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COLLEGE OF BUSINESS AND ECONOMICS
MASTER OF BUSINESS ADMINISTRATION PROGRAM

THE EFFECT OF CORPORATE GOVERNANCE ON THE ROA
OF INSURANCE COMPANIES IN ETHIOPIA

BY:

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DECLARATION

I, Nof Bilal, hereby declare that this thesis entitled “The Effect of Corporate Governance on the Return on Asset of Insurance Companies in Ethiopia” is outcome of my own effort and study and that all sources of materials used for the study have been duly acknowledged.

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

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This is to certify that the thesis prepared by Nof Bilal, entitled “The Effect of Corporate Governance on Return on Asset of the Ethiopian Insurance Companies” and submitted in partial fulfillment for Masters of Business Administration in Management complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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LIST OF ABBREVIATIONS & ACRONYMS

AC	Audit committee
CEO	Chief Executive Officer
CG	Corporate Governance
NBE	National bank of Ethiopia
OECD	Organization for Economic Co-operation and Development
ROA	Return on Asset
ROE	Return on Equity

ABSTRACT

The study looked at the effects of corporate governance on ROA of Insurance companies in Ethiopia. This explanatory study sought to analyze the effect of different corporate governance mechanisms, particularly board size, variety number of internal board sub-committee, meeting frequency, CEO duality, gender diversity and educational qualification of directors on the ROA of 9 privately owned insurance companies of Ethiopia. In order to achieve this objective, the study used mixed research approach that is by adopting the quantitative method supplemented by the qualitative method of inquiry that helps to get benefits of a mixed methods approach and to mitigate the bias in adopting only either quantitative or qualitative approach as well as capturing and administrating primary data using unstructured questionnaire and in-depth interviews which were completed by board secretary and delegated staffs as he/she is in a better position to comment on corporate governance affairs. Panel data covering 10-year period from 2006-2016 was analyzed and regression result with recommendation are displayed for the selected 9 insurance companies. The Fixed effect model technique has been applied to find out the most significant variables from considered corporate governance variables and estimate the regression equation. The findings indicated that board size and variety, number of internal board sub-committee had positive effect on insurance company ROA whereas board meeting frequency had negative impact on ROA. Future researchers need to focus on these significant variables and additional corporate governance mechanisms.

Keywords: Insurance companies, ROA, Corporate Governance

CHAPTER ONE

1. Introduction

1.1. Background of the study

Investors want to see how insurance companies manage themselves and their relationships with shareholders and stakeholders and they wanted to evaluate the risk management & the return on asset of Insurance Company and thus help to build their confidence on the sustainability of the insurance operation.

Financial institutions occupy a unique position within the broader economy. Financial sector considers the insurance industry as a mirror for the financial stability of a country (Adrian, 2014). Developing countries are now increasingly embracing the corporate governance concept knowing it leads to sustainable growth. Ever since the financial crisis in 2008, financial institutions have been closely examined. Capital market regulation due to the 1929 market crash and 1930 economic crises in the United States was resulted due to questionable corporate governance practices (Imeokparia, 2013). The national and international response to the crisis has been characterized by calls for further regulation of the financial services sector. (Organization for Economic Development, 2009). Mehran and Mollineaux (2012) also implied that healthy economy cannot exist without a well-functioning financial system. Financial instability has highlighted the potential fragility of financial systems and the effect it can have on the broader economy. As a result, international attention is now being given to understanding the causes and dynamics of financial crises and to developing policy frameworks for promoting robust and efficient financial systems. An important part of this work relates to corporate governance arrangements and the role that these can play in encouraging sound risk management practices. (Commonwealth Working Group, 2000)

Corporate governance is a sum of involvement of different groups and with different roles. Board, management, stockholders, depositors, and employees are the key elements in any institution corporate governance. To be more specific, board size, financial expertise of directors, numbers of board meetings, committees of the board (audit committee, remuneration committee, and nomination committee) are the key players in organization corporate governance. The size of board is believed

to have a significant impact on firm's return on asset and directors should be financially literate, so that they can better understand the implications of decisions taken by management and thus, lead to better & effective controlling. Moreover, board members should meet sufficient number of times as very few meetings show lack of interest on the part of board, while too frequent meetings indicate some trouble in the organization. Additionally, board committees (audit committee, remuneration committee, nomination committee and others) add to effectiveness of board by exercising better control over management decisions (Aggarwal, 2013)

Potential conflict between investors, stakeholders and managers resulted in the corporate governance subject. (Wells, 2010) It's an important concept because of its great effect on the financial and economic health of corporations and society in general (Nwokoma, 2005). Engidawork (2015) infers that it is the separation of ownership and control that resulted the concept of corporate governance. According to Tura (2012) the practice of good corporate governance is also considered as a source of competitive advantage. Well-governed companies are considered to draw huge investment premiums, get access to cheaper debt, and outperform their objectives. Good corporate governance practices convert principles into objective recommendations, aligning interests with the purpose of preserving and enhancing the organization's value, facilitating its access to capital and contributing to its longevity.

Insurance companies are in the business of taking risks and writing policies that deal with specific risks, and in many cases, even underwrite exotic risks. In carrying its core activities, i.e., pricing, underwriting, claims handling and reinsurance management, an insurer will face a wide range of risks which are often interlinked and if not properly managed, could threaten the ability of the institution to achieve and sustain its viability.

Mulugeta (2010) has also noted that Ethiopia has established strategic framework for the financial sector and accentuate the importance of further strengthening corporate governance and making the financial institutions accountable. Better corporate governance of corporations, financial institutions and markets is increasingly recognized as a pre-condition for the country's development and it is directed and monitored by NBE. This research aimed to look the effect of corporate governance mechanisms on the return on asset of Ethiopian Insurance companies.

1.2. Statement of the Problem

Due to the sensitive business nature and an irreplaceable role financial institutions play in the macro economy of a given country, poor corporate governance practice may have a macroeconomic impact that could potentially affect the whole economy (Engidawork, 2015). He further noted that the failure of giant international organizations had provided costly lesson to the business world and the need to have a well-studied governance system in organizations. In connection with this, tight corporate governance requirements were imposed on publicly traded firms by regulators and other organizations in different periods. This is a reactive way of addressing the issue of corporate governance across the world and can be evidenced by most of the guiding principles which have been enacted based on the incidents observed in the business world. Imeokparia (2013) stated that emergence of capital market regulation in the United States was a reaction to questionable corporate governance practices.

Anthony et al. (1997) stated that insurers are in the risk business. In the process of providing insurance and other financial services, they assume various kinds of actuarial and financial risks. Thus, Insurance companies have a dominant role in developing economic financial stability and are basic machines to ignite the economic growth of a country.

In recognition of the importance of financial systems to the wider economy, and the role that corporate governance can play in promoting financial stability; there have been huge concerns and calls for better corporate governance practices in Ethiopia. Furthermore, the finance sector is sensitive environment where any weak corporate governance in financial institutions may affect the whole economy as a whole. Though literatures don't ignore the influence of corporate governance on return on asset, there are inconsistent findings on effect of corporate governance on Ethiopian major insurance companies.

One of the study for instance conducted by Tura (2012) focused and dealt with legislative provisions on governance issues related to the separation of ownership and management responsibilities, on the composition, independence and remuneration of board of directors in share companies. Furthermore, research has found that the current global financial crisis is mostly attributed to failures in corporate governance. (Erkens, Hung, Matos, 2009)

Developing countries are now increasingly embracing the concept knowing it leads to sustainable growth (Fred, 2012). Dunlin (2003) agrees to the recognition of a society's financial system as playing important roles in the economic development of that society. Hence, this research addressed which major variable of corporate governance among many have positive and which variable have negative effect on insurance performance based on ROA in Ethiopia and increase the body of knowledge of researchers and other users in Ethiopia by analyzing the hypothesis developed under this research. In addition, in developing countries like Ethiopia only few corporate governance variables have been incorporated and the numbers of observations were limited in terms of the variables and number of years of observations. To mention some of the observations' limitations: Using narrow period or number of years and small sampling size, methodology of data gathering and analyzing focused by some of the studies were limited only on secondary data. To come up with a better insight; this study has been covered by assessing and including vaster corporate governance mechanisms including major areas of board of directors' characteristics such as board size, number of board sub-committee and meeting frequency of board. Hence this paper addressed the effect of selected corporate governance mechanisms, which have been sufficiently uncovered variables in the previous studies to be further explained and return on asset of the insurance companies within the given period which is measured by the return on asset (ROA). This help stakeholder to take lesson from the study to strengthen their best practice and improve on the gaps identified as well as point out areas which need further study and evaluate to incorporate additional & wider corporate governance mechanisms

1.3. Objectives of the Study

1.3.1. General Objectives

The main objective of this study is to identify the effect of corporate governance factors on insurance Return on Asset.

1.3.2. Specific Objectives

The study addresses the following specific objectives:

- i. Identifying the effect of board size (members of board of director) and their educational qualification on the Return on Asset of the insurance company.
- ii. Identifying the effect of board subcommittees on Return on Asset of insurance company.
- iii. Identifying the effect of frequency of board meetings on the Return on Asset of the insurance company
- iv. Identifying the effect of CEO duality & his/her compensation on the Return on Asset of the insurance company
- v. Identifying the effect of CEO duality & his/her compensation on the Return on Asset of the insurance company
- vi. Identifying the effect of the presence of female directors on the Return on Asset of the insurance company
- vii. Identifying the effect of the age of the insurance company on Return of Asset.

1.4. Research Hypothesis

This section discussed the research hypotheses, research methods and different data sources which were used to address the study problem. In general, basing the research problems and objective of the study; eight hypotheses were tested. Similarly, based on the underlying principles of research methods and research problem; mixed method were chosen as appropriate to this research. Specifically, a structured record review was used to collect quantitative data whereas in-depths interviews were conducted to gather qualitative data.

Ha1: There is no significant relationship between board size and Return on Asset.

Ha2; There is no significant relationship between educational Qualification of directors with business backgrounds and Return on Asset in Ethiopian Insurance company

Ha3: There is no significant relationship between the proportions of female directors and Return on Asset.

Ha4: There is no statistically significant relationship between Frequency of board meetings and Return on Asset.

Ha5: There is a no significant association between board member's other business management experience and Return on Asset.

Ha6: There is no significant association between board member's industry specific experience and Ethiopian Insurance company Return on Asset.

Ha7: CEO duality of the insurance companies has no statically significant effect on Return on Asset.

Ha8: Age of the insurances' company has no statically significant relationship with Ethiopian insurance companies' Return on Asset.

1.5. Scope of the Study

There are several corporate factors that influence the return on asset of a certain insurance company. However, the current study focused on major corporate governance factors and board of directors' structure to see their impact on ROA of Ethiopian insurance companies. The study covered private insurances having 13 and more years of experience ranging from 2006 to 2016.

1.6. Limitation of the Study

Due to the exposure that board members and executive management has about the topic, the researcher encountered several limitations concerning limited accessibility of board members. Lack of timely submission of the questionnaires, confidentiality of some information and reliability on accounting based return to measure insurance return on asset is also considered as one limitation of the study.

1.7. Significance of the Study

Studying the corporate governance practice is hoped to assist the Ethiopian insurance industry in particular and the Ethiopian economy in general and increase the understanding of all interested stakeholders. The researcher also hopes that the findings and recommendations of this study provide a framework for the adoption of sound corporate governance practices in Ethiopian insurance

companies to be used by management or other interested stakeholders as well as an input for policy makers to identify the effect of corporate governance mechanism on insurance return on asset. Finally, the results of this study motivate potential researchers and lay foundation for further study on the field of business and related disciplines and use academicians as a reference in their study.

1.8. Structure of the Paper

The Study is organized into five chapters. The first chapter present brief introduction of the study. The second chapter is dedicated to review of related literature pertinent to the title. The third chapter presents methodology of the study. The fourth chapter presents the findings, analysis & discussion of the data. Finally, chapter five contains conclusion of findings and recommendations. Last part includes Appendices and Bibliography.

CHAPTER TWO

2. Literature Review

The wide range of literature reflects a strong diversity of theoretical grids. This chapter focused on the theoretical review which is relevant to the title and previous studies on corporate governance variables are also reviewed as the views are different due to the different corporate governance theories. These theories attempt to explain how managers in an organization are governed (Gerard, 2004).

According to (Fernando, 2009) corporate governance concept has gone further as a subject of matter, an objective, or a regime followed for the benefit of shareholders, employees, customers, bankers and indeed for the reputation and standing of a nation and its economy.

In recent years, researchers all over the world have faced some challenges to analyze the effect of corporate governance on corporate return on asset. A challenge was discovered to be the ideal measure of corporate governance, as there is no universally accepted measure of corporate governance (Calabrese, Costa, Menichini, Rosati, & Sanfelice, 2013). Yakasai (2001) argued that board structure could be an ideal measure of corporate governance. However, (Chiorazzo ,2008) has used corporate ownership and control as the measure of corporate governance for big and non-financial corporations. According to Ramano (2012), corporate governance should use any variable, which has a direct impact on corporation return on asset. After measuring this concept using board structure Boone, Casares Field Karpoffa and Raheja (2007) confront that good corporate governance practices seem to enhance company return on asset.

2.1. Theoretical and Conceptual Review

Although corporate governance as a term has only been around for about 15 years, the theories that underlie its development have been around for much longer. It is argued by the academics that several theories have influenced the development of corporate governance. These are:

2.1.1. The Agency Theory

The Agency theory was first proposed by Jensen and Meckling (1976) in a theory of the firm based upon conflicts of interest between various contracting parties such as shareholder's corporate managers and debtors. This theory is based on the belief that there is a basic conflict of interest between the owners and managers of the company (Kiel & Nicholson, 2003). The main challenge that arises from the agency conflict is how to induce the agent to act in the best interests of the principal. In such corporations, the managers (agents) are hired to work and make decision on behalf of the owners (principals) in order to maximize return to the shareholders. However, the managers (agent) who are put in control of the affairs of the organization may not always consider the best interest of the owners and may pursue their self-activities to the detriment of the welfare of the principals (David and Tobias 2013). The effect of this agency theory is that one can only try to mitigate against this agency problem when the board is composed largely by non-executive directors (independent and dependent) who be able to control the activities of managers and thereby maximize shareholders 'wealth. The governance structures suggested by the agency theory involve size of the board, composition of the board, remuneration to CEO, directors 'shareholding and shareholder right (Luan & Tang, 2007; Rashid, 2011).

2.1.2. The Stewardship Theory

According to Davis (1997), the best stewards are the managers and these managers are collectivists who prioritize organization interest over self and individual interests under this theory and this is what makes this theory different from agency and stakeholder theories. Thus, the managers are always there to attain organizational objectives.

The stewardship theory indicates that there is no misalignment between the interests of managers and owners because steward managers believe the pursuit of what is best for the organization is what is best for their constituents and themselves. Under this theory corporate governance model, managers are believed to be loyal to the company and interested in achieving best return on asset. Managers have the desire to perform best and it is this motive that directs them to accomplish their plans and set objectives. In this perspective, stewards are company executives

and managers working for the shareholders, protects and make profits for the shareholder (cited in David and Tobias 2013).

This underlying assumption of commonality between managers and owners runs counter to the assumption of the individualistic, self-serving, opportunists that organizational economists have offered as the model of firm management in a market system (Arthurs, 2003). Stewardship theory also argues that individuals can abandon self-interest. In this case, the managers are not motivated by personal or individual goals but rather by the firm interests (Wesley, 2010). This theory is a contrast or a direct opposite to the agency theory and this theory adopts a more idealistic view of humans.

2.1.3. Stakeholder Theory

The other popular theory of corporate governance is the Stakeholder theory. It is based on the argument that other than shareholders there are several agents with an interest in the actions and decisions of companies. In addition to shareholders, stakeholders include creditors, employees, customers, suppliers, and the communities at large. Stakeholder theory asserts that companies have a social responsibility that requires them to consider the interests of all parties affected by their actions. Management should not only consider its shareholders in the decision making process, but also anyone who is affected by business decisions. In contrast to the classical view, the stakeholder view holds that “the goal of any company is or should be the flourishing of the company and all its principal stakeholders (Freeman et al., 2004). It looks further than the traditional members of the corporation (officers, directors, and shareholders) and also focuses on the interests of any third party that has some level of dependence upon the corporation.

Companies should act as good corporate citizens, acting in ways that benefit society. The board in making decisions should give priority to those stakeholders who are the most important to the company, for example, employees, investors, customers, suppliers, creditors, and the public. This means that a company’s Board has to balance many objectives, as their stakeholders have different interests, not just maximizing shareholder value. Stakeholder theory formed the basis for the stakeholder approach to corporate governance adopted by the Organization for Economic Co-

operation and Development (OECD) in their principle of Corporate Governance by Jensen and Mackling.

2.1.4. Resource Dependency Theory

This theory promotes firms' environmental linkages with outside resources. The theory suggests that organizations have varying degrees of dependence on the external environment, particularly for the resources they require to operate. According to Pfeiffer (1972), firms' success is defined based on the ability to maximize power through accessing scarce and essential resources and it of the assistance of boards to get reach in such resources.

Hillman et al. (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson et al, (1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. It has been argued that the provision of resources enhances organizational functioning, firm's return on asset and its survival (Daily et al, 2003).

2.2. Corporate Governance Tools and Firm Return on Asset (*Empirical Literature*)

Corporate governance mechanisms are essential tools needed in managing any corporation including banks. There are different mechanisms that reduce agency cost whereby corporate governance can be measured in an organization. Management and its board of directors are internal corporate governance instruments. The existence of regulation is one of the external governance forces, in addition to the market, with the power to discipline the agent. In the corporate governance literature board size, diversity of board sub-committees, board gender diversity and experience and audit committee size were used as corporate governance mechanisms. There are scanty and inconclusive studies and findings on the effect of corporate governance mechanism on the return on asset of Insurance companies in developing countries (Joan, et.al, 2010). Many researchers argued that the

board of directors is the central corporate governance control mechanism responsible for monitoring the activities of managers and improving the performance of firms and board of directors have been described as the apex of the internal control mechanism in an organization (Jensen 1993; Hillman et al. 2000; Joan, et.al, 2010).

The empirical review of the literature has focused on more relevant explanatory variables that are deemed to have effect on the performance of Ethiopian Insurance companies. These endogenous explanatory variables and corporate governance mechanisms considered in this paper include board size, board independence, size and independence of audit committee, board diversity, CEO duality and compensation and frequency of board meeting.

International organizations such as Organization for Economic Cooperation and Development (OECD) have developed corporate governance principles which stressed on the role of boards. A strong board can play an important role in improving firm return on asset and can help the firm to achieve better performance by effectively undertaking their monitoring duties (Bathula, 2008). When the board is effective it is expected to drive the company towards better financial achievement (Andres and Vallelado, 2008).

A great number of studies reviewed the relation between corporate governance variables and performance of firms in various economic contexts, however the results from these studies have been found to be inconsistent. From these studies, empirical & conceptual evidences that deal with the corporate governance mechanisms such as board size, board meetings, audit committee, gender diversity, and board compensation are summarized in relation to firm's performance below:

2.2.1. Board Size

Board size is defined as the number of directors on the board. The size of board is believed to have a significant impact on firm's performance; which is usually observed to be positive (Aggarwal, 2013). Vanden Berghe and Levrau (2004) argue that expanding the number of directors provides an increased pool of expertise and thus larger boards are likely to have more knowledge and skills at their disposal than smaller boards. however, on the contrary, Lipton and Lorsch (1992), asserted that large boards are associated with greater free riding, slower decision making, and

problems of coordination, control and flexibility in decision making. According to Jensen (1993), the decision-making power of the board becomes slower with the involvement of more people. Similarly, Gill and Mathura (2011), found a negative relationship between the performance of 75 Canadian service firms and board size. Another research by Olubukunola (2011), concluded that bank with large board size record a profit lower than those with smaller board size.

Another study states that small size of a board has a positive contribution because smaller number of boards of directors is more effective and exhibited better values for financial ratios (Jackson, 2007, Lukwago Joel, 2012, Abdi, et. al, 2014). Adetunji and Olawoye (2009) argue that board size determines the number of directors in a board and the board should be of reasonable size, and the terms of its directors should be fixed and advocates for optimal size of board of directors for good corporate governance as well as performance in the firm. Moreover, the National bank of Ethiopia (2015) has stated the minimum number of board size of an insurer to be nine. Coles, et al. (2008) provide evidence that the nature of the firm determine the size of the board. They also noted that, for firms with character of large size, highly leveraged or diversified nature, board size and performance have positive relationships.

2.2.2. Board Meeting Frequency

There are two theoretical views on board meeting frequency: those who are in favor of higher frequency of board meetings and those who are not (e.g. Lipton and Lorsch, 1992; Jensen, 1993). A higher frequency of board meetings will result in a higher quality of managerial monitoring. When boards hold regular meetings, they are more likely to remain informed and knowledgeable about relevant performance of the company leading them to take or influence and direct the appropriate action to address the issue (Adams, 2000; Abbott et al., 2003; Funmi, 2014). This will imply that there is a positive relationship between frequency of board meetings and financial performance. (Vafeas 1999, p.118).

However, on the other hand, opposing theoretical view is that board meetings are not necessarily beneficial to shareholders Vafeas (1999, p.114) argues that normally the limited time directors spend together is not used for the meaningful exchange of ideas among themselves. Instead, routine tasks, such as presentation of management reports and various formalities absorb much of the meetings

Nevertheless, the frequency of meeting to be held by the board depends on the size and volatility nature of the businesses. Firms with small size and stable environment are expected to have less number of meetings than large and risky businesses (Colley, et al., 2005).

2.2.3. Audit Committee

The audit committee is a subcomponent of the main board which is responsible for overseeing the company's financial reporting process and ensuring that accounting policies are sound and financial statements are properly prepared and audited (Green, 2005).

The evidence suggests that having audit committee with qualification of accounting and finance improves governance quality. For instance, Defond, et al., (2005) indicated a positive reaction of the market for firms having an audit committee which is composed of accounting background than those with non-accounting background.

2.2.4. Gender Diversity

Gender diversity of the board is measured as the percentage of number of female directors divided by the total number of board members. Due to the varying size of boards from one insurance to another, a percentage variable provides a more accurate and comparable measurement thus the percentage has been taken. Board gender diversity is assumed to improve company performance since it provides new insights and perspectives (Bathula, 2008). It is also believed that female board members bring diverse viewpoints to the boardroom which is not possible if all directors are male. Those who hold the view in favor of gender diversity in enhancing firms' performance argue with the anecdotal evidence that women may have a competence and network which may be absent with male board members, and this directly contributes to product, process, organizational and market development, and subsequently improves firm's performance (Huse,2007). For instance, the study made on 2500 Danish firms identified that women working in top management positions have a positive effect on the firm's performance (Smith, et al., 2005). Moreover, a more recent study which was conducted in listed firms in China, also verified the positive relationship (Liu, et al., 2014). In addition, board diversity of a moderate board size

with a considerable number of women is better placed to ensure independence of the board hence boosting return on asset (Abdi, et. al, 2014, Lukwago Joel, 2012, Roy Mersland, 2008).

2.2.5. CEO Compensation

There is a large volume of published studies evidencing the importance of top executive compensation on firms' performance, such as Murphy (1985); Jensen & Murphy, (1990). Further investigation on whether the type of compensation (cash or equity) give rise to a variation in performance was made by Mehran (1995) and the finding shows a positive relationship between equity rather than cash compensation with firms' performance.

Under this section corporate governance in the context of Ethiopia is presented. According to NBE recent intended corporate governance guideline corporate governance plays a vital role in maintaining the safety and soundness of financial system in general and insurance sector in particular the benefit of corporate governances gives way to balanced risk taking and enhances business prudence, prosperity and corporate accountability with ultimate objective of realizing long term Shareholders value, insurance consumers' and other stakeholders interest Introduction and development of corporate governance in Ethiopia is therefore a necessary but revolutionary change in the ownership philosophies, management and operations of Ethiopia companies. It would help to dissolve financial and market access blockages but at the same time place far reaching requirements for revision of business practices by companies aiming at growth and prosperity for their owners and stakeholders.

Corporate governance in Ethiopia is not improving even though the Ethiopian economy is at a stage of transformation. This is evidenced by study of Ahamed (2012) who critically examines Ethiopia company law and found that the Ethiopia company law does not have adequate legislative provisions on governance issues related to the separation of supervision and management responsibilities, and on the composition, independence and remuneration of board of directors in share companies. Furthermore, the author argues that there is a need to distinguish between corporate governance and corporate management in Ethiopia company law, and that the board should be suitably composed of non-executive and truly independent members who should be professionally competent.

In addition, Minga (2008) states that the status of corporate governance in Ethiopia is Disappointing and noted that the Commercial Code of 1960 does not provide adequate legislative response to complex governance issues of the day, the new draft corporate law has not yet been finalized; and he further states that key international conventions, codes and standards are not ratified; political parties own substantial number of business enterprises and operate in key sectors of the economy ownership concentration through pyramid structure introduces particular problems of agency and creates crony capitalism investor and creditor protection laws are inadequate; the absence of organized equity market is a serious void. Consistently, Kiyota, Peitsch, and Stern (2007) contended that the closed nature of the Ethiopia financial sector in which there are no foreign banks, a non-competitive market structure, and strong capital controls in place; and the dominant role of state-owned banks are the two major factors that may constrain Ethiopians financial development.

Similarly, Fekadu (2010) argues that the regulation of NBE is not sufficient to protect minority rights, because the main objective of NBE is financial regulation and which is just one aspect of governance. The study conducted by the Addis Ababa and Ethiopia Chambers of Commerce and Sectoral Associations (2009) on corporate governance in Ethiopia suggests that the introduction of a voluntary code of corporate governance in the country. It recommends that corporate governance law reform should consider key development policy aspects which match with the countries plans for poverty reduction and wealth creation. Good corporate reporting and disclosure are important aspects of sound corporate governance.

According to World Bank (2007) in Ethiopia, however, there is no particular accounting standard regarding financial reporting and disclosure in Ethiopia. Neither are any of the international standards officially adopted. Some of the laws indicate the use of generally accepted accounting principles. The absence of a particular accounting standard to be followed by all companies may be a drawback to the corporate governance practice in Ethiopia. Nonetheless, currently National Bank of Ethiopia is working to adopt the International Financial Reporting Standards (IFRS) to be followed by financial institutions operating in the country.

2.3. ROA of Insurance Companies

This section of literature review concentrates on previous studies that have been conducted in relation to this study. There were mixed results concluded by previous studies pertaining to the relationship between corporate governance mechanisms and firms' financial performance. The important empirical studies are summarized below in this section.

Uadiale (2010) examines the impact of board structure on corporate return on asset in Nigeria. He found as the existence of strong positive association between board size and corporate financial performance. It investigates the composition of boards of directors in Nigerian firms and analyses whether board structure has an impact on financial performance, as measured by return on asset and return on capital employed. Based on the extensive literature, four board characteristics (board composition, board size, board ownership and CEO duality) have been identified as possibly having an impact on corporate return on asset and these characteristics are set as the independent variables. The Ordinary Least Squares (OLS) regression was used to estimate the relationship between corporate performance measures and the independent variables. Further he noted as exists of positive association between outside directors sitting on the board and corporate financial performance. However, a negative association was observed between directors' stockholding and firm return on asset measures. In addition, the study reveals a negative association between return on capital employed (ROE) and CEO duality, while a strong positive association was observed between ROE and CEO duality. The study suggests that large board size should be encouraged and the composition of outside directors as members of the board should be sustained and improved upon to enhance corporate financial performance.

Ibrahim et al. (2010) examined the role of corporate governance in firm performance. Their study was a comparative analysis between chemical and pharmaceutical sectors of Pakistan using a sample of five companies from each sector from the year 2005 to 2009. Multiple linear regression models with panel data methodology were used. Return on asset and return on asset was used as a measure of performance and they used three corporate governance variables; board size, board independence and ownership concentration. They found that in both sectors, the impact of corporate governance on return on asset is significant but there is no significant impact on return on asset. In case of sector analysis, there is an insignificant impact of corporate governance on return on asset for chemical and

pharmaceutical. On the other hand, there is a significant impact of corporate governance on return on asset in chemical sector, but in pharmaceutical the impact is insignificant.

Aldamen et al. (2011) conducted a study on the effect of audit committee characteristics and firm performance during the global financial crisis. The researchers used logit model analysis with a sample of 120 firms listed on the S&P300 during the period of 2008 and 2009. The study revealed that smaller audit committees with more experience and financial expertise are more likely to be associated with positive firm performance in the market. It also found that longer serving chairs of audit committees negatively impacts accounting performance. However, accounting performance is positively impacted where audit committees include block holder representation, the chair of the board, whose members have more external directorships and whose chair has more years of managerial experience.

Amran (2011) empirically studied the association between Corporate Governance Mechanisms and Company Performances. It was expected that corporate governance mechanisms affect company performance. The hypothesis was tested on 424 public listed Malaysian Companies (233 family controlled firms and 191 non-family controlled firms) and the data about corporate governance mechanisms and company's performance was collected from Sultanah Bahiyah Library database from the year 2003 to 2007. Board size, board independence director's professional qualification, leadership structure was used as a corporate governance mechanism, debt, firm age and firm size were used as a control variable while Tobin's Q were used as a measure of company performance. Panel data methodology with generalized least square estimation method was used to test the hypothesis. The analysis has been done by classifying the sample as family controlled firm and non-family controlled firm. The researcher revealed that director's qualification measured as the percentage of directors with degree and above divided by total directors helps to enhance the performance of non-family controlled firms but insignificant for family controlled firms. Board size and leadership duality was a significant negative influence on family controlled firms' performance but insignificant for non-family controlled firms. Firm age was a significant negative and positive association between the performance of family controlled and non-family controlled firms respectively. On the other hand, there was a significant negative relationship between firm size and performance of both families controlled and non-family controlled firms. The other variables such

as board independence and director's professional qualification were insignificant for both classes of firms.

Al-Manaseer et al. (2012) empirically investigated the impact of corporate governance on performance using 15 Jordanian banks listed at Amman Stock Exchange from the year 2007 to 2009 with a total of 45 bank-year observation. The study employed pooled data, and OLS estimation method with panel methodology. Return on asset, return on asset, profit margin (measured as net interest income divided by total asset) and earnings per share were the dependent variables of the study and board size, board composition (independence), chief executive officer status, foreign ownership and bank size were the independent variables of the study. The study revealed a significant negative relation between board size and banks performance as measured by return on asset and earnings per share but insignificant negative association of board size with return on asset and profit margin was found. Bank size was negatively related with return on asset, return on asset and profit margin but only significant with profit margin. The study also reveals a positive association between board composition and foreign ownership and bank performance. In addition, chief executive officer status has a negative influence. Finally, the researchers suggest extending the study period.

When we see empirical evidence on insurance sectors there is rare international evidence on corporate governance mechanism impact on performance in the insurance industry compared to the literature on international corporate governance of typical public firms. One recent exception relates to the risk-taking behavior of European insurance companies from the United Kingdom and Germany. Specifically, Eling and Marek (2011) are able to provide evidence that controls for the differences between the market-based U.K. corporate governance environment and the control-based system that prevails in Germany. Using a sample of 276 firms between 1997 and 2009, they proxy risk taking by asset risk and product risk, and focus on stock insurance companies. Their corporate governance indicators include executive compensation, supervisory board compensation, and independence, as well as the number of board meetings and ownership structure. The study concludes that U.K. insurance firms engage in more risk taking than their German counterparts and that large shareholdings and concentrated ownership contribute to increase risk taking.

Lai and Lee (2011) exploit the particular organizational structure of the U.S. property and casualty insurance industry to assess the link between corporate governance and risk taking (captured by

underwriting risk, leverage risk and investment risk, in addition to a measure of total risk). According to the authors stock organizational structure may provide incentives for risk taking to increase the wealth of shareholders. Indeed, shareholders who have limited liability are more likely to take risk in order to maximize firm value and hence directly benefit from increased earnings Najjar (2012) examine the impact of corporate governance mechanisms on firm's performance of the insurance industry in Bahrain, to understand how to minimize the agency costs effectively and design the appropriate organizational structure. Also, to distinguish between good and bad corporate governance which is a crucial step in building the market's confidence and attracting positive investment flows to the institution and the economy. Pooled data method was used for Five insurance companies listed in Bahrain stock exchange for the period of 2005-2010 year and he conclude that there is no statistically significant impact of corporate governance expressed by CEO status, ownership concentration, the number of employees, industry performance, and number of shares traded on firm's performance in the insurance industry expressed by the dependent variable - return on asset (ROA). On the other hand board size, firm size, number of block-holders found to have statistically significant impact on firm's performance in the insurance industry expressed by the dependent variable return on asset (ROA). This result, confirms the importance of good governance structure on the firm and the whole economy in the long run. The researcher suggests that every insurance firm should properly define corporate governance and its mechanisms and implement them effectively in order to reach the firm's long-term goals, build stakeholders' confidence and generate positive investment flows.

Tornyeva et al (2012) undertake study is to investigate the relationship between corporate governance and the return on asset of insurance companies in Ghana. Both primary and secondary data was used and secondary data was collected from the national insurance commission and the primary data was collected through the administration of interview questionnaires. Panel Data Methodology was used for the data analysis. The findings show that large board size, board skill, management skill, longer serving CEOs, size of audit committee, audit committee independence, foreign ownership, institutional ownership, dividend policy and annual general meeting are positively associated with the return on asset of insurance companies in Ghana. The authors argue as the insurance companies are encouraged to adopt good corporate governance practices to improve their return on asset and also to protect the interest of the shareholders. Most importantly the regulatory authorities must

ensure compliance with good governance and apply the appropriate sanctions for noncompliance to help the growth and development of the insurance industry.

Jackson (2012) did studies to examine the relationship between executive compensation, ownership structure, and firm performance for Chinese financial corporation's during 2001-2009. The results reveal that executive compensation in Chinese banks follows a relation-based rather than a market-based contract. There is little evidence in support of the pay-for-performance setting for Chinese executive compensation. Ownership concentration has significantly negative impacts while firm size has significantly positive impacts on CEO compensation. Further, the involvement of state ownership tends to limit executive compensation, while the compensation committee is friendly and enhances management compensation. The results suggest that the government or regulation may ensure efficient corporate governance in business activity as a helping hand when corporate governance is weak.

Fadun (2013) examines challenges and opportunities associated with corporate governance and insurance company growth. It advocates the imperative of good corporate governance in the insurance industry and he examines corporate governance theoretical perspectives, highlights the challenges of corporate governance in Nigeria, and explores the relationship which exists between corporate governance and insurance company growth in Nigeria. The study is an empirical designed using the responses of survey, structured questionnaires, of 112 respondents. Pearson product coefficient of correlation(r) is employed for data analysis and hypotheses testing. The findings reveal that good corporate governance promotes safe and sound insurance practice effective supervision promotes good corporate governance and the new code of good corporate governance for the Nigerian insurance industry enhances insurance companies' growth in Nigeria. The implication for practice suggests that effective corporate governance is necessary for proper functioning of insurance companies in order to promote growth and secure public confidence. The paper highlights the fact good corporate governance practices can enable the Nigeria insurance industry to generate more resources to create more employment opportunities and support the economy by way of prompt claims settlement.

David et' al (2013) undertakes study on effects of Corporate Governance on the return on asset of listed insurance companies in Kenya. Specifically, they examine board size, board composition, CEO

duality and leverage and how they affect the return on asset of listed insurance Companies in Kenya. They use data of all those insurance Companies which were quoted on the Nairobi Securities Exchange as at December 2012 by using a descriptive research design method and they noted as a strong relationship exist between the Corporate Governance practices under study and the firm's return on asset and also they report as Board size was found to negatively affect the return on asset of insurance companies listed at the NSE more additionally they noted as a positive relationship between board composition and firm return on asset exist. However, the most critical aspect of board composition was the experience, skills and Expertise of the board members as opposed to whether they were executive or non-executive directors. Similarly, leverage was found to positively affect return on asset of insurance firms listed at the Nigerian stock exchange. On CEO duality, they found that separation of the role of CEO and Chair positively influenced the return on asset of listed insurance firms in Kenya.

Brealey, Myers and Marcus (2009) indicate that return on asset can be measured in terms of profitability, liquidity, solvency, financial efficiency and repayment capacity. Profitability is the measures of the profit generated by a firm through the use of its productive assets; liquidity measures the ability of a firm to meet its obligations when they fall due; solvency measures a firm ability to pay all its financial obligations if all of its assets are sold. Therefore, a firm return on asset can be measured using net income or net operating income, its assets performance or even its cash flows.

Technically, performance is defined as a subjective measure which determines how well the organizations use their available resources to generate more revenues. It measures the financial soundness & health of the organization in monetary terms. The performance of the insurance companies plays a pivotal role in the growth of the economy.

Yuvaraj et al. (2013) suggested that although there are different ways to measure profitability, it is better to use ROA. Moreover, most researches in the field of insurance & their profitability stated that the key indicator of a firm's performance is ROA.

2.4. Literature Gap

Corporate Governance is important in all organizations regardless of their industry, size or level of growth. Good Corporate Governance has a positive economic impact on the Institution in question as it saves the organization from various losses such as those occasioned by frauds, corruption and similar irregularities. Besides it also spurs entrepreneurial innovation enabling the organization to better seize the economic opportunities that come its way. The main Corporate Governance themes that are currently receiving attention are adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles ensuring that the board has an effective mix of independent and non-independent directors and establishing the independence of the auditor and therefore the integrity of financial reporting, including establishing an audit committee of the board. Good Corporate aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Thus, the main tasks of Corporate Governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

The studies cited in the literature mostly concentrate on the developed countries whose strategic approach and Corporate Governance systems are not similar to that of Ethiopia. In Ethiopia, study done on corporate governance themes are very few in number for instance Minga (2008) explores the legal and other external institutional frameworks of corporate governance in Ethiopia and concluded that the overall standard of corporate governance was disappointing in the country. Fekadu (2010) also analyzed the ownership structure of corporations in the country and determined that the separation between ownership and control (or shareholders and management of the corporations) is growing in Ethiopia, however, there are weaknesses in the Commercial Code to protect minority shareholder rights. In addition, Ahemad (2012) studied Ethiopia company law and found that the Ethiopia company law does not have adequate legislative provisions on governance issues related to the separation of supervision and management responsibilities, and on the composition, independence and remuneration of board of directors in share companies. More specifically research report submitted on Ethiopia banking sectors for example unpublished master thesis Ferede (2012)

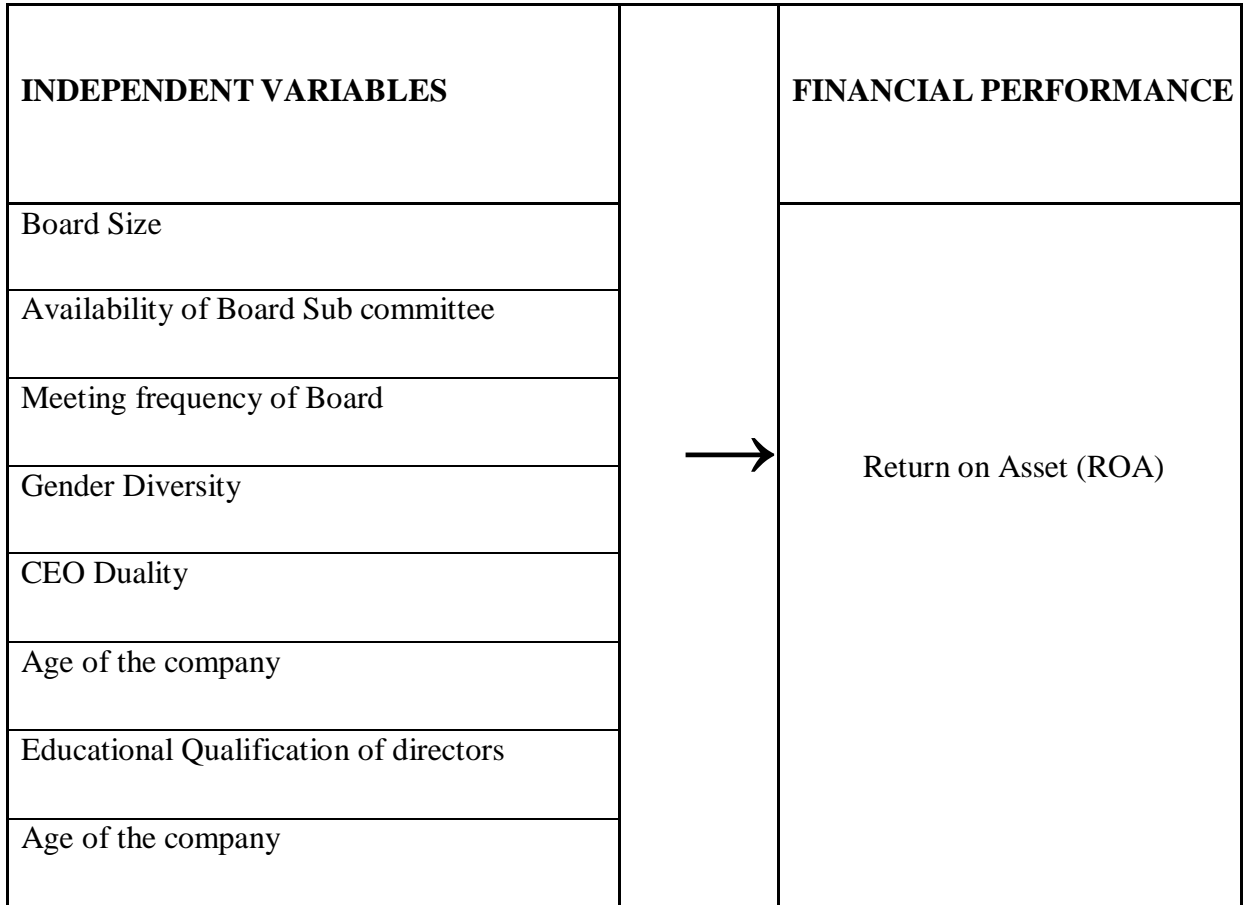
Studied to investigate the corporate governance mechanism and their impact on performance of commercial banks in Ethiopia.

Generally, earlier studies have made immense contributions to the corporate governance and financial performance; they were inclined towards the developed countries. However, developing countries received little attention in various literatures on this issue, at the same time majority of these studies were in banking industry. Consequently, a design feature that works well in one country/industry may not work in another. As Bird (2005) noted this may be referred to as the No-One-Size-Fits-All (the NOSFA) principle, i.e., the best policy and administrative design for each country/industry has to be determined carefully in light of the conditions and objectives of that country/industry. Specifically, in Ethiopia, though few studies have been conducted on corporate governance mechanism and financial performance, to the best of researcher's knowledge, no prior study has focused on insurance industry in Ethiopia thus current study tried to fill this left research gap.

The above review of the literature exposes the existence of many gaps of knowledge in relation to the effect of corporate governance particularly in the context of Ethiopia. The study conducted by Fikadu (2010) tried to expose the weakness of commercial code of Ethiopia in protecting minority shareholders by taking different corporate governance theories as a benchmark. Even if the study tried to evaluate the major document which dictates the corporate governance mechanism of Ethiopian corporation, it fails to disclose the effect of such mechanism on the corporate profitability.

2.5. Conceptual Framework of the Study

The following diagrammatic framework is developed.



Self-constructed

CHAPTER THREE

3. Research Methodology

This research methodology section of the thesis presents the methods, techniques, scientific paths and procedures followed and used to carry out the study. In particular, this study is employed in order to examine the effect of corporate governance on return on asset of the insurance company sector by taking evidence from selected insurance companies in Ethiopia. It presents the research design, procedures of data collection, the sampling procedure, sampling techniques and method of data analysis, validity and reliability, and Ethical Consideration.

3.1. Research Design

In this study the effect of corporate governance on return on asset of the insurance companies is to be tested and analyzed. The type of research which is appropriate to be employed for this study is explanatory survey design in nature. Cooper et al. (2003) discussed that explanatory studies unlike descriptive studies, go beyond observing and describing the condition and tries to explain the reasons of the phenomenon. Thus, explanatory research design was used in this research because the study identifies the effect of corporate governance and insurance companies' return on asset which is appropriate for the objective of the study.

3.2. Research Method Adopted

When conducting a research, there are different ways of approaching the problem. According to Creswell (2009), there are three approaches of research; quantitative researching approach, qualitative research approach and mixed research approach. The following discussions briefly presents the basic features of these research approaches. Quantitative research approach is a means for testing objective theories by examining the relationship among variables (Creswell, 2009). On the other hand, qualitative research approach is a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem with intent of developing a theory or pattern inductively (Creswell, 2009). Finally, mixed methods approach is an approach in which the researchers emphasize the research problem and use all approaches available to understand

the problem (Creswell, 2003). Hence, based on the above discussions of the three research approaches and by considering the research problem and objective, this study used mixed research approach. Therefore, to have a better insight and gain a richer understanding about the effect of corporate governance financial on return on asset of insurance companies, the quantitative method supplemented by the qualitative method of inquiry that helps to get benefits of a mixed methods approach and to mitigate the bias in adopting only either quantitative or qualitative approach.

Thus, employing mixed approach is used to counterbalance the biases (limitations) of applying any of a single approach and a means to offset the weaknesses inherent within method with the strengths of the other method (Creswell, 2003). In addition, adopting mixed approach in this study is justified as it provides the best understanding of a research problem because it can open the door to multiple methods of data collection and to both generalize the findings to a population and develop a detailed view of the meaning of a phenomenon or concept for individuals (Creswell, 2003). Thus, this study employed mixed research approach start with a quantitative study and identifies results then follows up these results with an unstructured in-depth interview of qualitative study to have a better understanding about the effect of corporate governance on Ethiopian insurance companies' return on asset.

The procedure followed in using these mixed research approach is as follows. The data collected from annual reports and secondary data sources of the insurance companies was analyzed using a quantitative techniques of analysis. And what might be inferred from these analysis results was interviewed from the board secretariat and the board members.

Decision regarding the selection of research instrument, the nature of collected data and the analysis of collection are based on the research method used in a study. Selection of appropriate research methods is very important because it decides the quality of study findings. For the purpose of the present study, mixed approach which advocates the combination of both qualitative and quantitative has proved to be ideal for the study impacts of corporate governance mechanism and return on asset of Insurers in Ethiopia. The central premise is that the use of quantitative and qualitative approaches in combination provides a better understanding of research problems than either approach alone (Creswell 2009). The following sections, thus, discuss consecutively the quantitative and qualitative aspects of the research method.

3.2.1. Quantitative Aspect of Research Method

Quantitative research approach deals with numerical data and statistical analyses to answer questions about relationships among measured variables. Even if there are two strategy of inquiry under quantitative approach, this study used a survey design due to its merit of economy and enables to gather enough information. In addition, the purpose of this study is to examine the impacts corporate governance on return on asset of Ethiopian Insurers. There is a need of a quantitative or numeric description of relationship between the independent and dependent variables.

The survey, as a quantitative research strategy, can collect quantitative data by different types. Fink (2002), as quoted in Creswell (2009 p. 146), says there are four data collection types of survey, self-administered questionnaires, interviews; structured record reviews to collect financial, medical, or school information and structured observations. The survey instrument adopted in this study to collect data was a structured record review. The following section, accordingly, reviews the issues in a sample design in respect of the current study.

3.2.2. Qualitative Aspect of the Study

Qualitative research approach is a means for exploring and understanding individuals or groups scribe to a social or human problem (Creswell, 2009). Qualitative research is typically used to answer questions of complex phenomena on which data can be collected using instruments like unstructured interviews, group discussions, unstructured observation and reflection field notes, various texts like reflexive Journals, pictures, and analysis of documents and literature. Thus, in the current study to gather the qualitative data needed for further addressing the objectives the study stated in the preceding section in-depth interviews were used in this study.

Interviews were held with selected board secretary sampled Insurers. They are considered in this study because they are assumed most knowledgeable part of about the issue under investigation so three boards chairman and one delegated person purposefully considered for discussion. Those considered board chairmen have high understanding and well experienced expertise in the sectors. Generally, based on the objective presented in the preceding section a number of unstructured interview questions were asked by researcher to gain additional insight.

Since the nature of this research requires in-depth understanding of the impacts of corporate governance mechanism on return on asset of insurance companies in Ethiopia, an interview was suitable to uncover such information. Easterly-Smith et al. (1991) commented that the interview method is the most fundamental of all qualitative methods and is claimed to be the best method for gathering information.

The researcher conducted an in-depth interview in unstructured face to face interview form. In respect of instrument, unstructured face to face interview was used because of its flexibility and also allowing new questions to be brought up during the interview.

Regarding the sample design, non-probability purposive sampling method was adopted. So, to explore issue of corporate governance mechanism three boards chair men and one delegated person were interviewed by using unstructured face to-face interviews at different times.

3.3. Study Population

The study populations include insurance companies registered by national bank of Ethiopia in 2017. There are seventeen insurance companies in Ethiopia. One of these insurance companies is owned by the government of Ethiopia and the rest sixteen are privately owned insurance companies all of which are listed in the following table.

Table 3.1:List of Ethiopian Insurance Companies

No	Insurer	Date of commencement
1	Abay Insurance Company	26/07/2010
2	Africa Insurance Company S.C	1/12/1994
3	Awash Insurance Company S.C	1/10/1994
4	Berhan Insurance S.C.	24/05/2011

5	Buna insurance S.C.	23/8/2011
6	Ethic-Life and General Insurance S.C	23/10/2008
7	Ethiopia Insurance Corporation	1/1/1976
8	Global Insurance Company S.C.	11/1/1997
9	Lion Insurance Company SC	1/7/2007
10	Lucy insurance S.C.	15/11/2012
11	National Insurance Company of Ethiopia S.C.	23/09/1994
12	NIB Insurance Company	1/5/2002
13	Nile Insurance Company S.C	11/4/1995
14	Nyla Insurance Company S.C	6/1/1995
15	Oromia Insurance Company S.C.	26/01/2009
16	Tsehay Insurance S.C.	28/03/2012
17	United Insurance S.C	1/4/1997

Source : < www.nbe.gov.et >

3.4. Sampling Design

The target populations of the study were all insurance companies registered by NBE and under operation in Ethiopia. Currently, seventeen insurance companies operate in Ethiopia (as presented in table 3.1).

However, to undertake this study the researcher selects **nine** Insurers using purposive sampling method this is because those Insurance companies which couldn't provide all the necessary financial statement were not included in the study. Therefore, this study incorporated only Nine Insurance companies that have financial statements for the year 2006 and onwards. Hence samples are chosen to represent the relevant attributes of the whole population. Thus, to make the balanced panel data structured, i.e. every cross-section follows the same regular frequency with the same start and end dates. Besides, ten years is assumed to be relevant because five years and above is the recommended length of data to use in most literatures. Hence; the samples taken were presented in the following table.

Table 3.2: List of Insurance Companies Sampled

		Date	of Age
1	Africa Insurance Company S.C	12/1/1994	23
2	Awash Insurance Company S.C	10/1/1994	23
3	Ethiopia Insurance Corporation	1/1/1976	42
4	Global Insurance Company S.C.	11/11/1997	20
5	National Insurance Company of Ethiopia S.C.	9/23/1994	23
6	NIB Insurance Company	5/1/2002	16
7	Nile Insurance Company S.C	4/15/1995	23
8	Nyla Insurance Company S.C	1/6/1995	23
9	United Insurance S.C	4/1/1997	21

3.5. Instruments of Data Collection

The panel data which is a combination of time-series and cross-sectional data has been used to analyze this quantitative study. The data is obtained by document analysis from the series of annual reports of National Bank of Ethiopia about these insurance companies. And hence the first instrument of data collection used in this study was document analysis which is a type of secondary data, data taken from written reports.

Gujarati (2004) highlighted some of the merits of panel data over cross-sectional or time-series data as follows: “it explicitly accounts for unobservable and constant heterogeneity across individual units, that is, specific to each bank (management style, business strategy, etc.); it helps capture cross-sectional specific attributes and time-series properties of units; unlike time series, panel data gives more informative data, more variability, more degrees of freedom, less collinearity among variables, and more efficiency; and it minimizes the bias caused from aggregation in pure time series data”. Consequently, this study used panel data of 9 private insurance companies and one government owned insurance company for 10 years.

The second data collection instrument used for this thesis was an interview. The board members of the insurance companies were asked about the effect of corporate governance on return on asset of the insurance companies they lead or govern.

3.6. Variables of the Study

3.6.1. Dependent Variable

Mostly return on asset is measured by either with accounting-based return, market based return or both. Even though market-based returns are widely acceptable for return on asset measure by most researchers, they are excluded from this study. This is because of the unavailability of data. For example, to use Tobin's Q we need current market price of stock. Such data is not available in Ethiopia as the country has no stock market. In absence of market based data most researches used ROA and ROE as a proxy to financial performance. In this study the researcher chooses ROA over ROE as a proxy to insurance companies return on asset because ROE weighs net income only against owners' equity, it doesn't say much about how well a company uses its financing from borrowing and bonds. Such company may deliver an impressive ROE without actually being more effective at using the shareholders' equity to grow the company. ROA, because its denominator includes both debt and equity, can help us to see how well a company uses both these forms of financing.

Return on Assets (ROA): a dependent variable or a proxy for the insurance companies' return on asset which measures a firm's financial return on asset annually. It shows how management of an entity could turnover assets of the organization over-one-year. To a large extent, ROA also deals with operational sustainability of these institutions.

$$ROA = \frac{\textit{profit after tax}(PAT)}{\textit{Average Total Asset (TA)}}$$

3.6.2. Independent Variables

Board Size: It is the number of boards elected at the time of board election. This include the number of female board members who has a seat on the board. Marta (2010), indicated that the size of board is considered to be crucial characteristics of board structure. Some researchers showed us that board size is positively related to return on asset by reasoning large boards could provide the diversity that would help companies get critical resources and increase monitoring capacity of the board (Haifa and Hoodia, 2006, p1038).

Number of Board Sub-committees: It is the number of subcommittees under the board of directors in the seven private and one governmental insurance companies. It has been calculated as the total number of internal board sub-committees of the private insurance companies has at the end of the period. The researcher expects that there is a significant positive association between number of internal board sub-committees and insurance companies' return on asset. Board Sub-Committees was measured by number of persons serving in the subcommittees of the Board

Meeting Frequency of Board: Refers the number of meetings that board meets on a year during the period under review. The researcher expects the number of board meeting has a positive effect on Ethiopian insurance company's financial return on asset. Board meetings frequency was measured by the number of meetings held by the board per year.

CEO duality: if the CEO and the chairman is the same person it is called CEO duality which is assumed to have effects on the return on asset of the insurance companies. CEO Duality was measured as dummy variable 1 if CEO and Chairman are the same person; and 0 if CEO and Chairman are different persons

Age of the company: the year of incorporation of the insurance company.

Chief Executive Compensation: the presence of compensation for the CEO or not was measured by interviewing.

Educational Qualification of Directors: is the educational status of the directors.

Gender Diversity: the presence of the female directors was measured by interviewing

3.7. Data Analysis Method

In this study to analyze the collected data descriptive, correlation and multiple panel linear regression data analysis method were employed. The descriptive statistics was used to quantitatively describe the important features of the variables using mean, maximum minimum and standard deviations. The correlation analysis was used to identify the relationship between the independent, dependent and control variables using Pearson correlation analysis. The correlation analysis shows only the degree of association between variables and does not permit the researcher to make causal inferences regarding the relationship between variables (Mack et al 2005). Therefore, multiple panel linear regression analysis was also used to test the hypothesis and to explain the relationship between corporate governance mechanism variables and return on asset measures by controlling the influence of some selected variables. Views 7 software was used for analysis and the results were presented through tables. Besides, the panel character of the data collected allow for the use of panel data methodology. Panel data involves the pooling of observations on a cross-section of units over several time periods and provides results that are simply not detectable in pure cross-sections or pure time-series studies (Freeman 1984). The general form of the panel data model can be specified more compactly as:

$$Y_{it} = \alpha_i + \sum \beta X_{it} + \varepsilon_{it}$$

In the equation Y_{it} represents the dependent variable in the model and X_{it} contains the set of explanatory variable in the model. The subscripts i and t denote the cross-sectional and time-series dimension respectively. Also α_i is taken to be constant over time t and specific to the individual cross-sectional unit i . If α_i is taken to be the same across units, then Ordinary Least Square (OLS) provides a consistent and efficient estimate of α_i and β .

In the light of the above model and on the base of selected explanatory variable the current study used econometric model as shown below.

$$ROA_{it} = \alpha + \beta_1 BS + \beta_2 CEC_{it} + \beta_3 EQD_{it} + \beta_4 FD_{it} + \beta_5 FM_{it} + \beta_6 ODS_{it} + \beta_7 ISE_{it} + \beta_8 PG_{it} + \beta_9 CD_{it} +$$

$\beta_{10}AC_{it}$

Where:

i denote Insurance Company's ranging from 1 to 9 (cross-sectional dimension). t denote years ranging from 2007 to 2016 (time-series dimension).

Dependent Variables

ROA_{it} Return on asset for i^{th} insurer and time period t

Independent variables

- BS_{it} Board size for i^{th} insurer and time period t
- $CCOP_{it}$ Chief Executives compensation i^{th} insurers and time period t
- EQD_{it} Board member educational qualification for i^{th} insurer and time period t
- FD_{it} Female directors in the board for i^{th} insurer and time period t
- FM_{it} Frequency of board meeting for i^{th} insurer and time period t
- ODE_{it} =other department experience Board member other business managements experience i^{th} insurer and time period t
- ISE_{it} Board members' industry specific experience for i^{th} insurer and time period t
- $CEOD_{it}$ COE duality for i^{th} insurance company and time period t
- $AGEC_{it}$ Age of the company for i^{th} insurance company and time period t

One issue that may arise from the use of panel data is whether the individual effect is considered to be fixed or random. The Hausman test was employed to select the appropriate method from the fixed effect model (FEM) and Random Effect Model (REM). Since random effects estimation

addresses the endogeneity issue by in instrument potentially endogenous variables, it also assumes that the individual firm effects are uncorrelated with the exogenous variables.

On the other hand, the fixed effect estimation deals successfully with the correlated effects problem, yet it fails to account for potential endogeneity of regresses. As it is mentioned above, for this study OLS were used. Therefore, before the regression was run tests for fulfillment of the basic Classical Linear Regression Model (CLRM) assumptions were tested. Consequently, the basic CLRM assumptions tested in this study were errors have zero mean, homoscedastic, autocorrelation, normality and multicollinearity.

According to Brooks (2008) when the assumptions are satisfied, it means that all the information available from the patterns was used. But, if there is assumption violation of that data usual means that there is a pattern of data that have not included in the model, and could actually find a model that fits the data better.

The first assumption is the errors have zero mean. According to Brooks (2008), if a constant term is included in the regression equation, this assumption never be violated. The second assumption is heteroskedastic. The assumption of homoscedasticity is that the variance of the errors is constant or equal. If the variance of the errors is not constant, this would be known as hetroscedacity (Gujirati, 2004 p.387). In order to test homoscedasticity, the white test was used.

The third assumption is the autocorrelation assumption that the covariance between the error terms over time is zero; it assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are serially correlated. Usually, Durbin-Watson (DW) value in the main regression table is considered and used to test the presence of autocorrelation.

According to Brooks (2008), DW has 2 critical values: an upper critical value (due) and a lower critical value (DL), and there is also an intermediate region where the null hypothesis of no autocorrelation can neither be rejected nor not rejected.

The rejection, non-rejection, and inconclusive regions are shown on the number line in figure 3.1. So, the null hypothesis is rejected and the existence of positive autocorrelation presumed if DW is less than the lower critical value the null hypothesis is rejected and the existence of negative autocorrelation presumed if DW is greater than 4 minus the lower critical value, the null hypothesis is not rejected and no significant residual autocorrelation is presumed if DW is between the upper and 4 minus the upper limits; the null hypothesis is neither rejected nor not rejected if DW is between the lower and the upper limits, and between 4 minus the upper and 4 minus the lower limits.

The fourth assumption is Normality of the error distribution that assumed the errors of prediction (differences between the obtained and predicted dependent variable scores) are normally distributed. Violation of this assumption can be detected by constructing a histogram of residuals (Brooks 2008)

Finally, the fifth assumption is multicollinearity assumption which refers to the situation in which the independent variables are highly correlated. When independent variables are multicollinear, there is overlap or sharing of predictive power. This may lead to the paradoxical effect, whereby the regression model fit the data well, but none of the explanatory variables (individually) has a significant impact in predicting the dependent variable (Gujarati 2004). A Pearson correlation is used for the purpose of testing multicollinearity in this study. The Pearson correlation matrix is a technique of testing multi-collinearity of explanatory variables by investigating the relationship of bivariate variables (Wooldridge 2006).

Regarding data collected through in-depth interviews, Qualitative analysis was used for qualitative data collected and the results were analyzed and presented in separate section and linked whenever necessary.

3.8. Ethical Consideration

Keeping Confidentiality and privacy are the main activities in research, to get relevant and appropriate data, so the researcher assured the purpose of the research paper, and confidentiality of

any information gathered were kept secure in the study. Formal letter was taken from the Faculty of Business and Economics of Addis Ababa University to get permission of the study population. Finally, the researcher asked for their permission to participate the study, Confidentiality and privacy were maintained by omitting their names and keeping their answers only.

CHAPTER FOUR

4. Data Analysis, Presentation and Discussion

4.1. Introduction

This chapter contains sections each of which presents the introduction, descriptive statistics, correlation analysis and multiple panel linear regression analysis of the study variables. The first section deals with the introduction of the chapter and the second section of the analysis and the results chapter presents the descriptive statistics and summarizes the main features of the study variables in terms of mean, maximum, minimum and standard deviation outputted from SPSS version 20. The third section deals with the correlation analysis and shows the degree of association between the study variables. The fourth section of this chapter analyzes regression result reports of the OLS estimation output of the two regression models. Descriptive, correlation and regression analysis and interpretation of the results were made hereunder.

4.2. Test Results of Classical Linear Regression Model Assumptions

This section presents the test for the assumptions of classical linear regression model (CLRM) namely the error has zero mean, heteroskedastic, autocorrelation, normality and multicollinearity.

The errors have zero mean ($E(\varepsilon) = 0$)

If a constant term is involved/included in a regression equation then the assumption of the Errors has zero mean will never be violated (Brooks, 2008). The regression model which is used in this research study included a constant term. This clearly means the assumption was not violated.

Homoscedasticity Test

Table 4.1: Heteroscedasticity Test: White

F-Statistic	2.0	Prob. F(44,45)	0.01
Orbs*R ²	59.8	Prob. Chi-Square (44)	0.06
Scaled Explained SS	31.3	Prob. Chi-Square (45)	0.92

Source: Data of sampled insurance companies and own computation

In the table 4.1 shown above the F-statistic shows as there is presence of heteroscedasticity since the p-values were less than 0.05 but Chi-Square versions of the test statistic and the third version of the test statistic, scaled explained SS, which as the name suggests is based on a normalized version of the explained sum of squares from the auxiliary regression, gave that there is no evidence for the presence of heteroscedasticity problem. Since both the p value was in excess of 0.05. Therefore, the conclusion of the test is somewhat ambiguous in this case. But as noted by Wooldridge (2002) existence of heteroscedasticity would not cause the parameter estimates to be biased and even in the presence of heteroscedasticity, more efficient estimation is possible provided that other assumptions are met.

Covariance between the Error Terms Over Time is Zero ($cov(u_i, u_j) = 0$)

This is an assumption that the errors are linearly independent of one another (uncorrelated with one another). If the errors are correlated with one another, it would be stated that they are auto correlated. The DW test statistic value in the multivariate regression result was 1.721. And this value is in between two critical values of 1.5 and 2.5. Therefore, we can assume that there is no first order linear auto-correlation in the multiple linear regression model.

Table 4.2: Durbin-Watson test of co-linearity

Model Summary^b					
Model	R	R Square	Adjusted R Square	Std. Error of the	Durbin-Watson
1	.744 ^a	.554	.498	.07967	1.721
a. Predictors: (Constant), AGECE, ODS, EQD, GP, FD, ISE, Year, BS, FM, CCOP					
b. Dependent Variable: ROA					

Source: Own Computation

Normality (errors are normally distributed ($ut \ N(0, \delta^2)$))

According to Brooks (2008), if the residuals are normally distributed, the histogram should be bell-shaped and the Jarque Bera statistic would not be significant. This means that the p-value given at the bottom of the normality test screen should be greater than 0.05 to support the null hypothesis of presence of normal distribution at the 5 percent level.

Table 4.3:Tests of Normality

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
ROA	.133	90	.112	.914	90	.112

a. Lilliefors Significance Correction

Source: Data of sampled insurance companies and own computation.

The above table witnesses that normality assumption holds, i.e. the Bera-Jarque statistic has a P-value of 0.112 implying that the data were consistent with a normal distribution assumption. Also, it implies that the inferences made about the population parameters from the sample parameters tend to be valid.

Assumption five: Multi collinearity Test

Multicollinearity in the regression model suggests substantial correlations among independent variables. This phenomenon introduces a problem because the estimates of the sample parameters become inefficient and entail large standard errors, which makes the coefficient

values and signs unreliable. In addition, multiple independent variables with high correlation add no additional information to the model. It also conceals the real impact of each variable on the dependent variable (Anderson et al. 2008).

Hair et al. (2006) argued that correlation coefficient below 0.9 may not cause serious multi collinearity problem. Also, Cooper and Schendlar (2009) suggested that a correlation above 0.8 should be corrected for. In addition, Malhotra(2007) stated that multi collinearity problems exists when the correlation coefficient among variables should be greater than 0.75.

Table 4.2: Correlation Matrix between independent variables.

		ROA	BS	FM	FD	EQD	ISE	GP	ODS	CCOP	AGEC
ROA	Pearson Correlation	1									
	Sig. (2-tailed)										
BS	Pearson Correlation	0.129	1								
	Sig. (2-tailed)	0.225									
FM	Pearson Correlation	.300**	.558**	1							
	Sig. (2-tailed)	0.004	0								
FD	Pearson Correlation	.342**	0.159	0.019	1						
	Sig. (2-tailed)	0.001	0.134	0.857							
EQD	Pearson Correlation	0.142	.517**	.483**	.248*	1					
	Sig. (2-tailed)	0.181	0	0	0.018						
ISE	Pearson Correlation	.225*	.673**	.549**	0.078	.214*	1				
	Sig. (2-tailed)	0.033	0	0	0.466	0.043					
GP	Pearson Correlation	0.085	-0.005	-0.007	0.078	0.188	0.001	1			
	Sig. (2-tailed)	0.425	0.962	0.951	0.467	0.076	0.991				
ODS	Pearson Correlation	.582**	.248*	.298**	0.206	0.002	.396**	-0.071	1		
	Sig. (2-tailed)	0	0.018	0.004	0.051	0.986	0	0.507			
CCOP	Pearson Correlation	.363**	.397**	.455**	0.018	-0.117	.694**	-0.067	.450**	1	
	Sig. (2-tailed)	0	0	0	0.868	0.271	0	0.527	0		
AGEC	Pearson Correlation	-0.12	-0.061	-.453**	0.003	0.062	-0.032	0.049	-0.001	-.325**	1
	Sig. (2-tailed)	0.26	0.567	0	0.981	0.564	0.768	0.647	0.993	0.002	

Source: Data of sampled insurance companies and own computation

The method used in this study to test the existence of multi collinearity was by checking the Pearson correlation between the independent variables. The correlations between the independent variables are shown in table 4.2 above. All correlation results are below 0.75, which indicates that multi collinearity is not a potential problem for this study. In general, all tests illustrated above were testimonials as to the employed model was not sensitive to the problems of violation of the CLRM assumption.

4.3. Descriptive Statistics

Table 4.3 provides a summary of the descriptive statistics of the dependent and independent variables for nine insurance companies for a period of ten years from year 2007-2016 with a total of 90 observations. The table includes the mean, median, standard deviation, number of observations, minimum and maximum for the independent and dependent variables of the model. This was generated to give overall description about data used in the model and served as data screening tool to spot unreasonable figure. As shown in chapter three, return on asset which gives an idea how efficient management is at using its assets to generate earnings was measured as net income after tax divided by total asset. The average value of return on asset for the sample Ethiopia insurance companies for the period of 10 years from the initial year taken to be 2007 to the last year taken to be 2016 is **16%** percent (which is shown to be the mean=**0.16**). This number is a ration and it can be expressed in percent. All ROA values are ratio values of Net Income after Tax to the total asset and hence can be told in percent. The maximum value of the ROA is the value of 40% percent (0.4) and the minimum value is **0** percent (0%) respectively. At the same time, the standard deviation which measures the data distribution from the mean is **11** percent. This result indicates that most performing insurance among the sampled Insurance Companies (ICs) earned 40 cents of profit after tax for a single birr invested in the assets of the firm. On the other hand, less efficient Insurance Company's (IC's) during study period from the sampled Insurance Companies (ICs) incurs loss of 0.00 cents for each birr invested in the assets of the firm. More additional, standard deviation statistics for return on asset was 11 percent which shows that how individual values of return on asset in a data set vary from the mean of return on asset over the last ten years by 11 percent. Likewise, the during study period insurance companies in Ethiopia generate 13 percent income on average from mobilizing their asset.

Table 4.4 Descriptive Statistics of Regression Variables

Statistics		ROA	BS	FM	FD	EQD	ISE	GP	ODS	CCOP	AGEC	CEOD
N	Valid	90	90	90	90	90	90	90	90	90	90	90
	Missing	0	0	0	0	0	0	0	0	0	0	0
	Mean	0.16	7.41	19.2	0.83	6.51	3.21	0.27	0.79	12.9	17.7	2
	Median	0.13	7	16	1	6	3	0.26	0.83	13.1	16	2
	Mode	0.05	9	16	0	6	2	.10a	1	13.6	13.00a	2
	Std.	0.11	1.64	16.1	1.08	2.2	1.49	0.2	0.22	0.8	7.36	0
	Minimum	-0	5	2	0	2	1	-0.1	0.29	11.1	5	2
	Maximum	0.4	9	66	4	10	6	0.84	1	14.3	40	2
	Sum	14.6	667	1728	75	586	289	24.6	71	1163	1595	180

Source: SPSS Output from Data of Sample Insurance Companies (ICs), 2007– 2016

Another issue mentioned by the interviewees was there is no appropriate national code of corporate governance adopted in the country except the commercial code which needs major improvements as per the interview conducted with Ethiopia Insurance Corporation (IC) board chairman. Regarding Insurance Companies (ICs) board size there is no problem with board size of the Insurance Company. Boards of directors are expected to prove strategic leadership to the company by include supervision of corporate governance along with the monitoring of strategic area including internal control and risk management. The board is also expected to reviews the management of corporate resources (human resource finance and information) thus effective and efficient leadership of the board can be realized through full board members and board committees that monitors thematic area such organization demand.

Regarding explanatory variable there are some imperative statistics that have to be mentioned. Board size of sample Insurance Companies (ICs) which is measured as number of directors set on board. It is confirmed in the table below that the average board size for the sample Insurance Companies (ICs) is about 7 members (mean = 7.41) with a maximum of nine and a minimum of five directors. Lipton and Borsch (1992) recommend average board size of (i.e. between 8 and 10) for greater board efficiency and effectiveness but this data is not within this recommendation in contrast to this Brown and Saylor (2004) suggested a board size of between 6 and 15 further in Ethiopia case National Bank of Ethiopia currently propose corporate governance guidelines for Ethiopia Insurance Companies (ICs) with postulates minimum number board size for each Insurance Companies (ICs) should be nine. The standard deviation indicates that for the sampled Insurance Companies (ICs) board size varies by 1.64 or 2 directors from the average value of 7.38 or 7 directors. This also indicates as there is low dispersion in the board size of the sample Insurance Companies (ICs) during study period.

Furthermore, another interesting observation is that there was somewhat a higher variation in frequency of board meeting during study period which is measured as Number of directors meeting in the year, on average is 19.2. The standard deviation values of 16.1 with the minimum of 2 and the maximum of 66. This result indicates that in sample Insurance Company's during study period there is a company which conduct highly frequent meeting in a year at the maximum of 66 times however in sample Insurance Companies (ICs) there is a company which conducts meeting only two

times during a year. The result further stipulates as there is high variation in conducting a meeting among Insurance Companies (ICs) during study period by 16.1 or 16 meeting times. Generally, the sample Insurance Companies (ICs) conduct meeting 19.2 or 19 times on the average which is high when we compare with currently proposed corporate governance guidelines by National Bank of Ethiopia for insurance companies which postulates as each Insurance Companies (ICs) should at least conduct meeting of 12 times in a year.

More additionally educational qualified directors measured as number of directors who had college degree or higher is a mean value of 6.51 or 7 directors which indicates on average directors who have collage degree or above was 7 people during study period sample Insurance Companies (ICs). On the hand maximum and minimum value of statics is ten and two respectively. This indicates that from sample Insurance Company's there is a company which have maximum of qualified of ten directors and at the minimum from the sample Insurance Company's there is a company which have only two qualified directors during study period. The table 4.3 also depicted directors who had prior insurance industry experience which was measured as number of directors who served in other Insurance Companies (ICs) earlier in the same capacity and the descriptive statics shows as the mean value of directors in the boards of sample Insurance Companies (ICs) who have prior experience in insurance sectors are 3.21 or 3 directors. This also suggests that only small number of directors in Ethiopia insurance industry have specifically prior Insurance related experience. On the other hand, the standard deviation value of directors who had early insurance experience is 1.49 or one directors which indicate that there is very small variation in the industry in appointing directors who had early insurance experience. Further the test statics indicates as maximum and minimum value of industry specific experience of directors is 6 and 1 respectively. Which conform that from sample Insurer there is a campiness which have appoint 6 directors who had early insurance specific experience and at the minimum there is a company which have only one directors who have early insurance experience during study period.

The table 4.3 also shows the mean value board of director other business management experience, is 0.79 or 79 percent. Which were measured by the number of directors who had business management experience, divided by total number board of directors ; maximum of 1.00 or 100% percent and a minimum of 0.22 or 22 percent. This result depicts as 79 percent of directors who

serve in sample Insurance Companies (ICs) during study periods have other business management experience. On the other hand, at maximum there is a company in sample who appoints all directors or 100 percent who have other business management experience likewise at the minimum there is a company which only appoint 29 percent those who have other business management experience. As the same time the variation in sample Insurer during the study period is 23 percent which stipulates as there is high vibration among the sample Insurance Companies (ICs) in terms of appointing directors who have other business management experience.

Further table 4.3 also indicates that the mean and standard deviation of female directors in the board of Insurance Companies (ICs) are 0.83 or one directors and 1.08 or one person

respectively which is measured as number of female directors who seat in board as directors. The result suggests that there are small number and high dispersion of women in the board during the sample period. The minimum and maximum of female director's ranges from 4 and 0 respectively, 0 indicates Insurance Companies (ICs) that do not have any representation for women on their boards.

Moreover, the table 4.3 shows the mean value of chief executive officer compensation of the sample Insurance Companies (ICs) is 12.9 during a study period which was measured by the natural logarithm of chief Executives' payment with a maximum of 14.3 and minimum of 11.1. It varies from the average value by 0.4. Which indicates the maximum compensation of chief executives of sample Insurance Companies (ICs) during study period is 12.9 whereas the minimum compensation is 11.1 as the general the descriptive statics suggests that chief executive's composition structure of sample Insurance Companies (ICs) during the study period are all most similar with small variation.

The average age of the insurance companies is 22 with standard deviation of 8. They all have higher year variance of commencement. The maximum age among the insurance companies is 40. This means there is an insurance company which is 40 years of age and an insurance with a minimum of eight years. The standard deviation 8 shows their variability in commencement. The other variable is that the CEO Duality. There were average of 0 duality means there were no one who were serving as board manager and CEO which is called CEO duality with standard deviation of 0 and maximum and minimum of 0. Since this was a yes and no question 2 stands for no and hence there were no one who served both.

The interviewees rise about board member ability to translate broad knowledge into good strategic decisions and they suggest board members' human capital in terms of background and experience certainly influences the outcomes of board decision making. This knowledge involves technical expertise concerning areas needed to govern effectively, such as business strategy, succession, finance, law, government, technology, society and how organizations operate as general this lead qualified decision that lead financial return on asset. But the problem is with director's experience and qualification as there are few directors that have prior experience in insurance sector and qualified directors in the board. The interviewees also raised board of director's motivation or directors desire to attend meetings, read materials, spend time on corporate activities, and to make

decisions that contribute to organizational success. Motivated directors desire to information about the operations and management of the organization as well as information about the business environment, the return on asset and activities of competitors which is vital factors lead board of director's effectiveness that enhance return on asset of companies. Further they noted there is lack of motivation and commitment of directors which hamper company return on asset and the challenging part of working in groups. The interviewees also pointed out as corporate transparency and disclosure is weak in case of Ethiopia. Effective legal framework that identifies the specific disclosure requirements didn't exist in the country. Furthermore, they noted that in Ethiopia issues on corporate governance disclosure such as; financial disclosures, non-financial disclosures, annual general meetings timing and means of disclosure and best practices for compliance with corporate disclosure are very low.

The interviewees point out as professionals with requisite technical skill and experience should head and manage insurance companies. This practice promotes professionalism in the industry. The need for strong internal control system was emphasized, in order to promote good corporate governance and improve the image of the Ethiopia insurance industry. Besides, they mentioned that there is a high unfair competition with aggressive price cutting in the market which totally obstacle for growth of the industry the government (NBE) remain silent for situation still. As the interviewers point out placing sound corporate governance system in the industry which mitigate these and other problem in the market which lead enhanced growth and create matured industry to support the booming economic developments of the country. Interviewees also agreed that effective risk management is necessary to ensure development and growth of the Ethiopia insurance industry. Furthermore, adequate capital base and compliance with NBE guidelines for insurance business practice are raised as an important role which turns redeem the image of the insurance industry in Ethiopia. They also underline as this can promote strong financial base and increase the capacity of the nation's insurance industry. However, government need to provide enabling environment, as corporate governance thrives in economic and political stable environment.

Putting governance guidelines promotes health of the industry and keeps interest of all stakeholders in sectors and avoids sectors systemic collapse. But when we add this guideline to our list of

directives (law) we should take a great care in analyze pros and con of each issue included in guideline. The interviewees suggest that the proposed corporate governance guideline for the financial sectors as general and specifically for insurance industry can enhance insurance companies' growth in Ethiopia. They underline their arguments by indicating as nature of governance practices are not endogenous one country governance nature may not exact fit to other country governance practice. So when we adopt/develop its batter if it can be supported by in-depth research and further they note as the proposed corporate governance guideline need sort of correction.

As per discussion the size of the board should be adequate. As the participant point out board size have no problem. This is also evidenced that the regulatory requirement under Article 347 of the Commercial Code of Ethiopia (1960), states that a share company should have a board size of between 3 and 12 members only accordingly all Insurance Companies (ICs) have a board size of five to ten.

The interviewers further revealed that the closed nature of the Ethiopia financial sector in which there are no foreigner, absence of organized stock market, a noncompetitive market structure, and strong capital controls in place and the dominant role of state owned Insurance Company (Ethiopian Insurance Corporation) are the key factors that affect the corporate governance of the country. This is also confirmed by the study of Kiyota et al. (2007). Likewise, Manga (2008) stated that the absence of organized equity market is a serious void. Since there is no organized equity market in the country when shareholders want to sale their shares, they face difficulty finding a buyer.

4.4. Correlation Analysis

This section of the study presents the results and discussions of the Pearson correlation analysis. To identify the relationship among the considered corporate governance mechanism variable and Insurance Company's financial return on asset, Pearson correlation coefficients were used. The correlation coefficient shows the extent and direction of the linear relationship between considered internal corporate governance variables and Return on Asset of Insurance Companies (ICs) of the sample Insurance Companies (ICs) in Ethiopia during study period

Accordingly, in table 4.2 the correlation matrix which shows the relationship of the return on asset with board size, chief executive compensation, board members educational qualifications, female directors in board, directors frequency of meeting, directors' industry specific experience, board members other business management experience, and Insurance Companies (ICs) growth premium.

The probability is shown in parenthesis with the correlation coefficient in the correlation matrix below. The significance level also shown that is ***, ** and * for 1%, 5% and 10% level respectively. The correlation coefficients are checked for the presence of high collinearity among regresses.

Table 4.2. Point out that top executive compensation, female boards of directors, frequency of meeting and board member's other business management experience are positively and significantly correlated at 1 percent significance level with return on asset. Whereas director's industry specific experience is positively significant at five percent however board size and Directors educational qualification are insignificant with return on asset. Even though they are not significant board of director's educational qualification shows a positive coefficient which is as expected but board size coefficients are not as expected in this study. And CEO duality wasn't shown weather to have a correlation or not because of its similarity in data for all of the companies. There were no any CEO who had a dual purpose as a CEO and a manger.

Further, the correlation result suggests in table 4.2 the Pearson correlation coefficients of board size experience, chief executive's compensation, director's educational qualification, female directors, director's frequency of meeting, industry specific experience of directors and director's other business management are 12 percent, 30 percent 14 percent 34.2 percent 29 percent 22.5 percent and 58.2 percent respectively. From this it can be understand that board member's other business management, top executive's composition, female director's presence in the board and board frequency of meeting are a strong association with return on asset. In contrast board size educational qualification of directors and industry specific experience of directors does not have high association with return on asset high.

Moreover, as it is shown in the above correlation matrix control variables are not significantly correlated with return on asset. As it is observed on the coefficients values, of growth premium are weakly correlated at 3 percent level.

Generally, the correlation analysis shows that the degree and directions of association of some study variable and return on asset. The correlation analysis shows only the direction and degree of association between variables and it does not permit the researcher to make causal inferences regarding the relationship between the identified variables. Therefore, it is not possible to explain the relationship between corporate governance variables and return on asset measures by controlling the influence of some selected variables using correlation analysis. As a result, the main analysis is left for regression analysis that overcomes the shortcomings of correlation analysis.

4.5. Regression Analysis Result

This section covers the empirical regression model used in this study and the results of the regression analysis. The panel data is used to run the regressions to investigate the Impact of corporate governance mechanism on Insurance Company's return on asset measured by return on asset. In doing this, the empirical models were developed in chapter three to guide the analyses are provided as follows:

$$\mathbf{ROA}_{it} = \alpha + \beta_1\mathbf{BS} + \beta_2\mathbf{Cop}_{it} + \beta_3\mathbf{EQD}_{it} + \beta_4\mathbf{FD}_{it} + \beta_5\mathbf{FM}_{it} + \beta_6\mathbf{ODS}_{it} + \beta_7\mathbf{ISE}_{it}$$

Further they are two broad classes of panel estimator approaches that can be employed in financial research: fixed effects models (FEM) and random effects models (REM) (Brooks 2008). To check which of the two (FEM or REM) models provide consistent estimates for this study Housman test was employed and the result is presented as follows.

Table 4.5: Correlated Random Effects Housman Test

Test Summary	Chi -Sq. Statistic	Chi-Sq. def.	Prob.
Cross-section	100.4885	8	0

Source: Data of sampled Insurance companies and own computation

The null hypothesis of the test was that the random effect method is the preferred regression method. Tables 4.5 show the p-value for the test is significant at one percent's, which indicate that the null hypothesis was rejected. Hence, the fixed effect was preferable. Accordingly, FEM was employed to estimate the relationship between the dependent variable and the independent variables.

The regression output in table 4.6 is run by taking ROA as a dependent variable, considered corporate governance mechanism and control variables as independent variable. The regression output reveals that the dependent variable is well explained by the explanatory variables in the model with R-square and adjusted R-square of 0.815 and 0.774 respectively.

The coefficient of determination R-square indicates that about 81.5% of change in return on asset is accounted for by the explanatory variables while the adjusted R-squared of 77.4% further justifies this effect. The F- statistic of 20.14 is also significant with P- value of zero indicating that the null hypothesis, that all the coefficients are jointly zero is rejected and the models do not suffer from specification bias. So, the variation in the dependent variable is well explained by the regresses in the model

Table 4.6: Regression Result of the Model

Variable	Coefficient	Std. Error	t-Statistic	Prob
Constant	-0.844422	0.189859	-4.447626	0.0000
BS	0.014359	0.013946	1.029588	0.3063
CCOP	0.107763	0.033590	3.208222	0.0020***
EQD	0.011309	0.006763	1.672191	0.0988*
FD	0.004810	0.007048	0.682438	0.4971
FM	-0.000310	0.001638	-0.188951	0.8507
ODS	0.181433	0.064118	2.829671	0.0060***
ISE	0.017609	0.008341	2.111107	0.0382**
GP	0.046762	0.026602	1.757875	0.0830*
R-squared	0.815339			
Adjusted R-squared	0.774865			
F-statistic	20.14490	Durbin-Watson stat		1.935916
Prob(F-statistic)	0.000000			

***, ** and * denotes significance at 1%, 5% and 10% levels respectively

Source: Output from Data of Sample Insurance Companies (ICs), 2007 to 2016

Based on the results shown in table above independent variables like board member educational qualification (EQD) and Growth premium (GP) is statistically significant at 10%, whereas industry specific experience of directors (ISE) is statistically significant at 5%. In addition, explanatory variables such as chief executive’s composition (CCOP) and other business management experience of directors (ODS) are significant at 1% significance level. Since the p- value for both variables are less than 0.01. On the other hand, board sizes (BS), Existence of female directors (FD) and Board of directors’ frequency of meeting (FM) are not statistically significant.

Moreover, the signs of the parameter coefficients indicate that there is positive relationship between, chief executive’s composition, educational qualification of directors, industry specific experience of directors, other business management experience of directors and Growth premium. This reveals that there are a direct relationship between the above five independent variables and ROA.

4.6. Discussion

This section of the chapter discusses some of the main implications of the results. The analysis is based on the results of the regression between the dependent variable and the independent variables presented in table 4.5 and in-depth interview. The results obtained under these different methods are jointly analyzed.

4.6.1. Board size

Larger boards are associated with diversity in skills, business contacts, and experience that smaller boards may not have, which offers greater opportunity to secure critical resources (Haniffa and Hudaib, 2006, p.1038). And hence the results of this study indicates existence of positive association between board size and return on asset. Further, Kiel and Nicholson (2003), Beiner *et al.* (2006), and Coles *et al.* (2008) offer recent evidence for Australian, Swiss, and US listed firms, respectively, which is entirely in line with those of Haniffa and Hudaib (2006). It is shown that there is a positive, but a statistically insignificant nexus between the Board size and the ROA which indicates that even though the board size has no valuation implications for the sampled Insurance Companies (ICs), the market perceives it as a good corporate governance practice. This finding is also consistence with Mangena and Chamisa (2008) which record positive and insignificant relationship between board size and incidences of listing suspension by the JSE. More additionally Aggarwal *et al.* (2007) found no relationship between board size and firm return on asset. The result also indicates as the proposed national bank of Ethiopia corporate governance guideline for insurance sectors which say an Insurance Company shall have at least nine directors was not empirically supported.

There is one question posed here. The question arises as to what is the optimal board size? It is difficult to provide one solution to the question that would fit all companies. This is because companies have different needs and several considerations are made before appointing directors, for instance, issues of the diversity of the company's operations, skills requirement, shareholding structure, regulatory requirements, and size of the company among others would have to be taking into account. Studies such as Brown and Saylor (2004) suggested a board size of between

6 and 15 members whilst Jensen (1993) argues for 7 or 8 members. Lipton and Lorsch (1992) are in support of a board size of between 8 and 9. It would be ideal to have a board size of between 7 and 9 members to ensure efficiency of operations and for an improved return on asset. More additionally this result also consistence with interviews result as board size has no huge impacts on companies' return on asset. Therefore, based on this premise, the null hypothesis which states there is no significant positive relationship between board size and Insurance Companies (ICs) return on asset in Ethiopia is supported by this data.

4.6.2. Frequency of Board Meeting

As it was shown in the results section this study it was shown that the existence of negative association between board frequency of meeting and return on asset. The result is inconsistent with this study expectation. It was expected that the two would have an association. A possible theoretically explanation of the negative nexus between the frequency of board meetings and the ROA supports the idea that frequent board meetings are not necessarily beneficial. A higher frequency of board meetings, for example, can result in higher costs in the form of managerial time, travel expenses, refreshment, and directors' meetings fees. This finding also implies that the currently proposed corporate governance guidelines for Insurance Companies (ICs) by national bank of Ethiopia which postulates frequency of meeting to at list ones in the month is not empirically supported. Empirically, this finding is consistent with the result of El Mehdi (2007) who reports a statistically insignificant association between the frequency of board meetings and the ROA for a sample of 24 Tunisian listed firms from 2000 to 2005.

By contrast, it does not support the results of Mangena and Tauringana (2006) who document a statistically significant and positive relationship between the frequency of board meetings and the ROA in sample of 157 Zimbabwean listed firms from 2001 to 2003. This finding also supported by in qualitative party of the study result which suggests high frequent meeting is boring, managerial time consuming which totally affects return on asset of firm. Therefore based on this premise, the null hypothesis which says there is no statistically significant positive relationship between the frequency of board meetings and Insurance Company's financial return on asset, as measured by ROA is supported by this data.

4.6.3. Chief Executives Compensation

The regression result provided in table 4.5 reveals a positive coefficient parameter of 0.1697 between the variables and ROA which is significant at 1% which entails that the more compensation is made for CEO, the higher the return on asset of Insurance Companies (ICs) in Ethiopia. This also confirms that CEOs compensation does have significant and positive impact upon Insurance Company's (IC's) return on asset as measured in terms of ROA. Hence, the data of this study rejects the premises of null hypothesis which says there is no significant positive relationship between chief executive's compensation and Insurance Companies (ICs)' return on asset in Ethiopian Insurance Companies. Thus, the positive and significant coefficient of CEO Compensation shows that there is a point at which adding a compensation for CEO increases Insurance Companies (ICs) value. Compensation contracts are therefore seen as a remedy to the principal agent problem. Besides this, short term and long term incentive plans benefit shareholders by incentivizing managers to perform better in their own interests. Furthermore, the result suggests that at least in Ethiopia insurance industry the incentive of chief executives pay is directly linked to Insurance Companies (ICs) return on asset. Thus, the chief executive's compensation plays important and efficient incentive mechanisms, which inevitably enhances return on asset. This is in line with Zhang and Yang (2011) who argue that executive compensation incentives have a significant positive impact on firm return on asset.

4.6.4. Proportion of Female Directors

The relationship between female presence in board gender (FD) and return on asset measures by ROA are insignificant since the premise of null hypothesis under this study which says there is no statically positive/negative relationship between the proportions of female directors and Insurance Companies (ICs) return on asset were not rejected. Therefore, this study does not support the view that gender diversity leads to superior Insurance Companies (ICs) financial return on asset. Some previous studies document a positive effect of the role of women on boards and find that women enhance the quality of decision making and firm return on asset (Bathula, 2008; Erhardt et al. 2003). However, this study does not find a significant positive/ negative association between percentage of women directors and Insurance Companies (ICs) financial return on asset.

The result is not surprising because other studies that examined the association between proportion of women on boards and firm return on asset also found insignificant result (for example see Rose, 2007; Habbash, 2010). But the result simply indicates the presence of female directors will not improve Insurance Companies (ICs) operation and return on asset unless they are qualified and competent. Whether gender diversity help improve Insurance Companies (ICs) operation and return on asset it depends on factors such as experience, education and assertiveness of female directors.

4.6.5. Educational Qualification of Directors.

Board member's educational qualification (EQD) has a positive effect on Insurance Company's financial return on asset. Board member's educational qualification explains the variations of the return on asset of Insurance Companies (ICs) with a coefficient of 0.011309 and statistically significant at, 10 percent for return on asset. The result indicates that the increase in the proportions of directors who had college degree or higher have a significant positive influence on the return on asset of Insurance Companies (ICs) in Ethiopia and vice versa. In other words, the higher the number of directors who had college degree or above sitting on the board the higher the return on asset of sample Insurance Companies (ICs) in Ethiopia and vice versa. This suggests that the presence of qualified directors on the board plays an important role in carrying out the boards monitoring responsibility and in improving financial return on asset.

The null hypothesis under this study which says there is no significant positive relationship between educational Qualification of directors with business background and Insurance Companies (ICs) return on assets were rejected and the alternative hypothesis were accepted. This result supports the finding revealed by Arman (2011) and Yasser (2011). They argue that directors with higher education are better in managing the business operation and controlling agency problem than less educated counterparts this reduce agency cost. Educational qualification affects the oversight and monitoring role of boards of directors. The result supports the view that educational qualification is potentially important since the ability to seek and interpret appropriate information is essential for the efficient operation of Insurance Company's and the effective control or guidance of management by boards of directors. The qualification of directors as measured by the percentage of directors who had college degree or higher significantly influences Insurance Company's return on asset in Ethiopia. Thus, educational qualifications of directors play a great role in board decision making.

Both the regression result and the qualitative result indicate that educational qualification of directors is important factor to improve return on asset of the sampled Insurance Companies (ICs) in Ethiopia.

4.6.6. Other Business Management Experience of Directors

Other Business management experience of directors (ODS) has a positive effect on measures of Insurance Companies (ICs) financial return on asset. Other Business management experience of directors explains the variations of the return on asset of Insurance Companies (ICs) with a coefficient of 0.18 and statistically significant at, one percent. The result indicates that the increase in the number of directors who have other directorial ship have a significant positive influence on the return on asset of Insurance Companies (ICs) in Ethiopia and vice versa. In other words, the higher the number of directors who had Other Business management experience sitting on the board the higher the return on asset of sample Insurance Companies (ICs) in Ethiopia and vice versa. The premises of null hypothesis under this study which says there is no a significant positive association between board member's business management experience and return on asset of Insurance Companies (ICs) is rejected by this data. This finding is consistence with (Sat et al.2011) he argues as business management experience of directors enables them to have better knowledge and understanding about business and enable to contribute effectively in the decision making process as well as in effectively monitoring the activities of management.

The results also parallel with Kroll, et al (2008) which point outs that boards rich in appropriate experience are associated with superior returns. The results of qualitative part also support this finding which indicates that boards comprising directors with appropriate knowledge gained through experience can be not only better monitors, but also more useful advisors to top managers.

Table 4.7: Test Result summary

Independent Variable	Actual	Significance
Board size	+	Insignificant
Chief Executive Compensation.	+	Significant
Educational Qualification of Directors	+	significant
Female directors	+	Insignificant
Frequency of board Meeting	-	Insignificant
Other business Mgt experience	+	Significant

CHAPTER FIVE

5. Summary of findings, Conclusions and Recommendations

This chapter deals with the conclusions and recommendations of the study based on the findings. Hence, section 5.1 presents the summary, section 5.2 presented conclusions, and section 5.3 presents the recommendations and avenues for Future Research and Improvements provided in section 5.4.

5.1. Summary of Finding

The result of regression analysis showed existence of positive but insignificant association between board size (BS) and return on asset. This statically insignificant nexus between the Board size and the ROA indicates that even though the board size has no valuation implication for the sampled firms, the market perceives it as a good corporate governance practice. At the same time, the result indicates as the proposed corporate governance guideline which postulates at least nine directors for one insurance company is not empirically supported.

The results also show existence of negative association between board frequency of meeting and return on asset. A possible theoretically explanation, the negative nexus between the frequency of board meetings and the ROA supports the idea that frequent board meetings are not necessarily beneficial. A higher frequency of board meetings, for example, can result in higher costs in the form of managerial time, travel expenses, refreshment, and directors' meetings fees. This finding also implies that the currently proposed corporate governance guidelines for Insurance Companies (ICs) by National Bank of Ethiopia which postulates frequency of meeting to at list ones in the month is not empirically supported in area of determining proper number of board meeting.

Further the result also confirms that CEOs compensation does have significant and positive impact upon Insurance Company's (IC's) return on asset as measured in terms of ROA. Hence, the data of this study rejects the premises of null hypothesis which says there is no significant positive relationship between chief executive's compensation and Insurance Companies (ICs)' return on asset in Ethiopian. Thus, the positive and significant coefficient of CEO shows that there is a point

at which adding a compensation for CEO increases Insurance Companies (ICs) value. Compensation contracts are therefore seen as a remedy to the principal agent problem.

Beside this study result also shows insignificant positive association between percentages of women directors and Insurance Companies (ICs) financial return on asset. In addition to this the result indicates Board members' educational qualification has positive and significant impacts on Insurance Company's return on asset. This means that the increase in the proportions of directors who had college degree or higher have a significant positive influence on the return on asset of Insurance Companies (ICs) in Ethiopia and vice versa.

Also study clearly shows Other Business management experience of directors has positive significant impacts on Insurance Company's financial return on asset. This means that the increase in the number of directors who have other directorial ship have a significant positive influence on the return on asset of Insurance Companies (ICs) in Ethiopia and vice versa. More additionally, study result shows significant positive association between board members industry specific experience and Insurance Company's return on asset in Ethiopia.

Lastly, in the corporate governance of Ethiopia insurance sectors, as per the result of interview: the major factors that have impact on the return on asset of the Insurance Companies (ICs) are identified as (a) weak corporate transparency and disclosure i.e. absence of nationally implemented standards for corporate governance, (b) closed nature of the Ethiopia financial sector and (c) lack of qualified and experienced directors in the board. (d) Unfair price cutting which challenge the growth the industry as general.

5.2. Conclusions

Good corporate governance is beneficial to insurance companies because it facilitates accountability, promotes transparency of operations, improves firm's profitability and enhances growth of the insurance industry. Corporate governance helps to protect stakeholders' interest by aligning their interest with that of managers.

To this end, this study aimed at examining corporate governance mechanism that could influence the return on asset of insurance companies in Ethiopia. In order to achieve this objective, seven hypotheses have been developed. To address research hypotheses and achieve the broad research objective, the study used mixed research approach. More specifically, the analyses were performed documents reviews of insurance companies in Ethiopia during a twelve-year period from 2004-2015 and in-depth interview with selected Insurance Companies (ICs) board chairman.

Nine insurance companies were selected as a sample from seventeen insurance companies currently operating in Ethiopia. Fixed effect model was used to estimate the regression equation. In the study board size, chief executive compensation, proportion of female directors, frequency of board meeting, educational qualification of directors, industry specific experience of directors and other business management experience directors and growth premium were considered as independent variables while return on asset was considered as dependent variables. With regard to in-depth interviews, the study conducted interview with three board chairman and one delegated person of selected Insurance Companies (ICs).

5.3. Recommendation

On the basis of the findings of this study, the Researcher has drawn the following recommendations. As the finding of this study indicates in Ethiopia insurance industry board of directors both industry and general business experience plays pivotal role in increasing Insurance Companies (ICs) financial return on asset. Thus, if shareholders give due considerations to director's experience during their nomination for approval they further allow their company to show better return on asset. CEOs compensation does have significant and positive impact upon Insurance Company's (IC's) return on asset in Ethiopia. This Compensation contracts are therefore seen as a remedy to the principal agent problem. Besides this, short term and long term incentive plans benefit shareholders by incentivizing managers to perform better in their own interests. Hence, it is recommended for Insurance Companies (ICs) operating in Ethiopia to give further attention on their CEO compensation package.

Good corporate governance practices in insurance sectors will be positive that maintain the level of risk they can handle and give stakeholders a sufficiently safe level of their protection and

investments. Moreover, the government should revisit its proposed corporate governance guidelines for Insurance Companies (ICs) especially in the area determination of proper board size and optimal level of frequency of meeting. National Bank of Ethiopia should focus on the industry specific experience of directors and director's other business management experience when enact corporate governance related rule or directive. Finally, there is the need to set up a unified corporate body saddled with the responsibility of collecting corporate governance related data and constructing the relevant indices to facilitate corporate governance research in Ethiopia.

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APPENDICES

Dear Sir or Madam

My name is Nof Bilal. I am attending MBA in Faculty of Business and Economics at Addis Ababa University. I am conducting a research on the title “The Effect of Corporate Governance on Performance on the Ethiopian Insurance Companies” as a partial fulfillment of the requirements for the Masters of Business Administration, Addis Ababa University, Faculty of Business and Economics.

This questionnaire is designed to collect data on Corporate Governance and its effect on Return on asset of insurance companies. The data collected through the questionnaire is highly valuable to meet the objectives of this study. Therefore, you are kindly requested to fill in and return the questionnaire. The information you provide would be used for academic purpose only and will be kept confidential.

Thank you in advance for your cooperation!

Nof Bilal

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CEO and Chairman are the same person											
number of non-executive directors in the board											
number of executive directors											

7. Year of incorporation of the insurance company _____