAR requirement to classify the health level of financial institutions (Tandelilin et al. 2007). Konishi and Yasuda (2004) also found that the implementation of the capital adequacy requirement reduces risk taking behavior of commercial banks. The minimum CAR required by NBE (Directive. No. SBB/21/1996) as well as

International Standards (eg. Basel Accord) is 8%. Previous studies such as: Tandelilin et al. (2007), and Kim and Rasiah (2010) used CAR of commercial banks as the main proxy of good external corporate governance practice in banks. Hence, the third hypothesis can be put as:

H3: There is positive relationship between external corporate governance mechanisms as measured by CAR and bank performance.

In addition to CAR, there are also other models which are related to external corporate governance. Supriyatna (2006) (cited in Tandelilin et al. 2007) has developed model to get composite values of external corporate governance. The model includes six exogenous variables that are also relevant to assess corporate governance based on health level of banks. These are capital ratio (CR), cash claim on central bank (CCC), secondary reserve ratio (SRR), loan to deposits ratio (LDR), loan loss provision (LLP) and fixed assets and inventories to capital (FAI). Out of these variables Capital adequacy ratio (CAR), capital ratio (CR), loan to deposits ratio (LDR), and loan loss provision (LLP) were used in this study as well, and they are computed as:

Capital Adequacy Ratio (CAR)

$$\text{CAR} = \frac{\text{Total Capital}}{\text{Total Risk Weighted Asset}}$$

Loan loss provision (LLP)

$$\text{LLP} = \frac{\text{Allowance for loan losses}}{\text{Total loan}}$$

Capital Ratio (CR)

$$\text{CR} = \frac{\text{LLP} + \text{Equity}}{\text{Total Loan}}$$

Loan to deposits ratio (LDR).

$$\text{LDR} = \frac{\text{Total Loan}}{\text{Total Deposits}}$$

Loan loss provision (LLP) is the ratio of allowance for losses to total loans. This ratio represents managerial risk-taking behavior relative to all organization resources. Higher

LLP indicates that banks take more risk in their operations, this indicates poor risk management. This behavior tends to expropriate the public interest. Thus to protect the public interest and to maintain the stability of banking systems, central banks set the maximum limit for LLP (Tandelilin et al. 2007). The empirical findings of Tandelilin et al. (2007) also show positive relationship between bank performance and risk management. Directive No. SBB/43/2007 of NBE puts a maximum limit of 5% LLP for banks in Ethiopia. Hence, LLP can be taken as another proxy of good external corporate governance. The fourth hypothesis will be put as:

H4: There is negative relationship between loan loss provision and bank performance.

Capital Ratio (CR) measures the percentage of total loans covered by equity capital of the bank and it shows the bank's dependence on its own capital for making loans. The larger the ratio the better the external corporate governance of the bank will be. So, the fifth hypothesis is stated as:

H5: There is positive relationship between capital ratio and bank performance.

Loan to deposits ratio (LDR) on the other hand is computed by dividing the total loans made by the bank divided by total deposits (saving deposit, demand deposit, and time deposit). This ratio shows the proportion of public contribution as a source of capital to finance the bank's loans. The larger the LDR shows the higher reliance of the bank on the public to support its loan. Therefore, bank regulators determine the maximum value of LDR permitted for a bank. Finally, the sixth hypothesis is stated as:

H6: There is negative relationship between loan to deposit ratio and bank performance.

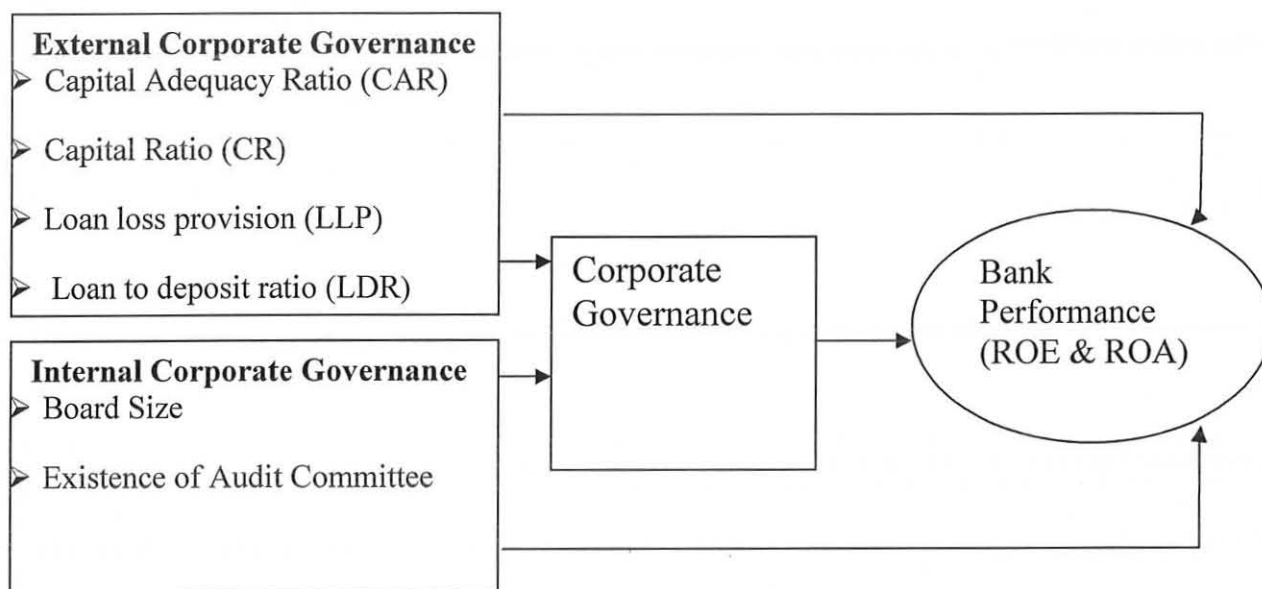
2.2.2 Proxies of Bank Performance

The performance of a firm can be measured in many different ways. However, financial performance measures are the most widely used methods to evaluate the performance of banks. Within financial performance measures we find accounting based performance measures and market based performance measures. The market based performance

measures can be used in countries where there is active securities market that can effectively reflect the performance of the firm on the firm's securities. Otherwise, the accounting based performance measures are used, which includes Return on Equity (ROE), Return on Asset (ROA), cost-to-income ratio, and net interest margin of banks. Particularly, ROE is regarded by ECB (2010) as an internal performance measure of shareholder value, and it is by far the most popular measure of performance, because: (i) it proposes a direct assessment of the financial return of a shareholder's investment; (ii) it is easily available for analysts, only relying upon public information; and (iii) it allows for comparison between different companies or different sectors in a given economy (ECB 2010).

Hutchinson and Gul (2004) argue that accounting-based performance measures like ROE and ROA are preferable than market based performance measures because they show the result of managers' actions. ROE is defined as net income after tax divided by the year-average book value of total capital of a bank, whereas ROA represents net income after tax divided by year-average total assets of a bank. Thus, this study used ROE and ROA as a measure of bank performance.

Figure 1.1: Conceptual Frame work of corporate governance and performance in banks



Source: Adapted from Kim and Rasiah (2010).

2.3 Empirical Studies on Corporate Governance and Bank Performance

In this section of the paper, the brief overview of empirical findings of previous studies on the relationship between corporate governance and bank performance are presented.

Previous researches have used different proxy variables of internal and external corporate governance mechanisms to see their impact on the performance of banks by taking different performance measures. Of the internal governance variables, board size and composition are frequently used to test their relationship with firm performance. Nevertheless, the results of previous studies regarding the impact of board size on bank performance were of mixed type. Kiel and Nicholson (2003), Adams and Mehran (2011), and Yung (2009) found significantly positive relationship between board size and bank performance; whereas Samuel and Ranti (2012), and Sunday (2008) found significantly negative relationship between board size and firm performance. On the other hand, Klein (2002) reported a negative relationship between earnings manipulation and existence of independent audit committee in the board. Some of the empirical evidences are discussed below.

Al-Hawary (2011) investigated the effect of governance on the performance of Jordanian commercial banks. He tested the effect of governance mechanisms such as board size, CEO duality, percentage of non-executive directors, capital adequacy, the ownership percentage of large shareholders, and the ownership percentage of the largest shareholder on the bank performance as measured by Tobin's Q; by using a sample of 13 banks for 8 years period. Al-Hawary (2011) found that CEO duality, and percentage of nonexecutive directors had statistically significant positive effect on Tobin's Q; whereas leverage value had statistically significant negative effect on Tobin's Q. Other governance variables had no statistically significant effect on Tobin's Q. And Hawary (2011) concluded that as CEO duality, percentage of non-executive directors, ownership concentration, and capital adequacy are recognized as effective determinants on banking performance; and corporations should take governance as vital not as duty before authorities.

Sunday (2008) also studied corporate governance and firm performance in 20 Nigerian listed firms for 5 years period. He examined the effect of corporate governance variables

including: board size, board composition, chief executive status and audit committee on performance measures of return on equity (ROE) and profit margin (PM). The results showed a positive significant relationship between ROE and board size as well as chief executive status (i.e. separating the posts of CEO and board chair), unlike the evidence found by Al-Hawary (2011). However, Sunday (2008) found no significant relationship between the two performance measures, and board composition and audit committee independence. He also recommended that the board size should be limited to a sizeable limit and that the posts of the chief executive and the board chair should be occupied by different persons.

Similarly, Kiel and Nicholson (2003) analyzed the relationship between board composition and corporate performance using 348 Australian listed companies. Their findings show that board size and the proportion of inside directors, were significantly positively related to market-based measure of firm performance. These evidences are also supported by Yung (2009); who analyzed the impacts of corporate governance arrangements such as board size and composition on bank performance; and reported significant positive relationship between board size and bank performance as well as significant negative relationship between the level of related-party loans and bank performance.

Another dimension of the literature on bank corporate governance and performance has focused on the relationship between external corporate governance mechanisms and bank performance. Tandelilin et al. (2007) has extensively investigated the relationship among corporate governance, risk management, and bank performance in Indonesian banking sector using primary and secondary data. They take capital adequacy ratio (CAR) as the main measure of external corporate practice, and value at risk (VAR) as the main measure of risk management, return on equity (ROE) and net profit margin (NPM) as the measure of bank performance. Tandelilin et al. (2007) also used various proxies of corporate governance, and risk management in addition. Their findings show that the relationship between corporate governance and risk management and between corporate governance and bank performance are sensitive to the type of bank ownership. Furthermore, risk management has significant effect on bank performance, and vice

versa. More specifically, variables such: capital ratio (CR), cash claim on central bank (CCC), secondary reserve ratio (SRR), loan to deposits ratio (LDR), loan loss provision (LLP) and fixed assets and inventories to capital (FAI), and ownership type have significant relationship with corporate governance as measured by capital adequacy ratio (CAR). They also found non linear relationship between CAR and ROE

Similarly, Kim and Rasiah (2010) studied the relationship between corporate governance and bank performance in Malaysia during the pre and post Asian Financial Crisis using yearly data of 11 banks for the period 1995 -2005. They found evidence that CAR, as a proxy of corporate governance, has significant positive relationship with ROE as a proxy of bank performance. Kim and Rasiah (2010) also determined that foreign owned banks have better corporate governance practices than domestically owned private banks.

A study conducted in a developing country in Uganda by Rogers (2008) also tried to address the issue from a slightly different point of view. Rogers (2008) investigated the corporate governance and financial performance of selected commercial banks in Uganda from the perspective of bank depositors and bank officials. Rogers (2008) used questionnaire with 5-point Likert Scale to collect data on the perception of 388 respondents. He also used variables such as trust, disclosure, and financial transparency as a measure of corporate governance and CAMEL framework as a measure of bank performance. Rogers (2008) concluded that trust, disclosure, and transparency have a major positive contribution to the performance of commercial banks, in which corporate governance predicted 34.5 % bank performance. However, his study had weaknesses in that the statistical tools were not applied as they should have been; and the level of significance of each variable was not determined.

Therefore, the above empirical literature shows that there has been inconclusive evidence regarding the relationship between corporate governance and bank performance. This research will also contribute its part to the debate on this subject.

2.4 The OECD Principles of Corporate Governance

Organization for Economic Co-operation and Development (OECD) has developed the *OECD Principles of Corporate Governance*; which were endorsed by OECD Ministers in 1999 and have since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide (OECD 2004). The OECD Principles of Corporate Governance have been revised in 2004 to take in to account new developments and experiences since 1999. According to OECD (2004) the principles have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non OECD countries. Furthermore, the principles were regarded by *Financial Stability Forum* as one of the 12 key standards for sound financial systems. The following are the 6 OECD Principles of Corporate Governance (OECD 2004):

1. *Ensuring the basis for an effective corporate governance framework*

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

2. *The rights of shareholders and key ownership functions*

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

3. *The equitable treatment of shareholders*

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

4. *The role of stakeholders in corporate governance*

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

5. *Disclosure and transparency*

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

6. The Responsibilities of the Board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The above principles are non-binding standards and good practices as well as guidance on implementation, and thus they can be adapted to the specific circumstances of individual countries and regions (OECD 2004).

2.5 Corporate Governance in Ethiopian Context

The Ethiopian economy is at a stage of transformation. Reforms during the last couple of decades brought market economy, privatization of state owned enterprises and openings in the financial system. Developments of the last few years indicate these new economic progresses. Investors and joint ventures with foreign investors are making progress. Over the past couple of years, ambitious investors are seen to raising large amounts of capital from the public through offers of shares in new business ventures. These new trends and changes in the Ethiopian economy and business environment need to be followed up by major changes in the way of conducting business in the country. Thus, corporate governance in its broadest sense will be essential (Precise Consulting International 2011). This implies that corporate governance in Ethiopia is not improving at the rate the corporations are increasing both in number and size in Ethiopia.

The major legal foundation of corporate governance in Ethiopia is the company law of the country. As stated in USAID (2007) Ethiopia's current company law is part of the commercial code, which has remained unchanged since its enactment in Imperial times (1960). This company law was effectively suspended during the communist Derg period (1975-1991) when formation of new limited liability companies was not permitted. However the company law was restored to full effect under the present government.

It is also stated in USAID (2007) that the current company law of Ethiopia contains important provisions for corporate governance, although many of them require revision to comport with governance of other countries and current international best practices. Among the significant corporate governance provisions are:

- Conflict of interest dealings between a company and a director must receive prior approval by the board of directors (Article 356)
- A company may not make loans to a director (Article 357)
- Directors are personally liable to the company for failure to carry out their duties that include a duty of due care and diligence (Article 364)
- A company may sue a misbehaving director up on approval of shareholders representing 20% of the capital (Article 365)
- A company should have not more than 12 and not less than 3 directors in a board (Article 347)

However, the current company law also contains provisions that are contrary to the international best practices and facilitate insider minority control and hinder transparency in governance (USAID 2007).

In addition, Minga (2008) argues that in Ethiopia, the overall standard of corporate governance is “disappointing”, because: (1) the legal and constitutional instruments do not provide adequate legislative framework; (2) key international conventions and standards are not ratified; (3) political parties own substantial number of business enterprises and operate in key sectors of the economy; (4) ownership concentration through pyramid structure introduces particular problems of agency and creates crony capitalism; (5) investor and creditor protection laws are inadequate; the absence of organized equity market is also a serious void (Minga 2008).

In the banking sector, however, the National Bank of Ethiopia is the Major institution which regulates the corporate governance and operation of commercial banks in Ethiopia based on the authority given to it. Currently there are 17 banks which are operating in Ethiopia. Out of the 17 banks 3 are state owned and 14 are privately owned banks. All of them are under the supervision of the NBE. NBE issues directives to guide the governance and operation of banks besides the company law. For example, *the Banking*

Business Proclamation No.592/2008 of FDRE 2008 address issues regarding the required competence of members of board of directors; the selection procedure of board members; the period of service of a board member; the required competence of a CEO, the shareholders right, the maximum number of shares that can be owned by a shareholder from a given bank and others. However, Fekadu (2010) argues that the regulation of NBE is not sufficient to protect minority rights, because the main objective of NBE is financial regulation and which is just one aspect of governance. He also adds that NBE pays more attention to the protection of depositors and the maintenance of a sound monetary system rather than giving solution to the problems minority investors face in these companies.

Good corporate reporting and disclosure are important aspects of sound corporate governance. Regarding financial reporting and disclosure in Ethiopia, however, there is no particular accounting standard in Ethiopia. Neither are any of the international standards officially adopted. Some of the laws indicate the use of generally accepted accounting principles. For example, the income tax law of Ethiopia states generally accepted accounting principles and generally accepted auditing standards to be used for the purpose of income tax reporting, however, these principles are not defined (World Bank 2007). The absence of a particular accounting standard to be followed by all companies may be a drawback to the corporate governance practice in Ethiopia. Nonetheless, currently National Bank of Ethiopia is working to adopt the International Financial Reporting Standards (IFRS) to be followed by financial institutions operating in the country (Next Consult Plc. 2011).

2.6 Summary

This chapter of the paper has discussed the review of related literature on corporate governance and its impact on bank performance. The theoretical as well as empirical literature on the topic was explored. From the discussion, it can be noted that the significance of corporate governance is profound to the success of firms, industries as well as economies. Despite the fact that, there is agreement on the idea that good corporate governance improves firm performance, there is no agreement as to how and which corporate governance mechanisms affect firm performance, because, similar

studies would often result in absolutely different outcomes. There are also differing theories regarding what corporate governance is and what it should strive to achieve.

Therefore, to get conclusive evidence on the relationship between corporate governance and firm performance, more empirical research is needed. Furthermore, most previous studies were made in developed nations and the findings may not apply to developing nations like Ethiopia. Particularly in case of Ethiopia, absence of organized stock exchange market may make corporate governance different from that in other countries. There were only few studies conducted in Ethiopia on corporate governance. None of those studies, however, examined the relationship between internal and external corporate governance mechanisms, and bank performance in Ethiopian commercial banks, to the extent of the researcher's knowledge. As a result this study tries to fill this knowledge gap and contribute to the corporate governance literature by assessing selected internal and external corporate governance mechanisms and their impact on the performance of commercial banks. Therefore, the findings of this study will be very crucial for understanding corporate governance and its effect on bank performance in a context of developing country as well as in the absence of stock exchange. Finally, the next chapter deals with the methodology adopted to achieve the objective of this research.

Chapter Three

3. Research Methodology

Research methodology is a way to systematically solve the research problem. It includes the various steps that are generally adopted by a researcher in studying his/her research problem along with the logic behind them (Kothari 2004). The main objective of this research is to investigate the corporate governance mechanisms and their impact on Performance of Commercial Banks in Ethiopia. As data and methodology are highly interdependent, the methodology to be used for a particular research problem must always take into consideration the nature of data that will be collected to resolve the research problem (Leedy and Ormrod 2005, cited in Semu 2010). This chapter discusses the research methodologies and creates link among the objectives of this research; hypothesizes, and the strategies and philosophies adopted for the study. The chapter is organized in two sections. Section 3.1 discusses the research approaches and section 3.2 presents the method adopted in the study including the specific methods of data collection and analysis.

3.1 Research approaches

There are three, frequently used approaches of inquiry. These are quantitative approach, qualitative approach, and mixed methods approach (Creswell, 2009). Each of these approaches has their own strengths and weaknesses. The basic features of the three approaches are summarized below to select the methodology that best suits the research objective.

The quantitative research approach is one in which the researcher primarily uses postpositive claims for developing knowledge. Post positivism assumes that causes determine outcomes (Creswell 2009). The approach involves the generation of data in quantitative or numerical form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion (Kothari 2004, p.5). Similarly, Creswell (2009) states that, in the quantitative approach the researcher use survey or experiment to collect data needed to see cause and effect relationship among variables of interest. The quantitative approach follows deduction in that it tests existing theories to verify them. The major benefit of the quantitative approach is that it enables the researcher to utilize statistical

techniques to make generalization about the population. As the data in quantitative approach are numerical, the numbers are readily collected, coded, summarized and analyzed. The major weakness of a quantitative research is that the researcher knows only about the collective or average experience of study participants but not their individual experiences (Dunn 1999, p.37).

The qualitative approach is defined by Creswell (2009) as one in which the researcher often makes knowledge claims based primarily on constructivist perspective. In other words, in this approach the researcher tries to develop theories from the individual experiences of study participants. Qualitative data are not numerical nor are they usually subjected to statistical methods of analysis. Rather they are examined in their raw form (Dunn 1999). Hence, in qualitative methodology the researcher follows induction, as the researcher collects open-ended data with the primary intent of developing theory from the data. The main benefit of using qualitative approach as stated by Dunn (1999) is that the information gathered is of no fixed variety; hence, it represents *open systems view*. The openness of the approach becomes very useful when it come to developing hypothesis in the early stages of investigating a topic. However, the disadvantages of qualitative researches are the fact that the data cannot be quickly, easily, or efficiently summarized nor is it often possible to generalize from given qualitative observation to another situation (Dunn 1999).

The mixed methods approach tries to combine the benefits of both quantitative and qualitative approaches. It integrates the two approaches for the purpose of gaining better insight into a social phenomenon (Baker 2010). Baker (2010) further argues that the mixed methods approach is better than either method alone because it provides not only more information but also better quality of information. Therefore, in the mixed methods approach the researcher uses both the qualitative and quantitative approaches together at the same time or sequentially. As cited in Baker (2010), Creswell and Plano Clark (2007) summarized the advantages of mixed methods approach as: (1) the ability to choose from among all the quantitative and qualitative tools in order to perform a comprehensive study of the research problem, (2) the ability to answer more in-depth research questions, (3) the ability to combine both inductive and deductive reasoning. They also stated the

disadvantages of using a mixed methods approach include: (1) more resources are needed to implement the study and collect the necessary data, (2) mixed methods research can be complicated to perform and difficult to sort out the results, and (3) researchers must be skilled in both quantitative and qualitative techniques in order to use this method.

3.2. Methods adopted

The purpose of this study is to assess the corporate governance mechanisms and their impact on performance of Commercial Banks in Ethiopian. Based on the features, strengths and weaknesses of different research approaches discussed above, the researcher found the mixed methods approach to be suitable for this study. The use of mixed methods approach for this research was intended to drive the benefits of both quantitative and qualitative approaches. The quantitative features in this case enabled the researcher to generate data from larger sample size about different variables in order to analyze the relationship between corporate governance mechanisms and bank performance, then to generalize the results to the population, whereas, the qualitative features allowed the researcher to explore the current status of corporate governance mechanisms in Ethiopian commercial banks. Both primary and secondary data were used in this study. More specifically, the researcher used structured review of documents, and in-depth interview in order to substantiate results obtained from different data sources.

3.2.1. Survey design

The use of survey design provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample of that population in order to generalize from the sample to the population (Creswell 2009). Besides, surveys provide a systematic and structured method for obtaining research information on the same topic from a large group of people in a relatively short time (Gerhardt 2004). Although the primary form of data collection in survey design is using questionnaire to get opinion data, structured review of documents can also be used to collect data related to financial, medical, or school information in a survey (Fin 1995, cited in Creswell 2009). In this study, structured review of documents is used as one method to collect corporate governance and bank performance data, because the researcher wants to generalize the

results to all commercial banks operating in Ethiopia by studying a sample of commercial banks' governance mechanisms and their performance. The structured review of documents also enabled the researcher to incorporate relatively larger number of banks and operating periods in the sample to be investigated within the limited time and budget.

3.2.2 Sample Frame, Sample Size, and Sampling Method

The target population for this research was all commercial banks registered by NBE until the end of the year 2011. The sample frame was all banks that have been under operation for the previous 7 years by the end of the year 2011 in Ethiopia. According to NBE, the total number of banks that were operating at the end of the year 2011 in Ethiopia was 17. Out of the 17 banks, 3 banks are state-owned and 14 banks are privately owned banks. One of the 3 state-owned banks is Development Bank of Ethiopia, whose activity is not commercial banking. Hence, it is excluded from the sample, leaving only two state-owned commercial banks. On the other hand, out of the 14 private commercial banks, 7 of them were established after the year 2005, thus, they do not meet the study requirement that a bank has to be at least 7 years in operation. Thus, only the other 7 private commercial banks are included in the sample. As a result, 7 years data from a total of 9 (2 state and 7 private) commercial banks was taken as a sample in this study for structured review of documents. In other words, a population census of all commercial banks having 7 years data was used. Consequently, this study used panel data of 9 commercial banks for 7 years or 63 firm year data.

This sample size is decided based on the availability of operating data in the commercial banks operating in Ethiopia. However, the researcher believes that this sample size is not very large enough. It should also be noted that increasing the number of years covered in the study would reduce the number of banks to be included because of the absence of their operating data due to their establishment date and it may also reduce the accuracy of the collected data due to remoteness of the period. Similarly, purposive sampling is used because of unavailability of 7 years data for recently established banks. This may pose some limitation on the outcomes of the research. However, according to Fowler (1986), the appropriateness of any sample design feature can be evaluated only in the context of

the overall survey objectives. The important point for the researcher is to be aware of the potential costs and benefits of the options and weigh them in terms of the main purpose of the study.

3.2.3 Structured Review of Documents

Structured review of documents is one of the specific forms of data collection within survey design. In this research also structured review of various documents were made to collect data on corporate governance mechanisms and performance of banks. Besides, the data to be collected were composed of data related to internal corporate governance mechanisms, external corporate governance mechanisms, and performance of banks for a period of 7 year (from 2005 up to 2011).

The data on internal corporate governance variables such as board size and existence of audit committee for each of the 7 years was collected by the researcher personally from the head offices of each bank. At the head offices, this information was accessed from the corporate communications officer, as well as human resource officers of banks. In addition documents like reports of board of directors, and internal corporate governance manuals were examined to find the actual size of board of directors and existence of audit committee for each of the years under study. Furthermore, a simple data collection instrument was used to collect data regarding board size and existence of audit committee for each of the 7 years, which was completed by the bank officials. The instrument was developed by the researcher himself and is presented in Appendix 1 at the end of the paper.

To gather data on external corporate governance variables such as Capital Adequacy Ratio (CAR), Capital Ratio (CR), Loan Loss Provision (LLP), and Loan to Deposit Ratio (LTD); audited annual reports of banks were reviewed, and the annual reports were also accessed from the head offices of each bank as well as from the NBE. Then structured documentary review of annual reports was made and the ratios were computed using Microsoft Excel. Finally, this study used Return on Equity (ROE) and Return on Asset (ROA) as bank performance variables, thus ROE and ROA were calculated using structured review documents of audited annual financial reports.

3.2.4 In-depth interview

In-depth interview is one of the specific methods of data collection used in a qualitative research. In this research, the in-depth interview was conducted with three interview respondents from different banks. Out of the three interviewees, the two are directors currently serving as board members in different commercial banks in Addis Ababa; and the third one is a recently retired private bank board chairman. The preference of bank board members for the interview was because in any corporate entity board of directors is the main body entrusted with the responsibility of maintaining good corporate governance. Therefore, the bank directors are expected to have good understanding and experience related to the subject. The selection of the respondents was made using purposive sampling i.e. directors who have actively participated in corporate governance and were willing to participate in the interview were interviewed. The interview questions were unstructured in type. The aim of the interview was to explore the current status of major corporate governance mechanisms and how they may influence performance of Ethiopian commercial banks. During the interview the responses were recorded using audio recording material and then analyzed later by categorizing them.

Finally, the table below presents the linkage among the research objectives, hypotheses, and independent and dependent variables as well as the different data sources utilized to address them.

Table 3.1: Link between research objective, hypotheses, variables and the different data sources

Hypothesis to be tested/ Objectives to be achieved	Variables Used	Data Sources
<p>H1. There is positive relationship between Board size and bank performance.</p>	<p>- The number of members sitting in the board of directors (BDSZ)</p> <p>- Return on equity (ROE)</p> <p>- Return on asset (ROA)</p>	<p>Bank head offices and NBE</p>
<p>H2. There is positive relationship between existence of audit committee and bank performance.</p>	<p>- Existence of Audit committee in the board of directors (AUDC)</p> <p>- Return on equity (ROE)</p> <p>-Return on asset (ROA)</p>	<p>Bank head offices and NBE</p>
<p>H3. There is positive relationship between external corporate governance mechanisms as measured by CAR and bank performance.</p> <p>H4. There is positive relationship between CR and bank performance.</p> <p>H5. There is negative relationship between LLP and bank performance</p> <p>H6. There is negative relationship between LDR and bank performance</p>	<p>- Capital adequacy ratio (CAR)</p> <p>- Capital ratio (CR),</p> <p>- Loan loss provision (LLP),</p> <p>- Loan to deposit ratio (LTD)</p> <p>- Return on equity(ROE)</p> <p>- Return on asset (ROA)</p>	<p>Computed from annual reports which will be obtained from bank head offices and NBE</p>
<p>To explore the current status of major corporate governance mechanisms in Ethiopian commercial banks.</p>	<p>Current corporate governance mechanisms of banks is explored from secondary data and In-depth interview, and compared with International standards</p>	<ul style="list-style-type: none"> • NBE directives • Commercial code of Ethiopia • Bank Corporate governance rules • OECD corporate Governance principles • Interview results

Source: Researcher's Own design

3.3.5 Data analysis method

This research used both quantitative and qualitative methods of data analysis to analyze the sample data. The quantitative methods of analysis involved were descriptive and inferential statistical analysis, and regression model analysis. These techniques were used to test the hypotheses, and achieve objectives of the study. Particularly, to examine the relationships among the governance mechanisms and performance of selected commercial banks, this research used multiple regression analysis. The descriptive statistics was used to analyze the means and standard deviations of regression variables. In addition, before conducting regression analysis, various tests were made for Classical Linear Regression Model (CLRM) assumptions. The results of the in depth-interview are presented in a separate section from the results of the review of documents, and the two results are linked whenever necessary.

The following two regression models were used to test the six hypotheses developed for the study.

$$\text{Model 1 ROE} = a_0 + a_1\text{BDSZ} + a_2\text{AUDC} + a_3\text{CAR} + a_4\text{CR} + a_5\text{LLP} + a_6\text{LDR} + a_7\text{BK SZ} + a_8\text{OWTP} + a_9\text{CAR}^2 + E.$$

$$\text{Model 2 ROA} = a_0 + a_1\text{BDSZ} + a_2\text{AUDC} + a_3\text{CAR} + a_4\text{CR} + a_5\text{LLP} + a_6\text{LDR} + a_7\text{BK SZ} + a_8\text{OWTP} + a_9\text{CAR}^2 + E.$$

The dependent variables used in this study were return on equity (ROE) and return on asset (ROA) to measure bank performance.

- ROE is net income after tax divided by the year-average total capital at book value
- ROA is net income after tax divided by year- average total assets at book value

The independent variables used in this study were board size (BDSZ), existence of audit committee in the board (AUDC), capital adequacy ratio (CAR), capital ratio (CR), loan loss provision (LLP), and loan to deposit ratio (LDR)

- BDSZ is board size representing the number of directors sitting in the board.
- AUDC is presence of audit committee in the board with dummy variable taking 1 if there is audit committee in the board, and 0 otherwise.

- CAR is year-end capital of the bank divided by year–end total risk-weighted assets of the bank.
- CR is the sum of capital and loan loss provision divided by total loan.
- LLP is allowance for loan loss divided by year-end total loans.
- LDR is year-end total loan divided by total deposits.
- CAR^2 is the square of capital adequacy ratio.

This study uses two control variables, namely, ownership type (OWTP) and bank size (BKSZ). There are two types of bank ownerships in Ethiopia state-owned and private bank ownerships. As the type of ownership is likely to lead to difference in the corporate governance practices and bank performance, ownership type is used as a control variable. In addition bank size is also the other control variable used in this research, as firms can enjoy better earnings due to economies of scale.

- BKSZ is bank size measured as a logarithm of the year- end total assets.
- OWTP is ownership type with dummy variable taking 1 if the bank is a private bank and, 0 otherwise.
- E is the error term.

Finally, the descriptive statistical analysis and regression analysis of the variables were performed using Eviews software and the results were presented in tables.

In this chapter of the paper the different types of research approaches; and the methods adopted in this study to achieve the research objectives were discussed. The next chapter presents the study results and discussion of the results.

Chapter Four

4. Results and Discussions

The main objective of this study is to see the corporate governance mechanisms and their impact on the performance of commercial banks. Accordingly, in the preceding chapter, the research approaches and methods adopted to achieve the objective were discussed. In this chapter, the results obtained using the adopted research methods are discussed and analyzed. The results obtained through structured review of documents and in depth-interview are presented in section 4.1, which includes information on profile of sample banks, descriptive statistics, correlation analysis, tests for CLRM assumptions, multiple regression results, and in depth- interview results. Then, discussion of the related results is provided in section 4.2.

4.1 Results

In this study the necessary data were collected mainly through structured review documents and in depth-interview. The data is used to assess the corporate governance mechanisms and see the existing relationship between the governance mechanisms and bank performance. Consequently, both governance and, performance data were collected from all the commercial banks that have been in operation from the year 2005 up to 2011 in Ethiopia. There were 9 commercial banks with operating history of 7 years by the end of 2011. This results in 63 observations data. The corporate governance data and performance data were accessed from NBE, and head offices of the sample banks. Finally, the data were extracted from audited annual financial and board of directors' reports as well as from the data collection instrument developed by the researcher for this study. The summary of the collected data for each bank and year is presented in appendix 2.

4. 1.1 Profiles of sample banks

Some of the basic characteristics of commercial banks involved in the sample are presented in Table 4.1. The figures in the table are average amounts of the last 7 years for each bank. It can be seen from Table 4.1 that there were 2 state-owned and 7 private banks included in the sample. The largest commercial bank is a state-owned, Commercial

Bank of Ethiopia (CBE), with average assets, capital, and net income of birr 58,679.07, birr 4,081.80, and birr 1,478.72 million respectively followed by a privately owned one, Dashen Bank (DB) with average assets, capital, and net income of birr 8,368.76, birr 761.79, and birr 236.38 million respectively. The smallest bank in the sample is a privately owned, Cooperative Bank of Oromia (CBO) with average assets, capital, and net income of birr 963.82, birr 157.64, birr 11.94 million respectively.

Table 4.1: Profiles of sample banks.

Profiles of Sample Banks						
Bank Name	Av. Asset (million birr)	Av. Capital (million birr)	Av. CAR (%)	Av. Board Size	Av. Net Income (million birr)	Type of bank Ownership
CBE	58,679.07	4,081.80	12.20	10	1,478.72	State
CBB	2,452.67	240.92	14.57	6	66.31	State
DB	8,368.76	761.79	13.57	7	236.38	Private
AIB	5,473.36	651.58	19.45	12	164.71	private
BOA	4,512.95	463.45	17.34	9	92.79	private
WB	4,343.01	666.99	26.06	8	156.73	private
UB	3,768.26	457.53	21.78	9	104.27	private
CBO	963.82	157.64	53.01	11	11.94	private
NIB	3,986.42	621.16	25.01	12	127.72	private

Source: Eviews Output from data of sample banks, 2005 – 2011.

The banks with the largest average board size are Awash International Bank (AIB), and Nib International Bank (NIB) having 12 board members each. On the other hand, Construction and Business Bank (CBB) has the smallest average number of board members (i.e. 6 members). The regulatory requirement under Article 347 of the Commercial Code of Ethiopia (1960), states that a share company should have a board size of between 3 and 12 members only. It is also observable from the table that CBO has the largest average capital adequacy ratio (CAR) of 53% whereas; CBE has the smallest

CAR of 12.2%. However, all the banks have CAR above the NBE's regulatory requirement of 8% (NBE Directive No. SBB/21/96).

4.1.2 Descriptive Statistics

Table 4.2 presents the descriptive statistics for the independent regression variables that are proxy variables of corporate governance, the dependent regression variables which are proxy variables of bank performance and control variables. The descriptive statistics are based on panel data of the banks from the year 2005 up to 2011. The table presents the mean, and standard deviation including minimum and maximum values of regression variables. The regression variables included in the descriptive statistics are: the independent variables including control variables, namely board size (BDSZ), existence of audit committee in the board (AUDC), capital adequacy ratio (CAR), capital ratio (CR), loan loss provision (LLP), loan to deposit ratio (LTD), ownership type (OWTP) and bank size (BKSZ), and the dependent variables which are return on equity (ROE) and return on asset (ROA).

Table 4.2 Descriptive Statistics of regression variables

Variable	State (N=14)		Private (N=49)		Total sample (N=63)			
	Mean	Std.Dev.	Mean	Std.Dev.	Mean	Std.Dev.	Min	Max
Proxies of Corporate Governance								
CAR	0.13	0.04	0.25	0.19	0.23	0.18	0.08	1.25
CR	0.31	0.09	0.32	0.17	0.31	0.15	0.14	0.98
BDSZ	7.79	2.33	9.65	1.84	9.24	2.09	5.00	12.00
AUDC	0.50	0.52	0.65	0.48	0.62	0.49	0.00	1.00
OWTP	0.00	0.00	1.00	0.00	0.78	0.42	0.00	1.00
LLP	0.11	0.06	0.04	0.02	0.05	0.04	0.00	0.21
LDR	0.65	0.30	0.70	0.19	0.69	0.22	0.20	1.30
BKSZ	23.15	1.66	21.91	0.96	22.18	1.25	18.68	25.46
Proxies of Bank Performance								
ROE	0.36	0.10	0.24	0.10	0.27	0.11	-0.04	0.55
ROA	0.03	0.01	0.03	0.01	0.03	0.01	-0.02	0.05

Source: Eviews Output from data of sample banks, 2005 – 2011.

The descriptive statistics figures in Table 4.2 are first computed separately for state-owned banks, and for private banks, then for the total sample in order to analyze the differences in the values of regression variable, if any.

The descriptive statistics indicates that private banks have mean CAR of 25%, which is more than the CAR of state-owned banks (13%). But the CAR for the total sample is 23%, this is above the minimum CAR required by both the NBE and Basel Accord (i.e. 8%). The minimum value of CAR (0.08) shows that all of the banks have at least 8% CAR during the study period. Private Banks also have mean CR of 32% a little more than the CR of state-owned banks, 31%. Private banks have mean board size (BDSZ) of 9.65 whereas state-owned banks have mean BDSZ of 7.79. This implies that in private banks there are on average more number of directors in a board than the case in state-owned banks. Regarding the existence of audit committee in the board of directors (AUDC), on average state-owned banks have AUDC 50% of the time, while private banks have AUDC 65% of the time, and all of the sample banks have AUDC 49% of the time during the study period. This is because some of the banks have established audit committee very recently and some don't have at all or the function of an audit committee is performed by other committees in the board.

The mean loan loss provision (LLP) for the state-owned banks, private banks and total sample banks is 11%, 4%, and 5% respectively. These indicate that state-owned banks take more risk compared to private banks, as LLP measures the management's risk taking behavior. Directive No. SBB/43/2007 of NBE sets a maximum limit of 5% LLP for banks; therefore, all banks on average have met this requirement. State-owned banks have mean loan to deposit ratio (LDR) of 65%, less than the LDR of 70% for private banks implying that private banks rely more on the depositors fund to make loan. On the other hand, the bank size (BKSZ) as measured by natural logarithm of total assets shows that state-owned banks have larger mean total assets (23.15) than private banks (21.91). This is due to the fact that the largest bank in the sample, CBE, is a state-owned bank which increased the average for the state-owned banks (see Table 4.1 above). Finally, based on average ROE as a measure of bank performance, the state-owned banks performed better than private banks, because, ROE for state-owned and private banks is

36% and 24% respectively. However, the two types of banks have equal performance when measured in terms of average ROA (i.e. 3%).

In general, the descriptive statistics show that the private banks have higher CAR, CR, and AUDC as well as lower LLP than state-owned banks; suggesting that private banks tend to be more concerned about implementing good corporate governance.

4.1.3 Correlation Analysis

The Pearson's correlation matrix is used to determine the relationship among the regression variables involved. The correlation coefficients between each pair of variables are presented in Table 4.3. Correlation coefficients show the sign and strength of relationship that exists between any two regression variables. The correlation table is also used to compare the expected and actual relationship between governance and performance variables.

Table 4.3: Pearson's Correlation Matrix

	CAR	CR	BDSZ	AUDC	OWTP	LLP	LDR	BKSZ	ROE	ROA
CAR	1.000									
CR	0.915	1.000								
BDSZ	0.307	0.313	1.000							
AUDC	0.219	0.275	0.263	1.000						
OWTP	0.277	0.026	0.374	0.131	1.000					
LLP	-0.331	-0.065	-0.330	-0.160	-0.693	1.000				
LDR	-0.062	-0.145	-0.245	-0.235	0.091	-0.009	1.000			
BKSZ	-0.558	-0.353	-0.013	0.145	-0.418	0.241	-0.547	1.000		
ROE	-0.642	-0.545	-0.382	-0.227	-0.448	0.354	-0.132	0.659	1.000	
ROA	-0.584	-0.571	-0.181	-0.204	-0.015	0.039	0.014	0.424	0.683	1.000

Source: Eviews Output from data of sample banks, 2005 – 2011.

The signs of the correlation coefficients in Table 4.3 show that, the relationship of capital adequacy ratio (CAR) with both return on equity (ROE) and return on asset (ROA) is negative; which means, the larger the CAR of a bank the smaller will be its ROE and ROA. The same is true for the relationship of capital ratio with both return on equity

(ROE) and return on asset (ROA). There is also inverse relationship between board size (BDSZ), and ROE as well as ROA. On the other hand, loan to deposit ratio (LDR) has positive relationship with ROA but negative relationship with ROE. The remaining variables, such as existence of audit committee (AUDC) and ownership type (OWTP) have negative relationship, and loan loss provision (LLP) and bank size (BKSZ) have positive relationship with both ROE and ROA respectively. In addition, the relationship of BKSZ with both ROE and ROA as well as the relationship of LDR with ROA is as expected. The relationship of the remaining variables with ROE and ROA are not as expected, based on the literature review. These relationships are further discussed later in connection with regression results.

4.1.4 Tests for the Classical Linear Regression Model (CLRM) Assumptions

The Classical Linear Regression Model (CLRM) is based on certain assumptions that should be satisfied in order to make valid estimation of the coefficient parameters. Thus, various tests for CLRM assumptions were conducted before regressing the variables in this study. These tests are done to check whether: (1) the expected value of the errors are zero, (2) the errors have constant variance, (3) covariance between the error terms is zero, (4) the regressors are uncorrelated with the error terms (5) the disturbances are normally distributed and (6) independent variables are uncorrelated with each other . The results of the tests for these assumptions are presented below.

- **Assumption 1: $E(u_t) = 0$.** The first assumption of the CLRM states that the expected value of the errors must be zero. Brooks (2008) stated that this assumption would never be violated, if a constant term is included in the model. Accordingly, a constant term is included in the regression models in this study and this requirement is satisfied.
- **Assumption 2: $\text{var}(u_t) = \sigma^2 < \infty$.** The second assumption requires that the errors have constant variance. This is also referred to as the *Homoscedasticity* assumption. But if the errors do not have constant variance, they are said to be *Heteroscedastic*. The test for this assumption was performed using white's Heteroskedasticity test and the results are presented below in Table 4.4. The null hypothesis of homoscedasticity was tested. Both the F and χ^2 version of the test statistic reveal that there is no evidence of

heteroskedasticity. However, the ‘Scaled explained SS’ version of the test suggests that there is evidence of heteroskedasticity. Therefore, the conclusion of the test is somewhat ambiguous in this case. But existence of heteroskedasticity would not cause the parameter estimates to be biased and even in the presence of heteroscedasticity, more efficient estimation is possible provided that other assumptions are met (Wooldridge 2002).

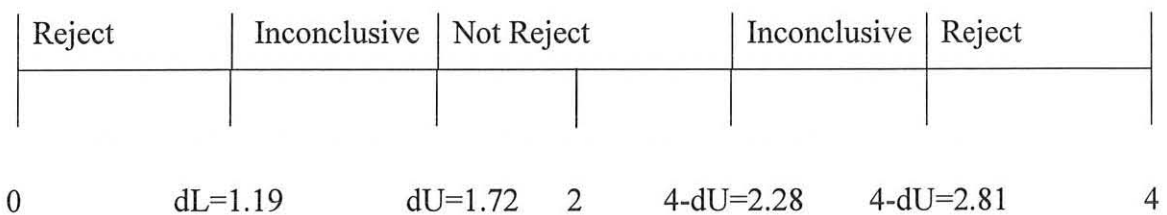
Table 4.4 Heteroskedasticity Test: White

F-statistic	1.116429	Prob. F(42,20)	0.4065
Obs*R-squared	44.16311	Prob. Chi-Square(42)	0.3803
Scaled explained SS	84.05202	Prob. Chi-Square(42)	0.0001

Source: Eviews Output from data of sample banks, 2005 – 2011.

- **Assumption 3: $cov(u_i, u_j) = 0$.** The CLRM also assumes that the covariance between the error terms is zero or the error terms are uncorrelated. The test for the violation of this assumption or existence of autocorrelation is made using the Durbin-Watson (DW) Test. The DW test uses two critical values - the upper critical value (d_U) and the lower critical value (d_L) as shown in figure 4.1. According to DW test, the null hypothesis of there is no autocorrelation will be rejected if the DW value from the regression is less than d_L and greater than $4 - d_L$. But the null hypothesis is not rejected if the DW value is between d_U , and $4 - d_U$. And finally, the test result will be inconclusive if the DW value is between d_U and d_L , and between $4 - d_U$ and $4 - d_L$ (Brooks 2008).

Figure 4.1 Rejection and Non-Rejection Regions

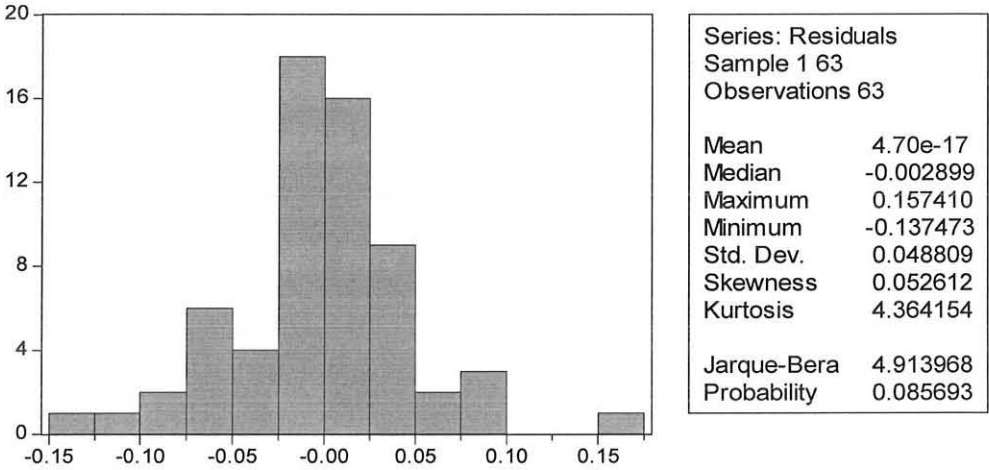


Source: Adapted from Brooks (2008).

The DW value for this regression is 1.68, and dL and dU from Durbin-Watson statistic Table are 1.19, and 1.72 respectively; hence, $4 - dU$ is 2.28, and $4 - dL$ is 2.81. DW value of 1.68 lies between the dU (1.19) and dL(1.72); which is the inconclusive region. In other words the null hypothesis is neither rejected nor not rejected.

- Assumption 4: the x_t are non-stochastic.** The fourth assumption requires that the regressors should be uncorrelated with the error terms. This assumption will not be violated provided that assumption 1 (i.e. $E(u_t) = 0$) is met (Brooks 2008). Hence, there is no need to do further tests because assumption 1 is already satisfied.
- Assumption 5: the disturbances are normally distributed.** CLRM also assumes a normal distribution so that valid estimation of the coefficient parameters could be made. The Bera-Jarque normality test is used to test the null hypothesis of normally distributed errors. If the errors are normally distributed the histogram will be bell shaped and it will be symmetric about its mean. Furthermore, the Bera-Jarque statistic would not be significant (Brooks 2008). Figure 4.2 demonstrates that the residuals are normally distributed. The histogram for residuals is almost bell shaped with mean of $4.70e-17$, and standard deviation of 0.049, and the Jarque -Bera statistic of 4.9 is not significant at 5%; implying that the null of normality is not rejected or the residuals are normally distributed.

Figure 4.2 Bera-Jarque normality tests



Source: Eviews Output from data of sample banks, 2005 – 2011.

- **Multicollinearity:** Another important assumption of CLRM in using OLS estimation is that the independent variables in the regression are uncorrelated with each other. The test for this assumption is performed using Pearson's Correlation Matrix and the outcome of the test is provided in table 4.3 above. According to Cooper and Schendlar (2009), if the correlation coefficient between two independent variables is above 0.8 then it should be corrected. And of those techniques of correction for presence of high multicollinearity, dropping one of the highly correlated variables is a possible solution (Brooks 2008; Wooldridge 2004). The highly correlated variables in correlation table 4.3 are CAR and CR, having correlation coefficient of 0.91. All the other correlation coefficients are below 0.7 and are not of much concern. As a remedy for the high correlation between CAR and CR, CR is dropped from the regression model, since CAR is the main proxy for external corporate governance. Instead, the square of capital adequacy ratio (CAR^2) is included in the regression because CAR can have non-linear effect on the performance of banks as a result of government regulation (Tandelilin et al. 2007).

4.1.5 Regression Results

The multiple regression results of the study are presented in table, 4.6 and table 4.7 for model 1 and model 2 respectively. To run the regressions the Panel method is used, because the data is pooled or the data has both cross-sectional and time series dimensions. Of the two panel estimator methods i.e. fixed effects model (FEM) and random effects model (REM), the REM is adopted after testing for suitability of REM for the regression using Hausman test as presented in table 4.5. The null hypothesis that says REM is preferable is not rejected.

Table 4.5: Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	11.170098	7	0.1314

Source: Eviews Output from data of sample banks, 2005 – 2011

The regression output in Table 4.6 is run by taking ROE as a dependent variable and other governance and control variables as regressors. The regression output reveals that the dependent variable is well explained by the explanatory variables in the model with R-square and adjusted R-square of 0.68 and 0.63 respectively. R^2 of 0.68 indicates that 68% of the variation in the dependent variable (ROE) is explained by the explanatory variables. Similarly, adjusted R^2 of 0.63 means 63% of the variability in ROE is attributable to the explanatory variables in model 1. The F- statistic of 14.57 is also significant with P- value of zero, indicating that the null hypothesis, that all the coefficients are jointly zero is rejected. So, the variation in the dependent variable is well explained by the regressors in the model.

Table 4.6 Regression Result for Model 1

Variable	Coefficient	Std.		
		Error	t-Statistic	Prob.
CAR	-0.4418	0.1847	-2.3917	0.0203**
BDSZ	-0.0107	0.0049	-2.1964	0.0324**
AUDC	-0.0437	0.0191	-2.2876	0.0261**
OWTP	0.0199	0.0340	0.5852	0.5609
LLP	0.1663	0.2876	0.5784	0.5654
LTD	0.0933	0.0582	1.6049	0.1143
BKSZ	0.0644	0.0134	4.7968	0.0000***
CAR ²	0.3070	0.1449	2.1186	0.0387**
Weighted Statistics				
R-squared	0.683372			
Adjusted R-squared	0.636465			
S.E. of regression	0.068468			
F-statistic	14.56842	Durbin-Watson stat		1.67706
Prob(F-statistic)	0.0000			

***, **, indicates significant at 1%, and 5% significance level respectively.

Source: *Eviews Output from data of sample banks, 2005 – 2011.*

The regression results in Table 4.6 show that explanatory variables such as capital adequacy ratio (CAR), board size (BDSZ), existence of audit committee (AUDC), as well as square of capital adequacy ratio (CAR^2) are statistically significant at 5%; and bank size (BKSZ) is statistically significant at 1%, whereas loan loss provision, loan to deposit ratio, and ownership type are not statistically significant. Besides, the signs of the parameter coefficients indicate that there is negative relationship between capital adequacy ratio, board size, existence of audit committee, and bank performance; while there is positive relationship between bank size, square of capital adequacy ratio, and bank performance. In addition, all variables having statistically insignificant coefficients (loan loss provision, loan to deposit ratio, and ownership type) have positive relationship with bank performance. However, the negative coefficient signs of CAR, BDSZ, and AUDC are as opposed to the expected positive sign; while the positive coefficient signs of BKSZ and CAR^2 are as expected. The coefficient signs of LLP and LDR are also not consistent with the expectation. And finally, the largest contributor to the variation in bank performance (ROE) is attributable to CAR, with a coefficient of -0.44 and the smallest is BDSZ with a coefficient of 0.0107.

In addition to the regression run by taking return on equity (ROE) as a dependent variable, a regression was also run by taking return on asset (ROA) as a dependent variable (bank performance), and all independent and control variables that were used in the previous regression (in Model 1), as explanatory variables; in order to analyze the relationship between governance mechanisms and bank performance using different performance measures. Table 4.7 reports the regression results obtained by using ROA as a dependent variable and other independent and control variables (in Model 2). The adjusted R^2 for this regression is 0.45; indicating that the regressors in Model 1 can explain 45% of the variation in the independent variable (ROA). The F- statistic for the regression is also significant at zero P-value to five decimal places. Implying that, the null hypothesis that all the coefficients are jointly zero is rejected. This shows still a good explanatory power of the regressors in the model.

Table 4.7 Regression Result for Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.06624	0.036312	-1.82405	0.0737*
CAR	0.044593	0.019324	2.307658	0.0249**
BDSZ	-0.00111	0.000508	-2.185153	0.0332**
AUDC	-0.00512	0.001999	-2.559854	0.0133**
OWTP	0.005264	0.003561	1.478264	0.1451
LLP	-0.02403	0.030083	-0.798607	0.428
LDR	0.004289	0.006084	0.70495	0.4839
BKSZ	0.004365	0.001404	3.109833	0.003***
CAR2	-0.05742	0.01516	-3.787429	0.0004***
Weighted Statistics				
R-squared	0.522226			
Adjusted R-squared	0.451445			
S.E. of regression	0.009279			
F-statistic	7.378017	Durbin-Watson stat	1.307614	
Prob(F-statistic)	0.000001			

***, **, * indicate significant at 1%, 5%, 10% significance level respectively.

Source: Eviews Output from data of sample banks, 2005 – 2011.

The regression results in Table 4.7 reveal that all the significant variables in the previous regression (Table 4.6) are still significant. Capital adequacy ratio, board size, as well as existence of audit committee are statistically significant at 5%; and square of capital adequacy ratio and bank size are statistically significant at 1%; whereas loan loss provision, loan to deposit ratio, and ownership type are not yet statistically significant. However, the coefficient signs indicate that the relationship of of CAR, CAR² and LLP with ROA are now changed in to positive, negative and negative respectively. The remaining variables have still the same relationship with ROA as they had with ROE.

4.1.6 In-depth interview Results

The in-depth interview in this study was conducted with three directors from the Ethiopian commercial banks. Out of the three interviewees, the two are currently serving as board members in different commercial banks in Addis Ababa while the third one is a recently retired. All the interviewees have got an education level of at least a masters degree in a business related area and have the experience of working in different banks' board of directors. Hence, they were believed to have a good knowledge and experience in corporate governance. The interviews were conducted independently with each director. The interview questions were unstructured and focused on exploring the current status of major corporate governance mechanisms and how they might affect performance of banks in Ethiopia.

According to the interviewees, even though there are various challenges in corporate governance mechanisms in Ethiopian banks, absence of organized stock exchange market was argued to be the first one and its effects are said to be very broad. The directors believe that the effects of absence of organized stock exchange on corporate governance and bank performance is in three dimensions. The first one was attributed to lack of the signaling effect of the markets. In other words, the effect of maintaining good or bad corporate governance as well as performance in a given bank is not reflected in the share price of the banks. As a result of this, management and directors of banks may not strive to establish good governance and performance in their banks leading to lack of competition. The second effect of absence of stock exchange mentioned by the directors was lack of diversified financing source to banks. The only sources of finance to banks would be either borrowing from other banks or selling their shares to small number of shareholders (block holders) who would exert high control on decisions regarding the company to their own best interest at the expense of minority shareholders interests. The directors also claim that even the neighboring countries like Uganda and Kenya are doing very well in establishing good corporate governance because they have established more formal financial markets including stock exchange, hence, Ethiopia also needs to learn from them. In this regard, Minga (2008) argue that the absence of organized equity market is a serious void in corporate governance in Ethiopia, which resulted in high ownership concentration. The third point revealed by the directors in relation to absence

of stock exchange was that, when shareholders want to sale their shares, they face difficulty finding a buyer.

Another major issue raised by the respondents was high government intervention and engagement in businesses activities, which created unfair competition between state-owned and private banks. As an example, the directors mention the *NBE Directive No. MFA/NBEBILLS/001/2011*, in which only private banks are required to purchase government bonds that equal to 27% of loans. This creates unfair competition between state and private banks in favor of the state owned ones. Both Geda (2008) and Asnahech (2011) also agree with this claim by arguing that NBE enforces rules that discriminate between state and private banks. Besides, the interviewees stated that corruption is another major problem when it comes to establishing good corporate governance in Ethiopian commercial banks. For example, one of the respondents said “bank managers sometimes grant loans not based on creditworthiness of borrowers, rather based on bribe and other relationships with borrower”

Another issue mentioned by the interviewees was low voluntary implementation of the international corporate governance standards like the OECD principles, even though they are not required by law. They added that there is no appropriate national code of corporate governance adopted in the country except the commercial code which needs major improvements. However, they indicated that there are bank specific policies of corporate governance that are formulated by most of the banks individually. Furthermore, according to (Geda 2008) the Ministry of Justice is working together with other concerned bodies on the revision of the commercial code of Ethiopia, which has been in operation since 1960, in order to include new improvements related to corporate governance in the country.

On the other hand, according to the interviewees, corporate transparency and disclosure is weak in case of Ethiopia, in general, and in the commercial banks, in particular, which, resulted in poor or misleading information provided to shareholders, and government as well as any other interested information user. With regard to financial reporting for instance, companies submit inflated financial statements when they want to borrow

money from banks, leading to high non performing loan. Besides, most businesses do not keep proper books of accounts. On the other hand, the directors believe that absence of nationally implemented accounting and auditing standard has contributed negatively to corporate transparency and disclosure which led to poor accounting and reporting practices. Besides, according to the directors, the independent auditing service providers depend largely on the income from the client and are sometimes afraid of losing their clients should they issue qualified or adverse audit reports. However, there are efforts to overcome this weakness by implementing national accounting as well as auditing standards in the country. According to Geda (2008), Addis Ababa Chamber of Commerce and Sectoral Associations (AACCSA), in cooperation with the Office of the Federal Auditor General (OFAG) and the Ethiopian Professional Association of Accountants and Auditors (EPAAA), is undertaking important work to standardize the accounting and auditing practices in the country. In addition, NBE is working on the implementation of International Financial Reporting Standards (IFRS) for financial institutions including banks (Next Consult Plc 2011).

In relation to preventing minority share holder rights, the directors argued that the commercial code of Ethiopia does not sufficiently protect minority shareholder rights and there is also high concentration of ownership in most banks. Basically, this idea of the directors is also supported by Fekadu (2010). In the banking sector, however, Proclamation No. 592/2008 of FDRE (2008) has an important provision that prevents the concentration of ownership by not allowing a single investor including his family from purchasing more than 5% of the total shares of a bank. However, the directors believe that it would be very difficult to discover the existing relationship between two shareholders and sometimes different shareholders collide to control the bank, which enables the shareholders to exert high control and that may result in exploitation of minority shareholders.

According to the interviewed directors, the bank shareholders very often lack the awareness and active participation needed from them to establish good corporate governance. The shareholders tend to focus more on short term profits. The interviewees have also disclosed that many times the members of board of directors lack the necessary

knowledge and experience required to supervise and guide the executive management and even members of the sub-committees of the board lack sufficient expertise needed for the committee which they belong to. Furthermore, Addis Fortune Newspaper (January 30, 2011), quoting a bank director, stated that the selection of directors in private banks is for two reasons. The first one is because being a director is highly lucrative job that pays between 100,000 and 1 million birr annually without having to do a lot. The second is that large shareholders place their own person on the board to ensure they have agents to guarantee them a constant flow of millions of Birr in loans and advances. Similarly, in state-owned banks the selection of directors will not be based on their merit (Geda 2008).

4.2 Discussion of Results

The regression results of model 1 and model 2 presented in table 4.6 and table 4.7 respectively were performed to see the effect of corporate governance mechanisms on bank performance using ROE and ROA respectively as a measure of bank performance. These results are discussed in this section in light of theory, previous empirical studies and the in depth-interview results.

Table 4.6 depicts that there is inverse relationship between CAR as a measure of external corporate governance and ROE as a measure of bank performance. The coefficient parameter of CAR (-0.44) is statistically significant at 5% level of significance. Keeping other variables unchanged, a 1% increase in CAR will result in a decrease in ROE by 0.44%. In other words, the profitability of the bank based on ROE decreases when the capital adequacy ratio of the bank increases. This result, even though not as expected, it is supported by the finding of Tandelilin et al. (2007). Furthermore, Tandelilin et al. (2007) argue, that the effect of CAR on ROE may not be linear due to central bank regulation. The central bank requires banks to maintain CAR level of at least 8% to protect the depositors' interest. So, the negative effect of CAR on ROE will turn in to positive when CAR exceeds the particular CAR number of which depositors perceive and believe that bank will be concerned about implementing good corporate governance; then they will be interested to deposit their money as well as buy the shares of the bank, leading to profitability of the bank. Due to the fact that, the effect of CAR on ROE may not be linear, CAR^2 is included in the regression of model 1. The relationship between CAR^2

and ROE is positive; suggesting, the existence of non linear relationship between CAR and ROE. The coefficient parameter of CAR^2 for ROE is 0.30 which is statistically significant at 5% significance level. Accordingly, an increase in CAR^2 leads to higher ROE.

Model 1 was also used to see the relationship between board size (BDSZ) and bank performance (ROE). The results of the regression in table 4.6 reveal that board size and bank performance have inverse relationship. The coefficient parameter of BDSZ (-0.0107), is significant at 5% significance level. Suggesting; that if one board member is added to board of directors of a bank then the bank's ROE will decrease by 1.07%. Banks with larger boards tend to perform poorly compared to banks with smaller boards. This result is consistent with findings of Samuel and Ranti (2012), and Sunday (2008), who found statistically significant negative relationship between board size and bank performance, though it contradicts the evidence of Kiel and Nicholson (2003), Adams and Mehran (2011), and Yung (2009) that they found statistically significant positive relationship between board size and bank performance. The negative effect of board size on bank performance will be due to the fact that boards with too many directors could be unproductive, with ineffective communication among directors in the board (Dallas 2004). This leads to director free riding problem i.e. directors consume more resources than they contribute to the bank, and thereby reducing bank performance. The interview results are also consistent with this argument because most of the time bank directors are not selected based on their competence in the banks and their compensation is too much.

The effect of existence of audit committee (AUDC) on bank performance (ROE) is also negative and statistically significant at 5% with parameter coefficient of -0.044, indicating that banks having a designated audit committee in the board perform less compared to the banks which do not have a designated audit committee. This result is not as expected, because the existence of independent audit committee increases the effectiveness of board of directors in the governance of the firm (Bean, 1999, cited in Waweru, Kamau & Uliana 2008). Nevertheless, the negative effect of audit committee on bank performance could be attributed to the audit committee members' lack of the necessary expertise to help the board in the governance of the bank, leading to mere

increase in board size and board of directors' fee. Based on the empirical evidence of Chan and Li (2008), the existence of majority expert-independent directors in the audit committee resulted in better firm performance, only if, the majority of directors in the board were expert as well as independent; otherwise, the mere presence of independent audit committee showed no impact on firm performance. The interview results also support the regression result in that the members of board sub committees do not have the expertise needed for the committee they belong to. In addition, the main benefit of having audit committee in a board is to enhance the quality of corporate financial disclosure and thereby improve corporate governance. However, this benefit may not result in improvement of bank performance due to the absence of stock exchange to reflect this quality in the share price.

The relationship between bank size (BKSZ) and bank performance (ROE) is as it might be expected. The size of the bank as measured by the natural logarithm of total assets has statistically significant positive effects on the performance of the bank at 1% significance level. The coefficient parameter of BKSZ (0.064) tells us that, keeping others unchanged, if the asset size of the bank increases by 1%, its ROE will also increase by 0.064%. Therefore, large banks enjoy better profits than smaller banks. This benefit is likely to be due to economies of scale and larger market share possessed by the larger banks. It is also well supported by the results of Bino and Tomar (2008) who found statistically significant positive relationship between bank size and bank performance.

The regression result of model 2 provided in table 4.7 was conducted by taking return on asset (ROA) as a measure of bank performance and other governance and control variables to see whether the results were consistent with the regression results of model 1. It is evident from Table 4.7 that there is positive relationship between CAR and ROA; and the coefficient parameter of CAR (0.044) is still statistically significant at 5%. When the CAR of a bank increases its ROA also increases. In other words, when external corporate governance of the bank improves the performance of the bank will improve too. This relationship is consistent with the expectation and is also supported by the finding of both Kim and Rasiah (2010) as well as Fukuda, Kasuya and Nakajima (2005). Consequently, the hypothesis that there is positive relationship between external

corporate governance as measured by CAR and bank performance (H3) is supported by the regression result of model 2. Unlike CAR, CAR² now has inverse relationship with ROA and its coefficient parameter (-0.057) is statistically significant at 5%. However, this pattern is irrelevant with the non linear argument.

Consistent to the results obtained from regression Model 1, the relationship between board size and bank performance is negative and statistically significant at 5% based on regression result of Model 2. However, the coefficient of BDSZ was changed from -0.0107 (in Model 1) to -0.0011 (in Model 2) signifying that the contribution of board size to the decline in bank performance is reduced. Thus, the hypothesis that, there is positive relationship between board size and bank performance (H1) is not supported by these evidences. Similarly, the relationship between existence of audit committee in the board (AUDC) and bank performance (ROA) is negative and statistically significant at 5%, which indicates that the hypothesis that was stated as there is positive relationship between existence of audit committee in the board and bank performance (H2) is not supported based on the two regression results. The effect of bank size (BKSZ) on bank performance (ROA) is positive, which agrees with the regression result of model 1. The coefficient parameter of BKSZ (0.0044) is still statistically significant at 1% significance level. This implies that larger asset size leads to better bank profitability.

The parameter coefficients of ownership type (OWTP), loan loss provision (LLP) and loan to deposit ratio (LDR) are 0.0199, 0.1663 and 0.093 with ROE (in Model 1), and 0.0052, -0.024, and 0.0042 with ROA (in Model 2), respectively indicate that all of these three variables (OWTP, LLP and LDR) have positive relationship with bank performance except for the relationship between LLP and ROA. However, all of these parameter coefficients are not statistically significant at 10% significance level. The summary of the expected and actual relationships found between the independent and dependent variables are presented in Table 4.

Table 4.8: Summary of the expected and actual relationships

Independent variable	Dependent variable	Expected Relationship	Actual Relationship	Significance (at 5%)
CAR	ROE	Positive	Negative	Significant
	ROA	Positive	Positive	Significant
CAR ²	ROE	Positive	Positive	Significant
	ROA	Positive	Negative	Significant
BDSZ	ROE/ROA	Positive	Negative	Significant
AUDC	ROE/ROA	Positive	Negative	Significant
LLP	ROE	Negative	Positive	Not Significant
	ROA	Negative	Negative	Not Significant
LDR	ROE/ROA	Negative	Positive	Not Significant
BKSZ	ROE/ROA	Positive	Positive	Significant

Source: Summary of regression results.

The size of loan loss provision as a measure of management's risk taking behavior does not have any significant effect on bank profitability. This situation may be due to the fact that the size of loss due to risk of uncollectible loans is equally compensated by the income from loans made. This result does not support the hypothesis, that there is negative relationship between loan loss provision, and bank performance (H4). Similarly, the magnitude of loan to deposit ratio does not significantly affect bank performance; suggesting that the source of funds (depositors or shareholders) for making loan does not matter to a bank's performance. This result also does not support the hypothesis, that there is negative relationship between loan to deposit ratio, and bank performance (H6). Furthermore, the type of ownership of the bank (state-owned or private) does not affect the bank's profitability significantly. This result is also supported by Semu (2010) who found insignificant difference between performance of state-owned and private banks in Ethiopia in terms of ROE and ROA. The fact that the data did not support the general idea that privately owned firms in general perform well as compared to state-owned ones. This might be due to the fact that leadership, management and operation systems of the Ethiopian private banks are replications of the state-owned ones. Especially, almost all people holding higher, middle and lower managerial positions in private banks came from the state-owned banks which replicate the bureaucracy and management systems they had in the state-banks. There is no difference between the private and state banks in terms of the type and quality of service both provide.

Chapter Five

5. Conclusion and Recommendation

In the previous chapter, the results of the study were presented and discussed. This chapter deals with the conclusions and recommendations of the study based on the findings. Hence, section 5.1 presents the conclusions and section 5.2 presents the recommendations.

5.1 Conclusions

The main objective of this study was to assess the corporate governance mechanisms and their impact on the performance of commercial banks in Ethiopia. Mixed method research approach, particularly structured review of bank documents and in-depth interviews were used to achieve the stated objective. All commercial banks having operating history of 7 years were included in the sample for structured review of documents resulting in 63 observations. The data collected provided information on selected internal and external corporate governance mechanisms, and bank performance. The data was analyzed using descriptive statistics and multiple regressions. Two regression models were used: Model 1 used ROE as a measure of bank performance and Model 2 used ROA as a measure of bank performance. In addition, in-depth interview was conducted with three board directors of the commercial banks.

The result of the two regression models revealed consistent evidences. CAR as a proxy of external corporate governance has positive relationship with bank performance indicating that better corporate governance leads to better bank performance. The effect of CAR on ROE is non-linear due to government regulation. Hence, the negative effect of CAR on ROE is expected to turn in to positive when CAR increases to a certain level where the financial health of the bank becomes strong. On the other hand, the size of board of directors affects the profitability of the bank negatively. This means that the less the number of directors in the board, the better the profitability of the bank will be based on ROE and ROA. Similarly, the existence of audit committee in the board has adverse impact on the profitability of the bank while the size of the bank is an important factor contributing positively to its profitability. Bank profitability is not affected by the proportion of loan loss provision. This appears to mean managers who take more risk of loss due to uncollectible loans are equally compensated by the income from loans made.

Similarly, the level of a bank's reliance on the depositors' fund to make loan (i.e. loan to deposit ratio) has no impact on the banks profitability. And finally, whether a bank is owned by the state or the private investors its profitability will be basically the same.

The major challenges related to current status of corporate governance mechanisms that have adversely influenced bank performance in Ethiopia are identified to be (1) absence of organized stock exchange market, (2) high government intervention and involvement in business activities leading to unfair competition in business, (3) lack of corporate governance awareness, (4) lack of competence of board members, (5) absence of nationally implemented standards for corporate governance, (6) absence of nationally implemented accounting as well as auditing standards, (7) weak legal framework to protect minority shareholder rights.

5.2 Recommendation

Based on the evidence obtained from this research the following recommendations are forwarded:

- Empirical findings reveal that as a means to strengthen the performance of commercial banks in Ethiopia, the government or National Bank of Ethiopia should be concerned about the level of both internal and external corporate governance mechanisms of commercial banks.
- The findings also suggest that shareholders should actively take part in establishing good corporate governance in the banks they own in order to earn better and sustainable profits.
- The National Bank of Ethiopia should encourage banks to implement good corporate governance practices through enacting rules and regulations.
- Keeping the number of director in a bank board to a minimum size is recommended, so long as that minimum size enables the board to perform its supervision activities properly.
- Commercial banks should increase their branches as well as their size in order to improve bank profitability due to economies of scale.

- The government, and financial institutions as well as the business community should work towards the establishment of a formal capital market institutions especially stock exchange which enhances corporate governance, and competition among businesses in the country.
- Creation of public awareness regarding corporate governance is crucial. In addition, providing corporate governance education at higher level academic and training institutions is necessary.
- National code of corporate governance should be formulated. In addition, national accounting and auditing standard should be developed or the international standards be adopted.
- Finally, future research should focus on assessing corporate governance mechanisms and firm performance: (1) from the perspective of different stakeholders such as employees, management, shareholders and depositors of commercial banks, and (2) using different sectors of the economy such as manufacturing companies, non-bank financial institutions, and other service industries.

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Appendix - 1

Information submission form

My name is Kelifa Srmolo and I am currently conducting a master's thesis for the partial fulfillment of the master's degree in Accounting and Finance at Addis Ababa University Faculty of Business and Economics.

The purpose of the study is *to assess corporate governance mechanisms and their impact on the performance of Commercial Banks in Ethiopia*. To achieve this objective, the study intends to gather corporate governance and performance information from all commercial banks that have been in operation from the year 1997 up to 2003 E.C. the data obtained from the banks will be confidential. I am grateful for your cooperation in providing the following information for the study regarding the bank:

- Annual report from the year 1997-2003
- Please answer the following specific questions:

1. What was the number of board of directors at the end of the following years?

- 1997 E.C.: _____
- 1998 E.C.: _____
- 1999 E.C.: _____
- 2000 E.C.: _____
- 2001 E.C.: _____
- 2002 E.C.: _____
- 2003 E.C.: _____

2. Was there Audit in the board of directors at the end of the following years?

	Yes	No
◆ 1997 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 1998 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 1999 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 2000 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 2001 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 2002 E. C.	<input type="checkbox"/>	<input type="checkbox"/>
◆ 2003 E. C.	<input type="checkbox"/>	<input type="checkbox"/>

Appendix-2

Data from review Bank Documents

Commercial Bank of Ethiopia (CBE)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	10	9.01	36.12	21.17	37.67	State	39.11	1.87	33169.00
2006	10	10.09	33.87	17.67	32.86	State	54.65	2.32	35849.00
2007	10	23.29	57.48	14.23	29.69	State	30.18	2.18	43456.00
2008	10	13.88	32.43	6.13	46.07	State	31.00	2.90	50416.11
2009	10	11.43	27.22	3.11	48.07	State	40.01	3.50	59411.45
2010	10	9.38	24.98	1.85	43.95	State	37.15	2.95	74186.91
2011	10	8.30	19.85	2.45	42.58	State	48.46	3.04	114265.00

Construction and Business Bank (CBB)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	5	8.27	25.20	12.84	81.16	State	18.38	1.23	1832.00
2006	5	11.86	24.60	11.28	121.17	State	46.67	3.92	1797.00
2007	5	15.20	30.02	14.07	116.99	State	35.22	3.01	1889.00
2008	6	17.26	31.78	13.11	93.13	State	40.46	4.02	2392.02
2009	6	16.04	28.68	11.57	85.77	State	30.57	3.28	2592.15
2010	6	16.31	29.22	10.91	74.28	State	31.64	3.30	3161.66
2011	6	17.07	28.86	12.19	61.66	State	25.13	0.03	3504.87

Dashen Bank (DB)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	7	9.71	14.11	3.23	76.24	Private	34.22	2.33	3420.00
2006	7	11.01	14.85	2.65	83.42	Private	42.29	3.34	4546.00
2007	7	12.09	16.14	2.48	80.00	Private	40.19	3.53	6041.00
2008	7	14.36	18.99	2.32	69.58	Private	37.50	3.45	7828.59
2009	7	17.45	22.71	2.30	54.88	Private	30.49	2.85	9732.58
2010	7	14.77	24.43	2.18	48.68	Private	31.89	2.93	12353.38
2011	6	15.63	24.45	1.99	51.46	Private	35.77	3.34	14659.79

Awash International Bank (AIB)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	12	16.13	23.88	6.20	66.49	Private	19.84	1.90	2226.00
2006	12	14.48	21.15	4.91	72.93	Private	29.32	3.01	2954.00
2007	12	15.55	21.60	4.34	80.72	Private	38.78	4.22	3830.00
2008	12	19.37	26.45	4.64	70.75	Private	27.71	3.30	4820.22
2009	12	21.91	33.14	5.50	54.67	Private	21.23	2.54	6422.55
2010	11	22.75	34.61	4.71	51.52	Private	29.29	3.45	7944.78
2011	11	25.96	36.45	3.64	51.48	Private	32.08	3.99	10115.99

Bank of Abyssinia (BOA)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	9	18.96	25.53	4.94	75.85	Private	27.29	3.35	2057.00
2006	9	19.19	23.59	3.11	90.17	Private	25.91	3.48	2834.00
2007	9	16.61	22.17	4.69	84.71	Private	16.65	2.15	3396.00
2008	9	14.54	23.79	8.89	81.00	Private	3.54	0.38	4269.94
2009	9	18.16	28.99	9.83	60.28	Private	21.40	2.06	5476.62
2010	9	16.94	25.97	7.41	61.36	Private	25.45	2.39	6279.54
2011	9	17.01	23.26	3.33	54.58	Private	29.04	2.67	7277.56

Wogagen Bank (WA)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	7	16.56	23.05	5.09	77.80	Private	31.07	3.48	1616.00
2006	7	15.31	20.84	4.83	89.60	Private	32.64	3.66	2259.00
2007	7	17.33	23.11	4.41	79.13	Private	34.04	3.90	3480.00
2008	9	24.52	31.72	5.92	79.11	Private	27.54	3.65	4124.89
2009	9	35.69	45.69	6.09	56.66	Private	25.06	3.91	5118.31
2010	9	34.92	46.48	3.97	63.06	Private	23.66	4.11	5741.93
2011	9	38.11	50.50	4.54	48.85	Private	27.06	4.68	8060.93

United Bank (UB)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	9	19.23	24.96	3.88	68.55	Private	28.05	3.55	1073.00
2006	9	18.12	21.91	2.89	82.30	Private	27.85	3.29	1599.00
2007	9	23.61	28.55	3.01	91.50	Private	23.23	3.38	2182.50
2008	9	23.47	27.83	2.68	76.11	Private	22.00	3.35	3249.96
2009	9	22.17	27.25	3.09	59.52	Private	18.95	2.37	4651.70
2010	9	22.26	28.04	3.65	55.32	Private	30.14	3.31	5896.23
2011	9	23.56	30.28	2.77	54.02	Private	30.13	3.40	7725.44

Cooperative Bank of Oromiya (CBO)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	11	125.00	98.00	0.00	20.00	Private	-1.96	-1.71	129.00
2006	11	89.31	96.85	0.79	129.59	Private	-3.58	-2.37	224.00
2007	11	50.82	55.65	1.26	86.28	Private	1.90	0.74	424.00
2008	11	41.38	47.25	1.23	65.79	Private	8.45	2.13	678.20
2009	11	23.45	27.59	1.36	75.57	Private	1.55	0.28	1022.88
2010	11	19.86	28.72	2.53	52.61	Private	14.53	1.80	1768.32
2011	11	21.27	32.66	2.00	40.49	Private	21.74	2.21	2500.35

Nib International Bank (NIB)									
Year	BDSZ (No.)	CAR (%)	CR (%)	LLP (%)	LTD (%)	OWTP (%)	ROE (%)	ROA (%)	BKSZ (Ml. Birr)
2005	12	17.05	23.92	4.15	92.64	Private	23.17	3.09	1732.00
2006	12	17.40	23.19	3.86	101.58	Private	22.79	3.09	2027.00
2007	11	21.63	26.80	3.41	96.70	Private	21.41	3.28	2607.00
2008	12	25.22	32.08	3.79	85.58	Private	22.10	3.61	3650.11
2009	12	28.55	37.43	4.60	67.36	Private	23.16	3.63	4806.50
2010	12	29.51	39.90	3.90	61.69	Private	24.42	3.73	5970.51
2011	12	35.72	46.44	4.12	53.64	Private	23.61	3.77	7111.80