CORPORATE GOVERNANCE AND ITS EFFECT ON PERFORMANCE OF ETHIOPIAN PRIVATE COMMERCIAL BANKS

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STATEMENT OF DECLARATION

I, hereby, declare that this thesis entitled "**Corporate Governance and its Effect on Performance of Ethiopian Private Commercial Banks**" is submitted in partial fulfillment of the requirement for Degree of Master in Business Administration in Finance with the guidance and support of the thesis advisor. This study is my original work and it has not been presented for any degree or diploma program in this or any other university/institution, and that all source of materials used have been dully acknowledged.

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This is to certify that the thesis prepared by Reza Demissie Retta entitled Corporate Governance and its Effect on Performance of Ethiopian Private Commercial Banks and submitted in partial fulfillment of the requirement of the Degree of Master in Business Administration in Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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Abstract

Corporate governance is an important factor for well-functioning of firms. Given the importance of banks, their governance assumes a central role. The study aims to identify the effect of corporate governance on bank performance measured by return on assets. Eight year data for the period 2010-2017 was used to study ten private Ethiopian commercial banks. Corporate governance variables considered includes board size, board gender diversity, industry related qualification of board members, board ownership, number of board meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity position and management efficiency. Control variables of bank size and leverage were considered. Audited annual reports and questionnaires were used to collect data to determine causal link between the independent and dependent variables. Fixed effect regression model using SPSS was employed to analyze result output. Findings of the study indicate that board size has negative but statistically insignificant effect on return on asset. Industry related qualification, board ownership, number of board meetings, and number of board committees have positive but statistically insignificant effect on return on asset. Board gender diversity, capital adequacy ratio, legal reserve, and management efficiency have negative and statistically significant effects on the dependent variable. Whereas liquidity ratio has a positive and statistically significant effect on return on asset.

Keywords: Corporate governance, bank performance, private commercial banks

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LIST OF ACRONYMS AND ABBREVIATIONS

ANOVA	ANALYSIS OF VARIANCE
BGD	BOARD GENDER DIVERSITY
BSZ	BOARD SIZE
BOW	BOARD OWNERSHIP
CAR	CAPITAL ADEQUACY RATIO
IQL	INDUSTRY RELATED QUALIFICATION
LER	LEGAL RESERVE
LEV	LEVERAGE
LIQ	LIQUIDITY RATIO
LOGBKS	LOG OF BANK SIZE
MEF	MANAGEMENT EFFICIENCY
NBC	NUMBER OF BOARD COMMITTEES
NBM	NUMBER OF BOARD MEETINGS
OECD	ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
ROA	RETURN ON ASSET
VIF	VARIANCE INFLATION FACTOR

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

The development and refinement of corporate governance standards has often followed the occurrence of corporate governance failures that have highlighted areas of particular concern (Kirkpatrick, 2009). Governance means to control and regulate; the exercise of influence to maintain good order and adherence to predetermined standards of behaviour. Corporate Governance is the regulating influence applied to the affairs of a company to maintain good order and apply predetermined standards. Put simply, corporate governance is an ethical environment in which all business processes are undertaken (Knell, 2006). According to Baker and Anderson (2010) the importance of corporate governance became dramatically clear at the beginning of the twenty-first century as a series of corporate meltdowns arising from managerial fraud, misconduct, and negligence caused a massive loss of shareholder wealth. The firm's owners (shareholders) asked who, if anybody, is responsible for protecting and promoting the value of their investment. Yet governance issues and problems have a long and sometimes shocking history. According to Adam Smith (1776/1904, V.1.107) in*Wealth of Nations* (cited in Baker & Anderson, 2010) *Being the managers of other people's money rather than their own, it cannot be expected that they (managers) should watch over it with the same anxious vigilance which (they would) watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.*

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies (Organization for Economic Cooperation and development, OECD, 2015). The subprime-mortgage crisis was the latest event to highlight shortcomings in corporate governance. Many past failures, including that of Enron, were often the result of poor corporate oversight. In some cases, out-and-out fraud was involved. However, fraud that goes undetected or unaddressed is, to some extent, a failure of corporate governance. Banks and other financial companies, as well as their investors, were dramatically hit as the effect rippled throughout the world (Lamm, 2010).

Corporate governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized. Good corporate governance structures encourage companies to create value and provide accountability and control systems commensurate with the risks involved (Australian Stock Exchange corporate governance council, 2003).

Corporate governance provides a framework that reflects an interplay between internal incentives (which define the relationships among the key players in the corporation) and external forces (notably policy, legal, regulatory, and market) that together govern the behavior and performance of the firm. In its narrowest sense, corporate governance can be viewed as a set of arrangements internal to the corporation that defines the relationships between managers and shareholders. At the center of this system is the board of directors. Its overriding responsibility is to ensure the long−term viability of the firm and to provide oversight of management. The internal mechanisms for corporate governance are strengthened by external laws, rules, and institutions that provide a level, competitive playing field and discipline for the behavior of insiders. Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability, and responsibility to protect shareholders, consumers, workers, the environment, and even competitors from abusive practices. A good legal and regulatory framework efficiently addresses the entry, operations, and exit of firms **(**Iskander & Chamlou, 2000).

Banks serve a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the banking sector and the economy as a whole (Basel committee on banking and supervision, 2014).

Bank regulation is justified by the negative externalities that are associated with a bank failure. Specifically, an individual bank failure not only affects its shareholders but also poses serious consequences to depositors and other participants in the financial system and in the global economy. Bank regulation aims to protect depositors and promote stability of the financial system (John, De Masi & Paci, 2016).

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they set corporate objectives, operate the bank's on a day-to-day basis, meet the obligation of accountability to shareholders and interest of depositors, supervisors, align corporate activities and behavior with expectation that bank operates in safe and sound manner, and in compliance with regulations *(*Basel committee on banking and supervision, 2006).

The Basel Committee on Banking Supervision and the Organization for Economic Co-operation and Development has been at the forefront in establishing international norms of corporate governance that apply to the banking institutions. They have developed principles, guidelines, and codes that help ensure adoption and implementation of sound corporate governance practices by banking organizations. In Ethiopia, the National Bank is responsible to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conductive to rapid economic development of Ethiopia (National Bank of Ethiopia establishment proclamation number 591/2008). Hence, the National Bank of Ethiopia has issued Bank Corporate Governance Directives No SBB/62/2015 to be effective from September 21, 2015 with the aim of giving way to balanced risk taking and enhancing business prudence, prosperity and corporate accountability with the ultimate objective of realizing long term shareholders' value and customers' and other stakeholders' interest. The directive states that corporate governance plays a vital role in maintaining the safety and soundness of financial system in general and banking sector in particular.

According to Obeten, Ocheni, and John (2014) corporate governance affects banks' performance and value of the firm and that strong governance lead to higher levels of investment and to growth opportunities. Corporate governance in banks contributes to collaborative working relation between bank management and bank supervisors (Katrodia, 2011). The balance and

effectiveness of the corporate governance mechanism can create a better corporate financial performance (Dharmastuti & Wahyudi, 2013).

Corporate governance is about building credibility, ensuring transparency and accountability as well maintaining an effective channel of information disclosure that would foster good corporate performance. It is therefore crucial that banking sector observe a strong corporate governance ethos (Onakoya, Ofoegbu, & Fasanya, 2012). A bank's failure to follow good practices in corporate governance and the lack of effective governance are among the most important internal factors which may endanger the solvency of a bank. Corporate fairness, transparency and accountability are thus the main objectives of corporate governance, taking into account the corporate "democracy", which is the broad participation of stakeholders (Marcinkowska, 2012).

1.2. Statement of the Problem

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (Organization for Economic Cooperation and development, OECD, 2015). Bank governance has been blamed to varying degree for the recent financial crisis (Baker & Anderson, 2010). Regulations affect governance because regulators care about financial stability; they pressure bank boards to act to ensure the safety and soundness of the financial institution through direct and indirect restrictions.

Banks efficiently mobilize and allocate funds; this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. Thus, weak governance of banks reverberates throughout the economy with negative ramifications for economic development. Given the importance of banks, the governance of banks themselves assumes a central role. Banking crises dramatically advertise the enormous consequences of poor governance of banks. Banking crises have crippled economies, destabilized governments, and intensified poverty. When bank insiders exploit the bank for their own purposes, this can increase the likelihood of bank failures and thereby curtail corporate finance and economic development, banks are frequently very heavily regulated (Levine, 2004).

Corporate governance is a tool to ensure the existence of transparency, accountability and fairness in corporate reporting; it encompasses ensuring that the company's strategy and life cycle development safeguards the interest of various stakeholders. According to Mulbert, Adams and Mehran (cited in Bebeji, Mohammed & Tanko, 2015) corporate governance represents a central issue for the operation of modern banking industry.

One of the core purposes of bank regulation is to prevent bank failures. Regulators try to reduce two problems at the root of bank failures. One is the phenomenon of a bank run. The second source of failure is a problem of moral hazard: owners and managers of banks may misuse the funds they are given by depositors. To address these issues, regulators limit the types of assets that banks can hold in their balance sheet, and set minimum levels of capital that banks must maintain (Ball, 2012). Regulators intervene to modify the corporate governance of banks. The main rationale of bank regulation is the safety and the soundness of the financial sector, reducing systemic risks and protecting depositors (John et al. 2016).

By appointing the board of directors, shareholders have an instrument to control managers and ensure that the firm is run in their interest. The two most important roles of a board of directors are monitoring and advising. As a monitor the board supervises the managers so as to ensure that their behavior is in line with the interests of the shareholders. As an advisor the board provides opinions and directions to managers for key strategic business decisions (Hann & Vlahu, 2015).

Different scholars use different proxies of internal and external corporate governance mechanisms to see their impact on bank performance, and the studies reveal inconclusive results. (Ashenafi et al. 2013). Nevertheless, previous empirical studies have provided the nexus between corporate governance and firm performance. However, despite the volume of the empirical work, there is no consensus on the impact of corporate governance on firm performance. Consequently, this lack of consensus has produced a variety of ideas (or mechanisms) on how corporate governance influence firm performance (Babatunde & Olaniran, 2009).

There is significant literature and empirical studies that link board characteristic and central regulators role to improved bank performance. Studies have been conducted in Ethiopia (Rao & Kidane, 2016; Olani & Berhanu, 2015; Ashenafi et al. 2013; Assefa & Megbaru, 2014; Yenesew 2012; Kibrysfaw 2013; Firehiwot 2015; Abdurazak 2017) to identify the effect of corporate

governance on the performance of Ethiopian banks. The various studies undertaken to assess effect of corporate governance on bank performance have used a varied combination of governance mechanism as explanatory variables. Moreover, results of the studies show varied effects of the corporate governance proxies in terms of significance level and direction of relationship to bank performance. Hence the subject remains a topic for further investigation to enable identify pertinent governance mechanisms that require due attention. Healthy financial sector is fundamental for sustained growth. And good corporate governance ensures that banks are sound and stable.

Therefore, this study contributes to existing knowledge and bridge gap by identifying the effect of selected internal and external corporate governance mechanisms on performance of private banks in the country. Corporate governance variables of; board size, board gender diversity, industry related qualification of board members, board ownership, number of board meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity position and management efficiency have been used to study their effect on the performance measured by return on assets.

1.3. Research Objective

1.3.1. General Research Objective

The general objective of the study is to examine the effect of corporate governance mechanism on the performance of private commercial banks in the country.

1.3.2. Specific Research Objective

- To examine the effect of internal corporate governance mechanisms on the performance of private commercial banks
- To examine the effect of external corporate governance mechanisms on the performance of private commercial banks

1.4. Research Hypothesis

The following null hypotheses have been formulated to test causal relation between the dependent and independent variables.

Null hypothesis (Ho)

Ho1: There is no relationship between board size and bank performance

Ho2: There is no relationship between board gender diversity and bank performance

Ho3: There is no relationship between industry related qualification of board members and bank performance

Ho4: There is no relationship between board ownership and bank performance

Ho5: There is no relationship between number of board meetings and bank performance

Ho6: There is no relationship between number of board committees and bank performance

Ho7: There is no relationship between capital adequacy ratio and bank performance

Ho8: There is no relationship between legal reserve and bank performance

Ho9: There is no relationship between liquidity position and bank performance

Ho10: There is no relationship between management efficiency and bank performance

1.5. Significance of the Study

Banking holds one of the most important positions in the economic world. The importance of a transparent and healthy banking system in the mobilization and intermediation of fund, for the growth and development of the economy is of paramount importance. Studying and understanding the effects of corporate governance mechanism in banks provides insight to the banks and regulators, and policy makers that enforcing the governance principles will create discipline in the industry, strengthen and stabilize banks and the economy as a whole, and create trust and dependability among various stakeholders.

The study contributes to existing research by increasing the time frame of study, increasing number of banks included in the sample, studying banks under similar mode of operation and incorporating internal and external proxies of corporate governance. Identifying variables through repeated studies using varied mix of corporate governance proxies helps identify explanatory variables which significantly affect the bank performance in Ethiopia.

The study will shed light for further studies by cumulating knowledge and facts about the banking governance principles of the country. The study contributes to confirm present knowledge, to add or change understanding, direction and policies. The study identifies effect of the corporate governance mechanism are in the Ethiopian banking industry so that emphasis will

be given by regulators and stakeholders while shaping, formulating and addressing banking governance mechanisms.

1.6.Limitation and Delimitation

The scope of the study is confined to private commercial bank in the country that have been in operation for the eight-year period from 2010 to 2017. The eight-year period is selected to capture at least two-term tenure of board directors. As per the National Bank of Ethiopia's official website, there are 16 private commercial banks and 6 of the banks have not fulfilled the requirement of the study as they have not been operational for the full study period. Private banks are set subjects of study as they have common platforms of operation. To study the effect of corporate governance on bank's performance, the study is delimited to independent variables of board size, gender diversity of board, industry related qualification of board, board ownership, number of board meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity position, and management efficiency. Return on asset has been taken to measure bank performance as a dependent variable. Bank size and bank leverage ratio are the control variables. The internal and external explanatory variables have been selected considering the fact that these mechanisms are used to explain corporate governance in the industry under study. Review of literature also pointed to these variables being selected as proxies of corporate governance.

In countries like Ethiopia, where there is no capital market, the effect of the market for corporate control on corporate governance may be minimal (Ashenafi et al. 2013), hence; the study used return on asset (ROA), a financial performance indicator, this may limit the finding of the study. ROA a measure of overall earning power or profitability has been selected as it measures the income available to debt and equity investors per unit of currency of the firm's total assets. Total assets (which equal total liabilities plus shareholders' equity) is greater than total capital and hence a better proxy for bank performance.

1.7. Organization of the Study

The study has been organized into a total of five chapters. The following chapter focuses on literature review; chapter three presents the research methodology. Data presentation and analysis is presented in chapter four, conclusions and recommendations are presented in the last chapter.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

This chapter presents reviews of theoretical perspectives and empirical literature of studies and their findings.

2.1.Introduction

A healthy and vibrant economy requires a financial system that moves funds from people who save to people who have productive investment opportunities. The financial system is complex in structure and function throughout the world. It includes many different types of institutions: banks, insurance companies, mutual funds, stock and bond markets, and so on—all of which are regulated by government. Because banking plays such a major role in channeling funds to borrowers with productive investment opportunities, this financial activity is important in ensuring that the financial system and the economy run smoothly and efficiently (Mishkin, 2004).

Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the great agencies of commerce (Somashekar, 2009). Banking is a highly regulated business. Regulation helps maintain customers' trust in the banking system. Customers have a high level of trust in banking due to the combination of competent banking employees and the ''security blanket'' of government supervision. Regulations are a source of many policies and procedures in banks that must be followed as part of the banking business. Procedures that are the result of regulatory requirements must be followed very closely and documented to demonstrate compliance (Dilley, 2008).

Corporate governance is the set of mechanisms used to manage the relationship among stakeholders and to determine and control the strategic direction and performance of organizations. At its core, corporate governance is concerned with identifying ways to ensure that strategic decisions are made effectively. Governance can also be thought of as a means corporations use to establish order between parties (the firm's owners and its top-level managers)

whose interests may conflict. Thus, corporate governance reflects and enforces the company's values (Hitt, Ireland & Hoskisson, 2007).

Corporate governance—the system of controls, regulations, and incentives designed to prevent fraud—is a story of conflicts of interest and attempts to minimize them. It is often not feasible for the owners of a corporation to have direct control of the firm; direct control and ownership are often separate. Rather than the owners, the board of directors and chief executive officer possess direct control of the corporation. The shareholders of a corporation exercise their control by electing a board of directors, a group of people who have the ultimate decision-making authority in the corporation. The board of directors makes rules on how the corporation should be run (including how the top managers in the corporation are compensated), sets policy, and monitors the performance of the company. The board of directors delegates most decisions that involve day-to-day running of the corporation to its management. The chief executive officer (CEO) is charged with running the corporation by instituting the rules and policies set by the board of directors. The different stakeholders in a firm all have their own interests. When those interests diverge, we may have agency conflicts (Berk & Demarzo, 2014).

A corporation is a structure established by law to allow different parties to contribute capital, expertise, and labor for the maximum benefit of all of them. The investor gets the chance to participate in the profits of the enterprise without taking responsibility for the operations. The management gets the chance to run the company without taking the responsibility of personally providing the funds. In order to make both of these possible, the shareholders have limited liability and limited involvement in the company's affairs. That involvement includes, at least in theory, the right to elect directors and the fiduciary obligation of directors and management to protect their interests (Monks & Minow, 2011).The separation between owners and managers creates an agency relationship. An agency relationship exists when one or more persons (the principal or principals) hire another person or persons (the agent or agents) as decision-making specialists to perform a service. The firm incurs costs when it uses one or more governance mechanisms. Agency costs are the sum of incentive costs, monitoring costs, enforcement costs, and individual financial losses incurred by principals because governance mechanisms cannot guarantee total compliance by the agent. If a firm is diversified, governance costs increase because it is more difficult to monitor what is going on inside the firm. In general, managerial

interests may prevail when governance mechanisms are weak, as is exemplified by allowing managers a significant amount of autonomy to make strategic decisions. If, however, the board of directors controls managerial autonomy, or if other strong governance mechanisms are used, the firm's strategies should better reflect the interests of the shareholders (Hitt et al. 2007).

Given the separation of ownership and control (or stake holding and management) that is endemic to a market economy, how the stakeholders control management is the subject of corporate governance. The basic principle of corporate governance is that the shareholders elect the board of directors who in turn select top management. The monitoring role of the board of directors is an important component of corporate governance. Thus, the board effectiveness in its monitoring function is determined by its independence, size, and composition (John & Lemma, 1998).

Corporate governance in the banking sector requires judicious and prudent management of resources and the preservation of resources (assets) of the corporate firm; ensuring ethical and professional standards and the pursuit of corporate objectives, it seeks to ensure customer satisfaction, high employee morale and the maintenance of market discipline, which strengthens and stabilizes the bank. Corporate governance is used to monitor whether outcomes are in accordance with plans and to motivate the organization to be fully informed in order to maintain organizational activity. It is also seen as a mechanism by which individuals are motivated to reconcile their actual behaviors with the overall objectives of the organization. It ensures that the values of all stakeholders are protected and also minimizes asymmetric information between bank's managers, owners and customers. Forms of bad corporate governance include official recklessness amongst managers, unethical practices and professional misconduct, insider abuses, poor quality services and weak supervisory structures (Obeten et al. 2014). Governance is "everybody's job." However, the key governance responsibilities are typically entrusted to the board of directors and the executive management of a corporation who are responsible for providing the oversight that is intended to help ensure that a company meets its goals (Levine, 2004).

According to Andres and Vallelado (2008) bank board's play a significant role in bank governance, either in monitoring managers or advising them in the design and implementation of strategies. Good corporate governance standards are imperative to every bank and important to

investors and other stakeholders (Al-Amarneh, 2014). Internal and external corporate governance mechanism and their effect on bank performance of selected banks in Ethiopia has been conducted; high government intervention, lack of corporate governance awareness, and absence of national standards of corporate governance, and weak framework to protect minority shareholder right are major factors with adverse impact on corporate governance and bank performance in Ethiopia. Good corporate governance will lead to increase in firm value as well as better firm performance (Ashenafi, Kelifa, & Yodit, 2013). According to Yenesew (2012) banks with effective corporate mechanisms improve financial performance.

A bank's failure negatively affects the economy of the country, hence assessing the effect of corporate governance on the performance of banks and understanding the role it plays will help device means of strengthening its prevalence thereby promoting transparence and trust among all stakeholders involved in the industry.

2.2. Theoretical Review

2.2.1. Agency Theory

Firms are assumed to exist for the benefit of its owners who are assumed to be solely interested in the maximization of their wealth. Managers, on the other hand, are the decision-makers in an organization and they are implicitly assumed to automatically act in the best interests of the owners. Agency theory recognizes that people are unlikely to ignore their own self interest in making decisions. The theory provides a means of establishing a contract between the principal and the agent which will lead to optimal performance by the agent on behalf of the principal (Crowther & Seifi, 2011).

The advent of the modern corporation created a separation between ownership and control of wealth. Even though owners would prefer to manage their own companies and reap the maximum utility for themselves, this is impossible because of the capital requirements of the modern corporation. Corporations grow beyond the means of a single owner, who is incapable of meeting the increased economic obligations of the firm. Owners become principals when they contract with executives to manage their firms for them. Executives accept agent status because they perceive the opportunity to maximize their own utility. Principals invest their own wealth in

companies and design governance systems in ways that maximize their utility (Berle & Means, 1932).

According to Alchian and Demsetz (1972); if every stock owner participated in each decision in a corporation, not only would large bureaucratic costs be incurred, but many would shirk the task of becoming well informed on the issue to be decided, since the losses associated with unexpectedly bad decisions will be borne in large part by the many other corporate shareholders. More effective control of corporate activity is achieved for most purposes by transferring decision authority to a smaller group, whose main function is to negotiate with and manage (renegotiate with) the other inputs of the team. The corporate stockholders retain the authority to revise the membership of the management group and over major decisions that affect the structure of the corporation or its dissolution.

The importance of Alchian and Demsetz's model for corporate governance lies in the fact that it justifies the role of shareholders as profit-earning entrepreneurs by using efficiency considerations. The shareholders are the constituency that determines what objectives should be pursued by the firm if it is to be efficient, but they also have the necessary incentives to ensure that these objectives are actually pursued. The implication is that firms controlled by unconstrained managers are not efficient, because of the divergence between the objectives of managers and those of profit-maximizing shareholders. Hence, in order to promote efficiency and economic welfare, one would have to ensure that within the firm structure there are sufficient constraints on managerial discretion aligning management motivation to the profit-maximization objective which in turn leads to the maximization of the firm's market value (Dignam & Galanis, 2009).

Jensen and Meckling (1976) state that an agency relationship is a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent. Agency costs is the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss.

In the theory of the firm, Jensen and Meckling state that the relationship between the stockholders and the managers of a corporation fits the definition of a pure agency relationship. Corporations are associated with the general problem of agency as there is separation of ownership and control. The problem of inducing an "agent" to behave as if he were maximizing the "principal's" welfare is quite general.

Fama and Jensen (1983) in their article of Separation of Ownership and Control state that the agency problems of diffuse decision management can be reduced by separating the management (initiation and implementation) and control (ratification and monitoring) of decisions. Without effective control procedures, decision managers are more likely to take actions that deviate from the interests of residual claimants. The common apex of the decision control systems of organizations, large and small, in which decision agents do not bear a major share of the wealth effects of their decisions is some form of board of directors. Exercise of these top-level decision control rights by a group (the board) helps to ensure separation of decision management and control. Separation of decision management and decision control at all levels of the organization helps to control agency problems by limiting the power of individual agents to expropriate the interests of residual claimants.

Fama (1980) stated that the board is viewed as a market-induced institution, the ultimate internal monitor of the set of contracts called a firm, whose most important role is to scrutinize the highest decision makers within the firm.

A key issue in the agency view of corporate governance is how to align the interests of the agent with those of the principal. Other important issues include the timely minimization of any divergences, and how to balance the need for and the cost of monitoring with the benefits that arise from the separation of control and ownership (Marnet, 2008).

2.2.2. Stakeholder Theory

According to Abrams's article of 1951 (cited in Yusoff & Alhaji, 2012) this theory centers on the issues concerning the stakeholders in an institution. It stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction.

According to Freeman (1984) managers bear a fiduciary relationship to stakeholders. Corporations have stakeholders, that is groups and individuals who benefit from or are harmed by, and whose right are violated or respected by, corporate actions. The stake holder theory states that corporations shall be managed in the interests of its stakeholders and that directors shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation. Freeman states that the stakeholders are those groups who have a stake in or claim on the firm. He includes suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups. The stakeholder theory does not give primacy to one stakeholder group over another.

Stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity. Stakeholder theory intends to explain and to guide the structure and operation of the established corporation. The ultimate managerial implication of the stakeholder theory is that managers should acknowledge the validity of diverse stakeholder interests and should attempt to respond to them within a mutually supportive framework, because that is a moral requirement for the legitimacy of the management function (Donaldson & Preston, 1995).

Wang and Dewhirst (1992) state that stakeholder theory can best explain how members of governing boards think about the interests of corporate constituencies and thus how organizations are actually managed.

2.2.3. Stewardship Theory

Davis, Schoorman, and Donaldson (1997) define stewardship theory as situations in which managers are not motivated by individual goals, but rather are stewards whose motives are aligned with the objectives of their principals. In the theory, the model of man is based on a steward whose behavior is ordered such that pro-organizational, collectivistic behaviors have higher utility than individualistic, self-serving behaviors. Where the interests of the steward and the principal are not aligned, the steward places higher value on cooperation and seeks to attain the objectives of the organization. This behavior in turn will benefit principals. Stewardship theorists assume a strong relationship between the success of the organization and the principal's satisfaction. A steward who successfully improves the performance of the organization generally satisfies most groups, because most stakeholder groups have interests that are well served by

increasing organizational wealth. The steward realizes the trade-off between personal needs and organizational objectives and believes that by working towards organizational, collective ends, personal needs are met.

The essential assumption underlying the stewardship theory is that the behaviors of the executive are aligned with the interest of the principals. Thus, stewardship theorists focus on structures that facilitate and empower rather those that monitor and control. When both the principal and the manager choose a stewardship relationship, the result is a true relationship that is designed to maximize the potential performance of the group.

2.2.4. Resource Dependency Theory

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. Directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy (Abdullah & Valentine, 2009).

Pfeffer and Salancik (2003) state that organizations are constrained and affected by their environments and they act to attempt to manage resource dependencies. Pfeffer (1972) asserts that boards enable firms to minimize dependence or gain resources. Pfeffer (1972) finds that board size relates to the firm's environmental needs and those with greater interdependence require a higher ratio of outsider directors. He concludes "that board size and composition are not random or independent factors, but are, rather, rational organizational responses to the conditions of the external environment" Pfeffer and Salancik's (1978) asserts that boards can manage environmental dependencies and should reflect environmental needs. Pfeffer and Salancik (1978) suggest that directors bring four benefits to organizations: (a) information in the form of advice and counsel, (b) access to channels of information between the firm and environmental contingencies, (c) preferential access to resources, and (d) legitimacy (cited in Hillman, Withers, & Collins, 2009)

2.2.5. Transaction Cost Theory

The main advantage that transaction cost economics brings to the study of corporate governance is that it provides a robust framework to investigate contracting problems such as those occurring between the management of the firm and its shareholders. The unit of analysis in transaction cost theory is the transaction. Therefore, the combination of people with transaction suggests that in transaction cost theory managers are opportunists and arrange firms' transactions to their interests (Williamson 1996, cited in Abdullah & Valentine, 2009).

According to the theory, the equity governance structure has three important properties; first, shareholders bear a residual claiming status. Second, the equity contract lasts for the duration of the life of the corporation. And third, a safeguard in the form of a board of directors is created and awarded to equity-holders. According to this view, the board bears a decision-review and monitoring relation to the firm's management, including the review and monitoring of management's investment policy (Williamson, 1988 cited in Saravia & Chen, 2008)

For the theory, bounded rationality is the reason all complex contracts are unavoidably incomplete. One of the key elements of Williamson's theory is a governance structure with a safeguard in the form of a board of directors and opportunism. The establishment of the contractual safeguard helps reduce contractual hazard premiums; this means that the cost of outside equity will fall if the governance structure is credible, hence growth can carry on thereafter at a higher rate. Moreover, safeguards are also advantageous in that they protect shareholders investments from expropriation.

Opportunism is defined by Williamson as "self-interest seeking with guile" and includes "calculated efforts to mislead, deceive, obfuscate, and otherwise confuse." According to this view, managers can be expected to behave opportunistically whenever the relevant governance structure fails to contain them. Hence, opportunism is the source of deviations from shareholder wealth maximization and constitutes a critical unit of the theory (Williamson, 1996 cited in Saravia & Chen, 2008)

2.3. Corporate Governance Mechanisms

Corporate governance generally refers to the process or mechanism by which the affairs of businesses and institutions are directed and managed, with a view to improve long term value of

shareholders while taking into account the interests of other stakeholders interested in the well-being of an entity. Corporate governance is divided into external and internal corporate governance. Internal corporate governance covers public's interest, employees' interest, and owners' interest. While external corporate governance is defined as a mechanism through which governments' responsibility to control the operations of banks are exercised based on the prevailing bank regulations (Ben, Patrick & Caleb, 2015).

If corporate governance mechanisms are not properly structured and practiced with business firms, it will highly damage the financial performance of a firm. The agency theory provides a basis for the governance of firms through various internal and external mechanisms. Corporate governance mechanisms are designed to align the interest of owners and managers, constrained the opportunistic behaviors of managers and protect shareholder interests, generally to solve agency problem. Enhancing corporate governance mechanisms should result in improved financial performance (Manini & Abdillahi, 2015). Corporate governance mechanisms are means or control structures used by the principals to align the interests of principals and agents and to monitor and control agents. The purpose of these governance mechanisms is to limit the scope and frequency of agency costs and to ensure that agents act in accordance with the best interests of their principals (Gebba, 2015).

Researchers often categorize corporate governance mechanisms into two categories, i.e. internal and external corporate mechanisms. The internal mechanism is divided into five basic categories, they are: the board of commissioners (roles, structures and incentives), managerial incentives, capital structure, constitutions and corporate regulations, and internal control system. Whereas external mechanism is divided into five categories, they are: law and regulations, market, capital market information and analysis, accounting market, finance and law, and special sources of external control (Gillan, 2006 cited in Dharmastuti & Wahyudi, 2013).

In the context of banking, corporate governance has been defined as the manner in which bank systems, procedures, processes and practices are managed. In addition, assets and resources should be managed with an aim of increasing shareholder value and shareholder satisfaction together with improved accountability, resource use and transparent administration (Al-Amarneh, 2014).

2.3.1. Internal Governance Mechanisms

A well governed corporation needs to balance the roles of three groups of players: shareholders, boards of directors, and managers, while meeting all of its financial commitments and other obligations to a broad array of stakeholders. The board of directors represents the interests of shareholders and may have obligation to other stakeholders under various statutory and voluntary provisions. An independent board of directors, the core internal governance mechanism, is the bridge between management and owners, other stakeholders, and the outside world (Babatunde & Olaniran, 2009).

Good corporate governance requires a board of directors to fulfill its statuary duty to oversee the management of its company, to guard the interests of shareholders and to ensure conformity with regulatory requirements (Salim, Arjomandi, & Seufert, 2016). Several characteristics of the board of directors (size, composition or functioning) might reflect directors' motivation and their ability to effectively monitor and advise managers. Banks with boards that are more effective in monitoring and advisory terms are better governed, and that better governance creates shareholder value (Andres & Vallelado, 2008).

By bringing expertise and knowledge, the board plays an important role in formulating and implementing business strategy. The board can oblige management to justify its proposed actions and to invoke reasoned arguments to support the options it has chosen, thus, performing a monitoring function (Fernandes, Farinha, Martins, & Mateus, 2017).

According to Madhani (2017) the outcome of a good corporate governance practice is an accountable board of directors who ensures that the investors' interests are not jeopardized. Board of directors is one of the most important internal corporate governance mechanisms used by the shareholders to monitor management. The board of directors has generally been perceived as the backbone of corporate governance as board contributes to alleviating agency costs to the firm by monitoring and rewarding top executives to ensure wealth maximization for the shareholders.

Four major roles and responsibilities of the board have been widely recognized by researchers: (1) the control role; (2) the strategic role; (3) the service or resource provision role and (4) the advice and counsel role. The control role of the board implies its legal duty of monitoring and

supervising the firm's operations, current as well as preventive, i.e. the monitoring of business decisions and firm's plans as well as monitoring and controlling top management. The strategic role of the board relates to supporting and leading the management in realizing the firm's mission and its goals by advising, improving and enhancing the discussion on strategic issues, in particular the strategic problem solving and decision-making. The service or resource provision role of the board is primarily concerned with providing the access to networks and resources and maintaining the formal and informal relationships with firm's stakeholders and overcoming the inherent conflict between them.

According to Fama (1980) cited in (Salim et al. 2016) agency theory assumes that managers may engage in actions maximizing their personal utility, minimizing their own work effort, indulging in perquisites, or, generally speaking, employing inputs and outputs which do not maximize the firm value. Hence, the role of the board of directors is to mitigate this conflict and to supervise managers to align their interests with those of shareholders.

There are different mechanisms embraced that defend the interests of the stakeholders. Such corporate governance mechanisms include board size, board gender diversity, and board of directors' educational qualification (Stephen, Djan, Bawuah, Halidu, & Kuutol, 2015). The reason for the choice of board characteristics is that, it is an important tool or mechanism for monitoring and advising, management of corporations to managing the affairs of the business for the benefit of shareholders (Akpan & Amran, 2014).

Corporate governance is perhaps synonymous with corporate boards who have statutory duties to represent and protect shareholder interest basically by formulating corporate strategy and instituting control mechanisms through the mix of skills and talents available to the board (Puni, 2015). Uadiale, 2010 cited in Stephen et al. 2015) states that the effectiveness of the board is influenced by factors such as board composition and quality, size of board, board diversity, board committee effectiveness. Agency theories suggests that corporate boards must implement various mechanisms (board composition, board size, frequency of board meeting, board committee etc.) in order to align the interest of opportunistic agents to shareholders interest (Puni, 2015).

Boards' ability to fulfill their functions of advising and monitoring management is affected by the choices of board characteristics. Hence, the following governance mechanisms have been selected

based on their significance in context of reviewed governance theories, in relation to framework of banking industry in the country, and studies conducted in Ethiopia and abroad. National Bank of Ethiopia under its directive No SBB/62/2015 has set characteristics and requirements to be fulfilled by board members to maintain safety and soundness of financial system.

2.3.1.1. Board Size

Board size represents number of directors on a board. Boards having too many directors could be unproductive with ineffective communication that results directors free riding problem (Alam & Akhter, 2017). While the board's capacity for monitoring increases as more directors are added, the benefit may be outweighed by the incremental cost of poorer communication and decision-making associated with larger groups (John & Lemma, 1998). Jensen (1993) cited in Liang, Xu, & Jiraporn, (2013) argues that large corporate boards are less effective due to the problems of coordination, control, and flexibility in decision-making and give excessive control to CEOs.

Board size can have either a positive or negative effect on corporation performance. On one hand, a large board makes coordination and communication difficult triggering the agency issue and reducing company performance. On the other hand, resource-dependent theory suggests that a larger board allows for more specialists from different fields and therefore facilitates high-quality decision making (Eisenberg et al., 1998 & Kiel & Nicholson, 2003 cited in Salim et al. 2016).

Lipton and Lorsch (1992) cited in Uwuigbe and Fakile (2012) suggested that larger boards are less effective than smaller boards due to co-ordination problems in larger boards. They recommended limiting the membership of boards to ten people, with a preferred size of eight or nine. They further opined that even if boards' capacities for monitoring increases with board size, the benefits are outweighed by such costs as slower decision-making, less candid discussions of managerial performance, and bias against risk-taking.

2.3.1.2. Board Gender Diversity

According to Adams and Mehran (2003) cited in Fernandes et al. (2017) the rationale behind the view of diversity as a positive force within boards builds on the assumption that the existence of

multiple and divergent viewpoints within a board will decrease the likelihood that the agenda and initiatives will be dominated by management thus improving the monitoring role of the board.

From an agency theory perspective, women often bring fresh perspective on complex issues, and this can help correct informational biases in strategy formulation and problem solving. They have better oversight, display participative leadership which are expected to lead to better performance outcomes. Women's ability to influence board decisions increases with their numbers. From resource dependency theory, female directors bring unique and valuable resources and relationships to their boards (Terjesen, Couto, & Francisco, 2015). Presence of women on the corporate board can help add new resources and improve the efficiency of the firm (Agyemang-Mintah & Schadewitz, 2018)

According to Low et al. (2015) and Adams and Ferreira (2009) cited in Agyemang-Mintah and Schadewitz (2018); gender diversity, improves board monitoring because hiring directors from different backgrounds gives a different lens to the firm where the female members can challenge the status quo. A gender-diverse board is more fruitful in its monitoring roles, as women tend to question management practices and challenge conventional wisdom. Stakeholder theory states that corporations should maximize the welfare of a number of the firm's stakeholders, hence boardroom composition should be adjusted to reflect the expectations of all stakeholders, such as through the appointment of female directors.

According to Daily & Dalton (2003) and Julizaerma and Sori, (2012) cited in Wagana and Nzulwa (2016), female board directors provide unique perspectives, experiences, and work styles as opposed to their male counterparts, which can greatly enhance deliberations of the board These attributes will lead to better performance when combined with female characteristics such as communication and listening skills. Bart and McQueen (2013) state female directors can make significant contributions to the board due to their higher quality decision-making capability, which helps better explain the higher rates of return, more effective risk management and even lower rates of bankruptcy.

However, according to Eisenberg (1998), cited in Bussoli, Gigante, and Tritto (2015) increasing of gender differentiation could lead to the reduction of harmony within the "team" of directors, since it can affect the confidence among members of different genders and their willingness to

cooperate. Kilic (2015) state gender diversity in boardrooms can be a disadvantage, especially in terms of group performance. Different styles, attitudes, and perspectives may increase conflict, reduce cohesion, and hinder communication and coordination within the team.

Gallego-Álvarez et al., (2010), Adams & Ferreira (2004, 2009) Randøy et al. (2006) cited in Kilic (2015) state that the conflict arising from gender diverse board may slow the decision-making process, gender diversity may entail costs in digesting different viewpoints and resolving disagreement. Board diversity may increase the probability of ambiguities, misunderstandings, and decision errors.

2.3.1.3. Industry Related Qualification of Board

Higher education of directors in organizational contexts is positively related to receptivity to innovation, creativity, and better strategic decision-making. Existence of qualified directors increases banks performance as they promote corporate image, and demonstrate accountability and credibility within the management team (Olani & Berhanu, 2015).

By bringing expertise and knowledge, the board plays an important role in formulating and implementing business strategy. Academic papers emphasize experience rather than qualifications (Fernandes et al. 2017).

A board should consist of directors with diverse business experiences relevant to the firm's existing and future businesses (Madden, 2007). Resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization. Directors can be classified as support specialists such as lawyers, bankers, insurance company representatives', public relations experts and these specialists provide support in their individual specialized field Hillman, Cannella, and Paetzold (2000) cited in Abdullah and Valentine (2009).

2.3.1.4. Board Ownership

Efficient monitoring hypothesis (EMH) argues that greater ownership concentration can eliminate the agency conflict between owners and management and decrease the costs of management monitoring and leads to improved performance and productivity (Al-Amarneh, 2014). Levine (2004) states that one corporate governance mechanism for preventing managers from deviating too far from the interests of owners is concentrated ownership. Large investors

have the incentives to acquire information and monitor managers. Furthermore, large shareholders can elect their representatives to the board of directors and thwart managerial control of the board of directors. Jensen and Meckling (1978) state that minority shareholders realize that the manager's interests will diverge somewhat from theirs; hence the price which they will pay for shares will reflect the monitoring costs and the effect of the divergence between the manager's interest and theirs.

Berle and Means (1933) and Shleifer and Vishny (1986) cited in Elbannan and Elbannan (2014) argue that widely dispersed ownership reduces the effective power of shareholders to control the management of the firm. They argue that concentrated ownership is better in monitoring management, especially in protecting the rights of weak or limited shareholders. It is argued that concentration may have negative effect leading to expropriation of minorities and poor performance. Large concentration owners may have different interests from the minority and seek to achieve their own interest (Elbannan and Elbannan, 2014).

2.3.1.5. Number of Board Meetings

In the agency framework, the intensity of board activity, measured by the frequency of board meetings, may indicate an active monitoring role of corporate boards and so, influence corporate performance (Fernandes et al. 2017).

Meetings provide board members with the chance to come together, and to discuss and exchange ideas on how they wish to monitor managers and bank strategy. Hence, the more frequent the meetings, the closer the control over managers, the more relevant the advisory role, factors that lead to a positive impact on performance (proactive boards). By contrast, frequent meetings might also be a result of board reaction to poor performance (reactive boards). Therefore, any hypothesis concerning the influence of board activity on firm performance is an empirical question, possibly yielding either proactive or reactive results (Andres & Vallelado, 2008).

Jensen (1993) cited in (Salim et al.2016) takes a contrary view and claims that board meetings might not necessarily be useful because of the shortage in time for directors to exchange meaningful ideas among themselves, the board or the management. Besides, Jensen (1993) states that the CEO determines the agenda of board meetings and routine tasks do not leave much time for board members to exert sufficient control over management. Thus, Jensen perpetuates the

view of the board as being reactive rather than proactive towards enhancement of governance, so increased board activity suggests poor corporate performance with unclear consequences.

2.3.1.6. Number of Board Committees

According to Fama and Jensen (1983), committees exist to manage agency problems among partners and to study and determine major policy issues in a manner that is less costly than when performed jointly by all partner.

The effectiveness of the board is influenced by board committees. The regulatory recommendations and the complexity of bank activities place emphasis on the importance of board committees in banks (John et al.2016).

The importance of committees is underpinned as the main influence on boards' most important decisions for the control over management (Salim et al. 2016). Boards use committee structures to facilitate, evaluate, and ratify long-term investment decisions and to monitor the performance of senior management (John & Lemma, 1998). Klein (1995, cited in John & Lemma, 1998) proposes a committee with specialized roles to enhance the board's performance in its productivity and monitoring. That is, each board committee should specialize in either productivity or monitoring issues.

Functional effectiveness to a large extent is connected to the inner workings of the board by various standing board committees which support and complement boards decision-making and supervisory functions (Puni, 2015).

2.3.1.7. Management Efficiency

Efficient management is an important factor behind the performance of all banks. It is important for ensuring bank stability and strength. Management efficiency includes administrative ability to react in diverse circumstances. The term management efficiency involves the capability of management in generating business and maximizing profits. It indicates the capacity of a bank to increase benefits or minimize costs. The two main questions, "what drives performance" and "what contribute to performance" are headed in the minds of managers. Finding or highlighting the source of better performance and adoption of right management strategies is very important to the managers. The performance of the management based upon the availability of useful

information for decision making and measuring the performance gives input as to what current performance level is and what can be done to enhance performance (Ishaq, Karim, Ahmed, & Zaheer, 2016).

According to the X-efficiency hypothesis under the efficient-structure theory, banks with better management and practices control costs and raise profit, moving the bank closer to the best-practice, lower bound cost curve (Jeon & Miller, 2005). Management efficiency means adherence with set norms, ability to plan and respond to changing environment, leadership and administrative capability of the bank (Misra & Aspal, 2013).

Jensen and Meckling (1976) state that value of the firm will fall by the amount of cost to the firm of the increased expenditures and increased manager's consumption of benefits. It is characterized that the agency conflict between the manager and shareholders as deriving from the manager's tendency to appropriate perquisites out of the firm's resources for his own consumption.

According to transaction cost theory, board bears a decision-review and monitoring relation to the firm's management as they are opportunists and arrange firms' transactions to their interests Williamson (1988) cited in Saravia and Chen (2008).

Management efficiency is used to assess administration's quality; it involves analysis of efficiency of management in generating business and in maximizing profits. High cost income ratio is equal to low productivity and low efficiency (Ishaq et al. 2016).

2.3.2. External Governance Mechanisms

Formal legal and regulatory obligations are part of the external incentive structure designed to ensure that competing companies abide by common standards of fairness, transparency, accountability, and responsibility to protect shareholders, consumers, workers, the environment, and even competitors from abusive practices. A good legal and regulatory framework efficiently addresses the entry, operations, and exists of firms (Babatunde & Olaniran, 2009).

Financial sector works as the backbone of the economy that controls the money supply. Banking is a very important sector because the development of the finance, and particularly the banking system, promotes economic growth. Hence, it is important to control and regulate bank

processes by an apex bank to ensure customers' safety, strengthen and promote soundness, stability and efficiency of the banking system. Assessment of financial performance of the banking sector is a powerful measure and pointer to check the soundness of economic activities of an economy. Parameters are used to evaluate the operating soundness, financial performance, financial condition and regulatory compliance of the banking organization (Ishaq et al.2016).

Financial regulators and central banks devote much effort to monitoring & regulating the banking industry. Good corporate governance is not the result of only internal corporate governance mechanisms, but there are also external corporate governance mechanisms which are important in reducing the agency problem in banks. In the banking sector, the government establishes relatively higher regulation to save the interests of the depositors as well as the general public. In countries like Ethiopia, where there is no capital market, the effect of the market for corporate control on corporate governance may be minimal. Instead the government's regulation and supervision as an external corporate governance mechanism plays major role in the governance of banks. Accordingly, external corporate governance is considered as a mechanism, which places the government's responsibility to control the operations of banks through prevailing bank regulations. Central bank regulation is exercised through the use of various financial ratios of individual banks (Ashenafi et al, 2013).

Central bank should be able to regularly assess the health of commercial banks. It has a formal duty to inspect the soundness of commercial banks' operations and to issue regulations that will ensure such soundness. Modern central banks have a number of related but diverse tasks as bank supervisors. These tasks might include (1) licensing of new banks, (2) examination and monitoring of banks' operations, (3) setting regulatory requirements for banks, (4) enforcement of regulations to ensure corrective action, and (5) providing resolution for troubled financial institutions when necessary.

Bank examination is a basic foundation of the bank supervisory process. It is done to assess the soundness of commercial banks' operations, and to ensure that commercial banks comply with rules and regulatory requirements. The supervisory central bank has the power to set rules and guidelines for commercial banks to ensure that they operate in a safe and sound manner. Such regulations might range from the banks' corporate governance and risk management practices to capital and reserve adequacy requirements. For a central bank, capital requirements (the

minimum capital that each bank needs to have to buffer against unexpected losses) and reserve requirements (the minimum reserves that each bank needs to hold against deposits to meet liquidity demand) are among the key regulations it can use to ensure the safety and soundness of commercial banks' operations (Moenjak, 2014).

2.3.2.1. Capital Adequacy Ratio

The concepts of asymmetric information, adverse selection, and moral hazard are factors why governments choose the form of banking regulation. Moral hazard in equity contracts is known as the principal–agent problem, because managers (the agents) have less incentive to maximize profits than stockholders (the principals). Bank regulations that restrict bank capital requirements are directed at minimizing moral hazard. Risk-based capital requirement is one form of bank capital requirements (Mishkin, 2004).

Capital adequacy or sometimes regulatory capital determines how well banks or other depository institutions can have enough capital equal to their asset in order to sustain operational losses and to show whether those institutions are not participating in investments that increase risk to default (Yonas, Hamdu, & W/Michael, 2015).

The capital structure of banks is highly regulated. This is because capital plays a crucial role in reducing the number of bank failures and looses to the stakeholders (Echekoba, Egbunike, & Ezu, 2014). Capital is one of the factors that influence the level of bank profitability. It is the amount of funds available to support the bank's business and act as buffer in case of adverse situations. The adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. The ratio is directly proportional to the resilience of the bank to crisis situations. (Ongore & Gemechu, 2013).

According to James and Joseph (2015) capital adequacy ratio is a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. The purpose of having a minimum capital adequacy ratio is to ensure that banks can absorb a reasonable level of losses before becoming insolvent and before depositors funds are lost. Higher capital adequacy ratio would represent more assets are allocated for the bank liquidation risks. Thereby lesser resources would be channeled to business activities that might improve the banks performance.

National Bank of Ethiopia under its directive no. SBB/50/2011 has set a minimum capital to risk weighted asset ratio of 8% to be maintained by all licensed banks to enable withstand adverse operational results.

2.3.2.2. Liquidity

Bank deals in funds belonging to the public. Hence, bank should always be on its guard in handling these funds. Banks should always have enough cash to meet the demands of the depositors. The success of a bank depends to a considerable extent upon the degree of confidence it can instill in the minds of its depositors. So, it should always be prepared to meet the claims of the depositors by having enough cash (Somashekar, 2009).

Liquidity is defined as the capacity of financial institutions to finance increases in their assets and comply with their liabilities as these mature (Yonas et al. 2015). During the recent global financial crisis several banks experienced some difficulties because they failed to manage liquidity in a prudent manner. Thus the crisis emphasized the importance of liquidity to the proper functioning of financial markets and the banking sector. Though insufficient liquidity is one of the major reasons for bank failures, holding liquid assets has an opportunity cost of higher returns. Banks are required to hold a considerable position in liquid assets while on the other hand; they are required to be profitable for them to be sustainable. Hence the dilemma in liquidity management is finding a balance between liquidity and profitability (Marozva, 2015).

The theory of asset management states that banks must seek high returns, reduce risk and make adequate provisions by holding liquid assets. Achieving high returns while holding a large portion of liquid assets at a low risk can be difficult as liquid assets are costly and have the tendency of reducing profits. The more liquid a bank is, the greater is its capability to meet its obligations as they fall due. According to the tradeoff theory, banks target an optimal level of liquidity to balance the benefit and cost of holding cash. The cost of holding cash includes low rate of return due to liquidity premium. The benefits of holding cash are saving of transaction costs to raise funds in which assets are liquidated to make payments and using of liquid assets to finance its activities and investment where other sources of funding are not available or very expensive (Edem, 2017).

National Bank of Ethiopia under its directive no. SBB/57/2014 has set a minimum liquid asset of 15% of net current liabilities for licensed commercial banks to enable maintain public trust and confidence.

2.3.2.3. Legal Reserve

The supervisory central bank has the power to set rules and guidelines for commercial banks to ensure that they operate in a safe and sound manner. Central bank sets legal reserve requirements- the minimum reserves that each bank needs to hold against deposits to meet liquidity to ensure safety and soundness of bank's operations. The requirement is used to enable regulate the flow and the amount of money in the economy.

Reserves are traditionally held in the form of cash, or deposits at the central bank, and thus banks can easily turn to them to meet liquidity demand. Cash kept as reserves do not provide returns, and can incur a cost of safekeeping. Deposits held at the central bank might also not earn interest or earn considerably less than could be gained from lending to customers. Historically, reserve requirements have also been used as a tool of monetary policy. When reserve requirements are raised, banks have to keep more reserves as cash or deposits at the central bank rather than lending them out as loans. With fewer loans being provided in the economy—all other things being equal—economic activity will slow down. When reserve requirements are lowered, banks are able to provide more loans, as they are required to hold less cash and deposits at the central bank as reserves (Moenjak, 2014).

Higher reserve requirements contribute to banks' solvency and the public's confidence in them. The reserve requirement, also called cash reserve ratio, sets the minimum fraction of customer deposits and notes that each commercial bank must hold as reserves rather than lend out. It secures banks, their customers, shareholders and the economy at large (MacCarthy, 2016).

National Bank of Ethiopia under its directive no. SBB/55/2013 has set that any bank at all times shall maintain in its reserve account 5% of its net deposit balance as a form of monetary policy instrument and prudential regulation tool.

2.4. Empirical Review

This section presents the summary of the empirical studies; the detail review is presented subsequently;

➢ Board Size

Manini and Abdillahi (2015); Assefa and Megbaru (2014); Ashenafi et al. (2013); Orazalin et al. (2016); Liang et al. (2013); and Firehiwot (2015) in their study indicates negative and significant effect of board size on bank performance. Whereas Rao and Kidane (2016); Olani and Berhanu (2015); James and Joseph (2015); Kibrysfaw (2013); and Yenesew (2012) in their study indicate that there is a negative and insignificant effect of board size on RoA. Positive and significant outcomes are results of the studies of Abdulazeez, Ndibe and Mercy (2016); Andres and Vallelado (2008); Malik, Wan, Ahmad, Naseem, & Rehman (2014); Al-Amarneh (2014); and Salim, Arjomandi, & Seufert (2016). The findings of Bussoli, Gigante, and Tritto (2015) and Elbannan and Elbannan (2014) show an insignificant and positive effect of board size on bank performance. Whereas Ben, Patrick and Caleb (2015) state that board size has no differential effect on banks' performance.

➢ Board Gender Diversity

Studies of Stephen, Djan, Bawuah, Halidu, and Kuutol (2015); and Akpan and Amran (2014) have outcomes of a negative and significant effect of board gender diversity on RoA. Whereas Olani and Berhanu (2015); Rao and Kidane (2016); Kilic(2015); Ekadah and Mboya (2011); Liang, Xu, & Jiraporn (2013) in their study indicate that there is a negative and insignificant effect of board gender diversity on banks performance. On the studies of Belhaj and Mateus (2016) it is found a positive and significant result. Whereas Yenesew (2012) in his study indicate that there is a positive and insignificant effect of board gender diversity on banks performance.

➢ Industry Related Qualification

Olani and Berhanu (2015) state that Industry related qualification has a positive and significant effect on bank performance. Pereira and Filipe (2015) found that there is a negative and insignificant effect of industry related qualifications on bank performance.

- Board Ownership

The results of the studies of Assefa and Megbaru (2014) and Al-Amarneh (2014) show significant and positive effect of board ownership on bank performance. But Orazalin, Mohmood, and Jung Lee (2016); Salim, Arjomandi, & Seufert (2016); and Abdurazak (2017) have findings that show insignificant but positive effect. Olani and Berhanu (2015) and Elbannan and Elbannan (2014) states that a negative and significant effect of board ownership on bank performance. Kibrysfaw (2013) states negative and an insignificant effect of board ownership on bank performance.

- Number of Board Meetings

The results of Olani and Berhanu (2015); Assefa and Megbaru (2014); Liang, Xu, & Jiraporn (2013); Salim, Arjomandi, & Seufert (2016); and Firehiwot 2015 shows significant and positive effect. Whereas, the study of Andres and Vallelado (2008) and Abdurazak (2017) indicates results of insignificant and positive effect. The results of Malik, Wan, Ahmad, Naseem, & Rehman (2014) states that a negative and significant effect of number of board meetings on bank performance.

- Number of Board Committees

The finding of Halidu and Kuutol (2015) is that number of board committee has a positive and significant effect. Abdurazak (2017) has an outcome of an insignificant and positive effect of number of board committees on bank performance. The study result of Orazalin, Mohmood, and Jung Lee (2016) has an outcome of a significant and negative effect of number of board committees on bank performance. The finding of Bussoli, Gigante, and Tritto (2015) indicate an insignificant and negative effect of number of board committees on bank performance.

- Capital Adequacy Ratio

Findings of Ashenafi, Kelifa, & Yodit (2013); Ben, Patrick and Caleb (2015); Elbannan and Elbannan (2014); Ongore and Gemechu (2013); Liu and Pariyaprasert (2011); Yonas, Hamdu, and W/Micheal (2015) reveal positive and significant effect of CAR on return on asset. The

studies conducted by James and Joseph (2015) and Kibrysfaw (2013) both having significant and negative results. Echekoba, Egbunike, and Ezu (2014) state an insignificant and negative result.

- Legal Reserve

Studies conducted by Abid and Ladhi (2015); Kibrysfaw (2013) and Abdurazak (2017) reveal results of a negative and significant effect of the legal reserve on return on asset. Whereas, Ben, Patrick and Caleb (2015) indicate a negative and insignificant effect.

- Liquidity

Echekoba, Egbunike, and Ezu (2014), Lukorito, Muturi, Nyang'au, and Nyamasege (2014), and Ferrouhi (2014) have results positive and significant effect of liquidity on return on asset. Ongore and Gemechu (2013) found the result of positive and insignificant effect. Whereas Elbannan and Elbannan (2014); Liu and Pariyaprasert (2011); and Yonas, Hamdu, and W/Micheal (2015) have results that are significant and negative effect. Abdurazak (2017) has result that is insignificant and negative effect.

- Management Efficiency

The findings of Yonas, Hamdu, and W/Micheal (2015); and Ishaq, Karim, Ahmed, & Zaheer, 2016) indicates negative and significant effect of management efficiency on bank performance. Whereas Echekoba, Egbunike, and Ezu (2014) indicate negative and insignificant effect.

Empirical Review in Detail

Ashenafi, Kelifa, & Yodit (2013) examined the internal and external corporate governance mechanisms and their impact on performance of commercial banks in the absence of organized stock exchange. Multivariate regression with a random effect model was used to analyze 7-year data of 7 private and 2 state-owned Ethiopian banks. Return on assets and return on equity was the dependent variable while board size, existence of audit committee, capital adequacy ratio, loan loss provision, capital ratio, loan to deposit ratio, and square of capital adequacy ratio were the independent variables. Results indicate that capital adequacy ratio has a positive effect on ROA and it is statistically significant at 5%. Board size and the existence of audit committee are

statistically significant at 5% and have negative effect on ROA. Loan loss provision and loan to deposit ratio are found to have no significant effect on bank performance. The square of capital adequacy ratio is statistically significant at 1% and has a negative effect on ROA.

Abdulazeez, Ndibe and Mercy (2016) studied the impact of corporate governance on the performance of Nigerian banks. 15 sample banks for a period of 7 years were part of the study. The study used regression analysis using panel data, for the independent variables of board size, board composition (number of non-executive directors), CEO duality, audit committee and for the dependent variable of return on assets. The regression results show that board composition is negatively and insignificantly related to the performance of banks. Audit committee has positive but insignificant relationship with performance. Board size is positive and significant at 5 per cent on bank performance. The result indicates that increase in board size would increase the performance of the banks.

Manini and Abdillahi (2015) examined the impact of corporate governance mechanisms on banks' profitability of forty-two sample banks in Kenya for a period of one year. Multiple regression analysis was used to test the relationship between the independent variables of audit committee size, board gender diversity, board size and the dependent variable of return on asset. The regression results show that there is no statistically significant relationship between board gender diversity, audit committee and bank profitability. There is statistically significant negative linear relationship between board size and banks' performance and a statistically insignificant negative linear relationship between board gender diversity and financial performance.

Bussoli, Gigante, and Tritto (2015) investigated the impact of corporate governance on bank performance and loan quality. 48 sample banks in Italy for a period of three years were analyzed using multivariate OLS regression model. Return on asset, return on equity and non-performing loan ratio are the dependent variables; board size, presence of women directors, number of board committees are the independent variables. Results indicate that there is statistically insignificant negative relationship between the number of committees and bank performance. There is statistically insignificant positive relationship between the board size and bank performance. There is a statistically insignificant positive relation between women directors and bank

performance. Bank size used as a control variable has a significant negative relation with return on asset.

Olani and Berhanu (2015) examined the determinants of the financial performances of commercial banks in Ethiopia from an internal corporate governance practices perspective. Data for the study was collected for a 6-year period for 10 sample banks (2 state owned and 8 private).Board size, number of board meetings, percentage of female directors, percentage of qualified directors in business-related backgrounds, percentage of directors with prior experience in banking, CEO pay, number of shareholders, presence of audit committee, existence of risk management committee and ownership dispersion were the independent variables while return on assets and return on equity were the dependent variables. Control variables were leverage and ownership type. Multiple linear regression analysis was used for the panel data. The parameter coefficients indicate that there is positive and significant relationship for frequency of board meeting, directors who have prior experience in banking, existence of risk management committee and bank leverage to return on assets. Qualification of directors and ownership dispersion has significant positive and negative relationship with financial performance of banks. Board size, female director in the board, and the existence of audit committee in the board did not have a statistically significant effect on bank performance, with negative, positive, effects respectively.

Ben, Patrick and Caleb (2015) investigated the impact of corporate governance on money deposit bank performance in Nigeria with data period of 8 years. The independent variables were capital adequacy ratio, loan to deposit ratio, non-performing loan to total loan ratio, liquidity ratio, deposit money banks lending rates, cash reserve ratio, board size, and audit committee; return on asset was the dependent variable. The panel data for the pooled observations was analyzed using multiple regression analysis-OLS. Capital adequacy ratio and deposit money banks' lending rates are statistically significant in predicting the bank performance and have positive impact on ROA. The size of loan to deposit ratio, and cash reserve ratio have insignificant negative correlation coefficient or relationship with banks' performance. Board size has no differential effect on banks' performance while audit committee on bank performance is effective. Liquidity ratio has positive insignificant effect on bank profitability.

Pereira and Filipe (2015) explored the role of the board of directors in the Portuguese banking sector. Data for 32 sample banks was collected for a period covering5 years to measure the effect of board member educational background on the dependent variables of return on assets and return on equity. Regression analysis reveals that the variable of "eduindex" which aggregates the different levels of board member education does not have a significant effect on the Banks' return on asset with a negative coefficient for the variable. The coefficient for the variable is however significant and influences the banks' return on equity.

Rao and Kidane (2016) undertook a study to determine the effect of corporate governance variables on the financial performance of commercial banks in Ethiopia. 14 banks (2 state-owned and 12 private) operational for 5 years were part of the study with independent variables of ratio of disclosure scored a bank to its maximum obtainable score of sampled commercial bank, board size, ratio of female directors, ownership type, capital structure(total debt to total equity). Return on assets and return on equity were the dependent variables. Panel regression model was employed; the results were on return on asset are: board size has insignificant but negative effect impact on ROA. A higher proportion of women directors in the board room, ownership type of commercial banks, do not have significant impact on ROA but have signs of negative and positive impacts, whereas total debt to total equity has a significant and negative effect on ROA.

Assefa and Megbaru (2014) examined whether corporate governance mechanisms have a significant effect on banks' financial performance and tried to identify the possible determinant factors of corporate governance mechanisms that affect banks' financial performance. Data for 9 banks in Ethiopia (2 state-owned, 7 private) covering a period of 7 years was used for study. Panel data analysis was employed for the pooled panel data of the dependent variables of return on asset, return on equity and, operating profit margin and the independent variables of board size, board independence, frequency of board meetings, audit committee, board ownership. The coefficients of board size imply that commercial banks' financial performance is negatively and significantly related with the number of board members. Frequency of board meeting has significant and positive association with and affects the return on asset. Audit committee in corporate governance has positive influence on financial performance of commercial banks.. Board ownership has positive association and is significantly affiliated with ROA.

Andres and Vallelado (2008) analyzed the effectiveness of the boards of directors in monitoring and advising managers in the bank industry. The study was conducted with sample data of 69 banks in 6 OECD countries covering 10-year period. Dependent variables of market to book value (Tobin Q), ROA, SMR (annual market return of a bank shareholder); and independent variables of were board size, outside directors, meetings per year were analyzed using OLS and within estimators along with the two-step system estimator (SE) and the generalized method of moments (GMM). Results indicate that appointment of new directors show a positive and significant relation with ROA although the increase in performance shows a diminishing marginal growth. There is positive and insignificant relation between the number of board meetings and bank performance.

Kilic(2015) tries to investigate the effect of board diversity on performance of 26 sample banks in Turkey covering a period of 5 years. Return on assets and return on equity were the dependent variables, percentage of women and foreign directors were the independent variables. Random effects model reveals that WOMAN have a negative insignificant impact on ROA suggesting that women directors on the board lead to lower performance in the banking industry.

Ekadah and Mboya (2011) analyzed the effect of board gender diversity on the performance of 44 commercial banks in Kenya covering a12-year period. Stepwise regression model was used to study the dependent variable of ROA and proportion of female directors as independent variable. Results indicate that board gender diversity has no significant effect on the performance of banks. This is shown by a statistically insignificant and negative relationship between board gender diversity and bank performance.

James and Joseph (2015) examined the corporate governance mechanisms specifically the ownership monitoring mechanism, internal control monitoring mechanism and regulatory mechanism influence on bank performance. 18 sample banks in Malaysia for a period of 5 years were examined with dependent variable of ROA and independent variables of bank ownership, board independence, board size, and capital adequacy ratio. Multiple regression analysis was employed revealing results that only capital adequacy ratio has a significant relationship with bank performance; there is a negative and significant relationship between capital adequacy ratio and ROA, indicating that a decrease in capital adequacy ratio could increase the corporate

performance of banks. Foreign ownership, board independence and board size have no significant but negative relationship with ROA.

Malik, Wan, Ahmad, Naseem, & Rehman (2014) examined the relationship between board size and firm performance of 14 sample banks in Pakistan covering a 5-year period. Dependent variables of return on asset, return on equity, and earning per share and independent variables of board size, number of meetings, size of audit committee were tested through linear regression models. Results indicate that both board size and the number of meetings are significantly positively and negatively associated with return on asset respectively.

Elbannan and Elbannan (2014) examines the association between governance quality and performance by estimating OLS regression models with pooled observation to test this relation. The study covered 48 sample banks in Egypt with a 10-year data. Dependent variables of return on asset, deposit market share, operating efficiency, and employee productivity; independent variables of board size, board composition (proportion of non-executive directors), CEO duality, ownership concentration, foreign ownership, institutional ownership and control variables of liquidity, capital adequacy, credit risk, real GDP growth, inflation rate (CPI), time effect, global financial crisis, bank size, management efficiency, fee income were used for the study. Results indicate ROA is significantly positively related to capital adequacy and management efficiency while it is significantly negatively related to liquidity. Board composition is marginally significantly negative, while ownership concentration is highly significantly negative, board size is found to be insignificant but positive determinant for bank performance.

Halidu and Kuutol (2015) examined the extent of board structure, compliance and its impact on performance. 20 Ghanaian banks were sampled for the period of 2010 and 2013. The variables of the study were return on asset as the dependent variable and number of board committees, CEO duality and board composition as the independent variables. Results indicate that the number of board committees has a significant and positive impact on return on asset. The expertise of the board members is important if the banks will be efficient.

Orazalin, Mohmood, and Jung Lee (2016) investigated the impact of different dimensions of corporate governance practices such as board characteristics (board composition, board committee, board size), ownership structure, corporate disclosure and CEO education on the operating performance of 30 Russian banks for a period covering 9 years. Dependent variables of

capital reserve ratio, annual asset growth ratio, net interest income ratio, return on assets, return on equity, total loans ratio, and loan to deposit ratio were used on the random effects model. Results show that board characteristics is negatively and significantly associated with ROA, while ownership component is positively and insignificantly associated with ROA and ROE. CEO education is statistically significant and positively associated with the ROA.

Ongore and Gemechu (2013) examined the effects of bank specific and macroeconomic factors on the performance of 37 sampled commercial banks in Kenya. 10 years' panel data was analyzed using linear multiple regression model. Dependent variables used were return on asset, return on equity, and net interest margin. Capital adequacy, asset quality, management efficiency, liquidity management, GDP, and inflation were the independent variables of the study. Result of the study indicates that there is significant effect of capital adequacy, asset quality, management efficiency on the financial performance of commercial banks. The relationship between bank performance and capital adequacy and management efficiency was found to be significant and positive and for asset quality the relationship was negative. However, the liquidity variable which is positively related with bank performance has no significant effect on the financial performance of commercial banks in Kenya.

Echekoba, Egbunike, and Ezu (2014) determined the effect of CAMEL on the profitability of banks in Nigeria. Time series data is used and the period covered in the study is 2001 to 2010 using ordinary least square method. The profitability ratio return on asset is assumed as the dependent variable while capital adequacy ratio, non-performing loan ratio, credit –to-deposit ratio, earnings ratio and liquidity ratio are assumed as the independent variables. Findings indicate that liquidity has a significant and positive impact on the profitability of banks in Nigeria while capital adequacy and management efficiency have insignificant and negative impact on the profitability of banks in Nigeria.

Liang, Xu, & Jiraporn (2013) studied empirically the impact of various board characteristics on bank performance. Dependent variables of ROA, ROE, NPL ratio, Stock of NPLs, net charge off ratio, level of net charge off, pre-provision profit ratio and independent variables of board size, meetings, CEO duality, independent director, political director, busy director, foreign director, old director, female director were analyzed. Panel data of 52 sample Chinese banks for the period of 8 years were examined using OLS regression. Results indicate that board size has a

significantly negative relationship with ROA. The number of board meetings has shown a significantly positive relationship with ROA. The coefficients on the proportion of independent directors are positive and significant. There are no significant relationships between ROA and other director characteristics variables. Control variable of bank size has a significant and negative effect on return on asset.

Liu and Pariyaprasert (2011) examined the impact of independent variables from CAMEL model on bank performance in 13 sample Chinese banks listed in Shanghai Stock Exchange and Shenzhen Stock Exchange from 2008 to 2011. Independent variables were the capital adequacy ratio, asset quality, management efficiency, earnings, and liquidity, while return on asset and return on equity were the dependent variables. The fixed effects multiple linear regression model was adopted for the study. Results show that capital adequacy and management efficiency ratios have a significant positive effect on ROA. However, as liquidity ratio decreases, ROA increases and the relation is significant.

Al-Amarneh (2014) investigated the ownership structure and corporate governance on bank performance in Jordan with sample of 13 banks for the years 2000-2012. Dependent variables of return on asset and operating efficiency and control variables of bank size and bank risk level were used. The independent variables of board size, ownership concentration, institutional and foreign ownership and CEO duality were analyzed. Results indicate that board size and ownership concentration were statistically significant and positively related to the ROA. The control variable of bank size has a negative and significant effect on return on asset.

Ferrouhi (2014) analyzed determinants of bank performance of 8 commercial banks in Morocco during the period 2001-2012. Independent variables used were liquidity ratios, bank size, bank size squared, bank capital to total asset, external funding to total liability, equity to total asset, unemployment rate, foreign direct investment, gross domestic product, realization of financial crisis. The dependent variables of the study were return on asset, return on equity, and net interest margin. Results indicate that liquidity ratio measured by liquid asset to deposit has a positive and significant effect on return on asset.

Salim, Arjomandi, & Seufert (2016) studied the effect of corporate governance on Australian banks' performance for the period 1999-2013. Independent variables of board size, number of

board meetings, number of committee meetings, concentrated shareholding, and ratio of non-executive independent directors and dependent variable of return on asset has been used. The control variables were bank size, capital strength and liquidity. Board size, number of committee meetings has a positive and statistically significant relationship with bank performance. The number of board meetings has no significant effect while largest share of the individual shareholders has a positive but insignificant effect. Bank size has a negative and significant effect of the ratio on return on asset.

Stephen, Djan, Bawuah, Halidu, and Kuutol (2015) examined the impact of corporate governance mechansims on financial performance using 5 year data from 2008-2012 with sample of nine Ghanaian commercial banks. Panel data set was used to examine relationship three performance variables were used namely, return on asset, return on equity and cost-income Ratio. Independent variables of the study were audit committee size, board size, business management experience, industry specific experience, board gender diversity, and educational qualification. Bank size, leverage, and bank growth were the control variables. Result reveals that board gender diversity has a significant and negative relationship with return on asset.

Akpan and Amran (2014) examined the relationship between board characteristics and company performance for the period 2010-2012.Independent variables of board size, board independence, board age, board education, board women, board equity were used. Results reveal that board gender diversity has a significant and negative effect on performance.

Abid and Ladhi (2015) examined the impact of reserve requirement on banks profitability in Pakistan. 10 year data for the independent variable of cash reserve ratio and dependent variables of return on asset and return on equity was used. Results indicate a negative and significant effect of the ratio on return on asset.

Yonas, Hamdu, and W/Micheal (2015) investigated the soundness of Ethiopian banks for the study period 2003-2013. The dependent variables were return on asset and return on equity while the independent variables were capital adequacy, management efficiency, liquidity, asset and earning quality. Results show that capital adequacy ratio and earning ability affect profitability positively but asset quality, management efficiency and liquidity position affect profitability measured by return on asset negatively.

Lukorito, Muturi, Nyang'au, and Nyamasege (2014) assessed the effect of liquidity on profitability of commercial banks in Kenya. Data for the period 2009-2013 for all 43 commercial banks in the country were considered. Independent variable of liquidity and dependent variable of return on asset were analyzed. Results indicate a significant and positive effect of the variable on return on asset.

Belhaj and Mateus (2016) investigated the impact of corporate governance on European bank performance during 2002-2011using sample of 73 banks from 11 European countries. Board size and composition, gender diversity, CEO duality were used as independent variables, and Tobin Q, return on equity, return on asset were used as proxies of financial performance and market valuation. Control variables of bank size, financial leverage ratio and liquidity ratio were employed. Result indicates that gender diversity and bank performance are positively and significantly related to bank performance. Bank size indicate a significant and negative effect.

Yenesew (2012) investigated the impact of corporate governance mechanisms on firms' financial performance using five year data from the year 2007 to 2011 with a sample of eight Ethiopian state and private commercial banks. Financial performance indicators such as return on asset, return on equity and net Interest margin were used. Corporate governance mechanisms considered included board size, board gender diversity, board members educational qualification, board members business management and industry specific experience, and audit committee size. The study controls the effect of size, leverage and growth of banks. Results show that board size has a negative and insignificant relation with return on asset. The relationship between board gender diversity and return on asset is positive and insignificant. Board members educational qualification has a positive and significant effect on return on asset. Business management and industry specific experience both have positive effect on return on asset but with insignificant and significant levels respectively. Audit committee size has a negative and significant effect on the return on asset. Bank size has negative and insignificant effect on the return on asset. Leverage has positive and significant effect on return on asset.

Kibrysfaw (2013) examined the impact of corporate governance mechanism on performance of Ethiopian commercial banks. The study included 9 state and private commercial banks in Ethiopia covering the period 2005-2012. The independent variables of the study are board size, board composition of independent non-executive directors, availability of audit committee, board

ownership, capital adequacy ratio, legal reserve, liquidity ratio, depositors' impact, ownership structure. Control variables of bank size, and income diversification and dependent variable of return on asset were analyzed using panel data framework. Results indicate that availability of audit committee on the board had positive impact on banks performance and it is statistically significant at 10% significant level. Board composition showed negative relationship and it is significant at 5% level. Board size and board ownership on bank performance was insignificant and negative. Capital adequacy ratio is negative and statistically significant at 10% to return on asset. The impact of reserve ratio on bank performance is negative and significant. Bank liquidity which is measured in terms of liquid asset to total asset does not have any significant effect and the parameter is negative. Bank size had statistically significant positive effect on bank performance.

Firehiwot (2015) examined the effect of corporate governance in firms' financial performance using ten years data from the year 2005 to 2014 with a sample of nine Ethiopian state and private commercial banks. Dependent variable of return on asset and independent variables of board size, board member gender diversity, board members educational qualification, board members industry specific experience, size of audit committee, and frequency of board meeting were used. Bank size and age are the control variables. Results reveal that board size and audit size has a negative and statistically significant association with return on asset. There is an insignificant and positive association between women directors and industry specific experience of directors on performance. Board members educational qualification and frequency of meeting has a positive and statistically significant influence on return on asset. Bank size had statistically insignificant negative effect on bank performance.

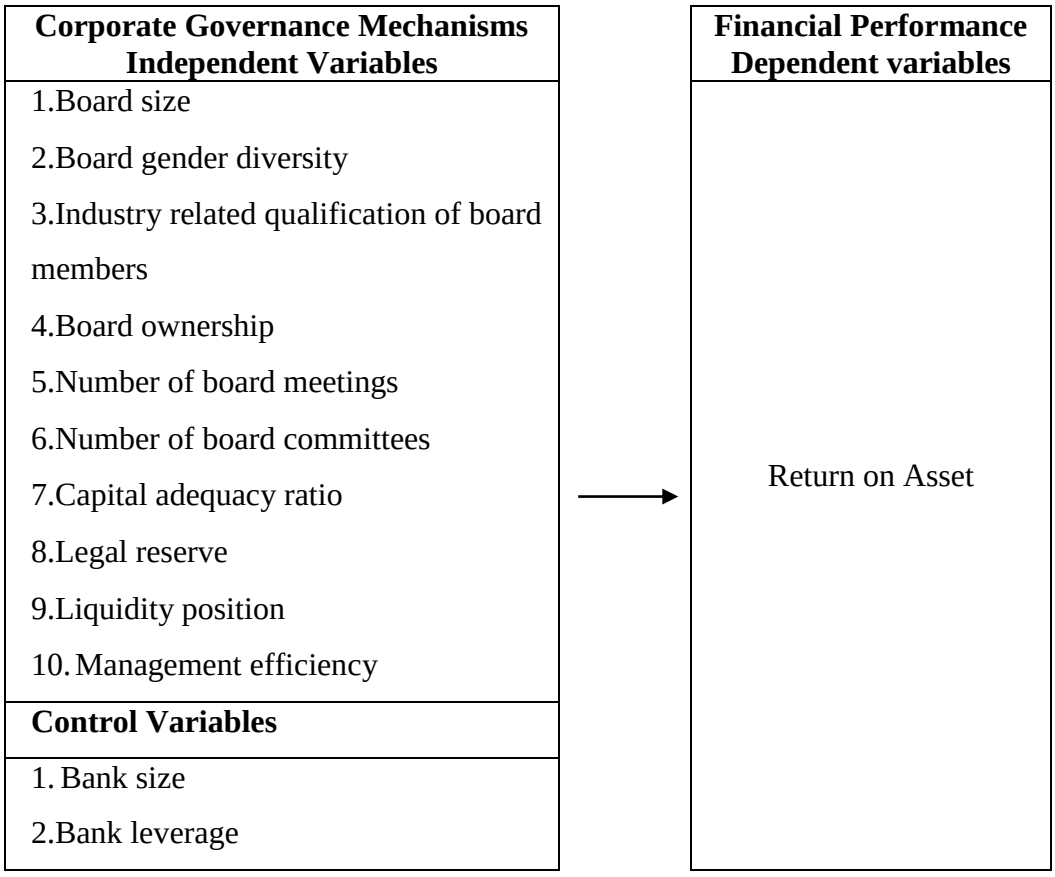
Abdurazak (2017) studied effect of corporate governance mechanism on performance of Ethiopian private commercial banks. Panel data covering 11 years 2005-2015 for selected 8 private banks was used. Independent variables of board gender diversity, educational qualification of directors, availability of variety board sub-committee, board ownership, deposit ratio, legal reserve and liquidity were used. Return on asset and bank size were the dependent and control variables. Findings of the study show that the variables of legal reserve ratio and private commercial bank size had statistically significant at 5% and 1% with negative and positive coefficients respectively. While, the effect of other governance variables like board

gender diversity, directors‟ educational qualification, availability of variety number of board sub-committee, meeting frequency of board, board ownership, and liquidity, on ROA are insignificant. The effects of these variables on the return on asset are negative, positive, positive, positive, positive, and negative respectively.

2.5. Conceptual Framework

The conceptual framework is developed after review of literature discussed above. Hence, the study is based on the presumption that corporate governance mechanisms (board size, gender diversity of board, industry related qualification, board ownership, number of meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity position, and management efficiency) have effect on banks' financial performance but this effect is intervened by control variables. The variables have been selected after assessing that these proxies are frequently used as measures of corporate governance and are in line with theories.

FIGURE 2.1: CONCEPTUAL FRAMEWORK



Source: Author, 2017

2.6. Research Gap

Better knowledge on how corporate governance impacts performance of banks is important as it has implications on shareholders, depositors, bank management, employees, various other stakeholders and on how regulators formulate and improve policies. Hence, corporate governance and its effect on bank performance is a topic researched well.

Theoretical literature indicates that some of the corporate governance mechanisms can have either positive or negative effects on bank performance; either direction of relation having valid justifications. This has also been backed by the reviewed empirical studies. Identifying the cut-off points will enable balance the effects of the variables in obtaining favorable outcome for the various stakeholders.

Rao & Kidane, 2016; Olani & Berhanu, 2015; Ashenafi et al. 2013; Assefa & Megbaru, 2014; Yenesew 2012; Kibrysfaw 2013; Firehiwot 2015; Abdurazak 2017 have conducted studies in Ethiopia. Except for Abdurazak 2017, the studies have included state owned banks in their sample; their results hence include effect of banks in varying platforms of operation. Number of observation has also been limited. There is also tendency of the studies to use internal corporate governance variables instead of including varied mix of governance proxies.

Study outcome will contribute in giving direction to make amendments and formulation of policies and directives of corporate governance that best monitor, control and guide operation to benefit various stakeholders.

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CHAPTER THREE

3. RESEARCH METHOD

This chapter presents the research methodology. It has sub-sections presenting the research design, population and sampling technique used, study variables and their measurements, data sources and collection methods, data analysis method and model specification.

3.1. Research Design

The research objective is to identify the effect of corporate governance on banks' performance; hence explanatory research design has been used to test the hypothesis of causal relationship between the dependent and independent variables. According to Adams, Khan, Raeside and White (2007) the explanatory type of research describes phenomena and attempts to explain why behavior is the way it is. Quantitative data is used to numerically measure and statistically analyze the variables.

3.2. Population and Sample

As per the official website of National Bank of Ethiopia there are 16 private banks in the country. The data of the study is collected for the period covering 2010 to 2017; hence, purposive sampling technique is used to select the banks that have relevant data for the selected time frame. 10 private banks, hence, are the selected sample of study as they fulfill the requirement of the time frame selected having being operational and data available for full fiscal years since 2010. The eight-year period is selected to capture at least two-term tenure of board directors. The sample private banks are Awash Bank, Bank of Abyssinia, Cooperative Bank of Oromia, Dashen Bank, Lion International Bank, Nib International Bank, Oromia International Bank, United Bank, Wegagen Bank, and Zemen Bank.

3.3. Source of Data and Collection Method

Primary and secondary data sources have been used to collect the quantitative data of the study. Banks' annual reports for the period covering 2010- 2017 have been used as secondary data to obtain inputs used for the calculation of the figures for independent variables of liquidity

position, legal reserve, management efficiency, return on asset and for control variables of bank size and bank leverage. Data for board size and board gender diversity has also been obtained from the annual reports.

Questionnaires distributed to board secretaries and finance managers have been sources of primary data. Variables of industry related qualification of board members, board ownership, number of board meetings, number of board committees and capital adequacy ratio have been collected from primary sources. In addition, the data for board size, board gender diversity, and return on asset have been cross validated through primary sources.

3.4. Method of Data Analysis

The study employs descriptive data analysis to describe the phenomena of the variables using minimum, maximum, mean and standard deviation. Correlation analysis using Pearson correlation is used to determine the association between the variables. Correlation analysis measures the strength of the linear relationship between variables while regression analysis provides a "best-fit" mathematical equation for the values of the variables used in determining and interpreting linear relationships of variables (Weiers, 2008). Hence, multiple linear regression model has been used to conduct inferential analysis to determine causal relation of the panel data. The method enables statistical testing of hypothesis to help estimate the dependent variable of bank performance based on the various independent variables of corporate governance. SPSS version 25, a statistical software package has been used to carry out the statistical analysis.

3.5. Variables and Measurement

Following review of theoretical and empirical literature, presented are the selected variables used as proxies to study the effect of corporate governance on bank performance. Operational definitions of the constructs have been included.

Agency theory, stakeholder theory, resource dependency theory, transaction cost theory are used as base to select the variables. Moreover, empirical studies reviewed have used the variables as proxies for governance mechanism. Ashenafi et al. (2013); Manini and Abdillahi (2015); Bussoli et al. (2015); Olani and Berhanu (2015); Ben et al. (2015); Rao and Kidane (2016); Assefa and

Megbaru (2014); Andres and Vallelado (2008); Kilic (2015); Halidu and Kuutol (2015); Salim et al. (2016); Yonas et al. (2015) are to site few of the reviewed empirical literature that have used the variables as proxies for corporate governance.

Dependent Variable

Return on Assets (RoA)

It is the variable used to measure bank performance. The ratio reflects the ability of a bank's management to generate profits from assets. It is measured as;

$$\text{Return on asset (RoA)} = \frac{\text{Profit before tax}}{\text{Average total assets}}$$

Independent Variables

Board Size

It is a measure of the total number of members serving as board of director.

Board Gender Diversity

The ratio of female board directors to total board members.

Industry Related Qualification of Board Members

Measured as the proportion of board members having academic qualifications in either of the fields of finance, accounting, economics, banking, auditing, business administration, law, information technology, investment management to total members.

Board Ownership

Ratio of influential board members to total board members. Influential board member is a member who directly or indirectly holds 2% or more of the total subscribed capital of the bank.

Number of Board Meetings

The count of total board committee and full board meetings held in a year.

Number of Board Committees

Measured as the count of the total number of board sub-committees within the banks.

Capital Adequacy Ratio

Capital level required by banks to enable withstand risks and protect stakeholder's interest.

It is measured as;

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Total capital}}{\text{Risk weighted assets}}$$

Legal Reserve

Cash reserve ratio is the minimum fund banks are obliged to deposit with the central bank.

It is measured as;

$$\text{Cash Reserve Ratio} = \frac{\text{Total reserve}}{\text{Total assets}}$$

Liquidity Position

The ratio measures the ability of banks to meet their obligation and protect stakeholders.

$$\text{Liquidity Ratio} = \frac{\text{Liquid assets}}{\text{Total deposits}}$$

Management Efficiency

It measures capability of management to maximize income and minimize cost increasing operational efficiency and fulfilling board and management fiduciary responsibility. It is calculated as;

$$\text{Management Efficiency} = \frac{\text{Non-interest expense}}{\text{(Net interest income +non-interest income)}}$$

Control Variables

Bank Size

It is measured by the natural logarithm of total assets at year-end.

Bank Leverage

It is measured as ratio of the total liability to total equity.

TABLE 3.1: EXPECTED RELATIONSHIP OF VARIABLES

Independent Variable	Expected Relationship
Board size	Positive
Board gender diversity	Positive
Industry related qualification	Positive
Board ownership	Positive
Number of board meetings	Positive
Number of board committees	Positive
Capital adequacy ratio	Positive
Legal reserve	Negative
Liquidity ratio	Negative
Management efficiency	Negative

Source: Author, 2017

3.6. Model specification

To test the study hypothesis, a panel data model is used. A panel of data embodies information across both time and space (Brooks, 2014). The data for this study comprises of both time series and cross-sectional elements as it considers 10 banks over a period of 8 years.

Statistical procedures are typically used to test the relationship between two or more variables. Statistical validity addresses the question of whether the statistical conclusions drawn from the results of a study are reasonable. The concepts of hypothesis testing and statistical evaluation are interrelated, and they provide the foundation for evaluating statistical validity (Marczyk, Dematteo & Festinger, 2005) Hence, diagnostic tests are undertaken prior to conducting regression analysis. This ensures that the hypothesis tests regarding the coefficient estimates

could be validly conducted. Moreover, the diagnostic tests validate that the assumptions of classical linear regression model have not been violated. The assumptions tested are normality, heteroscedasticity, autocorrelation, multicolinearity, and linearity.

To estimate the effect of corporate governance on banks' financial performance, the following general empirical research model is used. The panel data regression model was selected based on review of literature.

$Y_{it} = \alpha + \Sigma\beta K X_{it} + \varepsilon_{it}$

Where;

Y_{it} represents the dependent variable, representing the financial performance of the sample banks i for time t

α is the intercept

X_{it} represents the explanatory variable of the sample banks i for time t

β_k represents the vector of parameters to be estimated on the explanatory variables

ε_{it} represents the error term

Specifically, the model used for the study is presented below. This approach has been used by Al-Amarneh (2014), Manini and Abdillahi (2015); Liang et al. (2013); Abdulazeez et al. (2016); Andres and Vallelado (2008); Ashenafi et al. (2013); and Rao and Kidane (2016).

$ROA_{it} = \alpha + \beta 1 BSZ_{it} + \beta 2 BGD_{it} + \beta 3 IQL_{it} + \beta 4 BOW_{it} + \beta 5 NBM_{it} + \beta 6 NBC_{it} + \beta 7 CAR_{it} + \beta 8 LER_{it} + \beta 9 LIQ_{it} + \beta 10 MEF_{it} + \beta 11 BKS_{it} + \beta 12 LEV_{it} + \varepsilon_{it}$

Where;

ROA_{it} represents measure of bank performance of the sample banks i for time t

BSZ_{it} represents board size of the sample banks i for time t

BGD_{it} represents board gender diversity of the sample banks i for time t

IQL_{it} represents industry related qualification of board members of the sample banks i for time t

BOW_{it} represents board ownership of the sample banks i for time t

NBM_{it} represents number of board meetings of the sample banks i for time t

NBC_{it} represents number of board committees of the sample banks i for time t

CAR_{it} represents capital adequacy ratio of the sample banks i for time t

LER_{it} represents legal reserve of the sample banks i for time t

LIQ_{it} represents liquidity position of the sample banks i for time t

MEF_{it} represents management efficiency of the sample banks i for time t

BKS_{it} represents bank size of the sample banks i for time t

LEV_{i} represents bank leverage of the sample banks i for time t

CHAPTER FOUR

4. DATA PRESENTATION AND ANALYSIS

This chapter presents results and analysis of the findings. It has sub-sections presenting the tests for assumptions of linear regression model, descriptive statistics and correlation results and regression results.

4.1. Assumption Tests

Assumptions are made relating to the classical linear regression model (CLRM). This is required to show that the estimation technique has a number of desirable properties and that hypothesis tests regarding the coefficient estimates could validly be conducted (Brooks, 2008). Hence diagnostic tests have been conducted to ascertain fulfillment of underlying assumptions.

4.1.1. Linearity

The assumption requires the mean of the disturbances to be zero. Brooks (2008) states that if a constant term is included in the regression equation, this assumption will never be violated. The model used for the study includes a constant term, hence the assumption has not been violated.

4.1.2. Assumption of Homoscedasticity

The assumption assumes that the variance of the errors is constant. This is known as the assumption of homoscedasticity. If the errors do not have a constant variance, they are said to be heteroscedastic (Brooks, 2008). To test for fulfillment of the assumption, Koenker test; which is the studentized/generalized statistics of Lagrange Multiplier test (LM)-Breusch-Pagan test (BP) was used. Result of the test below indicates that the probability value (p-value) of the test statistics is 0.165 which is greater than 0.05. Hence, the null hypothesis of homoscedasticity is not rejected. The assumption of homoscedasticity is valid.

TABLE 4.1: TEST OUTPUT FOR HOMOSCEDASTICITY

```
-------Koenker test statistics and sig-values --------
                LM        Sig
Koenker     14.170       .165

Null hypothesis: heteroskedasticity not present (homoskedasticity)

if sig-value less than 0.05, reject the null hypothesis

---------
```

Source: SPSS result, 2018

4.1.3. Assumption of No Autocorrelation

Brooks (2008) states that the assumption will be fulfilled when covariance between the error terms over time or cross-sectionally is zero. It is assumed that the errors are uncorrelated with one another. Durbin-Watson (DW) test statistic of 2 and close to 2 results a no autocorrelation in the residuals. Hence, DW test has been conducted to verify that the assumption has not been violated. Result is as follows;

TABLE 4.2: TEST OUTPUT FOR NO AUTOCORRELATION

Model Summary[b]

Model	Durbin-Watson
1	1.826

a. Predictors: (Constant), Lev, LIQ, NBM, BSZ, BGD, BOW, IQL, MEF, NBC, LogBKS, CAR, LER

b. Dependent Variable: RoA

Source: SPSS result, 2018

DW for the model is 1.826 a value close to 2. The null hypothesis of no autocorrelation has not been rejected, hence the model has not violated the assumption.

4.1.4. Multicollinearity Test

Assumption made when using the OLS estimation method is that the explanatory variables are not correlated with one another (Brooks, 2008). The larger the value of Variance Inflation Factor (VIF) the more "troublesome" or collinear the variable X. As a rule of thumb, if the VIF of a variable exceeds 10, that variable is said be highly collinear (Gujarati, 2004). Variance Inflation

Factor (VIF) for the independent variables has been computed using SPSS. The result is as follows;

TABLE 4.3: MULTICOLLINEARITY TEST

Coefficients[a]

Model		Collinearity Statistics	
		Tolerance	VIF
1	BSZ	.581	1.723
	BGD	.530	1.887
	IQL	.539	1.854
	BOW	.578	1.730
	NBM	.471	2.124
	NBC	.383	2.614
	CAR	.305	3.274
	LER	.238	4.194
	LIQ	.247	4.049
	MEF	.538	1.860
	LogBKS	.316	3.160
	Lev	.229	4.373

a. Dependent Variable: RoA

Source: SPSS result, 2018

VIF for all the variables is below 10, hence there is no multicollinearity among the independent variables.

4.1.5. Normality Assumption

Normality test investigates whether the error term follows the normal distribution with zero mean and constant variance (Gujarati, 2004). Normal probability plot with tests have been conducted to check for normality. Output results are;

FIGURE 4.1: NORMALITY TESTS

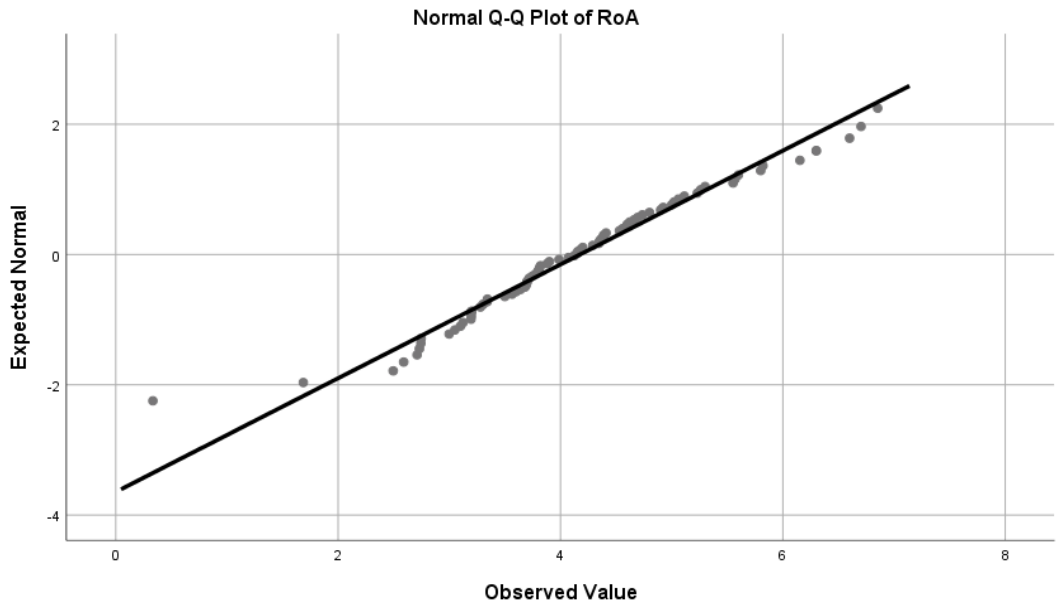

TABLE 4.4: NORMALITY TESTS

Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
RoA	.059	80	.200*	.978	80	.175

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

Source: SPSS result, 2018

If the variable is from a normal population, the probability plot will assume an approximate straight line (Gujarati, 2004). The plot of the residuals of the study shows that the fitted line is approximately a straight line, hence the variable of the study is normally distributed. Moreover, probability value (p-value) of the test statistics of Kolmogorov-Smirnov and Shapiro-Wilk should be greater than 0.05 to not reject the null hypothesis- distribution is normal at 5% level. Significance levels of both tests are above 0.05 indicating the residuals are normally distributed.

4.2.Descriptive Results

The section presents summary results and interpretation of descriptive statistics of minimum, maximum, mean and standard deviation for the study variables.

TABLE 4.5: DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
RoA	80	.33	6.85	4.1744	1.14498
BSZ	80	6	12	9.58	1.508
BGD	80	.00	28.57	11.0790	8.63349
IQL	80	40.00	100.00	81.2392	14.84906
BOW	80	.00	57.14	6.2339	11.19316
NBM	80	28	78	53.16	10.790
NBC	80	3	7	3.80	1.072
CAR	80	11.00	39.00	20.2395	6.24242
LER	80	3.06	14.51	6.1206	3.22297
LIQ	80	16.62	88.83	38.0465	16.39667
MEF	80	26.97	95.65	47.8387	12.67229
LogBKS	80	20.01	24.46	22.8576	.87046
Lev	80	4.12	10.68	6.6848	1.61566
Valid N (listwise)	80				

Source: SPSS result, 2018

The mean value of return on assets of the 10 sample private banks is 4.17%, on average the banks earned 4.17 cents for 1 Birr invested in assets. The minimum and maximum values were 0.33% and 6.85% respectively. The standard deviation of return on asset is 1.14% from the mean value.

Banks on average have 9 board members. They have a minimum of 6 board members and a maximum of 12. Standard deviation of the variable is 1.5 from the mean.

The proportion of female board members to total board members indicates a minimum of 0.00%; to a maximum of 28.57% composition of females as directors. On average 11.07% of the total board members are female; this indicates that there is low board gender diversity in the banks. The standard deviation of the variable is 8.63% from the mean value.

Regarding industry related qualification of board members, the maximum value of 100% indicates that all members have industry related qualifications, to a minimum of 40% members with industry related qualifications. On average 81.23% of bank board members have industry

related qualification. Standard deviation is 14.84% from the mean value which indicates a wider range of dispersion of the variable.

The proportion of board members who are influential shareholders to total members; range from a minimum of 0.00% to a maximum of 57.14%. On average only 6.2% of the board members are influential shareholders; this indicates that there is a less percent of influential board members who have the power to monitor managers. The standard deviation is 11.19% from mean value.

The average number of board meetings held in a year is 53 with a minimum of 28 meetings and maximum of 78. Standard deviation is 10.79 from mean value. Banks on average have 4 board committees, with minimum of 3 board committees and a maximum of 7, standard deviation of the variable of 1.07 from mean value indicates that the range of dispersion of the variable among the banks is low.

The mean value of capital adequacy ratio is 20.2%, with minimum value of 11%, a ratio well above the minimum statutory requirement of 8% of the National Bank of Ethiopia. The maximum CAR is 39% with standard deviation of 6.2% from mean value. Banks have on average maintained a ratio which is 2.5 fold the minimum set requirement which hinders their return but ensures ability to withstand adverse effects.

Legal reserve measured as a ratio of total reserve to total asset has a mean value of 6.12%; banks on average have deposited 6.12% of their total asset as cash reserve with National Bank of Ethiopia which is an amount unavailable for operation and hence affects return of the banks but indicates governance strength. Minimum and maximum ratios are 3.06% and 14.51% respectively. Standard deviation is 3.2% from mean value.

Mean value of liquidity is 38.04%; with minimum and maximum values of 16.62% and 88.83% respectively and standard deviation of 16.39%. Banks on average have 38% of their deposit in the form of liquid assets. As of October 2014, minimum liquidity ratio requirement of National Bank of Ethiopia is 15%. The average liquidity maintained is well above the minimum required which affects return but also shows strength in meeting obligations.

Management efficiency measured by the ratio of non-interest expense to the sum of net interest income and non-interest income has a mean value of 47.83%; minimum and maximum values of 26.97% and 95.65% respectively. Lower ratio indicates ability to minimize cost per unit of

revenue implying that value of the firm will increase due to decreased expenditures and managers' opportunistic behavior relating to agency problem. Standard deviation is 12.67% from mean value.

Leverage ratio has mean value of 6.6% with minimum and maximum values of 4.12% and 10.68% respectively and standard deviation of 1.61%. Bank size as measured by the natural log of total assets has a mean value of 22.85 with minimum and maximum values of 20.01 and 24.46 respectively and standard deviation of 0.87.Standard deviation of both variables indicate a smaller range of dispersion among the size and indebtedness of the banks.

4.3.Correlation

The correlation analysis helps discover if there is relationship between the variables. It enables determine the direction and strength/magnitude of relationship. The direction of relationship can be positive, negative or zero. The strength of a linear relationship between the two variables is measured by a statistic called the correlation coefficient which varies from -1, 0, and +1. +1 and -1 correlation coefficients have perfect relationship; coefficients ranging from -/+ 0.9 to -/+ 0.7 have strong correlation; coefficients ranging from -/+ 0.6 to -/+ 0.4 have moderate correlation; coefficients ranging from -/+ 0.3 to -/+ 0.1 have weak correlation; and zero coefficient implies no correlation (Dancey & Reidy, 2007) Pearson's correlation test has been used; the result and analysis is presented below;

Industry related qualification of board; capital adequacy ratio, legal reserve, liquidity, management efficiency, bank size, and leverage are significantly correlated to return on asset at 1% and 5% level. The direction of the relationship is positive for industry related qualification of board, capital adequacy ratio, legal reserve, and liquidity to return on asset. This implies that as the proportion of board members with industry related qualification increases, return on asset also increases, but the strength of the relationship is weak. As capital adequacy ratio, legal reserve, and liquidity increases, return on asset also moves in the same direction; the strength of relationship is weak for the first two variables and moderate for liquidity.

The direction of relationship is negative for management efficiency, bank size and leverage to return on asset. This implies that return on asset will decrease as the level of the variables

increase. Management efficiency has strong relationship while bank size and leverage have moderate and weak relationships respectively.

TABLE 4.6: PEARSON CORRELATION

	RoA	BSZ	BGD	IQL	BOW	NBM	NBC	CAR	LER	LIQ	MEF	Log BKS	Lev
RoA	1												
BSZ	-0.189	1											
BGD	-0.184	0.11	1										
IQL	.370**	-0.157	-.231*	1									
BOW	-0.034	-.432**	-0.142	0.061	1								
NBM	0.15	0.026	.315**	-0.071	-0.035	1							
NBC	0.167	0.025	.480**	0.112	-.306**	.555**	1						
CAR	.326**	-0.03	-0.193	.484**	-0.099	0.123	.317**	1					
LER	.316**	-0.098	-.332**	0.133	0.068	-0.114	-.241*	0.08	1				
LIQ	.547**	-0.092	-.241*	0.204	0.036	0.037	-0.035	.305**	.794**	1			
MEF	-.720**	.325**	0.133	-.258*	0.115	-0.197	-0.157	-0.201	-.370**	-.454**	1		
Log BKS	-.418**	-0.122	-0.005	-0.143	.232*	0.19	-0.11	-.367**	-.530**	-.616**	.223*	1	
Lev	-.362**	-0.174	0.109	-.525**	.306**	0.059	-.251*	-.727**	0.161	-0.045	0.146	.343**	1

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: SPSS result, 2018

4.4. Regression Results and Analysis

Regression analysis is concerned with the study of the dependence of one variable, the dependent variable, on one or more other variables, the explanatory variables, with a view to estimating and/or predicting the (population) mean or average value of the former in terms of the known or fixed (in repeated sampling) values of the latter (Gujarati,2004). Multiple regression analysis was conducted to determine the statistical dependence of return on asset (dependent variable) on the corporate governance proxies of board size, board gender diversity, industry related

qualification of board members, board ownership, number of board meetings, number of board committees, management efficiency capital adequacy ratio, legal reserve, and liquidity position.

4.4.1. Goodness-of -fit test

Hypothesis testing for the multiple regression model determines causal relationship between the dependent and explanatory variables. Brooks (2008) states that it is desirable to have some measure of how well the regression model actually fits the data; how well the model containing the explanatory variables that was proposed actually explain variations in the dependent variable. Hence, goodness of fit statistic R^2 and F test is employed to ascertain fitness of the model to the data. Output result is as follows,

TABLE 4.7: GOODNESS-OF- FIT TEST

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.853[a]	.728	.679	.64866

a. Predictors: (Constant), Lev, LIQ, NBM, BSZ, BGD, BOW, IQL, MEF, NBC, LogBKS, CAR, LER

b. Dependent Variable: RoA

Source: SPSS result, 2018

R^2 for the model is 72.8% while the adjusted R^2, which takes into account the loss of degrees of freedom associated with adding extra variables, is 67.9%. Adjusted R^2 interpreted implies 67.9% variability of bank performance measured by return on asset can be explained by the explanatory variables of the study. 32.1% of variability of bank performance is explained by factors other than the independent variables. Therefore, the model best fits the data.

The data of the study has cross-sectional and time series dimensions, where the same cross-sections (10 banks) are measured over time. Panel data regression model was used. There are broadly two classes of panel estimator approaches that can be employed in financial research: fixed effects models and random effects models. random effects model is more appropriate when the entities in the sample can be thought of as having been randomly selected from the population and the relationships between the explanatory and explained variables are assumed to

be the same both cross-sectionally and temporally. Fixed effects models allow the intercept in the regression model to differ cross-sectionally but not over time (Brooks, 2008).

The sample banks used in the study have been selected not randomly but purposively considering availability of data. Moreover, the intercepts are allowed to differ across the banks allowing for bank heterogeneity. Hence, fixed effects test has been conducted to determine if it is appropriate for the model.

Type III Tests of Fixed Effects tells whether the predictors significantly predict the outcome. Results below indicate that the f stat greater than zero; hence fixed effect model is appropriate and significantly predicts the outcome. Therefore, the regression was run using cross section fixed effect model.

TABLE 4.8: TYPE III TEST OF FIXED EFFECTS

Type III Tests of Fixed Effects[a]

Source	Numerator df	Denominator df	F
Intercept	1	80	23.532
BSZ	1	80	.021
BGD	1	80	4.415
IQL	1	80	1.058
BOW	1	80	3.975
NBM	1	80	2.625
NBC	1	80	.240
CAR	1	80	8.298
LER	1	80	7.040
LIQ	1	80	11.403
MEF	1	80	47.320
LogBKS	1	80	6.585
Lev	1	80	7.183

a. Dependent Variable: RoA.

Source: SPSS result, 2018

In addition, F test used in the analysis of variance (ANOVA) shows the joint significance of all the factors in explaining the dependent variable. F for the model equals 14.928, with p-value of 0.00; P-value less than 0.05 and f stat greater than zero implies that the null hypothesis of all

factors taken together is approximated by zero is rejected. Hence, all factors (independent variables) taken together can explain the bank performance measured by RoA; the variables are jointly significant. Result is presented below;

TABLE 4.9: ANOVA

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	75.376	12	6.281	14.928	.000[b]
	Residual	28.191	67	.421		
	Total	103.567	79			

a. Dependent Variable: RoA

b. Predictors: (Constant), Lev, LIQ, NBM, BSZ, BGD, BOW, IQL, MEF, NBC, LogBKS, CAR, LER

Source: SPSS result, 2018

4.4.2. Discussion of Regression Results

Regression results studying the effect of the governance variables on bank performance is presented based on output and analyzed in context of theoretical and empirical literatures. Coefficient estimates (β) and p-values are observed to determine direction and significance levels. Summary of result is presented below;

TABLE 4.10: REGRESSION COEFFICIENTS

Estimates of Fixed Effects[a]

Parameter	Estimate	Std. Error	df	t	Sig.	95% Confidence Interval	
						Lower Bound	Upper Bound
Intercept	15.606913	3.217274	80	4.851	.000	9.204334	22.009493
BSZ	-.008339	.058144	80	-.143	.886	-.124049	.107371
BGD	-.022328	.010627	80	-2.101	.039	-.043476	-.001181
IQL	.006300	.006124	80	1.029	.307	-.005887	.018487
BOW	.015647	.007848	80	1.994	.050	2.961321E-5	.031265
NBM	.014616	.009021	80	1.620	.109	-.003337	.032569
NBC	.049318	.100714	80	.490	.626	-.151110	.249746
CAR	-.055765	.019358	80	-2.881	.005	-.094290	-.017241
LER	-.112606	.042440	80	-2.653	.010	-.197064	-.028148
LIQ	.027678	.008196	80	3.377	.001	.011367	.043990
MEF	-.049450	.007189	80	-6.879	.000	-.063756	-.035144
LogBKS	-.349988	.136391	80	-2.566	.012	-.621415	-.078560
Lev	-.231684	.086447	80	-2.680	.009	-.403719	-.059648

a. Dependent Variable: RoA.

Source: SPSS result, 2018

4.4.2.1. Board Size

The coefficient parameter (β) for board size is -0.008 with p-value of 0.886. The p-value (0.886) > 0.05; hence the null hypothesis of no relation is not rejected (fail to reject Ho). The result indicates that board size has a negative but statistically insignificant effect on bank performance.

The study outcome is inconsistent with agency theory which states that larger boards are less effective than smaller boards due to co-ordination and free riding problems triggering agency cost and reducing performance. And with resource-dependent theory which states that larger board allows for more specialists from different fields with additional knowledge and skills to monitor, supervise and advise the management. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states that banks shall have at least nine directors.

Study findings of Rao and Kidane (2016); Olani and Berhanu (2015); James and Joseph (2015); Kibrysfaw (2013); and Yenesew (2012) have consistent outcomes with the study of a negative and insignificant effect of board size on RoA.

There is mixed consensus on the size of the board; both large and small boards have significant effect. Results of the following reveal the assumption and are against study outcomes. Positive and significant outcomes are results of the studies of Abdulazeez et al. (2016); Andres and Vallelado (2008); Malik et al. (2014); Al-Amarneh (2014); and Salim et al. (2016). Whereas negative but significant effect of the variable on bank performance is observed in the findings of Manini and Abdillahi (2015); Assefa and Megbaru (2014); Ashenafi et al. (2013); Orazalin et al. (2016); Liang et al. (2013); and Firehiwot (2015).

The implication of the study outcome is that the board size of the banks is not large enough to have a significant adverse effect on performance. Descriptive statistics indicates that banks on average have 9 members. The expectation of a positive outcome was not met.

4.4.2.2. Board Gender Diversity

The coefficient parameter (β) for board gender diversity is -0.022 with p-value of 0.039. The p-value (0.039) < 0.05; hence the null hypothesis of no relation is rejected. This shows that holding all other factors constant, as the proportion of female members to total board members increases by 1%, return on asset decreases by 2.2% and it is statistically significant at 5%. Board gender diversity has a negative and statistically significant effect on bank performance.

The study outcome is not consistent with agency theory, stakeholder and resource dependency theories which states that women have better oversight and monitoring capacity and that they bring valuable resources and ensure benefit of stakeholders are met leading to efficiency and better performance. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states that boards may preferably comprise of directors who provide a gender mixture.

Studies of Stephen et al. (2015); and Akpan and Amran (2014) have consistent outcomes with the study of a negative and significant effect of board gender diversity on RoA. Whereas Belhaj

and Mateus (2016) found a positive and significant result which is not consistent with the result obtained.

The implication of the outcome is that board gender diversity is disadvantageous as it leads to increase in conflict and lack of cohesion within the directors. The conflict may delay decision making and add to cost adversely affecting performance. Women have traits that differentiate them from men. Prudence, better oversight and monitoring ability are some; the mismatch in assignment of women to committees best fit for their personality traits may attribute to the adverse effect on performance. The expectation of a positive outcome was not met.

4.4.2.3. Industry Related Qualification

The coefficient parameter (β) for industry related qualification is 0.006 with p-value of 0.307. The p-value (0.307) > 0.05; hence the null hypothesis of no relation is not rejected (fail to reject the Ho). The result indicates that industry related qualification has a positive and statistically insignificant effect on bank performance.

The result is inconsistence with resource dependency theory which states that incorporation of directors with specialized fields would contribute to better performance. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states that boards may preferably comprise of directors who provide mixture of core competencies in areas of banking, finance, accounting, law, business administration, auditing, information technology and investment management.

Olani and Berhanu (2015) state that the variable has a positive and significant effect on bank performance. The implication of the study outcome is that the proportion of board members having industry related qualification is not large/adequate enough to significantly contribute to performance. Moreover the qualification provided by the board should match the needs of the banks.

4.4.2.4. Board Ownership

The coefficient parameter (β) for board ownership is 0.015 with p-value of 0.050. The p-value (0.050) = 0.05; hence the null hypothesis of no relation is not rejected (fail to reject the Ho). The

result indicates that board ownership has a positive and statistically insignificant effect on bank performance.

Outcome is inconsistent with efficient monitoring hypothesis which states that performance can be increased when there is greater owner concentration leading to improved monitoring and corporate control. Concentrated ownership enables gauge managers to maximize bank performance and stakeholder interest. And against agency theory where widely dispersed ownership increases agency cost and reduces power to control the management. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states that boards should comprise of a set proportion of influential and non-influential shareholders.

Orazalin et al. (2016); Salim et al. (2016); and Abdurazak (2017) have findings consistent with the study; insignificant but positive. The results of studies of Assefa and Megbaru (2014) Al-Amarneh (2014) show significant and positive effect of the variable on bank performance.

Implication of the study outcome is that the proportion of influential board members to the total board of directors is not large enough for the influential members to better monitor and gauge performance. The existing composition of board members with dispersed ownership is not significantly contributing to better performance through reduction of agency problem.

4.4.2.5. Number of Board Meetings

The coefficient parameter (β) for number of board meetings is 0.014 with p-value of 0.109. The p-value (0.109) > 0.05; hence the null hypothesis of no relation is not rejected (fail to reject the Ho). The result indicates that number of board meetings has a positive and statistically insignificant effect on bank performance.

The outcome is inconsistent with agency framework which implies frequent board meetings is beneficial to bank performance as it indicates an active monitoring role which reduces agency cost and improves performance. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states that board meetings should be held at least once in a month.

Andres and Vallelado (2008) and Abdurazak (2017) have similar results of insignificant and positive effect. Whereas the results of Olani and Berhanu (2015); Assefa and Megbaru (2014); Liang et al. (2013); Salim et al. (2016); and Firehiwot 2015 show significant and positive effect.

The implication of the outcome is that with the number of meetings held, bank performance has not been significantly affected. Descriptive statistics show that on average 53 meetings are held in a year, the frequency of meeting has however not resulted in a significant effect on return on asset. This could be due to relevance level of items on agenda of meetings, and nature of the meetings in relation to them being held in reaction to weak performance, poor strategic implementation (reactive) rather than proactive in nature.

4.4.2.6. Number of Board Committees

The coefficient parameter (β) for number of board committees is 0.049 with p-value of 0.626. The p-value (0.626) > 0.05; hence the null hypothesis of no relation is not rejected (fail to reject the Ho). The result indicates that number of board committees has a positive and statistically insignificant effect on bank performance.

The outcome is inconsistent with agency theory which states that committees exist to manage agency problems, determine major policy issues and monitor performance. The National Bank of Ethiopia in its Corporate Governance Directive No. SBB/62/2015 states various board committees should be established, the least being three committees.

The study result of Abdurazak (2017) is consistent with study outcome of an insignificant and positive effect. The finding of Halidu and Kuutol (2015) is that number of board committee has a positive and significant effect.

The implication of the study outcome is that the average number of 3 board committees per descriptive result is few in number to significantly contribute to performance. Moreover, the existing board committees may not be engaged in specialized committee compositions dealing with productive and monitoring roles that would significantly improve performance.

4.4.2.7. Capital Adequacy Ratio

The coefficient parameter (β) for CAR is -0.055 with p-value of 0.005. The p-value (0.005) < 0.05; hence the null hypothesis of no relation is rejected. This shows that holding all other factors constant, as CAR increases by 1%, return on asset decreases by 5.5% and it is statistically significant at 5%. CAR has a negative and statistically significant effect on RoA.

The result does not support the notion that banks with higher ratio show internal strength and capacity to withstand loss having a direct relation to profitability by curbing effect of risk. CAR is one measure of bank's wellness and its capacity to buffer against operational loss and bankruptcy. The outcome, however, is consistent with the assumption that higher ratio requirement reduces risk-taking hence, lower profits. Moreover, a higher CAR implies more assets will be used as buffer to protect banks resulting in less resources being channeled to increase bank performance. National Bank of Ethiopia under its directive no.SBB/50/2011 has set a minimum capital to risk weighted asset ratio of 8% to be maintained by all licensed banks to enable withstand adverse operational results.

Result obtained is consistent with the studies conducted by James and Joseph (2015) and Kibrysfaw (2013) both having significant and negative results. Findings of Ashenafi et al. (2013); Ben et al. (2015); Elbannan and Elbannan (2014); Ongore and Gemechu (2013); Liu and Pariyaprasert (2011); Yonas et al. (2015) however reveal positive and significant effect of CAR on return on asset.

Descriptive statistics results show that the mean CAR of the banks is 20.2% with minimum and maximum values of 11% and 39% respectively. The prevailing ratio which is well above the statutory limit of 8% is negatively affecting bank performance. This implies that more resources are allocated as buffer for risk instead of being channeled to productive avenues that contribute to enhancing bank performance. The expectation of a positive outcome was not met.

4.4.2.8. Legal Reserve

The coefficient parameter (β) for legal reserve is -0.112 with p-value of 0.010. The p-value (0.010) < 0.05; hence the null hypothesis of no relation is rejected. This shows that holding all other factors constant, as legal reserve increases by 1%, return on asset decreases by 11.2% and

it is statistically significant at 5%. Legal reserve has a negative and statistically significant effect on RoA.

The outcome is in line with the notion that cash reserve requirements which are deposited at central banks do not bear interest/return, moreover the funds are not available for granting of loans and advances and other banking operations thereby negatively affecting bank performance. National Bank of Ethiopia under its directive no.SBB/55/2013 has set that any bank at all times shall maintain in its reserve account 5% of its net deposit balance as a form of monetary policy instrument and prudential regulation tool.

Studies conducted by Abid and Ladhi (2015); Kibrysfaw (2013) and Abdurazak (2017) reveal similar results of a negative and significant effect of the variable on return on asset.

Reserve deposited at National Bank of Ethiopia is on average 6.12% of banks total asset which is 5% of their deposit balance. The implication is that the percentage has a significant adverse effect on their performance as it is funds tied up with no return but bearing cost.

4.4.2.9. Liquidity

The coefficient parameter (β) for liquidity is 0.027 with p-value of 0.001. The p-value (0.001) < 0.05; hence the null hypothesis of no relation is rejected. This shows that holding all other factors constant, as liquidity increases by 1%, return on asset increases by 2.7% and it is statistically significant at 5%. Liquidity has a statistically significant and positive effect on bank performance.

The result is inconsistent with the assumption that liquidity and profitability are inversely related as holding liquid asset has an opportunity cost of higher profit. The outcome is in line with the tradeoff theory with its notion that as liquidity comes with cost, trade-off between expense and safety can be maintained resulting in a positive outcome. National Bank of Ethiopia under its directive no. SBB/57/2014 has set a minimum liquid asset of 15% of net current liabilities for licensed commercial banks to enable maintain public trust and confidence.

Echekoba et al. (2014), Lukorito et al. (2014), and Ferrouhi (2014) have results similar to the study test outcome. Whereas Elbannan and Elbannan (2014); Liu and Pariyaprasert (2011); and Yonas et al. (2015) have results that are significant and negative.

The implication of result is that the prevailing liquidity position is not at a level that would have an adverse impact on return on asset as high liquidity has opportunity cost. The trust instilled by the public as a result of strong liquidity position of bank has contributed to their capacity of deposit mobilization; resources that can be channeled to boost performance. Banks have been able to manage their liquidity position in a way that it is not negatively affecting performance. The expectation of a negative outcome was not met.

4.4.2.10. Management Efficiency

The coefficient parameter (β) for management efficiency is -0.049 with p-value of 0.000. The p-value (0.000) < 0.05; hence the null hypothesis of no relation is rejected. This shows that holding all other factors constant, as management efficiency ratio increases by 1%, return on asset decreases by 4.9% and it is statistically significant at 5%. Management efficiency has a statistically significant and negative effect on bank performance.

The result is in line with agency theory's notion that value of the firm will decrease by the managers' tendency to maximize their benefit. Moreover, transaction cost theory; also state that firm's management is opportunists and arranges firms' transactions to their interests.

Study result is consistent with findings of Yonas et al. (2015); and Ishaq et al. (2016); negative and significant effect on bank performance.

Implication of the result is that high ratio is leading to an adverse effect on performance, as management is being opportunistic and maximizing their benefit.

4.4.2.11. Control variables

The coefficient parameter (β) for bank size is -0.349 with p-value of 0.000. The p-value (0.012) < 0.05. Bank size has a significant and negative effect on return on asset. The coefficient parameter (β) for leverage is -0.231 with p-value of 0.090. The p-value (0.009) < 0.05. Leverage has a significant and negative effect on return on asset.

Summary of the regression result is presented below;

TABLE 4.11: SUMMARY OF REGRESSION RESULT

Independent Variable	Actual Relationship	Result
Board size	Negative	Insignificant
Board gender diversity	Negative	Significant
Industry related qualification	Positive	Insignificant
Board ownership	Positive	Insignificant
Number of board meetings	Positive	Insignificant
Number of board committees	Positive	Insignificant
Capital adequacy ratio	Negative	Significant
Legal reserve	Negative	Significant
Liquidity ratio	Positive	Significant
Management efficiency	Negative	Significant

Source: Study outcome, 2018

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

The chapter is presented in two sections; conclusion and recommendations based on the research findings.

5.1. Conclusion

The aim of the study was to identify the effect of corporate governance on performance of Ethiopian commercial banks. Data of ten private banks for the period covering 2010-2017 (8 years) was collected from primary and secondary sources resulting in 80 observations. Audited annual reports and questionnaire was used to collect data. Independent variables; proxies for corporate governance mechanisms of board size, board gender diversity, industry related qualification, board ownership, number of board meetings, number of board committees, capital adequacy ratio, legal reserve, liquidity ratio, and management efficiency were used to study their effect on the dependent variable of return on asset. Control variables of bank size and leverage were used. Fixed effect panel data model was used to conduct regression analysis to test the hypothesis. Descriptive and correlation results were also used.

Regression results show that all independent variables (corporate governance mechanisms) do not have effect on return on asset. Board size has negative but statistically insignificant effect on return on asset. The size of the board is not large enough to have a significant adverse effect on performance according to agency theory.

Industry related qualification, board ownership, number of board meetings, and number of board committees have positive but statistically insignificant effect on return on asset. The composition of industry related qualified board member is not large/adequate enough to significantly contribute to performance, moreover in addition to qualification adequate experience in the specific fields is required to significantly contribute to better performance and monitoring capacity. The existing composition of board members with dispersed ownership is not significantly contributing to better performance. Agenda items of board meetings and nature of the meetings (proactive/reactive) in addition to the frequency of meetings would result in a significant effect of the variable on return on asset. The existing board committee is few in

number to significantly contribute to performance. Moreover, the board committees should be engaged in specialized committee compositions dealing with productive and monitoring roles that would significantly improve performance and monitoring capacity.

Board gender diversity, capital adequacy ratio, legal reserve, and management efficiency have negative and statistically significant effects on the dependent variable. The negative effect of the variables to return on asset is explained by the notion that there is mismatch of assignment of women to committees in line with their personality traits which result in lack of harmony and coordination. High capital adequacy ratio implies more resources are allocated as buffer for risk instead of being channeled to operational activities that contribute to enhancing bank performance. The legal reserve has a significant adverse effect on performance as it is funds tied up with no return but bearing cost. High management efficiency ratio is leading to an adverse effect on performance, as management is being opportunistic and maximizing their benefit.

Liquidity ratio has a positive and statistically significant effect on return on asset. Banks have been able to manage their liquidity position in a way that it is not negatively affecting performance.

5.2. Recommendation

Based on findings and conclusion, the following recommendations have been suggested;

Careful planning and appropriate placement of women to board committees best fit to their personality traits is required. This will maximize and make best use of the intrinsic benefit they contribute as members.

Capital adequacy ratio is at a level above creating buffer to a point where is has created adverse effect on performance. Hence, banks should meet the statutory requirement but be able to maintain a ratio level that does not have adverse effect on their performance.

The statutory reserve ratio requirement is at level that has adverse effect on return on asset. National Bank of Ethiopia should regulate the level such that it is used as a policy tool which does not have bearing on performance.

National Bank of Ethiopia should monitor and set the liquidity statutory requirement to a level where cost and benefit can be balanced. Banks should be able to manage their position to ensure that a high liquidity position does not hamper their return.

Boards should diligently perform their fiduciary responsibility in monitoring and ensuring cost per unit of revenue is minimized. They should study and design mechanisms to mitigate opportunistic behavior of managers.

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APPENDICES

APPENDIX-I- RESEARCH QUESTIONNAIRE 1

ADDIS ABEBA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
RESEARCH QUESTIONNAIRE

Dear Respondent,

My name is Reza Demissie. I am attending the MBA program specializing in Finance at the Addis Abeba University, College of Business and Economics. I am currently conducting a research on the title 'Corporate Governance and its Effect on Performance of Ethiopian Commercial Banks' as a partial fulfillment of the requirements for the Master in Business Administration.

This questionnaire is crafted to collect data on Corporate Governance and its Effect on Performance of Ethiopian Commercial Banks. The data to be 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 supply would be used for academic purpose only and will be kept confidential.

Thank you in advance for your cooperation

Instruction: Please fill in for the questions listed below under each period.

Question 1

Year	Total number of board members	Total number of female board members	Board ownership (Number of influential board members) *
2010			
2011			
2012			
2013			
2014			
2015			
2016			
2017			

***a member who directly or indirectly holds 2% or more of the total subscribed capital of the bank**

Question 2

Year	Number of board and sub-committee meetings	Number of board sub-committees	Name of board sub-committees
2010			
2011			
2012			
2013			
2014			
2015			
2016			
2017			

Question 3-Industry related qualification of board members

Year	2010	2011	2012	2013	2014	2015	2016	2017
Academic qualification in	**Number of board members***							
Finance								
Accounting								
Banking								
Auditing								
Economics								
Business Management								
Law								
Information Technology								
Investment Management								
Other°								
Total number of board members								

Thank you

APPENDIX-II- RESEARCH QUESTIONNAIRE 2

ADDIS ABEBA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
RESEARCH QUESTIONNAIRE

Dear Respondent,

My name is Reza Demissie. I am attending the MBA program specializing in Finance at the Addis Abeba University, College of Business and Economics. I am currently conducting a research on the title 'Corporate Governance and its Effect on Performance of Ethiopian Commercial Banks' as a partial fulfillment of the requirements for the Master in Business Administration.

This questionnaire is crafted to collect data on Corporate Governance and its Effect on Performance of Ethiopian Commercial Banks. The data to be 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 supply would be used for academic purpose only and will be kept confidential.

Thank you in advance for your cooperation

Instruction: Please fill in for the questions listed below under each period.

Question 1

Year	**Capital adequacy ratio** (Bank Capital/Risk Weighted Asset)	**Return on assets** (Profit Before Tax/Average Total Assets)
2010		
2011		
2012		
2013		
2014		
2015		
2016		
2017		

Thank you