



Addis Ababa University
College of Business and Economics

ASSESSMENT ON CORPORATE GOVERNANCE PRACTICE:
THE COMMERCIAL BANK OF ETHIOPIA

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**ASSESSMENT ON CORPORATE GOVERNANCE PRACTICE:
THE COMMERCIAL BANK OF ETHIOPIA**



**A THESIS SUBMITTED TO ADDIS ABABA UNIVERSITY COLLEGE OF BUSINESS
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Declaration

I, the undersigned, declare that this study entitled “Assessment on Corporate Governance Practice: The Commercial Bank of Ethiopia” is my original work and has not been presented for a degree in any other university, and that all sources of materials used for the study have been duly acknowledged.

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CERTIFICATE

This is to certify that this study, “Assessment on Corporate Governance Practice: The Commercial Bank of Ethiopia”, undertaken by Abel Atlabachew Tadesse for the partial fulfillment of the Requirements for the Degree of Master of Arts in Public Management and Policy at Addis Ababa University, College of Business and Economics, is an original work and not submitted earlier for any degree either at this University or any other University.

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Addis Ababa University College of Business and Economics
Department of Public Administration and Developmental Management

Assessment on Corporate Governance Practice:

The Commercial Bank of Ethiopia

Addis Ababa

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List of Abbreviations

BoD- Board of Directors

CBE- Commercial Bank of Ethiopia

CEO- Chief Executive Officer

CRO- Chief Risk Officer

NBE- National Bank of Ethiopia

OECD- Organization for Economic Cooperation and Development

SEC- Security Exchange Commission

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Abstracts

This study was conducted to evaluate the corporate governance practices of the commercial bank of Ethiopia with the requirements set by the government, the supervisory authority (NBE) and recommendations forwarded by internationally accepted organizations (OECD, the Basel committee, and other major multinational organizations). The practice of corporate governance was the critical focus of the study. Major components like the Role of the Owner/PFEA/ to Sound Corporate Governance, Responsibilities of the BoD of the Bank, The Board's size, nomination, composition and Qualification, Stakeholders, Disclosure and Transparency, Internal Control, Risk and Compliance and The Role of Senior Management of the Bank were taken as major determinant variables. A descriptive research approach was employed to achieve the goal of this research. The total population and target population were all managers of the bank and managers working in Addis Ababa. A sample of responding staff was drawn of 388 managers, 260 were working at branches and districts in Addis Ababa, whilst the remaining 128 were assigned in different organs of the Head Office, were involved in the study. In order to get relevant data from the target population questionnaire and interviews were used. A questionnaire prepared addressing those variables were distributed and related documents were also reviewed. The data gathered through questionnaires was analyzed and presented using SPSS software. The interview and secondary data that were compiled and duly analyzed against the data obtained through the questionnaire. A descriptive research approach was employed to achieve the goal of this research. Based on the outcome, conclusion and recommendations were forwarded. In this respect, generally the finding result portrayed that the culture of corporate governance in the CBE is good but still has a setback and needs improvements. Based on the major findings, the study reached a certain conclusion and presented some possible recommendations so as to alleviate the problems.

Keywords: *Corporate Governance, PFEA, The Board's size, nomination, composition and Qualification, Stakeholders, Disclosure and Transparency, Internal Control, Risk and Compliance and Senior Management of the Bank.*

CHAPTER ONE

INTRODUCTION

1.1 Background

Corporate Governance /CG/ has been an issue since the establishment of corporate form of business firms which created the possibility of conflict between investors and managers. The history of CG correspondingly extends back at least to the formation of companies launched in the 16th and 17th centuries. Modern form of “CG”, however, first came into vogue in the 1970s in the United States and within 25 years it became the subject of concern worldwide by academics, regulators, executives and investors (European Corporate Governance Institute, 2012).

The recent global financial and economic crisis also point to the importance of CG, the mechanisms that stakeholders use to ensure that their investments are properly used and that any sum owed them for the use of their resources are faithfully calculated and promptly paid in full. CG, thus, seeks the reduction of the principal-agent problem within major business firms (Robert W., 2004).

Most literatures define CG as a process and structure used to direct and manage the business and affairs of an institution/organization with the objective of ensuring its safety and soundness and enhancing shareholders value. The CG framework should promote transparent and efficient practices, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities (OECD, 2004).

Two major issues of CG are ownership issue and management issue. The ownership issue refers to protecting the minority of owners from the abuse of power of those owners who are in control; and the management issue refers to protecting shareholders and stakeholders from abuse of power by BoD and/or top management members who may have conflicting interests.

According to Assefa, Alemseged, former vice governor of the National Bank of Ethiopia/NBE/, CG covers the activities of the BoD and its relationships with the shareholders and with those managing the enterprise; as well as with the external auditors, regulators and other legitimate

stakeholders. CG is thought to focus on the internal structure and roles of the BoD: the creation of independent audit committees, rules for disclosure of information to shareholders and creditors and control of the management. CG is basically defined as “the system by which companies are directed and controlled”. It is commonly defined as the method of governing a company like a sovereign state in stating its own customs, policies and laws (Assefa. A., 2014).

Since 1990s, OECD, the Basel committee, and other major multinational organizations have issued successive recommendations, principles and several materials on the subject of CG in order to improve the performance of private and public companies or institutions. Financial Stability Board (FSB) has also designated the CG Principles as one of the 12 key standards for sound financial systems.

The CBE is a public enterprise owned by the Federal Government of Ethiopia. It was established by the Council of Ministers Regulation No. 202/1994. As a public enterprise, CBE is governed by the Public Enterprises Proclamation No.25/1992 without prejudice to the applicability of Banking Business Proclamation No.592/2008. The provisions enshrined under Commercial Code of Ethiopia is not applicable on Government owned banks on the governance issues related to the separation of supervision and management responsibilities and on the composition, independence and remuneration of BoD.

The supervisory bank of Ethiopia (NBE) has issued different regulations and directives as deemed necessary to regulate/direct banks in the country based on article 14 (4b & c) and 59 (2) of Banking Business Proclamation No 592/2008. Specifically, the supervisory bank has issued “Bank CG Directives No.SBB/62/2015” to ensure whether banks and other financial institutions in the country are soundly and prudently managed and directed.

The Directives include the general principles, size and composition of BoD, approval and term of office, qualifications/trainings, meetings and responsibilities and authorities of the BoD. Moreover, the Directive has listed the responsibilities of CEO and state the requirements on disclosure issues. The directive also includes minimum criteria of key performance indicators to monitor the performance of senior management, minimum requirements of code of conduct to be established, minimum set-up of BoD sub-committees and their respective terms of reference and minimum required policies, procedure manuals and guidelines to be developed, including CG.

Therefore, the study examined the CG practice of the CBE with the requirement set by the government, the supervisory authority (NBE) and recommendations forwarded by internationally accepted organizations (OECD, the Basel committee, and other major multinational organizations)

1.2 Statement of the problem

The issue of CG has attracted increased attention since the late twentieth century due to many corporate collapses and financial crises in the last decade. This has resulted in a growth in attention to CG in both developed and developing countries. These collapses have highlighted the call for the management and directors of companies to be more accountable, and they have led governments and international organizations such as the OECD to be more active in establishing principles of CG. The system of CG has increased in different countries in relation to the nature of the economy, legal systems and cultural norms (Otman, 2014).

The process and structure in organizations like banks define the division of power and establish a mechanism for achieving accountability between BoD, management and shareholders; while protecting the interests of other stakeholders (i.e. depositors, creditors, employees, customers and larger community).Governance of banks has gained a prominent position in the light of the importance of financial services offered by banks, and being significantly exposed to probable risks and difficulties. Banks occupy a special position of trust in the national economy and their CG is therefore, a matter of paramount importance. They are highly leveraged, with most of their funds coming from depositors and creditors. They provide basic financial services to the public, financing to commercial enterprises and access to the payment system. With the advent of globalization, innovations in financial products, channels of delivery, technological advances, growing competitiveness and complexity of financial operations; the risks to which banks are exposed have significantly increased, simultaneously heightening the need for well-established CG system.

Moreover, banks operate within an ever-changing framework of laws and are subject to national laws and the direct control of central banks/the regulatory body. The BoD of banks must, therefore, ensure that laws and regulations are adhered to, while simultaneously ensuring that strategies for long-term success are set and implemented. It is, therefore, necessary to achieve a balance and alignment among external and internal controls, risk management and competitive behavior, and

at the same time operate within the principles of good CG. In this regard, good CG plays a crucial role in achieving and preserving public trust and confidence, which is essential for the proper functioning of the financial sector and the economy as a whole. The primary responsibility for CG rests with BoD and senior management of banks. In addition, banking regulators/supervisors have also important role in developing guidance and assessing bank CG practices.

In the past, commercial banks in Ethiopia have been involved in unethical practice, which puts the credibility of their corporate image doubt. As such the CBE (BBC NEWS, Jan9, 2002) just like other commercial banks has been constrained with issues arising from internal and external customers' complaint on CG practice. The poor governance of most banks indebted accounts in Ethiopian economy. The resource allocation and CG practice was not clear. A typical example is the foreign currency allocation made by Cooperative Bank of Oromia (CBO). The National Bank of Ethiopia (NBE) have suspended in mass senior executives of the (CBO), pending a probe on the bank's foreign exchange operations (Addis Fortune News Paper, Sep23, 2015).

Prior studies conducted in the area of CG in Ethiopia are very few. According to Kelifa (2012), absence of organized stock exchange market, high government intervention and involvement in business activities, lack of CG awareness, lack of competence of BoD members, absence of nationally implemented standards for CG, absence of nationally implemented accounting as well as auditing standard & weak legal framework to protect minority shareholder rights, hampers the current practice of CG mechanisms in Ethiopia. Consistent with this, USAID (2007) recommended establishing a program on CG which would provide training and education on CG and protection of investors in Ethiopia.

As a result, it is critical to assess the CG practice of the CBE and lessons can be drawn from the study on the level of effectiveness of the bank in terms of applying good CG practices and the discrepancies from the directives set by the NBE, laws put on proclamations and principles set by international organizations can be drawn out to address the gap observed in the practice.

Hence, this paper tried to assess the broad range of CG practice based on the directives, laws and principles put by the NBE, the government of Ethiopia and international organizations such as the Basel Committee and OECD. This will help the CBE to take lessons from the assessment to

strengthen its best practices and improve on the gaps identified and also point out areas which need further study.

1.3 Basic Research Questions

The central research question is: How well is the CG practice of the CBE doing with respect to the requirements and recommendations put by different national and international organizations?

The specific questions are:

1. What is the overall corporate governance system of the CBE?
2. What is the overall corporate governance practice of the CBE?

1.4 Objective (purpose) of the study

The intent of the study was to assess the CG practice of the CBE with the requirements set by the government, the supervisory authority (NBE) and recommendations forwarded by internationally accepted organizations (OECD, the Basel committee, and other major multinational organizations).

Specific objectives of the study were:

- To assess how sound is the practice of the owner/PFEA to good CG;
- To investigate if there is a level playing field or fair competition between the CBE and other private banks;
- To investigate the practice of the bank's BoD characteristics (nomination, size, composition, responsibilities and qualifications) with respect to the governing rules and guiding principles;
- To assess the risk management and internal control practice of the CBE;
- To assess the disclosure and transparency practice of the bank;
- To investigate the role of employees of the CBE for achieving sound CG practice; and
- To evaluate the results from the study and make recommendations to the management of the CBE on how to improve the extent of the application of the good CG.

1.5 Significance of the study

The study will be significant to the CBE for the fact that the findings of the study will contribute a lot for enhancing governance practice of same. The study will also add to the existing knowledge on the subject matter and will also be a reference material for further research on CG.

1.6 Definitions of terms or concepts

CG is a process and structure used to direct and manage the business and affairs of an institution/organization with the objective of ensuring its safety and soundness and enhancing shareholders value. It should promote transparent and efficient practices, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities (OECD Principles on CG, 2004).

1.7 Scope of the study

The study covered the assessment of the CG practice of the CBE.

The collection of secondary data were limited to, Public Enterprises Proclamation No. 25/1992, Banking Business Proclamation No. 592/2008, Financial Public Enterprises Agency Establishment—Regulation No. 98/2004, CBE Establishment—Regulation No. 202/1994 and CBE Establishment (Amendment)—Regulations No. 134/2007, Bank CG Directive No SBB/62/2015, Banking Supervision Directive SBB/54/2012, Commercial Code of Ethiopia, The Basle committee principles on CG-July 2015 and OECD principles and guidelines on CG.

The collection of primary data was limited to questionnaires and interview. The questionnaires were distributed to the line and middle level managers of the bank. The interview was made to the board secretary of the bank.

CHAPTER TWO

LITERATURE REVIEW

2.1. History of CG

CG has been an issue since the establishment of corporate form of business firms which created the possibility of conflict between investors and managers. The history of CG correspondingly extends back at least to the formation of companies launched in the 16th and 17th centuries (such as East India, the Hudson's Bay, the Levant and other major chartered companies). Modern form CG, however, first came into vogue in the 1970s in the United States; and within 25 years it became the subject of concern worldwide by academics, regulators, executives and investors (ECGI, 2012).

In the decades immediately following World War II, the U.S. experienced a prolonged economic boom and its leading corporations grew rapidly. Amidst the widespread corporate prosperity, the internal governance of companies was not a high priority and the phrase CG was not in use. With the "managed corporations" that were in the U.S. economic vanguard during this era "managers led companies while board of directors (BoDs) were expected to be collegial and supportive of management and shareholders followed. As for stockholders, the retail investors who dominated share registers were known for their indifference to everything about the companies they own except dividends and the approximate price of the stock (ECGI, 2012).

Concerned by those issues, the US Federal Securities and Exchange Commission (SEC) brought CG on to the official reform agenda in the mid-1970s. By 1976, the year the term CG first appeared in the official journal of the federal government, the SEC was beginning to treat managerial accountability issues as being part of its regulatory remit. The SEC brought measures against three outside directors of Penn Central Company, alleging that they had misrepresented the company's financial condition under federal securities law by failing to discover a wide range of misconduct perpetrated by Penn Central executives. Penn Central had gone bankrupt in 1970 with many criticizing its board for its passivity. Also, in 1976 the SEC prevailed upon the New York Stock Exchange to amend its listing requirements to require each listed company to maintain an audit

committee composed of independent directors and the New York Stock Exchange (NYSE) complied (ECGI, 2012).

The recent global economic and financial crisis also point to the importance of CG, the mechanisms that stakeholders use to ensure that their investments are properly used and that any sum owed them for the use of their resources are faithfully calculated and promptly paid in full. CG, thus, seeks the reduction of the principal-agent problem within major business firms (Robert E W., 2004).

2.2. Definition of CG

There has been increasing emphasis on CG, both in terms of practice and in academic research (Ali Shah, Butt & Hassan, 2009; Bebchuk, Cohen & Ferrell, 2009). This is due to the collapse of many companies worldwide, such as WorldCom, Enrol and Arthur Andersen (Dao, 2008). However, Ramon (2001), as cited in (Mulili&Wong, 2011), states that differences in culture, legal systems and historical developments from country to country make it difficult to identify one definition of CG. CG as a discipline in its own right is relatively new, with researchers in the disciplines of law, economics, accountancy and management all developing their own ideas about how it should be defined (Armstrong, 2005). The concept of CG can be viewed from at least two perspectives—the narrow view and the broad perspective (Olayiwola, 2010)—depending on the view of the policymakers, practitioners and theorists (Solomon, 2010).

The narrow standpoint aims to maximize and protect the shareholder, while from the broader viewpoint, the corporation is responsible for a wider constituency of stakeholders other than shareholders (Maher &Andersson, 2000).

From the narrow viewpoint, Shleifer and Vishny (1997) define CG in terms of the ways in which suppliers of finance to a firm assure themselves of a good return to their investment. This definition is shallow in that it emphasizes the suppliers of finance and does not recognize the relationships between a firm's stakeholders and managers. Similarly, the Cadbury Committee defines a governance system as 'the system by which companies are directed and controlled' (Cadbury, 1992). The Australian Standard (2003) defines CG as the process by which organizations are directed, controlled and held to account. Sheikh and Chatterjee (1995, p. 5) define CG as 'a system

whereby directors are entrusted with responsibilities and duties in relation to the direction of a company's affairs', while Sternberg (2004, p. 28) views it as 'ways of ensuring that corporate actions, agents and assets are directed at achieving the corporate objective established by the corporation's shareholders'.

Lin and Hwang (2010, p. 59) define the benefits of well-organized CG as follows: 'A good CG structure helps ensure that the management properly utilizes the enterprises resources in the best interest of absentee owners, and fairly reports the financial condition and operating performance of the enterprise'.

These definitions are consistent with the views of some researchers who argue that the main obligation of a company is towards maximizing the wealth of its shareholders (Friedman, 2008; Sternberg, 2004; Sundaram&Inkpen, 2004). The narrow perspective of these definitions is consistent with the conventional finance model that can be explained through the agency theory. The shareholder plays the role of principal and the manager is the agent. This view is similar to a recent definition of the Walker Review (2009, p. 23), which asserts that 'the role of CG is to protect and advance the interests of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this'.

The OECD (2004, p. 11) defines CG as:

'CG involves a set of relationships between a company's management, its board, its shareholders and other stakeholders'. The CG structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.'

In this case, the company is considered a social entity that has accountability and responsibility to a variety of stakeholders, encompassing shareholders, creditors, suppliers, customers, employees, management, government and the local community (Freeman & Reed, 1983; West, 2006; Mallin, 2007). Rezaee (2009) describes CG as an ongoing process of managing, controlling and assessing

business affairs to create shareholder value and protect the interests of other stakeholders. According to this definition, there are seven important functions of CG: oversight, managerial, compliance, internal audit, advisory, external audit and monitoring.

These definitions support other schools that argue that a firm has an obligation not only to its shareholders, but to all stakeholders, whose contributions are necessary for the success of the firm (Donaldson & Preston, 1995; Freeman, 1984). In these terms, Solomon (2010, p. 6) defines CG as ‘the system of checks and balance, both internal and external to companies, which ensure that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity’.

The aim of CG is to facilitate the efficient use of resources by reducing fraud and mismanagement with the view not only to maximize, but also to align the often conflicting interests of all stakeholders (Cadbury, 1999; King Report, 2002). Thus, this view considers a corporation to be an extension of its owners, with its central aim being to provide goods or services to customers, primarily to maximize the wealth of its owners (West, 2006).

According to Mallin (2010), the essential features of CG are that: it assists in ensuring that an adequate and appropriate system of controls operates within a company and that assets may therefore be safeguarded; it avoids any single individual having too much influence; and it tries to encourage both transparency and accountability in the relationship between company management, the board of directors and other stakeholders, which investors are increasingly looking for in both corporate management and performance.

Sheridan and Kendall (1992) emphasize that achieving good CG requires a system of structured operation and control that fulfils the following objectives:

- Achieve a long-term strategy of goals of the owner to maximize shareholder value or control market share;
- Secure the interests of employees at all times and ensure that they are guaranteed a positive working atmosphere, further training courses, health coverage and fair retirement packages;

- Maintain excellent long-term relations with customers and suppliers in terms of service, quality and financial settlement procedures;
- Comply with all relevant legal and regulatory requirements.

In addition, the primary concern of CG is how effectively different governance systems manage the relationship with the various stakeholders (Maher & Andersson, 2000). Allen (2005) finds that the stakeholder model of CG is more useful to developing countries, as pursuing their interest might help overcome the market failure in these economies. Iqbal and Mirakhor (2004) examine the conventional stakeholder theory of CG, which views a firm as a ‘nexus-of-contracts’ with different stakeholders, and they highlight that the firm’s objective should be to maximize the welfare of all stakeholders. The results suggest that research participants take a broad view of the CG concept, with recognition of a wide range of stakeholders evident (Wanyama, Burton & Helliar, 2013).

According to Assefa (2014) CG covers the activities of the BoD and its relationships with the shareholders and with those managing the enterprise; as well as with the external auditors, regulators and other legitimate stakeholders. CG is thought to focus on the internal structure and rules of the BoDs: the creation of independent audit committees, rules for disclosure of information to shareholders and creditors and control of the management. CG is basically defined as the system by which companies are directed and controlled. It is commonly defined as the method of governing a company like a sovereign state in stating its own customs, policies and laws.

2.3. CG in Developing Countries

CG is significant in enhancing market economies and civil societies in developing countries (McCarthy & Puffer, 2002). The review of empirical studies in different developing countries shows strong evidence that CG is still weak and that more efforts are needed to tackle these challenges. For instance, Black, De Carvalho and Gorga (2010) study the CG practices of Brazilian public companies to identify strong and weak areas related to their governance. They find that BoDs are weakness and that many firms have small boards with either no independent directors or one token independent director. Black, De Carvalho and Gorga (2010) also find that audit committees are uncommon and that financial disclosure lags behind world standards. Le Minh and Walke (2008) examine the CG of Vietnamese listed companies and find that they need to improve

their CG. They also find that the framework for CG in Vietnam is in its early period of development and requires reform. Caliskan and Icke (2010) analyze a general picture of CG non-financial service sector firms in Turkey. They report that there are still some challenges facing Turkish companies and that these companies should thus enhance their CG to enable them to be more competitive in Turkey as well as internationally.

From the review of the above literature, it can be noted that developing countries attempt to ensure market transparency, investor protection and effective management in order to ensure better development of the securities market. Therefore, developing countries have been paying increasing attention to the CG system and trying to investigate CG practice. In addition, as discussed above, there is a clear understanding that CG practice is still weak in developing countries.

2.4. CG Mechanisms (variables)

The importance of CG internationally has increased in the last decades since the financial crises, technological progress, and liberalization, opening up of financial markets, trade liberalization and mobilization of capital. CG is considered a mainstream concern in companies' boardrooms, among academics and legislators, and throughout businesses as an essential framework for firms (Claessens, Djankov & Lang, 2000). CG mechanisms are the procedures employed by companies to solve CG problems; however, the use of these mechanisms depends on the CG system (Weimer & Pape, 1999). Mechanisms for CG can be divided into two parts: internal and external mechanisms (Fan, Lau & Wu, 2002). External CG mechanisms refer to the components by which actors are external to the direct administration or management of firm, while internal governance mechanisms refer to the structural components that serve to mitigate the principal-agent problem (Kiel & Nicholson, 2003; Weir, Laing & McKnight, 2002).

The BoDs and the audit committee are considered internal governance mechanisms and thereby incorporate four variables: size of board; board composition, audit committee's independence and BoD leadership structure (Mehdi, 2007). These mechanisms are internal governance mechanisms because their usage is solely dependent on internal decision-makers (Agrawal & Knoeber, 1996). Consequently, the main objective of CG mechanisms, in particular BoDs, is to monitor management operations and processes (Gillan, 2006). Clearly, adopting better internal

mechanisms of CG, such as an enhanced BoD and audit committee, improves the monitoring of management and reduces information asymmetry problems (Aldamen et al., 2012).

Therefore, firms need internal mechanisms of CG to mitigate the probability of having agency problems. The agency theory is assumed to afford a foundation of CG through the use of internal CG mechanisms. In addition, the agency theory could arrange the relationship between BoD characteristics and firm performance (Kyereboah-Coleman & Biekpe; 2006). Previous studies have found that CG mechanisms affect firm performance (e.g., Thomsen, Pedersen & Kvist, 2006; Hu & Izumida, 2008; Kajola, 2008; Lupu & Nichitean, 2011).

2.4.1 Board size

The two most important functions of the BoDs are those of advising and monitoring (Raheja, 2005; Adams & Ferriera, 2007). Therefore, the BoD has been considered a vital CG mechanism for aligning the interests between managers and all stakeholders in a firm (Sanda, Garba & Mikailu, 2011). Zahra and Pearce (1989) classified two main roles of the board: it should control the operations of the firm and the activities of the CEO; and it should enhance the image of the firm and sustain a good relationship between the stakeholders and firm management to encourage the organization culture. This shows that these board functions could develop the performance of a firm. Small board size was favored to promote critical, genuine and intellectual deliberation and involvement among members, which presumably might lead to effective corporate decision-making, monitoring and improved performance (Lawal, 2012).

The Cadbury Committee (Cadbury, 1992) recommends an ideal board size of 8–10 members, with an equal number of executive and non-executive directors. Jensen (1993) argues that the optimum board size should be around 7–8 directors. Based on the Codes of CG in the UAE, the board of directors consists of 3–12 members. Brown and Caylor (2004) also suggest that a board size of between six and 15 members is ideal to enhance firm performance. Lipton and Lorsch (1992) argue that board size should be small and limited: a board size of 8–9 directors is optimal for coordination and communication, because if the board has more than 10 members, it is not easy for directors in the board to indicate their opinions and ideas. However, Dalton and Dalton (2005) argue that the advantage of larger boards is the spread of expert advice and opinions around the table compared

to a small board. Larger boards are expected to increase board diversity in relation to experience, skills, gender and nationality.

2.4.2. Board composition

The board of directors plays an important role in CG practices because it is responsible for planning and monitoring a company's objectives (Bhagat & Bolton, 2008; Haniffa & Cooke, 2002). Thus, an effective board director with an appropriate composition of directors is important in order to help the board accomplish its aim and ensure the success of the company (Al-Matari et al., 2012). The composition of the board has a direct effect on the company's activities (Klein, 1998). Generally, the composition of the board refers to the proportion of inside and outside directors serving on the board. Boards of directors include both executive and non-executive directors.

Executive directors refer to dependent directors, while non-executive directors refer to independent directors (Ali Shah, Butt & Hassan, 2009).

The Cadbury Report (1992) indicates that the presence of non-executives should be effective in enhancing board independence and firm performance. The Code of Best Practice recommended that the board of directors include non-executive directors of sufficient number and caliber in order to give non-executive directors an important influence on the board's decisions. In this regard, best practice recommendations on CG require boards to be composed of a majority of non-executive directors (Australian Stock Exchange CG Council, 2003). In the United Arab Emirates, the board of directors should consider an appropriate balance between executive and non-executive and independent board members, provided that at least one-third of members are independent members and that a majority of members are non-executive members (United Arab Emirates Code of CG, 2009).

Non-executive directors are outside directors who offer checks and balances to protect the interests of shareholders, and inside directors, who participate directly in the day-to-day management of the firm (O'Sullivan & Wong, 1998; Petrovic, 2008; Wan & Ong, 2005; Klien, 2002a). Fama and Jensen (1983b) argue that a higher proportion of independent non-executive directors increases board effectiveness in monitoring managerial opportunism and, consequently, increases voluntary disclosures. Similarly, vein, Forker (1992) argues that the inclusion of non-executive directors on

corporate boards enhances the quality of financial disclosure and reduces the benefits of withholding information. Hermalin and Weisbach (1998) and Pye (2001) identify the following major functions that non-executive directors should fulfil: preventing the undue exercise of power by executive directors, safeguarding shareholders' interests in board decision-making, contributing to strategic decision-making and ensuring competitive performance.

2.4.3. Board qualifications

Boards which are endowed with varied skills can assess the internal business conditions and scan the external environment properly in running the business fruitfully. The possessions of these qualities make them the best suited to driving it forward and achieving the company's goals. In light with this, (Carey, 2008) suggests that the board needs to prepare a description of the role, experience and skills required for a particular new appointment.

Boards are often criticized for failing to meet their governance responsibilities in firms since they lack detailed knowledge and also existence of information asymmetry among the executives and non-executives (Levrau, 2009). These considerations are especially true for bank boards' considering the complexity of the business, the high dynamism and volatility of the markets in recent years and the responsibility of banking boards in supervising and monitoring as a prerequisite for the sound and prudent management of financial intermediaries (OECD, 2005).

2.4.4. Board Committees

A BoD may establish certain specialized board committees. The committees should be created and mandated by the full BoD. The number and nature of committees depend on many factors, including the size of the bank and its board, the nature of the business areas of the bank, and its risk profile. (John, 1998) stress the role of committee structure as a means of increasing the independence of the board. Klein (1998) argues for the need to set up specialized committees on audit, risk, remuneration and appointment.

2.4.5. Audit Independence

The separation of corporate ownership and control results in agency conflict problems that require the effective functioning of audit committees as governance mechanisms to solve. The audit committee is seen as an effective sub-committee of a board of directors, which is important in

good CG (Abbott, Park & Parker, 2000; Jensen & Meckling, 1976). Garcia-Meca and Sanchez-Ballesta (2009) argue that an independent audit committee could enhance the quality and credibility of financial reporting. Cohen and Hanno (2000) emphasize the significance of audit committee independence to appraise management actions regarding risk assessment. In addition, independent directors do not have personal or economic interests in the company in their role of overseeing and monitoring the company's executive management as professional referees (Munro & Buckby, 2008). Thus, independent directors are viewed as being better prepared for maintaining the integrity of external financial statements (Bradbury, 1990).

An audit committee is considered a monitoring mechanism that establishes a proper communication relationship between the board of directors, the internal monitoring system and the internal and external auditors to improve the audit attestation function of external financial reporting and external auditor independence (Blue Ribbon Committee, 1999; Bradbury, 1990). Independent directors can support external auditors over executive management regarding external auditor–management conflict situations. The independent board may not be expected to reword their financial statements, where rewording is considered a failure to maintain the integrity of external financial statements (Abbott, Park & Parker, 2000; Beasley, 1996; Farber, 2005; DeZoort & Salterio, 2001).

2.4.6. Leadership structure

The separation of the role of the CEO and the chairman is essential in alleviating issues of CG practices in a firm (Brickley, Coles & Jarrell, 1997; Dalton et.al., 1998; Dedman & Lin, 2002). The business of a firm is managed under the direction and supervision of a board of directors that delegates to the CEO and other management staff for the day-to-day management of the affairs of the firm (Yasser, Entebang & Mansor, 2011). An important function of the board of directors is to monitor the performance of the top management (Varshney, Kaul & Vasal, 2012). This means that the combined leadership will have more managerial discretion because its leader is also the leader of the board of directors. Therefore, the board will have less incentive to monitor the activities of the corporate managerial team, which will increase information asymmetry between the agent and its principles (Zhang, Li & Zhang, 2011).

Based on the agency theory, the CEO and chairman should be separated because the chairman cannot accomplish these functions without conflicts of personal interests (Jensen, 1993). Cadbury (1992) believes that the role of chairman should, in principle, be separate from that of the chief executive; if the two roles are combined, it represents a considerable concentration of power within the decision-making process. This view is supported by many other reports (e.g., Greenbury, 1995; Higgs, 2003). Various CG guidelines recommend that the role of the CEO be separated from the role of the chairman of the board of directors (e.g., Australian Stock Exchange CG Council, 2007). In the UK, according to the Cadbury Committee (1992) and the Hampel Committee (1998), the main function of the board of directors is to reduce agency costs resulting from the separation of ownership and control (Fama & Jensen, 1983b).

2.4.7. The Role of Supervisory Authority

It is very clear today, more than ever, that regulators also have a key role to play in achieving good CG. As hypothesized by (La Porta et al., 2000) cited by (Keasey, 2005) the legal system is fundamentally important CG mechanisms. They in particular argue that the extent to which country's laws protect investor rights and the extent to which those laws are enforced are most basic determinants of the ways in which corporate finance and CG evolve in that country. Their empirical evidence indicates that there are significant differences across countries in the degree of investor protection, and that countries with low investor protection are generally characterized by a high concentration of equity ownership within firms and a lack of significant public equity markets.

For the banking organizations particularly all regulations are intended in one way or another, to enforce prudential requirements on key areas of affairs of institutions to mitigate identified risks. Regulations on ownership, related party transactions, and fitness and propriety tests for directors are directly based on modern CG principles. The primary responsibility to ensure sound CG practice rests on the individual firm itself. Hence, regulatory oversight is not a substitute, but rather a complement to CG (Adams and Mehran, 2008).

2.4.8. The Role of Stakeholders

The CG 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 (Basel committee for bank supervision, 2006).

The proposal that is fundamental to the stakeholder theory is that a firm's success is based on the efficient management of all of the relationships that a company has with its stakeholders (Elijido-Ten, 2009). This is supported by Christopher (2010), who argues that the stakeholder theory provides a foundation that enables management to be aware of the various needs of all stakeholder bases and to align those interests with the company's various objectives. Thus, the stakeholder theory is an important factor in CG (Abu-Tapanjeh, 2009) and invites firms to consider the interests of stakeholders in order to maximize firm wealth and the combined benefits offered by all stakeholders (Donaldson & Preston, 1995). This provides clear evidence that the influences and functional mechanisms of stakeholders can affect a firm's ability and performance (Clarkson, 1995).

According to John and Senbet (1998), who provide a comprehensive evaluation of CG and the stakeholder theory in particular, a company that protects the interests of all stakeholders could increase its value in the long term. Mallin (2010, p. 21) highlights that 'stakeholders theory is coming more into play as companies increasingly become aware that they cannot operate in isolation and that, as well as considering their shareholders, they need also to have regard to a wider stakeholder constituency'. The stakeholder perspective states that firms should consider the interests of any individuals or organizations with a stake in those firms (Shao, 2010). Good CG practices are considered an internal management monitor and an effective tool that will assist the firm to attain higher performance (Ghabayen, 2012).

2.4.9. Disclosure and Transparency

Transparency is essential for sound and effective CG. It is difficult for shareholders, depositors, other relevant stakeholders and market participants to effectively monitor and properly hold accountable the board and senior management when there is insufficient transparency. Transparency and disclosure of information are key attributes of good CG for banking organizations which they must cultivate with new enthusiasm so as to provide stakeholders with the necessary information to judge whether their interest are being taken care of (Anameje, 2007).

Information disclosure rules go some way to remedying the information asymmetry between the professional managers and large and increasingly defused body of shareholders. The legal responsibilities of the board of directors are managing the business in accordance with that benefits the shareholders and to comply with the financial reporting and other disclosure requirements stipulated by company law (Keasey, 2005).

2.4.10. Risk Management and Internal Control Functions

The quality of sound CG framework is judged by application of robust risk management system in a firm which includes independent risk management function with sufficient authority, resources and access to the board. Banks which have advanced in risk management have greater credit availability, rather than reduced risk in the banking system. The greater credit availability leads to the opportunity to increase the productive assets and bank's profit (Cebenoyan, 2004).

An internal control system available to a firm according to Grieves (1998) consists of: management oversight and the control culture; risk recognition and assessment; control of activities and segregation of duties; information and communication and monitoring activities and correcting deficiencies. According to Harvey and Brown (1998), the major components of internal controls are control environment, accounting system and control procedures. Smircich (1983) subscribes to the same sentiments by highlighting that the tone at the top has implications on the direction taken by employees. Furthermore, Jansen (1998) pointed out that historically internal controls, has focused conforming employees' actions to the desires of management.

2.5. Principles of CG

2.5.1 OECD Principles of CG

The OECD was established based on Article 1 of the Convention signed in Paris on 14 December 1960, and it came into force on 30 September 1961. In a 1999 meeting, OECD ministers established the principles of CG, which were enhanced by an Ad Hoc Task Force on CG (Maher & Andersson, 2000). These principles were adopted by the 30 member countries of the OECD as reference tools for countries worldwide (Jesover & Kirkpatrick, 2005).

The OECD seeks to promote governance reforms in close cooperation with other international organizations, especially under a joint program with the World Bank, and with the participation of the IMF to organize Regional CG Roundtables. These Roundtables include senior policymakers, regulators and market participants in order to enhance understanding of governance and support regional reform efforts (Chowdary, 2002).

In 2000, the OECD Principles of CG became one of the 12 core standards of global financial stability, and they are now used as a benchmark by international financial institutions (Cornford, 2004). The OECD Principles of CG were revised in 2004 to assist governments in their effort to evaluate and improve legal, institutional and regulatory frameworks for CG in their countries. Therefore, the Principles also provide guidance in developing good CG for those interested. Although cultural and institutional differences exist between countries, the underlying principles may allow a more fundamental compatibility (Jesover & Kirkpatrick, 2005).

In 2006, the OECD issued the methodology for assessing the implementation of the OECD Principles on CG. The vital purpose of an assessment is to identify the nature and extent of specific strengths and weaknesses in CG and thus highlight policy dialogue that will identify reform priorities leading to the enhancement of CG and economic performance, as the principles are concerned in part with company law, securities regulation and the enforcement/legal systems (OECD, 2006).

The OECD Principles have been designed to be adaptable to different circumstances, cultures and traditions in different countries (Chowdary, 2002). These principles cover five areas: the rights of shareholders and key ownership functions, the equitable treatment of shareholders, the role of stakeholders in CG, disclosure and transparency, and the responsibilities of the board. The OECD Principles became the basis of codes developed in many countries, as well as by industry bodies such as the International CG Network and International Federation of Accountants, the International Organization of Securities Commissions and the activities of the Asian Development Bank and the World Bank in Roundtables in Asia (Ioana, 2007).

The six OECD Principles are stated as follows:

- I. Ensuring the Basis for an Effective CG Framework:**-the CG 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.
- II. The Rights of Shareholders and Key Ownership Functions:**-the CG framework should protect and facilitate the exercise of shareholders' rights.
- III. The Equitable Treatment of Shareholders:**-the CG 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.
- IV. The Role of Stakeholders in CG:**-the CG 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.
- V. Disclosure and Transparency:**-the CG 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.
- VI. The Responsibilities of the Board:** -the CG 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 (OECD, 2004).

OECD also provides guidelines on CG of state owned enterprises in 2005. The major challenge for state owned enterprises is to find a balance between the state's responsibility for actively exercising its ownership functions, such as the nomination and election of the board, while at the same time refraining from imposing excessive political interference in the management of the company. Another important challenge is to ensure that there is a level-playing field in markets where private sector companies can compete with state-owned enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers. Building on practical experience, the OECD guidelines tries to provide suggestions on how such dilemmas can be solved. For example, they suggest that the state should exercise its ownership functions through a centralized ownership entity, or effectively coordinated entities, which should act independently

and in accordance with a publicly disclosed ownership policy. The OECD Guidelines also suggest the strict separation of the state's ownership and regulatory functions (OECD, 2005).

In 2015, they have been updated to reflect a decade of experience with their implementation and address new issues that have arisen concerning State-Owned Enterprises in the domestic and international context.

These Guidelines are viewed as a complement to the 2004 OECD Principles of CG on which they are based and with which they are fully compatible. They are explicitly oriented to issues that are specific to CG of State-Owned Enterprises and consequently take the perspective of the state as an owner, focusing on policies that would ensure good CG.

The CG guidelines provided by OECD are as follows:

1. RATIONALES FOR STATE OWNERSHIP

The state exercises the ownership of State-Owned Enterprises in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

2. THE STATE'S ROLE AS AN OWNER

The state should act as an informed and active owner, ensuring that the governance of State-Owned Enterprises is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

3. STATE-OWNED ENTERPRISES IN THE MARKETPLACE

Consistent with the rationale for state ownership, the legal and regulatory framework for State-Owned Enterprises should ensure a level playing field and fair competition in the marketplace when State-Owned Enterprises undertake economic activities.

4. EQUITABLE TREATMENT OF SHAREHOLDERS AND OTHER INVESTORS

Where State-Owned Enterprises are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

5. STAKEHOLDER RELATIONS AND RESPONSIBLE BUSINESS

The state ownership policy should fully recognize State-Owned Enterprises' responsibilities towards stakeholders and request that State-Owned Enterprises report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by State-Owned Enterprises.

6. DISCLOSURE AND TRANSPARENCY

State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

7. THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of State-Owned Enterprises should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions. (OECD, 2015).

2.5.2 BASEL Principles of CG

The Basel Committee on banking supervision has also published supervisory guidance on CG first in 1999 to assist banking supervisors in promoting the adoption of sound CG practices by banking organizations in their respective countries. The guidance drew from principles of CG that were published earlier that year by OECD with the purpose of assisting governments in their efforts to evaluate and improve their frameworks for CG and to provide guidance for financial market regulators and participants. Since the publication of these documents, issues related to CG have continued to attract considerable national and international attention in light of a number of high-profile breakdowns in CG.

In response to such developments, the Basel Committee published revised CG principles in 2006. Subsequent to the publication of the Committee's 2006 guidance, there have also been a number of CG failures and lapses, many of which came to light during the financial crisis that began in mid-2007. These include, for example, insufficient board oversight of senior management, inadequate risk management and unduly complex or opaque bank organizational structures and activities. Against this background, the Committee decided to revisit its 2006 principles. Having reviewed and revised these principles in 2010, the Committee reaffirms their continued relevance and the critical importance of their adoption by banks and supervisors to ensure effective implementation of the principles. In the light of ongoing developments in CG, and to take account recent papers and recommendations addressing CG issues, the Committee has decided to revisit the guidance in 2015. Accordingly, the followings are the list principles:

1. **Board's overall responsibilities:** The board has overall responsibility for the bank, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture.
2. **Board qualifications and composition:** Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.
3. **Board's own structure and practices:** The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness. Accordingly, the Board should have audit committee, risk committee, compensation committee, nomination/human resources/governance committee and Ethics and compliance committee.
4. **Senior management:** under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board.
5. **Governance of group structures:** In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the

group and its entities. The board and senior management should know and understand the bank group's organizational structure and the risks that it poses.

6. **Risk management function:** Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board.
7. **Risk identification, monitoring and controlling:** Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.
8. **Risk communication:** An effective risk governance framework requires robust communication within the bank about risk, both across the organization and through reporting to the board and senior management.
9. **Compliance:** The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should establish a compliance function and approve the bank's policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk.
10. **Internal audit:** The internal audit function should provide independent assurance to the board and should support board and senior management in promoting an effective governance process and the long-term soundness of the bank.
11. **Compensation:** The bank's remuneration structure should support sound corporate governance and risk management.
12. **Disclosure and transparency:** The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.
13. **The role of supervisors:** Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on CG with other supervisors.(BASEL, 2015).

2.6. Theoretical Review of Literature on CG

CG is central to the management and operation of modern companies, and there is an ongoing debate about which theoretical models are appropriate (Letza, Sun & Kirkbride, 2004). However, a lack of consensus in the definition of CG has resulted in researchers from different backgrounds (finance, economics, sociology and psychology) proposing different theoretical views that are all aimed at understanding the complex nature of the concept (Lawal, 2012). A number of diverse fundamental theories underline CG, including the original agency theory, stewardship theory, stakeholder theory, resource dependency theory, transaction cost theory and political theory (Abdullah & Valentine, 2009).

However, most discussions on CG theories have focused on the shareholder and the stakeholder perspective (Letza, Sun & Kirkbride, 2004; Szwajkowski, 2000; Vinten, 2001). The purpose of the corporation and its associated structure of governance and arrangements are determined by two paradigms that each offer a different way of understanding governance (Ayuso & Argandona, 2007). Consequently, this research uses two theories—agency theory and stakeholder theory—to analyze the relationship between CG and performance in listed companies based in the United Arab Emirates. The main theories that have affected the development of CG and been adopted in the current study will be discussed in the following section.

2.6.1 Agency Theory

The separation of ownership and control is one of the key features of modern corporations, and CG has become necessary to mitigate the principal–agent problem (Berle & Means, 1932). The agency problem was first highlighted by Adam Smith in the eighteenth century and explored by Ross (1973), with the first detailed description of the theory presented by Jensen and Meckling in 1976. Fama and Jensen (1983a, b), Williamson (1987), Aghion and Bolton (1992) and Hart (1995) further explicated this problem over the next two decades.

According to this theory, shareholders who are the owners of the corporation appoint managers or directors and delegate to them the authority to run the business for the corporation's shareholders (Clarke, 2004). The agency relationship between two parties is defined as the contract between the owners (principals) and the managers or directors (agents) (Jensen & Meckling, 1976). On the basis of the agency theory, shareholders expect the managers or directors to act and make decisions in

the owners' interests. However, managers or directors may not necessarily always make decisions in the best interests of the shareholders (Padilla, 2002). The separation of ownership and control produces an innate conflict between the shareholders (principals) and the management (agents) (Aguilera et al., 2008). This conflict of interest can also be exacerbated by ineffective management monitoring on the part of shareholders as a result of shareholders being dispersed and therefore unable, or lacking the incentive, to carry out necessary monitoring functions. Consequently, the managers of a company might be able to pursue their own objectives at the cost of shareholders (Hart, 1995).

Thus, two problems involving the agency theory occur in the agency relationship. The first problem is that, because it is difficult or expensive for the principal to verify what the agent is actually doing, the principal cannot verify that the agent has behaved appropriately. The second problem is that, because of differing attitudes towards risk, the principal and the agent may favor different courses of action (Eisenhardt, 1989). Shareholder efforts to monitor the agent—for instance, shareholder engagement and incentive schemes or contracts—lead to additional costs for the company (Solomon, 2010). Grant (2003) argues that the main purpose of shareholders (principals) is to maximize their value (interest), whereas the main purpose of agents is to expand and grow the corporation because success will reflect favorably on management.

2.6.2 Stakeholder theory

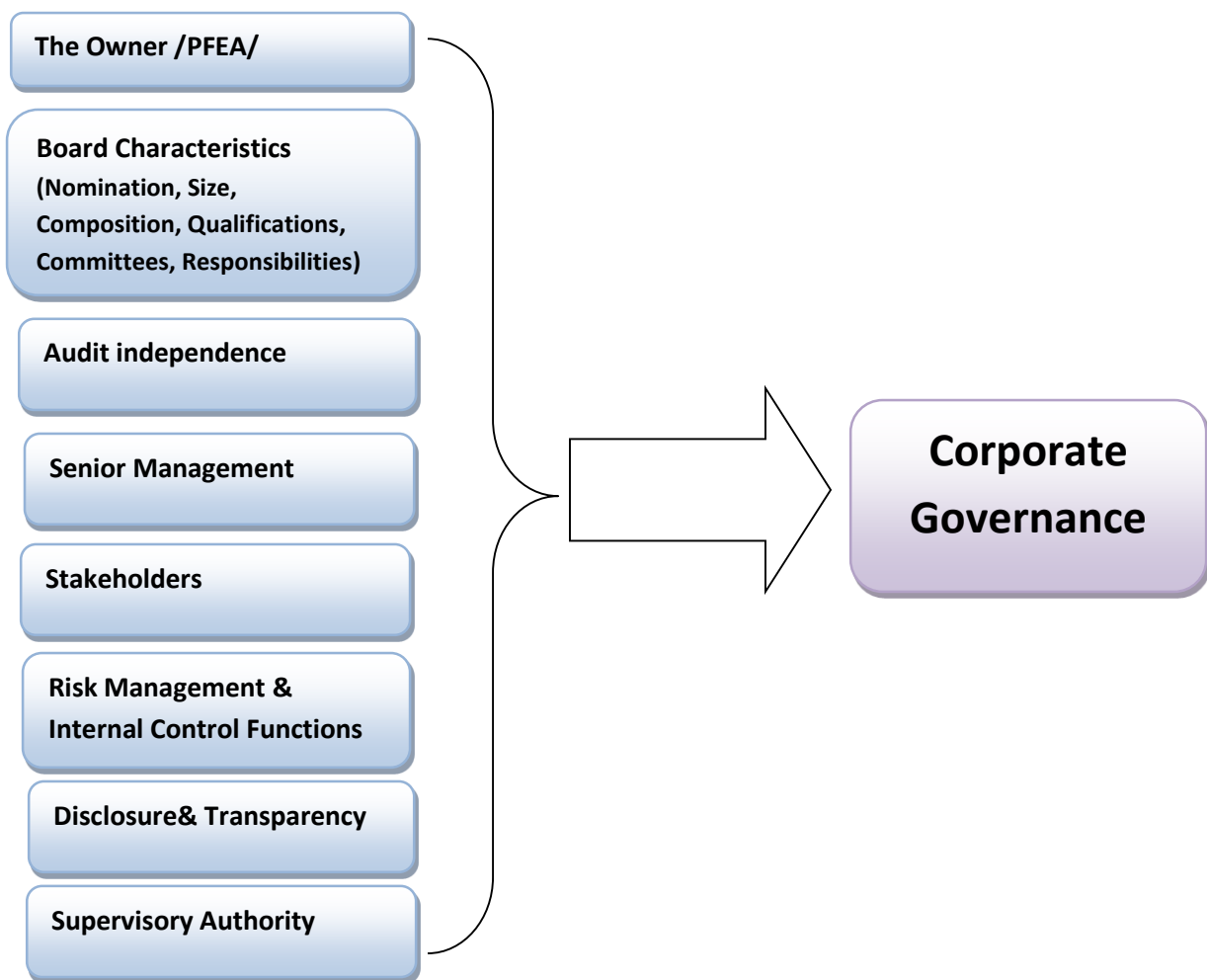
The stakeholder theory has been developing continuously over the past three decades. One of the first theorists to present the stakeholder theory as inherent in management discipline was Freeman (1984). He also proposed a general theory applicable to firms, which is based on the premise that firms should be accountable to a broad range of stakeholders (Solomon & Solomon, 2004). Freeman (1984, p. vi) defines stakeholder as 'any group or individual who can effect or is effected by the achievement of corporation's purpose'. Thus, the term stakeholder may cover a large group of participants; in fact, it applies to anyone who has a direct or indirect stake in the business (Carroll & Buchholtz, 2002). Stakeholders include shareholders, employees, suppliers, customers, creditors and communities in the vicinity of the company's operations, in addition to the public (Solomon, 2010).

The aim of the agency theory is to concentrate on shareholders' rights and the separation of ownership from control so that a company can maximize the wealth of its shareholders. The stakeholder theory focuses not only on shareholders, but it has been expanded to take into account the interests of many different stakeholder groups, including interest groups with social, environmental and ethical considerations (Clarke, 2004; Letza, Sun & Kirkbride, 2004). This is consistent with the views of the OECD (2004), which defines CG as a set of relationships between a company's management, its board, its shareholders and other stakeholders.

2.7. CONCEPTUAL FRAMEWORK

Based on the overall review of related literatures, the following conceptual frame work in which this specific study governed had been developed. In this study, CG was taken as a dependent variable while Board Characteristics (size,composition, qualifications, Committees and responsibilities), Audit independence, Senior Management, Supervisory Authority, Stakeholders, Disclosure and Transparency, Risk Management and Internal Control Functions were taken as independent variables. The relationship of the variables for this study is presented as follows.

Figure 2.1 Conceptual Frame work



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Methodology

The purpose of this chapter is to describe the research methodology and techniques that was used to conduct the study. In this chapter, the practical methods to be used in order to answer the research questions and fulfill the purpose of the research were presented. In doing so, both primary and secondary data were employed as a research process to study the various issues involved in the paper. The secondary data was collected from textbooks, journals, scholarly articles, proclamations, directives, recommendations and guidelines forwarded by various organizations and regulatory organs. In addition, questionnaires and interview were used as primary sources.

3.2 Research Design

The research design articulates what data is required, what methods are going to be used to collect and analyze this data, and how all of this is going to answer research questions. Both data and methods and the way in which they are to be configured in the research project, need to be the most effective in producing the answers to the research questions.

Researchers always opt for the best fit design/methodology for their purpose. In this regard, Chan (2008) explains that an appropriate study design is one that allows valid inferences to be made from the findings and these inferences have direct bearing on the research question that the study attempts to answer.

For the purpose of this thesis, descriptive research approach was employed as it was assumed to well address the problems in question and based of course on the respondents view and the review of related literature. On top of this, both qualitative and quantitative methods of analysis had been utilized. This is because using mixed research method neutralizes /cancels the bias of any single quantitative data (Creswell, 2009).

The Quantitative research is that which tries to find answer to a question through analysis of quantitative data, i.e., the data shown in figures and numbers. The strength of quantitative research

is the opportunities that it provides researchers to interact and gather data directly from their research participants to understand a phenomenon from their perspectives. In spite of its importance, questionnaire method also has several limitations, such as careless attitude of respondents, non-attendance and lack of cooperation. On the other hand, a qualitative research methodology can help researchers to approach fieldwork without being constrained by any predetermined categories of analysis. Qualitative research carries the uniqueness because it does not give conclusion in advance. It is often regarded as a scientific methodology of management sciences research (Neelam et al., 2014).

3.3 Population, Sample Size and Sampling Techniques

3.3.1 Population

A research population is a well-defined collection of individuals or objects known to have similar characteristics. In most cases, the description of the population and the common binding characteristic of its members are the same.

In line with the structure of the CBE, branches are grouped in four grades i.e. Grade 1 to 4. Grading is determined based on the volume of work or volume of transactions. The higher the volume of work, the larger is the grade of the branch. Responsibilities and the numbers of staff also increase depending on the size of the branch.

Grades 3 and 4 branches are located in big towns and cities. Smaller or grade one branches are situated at small towns scattered all over the country. Grade two branches can be found in both locations of Addis Ababa and other towns.

Of the overall fifteen districts of the bank, there are four big districts in Addis. Each district is headed by a manager and administers a lot of branches under its domain. There are various managers in the district office itself as well. In general with the exception of the variances in volume of works, all types of transactions, type and nature of tickets are the same at all branches throughout the bank.

The staff members are classified into two categories in the bank: clericals and non-clericals. Non-clericals are service workers such as messengers, drivers, carpenters, masons, guards, office

boys/girls, janitors and gardeners. The study disregards such employees as it exclusively focuses on supervisory personnel.

Clerical staff is divided into supervisory and non-supervisory. Non-supervisory staff was not considered in the study as the program exclusively focuses on supervisory personnel. Supervisory/managerial employees are also grouped in three levels: top level, middle level and lower level/line management. Top level consists of the CEO, vice presidents and chiefs while middle level refers to the directors of departments and district managers. Lower level/line management comprises branches' and all Head Offices' managers irrespective of their grades or status. The research excluded top management of the CBE for the fact that they are too busy to fill the questionnaires.

For this study, the total population and target population were all managers of the bank and managers working in Addis Ababa whose number stood at 1,269 and 388 as of September 2016, respectively.

3.3.2 Sampling Method and Size

Of the 388 managers, 260 were working at branches and districts in Addis Ababa, whilst the remaining 128 were assigned in different organs of the Head Office.

In this respect, it is apparent that branches of the bank are scattered all over the country, as a result of which, it was difficult to easily get pertinent data for the study. Hence, the researcher selected 260 middle and lower level/line managers located in Addis Ababa.

The target group of the study was selected using proportionate stratification ($\frac{N_h}{N} * n = n_h$) sampling techniques. The reason for the selection of this sampling is that it allows the researcher to obtain greater representatives. It also reduces the probable sampling error to ensure that all groups in a population are adequately represented in the sample.

In addition to this, purposive or judgmental technique was applied for qualitative data collection (interview) to nominate the board secretary of the bank who was believed to have sound experience and profound knowledge in the area of CG practice of the bank.

The strata sample size is determined by the formula as indicated in the table 3.1 below.

Table 3.1: Managerial Staff members by Number and Functional Unit

Organ /Functional unit	Total Population Size	Population size per stratum(Managers found in Addis Ababa)	(N_h/N)*$n=n_h$ or sample size
Head Quarter Managers	139	128	$(128/1,269)* 388= 39$
District and Branch Managers	1,130	260	$(260/1,269)*388= 79$
Total	1,269	388	119

Source: CBE, Human Resource Management, September 30, 2016

Where, n_h is the sample size for stratum **h**,

N_h is the population size for stratum **h**,

N is total population size and **n** is total sample size (stattrek.com, 2016).

3.4 Source of Data

The study took the advantage of both primary (Questionnaire and Interview) and secondary data sources. With regard to secondary data sources, textbooks, journals, scholarly articles, proclamations, directives, recommendations and guidelines forwarded by various organizations and regulatory organs were consulted.

3.5 Data Gathering Instruments

Appropriate data for the study were collected using questionnaires and interview.

3.5.1 Questionnaire

One of the survey instruments for this research and appropriate data for the study was collected using structured questionnaire. Personally administered questionnaire were produced to get the data and cope with research questions. Employing such technique is imperative as it was a prompt and comparatively low cost mechanism for offering information in the context and to enable to establish a good rapport with respondents and simpler to comply with them.

In the meantime, the questionnaires were distributed to the target groups along with the specification of the purpose of the research. What is more, convenience sampling technique was used to carry out the survey as most concerned managers usually were busy to cooperate in filling out the questionnaires.

The questionnaire had two parts. Part I, dealt with demographical questions about the respondents in connection with gender, age, marital status, years of work experience /length of service/ with the organization, educational level and designation/Job title.

In part II, stated list of points to be answered related to the CG practices of the CBE. A five point Likert scale that ranged from 1 (strongly disagree) to 5 (strongly agree) was applied for this section.

3.5.2 Interview

A carefully designed interview guide was developed to obtain pertinent information from the target participant for this project work. In this regard (Adams, Khan, Raeside &White, 2007) have argued that to obtain research data in business and management, asking and/or talking to people becomes important.

The researcher made use of structured interview technique to gather primary information from the board secretary of the CBE. The selected interviewee is believed to fully address the interview questions regarding the topic under consideration.

On the basis of this interview, first hand and relevant data was collected with regard to the role of the owner/PFEA/, BoD (size, composition, qualification, and responsibilities), responsibilities of the senior management, the risk management, internal control, and disclosure and transparency practice of the CBE. To be more specific, open-ended questions had been developed.

3.6 Procedure of Data Gathering

The data for this research was collected using a survey questionnaire and interview. The survey was created using suitable questions modified from related researches and individual questions formed by the researcher. The survey was comprised of 30 questions, which were related to the participant's perception regarding the CG practice of the CBE. In the questionnaire, Likert scale was used to determine if the respondent agrees or disagrees in a statement. After the advisor validated the questionnaire, those were distributed to the middle and lower level/line managers of the bank. The researcher assured the confidentiality of their survey sheets since the identities were not important. The researcher also understood that participants may feel discomfort and this may affect their honesty and effectiveness in answering the survey. Hence, the researcher gave the

respondents the option of being anonymous. Participants were given time to respond and then the researcher collected the surveys within three weeks.

Next the researcher planned the questions that have to be replied through interview. Then after a structured interview was conducted with the board secretary of the bank. In compliance with this, a total of 17 questions were prepared.

3.7 Methods of Data Analysis

Researchers pursue different methods of analysis while carrying out studies depending on the nature of the data/information. As to this research, descriptive data analysis was applied. In this case, demographic characteristics was described using frequencies and percentages in tabular form for variables such as age, marital status, gender, work experience, years on the current job position and educational level. With respect to the CG practices of the Bank, the data was gathered through questionnaires was analyzed and presented in same manner using SPSS software.

The interview and secondary data that were compiled and duly analyzed against the data obtained through questionnaire.

3.8 Ethical Considerations

The information/data obtained from any source was for the exclusively use of this study. It cannot be disclosed to any party and rather kept confidential. The rights of respondents or other data providers are respected.

CHAPTER FOUR

SURVEY RESULTS AND DISCUSSION

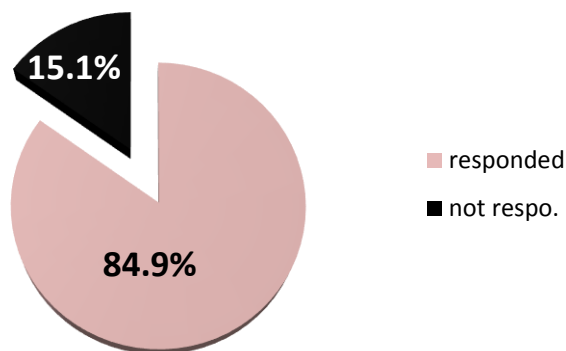
This chapter presents the research findings found from the questionnaire employed to answer the research questions of this study. SPSS was used to analyze the survey data. The questionnaire was distributed to branch managers, head office managers; district managers and directors. On the other side the board secretary was interviewed.

4.1. Quantitative Analysis /Questionnaire Results and Discussion/

Response Rate

To determine the actual number of responses who actively participated in the study, analysis of the response rate was conducted as shown in the figure here under. However, out of the 119 questionnaires sent, only 101 questionnaires were received back fully completed making a response rate of 84.9%. This is in agreement with Wit and Schindler (2003) who indicated that a response rate of between 30 to 80% of the total sample size can be generalized to represent the opinion of the entire population.

Figure 4.1 Response Rate



4.1.1. General Background of the Respondents

Table 4.1.1. General Background of the Respondents

Particular	Gender	Frequency	Percent
Gender	Male	77	76.2
	Female	24	23.8
	Total	101	100.0
Marital Status	Married	25	24.8
	Single	76	75.2
	Total	101	100.0
Age	30 or Less	8	7.9
	31 to 40	63	62.4
	41 to 50	23	22.8
	51 and Above	7	6.9
	Total	101	100.0
Number of Service Years	Below 10	27	26.7
	10 to 20	54	53.5
	21 to 30	15	14.9
	Above 30	5	5.0
	Total	101	100.0
Current Position	Branch Manager	65	64.4
	Head Office Manager	33	32.7
	District Manager	3	3.0
	Total	101	100.0
Educational Qualification	Diploma	2	2.0
	BA/BSc/LLB	52	51.5
	MA/MSc/LLM	47	46.5
	Total	101	100.0

Source: Computation from SPSS analysis

According to the survey result as shown on table 4.1.1, 76.2% of those surveyed were male, while 23.8% of the respondents were female. Again, 24.8% of those surveyed were married, while 75.2% of the respondents were single.

The distribution of respondents based on age depicts that 7.9% of those surveyed were less than 30 years old, while 62.4% and 22.8% of the respondents were aged 31–40 and 41–50 years old, respectively. 6.9% of respondents were aged 51 and above. Overall, 70.3% were below 41 years old, 29.7% were more than 40 years old and three-fourth of the participants were below 40 years old. The distribution of the respondents by job title shows that the lowest percentage of response

is that of District Managers (3%), followed by Head Office managers (32.7%) and branch managers (64.4%). The number of service years of the respondents shows that 80.2% of the respondents had less than twenty years of work experience and 26.7% had below 10 years of work experience. Those with work experience of between 10–20 years depicted 53.5% of the sample, while respondents with work experience of 21–30 years and above 30 years comprised 14.9% and 5% of the sample, respectively. As can be seen from the survey result, the majority of respondents have more than 10 years of experience implying that the majority of them are above 30 years of age. This is because the target group was managerial staff which requires some level of work experience in the bank.

The majority (98%) of participants had completed their bachelor's degree or higher. 51.5% of the participants had a bachelor's degree (BA/BSc/LLB), while 46.5% had a master's degree (MA/MSc/LLM) and 2% had a diploma as their highest qualification reflecting that the participants have high educational background. This is due to the fact that the minimum educational qualification requirement of the CBE at entry level is BA/BSc/LLB. Besides, recently the minimum educational qualification to have a managerial position is BA/BSc/LLB.

4.1.2. CG Practice of the CBE

This section is the second part of the questionnaire which examines respondents' perception regarding CG practice of the CBE. These questions were used to address issues regarding stake holders, disclosure and transparency, internal control, risk and compliance and the role of senior management of the bank. The analysis had been made and presented using SPSS (Version 20) software.

Stakeholders

This sub section covers research question numbers seven to eleven which addresses issues that are related to CBE's Stakeholders.

Table 4.1.2. Stakeholders

Statements	Str. Disagree		Disagree		Uncertain		Agree		Str. Agree		Mean	Std.	Rank
	F	%	F	%	F	%	F	%	F	%			
7. The bank takes stakeholders' interest into account and respects stakeholders' rights that are established by law.	1	1.0	1	1.0	8	7.9	61	60.4	30	29.7	4.2	0.7	1
8. The bank has a representative of employees on the board.	17	17.0	15	15.0	34	34.0	26	26.0	8	8.0	2.9	1.2	5
9. The bank's stakeholders have the opportunity to obtain effective response for the violation of their rights.	3	3.0	5	5.1	34	34.3	50	50.5	7	7.1	3.5	0.8	3
10. The bank's stakeholders have the right to freely communicate their concerns about illegal or unethical practices to the board.	2	2.0	21	20.8	37	36.6	35	34.7	6	5.9	3.2	0.9	4
11. The bank has an on-going program to raise employees' awareness of corporate governance issues and the role which every employee can play in strengthening governance within the bank.	1	1.0	15	15.0	24	24.0	45	45.0	15	15.0	3.6	1.0	2

Source: Computation from SPSS analysis

As illustrated on table 4.1.2. above a statement which states whether CBE takes stakeholders' interest into account registered the highest level of agreement (90.1%) and ranked the first with a mean score 4.2 and standard deviation 0.7.

Responses related to employees' awareness on CG issues and the role which every employee can play in strengthening governance within the bank ranked the second with mean score 3.6 and standard deviation 1. And a total of 60 respondents agreed with this statement.

In relation to a statement which concerns whether the stakeholders have the opportunity to obtain effective response for the violation of their rights ranked the third with mean score 3.5 and standard deviation 0.8. On the other hand, a statement which questions whether stakeholders have the right

to freely communicate their concerns about illegal or unethical practices to the BoD ranked fourth with mean score 3.2 and Standard deviation 0.9. 36.6% of the respondents chose the uncertain option to this statement.

In relation to a statement which asks if the bank has a representative of employees on the BoD ranked fifth with a mean score 2.9 and standard deviation 1.2. Two third (66%) of the respondents provided strong disagreement and uncertain with this statement. OECD guidelines (2012) recommend that employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the BoD skills, information and independence.

Overall in the foregoing findings, the majority of participants agreed with the questions regarding the CBE's stakeholders. Meaning, the CBE takes stakeholders' interest into account and respects stakeholders' rights that are established by law are respected by the company. More than 50% of the study finding indicates that the respondents agree with the statement 'the bank's stakeholders have the opportunity to obtain effective response for the violation of their rights'. This implies that the bank has a serious concern on its stakeholders and again those stakeholders have the opportunity to freely communicate their issues to the bank.

According to stakeholder theory decisions made regarding the company concern may be affected by different parties in addition to stockholders of the company. Hence, the management 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, C, Haarman, A and Schmid, S, 2006).

The BoD and managers need to have a relationship with the stakeholders and it is argued that this group of network is important and requires management's attention. Stakeholder theory maintains that managers in organizations are not only responsible for the interests of shareholders but also employees and business partners. A company should be operating by making helpful contributions and by encouraging its directors, managers and employees to form good relationships with each other. It also should be active in promoting the company's wellbeing, stakeholders' safety and

business issues, including any issues that are related to the specific types of businesses in which the corporation is engaged.

Disclosure and Transparency

This section aims to investigate responses concerning whether the CBE prepares and discloses both financial and non-financial information in accordance with the accounting standards. The Basel Committee on Banking Supervision (2015) states that the governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

Table 4.1.3. Disclosure & Transparency

Statements	Str. Disagree		Disagree		Uncertain		Agree		Str. Agree		Mean	Std.	Rank
	F	%	F	%	F	%	F	%	F	%			
12. The bank prepares and discloses information in accordance with accounting standards and financial and non-financial disclosure.	-	0.0	3	3.0	14	13.9	63	62.4	21	20.8	4.0	0.7	1
13. Issues regarding employees and other stakeholders, such as programs for human resource development and training are disclosed.	-	0.0	21	20.8	21	20.8	68	67.3	16	15.8	4.0	0.6	2
14. The bank provides channels for the dissemination of information to the relevant users on a timely basis.	-	0.0	7	6.9	18	17.8	62	61.4	14	13.9	3.8	0.8	4
15. The bank discloses full information about the members of its board, their qualification, and other company directorship and selection process.	10	10.0	20	20.0	46	46.0	21	21.0	3	3.0	2.9	1.0	7
16. The bank has a written information disclosure policy that seeks to make all material information (financial and non-financial) fully, timely and equally available to all stakeholders.	2	2.0	16	15.8	31	30.7	38	37.6	14	13.9	3.5	1.0	5
17. The bank's annual report contains a short report on the activities of the board committees.	5	5.0	23	22.8	33	32.7	31	30.7	9	8.9	3.2	1.0	6
18. The bank publishes an account of its business objectives and its organizational and governance structure.	-	0.0	4	4.0	16	15.8	70	69.3	11	10.9	3.9	0.6	3

Source: Computation from SPSS analysis

As depicted on Table 4.1.3., the perception of the respondents on whether the CBE prepares and discloses information in accordance with accounting standards registered the highest level of agreement (83.2%) and with the lowest level of disagreement 3% having a mean score 4.0 and Standard deviation 0.7. This is because the bank has a vision of becoming a world class commercial bank by the year 2025 and applying the international standards are crucial to achieve such a vision. Accordingly, it is now implementing the International Financial Reporting Standard/IFRS.

A statement regarding the disclosure of issues related to employees and other stakeholders, such as programs for human resource development and training, ranked the second having greater level of agreement 83.1% with mean score of 4.0 and standard deviation 0.6. Similarly, responses for Statement stating ‘The bank publishes an account of its business objectives and its organizational and governance structure’ registered the third higher level with the agreement level of 80.2%, mean score of 3.9 and Standard deviation 0.6.

On the other hand, a question stating whether the CBE provides channels for the dissemination of information to the relevant users on a timely basis scored fourth with the agreement level of 75.3% by mean score of 3.8 and standard deviation 0.8. While statement, ‘the bank has a written information disclosure policy that seeks to make all material information (financial and non-financial) fully, timely and equally available to all stakeholders’ listed fifth with the level of agreement 51.5% by mean score of 3.5 and standard deviation 1.00. In addition, a question stating whether the CBE’s annual report contains a short report on the activities of the BoD committees ranked sixth depicting level of agreement 39.6% only by mean score of 3.9 and standard deviation 0.6.

A statement stating issues related to the CBE’s disclosure of full information about the members of its BoD, their qualification, and other company directorship and selection process registered seventh positions with level of uncertainty and disagreement 30% and 46%, respectively, having mean score of 2.9 and Standard deviation 1.00. In this regard, one can easily recognize that the CBE fails to disclose information related to its BoD members.

Application of CG principles/recommendations provides a control mechanism for the company’s operations and thus encourages managers to be more successful and promotes the company’s

performance with long-term strategies. The questionnaire data reflects that the bank publishes its financial reports. The result from the analysis of the annual report of the CBE also revealed that the bank's annual report includes information in accordance with the accounting standards and financial and non-financial disclosures.

As set out in the Basel Committee on Banking Supervision (2015), enhancing bank transparency, timely and accurate disclosure should be made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. Therefore, public disclosure is desirable in the following areas: Board structure (size, membership, qualifications and committees); senior management structure (responsibilities, reporting lines, qualifications and experience); basic organizational structure (line of business structure, legal entity structure).

The OECD guidelines (2006) also recommend the CG frameworks to ensure timely and accurate disclosure on all material matters regarding the organization, including the financial situation, performance, ownership and governance of the company.

Internal Control, Risk and Compliance

This section deals with the presentation and analysis of issue related to Internal Control, Risk & Compliance. Table 4.1.4 illustrates the respondents' perception on Internal Control, Risk & Compliance practice of the CBE. Out of the total number of questions raised in this section, on average 85% of the respondents had provided with positive responses to all the questions raised.

Table 4.1.4. Internal Control, Risk & Compliance

Statements	Str. Disagree		Disagree		Uncertain		Agree		Str. Agree		Mean	Std.	Rank
	F	%	F	%	F	%	F	%	F	%			
19. The bank has a risk management system and a responsible organ for identifying risks and developing risk management framework.	1.00	1.0	1	1.0	5	5.0	53	52.5	41	40.6	4.3	0.7	1
20. The bank has a compliance program or procedure that includes the training of employees, auditing and monitoring systems.	1.00	1.0	3	3.0	11	10.9	56	55.4	30	29.7	4.1	0.8	4
21 An annual audit of the bank is conducted by an independent auditor.			4	4.0	17	16.8	42	41.6	38	37.6	4.1	0.8	6
22. Audited reports are published regularly.	1	1.0	8	8.0	16	16.0	41	41.0	34	34.0	4.0	1.0	7
23. The bank has code of conduct which all employees are required to comply.	1	1.0	3	3.0	4	4.0	44	44.0	48	48.0	4.4	0.8	2
24. The bank establishes policies, procedures and/or guidelines to govern the work and behavior of all its operating organs.			2	2.0	8	7.9	46	45.5	45	44.6	4.3	0.7	3
25. The bank has a formal "Compliance" office with a mission to ensure that the bank is in compliance with national and international requirements.	1.00	1.0	3	3.0	14	13.9	46	45.5	37	36.6	4.1	0.8	5

Source: Computation from SPSS analysis

A statement requesting if the bank has a risk management system and a responsible organ for identifying risks and developing risk management framework depicted the highest level of agreement (93.1%) with a mean score 4.3 and Standard deviation 0.7. A statement stating whether the CBE has a code of conduct that all employees must comply listed the second with the level of agreement (92%) having mean score of 4.4 and standard deviation 0.8. Similarly, responses for a

question which addresses issues whether the CBE has relevant policies/procedures/guidelines to govern the work and behavior of all its operating organs ranked the third with the level of agreement (90.1%) having mean score of 4.3 and standard deviation 0.7.

A statement discusses if the bank has a compliance program or procedure that includes the training of employees, auditing and monitoring systems listed fourth with the level of agreement (85.1%), mean score of 4.1 and standard deviation 0.8. By the same token, a question asking respondents' perception if the CBE has a formal "Compliance" office with a mission to ensure that the bank is in compliance with national and international requirements registered fifth with relatively lower level of agreement (82.1%), mean score of 4.1 and standard deviation 0.8.

A statement stating if the bank conducts external audit by an independent auditor listed sixth with the level of agreement 79.2% having mean score of 4.1 and standard deviation 0.8. Finally, a statement discussing if the bank's audited reports are published regularly ranked the least of all with the level of agreement 75%, mean score of 4.0 and standard deviation 1.0. Overall in the foregoing findings, the majority of participants agreed with statements related to internal control, risk and compliance with mean score between 4.4 and 4.0.

The Basel Committee on Banking Supervision (2015) recommends that risks should be identified, monitored and controlled on an ongoing bank-wide. The sophistication of the bank's risk management and internal control infrastructure should keep in pace with changes to the bank's risk profile, to the external risk landscape and in industry practice. An effective risk governance framework requires robust communication within the bank about risk, both across the organization and through reporting to the BoD and senior management.

It also recommended that, the bank's BoD is responsible for overseeing the management of the bank's compliance risk. The BoD should establish a compliance function and approve the bank's policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk. Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board.

The Role of Senior Management of CBE to CG

This section intends to analyze respondents' perception about the role of the senior management towards enhancing CG practice of the CBE. Hence, Table 4.1.5. Illustrates the respondents' views concerning same.

Table 4.1.5. The Role of Senior Management of the Bank

Statements	Str. Disagree		Disagree		Uncertain		Agree		Str. Agree		Mean	Std.	Rank
	F	%	F	%	F	%	F	%	F	%			
26. The management of the bank motivates employees to perform their duties at their highest capabilities.	2.00	2.0	14	14.0	11	11.0	62	62.0	11	11.0	3.7	0.9	2
27. The management of the bank develops individual values, institutional values and behavioral expectations to support the implementation of goals, strategies and plans that are established for appropriate processes.	1.00	1.0	8	7.9	24	23.8	55	54.5	13	12.9	3.7	0.8	3
28. The management of the bank regularly observes the implementation of policies and procedures and takes appropriate actions when employees break rules.	1.00	1.0	7	6.9	15	14.9	57	56.4	21	20.8	3.9	0.8	1
29. The management of the bank develops clear and flexible career paths and focus on career development and retention.	4.00	4.0	24	23.8	28	27.7	38	37.6	7	6.9	3.2	1.0	4
30. The management of the bank discloses material interests in any transaction or matter directly affecting the company.	3.00	3.0	12	12.0	43	43.0	37	37.0	5	5.0	3.3	0.9	5

Source: Computation from SPSS analysis

A statement stating if the management of the bank regularly observes the implementation of policies and procedures and takes appropriate actions when employees break rules scored the highest level of agreement (77.2%) with a mean score 3.9 and standard deviation 0.8. Secondly, a question inquiring whether the management of the bank motivates employees to perform their duties at their highest capabilities ranked the second with the level of agreement (73%) by mean score of 3.7 and standard deviation 0.9. Similarly, responses for statement stating if the management of the bank develops individual values, institutional values and behavioral expectations to support the implementation of goals, strategies and plans that are established for

appropriate processes registered third with the level of agreement (67.4%) by mean score of 3.7 and standard deviation 0.8.

A question stating whether the management of the bank develops clear and flexible career paths and focus on career development and retention listed fourth with lower level of agreement (44.5%) having mean score of 3.2 and standard deviation 1.0. Similarly, statement asking if the management of the bank discloses material interests in any transaction or matter directly affecting the company ranked fifth with the level of agreement (42%) by mean score of 3.3 and standard deviation 0.9.

The Basel committee on Banking Supervision (2015) recommends that under the direction and oversight of the board, the senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the BoD.

4.2. Qualitative Analysis /Interview Result and Discussion/

The bank's board secretary had been interviewed to gather first-hand information regarding the role of the owner/PFEA/, BoD characteristics (nomination, size, composition, responsibilities and qualification of the BoD), responsibilities of the senior management, the risk management, internal control, and disclosure and transparency practice of the CBE. To be more specific open-ended questions had been developed.

The Role of the Owner/PFEA/ to Sound CG

The list of questions regarding the role of the owner /PFEA/ to sound CG are stated here under:

1. Does the state act as an informed and active owner, ensuring that the governance of the bank is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness?
2. Consistent with the rationale for state ownership, does the legal and regulatory framework for the bank ensures a level playing field and fair competition in the banking industry?

3. Does the owner fully recognize the bank's responsibilities towards stakeholders and requests that the bank reports on its relations with stakeholders? Meaning, does the owner ensure whether the BoD members have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management?

According to the interview result, PFEA was established by Regulation No. 98/2004 to independently act as an owner of the bank to play the oversight role of CBE. By doing so, it ensures that the CBE operates in the interest of the general public and the owner-government. Hence, it is on the top of the governance structure of the CBE that provides power to the remaining stakeholders to administer the affairs of the bank. PFEA appoints the BoD as a balancing figure to the senior management of the CBE that plays crucial role on the overall oversight and control of the Bank. In order for the owner to have a full information whether the CBE's governance is carried out in a transparent and accountable manner with a high degree of professionalism and effectiveness, it has put a well-established system.

The government also tries to have a fair playing field with in the banking industry so that all banks operate in a competitive manner. Meaning, the CBE does not have any plus for being a state owned bank. All the international and national rules apply to it. This is because the banking business by its nature is a very competitive industry so that providing a competitive quality service with the competitive price is not an option. Rather, it is a matter of survival to the CBE. Hence, the bank developed a thoroughly studied strategy document that will enable it to sustain its biggest market share (greater than 50% in many of deposit, credit, asset and so on from the total industry). Besides, the bank not only has the aspiration of leading the Ethiopian banking business, but also wants to be among those 'World Bank Commercial Banks'. In order to achieve this, the bank puts in place two strategies, i.e. 'Business Growth' and 'Operational Excellence'. Regarding growth, the bank has put targets of increasing the customer base, the volume of fund, the number of employees, asset level and so on, taking the risk level into account. With regard to Operational Excellence, it means achieving efficiency, i.e. providing the highest level of service with the lowest possible price. Meaning, providing error free operation that is accessible at door steps and 24 hours and 7 days a week. Besides, the NBE regulation applies to the CBE the same way with those of the other commercial banks. The owner also ensures that the BoD is doing its responsibilities according to the Public Enterprise Proclamations number 25/1992.

The owner fully recognizes the bank's responsibilities towards stakeholders and requests that the bank reports on its relations with stakeholders. It also ensures that the BoD members have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They act with integrity and are accountable for their actions.

Responsibilities of the BoD of the Bank

Question asked with regard to the BoD of the Bank are listed here under:

1. Do the BoD members act in the best interests of the bank and the owner?
2. Does the BoD monitor the effectiveness of the CBE's governance practices?
3. Does the BoD thoroughly analyze and approve the bank's strategy, annual plan and budget?
4. Do the BoD and the meeting of the senior management/Process Council have one secretary?
5. Does the BoD effectively perform its oversight and directing role over the operations of the bank and the activities of the senior management?
6. Is there any employee that is a member of BoD of the CBE?
7. Does the BoD maintain a direct communications channel with internal and external auditors?
8. Do all members of the BoD have sufficient information and time that enable them to give strategic guidance of the bank?

The answer of the board secretary to the first question, i.e. do the BoD members act in the best interest of the Bank and the owner, is positive. The BoD members always try to do their maximum effort and knowledge to the best interest of the Bank. Basel Principle recommends that, the members of the board should exercise their "duty of care" and "duty of loyalty" to the bank under applicable national laws and supervisory standards. The duty of care requires that BoD members exercise reasonable care, prudence, and diligence in their oversight of the bank. The practical implications of this duty are that BoD members are expected to satisfy themselves that decision-making structures and reporting and compliance systems are functioning properly. The practical implication of the duty of loyalty is that BoD members are required to act in the interest of the bank and refuse any action, or to take part in any deliberation, in which they have a conflict of interest with in the bank.

The board secretary also agrees that the BoD closely monitors the effectiveness of the bank's governance practice. A fundamental component of good governance is a corporate culture of reinforcing appropriate norms for responsible and ethical behavior. These norms are especially critical in terms of the bank's risk awareness, risk-taking behavior and risk management (i.e. the Bank's "risk culture"). In this connection, the BoD takes the lead in reinforcing the "tone at the top" by setting and adhering to corporate values that create expectations, promoting risk awareness within a strong risk culture and confirming that employees, including management staff, are aware that appropriate disciplinary or other actions follow unacceptable behaviors and transgressions. The secretary also added that the BoD makes sure the establishment of code of conduct for employees of the Bank and the Bank's code of conduct or code of ethics or comparable policy, have clearly articulated acceptable and unacceptable behaviors.

The board secretary also agreed that the BoD ensures the bank's governance practice by establishing stakeholders' responsiveness mechanisms. The continuity and profitability of the bank depends on the satisfaction of the stake holders. The Bank's major stake holders are listed here under:

1. **Customers:** are Depositors, Borrowers, Foreign Currency Remitters, Essential Goods & Infrastructure Importers and Others. These stakeholders expect quality services, convenience (service accessibility), diversified banking products and competitive pricing. CBE's response to those expectations is to choose one of the customer value disciplines/ customer value proposition i.e. operational excellence. Operationally excellent service means providing standard services/products, convenience, error free service, and competitive price.
2. **The Owner /Government/:** the owner expects the bank to support the national development endeavor, achieve sustainable growth & profitability, providing banking services to the unbanked society, secure strong and sound in terms of risk management. CBE's response to such expectations is through increasing outreach & financial inclusion, introduce new products, enhance resource mobilization and build strong risk management and internal control system.

3. **Employees:** are people working in the CBE and their expectations are recognition, career development, merit based compensation and promotion, competitive salaries and benefit packages. CBE's response to such expectations is by creating conducive working environment, employee development & training, performance based reward system, clear human resource procedures and guidelines.
4. **Regulators (NBE):** NBE's expectation from the bank is the safety of depositors' money and financial sector stability. For this, CBE responds in such a way to comply with banking rules and regulations, set appropriate risk management system, exercise corporate governance practices.
5. **Development Partners:** Developmental partners expect the bank to increased accessibility and financial inclusion, support to their development efforts, job creation to local people. CBE also responds to such expectations by increasing accessibility through opening, branches/outlets, support social & community development efforts and merit based recruitment of employees from local areas.

The BoD monitors the effectiveness of the CBE's governance practices by making sure that such stakeholders' needs are addressed.

On the other hand, the Basel Principle Recommends that the BoD should oversee the implementation of the bank's governance framework and periodically review that it remains appropriate in the light of material changes to the bank's size, complexity, geographical footprint, business strategy, markets and regulatory requirements. But currently the bank has not yet approved its CG Framework and hence put it into practice. It has got only the draft CG framework document.

The board secretary also agrees to the question 'the BoD thoroughly analyzes and approves the bank's strategy, annual plan and budget'. The BoD in detail discusses on the bank's strategy, annual plan and budget by dedicating sufficient time. It fully involves in the analysis and approval process of the strategy by even going to retreat some place in order to effectively decide on grand issues that needs attention. The Basel committee recommends that BoD should establish strategic objectives, financial goals and professional standards that will direct the ongoing activities of the bank, taking into account the interests of all stakeholders and should take steps in ensuring these

objectives and standards are implemented accordingly. The BoD should always take the lead in establishing the leadership and instill corporate value for itself, senior management and other employees.

The CBE has one secretary that works for both the BoD and the Process Council /Committee of the senior management/. This contradicts with the Basel recommendation of board secretary independence to that of the senior management. It may raise conflict of interest and may hinder the BoD's oversight role.

The Basel Committee on Banking Supervision (2015) recommends that the Board Secretary shall be a member of staff of the Bank, but shall work directly with the Board on all matters relating to the Board's activities. The board secretary shall serve as a secretary to the main BoD and the BoD sub-committee meeting but shall not be the secretary to the management of the bank.

The Basel committee also recommends that the board secretary office shall be established as an independent office from the executive management activities, have the necessary personnel who have the necessary competencies in areas such as legal, diplomatic skill and communication; in order to ensure the BoD meets all its legal, regulatory and financial compliance obligations as well as to deal with a broad range of senior people. The office shall also have a clear terms of reference (as a support structure to the Board) with a focus on improving BoD procedures, preparing annual work plan for the BoD, systematic documentation of approved/signed minutes and reporting requirements, among others.

In contrary to such recommendations, the board secretary do not have the necessary personnel to assist the BoD to effectively meet its legal, regulatory and financial compliance obligations. He only has one secretary in his office that assists to handle clerical jobs with in the office.

The board secretary responded positively to the question of whether the BoD effectively performs its oversight and directing role over the operations of the bank and the activities of the senior management. According to the secretary, the BoD monitors the senior management of the bank and its actions are consistent with the strategy and policies of the bank, including the risk appetite; meets regularly with the Process Council, questions and critically reviews explanations and information provided by the Process Council, sets key performance indicators for the Process

Council consistent with the long-term strategic objectives and financial soundness of the bank, and monitors the Process Council's performance against these standards.

However, there are gaps with regard to the BoD's assurance on the Process Council's collective knowledge and expertise given the nature of the business and the bank's risk profile. Also there are gaps in the BoD's engagement in succession plans for the President, vice presidents and chief officers. The BoD also has a gap in ensuring the bank's organizational structure to facilitate effective decision making and good corporate governance because the structure is opaque and couldn't carry the new established departments following the growth of the bank. This may hamper for putting clear lines of responsibility and accountability.

The board secretary's response to the question if the BoD has any member of the employee of the bank is negative. He said that previously there were some members the BoD that represent the employees of the bank but nowadays there is no any employee member of the BoD. This is following the NBE's Directive No. SBB/49/2011 that prohibited any employee from being a board member with the intention of separating board and executive functions. On the contrary, experience and research suggest that increasing the voice of employees within and around governance structures can be a powerful way to help create a sense of shared purpose, reinforce alignment between employees and shareholders, and better manage risk by providing constructive challenge to the executives and boardroom (Center for Tomorrow's Company, 2016).

According to the Public Enterprises Proclamation number 25/1992, not more than 1/3 of the members of the BoD shall be elected by the general assembly of the workers and the rest of the members shall be appointed by the PFEA. On the contrary to this, the NBE directive states that there shall be no employee to be a member of the BoD. But according to the country's law, if there are two contradicting laws, in this case the proclamation and the NBE's directive, the proclamation shall be the governing law. Consequently, there shall be employees to be members of the BoD. But in our case, there is no any employee member of the BoD of the bank.

With regard to the question if the BoD has a direct communication with internal and external auditors, the secretary responded that BoD doesn't have direct relationship with internal and external auditors. Only they are communicating through reports.

The secretary only partially agrees to the question if all members of the BoD have sufficient information and time that enable them to give strategic guidance of the bank. Due to the fact that the BoD members are government officials, they do not have sufficient time to closely monitor the day to day operation. But they always try their best to give strategic guidance and play their oversight role.

The Board's size, composition and Qualification

Questions concerning the BoD's size, composition and qualification are listed here under:

1. Does the current mix of skill/experience on the BoD serve the bank's interest?
2. Are the BoD members educationally qualified?
3. Is there female member of the BoD of the bank?
4. Does the bank have a formal orientation program for new BoD members?
5. Does the bank organize formal training sessions for existing BoD members?
6. Does the board carry out annual plan, annual evaluation of itself, its committees and its members?

According to the secretary, there are 8 members of the BoD of the CBE. This is within a prescribed range which is supported the Public Enterprises proclamation number 25/1992 stating the BoD members to be at least 3 but not more than 12 as well as recommendations given by the Basel committee. But the NBE directive number SBB/62/2015 put the BoD size to be at least 9. The Code of best practice suggests that the typical corporate BoD size is in range of 8 to 16 directors. (Jensen. 2003) argues that an overcrowded BoD is less likely to function effectively and is easier for CEO to control. When a BoD gets too big, it becomes difficult to co-ordinate and often creates social loafing. Smaller boards also reduce the possibility of free-riding by CEO, and increase the accountability of individual directors.

According to the interview result, members of the BoD have a BA/MA and one member has a PhD which is way beyond the requirements put by the NBE. The NBE directive SBB/54/2012 requires at least 75% of board members to have minimum first degree qualification with minimum requirement to be completion of high school. In effect, the local requirement also promotes educated people to hold seats of directorship in the banking industry.

With regard to the age of the BoD members, of CBE the secretary replays that the age of all the BoD members is more than thirty years which is in line with the NBE directive on banking supervision directive SBB/54/2012.

The BoD meets once in a month, with additional meetings if necessary, which meets the requirement put by the NBE directive number SBB/62/2015 requiring a minimum of one meeting per month. Members of the BoD play critical role of policy making and overseeing the soundness of the business.

The secretary also noted that the BoD has got only two committees, the Loan Review and Risk Committee and the Audit Committee. The Loan Review and Risk Committee reviews quarterly reports of provisions for loan, evaluate the performance of top 100 loans, check the liquidity position of the bank and evaluate the overall risk of the bank. On the other hand, the Audit Committee reviews the audit findings and follow-up the major finding rectifications. These committees are composed of members of the BoD excluding the Chairman.

The above mentioned BoD sub committees are among the listed requirements put by NBE. The NBE directive number SBB/62/2015 requires BoD sub committees to be at least three, i.e. Audit Committee, Risk and Compliance Committee and Human Resource Affairs Committee. In this regard, the CBE does not have the Human Resource Affairs Committee that provides a formal and transparent proposal on the employment and removal of the senior management members if found negligent/errant, ineffective in discharging responsibilities. The committee also decides on the overall compensation and benefit of the bank.

With regard to the composition the BoD, the secretary replayed that the members of the BoD are of government officials and all are males. There was a woman member in the previous BoD but currently there is no women members in the BoD of the bank.

All the members of the BoD have been serving for more than six years. The tenure of members of the BoD of the bank doesn't have a defined period which contradicts with the requirements of the NBE. According to the NBE Directive SBB/62/2015, a person shall not serve on the BoD of the bank for more than six consecutive years but may be re-elected after a laps of six years provided only 1/3rd of them can be re-elected. But in the case of the CBE, all members have been served as

members of the BoD for more than six consecutive years. Board composition is one of the most important components that must be addressed when dealing with CG.

According to the response of the secretary, the bank does not have the experience of preparing a formal induction program for new BoD members. In order for BoD members to effectively discharge their responsibilities, there must be a well-organized sessions for induction on the current conditions and the overall set up of the business which must be given by the outgoing BoD members.

According to the NBE directive SBB/62/2015, the BoD members shall take a formal training at least once in a year. In this regard, the CBE arranges a formal training for the existing BoD members. A trainings program in a bid to enhance directors' effectiveness and it has become recognized valuable by both practitioners and academicians. Directors must be adequately competent, skilled and informed to offer a large and high contribution to the task of the BoD and, ultimately, to the process of creating value for the firm.

The secretary's response on whether the BoD has annual work plans, annually evaluates its performance including the sub-committee and all members is negative. Also the BoD does not have a Board Charter. The BoD does not have annual plan as well as a session of evaluating their annual performance. According to the Banking Business Proclamation No. 592/2008, the BoD members are jointly and severally liable to the bank for damage caused by their failure to properly carry out their duties. As a result, it is advisable that the BoD should have a formal procedures to assess both their own collective performance and that of individual directors so that the members might usefully consider in the interest of continuous improvement. Evaluations can be extremely useful in comparing the performance of the BoD against best practices, identifying gaps, and generating ideas for future improvements. Evaluations should always culminate in plans for how to improve the bank's governance.

4.3. Summary of Major Findings

The main objective of the study was to assess the CG practice of the CBE with the requirements set by the government, the supervisory authority (NBE) and recommendations forwarded by internationally accepted organizations (OECD, the Basel committee, and other major multinational organizations).

In order to achieve the above objective, descriptive research approach was employed based on the respondents view and the review of related literature. In this case, demographic characteristics was described using frequencies and percentages in tabular form for variables such as age, marital status, gender, work experience, years on the current job position and educational level. With respect to the CG practices of the Bank, the data that was gathered through questionnaires was analyzed and presented in same manner using SPSS software. In addition, interview and secondary data were compiled and duly analysed against the data obtained through questionnaire. On top of this, both qualitative and quantitative methods of analysis had been utilized.

Based on the analysis of the data, major findings of the study are presented as follows:

- The demographic analysis of survey questionnaire revealed that majority of the respondents were male (76.2%), aged above 30 years old (92.1%), single (75.2%), working as branch managers (64.4%) having a work experience of more than 10 years (73.3%) and a minimum of first degree educational qualification (98%).
- The CBE takes stakeholders' interest into account and respects stakeholders' rights that are established by law are respected by the company;
- The BoD monitors the effectiveness of the CBE's governance practices by making sure that such stakeholders' needs are addressed;
- The bank's annual report includes information in accordance with the accounting standards and financial and non-financial disclosures;
- The bank has no representative of employees on the BoD;
- The bank doesn't disclose full information about the members of its BoD, their qualifications and other company directorship and selection process;
- The bank's annual report doesn't contain a report on the activities of the BoD committees;

- The bank doesn't have a written information disclosure policy that seeks to make all material information (financial and non-financial) fully, timely and equally available to all stakeholders;
- The CBE has one secretary that works for both the BoD and the Process Council /Committee of the senior management/;
- The BoD secretary do not have the necessary personnel to assist the BoD to effectively meet its legal, regulatory and financial compliance obligations. He only has one secretary in his office that assists to handle clerical jobs with in the office;
- There are gaps with regard to the BoD's assurance on the Process Council's/the Senior Management of the bank's/ collective knowledge and expertise given the nature of the business and the bank's risk profile. Also there are gaps in the BoD's engagement in succession plans for the president, vice presidents and chief officers.
- The BoD has a gap in ensuring the bank's organizational structure to facilitate effective decision making and good corporate governance because the structure is opaque and couldn't carry the new established departments following the growth of the bank;
- The BoD doesn't have direct relationship with internal and external auditors. Only they are communicating through reports;
- The BoD members are government officials; they do not have sufficient time to closely monitor the day to day operation;
- There is no woman member in the BoD of the bank;
- The tenure of members of the BoD of the bank doesn't have a defined period;
- The bank does not have the experience of preparing a formal induction program for new BoD members;
- The BoD does not have a Board Charter; and
- The study result indicates that the BoD does not carry out annual evaluation of its committees and its members.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

A well-established CG system assists firms to construct sustainable economic development along with strong performance and competitive capacity. CG is a foundation to build long term viable and smooth relationship with the stakeholders of the firm and the corporate governors. It assists to create transparent, equitable, accountable and effective business developments. Building strong CG mechanisms assist firms to throwaway their challenges that disturb the sound well-being and existence of the firm by sweeping the road to reach the desired destination.

The main focus of this section is to make conclusion and hence forward suggestions based on the findings on the major dimensions of CG system of the CBE i.e. BoD characteristics (i.e. over all responsibilities, size, composition, qualification and nomination), PFEA/the owner of the CBE/, stakeholders, disclosure and transparency, internal control, risk and compliance and the role of the senior management.

5.1 Conclusion

Concerning the role of the PFEA to sound CG of the bank, the PFEA ensures that the bank operates in the interest of the general public and the owner-government by closely monitoring the performance of the bank with plan, budget and with basic good governance principles. This is ensured by the regular reporting of the performances against the plan, budget and good governance principles. The PFEA appoints the BoD members. But the office is not equipped with the necessary personnel and materials to play all the duties as per the Public Enterprises proclamation number 25/1992. Besides, there is no formal meeting schedule between with the BoD and senior management to discuss issues on table about the CBE. The CBE does not have any preferential treatment in the eye of the NBE. The purpose of the NBE is to have a sound financial system within the industry in particular and the country in general.

With regard to the BoD characteristics, the nomination of the members is made by the owner of the bank (PFEA) but there is no clear procedure on how the members should be elected. Besides,

some members of the BoD are high government officials which may raise the issue of political influence on the bank. The BoD size is within a prescribed range put by the Public Enterprises proclamation number 25/1992, stating the BoD members to be at least 3 but not more than 12 as well as recommendations given by the Basel committee. The composition of the BoD members has some gaps with respect to the NBE directive and the Basel Committee recommendations. This is because there are no woman member in the BoD. Besides, there are no employee members of the BoD which violates the Public Enterprises Proclamation number 25/1992 as well as recommendations of well-known organizations such as OECD. This may raise the issue of omitting the employees' voice to the higher level and hence not securing the major organ of the bank that has stake. Concerning the BoD qualification, the CBE's BoD members have minimum of BA degree and a maximum of PhD indicating that they are way above the requirement of the NBE directive requiring only 75% of the members to hold a first degree and the rest may have a minimum of high school completed. Again, all members of the BoD are more than thirty years which is in line with the NBE directive on banking supervision directive SBB/54/2012.

Regarding the overall responsibilities of the bank's BoD, the BoD thoroughly analyzes and approves the bank's strategy, annual plan and budget and monitors the effectiveness of the bank's performance with respect to the plan, budget and strategy. In addition, the BoD members meet once in a month which is as per the requirement of NBE. On the other hand, there are some shortcomings that the BoD doesn't accomplish as per the requirements. One, not all members of the BoD participate on the regular meetings to the extent of not being available several times implying that not all members of the BoD are dedicated. Two, some members of the BoD are government officials and hence are so busy handling other nationwide issues which may breach the guiding, controlling and over sighting role over the senior management and overall performance of the bank. Three, the BoD does not have direct relationship with internal and external auditors which may increase a problem of information gap on what is going on the bank.

Four, the tenure of the BoD members doesn't have a defined period. The members have served as members of the BoD for more than six years which violates the requirements put by the NBE and Public Enterprises proclamations; and recommendations made by Basel and OECD. In addition, there has not been any formal re-election process. Five, the board doesn't a board charter which

binds and guides the members on how to perform as board members. Six, the bank does not have the experience of preparing a formal induction program for new BoD members which hinders for the new member to not fully perform his duty. Seven, the BoD does not carry out annual plan and evaluation of its committees and its members. This may have a serious problem on identifying the BoD and its subcommittees' strength and weaknesses and hence may not bring any improvement on the effectiveness of the BoD. Eight, the bank's annual report doesn't contain a short report on the activities of the BoD and its sub-committees which violates the transparency and disclosure principles put by the NBE, Basel and OECD. Nine, the BoD secretary also serves for the bank's senior management which breaches the principles put by Basel. In addition, the BoD secretary office is not equipped with the necessary personnel that assist the BoD to effectively perform its roles.

The BoD has got only two committees, i.e. Loan Review and Risk Committee and the Audit Committee which meets the requirement put by the NBE. But the BoD does not have Human Resource Affairs Committee which has the intention of providing a formal and transparent proposal on the employment and removal of the senior management members if found negligent/errant, ineffective in discharging responsibilities and in deciding on the overall compensation and benefit of the bank.

There are also gaps with regard to the BoD's assurance on the Process Council's collective knowledge and expertise given the nature of the business and the bank's risk profile. Also there are gaps in the BoD's engagement in succession plans for the President, vice presidents and chief officers. The BoD also has a gap in ensuring the bank's organizational structure to facilitate effective decision making and good corporate governance because the structure is opaque and couldn't carry the new established departments following the growth of the bank. This may hamper for putting clear lines of responsibility and accountability.

Concerning Disclosure and Transparency, the bank doesn't have a written information disclosure policy that seeks to make all material information (financial and non-financial) fully, timely and equally available to all stakeholders. This is against the NBE directive and Basel principles of transparency and disclosure.

With regard to Internal Control, Risk and Compliance practice of the bank, the bank has a good risk management system and a responsible organ for identifying risks and developing risk management framework. It also has a compliance program or procedure that includes the training of employees, auditing and monitoring systems. Annual external audit of the bank is conducted by an independent auditor and audited reports are published regularly; the bank has code of conduct which all employees are required to comply. In addition, the bank establishes policies, procedures and/or guidelines to govern the work and behavior of most of its operating organs/processes. Also, the bank has a formal “Compliance” office with a mission to ensure that the bank is in compliance with national and international requirements.

About the Stakeholders, the study revealed that the bank respects stakeholders’ rights that are established by law. Respecting stakeholders’ interest is not a matter of choice; but rather is a matter of survival. But some of the employees’ rights are not respected. For example, being a member of the bank’s BoD is put in the Public Enterprises proclamation number 25/1992 as well as the OECD guideline but the NBE directive put the number to zero. This may result in the omission of some issues of the employees to the BoD.

According to the survey result, the role of the senior management of the bank to good CG is more or less good. The management of the bank motivates employees to perform their duties at their highest capabilities. It also develops individual values, institutional values and behavioral expectations to support the implementation of goals, strategies and plans that are established for appropriate processes. It regularly observes the implementation of policies and procedures and takes appropriate actions when employees break rules. In addition, the management of the bank develops clear and flexible career paths and focus on career development and retention. But the survey result revealed that not all members of the senior management effective to perform their duties and hence may not fit to the post. This may result in over burden on those who are committed and may hence have a dis-incentive effect on same.

Generally speaking, the practice of CG of the CBE with respect to the national and international requirements is good though there are some gaps.

5.2. Recommendations

Based on the major findings of the study and the conclusions drawn, the researcher suggests the following recommendations.

- PFEA should make sure the tenure of members of the BoD that is put by the NBE directive number SBB/62/2015 is in place;
- PFEA should have the necessary personnel and budget to effectively monitor and secure the interest of the government as an owner on one hand and the general public on the other hand;
- PFEA must have a procedure for nominating the BoD members and must enforce liabilities of the BoD for the damage caused if they do not perform their duties effectively;
- PFEA must call the BoD and senior management of the bank a meeting at least once in a year, like the general assembly in the case of private banks, and must review in detail the annual performance of the bank and discuss on the next year over all plan;
- The bank must have a thoroughly studied CG framework;
- The bank should have formal orientation program for new board members. To be effective, new directors need to have a good deal of knowledge about the company and the industry within which it operates. An orientation program should be available to enable new directors to gain an understanding of the company's financial, strategic, operational and risk management position, governance practices, the rights, duties and responsibilities of the BoD members, the roles and responsibilities of senior managements, and the role of the committees;
- The BoD must establish Human Resource Affairs Committee so that there isa formal and transparent proposal on the employment and removal of members of the senior management of the bank and the overall salary and benefit of the bank is updated given the change in the industry;
- The bank must review its organizational structure in line with the CG framework and its Human Resource plan;

- The BoD must prepare succession plan policy for posts of the CEO, Vice Presidents and Chief Officers;
- The BoD members should examine and acquire sufficient information and provide sufficient time to closely monitor the day to day operation of the bank. This in turn will help them to effectively carry out their duties and responsibilities which again may improve the performance and good governance of bank;
- The BoD has to have a direct communication between the internal and external auditors;
- There has to be woman member of the BoD of the bank;
- Employees must be a member of the bank's BoD;
- The BoD and the senior management meeting /Process Council/ should have a separate secretary;
- The bank should establish a BoD secretary office that have the necessary personnel with competencies such as Legal, Diplomatic Skill and Communications etc.;
- The board should prepare Board charter; and
- Disclosure of information is one of the most severe problems the industry is facing in terms of good CG practices. Only Financial performance of the bank is disclosed. But other non-financial disclosures like a short report on the activities of the board committees, full information about the members of its board, their qualification, and other company directorship and selection process must be disclosed. The NBE shall make a meaningful change towards the importance of this big milestone to bring a culture that will help the industry as well as the country by introducing non-financial information to be part of a disclosure requirement as stipulated in OECD as well as Basel principles.

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Annex-1 Questionnaire



ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENTAL MANAGEMENT

Dear Respondents

I am graduating a class of Masters in Public Management and Policy at Addis Ababa University, Department of Public Administration and Developmental Management. This questionnaire is prepared for research purpose entitled-**Assessment on Corporate Governance Practice of the Commercial Bank of Ethiopia /CBE/**. As a member of your organization, your participation in this study will be valuable and greatly appreciated. Information gathered will be treated with utmost confidentiality and will not be used for any other purpose.

SECTION ONE: Demographic Information

INSTRUCTIONS: This part of the questionnaire asks your personal and job related information. Please respond to each question by circling to the choice that represents your personal profile.

1. **Sex** 1. Male 2. Female
2. **Age** 1.30 or Less 2. 31-40 3.41-50 4. 51 and above
3. **Marital Status**1. Single 2. Married
4. **Highest Level of Education Qualification:**
1. Diploma 2. BA/BSC/LLB 3. MA/MSC/LLM
5. **Number of service years in CBE**
1. Below 10 2. 10-20 3.21-30 4. Above30
6. **Current Position or Job title**
1. Branch Manager 2. Head Office Manager 3.Director/District Manager
4.Other_____

Part II - Questions concerning the Practice of Corporate Governance of CBE

The following are lists of items relating to the governance practice of the bank. Please state the extent to which you agree/disagree with the following items as they exist in CBE.

INSTRUCTION: Please put a tick (√) sign to appropriate space of particular score, which is suitable to your agreement about the following statements.

Rank: 1= Strongly Disagree, 2= Disagree,3= Uncertain, 4= Agree and 5= Strongly Agree

No.	Particular	Strongly disagree (1)	Disagree (2)	Uncertain (3)	Agree (4)	Strongly Agree (5)
Stakeholders						
7	The bank takes stakeholders' interest into account and respects stakeholders' rights that are established by law.					
8	The bank has a representative of employees on the board.					
9	The bank's stakeholders have the opportunity to obtain effective response for the violation of their rights.					
10	The bank's stakeholders have the right to freely communicate their concerns about illegal or unethical practices to the board.					
11	The bank has an on-going program to raise employees' awareness of corporate governance issues and the role which every employee can play in strengthening governance within the bank.					
Disclosure and Transparency						
12	The bank prepares and discloses information in accordance with accounting standards and financial and non-financial disclosure.					
13	Issues regarding employees and other stakeholders, such as programs for human resource development and training are disclosed.					
14	The bank provides channels for the dissemination of information to the relevant users on a timely basis.					
15	The bank discloses full information about the members of its board, their qualification, and other company directorship and selection process.					
16	The bank has a written information disclosure policy that seeks to make all material information (financial and non-financial) fully, timely and equally available to all stakeholders.					

No.	Particular	Strongly disagree (1)	Disagree (2)	Uncertain (3)	Agree (4)	Strongly Agree (5)
17	The bank's annual report/annual meeting report/contains a short report on the activities of the board committees.					
18	The bank publishes an account of its business objectives and its organizational and governance structure.					
Internal Control, Risk and Compliance						
19	The bank has a risk management system and a responsible organ for identifying risks and developing risk management framework.					
20	The bank has a compliance program or procedure that includes the training of employees, auditing and monitoring systems.					
21	An annual audit of the bank is conducted by an independent auditor.					
22	Audited reports are published regularly.					
23	The bank has code of conduct which all employees are required to comply.					
24	The bank establishes policies, procedures and/or guidelines to govern the work and behavior of all its operating organs.					
25	The bank has a formal "Compliance" office with a mission to ensure that the bank is in compliance with national and international requirements.					
The Role of Senior Management of the Bank						
26	The management of the bank motivates employees to perform their duties at their highest capabilities.					
27	The management of the bank develops individual values, institutional values and behavioral expectations to support the implementation of goals, strategies and plans that are established for appropriate processes.					
28	The management of the bank regularly observes the implementation of policies and procedures and takes appropriate actions when employees break rules.					
29	The management of the bank develops clear and flexible career paths and focus on career development and retention.					
30	The management of the bank discloses material interests in any transaction or matter directly affecting the company.					

If you have any comments, please state them in the space provided below.

Annex-2- Applicable Laws and Directives on CG in Ethiopia

1. Regulation No. 98/2004/Establishment of Public Financial Enterprises Agency-PFEA/

The bank, as a state-owned enterprise, is supervised by the Public Financial Enterprises Agency which has been established by Regulation No. 98/2004 to independently act as an owner on behalf of the government of Ethiopia. The agency is accountable to the Prime Minister and was established with the objective making financial public enterprises become efficient, competitive and modern with a view to enabling them serve as instruments in implementing government development policies.

The Agency shall have the powers and duties to supervise financial public enterprises in accordance with Article 11 and other relevant provisions of the Public Enterprises Proclamation No. 25/1992.

2. Public Enterprises Proclamation No. 25/1992

The public enterprises proclamation No. 25/1992 has been formulated with the intention that as long as public enterprises have to stay under government control, it is necessary to create an organizational structure whereby they can enjoy management autonomy and thus enable them to be efficient, productive and profitable as well as to strengthen their capability to operate by competing with private enterprise.

Article 10: Organization of an Enterprise- Each enterprise shall have:

1. A supervising authority;
2. A management board;
3. A general manager, deputy general managers as may be necessary; and
4. The necessary staff.

Article 11: Powers and Duties of the Supervising Authority /PFEA/- The supervising authority shall:

- a) Appoint and remove the members of the board subject to Article 12(2) of this Proclamation;
- b) Appoint the chairman of the board from among the members appointed by it;
- c) Fix the allowances to be paid to the members of the board;
- d) Appoint external auditors;
- e) Cause the allocation of the initial capital of the enterprise;
- f) Decide the increase or decrease of the capital of the enterprise in accordance with Article 21 or 22. Decrease of Capital. Of this Proclamation;
- g) Cause the establishment of reserve funds or the allocation of funds by the Government so that the authorized capital of the enterprise shall be fully paid up within the period specified under Article 20(2) of this Proclamation;
- h) Determine, based on the proposals of the Board and following the relevant provisions of this Proclamation, the amount of state dividends to be paid to the Government from the net profits of each financial year;
- i) Approve financial reports of the enterprise and external audit reports;
- j) Approve the investment plan of the enterprise submitted to it by the Board;
- k) Propose, where necessary to the Council of Ministers the dissolution, amalgamation or division of an enterprise under its control, or the transfer of the enterprise or its management in any other manner;
- l) Approve, in consultation with the Board, the annual and long-term corporate targets of the enterprise; and follow up their fulfillment;
- m) Without prejudice to the powers and duties given to the Board, perform other functions necessary for the protection of the ownership rights of the State.

Article 12: Formation of the BoD

- a) The number of members of the board shall be at least three but not more than twelve.
- b) Not more than one-third of the members of the board shall be elected by the general assembly of the workers. The rest of the members of the board shall be appointed by the supervising authority.
- c) The chairman of the board shall be appointed in accordance with Article 11(2) of this Proclamation.

- d) The members of the board shall be appointed or elected on the basis of their profession, experience and competence.
- e) Any member of a board may also be appointed to act as a board member of any other non-competing enterprise.
- f) The term of office of the members of the board shall be at least 3 but not more than 5 years. When necessary, a member of the board may be reappointed or reelected at the expiry of his term of office.
- g) In order to maintain the continuity of the activities of the board, the term of office of its members shall not expire at the same time.
- h) Where any member resigns from membership, the board shall bring the matter to the attention of the supervising authority so that another person is assigned in the same manner as the member who has left the board was assigned.
- i) The supervising authority may, at any time, remove a board member where there are sufficient grounds that make him unfit to be a member. Where this provision is applied to a member elected by workers, the general assembly of the workers shall be notified of the removal and may elect another member in replacement.

Article 13: Organization of an Enterprise

- a. The board shall meet at least once a month.
- b. The chairman shall call a meeting of the board, at any time, in cases of urgency or where at least two members of the board so request.
- c. The agenda of a board meeting shall, in advance, be communicated to the board members.
- d. There shall be a quorum where a majority of the members are present.
- e. The board shall take decision by majority vote. In case of a tie, the chairman shall have a casting vote.
- f. The board shall select and assign a secretary from among the employees of the enterprise.
- g. The General Manager of the enterprise may attend meetings of the board without having the right to vote.
- h. The board shall keep minutes for every meeting, which shall be signed by the members present.
- i. The board shall draw its own rules of procedure.

Article 14: Powers and Duties of the BoD

The board shall:

- a. Decide on policy issues other than those to be submitted to the supervising Authority pursuant to Article 11 of this Proclamation;
- b. Appoint and dismiss the general manager of the enterprise and fix his salary and allowance;
- c. Approve the employment, assignment and dismissal of those officers of the enterprise accountable to the general manager, including their salaries and allowances;
- d. Approve the internal regulations of the enterprise as well as its work programme and budget;
- e. Approve long-term loans and credits of the enterprise;
- f. Approve the sale of fixed assets that may not affect the existence of the enterprise;
- g. Ensure that proper books of accounts are kept for the enterprise;
- h. Submit books of account to the auditors of the enterprise, and periodic reports on the state of activities of the enterprise and financial reports to the supervising authority;
- i. Propose to the supervising authority the increase or decrease of the capital of the enterprise.

Article 16: Powers and Duties of the General Manager/CEO/

- a) Organize, direct, administer and control the enterprise;
- b) Represent the enterprise in all dealings with third parties and in legal proceedings brought by or against it;
- c) Subject to the approval of the board, employ, assign and dismiss the officers of the enterprise accountable to him and define their functions;
- d) Employ, assign and dismiss other employees of the enterprise in accordance with the internal regulations of the enterprise and the appropriate law, and determine their salaries and allowances;
- e) Keep proper books of accounts of the enterprise, and open and operate bank accounts to the enterprise;
- f) Enter into short-term loan contracts for the purpose of providing the working capital of the enterprise, borrow money on a long-term basis with the approval of the board, and for those purposes pledge or mortgage the movable or immovable property of the enterprise;

- g) Prepare and submit to the board the internal regulations as well as the work program and budget of the enterprise, and implement same upon approval;
- h) Sell fixed assets that may not affect the existence of the enterprise with the approval of the board;
- i) Implement and cause the implementation of the decisions of the board;
- j) Submit report to the board in such manner as it shall prescribe;
- k) Delegate his powers to the officers and other employees of the enterprise to the extent deemed necessary by him;
- l) Establish, and preside over the meetings of, a management committee that shall advise on the operations of the enterprise and that may discuss on the progress, plans and decisions of the enterprise;
- m) Perform other duties assigned to him by the board.

3. The CBE Establishment- Regulation No. 202/1994

The aforementioned Regulation No. 202/1994, which is composed of ten articles, incorporates provisions including the CBE's establishment and its supervising authority, purposes of establishment, capital, liability, duration of the Bank and transfer of rights and obligations.

4. Banking Business Proclamation No. 592/2008

Article 14 - A Director shall be of a person with honesty, integrity, diligence and reputation to the satisfaction of NBE. This in line with commercial code art.347 of 1960. The appointment of any director, CEO, senior executive officer of a bank may not be valid unless a written approval is granted by NBE. The NBE may issue directives on qualification competency, minimum number of directors, duties, responsibilities and good CG of the bank, the maximum number of years a director may serve and condition for his re-election, and maximum number the employees at that may serve on the board.

As per **Article 15** -persons convicted of any offence involving breach of trust of fraud is prohibited from getting appointment as directors and officers. Persons worked in a failed bank require prior approval of the NBE for appointment to work in the management position. A director or CEO of a financial institution may not, at the same time, serve as a director of a bank, nor a business in

which such a director has more than 10% equity may not serve as a director of a bank. An employee of a bank may not be a chairperson of a BoD of the bank or a director of any other bank. This promotes the separation of the position of CEO and chairperson of board of directors.

Under **Article 17** it is provided that the NBE can suspend and remove a director, CEO and senior executive officer for sufficient cause.

5. Overview of Banks CG Directive No SBB/62/2015

The Bank CG directive is composed of articles related to general requirements, board of directors, shareholders, Chief Executive officer, Meeting and disclosure have been approved by the council of Ministers and became operational effective September 21, 2015.

Article 5 – BoD size and Composition:

- a. A bank shall at least have nine BoD members;
- b. The members shall have a good mixture of gender, education and other core competencies.

Article 10 – BoD:

10.1. Approval and Term of Office of the BoD;

- Appointments of the BoD members shall be approved by the NBE;
- Any member of the BoD shall not serve for more than six consecutive years. However, s/he may be re-elected for one more term-another six years.

10.2. Qualification and Training of BoD members;

- Training to members of the BoD shall be given by the bank at least once in a year;

10.3. Meeting of the BoD;

- The BoD shall have a formal rule for its meetings;
- The BoD shall meet at least once in a month;

10.4. Over all responsibilities of the BoD;

- Propose external Auditors;
- Select and Approve the CEO and the Senior management of the bank;
- Ensure that the overall operation of the bank is run prudently;
- Ensure that appropriate and timely actions are taken based on the findings and recommendation of NBE examiners, External Auditors, Internal Audit and Risk management;

- Assessing the effectiveness of the BoD semi-annually and report to NBE;
- Ensure that the capital adequacy of the bank is sound;
- Reviewing and Approving Annual Business Plans and Budgets, Strategies, Policies, Systems;
- Reviewing and Approving clear lines of responsibilities, accountabilities and delegation of authorities;
- Reviewing and Approving Code of Conduct of the BoD;
- Ensure that Code of Conduct of Employees of the bank is in place;
- Ensure that the bank put in place the overall risk management program, succession plan and HRD strategy of the senior management members;
- Ensure that independent Internal Audit system is in place.

10.5. Description of Authority;

10.6. Exit Report;

- At the end of the office term, the BoD shall prepare a comprehensive exit report and submit to the Board secretary and NBE;
- There shall not be remuneration unless the BoD submits the exit report.

Article 11 –Responsibilities of the CEO;

The CEO shall:

- Prepare strategies, annual business plans and budgets;
- Prepare, approve and implements policies, procedures, guidelines and other control instruments;
- Prepare organizational structure subject to the BoD approval;
- Provide accurate, regular and timely report to the BoD;
- Ensure that corrective actions are taken based of the findings and recommendations of the NBE, external auditors, internal audit and risk management reports.

Article 12- Disclosure

- The BoD, CEO and senior management of the bank shall disclose relevant information to the stakeholders.