ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

THE IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE: SELECTED MICROFINANCE INSTITUTIONS IN ETHIOPIA

BY

WONDEMALEM FEKADU

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ADDIS ABABA, ETHIOPIA

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ADVISOR: ABEBAW KASSIE (PhD)

A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (ACCOUNTING AND FINANCE CONCENTRATION)

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DECLARATION

I, the undersigned, declare that the thesis entitled 'The Impact of Corporate Governance on Financial Performance: selected Microfinance Institutions in Ethiopia' is my original work, prepared under the guidance of Dr. Abebaw Kassie. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a University advisor.

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It is the grace, help and kindness of the almighty God- Jesus Christ that made me achieve this Success and strength and to go through all these time.

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List of Abbreviations and Acronyms

AEMFI	Association of Ethiopian microfinance institutions
ACS	Audit committee size
BGD	Board Gender Diversity
BEFs	Board members experience in the finance sector
SZ	Board Size
CEO	Chief Executive Officer
CG	Corporate Governance
EQD	Educational Qualification Directors
FCEO	Female CEO
FMB	Frequency of meeting on the board
SMEs	Small and Medium Sized Enterprises
MFIs	Micro Finance Institutions
NGOs	Non-Governmental Organizations
OLS	Ordinary Least Square
OECD	Organization for Economic Cooperation and Development
ROA	Return on Asset

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ABSTRACT

The overall objective of the study was to examine the relationship between corporate governance and financial performance of microfinance institutions in Ethiopia over a period of seven years from 2010-2016. This explanatory study seeks to analyze the impact of different corporate governance mechanisms, particularly board size, board gender diversity, educational qualification of directors, board members experience in the finance sector, meeting frequency of board members, female CEO, and size of audit committee on the financial performance, measure by Return on Asset, microfinance in Ethiopia, and the study also controls the effect of microfinance size. Quantitative approach was employed and it was found suitable for the study since it aimed at establishing the relationship between corporate governance variables and financial performance of microfinance institutions. The population for the study was composed of 35 microfinance institutions in Ethiopia, and by using purposive sampling technique 12 microfinance was selected. Secondary data was collected from the National Bank of Ethiopia and primary data was captured using open-ended questionnaires which were completed by CEO and delegated staffs. The study utilizes panel data in order to examine relationships between variables and fixed effect technique has been applied to find out the most significant variables from considered corporate governance variables. The empirical result shows that board size have negative and insignificant relationship with financial performance of MFIs. And also Audit committee size has negative and significant relationship with financial performance of MFIs. Board gender diversity and Educational qualification of directors have positive but statistically insignificant association with performance of MFIs. While Board experience in the finance sector, female CEO and meeting frequency of the board have positive and significant relationship with ROA. Based on the result of the study, it is recommended that board and audit committee sizes should be kept low. It is better MFIs lead by experienced in finance sector board members, Gender diversity of the board and female CEO should also be maintained and attention should be given for the capacity development of women.

Keywords: Corporate governance, microfinance, return on asset

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

The impacts of financial service sector in social, economic and political environment of a country have increased from time to time. Economists and finance practitioners emphasize that the development of the financial institution is a major factor for the economic development of a country and the economic well-being of its people as it supports people to smooth their income and increase their investment opportunities (Calderón & Liu, 2003; Claessens, 2006; Erdal, Oguzhan, & Ahmet, 2011; Houssem & Hassene Ben, 2011; Jeanneney, Hua, & Liang, 2006; King & Levine, 1993) (cited in Thrikawala.S, 2013). Therefore, a country needs to have sound financial systems to offer appropriate access for people to obtain money to improve their standard of living. However, there are millions of people who do not have access to financial services, especially in developing countries and therefore the demand for financial services exceeds the available supply (Barr, Kumar, & Litan, 2007; Gobezie, 2005; Kathryn, 2005) (cited in Thrikawala.S,2013).

In developing countries, the formal banking sector serves only around 20 per cent of the population (Berenbach & Churchill, 1997; Robinson, 2001). To serve the rest of the population micro financial institution is best option. The objectives of MFIs are to alleviate poverty and financial sustainability, (Brau, Hiatt, & Woodworth, 2009; Daley-Harris, 2006). Awareness of the microfinance industry has increased in recent years, bringing the number of MFIs from 618 in 1997 to 3,133 in 2005 (Daley-Harris, 2006). It is estimated that in 2007, there were around 10,000 MFIs issuing loans around the world (Ming-Yee, 2007).

Ethiopia is a country that has been showing impressive performance in microfinance in Africa. Until 1996, the provision of microfinance services in Ethiopia has been carried out mostly by donor funded programs through NGOs and government institutions. This practice has undermined loan collection performance leading to huge default and hence weakened the development of self-sustaining MFIs. As a result; the first licensing & supervision of microfinance business was issued in 1996. This proclamation was again revised and replaced by Microfinance Business Proclamation no. 626/2009. MFIs provide wide range of services including lending, savings, money transfer, collecting taxes on behalf of tax authorities, paying pension payments etc. The current regulatory framework requires microfinance institutions to be formed as share companies owned only by Ethiopian nationals (As defined under art. 304 of the commercial code and Microfinance business proclamation NO. 626/2009).Therefore, all MFIs in Ethiopia are share companies by law. Since MFIs are to be formed as share companies they can raise capital by dividing the capital into shares and selling them to interested buyers. National Bank of Ethiopia Licenses MFIs upon fulfilling the requirements set by the MFI proclamation and directives. Most of MFIs has regional governments, individuals, commercial banks & NGOs as shareholders (Belete, 2015).

According to (NBE, 2016) the number of micro-finance institutions in Ethiopia (MFIs) reached 35 which jointly mobilized about Birr 22.7 billion in saving deposit, which showed a 22.7 percent annual growth. Likewise, their outstanding credit 26.6 billion, increased by 15.3 percent from last year, it reflect the growing role of the institutions in financing intermediation among low income groups both in rural and urban areas. Similarly their total asset expanded by 24 percent and stood at Birr 43 billion as of end March, 2016. The top five largest MFIs (Amhara, Dedebit, Oromia, Omo & Addis Credit and Savings Institutions) accounted for 83.6 percent of the total capital, 93.1 percent of the total deposits, 87.9 percent of the total credit and 89.6 percent of the total assets of MFIs. The commercial code of Ethiopia (1960) incorporates provisions pertinent to the governance of Share Company. Moreover, NBE directive No. MFI/21/2012 put a minimum requirement for persons with significant influence in Microfinance Institution what the directive calls fit and proper criteria. The fit and proper criteria include knowledge, experience and age of Board of Directors (BODs) and Chief Executive Officer (CEO).

Corporate governance has become an important factor in managing organizations in the current global and complex environment. Corporate governance can be defined as a frame work that protect stakeholders rights by illustrating an effective board of directors, efficient internal control and audit in addition to reliable financial reporting and disclosure (Hassn, 2011). Melvin & Hirt (2005) described that corporate governance as referring to corporate decision-making and control, particularly the structure of the board and its working procedures. Corporate governance is related to an institution's internal operating and control procedures. It plays a key role in providing strategic direction which helps the institutions in creating transparency and trust for investors and in attracting capital. Good corporate governance contributes to efficient management and to considering stakeholder interests. To boost the microfinance institution's reputation and integrity and fostering the customer trust corporate governance is mandatory. In last few years, Microfinance Industries significantly changes its shape, due to several reasons in which corporate governance also one of them which plays a pivot role to enhance the performance of Microfinance institutions. Effective Governance of these institutions is necessary due to its complex business as it provides saving, credit and other financial services and products of very small amounts mainly to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve a living standard which leads to socio and economic development of the country. Majority of MFIs have a dual mission, i.e. a social mission-to provide financial services to large numbers of low-income persons to improve their welfare, and a commercial mission-to provide those financial services in a financially viable manner. Maintaining and balancing both at the same time is very challenging and complex task for the board of directors and senior management who provides strategic vision to the institutions (Vishwakarma, 2015).

Microfinance institutions are institutions that offer microfinance services to the poor. Corporate governance on the other hand is concerned with maintaining a balance between economic and social goals, and between individual and collective aims, while encouraging efficient use of resources and higher levels of accountability (Vishwakarma, 2015). Good governance is about achieving corporate goals, for MFIs, multiple goals exist. The fundamental goal is to contribute to development which involves reaching more clients and poorer population strata. A second goal is to do this in a way that achieves financial sustainability, preferably independence from donors. While (Rhyne, 1998) considers these two main goal areas to be a 'win-win' situation, claiming that those MFI institutions that follow the principles of good banking will also be those that alleviate the most poverty. As (Keasey et al 1997 as sited on Vishwakarma, 2015) said that one must note that the key elements of an effective governance structure are ownership (this involves both institutional and managerial), board size, board composition and its structure, CEO characteristics and board members remuneration, auditing, information, and the market for corporate control. By looking on the importance of CG, the researcher needs to assess the CG on MFIs financial performance. Accordingly, the general objective of this study is to investigate the impact of corporate governance on financial performance of Ethiopian MFIs.

1.2 Statement of problem

Corporate governance addresses the need for organizational stewards or managers to act in the best interest of the firm's core stakeholders, particularly, minority shareholders or investors, by ensuring that only actions that facilitate delivery of optimum returns and other favorable outcomes are taken at all times (Joe Duke II et. al. 2011).According to Magdi & Nedareh,(2002) corporate governance define as , it is all about running an organization in a way that guarantees its owners or stockholders receive a fair return on their investment, while the expectations of other stakeholders are also met. The main responsibility for corporate governance rests with the Board of Directors of a firm and the board's responsibility include setting the company's strategic goals, providing leadership towards putting the set goals into effect, set financial policy and oversees its implementation, supervising the management of the firm and reporting to shareholders.

According to the Centre for the Study of Financial Innovation (CSFI, 2008) and other researchers (Hartarska, 2005; Hartarska & Nadolnyak, 2007; Mersland & Strøm, 2009; Rock, Otero, & Saltzman, 1998), (cited in Thrikawala.S, 2013) the issue of corporate governance for MFIs is an emerging consensus to conduct more studies on corporate governance of MFIs to analyses the relationship between institutional success and corporate governance especially for developing countries. Now a day's financial sustainability of MFIs is the main objective than to the social mission and the issue of corporate governance on microfinance institutions becomes increasingly relevant. (Campion, 1998).

Closer examination of the role of various governance mechanisms is important because MFIs managers control significant resources. The microfinance community has experienced some major failures because of inadequacies in its operations, including corporate governance (Labie, 2001). Given its tremendous outreach in recent years its future growth and financial sustainability depends on how well it is governed and if these corporate governance mechanism are not followed it will result in to collapse and closure of these microfinance institutions.

Corporate governance issues in Ethiopia are not only essential but also an important variable in the bid to promote the well-being of the poor due to their increasing role in controlling significant resources. Resource provision is also significant as boards consist of people with different experiences, skills, and background. Board members bring different types of resources, Such as advertising, counseling, facilitating access to resource such as funding and linking the organization to important stakeholders or other important entities (Kasey et.al 1997). Microfinance institutions, which are the focus of this paper, are expanding and growing faster in many parts of the world, especially in developing countries like Ethiopia and are becoming the backbone of many small and medium sized enterprises (SMEs) and poor people by financing their rapidly growing financing needs (Bitok, Stephen Kosgei, et al., 2014).

Most of the previous study like conducted by Yasser (2011), Al-Manaseer et.al. (2012) and Kyereboah colemen (2007) have been undertake on large firms operating within well-organized corporate governance mechanism in developed economic system and in countries where there are capital market. When we see developing countries specifically in Ethiopian some studies have been conducted on corporate governance previously. Most of the studies were conducted in the case of banks and the scenario of corporate governance of bank and microfinance has a difference. According to Bird (2005) a design feature that works well in one country/industry may not work in another noted this may be referred to as the No-One-Size-Fits-All (the NOSFA) principle, i.e., the best policy and administrative design for each country/industry has to be determined carefully in light of the conditions and objectives of that country/industry.

The inconsistent results observed in the previous studies of corporate governance mechanism like Belete's (2015) finding was a direct relationship between board size and ROA, whereas Eyob's (2016) finding was an inverse relationship between board size and ROA. On the other hand Board gender diversity and audit committee size had insignificant effect on ROA based on the finding of Belete (2015); on contrary Eyob (2016) result showed that board gender diversity and audit committee size had significant impact on ROA. The mixed result of the previous research needs further investigation and to have a better insight on the relationship of CG and financial performance by increasing sample MFI from 10 MFI to 12 MFI which was used by Belete (2015) necessitated the need to study the impact of CG on financial performance of the Ethiopia MFIs. In addition to this the immature stages of good corporate governance of Ethiopian MFIs need more studies to improve the performance of MFIs and to reduce the risk, Ameha (2008) & Eyob (2016). Therefore, in order to understand the governance practice that contributes to enhance the financial performance of MFIs in Ethiopia, this paper aimed to examine the impact of corporate governance on the financial performance of microfinance institution in Ethiopia.

1.3. Objective of the study

1.3.1. General objectives

The main objective of this research is to assess the impact of corporate governance on the financial performance of selected microfinance institution in Ethiopia specific variables using seven years data.

1.3.2. Specific objectives

The specific objective of this study is to analyze the relationship between corporate governance mechanisms are

1. To examine the relationship between board size and financial performance of selected MFIs.
2. To investigate the effect of board gender diversity and financial performance of selected MFIs.
3. To identify the influence of director's educational qualification of on selected MFIs financial performance.
4. To ascertain the influence of board members experience in the finance sector on selected MFIs of financial performance.
5. To find out the influence of meeting frequency of the board on selected MFIs of financial performance.
6. To identify whether female CEO effect on selected MFIs of financial performance.
7. To examine the impact of audit committee size in a board and financial performance of selected MFIs.

1.4. The study Hypotheses

Hypotheses is the proposition or a set for an explanation for the occurrence of some specified group of phenomena either asserted merely as provisional conjecture to guide some investigation or accepted as highly problem in light of established facts. Hypotheses are assertions of what the answer of the study's research questions will be (Schulte; 2011).

$H1_a$: Board size has a significant negative relationship with the financial performance of MFIs.

$H1_b$: Board Gender Diversity has a significant positive effect with the financial

Performance of MFIs.

H1$_c$: Educational qualification of the board members has a significant positive relationship with the financial performance of MFIs

H1$_d$: Board members experience in the finance sector has a significant positive relationship with the financial MFIs.

H1$_e$: Meeting frequency of board has a significant positive relationship with the financial Performance of MFIs.

H1$_f$: Female CEO has a significant positive relationship with the financial performance of MFIs.

H1$_g$: Size of audit committee in the board has a significant positive relationship with the financial performance of MFIs

1.5. The scope of the study

The scope of this study restricted to investigate the impact of corporate governance on financial performance of microfinance institutions. This study focused on selected microfinance institutions which are licensed and supervised by NBE and operating in Ethiopia. The study took seven years data from year 2010-2016 based on the availability of audited financial statement in NBE. . In addition the corporate governance variables that are selected to study are limited to board size, board gender diversity, educational qualification of directors, board members experience in the finance sector, meeting frequency of board, female CEO and Size of audit committee. Bit

1.6. Limitation of the Study

Regarding the limitation of the study it is well known that any study is not completely free from limitations. As a result, the researcher assumes that there are some sorts of limitations. The conceptual framework of the study was therefore, limited to examine the impact of corporate governance on financial performance of MFIs. The study has also been limited by the fact that most of MFIs were not willing to provide data to be used for the study and the researcher was forced to use data from 35 MFIs 12 MFIs which were willing to provide their data.

1.7 Significant of the study

This study is immense value to the institutions, regulators, investors, and academicians in the following ways.

- ✓ The study contributes to MFIs by identifying relevant internal corporate governance mechanism and how this governance affects financial performance.
- ✓ The government can use the study so as to come up with clear criteria of promoting CG of MFIs in Ethiopia and policy makers may find the study useful as a basis of formulating policies and procedures which can be effectively implemented for better and easier regulation of MFIs.
- ✓ The study also use for potential investor to develop selection criteria for their investments.
- ✓ Finally Researchers in particular and academic community in general can use this study as a stepping stone for further studies on MFIs CG issues.

1.8 Structure of the study

The study is organized in to five chapters. The first chapter included back ground of the study, statement of the problem, general and specific objective of the study, Hypotheses of the study, research questions, scope, limitation, significance and Structure of the study. Chapter two presents empirical and theoretical review of the literature related to the issue of impact of corporate governance on MFIs in Ethiopia, research gap and conceptual framework of the study. Chapter three provides research design & approach, sources of data & data collection techniques, target population &,sampling method, data analysis techniques and variables measurement, specification of empirical research model and Classical linear regression model assumptions. Chapter four contains result and discussion and Chapter Five includes Conclusions and Recommendation.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1. Concept of corporate governance and definition

In early 17th century, the concept of corporate governance doesn't exist. This is because in those days, ownership was divided into small number of people (partnership) who also participate in the operations of the organization, so they can easily control and safeguard their interest. (Ali, 2016).The study of corporate governance began with the work by Berle and Means (1932) cited as Coleman.A.K&Osei.K.A (2008) they tried to look at corporations and property rights. In that study, a fundamental agency problem in modern firms is described where there is a separation of ownership and control. The thrust of the argument is that firms are run by professional managers (referred to as agents) and are accountable to dispersed shareholders (referred to as principals). This view fits into the principal-agent paradigm where there is a divergence between the objective functions of firm managers and firm owners. In this scenario, the issue has always been how to ensure that the interest of shareholders and mangers are aligned ensuring a convergence of the different objective functions thereby reducing cost associated with principal-agent theory.

According to Rogers (2008),cited as Paul (2015) corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information Rogers (2008), stated that, corporate governance is about how to build trust and sustain confidence among the various groups that make up an organization. Depending up on the relative powers of owners, managers and capital providers, the concept of CG is defined and understood differently in different part of the world. A number of scholars have viewed corporate governance differently (Rediker, Seth, 1995; Shleifer, Vishny, 1997; and Keasey, Short, 2006). Maher, Anderson (1999), view corporate governance from two contrasting angles that is, the shareholder and the stakeholder model. Corporate governance in its narrowest sense (i.e. shareholder model) is used to describe the formal system of stewardship of the board to the shareholders. In contrast, in its widest sense (i.e. stakeholder model) CG is used to describe the network of relationships between an organization and its various stakeholders. However, it can be argued that there is no need for such a distinction since both the models have identified corporate governance as a network of relationships between a company and its public through which the board is held accountable.

Similarly, the hadbury Committee (1992) (as cited in Alexandra, Reed, Lajoux, 2005) defines corporate governance as the system by which companies are directed and controlled. The nature of corporate governance, therefore, going by this definition consists of two dimensions: direction and control. The direction side of corporate governance emphasizes the responsibility of the board to attend to strategic positioning and planning in order to enhance the performance and sustainability of the company. The control side of the definition, on the other hand, emphasizes the responsibility of the board to oversee the executive management of the company in the execution of the plans and strategies. Lukwago (2012) stressed that good corporate governance promotes efficient management and hence help to maintain the MFIs reputation and maintains the clients' trust. Adeusi et al (2013) argued that corporate governance places the structure, processes and management mechanisms to enhance the firm's performance. Corporate governance of companies, regardless of the nature of the business whether it is governmental, Non-Governmental or private, has become a popular discussion topic in developed and developing countries. Council of Microfinance Equity Funds (2012) stressed that sound governance in the MFI will keep an organization on track towards implementation of its major decisions. It further stressed that the sound governance will foster implementation of the MFIs goals and strategies and hence will maintain the MFI's health in terms of ensuring that it has the adequate human and financial resources and it will mitigate risks.

Corporate governance describes on how the organization should be operated based on the stakeholders' interests so as to improve firm performance Agumba (2008) cited in Magali &Lang'at (2014). Scholars assert that leaders following the good governance principles whether in MFIs or other institutions should operate in a democratic way. They should also act as stewards and agents for their clients, should use the organization resources and make good decisions for the benefits of clients and other stakeholders (Agumba 2008; Odera et al 2012; Lukwago 2012; Adeusi et al 2013). Lukwago (2012) as cited on Magali &Lang'at (2014). In the governance of Microfinance Institutions, a broad range of actors have an active role. It is possible to see these actors broadly as external or internal, according to their roles in the governance process. The external actors include: Entities that oversee the institutions' financial health, regulators and auditors, Providers of financing, shareholders, lenders, and depositors, Communities served by the institutions, Employees, and Clients. The internal actors include: The board of directors, senior management, and internal auditors, as they interact with the board although governance takes place in this broad context, the board of directors is the pivotal point through which all these players connect. (Kosgei, 2014).

2.2. Corporate governance in Ethiopia

According to NBE (2014), recent intended corporate governance guideline, corporate governance plays a vital role in maintaining the safety and soundness of financial system in financial sector in particular the benefit of corporate governances gives way to balanced risk taking and enhances business prudence, prosperity and corporate accountability with ultimate objective of realizing long term Shareholders value, borrowers and other stakeholders interest. Introduction and development of corporate governance in Ethiopia is therefore a necessary but revolutionary change in the ownership philosophies, management and operations of Ethiopia companies. It would help to dissolve financial and market access blockages but at the same time place far reaching requirements for revision of business practices by companies aiming at growth and prosperity for their owners and stakeholders.

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

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

Similarly, Fekadu (2010) argues that the regulation of NBE is not sufficient to protect minority rights, because the main objective of NBE is financial regulation and which is just one aspect of governance. The study conducted by the Addis Ababa and Ethiopia Chambers of Commerce and Pectoral Associations (2009) on corporate governance in Ethiopia suggests that the introduction of a voluntary code of corporate governance in the country. It recommends that corporate governance law reform should consider key development policy aspects which match with the countries plans for poverty reduction and wealth creation. Good corporate reporting and disclosure are important aspects of sound corporate governance. According to World Bank (2007) in Ethiopia, however, there is no particular accounting standard regarding financial reporting and disclosure in Ethiopia. Neither are any of the international standards officially adopted. Some of the laws indicate the use of generally accepted accounting principles. The absence of a particular accounting standard to be followed by all companies may be a drawback to the corporate governance practice in Ethiopia. Nonetheless, currently National Bank of Ethiopia is working to adopt the International Financial Reporting Standards (IFRS) to be followed by financial institutions operating in the country.

2.3. The Concept of Microfinance

According to Lukago Joel (2012), the founder of microcredit is Dr. Muhammed Yunus in 1976 in Bangladesh. The remarkable outreach of this movement in Bangladesh (which presently covers not only credit but also a number of financial and non-financial services) has shown that extending credit and financial services to the poor is feasible and profitable. The access of the poor to credit is also recognized as an important strategy in achieving the Millennium Development Goals of promoting gender equality, women's empowerment and poverty reduction. The World Development Report of 2000/2001 widely recommended the microcredit for poverty reduction and as a social safety net for the poor of the developing countries (World Development Report, 2001) cited in Eyob (2016). As of December 31, 2010, 3,652 microfinance institutions reported reaching 205,314,502 clients, 137,547,441 of whom were among the poorest when they took their first loan. Of these poorest clients, 82.3 percent, or 113,138,652, are women. (Microcredit Summit Report, 2012) cited in Eyob (2016). Microfinance is high on the public agenda after the UN Year of Microcredit in 2005 and the awarding of the Nobel peace prize to Dr. Yunus and the Grameen Bank' in 2006.

Microfinance is defined as the provision of financial services, mostly savings and credit to the poor and low income households that otherwise don't have access to mainstream commercial banks (Rock et al., 1998). Ledgerwood (1999) defines microfinance as the provision of financial services to low income clients. According to Robinson (2001) Microfinance is financial services primarily credit and savings provided to people who farm, fish or herd at a small scale and those who operate small enterprises. Microfinance industry is the primary source of credit and saving to low income earners. The industry is currently growing rapidly and how they are governed therefore matters (Kyereboah-Coleman & Biekpe, 2005). Stakeholders in the industry have recognized that good governance is an important element in the success of the MFIs (Campion, 1998); (Rock, 1998).

2.4. Microfinance Institutions in Ethiopia

The source of finance for micro enterprise in urban area and off and on farm activates in rural Ethiopia were confined only to informal sources of finance like moneylender, friends and relatives. Starting in the middle of 1980s following the drought of 1984/85, some non-governmental organizations (NGOs) introduced the idea of saving and credit among poor people's as a strategy for rehabilitation and development. Later on, special government programs operated mainly in collaboration with the international financial institutes came into the picture. Nonetheless, both type of program were operated in a scattered manner and lacked sustainability. (AEMFI, 2003).

The Ethiopian microfinance market is largely dominated by a few large MFIs which are owned by regional state governments. Since the first Proclamation of 1996 that gave the legal background for the operation of the micro-financing business in Ethiopia, the industry has witnessed a major boom. There are 34 MFIs registered with the National Bank of Ethiopia. The three largest Microfinance institutions; Amhara Credit & Saving Institute (ACSI), Dedebit Credit & Saving Institute (DECSI) and Oromia Credit & Saving S.C. (OCSSCO) account for 65% & 74% of the market share in terms of borrowing and loan provision, respectively.

Similar to microfinance approaches in many other parts of the world, MFIs in Ethiopia focus on group-based lending and promote compulsory and voluntary savings. They use joint liability, social pressure, and compulsory savings as alternatives to conventional forms of collateral

(SIDA, 2003). These institutions provide financial service, mainly credit and saving and, in some cases, loan insurance. The objectives of MFIs are quite similar across organizations. Almost all MFIs in the country have poverty alleviation as an objective. They focus on reducing poverty and vulnerability of poor households by increasing agricultural productivity and incomes, diversifying off farm sources of income, and building household assets. They seek to achieve these objectives by expanding access to financial services through large and sustainable microfinance institutions.

Microfinance institutions functioning currently in Ethiopia demonstrate a number of strengths. Some of the major strengths include:

- ✓ The service provision is centered on urban and rural poor community to particularly play a role in alleviating the chronic problem of poverty in those areas.
- ✓ The number of clients served is growing from time to time making it accessible for the needy partners.
- ✓ Regional distribution of the service is appreciable as microfinance institutions are operating in all regional states of the country.

However, there are still big challenges facing the microfinance industry in Ethiopia. The first challenge is the inaccessibility of foreign capitals which may foster their loan portfolio. As a result, many MFIs are limited to certain category of services. Lack of clarity in ownership structures persists specially in some MFIs where private investors are not the real owners of the MFIs though they are shareholders. Lack of skilled human power is also the common problem for Ethiopian Microfinance institutions and the industry is suffering from high turnover of experienced employees either for the need of better jobs or hates to work in rural areas where minimal facilities are provided as compared to urban areas which offer better living conditions (Yenesew 2012). The other challenge MFIs operating in Ethiopia are facing specially those microfinance institutions operating in remote rural areas having poor infrastructure development is limitation in terms of using modern core finance technologies and this has exposed them for non-standardized reporting and performance monitoring systems. On the other hand, MFIs face challenges of obtaining loans in the existing finance market particularly from banks and this hinder their strive for addressing various needs of their clients.

2.5 Corporate governance and microfinance institutions

According to Coleman.A.K&Osei.K.A (2008), traditionally, corporate governance has been associated with larger companies and the existence of the agency problem. Agency problem arises as a result of the relationships between shareholders and managers. Due to the separation between ownership and control of the firm, shareholders are faced with two choices at any point in time. The first, bothering on adverse selection, deals with their ability to select the most capable managers. The second, which is invariably moral hazard issues, bothers on the ability of shareholders to institute the right incentives for managers to align their objectives with that of the owners. The importance of governance for MFIs has assumed increasing importance. Because the grow of MFIs in their outreach, increase their assets, and in increasing numbers become regulated entities that can capture savings deposits, the change of ownership structure and the experience of some major failure has also played a very critical role in generating interest in the governance of MFIs.

2.6 Corporate Governance Issues specific to MFIs

MFIs have some unique characteristics that make the study of their governance more complicated. For example, they need to fulfill an outreach mission by serving poor clients, and many operate as NGOs, which makes them similar to non-profit firms. On the other hand, many MFIs are similar to banks because they are regulated or supervised by the same regulatory body and/or because they collect deposits. The organizational diversity of MFIs also makes the empirical study of their governance more difficult. This challenge is addressed by specifying several empirical models based on insights from the corporate governance literature, from the literature on governance in banks and from the literature on governance in non-profit organizations (Valentina, 2004).

2.6.1. Dual mission of MFIs

As the literature reveals, most MFIs originated with a mission that combines social and financial objectives. The social mission is to provide financial service to as many of lowest income groups among the population. On the other hand, the financial objective is to achieve financial self sufficiency that enables sustained service delivery without dependence on subsidies. The challenge hire is the difficult task of balancing social and financial objectives .i.e. reaching large numbers of very low income peoples whiles at the same time generating profit and attracting private investors. The assumption is that boards, through their own strategic decisions and polices, play a key role in assuring that the MFIs respond adequately to both objectives. (AEMFI, 2003)

2.6.2 Ownership structure of MFIs in Ethiopia

Ownership of financial institutions in Ethiopia is set aside for Ethiopian nationals only. Proclamation No.84/1994 clearly states that financial institutions including MFIs should be owned by Ethiopian nationals. In other words, foreigners are not allowed to participate in the MFIs; however, they can support the MFIs by providing fund as part of their objective of alleviating poverty and support development activities in the country. Amaha (2000) and SIDA (2003) claim that restriction of ownership in MFIs to Ethiopian nationals has led to the existence of nominal shareholders who nominally hold shares effectively provided by foreigners, and who do not have real stake in the MFIs. The ownership structure of the microfinance institutions (MFIs) is characterized by a mixture of regional government, local NGOs, associations and individuals. The majority of MFIs are in reality owned either by NGOs or Regional Governments. Individual owners except in very few cases have merely posed as owners at the request of either an NGO or Regional Governments and the ownership arrangements basically reflecting the promoters /investors behind them. ACSI, ADCSI, Benshangul, DECSI, Omo and OCSI are predominantly owned by regional government. When we look the percentage share of respective regional governments, ADCSI and Omo are largely owned by their respective regional governments with ownership share 96.7 percent and 80 percent respectively while ACSI, DECSI, and OCCSI have similar ownership with the same share of regional governments (25 percent) and for Benshangul 40 percent. On the other hand, AVFS, Agar, Metemamen, Shashemene, and Wisdom are truly individual owned MFIs in which owners expect profit from their share contribution. Bussaa, Eshet, PEACE and Wasasa are also institutions where individual ownership is high. According to Bienen et al. (2009) in many of the investor- owned MFIs (regional or NGOs), those classified as ‘individual shareholders’ are not the real owners with personal stake in the MFIs in the sense that they actually paid for the shares, hence have something to lose. Instead, the funds for the shares were actually contributed by the institutions/NGOs promoting the MFIs and the individuals are merely acting as nominal shareholders representing these institutions so as to satisfy the legal requirements of establishing them as share companies with at least five shareholders

2.6.3. Issues of the Board of Directors

Board members are not the owners of invested capital in most of MFIs in Ethiopia. Since they do not have a financial stake in the institutions, they need other positive incentives (Wolday, 2000). The lack of professionalism and MFI expertise and experience on some boards is also another issue. Board members often are civil servants, social workers, and NGO representatives. While they often have a strong commitment for poverty alleviation and development, many board members do not have sufficient experience, skill and proper mix to oversee the policies and efficient management of MFIs. While they are dedicated and committed, they may not always have a businesslike approach. These concerns necessitate a need for restructuring boards (to have mix of competencies required); need for training board members and need for regular assessment of MFI board structure.

2.6.4. Other governance issues

In its 2000 working paper, Association of Ethiopian Microfinance Institutions (AEMFI) argues that governance issues are fundamentally the same in MFIs supported by regional governments and in others supported mainly by international NGOs. The report asserts that almost all MFIs in Ethiopia have government support and depend on donor support as a major source of loan funds. While this point may be well taken, it begs the question of a political overlay in MFIs ownership and policies and the possible use of public resources (donor funds) and state infrastructure to support a political agenda. Governance and ownership issues would be important to pursue in the context of moves towards privatization and the creation of rural micro-banks in the country.

2.7. Theoretical Review for Corporate Governance

Corporate governance is the relationship among shareholders, board of directors and the top management in determining the direction and performance of the corporation. It includes the relationship among the many players involved (the stakeholders) and the goals for which the corporation is governed (Kim & Rasiah, 2010). According to Imam and Malik (2007) the corporate governance theoretical framework is the widest control mechanism of corporate factors to support the efficient use of corporate resources. The challenge of corporate governance could help to align the interests of individuals, corporations and society through a fundamental ethical basis and it fulfills the long term strategic goal of the owners. It will certainly not be the same for all organizations, but will take into account the expectations of all the key stakeholders (Imam & Malik, 2007). To maintaining proper compliance with all the applicable legal and regulatory requirements under which the company is carrying out its activities is also achieved by good practice of corporate governance. There are a number of theoretical perspectives which are used in explaining the impact of corporate governance mechanism on firm's financial performance. The most important theories are the agency theory, stakeholder's theory and resource dependency theory (Maher & Andersson, 1999).

2.7.1. Agency Theory

According to Daily, Dalton, Canella (2003), cited as Pual (2015) there are two factors that influence the importance of agency theory. Firstly, the theory is a conceptually simple one that reduces the corporation to two participants, managers and shareholders. Secondly, the notion of human beings as self-interested is a generally accepted idea.

In its simplest form, agency theory explains the agency problems arising from the separation of ownership and control. It "provides a useful way of explaining relationships where the parties' interests are at odds and can be brought more into alignment through proper monitoring and a well-planned compensation system" (Davis, Schoorman, Donaldson, 1997:24).

Agency theory is the most popular concept and has received greater attention from academics and practitioners (Habbash, 2010).The agency theory is based on the principal agent relationships. The separation of ownership from management in modern corporations provides the context for the functioning of the agency theory. In modern corporations the shareholders (principals) are widely dispersed and they are not normally involved in the day to day operations and management of their companies rather they hire mangers (agents) to manage the companies on behalf of them (Habbash, 2010). The agents are appointed to manage the day to day operations of the corporation. The separation of ownership and controlling rights results conflicts of interest between agent and principal. To solve this problem or to align the conflicting interests of managers and owners the company incurs controlling costs including incentives given for managers.

In performing this role, members are expected to be independent and monitor the actions of managers as agents of the owners to ensure they are acting in accordance with the owners' interests (Jensen & Meckling, 1976). The theory suggests that board composition is important for effectively monitoring top management. Boards have to be diverse in terms of skills, experience, and gender balance. This creates a balance on boards and leads to effective monitoring and subsequently to the successful performance of the organization.

The concept of corporate governance presumes a fundamental tension between shareholders and corporate managers (Jensen & Meckling, 1976). While the objective of a corporation's shareholders is a return on their investment, managers are likely to have other goals, such as the power and prestige of running a large and powerful organization, or entertainment and other perquisites of their position. Managers' superior access to inside information and the relatively powerless position of the numerous and dispersed shareholders, mean that managers are likely to have the upper hand (Fama & Jensen; 1983).

Therefore, shareholders monitor and controls managers through their representatives such as board of directors. Boards of directors are considered as an important device to protect shareholders from being exploited by managers and help to effectively control managers when they try to maximize their self-interest at the expense of the company's profitability. Fama and Jensen (1983) argues that in order to minimize agency problem that emanates from the separation of ownership and control the corporations need to have a mechanisms that enables to separate the authority of decision management from decision control. This would reduce agency costs and ensures maximization of shareholders wealth by effectively controlling the power and self-centered decisions of management. From agency theory view point, corporate governance improves corporate performance by resolving agency problems through monitoring management activities, controlling self-centered behaviors of management and inspecting the financial reporting process (Habbash, 2010). Moreover, corporate governance is able to alleviate agency costs by aligning the conflicting interests of management and shareholders through monitoring management and using different corporate governance mechanisms. Therefore, corporate governance mechanism such as boards of directors and audit committees enables shareholders to closely monitor the activities of managers. Ineffective board and audit committee may give confidence for managers to pursue their own interests but effective board and audit committee can reduce deceptive behavior of managers by detecting fraudulent financial report and actively monitoring. According to the assumptions of agency theory corporate governance affect financial performance. As a consequence, enhancing corporate governance should result in improved financial performance. Taking agency theory into consideration, the study variables were identified with the aim of examining the impacts of corporate governance mechanism on financial performance. Board structure has relied heavily on the concepts of agency theory, focusing on the controlling function of the board (Habbash, 2010). The corporate governance mechanism variable considered in this research include board size, board gender diversity, Educational Qualification of Directors, CEO/Chairperson Duality, Board Experience in the Finance Sector, board frequency of meeting, Female CEO, and Audit Committee Size.

2.7.2. Stakeholders theory

The significance of stakeholder theory is that it recognizes that organizations are not controlled or affected purely by those that exercise ownership rights in the organization. As Freeman et al. (2004) argued the notion that shareholders govern the corporation is largely a fiction; typically, executives have the greatest power. In this sense the conventional model of the corporation, in both legal and managerial forms, has failed to discipline 'self-serving' managerial behavior. The fundamental consequence of stakeholder theory for corporate governance is that it necessitates governance structures that promote alignment not just between agents and principals, but between agents, principals and parties who have broader, but reasonable, interests in the organization. It is precisely because of this multifaceted approach to understanding corporate governance that corporate governance should be responsive to multiple, competing interests, which provide intellectual rigor to a stakeholder framework.

According to Habbash, (2010) stakeholder refers to any one whose goals have direct or indirect connections with the firm and influenced by a firm or who exert influence on the firms goal achievement. These include management, employees, clients, suppliers, government, political parties and local community. According to this theory, the stakeholders in corporate governance can create a favorable external environment which is conducive to the realization of corporate social responsibility. Moreover, the stakeholders in corporate governance will enable the company to consider more about the customers, the community and social organizations and can create a stable environment for long term development. The benefit of the stakeholder model emphasis on overcoming problems of underinvestment associated with opportunistic behavior and in encouraging active co-operation amongst stakeholders to ensure the long-term profitability of the business firm (Maher & Andersson, 1999). According to Coleman (2007) management receive capital from shareholders, they depend upon employees to accomplish the objective of the company. External stakeholders such as customers, suppliers, and the community are equally important, and also constrained by formal and informal rules that business must respect. According to stakeholders theory the best firms are ones with committed suppliers, customers, employees and management. Recently, stakeholder theory has received attention than earlier because researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders (Coleman, 2007). Companies are no longer the instrument of shareholders alone but exist within society. It has responsibilities to the stakeholders. However, most researchers argue that it is unrealistic task for managers (Sundaram & Inkpen, 2004 Sanda, et al., 2005). The stakeholder theory has not been subjected to much empirical study. The common criticisms for stakeholder theory is that how to align the stakeholders conflicting interests since the difficulties result from how to administer different stakeholders with various needs and demands. It is not possible to treat all stakeholders equally (Habbash, 2010). Moreover, it is not practical for all stakeholders to be effectively represented in corporate governance recommendations as this may undermine the welfare of company (Habbash, 2010). The other critique of the stakeholder model is that managers or directors may use "stakeholder" reasons to justify poor company performance (Maher & Andersson, 1999).

2.7.3. Resource dependency theory

According to the resource dependency theory, directors bring resources such as information, skills, key constituents (suppliers, buyers, public policy decision makers, social groups) and legitimacy that will reduce uncertainty which in turn reduces the transaction cost and the potential of linking the organization with the external networks. This provides opportunity to gather more information and even skills in various specialties. Lawrence and Lorsch, (1967) linked the resource dependency theory as an environmental influence on corporate governance and they argued that successful organizations possess internal structures that match external environmental demand. Pfeffer, (1972) confirmed this argument and explained that board size and its composition is a rational organizational response to the conditions of the external environment and he further argued that external independent directors may serve to connect the external resources with the firm to overcome uncertainty, which is very important for long term sustainability. This was emphasized in the corporate governance which explains that a majority of external members could bring the most needed business skill into institutions. Further resource dependency theory was supported through appointment of external members to the board as a way of obtaining multiple skills and because of their opportunities to gather information and networking in various ways.

Each of the three theories is useful in considering the efficiency and effectiveness of the monitoring and control functions of corporate governance. But, many of these theoretical perspectives are intended as complements to, not substitutes for, agency theory Habbash (2010). Among the various theories discussed, agency theory is the most popular and has received the most attention from academics and practitioners. According to Habbash (2010), the influence of agency theory has been instrumental in the development of corporate governance standards, principles and codes. Mallin (2007) provides a comprehensive discussion of corporate governance theories and argues that the agency approach is the most appropriate because it provides a better explanation for corporate governance roles (as cited by Habash, 2010).

2.7.4. Stewardship theory

In contrast to agency theory, stewardship presents a different model of management, where managers are considered good stewards who will act in the best interest of the owners (Donaldson & Davis, 1991). The fundamentals of stewardship theory are based on social psychology, which focuses on the behavior of executives. The steward's behavior is pro-organizational and collectivists, and has higher utility than individualistic self-serving behavior and the steward's behavior will not depart from the interest of the organization because the steward seeks to attain the objectives of the organization (Davis; Schoorman & Donaldson, 1997). Thus the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control (Davis; Schoorman & Donaldson, 1997). Therefore stewardship theory takes a more relaxed view of the separation of the role of chairperson and CEO, and supports appointment of a single person for the position of chairperson and CEO and a majority of specialist executive directors rather than non-executive directors (Clarke 2004).

2.8 .Empirical Studies on Corporate Governance and financial Performance of MFIs.

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

Ahmad Nawaz and Sana Iqbal (2015) provide evidence models of the two-way relationship between corporate governance and financial performance of microfinance institutions of Asia. Using a panel of 173 microfinance institutions in 18 Asian countries between 2007 and 2011, a comprehensive corporate governance index (CGI) based, on seven corporate governance variables(Board size, Presence of Female Boards, Board Qualification, Local Directors, CEO/Chairman Duality, Female CEO, and Ownership Type) is being constructed as a proxy for the overall corporate governance mechanism of MFIs. The results suggest that corporate governance has no significant impact on financial stability of MFIs of Asia. However, financial performance to some extent does drives corporate governance mechanisms in MFIs after controlling for MFI related characteristics. We find greater operating expenses and higher portfolio yield to be associated with improved governance practices in microfinance institutions. Study opens new avenues of research in corporate governance and financial performance literature for the academia. Given the revealing results of financial performance as a determinant of better corporate governance practices, policy makers and regulators in Asia should devise corporate governance policies and guidelines in a way not undermining the financial objectives of microfinance.

Jacqueline C.Siele (2013) investigated the relationship between corporate governance practice and MFIs performance. The objective of the study is to determine the effect of corporate governance on the performance of Microfinance Institutions in Kenya by looking at how the following variables affect the MFI performance: CEO duality, board gender diversity, board size, board independence and ownership structure of the MFIs. The study used panel data of 35 MFIs and three years (2009-2011). Regression analysis and presentation was used. The study found that a positively significance relationship between the ownership structure and the MFIs financial performance. The relationship between CEO duality and the MFI financial performance is also positive significance. The study also found a negative relationship between the board gender diversity and board independence on MFI performance. Although the results of the board size shows a positive but not significant with MFI performance. The study concluded the ownership structure is very important component for the microfinance industry in Kenya since it has a positive effect on the financial performance of the MFIs. This implies that the preference ownership structure is a shareholder held MFI. CEO duality also has a positive relationship with MFI performance. This implies that MFIs in Kenya prefer when both positions are separated and not held by the same individual. The study recommends that MFIs ownership structure should be shareholder held since it impacts positively their performance. This will also make these MFIs independent from the donors. The study recommends further study on the board size since the number of board members does not have an effect on the financial performance of the MFI but rather the diverse expertise that the board members are bring on board so as to add value to the MFI which will also boost its performance.

Mohammed Abdi et al (2014) studied the effects of corporate governance on Microfinance Institutions financial sustainability in Kenya over a period of eleven years from 2000-2011. For this study explanatory research design was used in trying to establish the causal effect relationship between corporate governance variables (which were; board size, CEO duality, composition of the board and CEO gender diversity) and the financial sustainability of the MFIs in Kenya (measured using ROA). According to the study corporate governance practices plays an important role in the operation of Microfinance institutions for enhanced financial sustainability and the findings of the study revealed that board diversity of a moderate board size with a considerable number of women is better placed to ensure independence of the board hence boosting financial performance. From the study it was also clear that MFIs boards could enhance financial sustainability by having directors with diverse expertise and skills. A moderate board size is likely to improve whereas more diverse board is likely to have better relations with other stakeholders. According to the findings of CEO duality, it was established that separation of board chairman and CEO positions is vital in MFIs because this minimizes the tension between CEO and board members thus influencing positively on the financial sustainability of MFIs and it also reduces conflict of interest from the CEO.

Belete Zegeye(2015) investigated the impact of corporate governance on Microfinance Institutions financial Performance in Ethiopia over a period of seven years from 2007/08-2013/14. Explanatory research design was used in trying to establish the causal effect relationship between corporate governance variable (which were; board size, board gender composition, board competency, board experience in the finance sector, meeting frequency of , size of audit committee, CEO duality, and CEO gender) and the control variable (size of MFIs) was added. The financial performance measure was Return on Asset. 10 MFIs was selected as a sample from 35 licensed MFI from NBE. The study utilized panel data analysis methodology in drawing conclusions about the study. It was found that the average board size was 6 members, the average board member who had college degree or higher was 7 member, average female director was 1, average annual meeting was 7 and average size of audit committee was 1 with 20 % of the institutions having the CEO double up as the board, 20% of the institutions surveyed had a female CEO. Empirical findings confirmed that board size, board competency, board experience in the financial sector and meeting frequency of board has a significant impact on the financial performance of Microfinance Institutions. However, size of audit committee has a significant negative relationship with the financial performance of Microfinance Institutions. Board gender composition, CEO duality and CEO gender does not have significant impact on the financial performance of Microfinance Institutions

The study was conducted by Eyob Melkamu (2016) and focused On the effects of corporate governance mechanisms on the financial performance of Ethiopian MFIs. From the total of 34 MFIs which are operating in the country, five MFIs have been selected by using purposive sampling technique and he employed panel data from year 2005 to year 2014.six corporate governance variables (board size, educational qualification of boards, audit committee size, board gender diversity, business management experience of boards and industry specific experience of boards) have been used for the study. On the other hand, financial performance was measured using two variables (return on asset and return on equity). The researcher also used leverage, growth and capital adequacy ratio of MFIs as control variables. The type of research is quantitative research approach and multiple linear regression models for two profitability measures (ROE and ROA).The empirical result shows board size, gender diversity and size of audit committee have negative and significant relationship with performance of MFIs while industry specific experience and educational qualification of the board have positive relationship; and the effect of business management experience of directors on performance is inconclusive. Based on the result, the study recommended that board and audit committee sizes should be kept low. Gender diversity of the board should also be maintained and attention should be given for the capacity development of women.

2.9 The effect of corporate governance mechanisms on financial performance of MFIs

Effective corporate governance system is necessary for any company who wants to put and meet its strategic goals. A corporate governance system is regularly a mixture of various systems. Corporate governance systems are the procedures employed by companies to solve corporate governance problems; however, the use of these mechanisms depends on the corporate governance system (Weimer & Pape, 1999). Mechanisms for corporate governance can be divided into two parts: internal and external mechanisms (Fan, Lau & Wu, 2002).

The leading sets of controls for a corporation come from its internal mechanisms. These controls watch the development and actions of the business and take corrective actions when the business goes off track. These objectives include smooth operations, clearly defined reporting lines and performance measurement systems. Internal mechanisms include oversight of management, independent internal audits, structure of the board of directors into levels of responsibility segregation of control and policy development (Fan, Lau & Wu, 2002).

External control mechanisms are controlled by those outside an organization and serve the objectives of entities such as regulators, governments, trade unions and financial institutions. These objectives include adequate debt management and legal compliance. External organizations, such as industry associations, may suggest guidelines for best practices, and businesses can choose to follow these guidelines or ignore them. Typically, companies report the status and compliance of external corporate governance mechanisms to external stakeholders (Fan, Lau & Wu, 2002).

Corporate governance mechanisms are essential tools needed in managing any corporation including MFIs. There are different mechanisms that reduce agency cost whereby corporate governance can be measured in an organization and some of the characteristics improved firms' financial performance. International organizations such as Organization for Economic Cooperation and Development (OECD, 2004)) have developed corporate governance principles which stressed on the role of boards. So that it is important to adopt sound corporate governance mechanism in order to reduce information asymmetry problem and to improve controlling of management. A strong board can play an important role in improving firm financial performance and can help the firm to achieve better performance by effectively undertaking their monitoring duties (Bathula, 2008). Boards of directors are the agent of the shareholders and perform their task of monitoring and controlling the activities of firms' top management on behalf of shareholders to reduce agency problem (Jensen and Meckling, 1976). According to agency theory, boards have played critical role in solving the agency problems. When the board is effective it is expected to drive the company towards better financial achievement (Andres and Vallelado, 2008).

The board of directors is highly significant for shareholders as an internal control mechanism and its financial performance can be affected by board composition and quality, size of board, board diversity, and board committee effectiveness such as audit committee and information asymmetries (Uadiale, 2010). However, the effectiveness of the board of directors can only be efficient if bounded with appropriate size, composition and Audit committee (Lawal, 2012).

Audit committee is one of the sub-committee of the board of directors and its primary role is to monitor and review financial statements (Yammeesri and Herath, 2010). It also ensures the interests of shareholders are properly protected in relation to financial reporting and internal control (Habbash, 2010). Monitoring is performed by external audit and audit committees. The existence of an audit committee improves the monitoring of corporate financial reporting and internal control, it uses as a decision control system and it helps to promote good corporate governance in turn this improves firms financial performance by reducing agency cost (Al – Saeedand Al-Mahamid, 2011).

Based on theoretical studies the research variable was identified specifically on agency theories. According to (Habbash, 2010), board structure is heavily relay on the concept of agency theory, focusing on the controlling function of board. In addition to this, the issue that specifically related on the Ethiopian MFIs is considered to select the research variables. And lastly mixed result on the previous research are base to identify the research variables of the paper. The corporate governance elements considered on this researcher include Board size, Board gender diversity, Educational qualification of directors, board members experience in the finance sector, meeting frequency of board, Female ECO and Audit committee size.

2.9.1. Board Size

Board size is the number of members on a board. There is a belief that the number of directors can affect the performance of a company, especially its financial performance. A number of scholars have contended that larger boards have their benefits and when board size increases firm performance also goes up as more board members provide greater monitoring, advice and make available better linkages to the external environment (Adams & Mehran, 2003; Coles, Daniel, & Naveen, 2008; Hillman & Dalziel, 2003; Klein, 1998; Pfeffer, 1972).

It is easier for larger boards to monitor their managers' activities more effectively, but it would be difficult for the CEO to contact the board (Pearce & Zahra, 1989). Due to the complexity of the organization, the CEO of the organization needs many advocates (Klein, 1998). In non-profit organizations, when the board has a higher number of trustees, it is easy for them to deal with operational issues and wield more control over operating activities (Oster, 1995). Also, charitable organizations can improve their efficiency with larger boards (Tinkelman, 1999). Mersland and Strøm (2009) note in their MFI study that most MFIs have a board of seven to nine directors. Bassem (2009) states that large boards with a range of expertise provide better performance for MFIs. However, Yermack (1996) points out larger boards are related with lower performance for MFIs. The appropriate number of board members has been a matter of continuing debate and research gives mixed results (Dalton, Daily, Johnson, & Ellstrand, 1999; Hermalin & Weisbach, 2003; Jensen, 1993; Yermack, 1996). It can be seen that the number of members on a board influences firm performance as numbers affect the ability of the board to carry out its functions.

Small board size is considered efficient control mechanism because when number of director increases beyond seven or eight, their performance decreases (Jensen, 1993). According to Lipton and Lorsch (1992), when board size increases beyond ten members, it becomes difficult for all members to express their opinions. In the perspective of microfinance, board size of seven to nine members is considered ideal and five to eleven members is considered effective (council of microfinance equity funds, 2012). Hartarska and Mersland (2012) found evidence of improved performance in MFIs with board size of up to nine members. Therefore, it is important to consider board size for further studies for differently structured firms such as MFIs.

2.9.2 Board Gender Diversity

Enobakhare (2010),defined board diversity is the mixture of men and women, people from different age groups, people with different racial backgrounds and ethnic groups. The topic is highly debatable that puts more emphasis on, gender diversity, i.e. the inclusion of women on corporate boards of directors, considered as an instrument to improve board variety and thus discussions. It is computed as the total number of women in the board over the board size over a period. According to OECD principles of corporate governance (2004), one of the responsibilities of board of directors is ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards. In order to fulfill their responsibilities; there is a need for gender diversity in the composition of the board.

In recent years, the phrase ‘board diversity’ has become entrenched in the corporate governance vocabulary. The Alliance for Board Diversity in 2010 found that 72.9 per cent of directorships in Fortune 100 companies were held by white men and the rest were held by minorities and women. The board diversity concept suggests that boards should reflect the structure of society and properly represent the gender, ethnicity and professional backgrounds of those within it. Boards of directors in a company need to have the right composition to provide diverse viewpoints (Milliken & Martins, 1996). Board diversity supports on the basis of moral obligation to shareholders, stakeholders and for commercial reasons by obtaining extensive decisions (Daily & Dalton, 2003; Kasey, Thompson, & Wright, 1997; Mattis, 2000).

Gender diversity is considered part of the broader conception of board diversity (Milliken & Martins, 1996) and many scholars (Huse & Solberg, 2006; Singh & Vinnicombe, 2004; Walt & Ingley, 2003) have shown that few women sit on corporate boards. Even though Daily, Certo, and Dalton (2000) found similar results in USA, they also found that women's representation on boards is gradually increasing. Most women directors are not from the corporate sector but are usually outsiders or non-executive directors (Hillman, Cannella, & Harris, 2002). When compared to men, most women directors possess staff/support managerial skills, such as legal, public relations, human resources and communications rather than operating and marketing skills. However, gender is one of the most discussed issues, not only in the corporate governance research but also in political and societal environments. Several scholars have empirically tested the consequences of women directors on firm performance (Carter, Simkins, & Simpson, 2003; Farrell & Hersch, 2005; Fields & Keys, 2003; Smith, Smith, & Verner, 2006).

According to Smith et al. (2006), women directors on boards have a significant positive impact on firm performance. Carter et al. (2003) find a positive relationship between gender diversity and firm performance. In the MFI context, Bassem (2009) notes that board diversity with a higher percentage of women enhance MFI performance.

Based on the indication given by many empirical studies, it is important to further explore the impact of gender diversity of boards on MFI performance as it leads to better corporate governance provides diverse viewpoints, values and new ideas to the boards and provokes lively boardroom discussions (Burke, 1997; Daily, Certo, & Dalton, 1999; Huse & Solberg, 2006; Pearce & Zahra, 1991; Singh & Vinnicombe, 2004).

2.9.3. Educational Qualification of Directors

Educational Qualification refers to Board Competency of individual board members. Qualifications of individual board members are important for decision making. Board members with higher qualifications benefit the firms through a mix of competencies and capabilities which helps in creating diverse perspectives to decision making. Presence of more qualified members would extend knowledge base, stimulate board members to consider other alternatives and enhance a more thoughtful processing of problems. It is measured by the number of board members who had at least college degree to the total number of board members. Higher the number of educated directors in organizational contexts is positively related to receptivity to innovation, creativity, and better strategic decision making. Director's educational qualifications are central to effectively interpret and utilize the information generated by the management. (Abdurazak Harun, 2017)

Members with higher educational qualifications in general and research and analysis intensive qualification like PhDs in particular will provide a rich source of innovative ideas to develop policy initiatives with analytical depth and rigor that will provide for unique perspectives on strategic issues (Joel, 2012). Poon, Heong and Lee (2013) find that there is positive relationship between performance and the qualifications of directors. Their finding supports the belief that the board of directors who have qualifications in business-related disciplines such as banking, auditing, legal, accounting, business administration, information technology, investment management or finance, improved higher firms performance. These qualified directors chose to increase firm performance to promote corporate image, and demonstrate accountability and credibility within the board of directors. Personal profile factors of directors such as education and experience is important for board efficiency. Hence, less qualified directors are possibly less effective than directors with business qualifications (Ferreira, 2010). Therefore, it is important to consider educational qualification of board members for further studies for differently structured firms such as MFIs.

2.9.4. Board Members Experience in the Finance Sector

Board experience in the finance sector refers to board member who had any finance related work experience. Ayalew(2007) cited in Belete,(2016) stated that in Ethiopia, Board members of most MFIs do not have awareness and hence do not apply best practice corporate governance in their MFIs. Appointing directors with related and relevant skills and knowledge to perform task specific duties such as the firm's internal control and procedures will enhance the quality of information gathered and the solution to problems and of the views held and judgments made during the decision-making process (DeZoort, 1998 as cited by Saat et al 2011). The financial experience of directors enables them to guide, steer and monitor the firm more effectively. In other words, their knowledge of the industry, its opportunities and their connections to the industry participants based on their experience enables them to contribute substantively in the firm performance. Therefore it is important to consider board members experience in the finance sector for further studies.

2.9.5. Meeting frequency of Board

Meeting frequency refers to how much time Board meet on a year. For the board to effectively perform its oversight function and monitor management performance, the board must hold a regular meeting. Measuring the intensity and effectiveness of corporate monitoring and discharging is the frequency of board meetings (Jensen M., 1993).

Empirical findings on the effect of frequent board meetings and corporate performance show mixed results. Some studies concluded more meeting frequency has a negative impact on the performance of MFIs. Vefeas, (1999) reported a statistical significance and negative association between frequency board meetings and corporate performance. He also finds that operating performance significantly improves following a year of abnormal board activity. Meeting Frequency has a significant negative impact on ROA and an increasing in meeting frequency will reduce the ROA. (Ms.S.Danoshana & Ms.T.Ravivathani, 2013). Moreover, Akpan, (2015) found that board meetings negatively and significantly relate with company performance. Another study conducted on public listed companies in Malaysia using five years data 2003 to 2007 of 328 companies, shows that the higher the number of meetings the worse the firm performance (Amran, 2011). Whereas, Karamanou et al (2005) found a positive association between frequency board meeting and management earnings forecasts, using a sample of 157 firms in Zimbabwe from 2001-2003; Mangena & Tauringana (2008) report a positive relationship between board meeting frequency and corporate performance. Similarly in a study of the sample of 169 listed corporations from 2002-2007 in South African, a statistical significant and positive association between the frequency of board meeting and corporate performance exist (Ntim & Osei, June 2011). This implies that the board of directors in South Africa that meet more frequently tend to generate higher financial performance. Moreover, Ntim & Osei (2011) found a statistically significant and positive association between the frequency of corporate board meetings and corporate performance, implying that South Africa boards that meet more frequently tend to generate higher financial performance. Therefore it is important to consider meeting frequency of board for further studies.

2.9.6. Female CEO

Evolutionary Biology literature indicates that women are specialized in different tasks as a result of the requirements of nature. According to (Azmi & Barrett, 2013), Women have important characteristics like meticulous, risk averse, skilled in accounting and finance, and good decision-makers which is necessary for good governance. This makes several researchers to have recently focused on the effects that female executives and directors may potentially have on the firm's financial performance and market value.

Boehe and Cruz (2013) found evidence of improved performance in MFIs having more female members. Many MFIs in Asia that work with the mission of women empowerment mandate could benefit by bringing female membership at all levels of the management including its executive level (Campion et al. 2008) as female CEO is better able to gather information from females then a male CEO (Mersland and strom, 2009). Even in sectors other than microfinance, presence of females in the top management team has been linked with the improved financial performance in the literature (Welbourne, 1999). Therefore it is important to consider Female CEO for further studies.

2.9.7 Audit Committee Size

An audit committee is an operating committee of the board of directors charged with oversight of financial reporting and disclosure. Committee members are drawn from members of the company's board of directors, with a Chairperson selected from among the committee members. Its role includes choice and monitoring of accounting principles and policies, overseeing appointment, dismissal of external auditors, monitoring internal control process, discussing risk management policies and practice with management and overseeing the performance of internal audit function.

According to Jensen and Meckling, (1976) the audit committee plays a significant role in the monitoring process carried out by the directors of the firm and auditing is used by firms to reduce agency costs. In addition to that they revealed that most essential board decisions originate at the committee level, and this includes the audit committee. Audit committees thus, represent another internal governance mechanism whose impact is to improve the quality of financial management of a company and hence its performance. Coleman (2007) reported a significant positive relation between size of the audit committee and firm performance (ROA and Tobin "s q) using the overall sample. Coleman, (2007) describe that size of the audit committee could be an indication of the seriousness attached to issues of transparency by the organization. However, only using Ghanaian sample the size of the audit committee showed a negative effect on performance. He explained as free-ridership and difficulty in consensus building in large groups leads to low performance. In addition, Lin et al (2006) found significant positive association between audit committee size and occurrence of earnings restatement. It was explained that a certain minimum number of audit committee members may be relevant to the quality of financial reporting. Aldamen et al. (2011) reveals that smaller audit committees with more experience and better educational qualifications are more likely to be associated with positive firm performance. Therefore it is important to consider size of audit committee for further studies.

2.10. Summary and Research Gap

Corporate governance is important in all organizations regardless of their industry, size or level of growth. Good CG has a positive economic impact on the institution in question as it saves the organization from various losses such as those occasioned by frauds, corruption and similar irregularities. Besides it also stimulate entrepreneurial innovation enabling the organization to better seize the economic opportunities that come its way. The main CG themes that are currently receiving attention are adequately separating management from the board to ensure that the board is directing and supervising management, including separating the chairperson and chief executive roles ensuring that the board has an effective mix of independent and non independent directors and establishing the independence of the auditor and therefore the integrality of financial reporting, including establishing an audit committee of the board. The aim of good CG is to increase profitability and efficiency of the organization and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders.

Thus the main tasks of CG refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

The studies cited in the literature mostly concentrate on the developed countries whose strategies and CG system are not similar to that of Ethiopia. In Ethiopia, some studies done on the effect of CG on financial performance on bank industry like Ferde,(2012), Kass et.al.(2013),Abdurazak (2016).According to Bird (2005),a design feature that works will in one country /industry may not work in other, this may be referred to as NO-ONE-SIZE-FITS-ALL(the NOSFA) principles, i.e. best policy or administrative design for each country /industry has to be determine carefully in light of the condition and objective of that country/industry.

There are very few researches in numbers as cited in the literature above on the regard of microfinance industry .Belete (2015) and Eyob (2016). The empirical analysis of good CG practices in relation to MFIs is still at young stage and it is important to conduct more studies in the field to enhance MFIs' development. The previous research recommended for further study by incorporating additional variables, increasing sampling size and extending the period of year's data. Furthermore the contradictory conclusion that results from the previous studies call for a detailed investigation to be conducted in the area.

Generally, earlier studies had some gap like there was insufficient in sampling, and they have mixed results. The lack of sufficient research on the effect of internal CG mechanism on MFIs financial performance in the context of Ethiopia and the existence of knowledge gap in the area are the cause for undertaking this study. To come up with a better insight and be more robust; this study cover by assessing and including selected internal corporate governance mechanism, by increasing the number of observation through the use of large sample size . And this study has a contribution to the literature and provides empirical evidence on the impact of CG mechanism on financial performance of Ethiopian MFIs.

2.11. Conceptual Framework of the Study

Table 2.1 conceptual framework of the impact of CG in financial performance of MFIs

	INDEPENDENT VARIABLE	**DEPENDET VARIABLE**	**CONTRALVARIABLE**
1	Board size	ROA	SIZE
2	Board gender diversity		
3	Educational Qualification of Directors		
4	Board members Experience in the Finance Sector		
5	Board frequency of meeting		
6	Female CEO		
7	Audit Committee Size.		

Sources: researcher own construction based on different related review Literature.

Some of these are (Bathula, 2008, Belete, 2015, and Abdurazak, 2016).

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1 Research design and approach

The methodology to carry out the research is based on the objectives of the paper and the availability of relevant information. To confirm to the objective of this research, the primary aim of this study is to examine the impact of corporate governance on Ethiopian microfinance institutes financial performance. To achieve these objectives the study employed an explanatory research design with quantitative approach. The explanatory type of research design helps to identify and evaluate the causal relationships between the different variables under consideration. According to Creswell (2003) there are three common approaches to business and social research namely, quantitative, qualitative and mixed methods approach. Quantitative research is a means for testing objective theories by examining the relationship among variables, on the other hand, qualitative research approach is a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem with intent of developing a theory or pattern inductively and the mixed methods approach is the combination of Qualitative and quantitative approach.

Thus, in order to achieve the objectives stated in the preceding section, considering the nature of research problem and the research perspective, in this study the explanatory research design was employed to examine the impact of corporate governance on microfinance institution in Ethiopia over the period of 2010-2016.

3.2. Target Population and Sampling method

According to (Mugenda and mugenda, 2003) population is an entire group of individual, events or object having common observable characteristics. And another Author (Ngechu,2004) also define population is a will defined or set of people, services, element and events, group of things or household that are being investigated. Based on the NBE data as of June 2016 there are thirty five (35) MFIs which are licensed and operating in Ethiopia used as a target population of the study.

The research applied purposive sampling techniques for the selection of MFIs in Ethiopia. The analysis based on consolidated data from the 2010-2016 G.C financial statement of 12 MFIs.

Taking the research needs and the compatibility of data in to account; The sampling is based on the ownership nature of MFIs and availability of seven year data for analysis purpose that the first two MFIs are majority of the shares were owned by government, the next eight MFIs are NGO backed and the last two MFIs are established purely by private shareholders. The MFI which the researcher used for this study are Oromia saving and Credit Institution (OSCCO), Addis Saving and Credit Institution (AdSCI), Vision fund MFI, SFPI, Melilt MFI, PEACE MFI, Eshet MFI, Gasha MFI, Harbu MFI, Degaf MFI,S, Aggar Micro-financing, and Lefayda MFI.

3.3. Source of data and data collection techniques

The necessary data for this study were collected from both primary and secondary sources. Primary sources of data were gathered through close-ended questioners from the sample MFIs. Therefore the questionnaires which were capture CG variable were filled by CEO, and other senior managers of the selected sample MFIs. While secondary sources of data, the audited financial statement of the sample MFIs, obtain from National Bank of Ethiopia (NBE). The study used Panel data which combine the attribution of cross-sectional and time serious data. The advantage of Panel data analysis is that more reliable estimates of the parameters in the model can be obtained (Gujarati, 2004).

3.4. Data Analysis Technique and Variables Measurement

The data collected through the aforementioned tools could be analyzed using the method known as descriptive statistics, correlation and multiple panel linear regression methods. The descriptive statistics were used to quantitatively describe the important features of the variables using mean, maximum, minimum and standard deviations. Correlation analysis will be use to identify the relationship among the variables. But it does not permit the researcher to make causal inferences regarding the relationship between variables (Marczyk et al., 2005).That is why a multiple panel linear regression analysis used to test the hypothesis and to explain the relationship between corporate governance variables and financial performance measures by controlling the influence of selected variable. The least square was conducted using Eview10 econometric software package was used for analysis and the results are presented in tables and figures.

The variables were select based on alternative theories agency theories and previous empirical studies related to corporate governance and firm performance. Accordingly, the theory and empirical studies, the independent, dependent and control variable of the study were identified in order to examine the effect of corporate governance mechanisms on MFIs financial performance.

3.4.1 Dependent Variable

Dependent variable (Financial Performance) is measured by annual Return on Assets (ROA) which is a standard finance literature measure of performance. The financial performance measurement of ROA was selected because of ROE weight net income only against owners' equity, it doesn't say much about how well a company use its financing from borrowing and issuing bonds, such as a company may deliver an impressive ROE without actually being more effective at using the share holders' equity to grow the company. ROA, its denominator includes both debt and equity, can help to see how well a company put both these form of financing. Padachi, (2006). The return on asset determines the management efficiency to use asset generates earning, and it is a better measure since it relates the profitability of company to the asset base. Therefore, this study attempt to measure MFIs financial performance by using ROA similar to most of the pervious researches.

3.4.1.1 Return on Asset (ROA)

It shows how management of an entity will be able to turnover assets of the organization over-one-year. To a large extent, ROA also deals with operational sustainability of these institutions. It measures the overall efficiency of management.

$$\mathbf{ROA} = \frac{\textbf{Profit after Tax}}{\textbf{Total Asset}}$$

3.4.2 Control Variable

In this study size of MFIs is included to account its potential influence on Microfinance institutions' financial performance in order to know the selected explanatory variables effect on Microfinance Institutions' financial performance. These control variables are selected based on previous studies since in most of the previous studies firm size, firm growth rate and firms' leverage were used as control variables (Habbash, 2010). For the purpose of this study size of MFI was selected as a control variable of selected MFIs and measured as the natural logarithm of total assets at year-end.

3.4.3 Explanatory variables

The independent variables are variables that are used as a determinant of corporate governance of the sample Ethiopian microfinance institutions in this study. The independent variables of the study are board size, board gender diversity, Educational Qualification of Directors, board members experience in the Finance sector, meeting frequency of board, Female CEO, and size of audit committee.

3.4.3.1. Board Size

Board size can be defined as the number of directors sitting on the board. Based on the agency theory limiting board size to a particular level is generally believed to be improving financial performance. The reason is that the benefit of larger boards is outweighed by the poor communication and decision making when the board size is too large. Most of the previous studies found negative effect of board size on performance of firms (Al-Manaseer et al., 2012). For this specific study, board size is expected to influence MFIs performance negatively.

Hypothesis 1

H_{1a}: Board size has a significant negative relationship with the financial performance of MFIs.

3.4.3.2. Board Gender Diversity

Board Gender diversity is the Composition of boards (male-female proportion in the board room) during the period under review. Gender diversity of the board is measured as the number of female directors who serve as a board members. It is believed that female board members bring diverse viewpoints to the boardroom which is not possible if all directors are male. (Huse & Solberg, 2006). The researcher expects the presence of the female directors on board have a positive influence on financial performance of Ethiopian Microfinance Institution.

Hypothesis 2

H_{1b}: Board Gender Diversity has a significant positive relationship with the financial performance of MFIs

3.4.3.3 Educational Qualifications of Directors

The expertise, competence and quality of a firm's board inevitably impacts on financial performance. The higher the quality, the better will be the financial performance of the firm. Educational qualification is important determinant of board effectiveness. According to Rose (2007) as long as board members have a university degree/or equivalent skills, board members have sufficient human capital in order to understand and analyze information that is provided by management. Educational qualifications of individual board members are very important for board decision making (Amran 2011; Yasser; 2011). The monitoring role expected to be effectively implemented if the board members are qualified and experienced. It is measured by the number of board members who had college degree or higher from the total number of board members. The researcher expects that there is a significant positive association between director's educational qualifications and the MFIs financial performance.

Hypothesis 3

H_{1c}: Educational qualification of the board members has a significant positive relationship with the financial performance of MFIs.

3.4.3.4 Board members Experience in the Finance Sector

It is the number of directors who had earlier work experience in other Microfinance institutions or any financial institutions. Financial sector experience of directors enables them to guide, steer and monitor the firm more effectively. In other words, their knowledge of the industry, its opportunities and threats and their connections to the industry participants based on their experience enables them to contribute substantively in the firm performance. (DeZoort, 1998 as cited by Saat et al 2011). It is measured by the numbers of board members who had financial sector experience. The researcher expects that there is a significant positive association between board members experience in the Finance sector and MFI financial performance.

Hypothesis 4

H_{1d}: board members experience in the finance sector has a significant positive relationship with the financial performance of MFIs.

3.4.3.5 Meeting frequency of the board

The frequency of board meetings measures the intensity of a board's activities, and the quality or effectiveness of its monitoring (Vefeas, 1999, p.116, Conger et al. 1998, p.142). A higher frequency of board meetings will result in a higher quality of managerial monitoring, which can impact positively on financial performance. It has been contended that regular meetings allow directors more time to confer set strategy and to appraise managerial performance (Vafeas 1999, p.118). It can help directors to remain informed and knowledgeable about important developments within the firm. This will place the directors in a better position to timely address emerging critical problems (Mangena and Tauringana, 2006 p.12). In fact, Sonnenfeld (2002, p.107) suggests that regular meeting attendance is considered a hallmark of the conscientious director. Also, frequent meetings intermingled with informal sideline interactions can create and strengthen cohesive bonds among directors (Lipton and Lorsch 1992, p.69). Frequency of board meetings measured by the numbers of Meeting how much time Board meets on a year during the period under review. The researcher expects the number of board meeting has a positive impact on Ethiopian Microfinance Institutions financial performance

Hypothesis 5

H_{1e}: Meeting frequency of board has a significant positive relationship with the financial performance of MFIs.

3.4.3.6 Female CEO

According to (Azmi & Barrett, 2013), Women have important characteristics like meticulous, risk averse, skilled in accounting and finance, and good decision-makers which is necessary for good governance. Boehe and Cruz (2013) found Many MFIs that work with the mission of women empowerment mandate could benefit by bringing female membership at all levels of the management including its executive level (Campion et al. 2008) as female CEO is better able to gather information from females then a male CEO (Mersland and strom, 2009). This is a dummy variable captured whether a CEO was a female or otherwise, it adopted a dummy variable where, 1 is if CEO was a female and 0 if otherwise for the MFIs under review. The researcher expects female CEO has a positive impact on Ethiopian Microfinance Institutions financial performance

Hypothesis 6

H_{1f}: Female CEO has a significant positive relationship with the financial performance of MFIs.

3.4.3.7 Size of Audit committee

Size of an audit committee in a board refers to the total number of MFIs' audit committee members out of the total number of board of directors and affects MFI's performance and it is highly believed that it ensures effective monitoring (Kyereboah-coleman, 2007; Aldamen et al., 2011). It is also likely that if there is an audit committee in a board, it effectively communicates matters in the financial reporting process and helps problems to be resolved easily and timely. The researcher expects Size of an audit committee has a positive impact on Ethiopian Microfinance Institutions financial performance.

Hypothesis 7

H_{1g}: Size of audit committee in the board has a significant positive relationship with the financial performance of MFIs.

3.5 Specification of empirical research model

To estimate the impact of corporate governance mechanisms on the financial performance of the micro finance institution, the following general empirical research model similar to Brooks (2008) adopted.

$\mathbf{Y_{it} = \beta_0 + \Sigma\beta K X_{it} + \varepsilon_{it}}$ ………………………………………. (1)

Where:

$\mathbf{Y}_{it}$ represents the mean value of dependent variables (ROA)

$\boldsymbol{\beta_0}$ is the intercept

βK represents the coefficients of the X variable

$\mathbf{X}_{it}$ represents the explanatory variables (BS, BGD, EQD, BEFS, MFB, FCEO, SAC, and SZ)

$\boldsymbol{\varepsilon}_{it}$ is the error term.

Based on theoretical studies the research variables have been identified specifically on agency theories. According to (Habbash, 2010), board structure is heavily relay on the concept of agency theory, focusing on the controlling function of board. In addition to this, the issue that specifically related on the Ethiopian MFIs is considered to select the research variables. And lastly mixed result on the previous research are base to identify the research variables of the paper

The above general empirical research model is changed in to the study variables to find out the impact of corporate governance mechanisms on MFIs financial performance as follows:((Bathula, 2008,Belete ,2015, and Abdurazak,2016)

ROA= $\beta o + \beta 1\ (BS_{it}) + \beta 2\ (BGD_{it}) + \beta 3\ (EQD_{it}) + \beta 4\ (BEFS_{it}) + \beta 5\ (MFB_{it}) + \beta 6\ (FCEO_{it}) + \beta 7\ (ACS_{it}) + \beta 8\ (SZ_{it})$. ………………………. (2)

Dependent variables

ROA= Return on asset of the MFIs

Independent variables

BS =board size of the MFIs

BGD = Board gender diversity of the MFIs

EQD =Educational qualification of directors of the MFIs

BEFS =Board members experience of the MFIs

MFB = Meeting frequency of boards of the MFIs

FCEO=Female CEO of the MFIs

ACS = Audit committee size of the MFIs

Control variables

SZ =Size of the MFI

3.6 Classical linear regression model assumptions

The regression analysis used to examine the relationship between the CG mechanisms on the performance of MFIs in Ethiopia measured by ROA. To enhance the quality of the econometric estimate, model diagnosis and robustness checks were made followed by presentation of regression results on the impact of corporate governance mechanism on performance of sample MFIs. The regression analysis enables the researcher to empirically test the proposed hypothesis and to achieve the research objective. Due to the attractive statistical properties that made it one of the most powerful and popular methods of regression analysis (Gujarati, 2004), the study used ordinary least square (OLS). Therefore before the regression was run tests for fulfillment of the basic Classical Linear Regression Model assumption (CLRM) would be tested. Consequently, the basic CLRM assumptions tested in this study were error have zero mean, homoskedasity, autocorrelation, normality and multicollinearity.

Assumption 1: the mean of the disturbance is Zero (E (e) =0)

"The first assumption required is that the average value of the errors is zero. In fact, if a constant term is included in the regression equation, this assumption will never be violated." (Brooks .2008, P.132). In this model the constant term was included Brooks (2008).

Assumption 2: Homoskedasity (Variance of the Errors is Constant)) (var (*ut*) = $\sigma^2 < \infty$)

"It has been assumed that the variance of the errors is constant, σ^2- 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 P.132). In the model the P-value is not significant (>5%), accept the null hypotheses otherwise accept the alternative. To check this assumption white test was conducted.

Hypotheses

$\mathbf{H_0}$: The variance of the error is Homoscedastic

$\mathbf{H_1}$: The variance of the error is Heteroscedastic

Assumption 3: Covariance between the Error Terms over Time is Zero (Autocorrelation)

This assumption test has been conducted when the errors are linearly independent of one another or uncorrelated with one another. If the errors are correlated with one another, it would be stated that they are autocorrelated (serially correlated) (Brook 2008). Therefore to conduct test of this assumption, the first test was Durbin-Watson (D-W) which is shown that in the regression output of the model. D-W is test for first orders autocorrelation. It tests only for a relationship between an error and its immediate pervious value. In addition to D-W test it was desirable to conduct Breush Godfrey serial correlation LM test to examine a joint test for autocorrelation that will examination of the relationship between error term and several of its lagged value at the same time. Thus Breush-Godfrey test (P-value) should be greater than 5%.Meaning that to accept the null hypothecs P-value should be insignificant.

Hypotheses

H_0: The errors are uncorrelated with one another

H_1: The errors are correlated with one another

Assumption 4: Normality Test (Errors are normally Distributed)

This test is performed to confirm the assumption of CLRM which states that the disturbances terms are normally distributed. One of the most commonly applied tests for normality is the Bera- Jarque (BJ) test .According to Brooks (2008), if the residuals are normally distributed, the histogram should be bell-shaped and the Jarque bera statistic would not be significant. This means that to accept the null hypotheses the P-value given at the bottom of the normality test screen should be greater than 0.5%.

Hypotheses

H_0: Residuals are normally distributed

H_1: Residuals are not normally distributed

Assumption 5: Multicollinearity Test

The other Assumption of the CLRM test was there is no multicollinearity among the independent variables included in the regression model. When the explanatory variables are highly correlated with each other there is a problem known as multicollinearity. Multicollinearity in the regression model suggests substantial correlations among independent variables. Hair et.al. (2006) argued that correlation coefficient below 0.9 may not cause serious multicollinearity problem. Also, Cooper and Schendlar (2009) suggested that a correlation above 0.8 should be corrected for. In addition, Nalhota (2007) stated that multicollinearity problems exists when the correlation coefficient among variables should be greater than 0.75.The method used in this study to test the existence of multicollinearity has been by checked the person correlation between the independent variables. To accept the null hypotheses the correlation coefficient between the independent variable should be less than 90%.

H_0: there is no multicollinearity problem in the model

H_1: there is multicollinearity problem in the model

Fixed Effect versus Random Effect

There are two broad classes of panel estimator approaches that can be employed in financial research: fixed effects models (FEM) and random effects models (REM) (Brooks 2008). Fixed effect model allows for heterogeneity or individuality among 12 MFIs by allowing having its own intercept value, but the intercept does not vary over time. In random effect model the 12 MFIs have a common mean value for the intercept. Therefore, it is necessary to determine whether the fixed effect or random effect approach is appropriate. A common practice in corporate governance research is to make the choice between both approaches by running a Hausman test. To accept the null hypotheses the P-value should be not significant (greater than 5%).

Hypotheses

H_0: Random effect model is appropriate

H_1: Fixed effect model is appropriate

Table 3.1: Summary for Terms of Measurement

Variables	Acronym	Terms of Measurement
Return on asset	ROA	Amount of profit after tax as a percentage of total asset
board size	BS	number of directors sitting on the board
Board gender diversity	BGD	Number of female directors who serve as a board members
Educational qualification of directors	EQD	Number of board members who had college degree or higher
Board members experience in the financial sector	BEFS	Number of board members who served in the same capacity in other MFIs earlier
Meeting frequency of boards	MFB	Number of meeting how much time board meets on a year during the period
Female CEO	FCEO	If the CEO is female 1 otherwise 0
Audit committee size	ACS	Total number of audit committee out of the total number boards
MFIs Size	SZ	The natural logarithm of total assets at year end

Sources: Literature review

CHAPTER FOUR

4. DATA ANALYSIS AND DICUSSION

This chapter presents the result and analysis of the finding of different methods used. The first section deals with the Classical Linear Regression Model Assumption test for classical linear regression model. The second section present descriptive statistics and summarizes the main features of the study variables in terms of mean, maximum, minimum and standard deviation. The third section deals with the correlation analysis and shows the degree of association between the study variables. The fourth section of this chapter analyzes regression result reports of the OLS estimation output of the regression models.

4.1 Diagnostic tests of the data set

The data sets were tested for the classical linear regression model assumptions before running the model. According to Brooks (2008), there are five critical assumptions that must be met before utilizing OLS estimation in order to validly test the hypothesis and estimate the coefficient. The classical linear regression model assumptions and their diagnostic test are discussed below.

4.1.1 The mean of the disturbance is zero

According to Brooks (2008) the mean of the disturbance will always be zero provided that there is a constant term in the regression. If a constant term is included in the regression equation, this assumption will never be violated. So that the model of this account term is included. As a result this assumption was not violated.

4.1.2 Homoscedasticity

If the errors do not have a constant variance, they are side to be heteroscedasticity. To test for heteroscdasticity, the researcher used White test, Eviews 10 presents three different types of tests for hetroscedasticity. According to Brooks (2008), if F, R-squared and normalized version of the explained sum of squares from the auxiliary regression ('scaled explained SS') statistic have a P-value of more than 0.005, the test statistic give conclusion that there is no evidence for the inconsistency of variance of the errors. As per the table 4.1 below the F- statistic show as there was no evidence for presence of heteroscedasticity since the P-value were greater than 0.05. This means the null hypothesis was not rejected which says that the error variance is constant

Table 4.1 heteroscedasticity test

Heteroskedasticity Test: White

F-statistic	1.193597	Prob. F(45,37)	0.2918
Obs*R-squared	49.14555	Prob. Chi-Square(45)	0.3106
Scaled explained SS	55.28358	Prob. Chi-Square(45)	0.1401

Source: Eviews 10 output

4.1.3 Covariance between the Error Terms over Time is Zero

This assumption test is conducted when the errors are linearly independent of one another or uncorrelated with one another. If the errors are correlated with one another, it would be stated that they are auto correlated (serially correlated). Therefore to conduct test of this assumption, the first test was Durbin- Waston (D-W) which is shown in the regression output of the model. As per this test the value of Durbin- Watson (D-W) for the model is 0.93 which is blew 2. However, D-W tests only for a relationship between an error and its immediate previous value. Therefore, in addition to D-W test it is desirable to conduct Breush Godfrey serial correlation LM test to examine a joint test for autocorrelation that will examination of the relationship between error term and several of its lagged value at the same time. Thus Breush-Godfrey test was also conducted for the model and found that there is no problem of serial correlation for the model, meaning that the P-value (below table 4.2) of the test result is 0.48 which is greater than 0.05. This means the null hypothesis was accepted which says that the error are uncorrelated with one another.

Table 4.2 Autocorrelation Test - Breusch-Godfrey Serial Correlation LM

Breusch-Godfrey Serial Correlation LM Test:

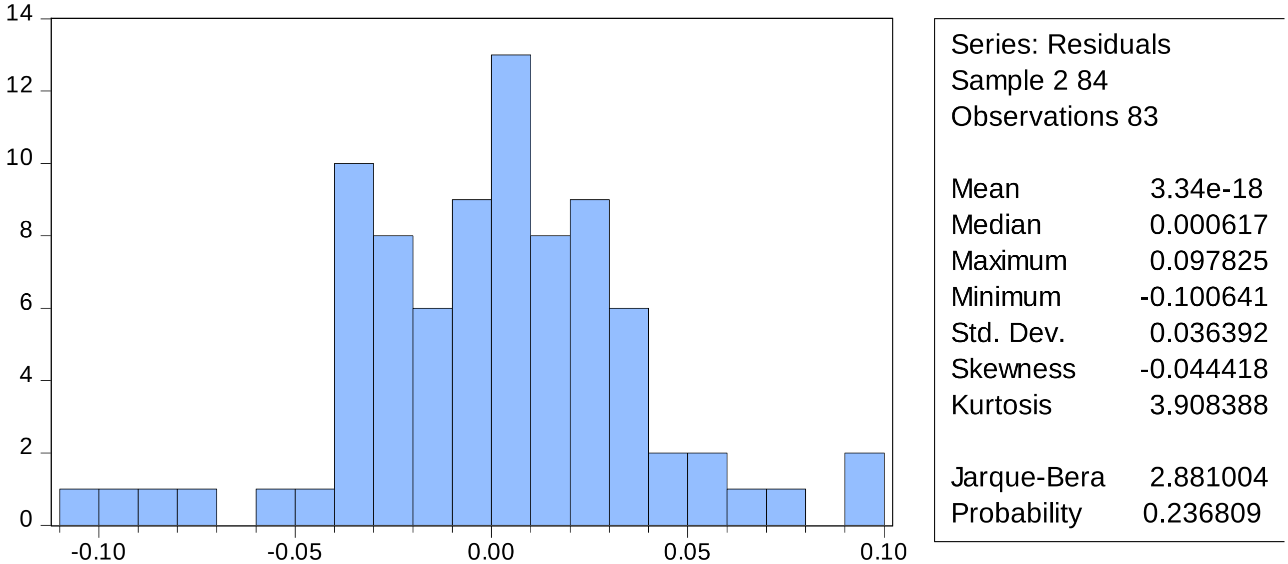
F-statistic	0.740498	Prob. F(2,71)	0.4805
Obs*R-squared	1.695931	Prob. Chi-Square(2)	0.4283

Source: Eviews 10 output

4.1.4 Normality test (Errors are normally Distributed)

This test performed to confirm the assumption of CLRM which states that the disturbance terms are normally distributed. One of the most commonly applied tests for normality is the Bera-Jarqua (BJ) test. According to Brooks (2008), if the residual are normally distributed, the histogram should be bell-shaped and Jarqua bera statistic would not be significant. This means that the P-value given at the bottom of the normality test screen should be greater than 0.05.

Figure 4.1: Normality Test Result



Sources: Eviews 10 out put

As we can see in the figure 4.1 the P-value of 0.23 (greater than 0.05) which is insignificant for the model and the researcher failed to reject the null hypothesis. Therefore, there is no normality problem on the data used for this study.

4.1.5: Multicollinearity Test

When the explanatory variables are highly correlated with each other there is a problem known as multicollinearity. Multicollinearity in the regression model suggests substantial correlations among independent variables. Accourding to Hair et.al. (2006) the correlation coefficient below 0.9 may not cause serious multicollinearity problem. So to accept the null hypotheses the correlation coefficient between the independent variable should be less than 90%.

As shown in the table 4.3, because of the correlation coefficient between educational qualification of directors and board size was above 90% that is 0.900589, the alternative hypothesis was accepted which was says that there is multicollineriaty problem in the mode.

Table 4.3 Covariance matrix estimation for repressors' of performance of MFIs

Correlation	BS	BGD	EQD	BEFS	FCEO	ACS	MFB	**SZ**
BS	1							
BGD	0.453512	1						
EQD	0.900589	0.312397	1					
BEFS	0.314956	0.163684	0.252124	1				
FCEO	0.048615	0.100371	0.062996	-0.07535	1			
ACS	0.359806	0.099986	0.417086	-0.03549	-0.15343	1		
MFB	-0.10346	0.003602	-0.00422	-0.01968	-0.06691	0.23388	1	
SZ	-0.05319	0.176209	-0.05988	0.200834	-0.04958	0.15665	0.074258	**1**

Sources: Eviews 10 out put

According to Brooks (2008,P, 173) there is an option to ignore the problem of multicollinearity "if the model is otherwise adequate, i.e. statistically and in terms of each coefficient being of a plausible magnitude and having an appropriate sign. Sometimes, the existence of multicollinearity does not reduce the *t*-ratios on variables that would have been significant without the multicollinearity sufficiently to make them insignificant. It is worth stating that the presence of multicollinearity does not affect the BLUE properties of the OLS estimator-i.e.it will still be consistent, unbiased and efficient since the presence of multicollinearity does not violate any of the CLRM assumptions 1-4**."** Even if the null hypothesis is rejected, there is no a problem of multicollinearity problem, the researcher ignore it because the presence of multicollinearitydoes not affect other CLRM assumptions and dropping one variable does not make the insignificant variable make to significant variable.

4.1.6 Fixed Effect versus Random Effect

There are two broad classes of panel estimator approaches that can be employed in financial research: fixed effects models (FEM) and random effects models (REM) (Brooks 2008). Fixed effect model allows for heterogeneity or individuality among 12 MFIs by allowing having its own intercept value, but the intercept does not vary over time. In random effect model the 12 MFIs have a common mean value for the intercept. Therefore, it is necessary to determine whether the fixed effect or random effect approach is appropriate. A common practice in corporate governance research is to make the choice between both approaches by running a Hausman test.

The hausman test result shows below in the Table 4.5 that the p-value of the test summary is 0.049%, less than 5%, indicate that the Random Effect Model is inappropriate. This means that the alternative hypothesis was accepted which say that the fixed effect model is appropriate.

Table 4.4.Random Vs Fixed effect Model test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	15.55637070177535	8	0.04918827 05533022

Source: Eviews 10 output

All the above tests of basic classical linear regression model (CLRM) assumptions for OLS estimation proved that, the results obtained from the regression model in this study are consistent, free from bias and efficient since the assumption holds.

4.2 Descriptive statistics

This section discussed the descriptive statistic of each variable in the study based on panel data of microfinance institution from the year 2010 to 2016. The table 4.6 below present mean, median, maximum value, minimum value and standard deviation of regression variables. The variables include the dependent (return on asset), independents (Board size, board gender diversity, educational qualification of directors, board members experience in the finance sector, meeting frequency of board, female CEO and audit committee size) and control variables (MFIs size).

Table 4.5 Descriptive statistics.

	ROA	BS	BGD	EQD	BEFS	ACS	FCEO	MFB	SZ
Mean	0.0292	6.4643	1.2976	6.0119	1.2381	1.8571	0.0119	5.6548	18.0499
Median	0.05	7	1	7	0	2	0	4	17.9899
Maximum	0.186	9	3	9	7	4	1	12	22.3653
Minimum	-0.24	3	0	2	0	0	0	3	13.3463
Std. Dev.	0.0838	1.2168	0.7727	1.732	1.8144	1.3366	0.1091	2.7309	2.28407
Observations	84	84	84	84	84	84	84	84	84

Source: Eviews 10 Output

As per the above table 4.6, the average mean value of return on asset for the Ethiopian MFIs is 2.9% mean value of 0.0292 with maximum and minimum value 0f 18.6% and -24% respectively. Meaning, among the sampled MFIs the most profitable MFIs achieved a profit of 18.6 cent per a birr invested in the assets. On the other side, the least profitable MFIs incurred a loss of 24 cent per one investment. The standard deviation of return on asset is deviated 8.38% from the average mean2.9%.

More additional, standard deviation statistics for return on asset was 8.38 % which shows that how individual values of return on asset in a data set vary from the mean of return on asset over the last seven years by 8.38 percents. Since ROA indicates the efficiency of the management of a company in generating net income from all resource of the institution , the higher ROA show that the company is more efficient in using its resources. Likewise during study period microfinance in Ethiopia generate 2.9 percents income on average from mobilizing their asset. When we compare this result with the previous finding Belete (2015) and Eyob (2016) the mean value of 1.97% and 3.9% .which means that the result of this study is inconsistent with the previous study. When we compare this result from the previous finding, management of MFIs was less efficient to generate income from mobilizing their asset than Eyob (2016) finding which was 3.9% but it was better efficient than the result of Belete (2015) which was 1.97%. The result implies that these MFIs need to optimize the use of their assets to increase the return on their assets.

Table 4.6 also examined the impact of board size for internal corporate governance mechanism of financial performance of sample MFIs. On average 7 members with maximum and minimum board members of 9 and 3 respectively. The standard deviation indicates that for the sample MFIs board size varies by 1.216814 from average board size of 7. The recommended optimal size of a board ranges from eight to thirteen as per ACCA, P1, 2012 and seven as per the National Bank of Ethiopia; and generally the sample MFIs was below the recommended size of a board of the ACCA and equal to the National Bank of Ethiopia . This result was consistent with previous studies Belete (2015) which was 6 average boards size and inconsistent with Eyob (2016) which was 8 average board sizes. The possible reason is that most of governmental MFIs directors are politically appointee and most of them are not finished their election period.

Concerning board gender diversity on average 1 board of directors of samples MFIs are female with a maximum of 3 females directors and minimum of 0 females directors .The gender diversity of sample MFIs boards as measured by number of directors position lead by women is low during the last seven years. The standard deviation indicates that for the sample MFI's females directors vary by 0.7724724 from the average value of 1. This finding is consistent with the previous research Belete (2015) and Eyob (2016) the average women directors was 1. The possible reason is that there is no movement for empowering females.

The other explanatory variable is Educational qualification of directors in the sample MFIs as measured by number of directors who have collage degree or above. The average is 7 with maximum of 9 and minimum value of 2. This is show that board members are educated. The standard deviation is 1.7320 from the mean of sample MFI which is 6. The mean result is inconsistent with pervious finding of Eyob (2016) & Belete (2015) which was 6 and 5. The possible reason for most of MFIs boards of directors are educated to fulfill the NBE requirement which says that board member shall be qualified.

Regarding to board members experience in the finance sector, the sample Ethiopian MFIs have mean value of 1.238095 on average 1 with a maximum of 7 and minimum value of 0 as measured by the number of directors who had experience in the finance sector .This show is that the Ethiopian MFIs board of directors' experience in the finance sector is low for the last seven years. The standard deviation is 1.814394 from the average value of 1. The average mean value is consistent with the previous research result belete (2015) and Eyob (2016) their average experienced board members in the finance sector was 1. The possible reason for the small number of board members who had financial experience is that almost all the governmental MFIs board of directores is politically assignee and board members of NGO backed MFIs are representatives of NGO coming from other sector.

Based on the above table 4.1 the meeting frequency of sample MFIs board of directors conduct averagely 6 times per year (mean=5.65476) with minimum of 3 times per year and maximum of 12 times per a year . The standard deviation is 2.73087 from the mean value of 6. There is an improvement on frequency of meeting on sample MFIs compare to the previous study (Belete, 2015) which was board members meet 4 times per year. But this result does not fulfill the requirement of NBE, board members shall be meeting 12 times per a year. The possible reason is that in the board member give inadequate attention to their responsibility.

When we come to female CEO, it is a dummy variable which was allocated 1 when CEO was women and 0 when otherwise. The table 4.6 show that the 98.8% of sample Ethiopian MFIs led by male CEOs there is despite the fact that their target client were women. This left only 1.2% of selected Ethiopian MFIs led by women .According to Mersland & Stom ,2007 ,MFIs perform better when CEO is women because females able to connect well with clients who are mostly women. The pervious study found that 20% MFI were lead by female CEO but based on this study almost all MFIs lead by male. The possible reason is female empowerment is week on sample MFIs.

The audit committee of sample Ethiopian MFIs has an average 2 (mean=1.857143) with a maximum value of 4 and minimum value of 0.The standard deviation is 1.336628 from the mean of 2. The numbers of Audit committee is decrease by one person from the previous study result of Belete (2015) and Eyob (2016). The possible reason is that most of governmental MFIs directors are politically appointee and most of them are not finished their election period.

When we see the control variable, the mean value of MFI size as measured by the natural logarithm of total asset is 18.04988 with maximum value of 22.36529 and minimum value of 13.34634. The standard deviation of MFIs size among sample MFI is 2.284071. Compare to the pervious result of Belete (2015) the average asset size is increase, the possible reason is that due to the increase number of branch in sample MFIs.

4.3 Correlation Analysis of ROA and CG mechanism

The table 4.2 below was run by taking ROA as a dependent and other governance and control variable as an independent variable. The correlation coefficient show the extent and direction of the linear relationship between considered corporate governance and financial performance proxy by ROA of the sample Ethiopian MFIs during the study period .The correlation matrix show the relationship of ROA with Board size, Board Gender Diversity, Educational Qualification of Directors, Board Members Experience in the Finance Sector, Meeting Frequency of Board, Female CEO, Audit Committee Size and MFI Size. And the probability is shown in parenthesis with the correlation coefficient in the correlation matrix below in the table 4.7.

Table 4.6: Correlation Matrix of Dependent and Independent Variables

Correlation Probability	ROA	BS	BGD	EQD	BEFS	FCEO	MFB	ACS	SZ
ROA	1								
BS	-0.0505	1							
	0.64806								
BGD	0.24027	0.45351	1						
	0.02771	0.0000							
EQD	-0.0537	0.90059	0.3124	1					
	0.62756	0.0000	0.0038						
BEFS	0.42323	0.31496	0.1637	0.25212	1				
	0.0001	0.00352	0.1368	0.02069					
FCEO	0.13176	0.04862	0.1004	0.063	0.0754	1			
	0.23219	0.66055	0.3637	0.56917	0.4957				
MFB	0.31054	-0.10346	0.0036	-0.0042	0.0197	-0.0669	1		
	0.00404	0.34898	0.9741	0.96965	0.8589	0.54535			
ACS	-0.0792	0.35981	0.1	0.41709	-0.0355	-0.1534	0.2339	1	
	0.47383	0.00077	0.3655	0.0000	0.7486	0.16351	0.0323		
SZ	0.65423	-0.05319	0.1762	-0.0599	0.2008	-0.0496	0.0743	0.15665	1
	0.0000	0.63087	0.1089	0.58844	0.067	0.6542	0.502	0.15473	

Source: Eviews 10 output

Based on the correlation matrix table 4.2, the independent variable: such as meeting frequency of board, Board experience in the finance sector and board gender diversity positively and significantly correlated at 1% and 5% significant level with ROA respectively.

And Female CEO has positive and insignificant association with ROA. However Audit committee Size, Board Size and Educational qualification of directors negative and insignificantly correlated with ROA.

Whereas, control variable (MFI size) measured by natural logarithm of total asset of MFI has positive and significant correlation with ROA at 1% level in this study

In general, the correlation analysis shows only the direction and degree of association between variables and it does not permit the researcher to make causal inference regarding the relationship between the identified variables. Therefore, it is not possible to explain the relationship corporate governance variable and performance measure by controlling the influence of some selected variable using correlation analysis. As a result the main analysis is left for regression analyses that overcome the shortcoming of correlation analysis.

4.4 regression Results and Discussion

This section of the study presents the results and discussions of the regression output. The analysis was based on the results of the regression between the dependent variable and the independent variables. The result of regression model that has been estimated the impact of corporate governance variable of the financial performance of selected MFIs in Ethiopia are jointly analyzed and discussed in table 4.8 below.

Based on the regression result indicated in Table 4.8 the study found out that the estimated result of multiple regression analysis is at a fairly satisfactory level. This is evidenced by the fact that the R-squared is 71% and the Adjusted R-squared value is 65% for ROA. The values of the Adjusted R-squared revealed that the existence of good relationships between dependent and independent variables, where all independent variables can explain collectively about 71% of the performance of MFIs as measured by ROA, while the remaining 29% of the change in performance regression model is explained by other factors which are not included in the regression line. Both the R-squared and the Adjusted R-squared values of the models in this study are found to be higher implying that they have more explanatory power. Moreover for panel data, R-Squared greater than 20% is still large enough for reliable conclusions (Cameron Trivedi, 2009; Hsiao, 2007, cited in Nyamsogoro, 2010). Generally, the R squared results indicate the overall Goodness-of-fit of the models used in this study.

Table 4.7: Regression Result for the Model

Dependent Variable: ROA
Method: Panel Least Squares
Date: 05/16/18 Time: 18:27
Sample: 2010 2016
Periods included: 7
Cross-sections included: 12
Total panel (balanced) observations: 84

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BS	-0.007097	0.012332	-0.575493	0.5668
BGD	0.015048	0.008514	1.767355	0.0816
EQD	0.001273	0.007874	0.161687	0.8720
BEFS	0.015422	0.003356	4.595806	0.0000
FCEO	0.119664	0.053280	2.245927	0.0279
MFB	0.010341	0.002186	4.729908	0.0000
ACS	-0.011531	0.004945	-2.331939	0.0226
SZ	0.021399	0.002625	8.152195	0.0000
C	-0.395933	0.069639	-5.685500	0.0000
Effects Specification				
Period fixed (dummy variables)				
R-squared	0.713173	Mean dependent var		0.029209
Adjusted R-squared	0.654976	S.D. dependent var		0.083821
S.E. of regression	0.049236	Akaike info criterion		-3.023964
Sum squared resid	0.167266	Schwarz criterion		-2.589890
Log likelihood	142.0065	Hannan-Quinn criter.		-2.849470
F-statistic	12.25448	Durbin-Watson stat		0.934944
Prob(F-statistic)	0.000000			

Source: Eviews 10 output

The F-statistics of the model is 12.25 and the P- value is less than 5% , the model variables are significant. The model adequately describes the data. Here one can infer from the results of R-squared and F-statistics that the implemented model of this research is well fitted that corporate governance elements have a significant effect on MFIs' financial performance. The F-statistic shows the overall significance of variables in other words the significance of each models slope parameters jointly.

The overall reliability and validity of the model was also further enhanced by the fact that the Prob (F-statistic) values being (0.000000) for the models, which indicates strong statistical significance. Thus the null hypothesis of the overall test of significance that all coefficients are equal to zero was rejected as the p-value was sufficiently low (less than 0.05).

4.4.1 Corporate governance: Result and Discussion

4.4.1.1 Board size

As shown in the table 4.8, the finding of this study reveals that the relationship between board size (BS) and Return on Asset has a negative coefficient (-0.0070) and statistically insignificant (p-value of 0.5668> 0.05). Hypothesis **$H1_a$** predicts that the board size significant negatively associated with financial performance, measured by ROA. The insignificant level of the board size does not support the alternative hypothesis. Meaning that the null hypothesis which states the negative effect of board size does not have a significant effect on Ethiopian MFIs financial performance is accepted. The insignificant effect of the board size in the Ethiopian MFIs financial performance measured by ROA implies that board size has nothing to do with the financial performance MFIs or its contribution for financial performance is negligible. The result is contradicted with the previous studies which finding that the board size has positive and significant effect on financial performance of MFIs. The possible reason for this result can be that the nominee director's free ride and do not bring any incremental skills to the business of microfinance that can enhance the returns to asset or a larger board finds it difficult to come to consensus and is slow in decision making.

4.4.1.2 Board Gender Diversity

Based on the result table 4.8, the relationship between board gender diversity (BGD) and Return on asset has a positive coefficient (0.0150) with statistically insignificant (P-value of 0.0816>0.05). Hypothesis **$H1_b$** predicts that numbers of female directors on the board is positively and significantly associated with financial performance. The insignificant level of the numbers of women directors does not support the hypothesis. Meaning that the null hypothesis which stats the gender diversity of board does not have positive and significant effect on MFIs financial performance is accepted. Therefore, this study does not support the view that gender diversity composition leads to superior to support MFI financial performance. The result indicates that the presence of female directors will not improve MFIs Financial performance unless they are qualified and competent.

So the result is consistent with Eyob (2016), (Belete ZEgeye (2015), and Habbash, (2010) that all found that insignificant relationship between board gender diversity and firm financial performance. This may be due to the fact that there are small proportion of board members who are female compared to proportion of board members are male as shown in the descriptive analysis section ,which does not permit them to be powerful enough to make a difference to monitoring. Gender composition of the board of directors is one current governance issue facing corporate organization today. Many Scholars believe that Greater female representation on boards provides some additional skills and perspectives that may not be possible with all-male boards (Boyle, 2011).

4.4.1.3 Educational Qualification of Directors

As indicate the above table 4.8, Board members educational qualification (BQD) explain the variation of financial performance of MFIs with the coefficient of 0.001273 and P- value of 08720 which means there is a positive association between educational qualification of board members and financial performance of MFIs as measured by ROA but the effect is statistically insignificant. Hypothesis $\mathbf{H1_c}$ predict that there is a significant positive relation between board competencies and MFIs financial performance. Based on the result null hypothesis which is stated the numbers of directors who had college degree or above sitting on the board does not have a positive significant effect on sample MFIs financial performance is accepted. The finding implies that having degree or above has no impact on financial performance of MFI but knowledge of business related filed and experience MFIs do matter. The possible reason for the insignificancy of educational qualification of directors with the financial performance of MFIs, measured by ROA is that most of board members are not qualified in business related discipline and they have not business management experience.

The result consistent with the finding revealed by (Belete Zegeye 2015, Eyob 2016) they argues that directors with higher education are better in the business operation and controlling agency problem than less educated counterpart by reducing agency cost. This result does not necessarily contradict the notion that directors' educational competency sitting on the board may be useful and positive in general.

4.4.1.4 Board Members Experience in the Finance Sector

Table 4.8 shows that a positive and significant effect between board member experience in the finance sector and return on asset with coefficient and P-value of 0.0154 and 0.0000 respectively. Hypothesis $\mathbf{H1_d}$ expect that board member experience in the financial sector (BEFS) has positive and significant relationship with the financial performance of MFIs. This means the higher the number of directors had earlier work experience in the finance sector, the higher the financial performance of sample MFIs in Ethiopia. This result implies that if one board of directors with prior experience in MFI are added to board of directors then MFI ROA will increase by 1.54%. The alternative hypothesis which is stated as, board members experience in the finance sector has a significant positive relationship with the financial MFIs, is accepted. The result is consistent with the studies by Pool, Heong and Lee (2023) who suggest that the more senior the firm directors, the greater experience, wisdom and understanding of the industry and the better the firm performance. The possible reason is that senior director are more conservative in pursuing firms' strategies and tend to focus on business activities that yield immediate profits in the short term during their service periods, ultimately improving firm performance. The NBE directives which states that members of board of directors shall have adequate experience in business management ,preferable in accounting ,economics, management, and /or should board is appropriate in order to increase the financial performance of MFIs in Ethiopia.

4.4.1.5 Meeting Frequency of Boards

The above table 4.8 shows that there is a significant positive relationship between meeting frequency of board and MFIs financial performance as measured by ROA. Hypothesis $\mathbf{H1_e}$ predict that there is a significant positive relationship between meeting frequency of board and MFIs financial performance as measured by ROA, With the coefficient of 0.0103, and the P-value is 0.0000 this hypothesis is accepted. This result implies that increasing meeting frequency by 1 time per year, financial performance of MFIs, measured by ROA, also increase by 1%. The result is consistent with prior studies (Karamanou and Vefeas, 2005; mangena & tauringana , 2008, Ntim & Osei, 2011 ;and Belete Zegeye ,2016) in a way that the frequency of board meeting is a measure of board activities and effectiveness of its monitoring ability. The possible reason is that frequent meeting create a room to discuses good agenda, generate new idea, and create a higher qualities of management monitoring and follow up the institution.

4.4.1.6 Female CEO

Based on table 4.8 the relationship between female CEO (FCEO) and Return on Asset has a positive coefficient (0.1196) which is significant (p-value of 0.00279< 0.05). The alternative hypotheses, $\mathbf{H1_f}$, predict that the female CEO has positive and significant association with financial performance measured by ROA is accepted. The result implies that when female ECO increase by 1%, financial performance of MFIs also improved by 11.96%. The possible reason for the enhancement of MFIs financial performance because of female CEO is that females are more disciple, risk averse, more conservative dealing with finance issue and the mission of MFIs is empowering women so to gather relevant information from women, Female CEO is better from male CEO.

The result consistent with Boehe and Cruz (2013),Capion.et.al.(2008),Marsland &Storm(2009) and Welbourn(1999) Women have important characteristics like meticulous, risk averse, skilled in accounting and finance, good and good decision-makers which is necessary for good governance this potential of women CEO linked to the financial performance of MFIs.

4.4.1.7 Audit Committee Size

The result of this study showed in the table 4.8 that the size of audit committee has negative and significant effect on financial performance of MFIs, measure by ROA, with coefficient of (-0.0214) and P-value (0.0225) and the alternative hypothesis, $\mathbf{H1_g}$, which says that Audit committee size has positive and significant relationship with ROA is rejected. It indicating that when the size of audit committee increased by an individual, the performance of the MFIs decrease by 1.2%, as measured by ROA. The result is consistent with the previous studies conducted by (Jensen and Mecking ,1917 ;Kyereboach-coleman, 2007; and belete Zegeye ,2015). This result supports the notion that a certain minimum number of audit committee may be relevant to the quality of financial reporting and to enhance financial performance. The possible reason for the negative significance of Audit committee size is that free-riding and difficulty to reach in consensus may affect financial performance when the size gets large and large.

4.4.2 Control variable (MFI size)

As show in table 4.8 the Microfinance Institution size which was measured by natural Logarithm of total asset has a positive coefficient (0.0214) and statistically significant (p-value of 0.0000< 0.05) relationship with financial performance of MFIs, as measured by ROA. It is also. The result implies that the increasing the size of MFI by 1%, measured by its asset, financial performance of MFIs measured by ROA, also enhanced by 2.14%. The possible reason for positive significant impact of MFIs is that Ethiopian Microfinance Institutions are utilizing advantage of economics of scope and scale to enhance their financial performance.

CHAPTER FIVE

5. CONCLUSIONS AND RECOMMENDATIONS

In the previous chapter, the results of the study were presented and discussed. This chapter deals with the conclusions and recommendations of the study based on the findings. In addition recommendation for future research was included.

5.1. Conclusion

Based on the descriptive statistics on average the financial performance of sample Microfinance Institution are 2.9% as measured by return on asset. The average board size of sample Microfinance Institutions is 6. While the average audit committee size is 2 and the average female directors is one, this shows that board is dominated by male. And also on average 6 boards of directors were degree holder and above, however on average directors who have prior experience in the finance sector was one. In addition to this Ethiopian Microfinance institutions Board of directors averagely conduct 5 times per year. Moreover, only 1% of sample Microfinance Institutions have a female CEO.

The correlation analysis of the study revealed that Board experience in the finance sector, gender diversity of the board, meeting frequency of the board and MFI size (control variable) have positively and significantly correlated with ROA. Sizes of audit committee, size of the board, educational qualification of the board were negatively and insignificantly correlated with ROA. Female CEO also positively and insignificantly correlated with financial performance of ROA.

The regression analysis showed that existence of negative and insignificant association between board size (BS) and return on asset. This means that the insignificant effect of board size with financial performance of MFIs is negligible because of free ride board members.

The result also show that Board gender diversity (BGD) has no statistically significant relation was find with performance of MFIs, as measured by ROA, implying that female directors contribution for the performance of MFIs is negligible, which is assumed to be due to the very small numbers of female directors in the board.

Educational qualification of the directors (EQD) has positive and statistically insignificant impact on performance of MFIs as measured by ROA. The result indicates that qualified directors contribute for the performance of MFIs is negligible. These due to board members have other than business related knowledge and experience.

From the regression result, Board Experience in the Finance sector (BEFS) has positively and significantly influence return on asset. The result is stated in the way that the higher the numbers of directors who had earlier working experience in the microfinance industry, the higher will be the financial performance, as measured by return on asset. The result justified that board of directors who had an experience in the financial sector is highly important because they share the experience they had, challenges they faced and actions they took in their previous job. The result is also supported by many previous empirical studies.

Meeting Frequency of the board (MFB) has a significant positive impact on ROA and an increasing in meeting frequency will improve the financial performance of Ethiopian Microfinance Institutions. The result is consistent with previous studies in a way that the frequency of board meetings is a measure of board activities and effectiveness of its monitoring ability.

Further the result also confirms that audit committee size (ACS) does have negative and significant influence on financial performance of MFIs as measured by ROA. This indicates that the larger the size of an audit committee in the board, the lower will be performance of MFIs. Based on these findings it is concluded that the effect of size of audit committee has inversely related with financial performance of MFIs.

Female CEO has positive and significant effect on Ethiopia's Microfinance Institutions financial performance measured by ROA. The result reveled that the increases of female CEO in Ethiopian MFIs have great influence for improvement of financial performance of MFIs. The very nature of female that is carful, risk averse and decision makers which is necessary for good governance will improve the firm performance

Lastly the size of MFIs is an important factor with a positive and statistically significant contribution to financial performance of MFIs. This implies that increasing of MFIs also increase ROA because of MFIs enjoyed their economic scale and scope.

Generally, in this study the effect of corporate governance mechanisms on performance of MFIs is characterized by:

- ✓ Board size, Board gender diversity and Educational qualification of directors have negligible effect on the financial performance of Ethiopian MFIs.
- ✓ Male dominated of Ethiopian microfinance institution board member and chief executive office found in descriptive statistics.

- ✓ Board member experience in the finance sector, female CEO and Meeting frequency of board have significant and positive relationship with financial performance of MFIs.

5.2. Recommendations

The focus of this study was to examine the impact of corporate governance mechanisms on financial performance of microfinance institutions in Ethiopia. On the basis of the findings of this study, the Researcher has drawn the following recommendations.

- This research found that there are limited numbers of experienced board of directors in MFIs. But the experience of board of directors in the finance sector is positively and significantly affects the performance of Microfinance Institution. Therefore, the researcher recommends that Ethiopian Microfinance institutions should include experienced board in other finance related area to improve their financial performance.
- The research found that meeting frequency of board of directors has positive and significant impact on the financial performance of MFIs. Therefore it is advisable board members meet frequently by having good agenda and new idea to generate higher financial performance.
- MFIs should make their audit committee size small, so that there would be a smooth communication and a simple and transparent decision making process, which contributes in improving their performance. Because, as this study revealed, large size of an audit committee negatively affects performance and may not play its role effectively in mitigating the risk of fraud and misrepresentation of information and improve monitoring and transparency in operations which lead to timely and accurate reporting of the loan defaults and poor performance in an MFI.
- Microfinance Institutions should include qualified and competence female directors to enhance gender balance and to develop new product line for female clients of Microfinance Institutions as researcher found Microfinance institutions board was dominated by males.

5.3. Recommendation for future Research

The relationship between corporate governance mechanisms and MFIs' financial performance can also be further explained and the result will be more robust by increasing the sample size and number of year of observation. Moreover, the researcher recommend for future researchers to conduct study by including more unstudied corporate governance variables.

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Appendix

ST. MARY'S UNIVERSTIY COLLEGE

SCHOOL OF GRADUATE STUDIES

FACULTY OF BUSINESS

MBA IN ACCOUNTING AND FINANACE

RESEARCH QUESTIONNAIRE

Dear respondents this questionnaire is devised to gather data for research to be conducted on **the impact of corporate governance on financial performance of microfinance institutions in Ethiopia** as partial fulfillment of the requirement for the MBA in Accounting and finance .St. Mary university collage of graduate studies facility of business.

The aim this questionnaires is purely for academic value. Thus any response given will be kept confidentiality and wouldn't be used for any other purpose. So, your timely, genuine and frank response to the questionnaire vital for the successfulness of the study.

Student Name: - Wondemalem Fekadu Asfaw

E-mail:- wenduf@gmail.com

Direction:

- ✓ No need to write your name.
- ✓ Please kindly put this sign (√) on the appropriate box and give your justification if need.
- ✓ In case you have ambiguities on any of the given questions, please don't hesitate to contact me via my address.

Thank you in advance for your cooperation!!!

Part I: Personal information

1. Name of the Microfinance institution

   ____

2. Gender: Male ☐ Female ☐
3. Which of the following age categories describes you?

   A) Below 25 ☐ B) 25- 35 ☐C) 36- 45 ☐ D) 46-55 ☐E) Above 55 ☐

4. Educational qualification

   A) Below Diploma ☐ B) Diploma ☐C) Degree ☐ D) Masters ☐ E) PhD ☐

5. Work experience

   A) Less than 2 years ☐B) 2-5 years ☐ C) 6-10 years ☐D) 11-15 years ☐

   E) 16-20 years ☐ F) above 20 years ☐

6. Your position in the organization

   A) CEO ☐ B) Board secretary ☐ C) CEO and Chair person ☐D) Middle level manage ☐

   E) Supervisor ☐F) Board Member ☐G) Any other (Specify) ____________

7. Do you sit on Board as a member?

   A) Yes ☐ B) No ☐

Part III: Please fill the numbers Questions	Calendar						
	20010	2011	2012	2013	2014	2015	2016
Total number of directors sitting on the board							
Total number of female board of directors							
Number of board of members who had college degree and above							
Number of board of members who had experience in the finance sector like bank, insurance and other MFs							
The actual total number of board meeting hold per year							
Total number of Audit committee members under the board of MFIs							
Does CEO of the MFIs is female? Say “yes” or “No”							