MEKELLE UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

THE EFFECT OF CORPORATE GOVERNANCE ON THE PERFORMANCE OF MICROFINANCE INSTITUTIONS

ATHESIS SUBMITTED TO DEPARTMENT OF ACCOUNTING AND FINANCE IN PARTIAL FULFILMENT FOR THE DEGREE OF MASTER IN ACCOUNTING AND AUDITING

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DECLARATION

I hereby declare that this thesis entitled Assessing the Status of Corporate Governance in Selected MFIS in Ethiopia (The case of Board of Directors and Auditing) has been carried out by me under the guidance and supervision of Aregawi G.Michael Tirfe (PhD).

The thesis is original and has not been submitted for the award of any degree or diploma to any university or institutions.

Researcher's Name	Date	Signature
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APPROVAL SHEET

This is to certify that the thesis entitled Assessing the Status of Corporate Governance in Selected MFIS in Ethiopia (The case of Board of Directors and Auditing) prepared by ***Kidist Tsegaye Mitiku*****,** submitted to Mekele University in partial fulfillment of the requirement for the award of the Degree of Master of Art Degree in Accounting and Auditing and complies with the regulation of the university and meets the accepted standards with respect to originality and quality.

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LIST OF ACRONYMS

AdCSI	Addis Credit and Saving Institution
AEMFI	Association of Ethiopian Micro Finance Institutions
AGM	Assistant General Manager
AMFSC	Aggar Micro Finance Share Company
BD	Business Development
BE	Board Experience
BMF	Board Meeting Frequency
BODs	Board of Directors
BS	Board Size
BSC	Board Sub Committee
CBM	Competence of Board Members
CEO	Chief Executive Officers
CG	Corporate Governance
DCEO	Deputy Chief Executive Officer
ECG	Effective Corporate Governance
IA	Internal Audit
ICS	Internal Control System
MD	Managing Director
MFIs	Micro Finance Institutions
NFP	Non for Profit
NGO	Non-Governmental Organizations
OCSSCO	Oromia Credit and Saving Share Company
PEACE	Poverty Eradication and Community Empowerment
PY	Portfolio Yield
ROA	Return on Asset
ROE	Return on Equity
SAC	Size of Audit Committee

ABSTRACT

The research is centered on Assessing the effect of Corporate Governance on the performance of Selected MFIs. The researcher used explanatory research design based on quantitative approach in order to get better analysis of the study. In addition, correlation and regression analysis also computed through SPSS result. From the study findings prove that; Based on the statistics the financial performance of sample Microfinance, board size ranges from 5 to 10 members. This indicates that almost all sample MFIs have complied the regulation of NBE which need to have not less than 7 board members. With regards to educational background, the majority we can say 90 percent reveals that the board members have BA degree and above up to PhD. This show that, the board members have better educational background adequately understand financial reports and other company reports in order to know or better still make appropriate decisions that would help the institution grows. 83.3% characterized by the presence of competence directors that majority of the directors have business related educational background. The study shows around 63.3% board members have seven years and above experience in financial sector. This also contributes for better improvement of MFIs financial performance. So, effective implementation and strengthening the internal control system is very essential for MFIs growth and sustainability. The correlation analysis indicates that board size, educational back ground, Frequency of board meeting, and board experience in the sector are positively and significantly correlated with Return on Asset. However, Board sub-committee size is negatively correlated with return on asset. From the model summary above indicates that 88.3% of variation in the return on equity is explained by variations in corporate governance variables indictors. Four of the hypothesis is accepted and one was rejected and the null hypothesis is validated. The researcher recommended that, effective implementation and strengthening the internal control system is very essential for MFIs growth and sustainability.

Keywords: Corporate governance, financial performance, MFIs

CHAPTER ONE

INTRODUCTION

1.1.Background of the Study

Microfinance comprises the provision of loans and other financial services to the productive poor who cannot access formal financial intermediation. Indeed, microfinance has evolved primarily as a consequence of the efforts of individuals and agencies committed to the idea of ensuring that the poor have access to some form of credit (Kyereboah-Coleman, 2007). The microfinance industry is a new global industry that services the poorest market segments with banking services, mostly in developing and newly industrialized countries.

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. (National Bank of Ethiopia, 2012).

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 (Belete, 2015).

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. The number of shareholders range from 6 to 2,805 shareholders. There are also MFIs like Aggar, Dynamic, Lefayda, and Nisir MFIs that are purely established by private investors. The microfinance sector in Ethiopia is not yet proved to be a profitable venture than

investing somewhere else. As a result, most of the shareholders of the MFIs are regional governments, associations and NGO's. The sector has not yet been in a position to attract commercial conventional investors (Ebakeh, 2005).

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 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, boosting the microfinance institution's reputation and integrity and fostering the customer trust.

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 thrift, 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).

Therefore, Microfinance institutions are again adopting best corporate practices to increase the investors' confidence as well as other stakeholders. The improvement of corporate governance practices is widely recognized as one of the essential elements in strengthening the foundation for the long-term economic performance of countries and corporations (Belete, 2015).

During the last two decades, there is a tremendously development of the microfinance industry and its role in the economic growth of developing countries. This success can be attributed to their ability to grant small loans to those excluded from the formal banking sector due to lack of collateral (Belete, 2015).

The separation of ownership and control in modern corporations leads to an agency problem where the agent operates the firm in line with their own interests, instead of shareholders (Jensen & Meckling, 1976). The need for corporate governance arises from these potential conflicts of interest among stakeholders such as shareholders, board of directors and managers in the corporate structure. According to Imam and Malik (2007) these conflicts of interest often arise from two main reasons. First, different participants have different objectives and preferences. Second, the participants have imperfect information as to each other's actions, knowledge, and preferences. Corporate governance is intended at reducing divergence of interest and monitoring of con rolling interests of the firm, the absence of which firm value is declined (Nanka-Bruce, 2009).

1.2. Statement of the Problem

The microfinance sector in Ethiopia plays a crucial role in alleviating poverty and promoting economic development among underserved populations. However, many Microfinance Institutions (MFIs) struggle with systemic governance challenges that hinder their operational efficiency and financial sustainability (Ferede,2012). Corporate governance is integral to the performance and sustainability of Microfinance Institutions (MFIs), especially in the context of developing economies like Ethiopia. Despite the significant role that effective governance plays in achieving institutional goals, many Ethiopian MFIs face

challenges related to governance practices, which can impact their financial performance and overall effectiveness (Belete,2015).

As a result, this research seeks to investigate the relationship between corporate governance mechanisms and the financial performance of Ethiopian MFIs. Identifying these correlations is essential for enhancing governance frameworks that will not only improve financial outcomes but also foster greater trust and confidence among investors and stakeholders, ultimately ensuring the long-term sustainability of MFIs in Ethiopia.

1.3. Objectives of the Study

The general objective of this study is to assess the effect of corporate governance on the financial performance of selected MFI's.

The specific objectives include:

a. To examine the status of board size and its impacts on selected MFI's financial performance.
b. To examine competency (experience, educational qualification etc.) of board of directors and its effect on financial performance of selected MFIs.
c. To examine the effect of board meeting frequency on financial performance of selected MFIs financial performance.
d. To examine the effect of board experience on financial performance of selected MFIs financial performance.
e. To explore the size of audit committee and its effectiveness and its effect on performance of the MFIs.

1.4. Research Questions

To define the core issue and fulfill the aims and objectives of the research, research questions have been developed. This thesis aims to answer the following questions by utilizing the results obtained throughout the study:

a. In what ways do corporate governance factors affect the financial performance of microfinance institutions in Ethiopia?

b. What is the relationship between board size and the financial performance (measured by Return on Assets) of selected microfinance institutions?
c. How does the competency of board members (in terms of education and experience) affect the financial performance of microfinance institutions?
d. What effect does the frequency of board meetings have on the financial performance of microfinance institutions?
e. How does board experience in the finance sector influence the financial performance of microfinance institutions?
f. What is the role of the audit committee's size in the financial performance of microfinance institutions, and how does it compare to other governance variables?

1.5.Hypothesis of the Study

In this study based on the conceptual framework the following hypotheses were formulated to test:

Hypothesis – 1

H_{01}: Board size has no positive and significant effect on financial performance (ROA) of MFIs.

H_{a1}: Board size has a positive and significant effect on financial performance (ROA) of MFIs.

Hypothesis – 2

H_{02}: Competence of board members has no positive and significant effect on financial performance (ROA) of MFIs.

H_{a2}: Competence of board members has a positive and significant effect on financial performance (ROA) of MFIs.

Hypothesis – 3

H_{03}: Board experience has no positive and significant effect on financial performance (ROA) of MFIs.

H_{a3}: Board experience has a positive and significant effect on financial performance (ROA) of MFIs.

Hypothesis – 4

H_{a4}: Board meeting frequency has no positive and significant effect on financial performance (ROA) of MFIs.

H_{a4}: Board meeting frequency has a positive and significant effect on financial performance (ROA) of MFIs.

Hypothesis – 5

H_{05}: Size of audit committee has no positive and significant effect on financial performance (ROA) of MFIs.

H_{a5}: Size of audit committee has a positive and significant effect on financial performance (ROA) of MFIs.

1.6. Significance of the Study

It is believed that the study will have in valuable importance for different actors in the Corporate Governance system of MFIs. The BODs/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 will have a significant effect for the researchers in particular and academic community in general could use this study as a stepping stone for further studies on MFI's CG issues. Management of the MFIs may also find the study invaluable in making decisions regarding corporate governance issues. Generally, it is highly believed that the result of this study could contribute its own share for Micro finance institutions in terms of identifying relevant corporate governance mechanisms and their impact on their financial performance.

1.7. Scope of the Study

The scope of the study focuses on the effect of corporate governance on the performance of selected MFIs mainly focusing on boards structure (directors' size, capability, and experience, and the average frequency of board meetings and the effectiveness of the audit committee). To this end, the study targets and focuses on the microfinance institutions approved and licensed to operate by the National Bank of Ethiopia. The performance of these organizations is measured using the return on asset (ROA), indicating the efficiency of the institution.

1.8. Limitation of the Study

The concept of corporate governance in developing countries is not well developed and studies have not been conducted in sufficient depth, and the same is true in Ethiopia MFIs. In this regard, it would be better studying the effect of corporate governance on the financial performance of all MFIs in Ethiopia, but due to time, cost and other relevant limitations, the scope of this study will be limited to the effect of corporate governance on the financial performance of selected MFIs in Ethiopia. The study was also being limited by the fact that most of MFIs don't have well and organized data due to lack of technological support operation.

1.9. Organization of the Study

The study was organized in to five chapters. The first chapter introduces what the study is about and gives a brief introduction about the study, the problem statement, objectives, significance, scope and limitations of the study while chapter two provides a highlight of pertinent theoretical and empirical reviews of the literature and conceptual framework relevant to the study. The third chapter provides description about the methodology and the variables used in the study and the fourth chapter will present the results and discussions of the study conducted based on data collected from both secondary and primary sources. The study ends up with the conclusion and recommendations chapter, which is chapter five, that try to bring light for the conclusion and major findings of the study with possible recommendations in a manner that relates to the topic.

CHAPTER TWO

LITERATURE REVIEW

2.1.Theoretical Literature Review

2.1.1. The Concept of Corporate Governance

Governance is concerned with the manner in which rules and regulations are applied and followed, the relationships that these rules and regulations determine or create and the nature of those relationships (Otieku, 2010). Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission (Chenuos, Mohamed, & Bitok, 2014). It is concerned with creating a balance between economic and social goals and between individual and communal goals while encouraging efficient use of resources, accountability in the use of power and stewardship and as far as possible to align the interests of individuals, corporations and society.

Sound corporate governance encourages the efficient use of resources and provides for accountability for the stewardship of those resources by managers. Institutions that practice good corporate governance are more likely to achieve institutional objectives and goals. Good corporate governance should thus be of prime concern to owners and other stakeholders of these institutions. In fact, good corporate governance helps promote the general welfare of the society and should be of interest to the general public and governments. Corporate Governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. "Good governance is the ability of the board members to monitor the status of the organization, make good strategic decisions, and hold executives accountable for their execution. Ultimately, that comes down to the quality of the board members, the culture and practice of the board, and the power relationships among board members and executives" (Elisabeth, 2014).

A governance structure identifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and includes the rules and procedures for making decisions in corporate affairs. Corporate governance includes the

processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. Governance mechanisms include monitoring the actions, policies and decisions of corporations and their agents. Corporate governance practices are affected by attempts to align the interests of stakeholders. 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 member's remuneration, auditing, information, and the market for corporate control (Keasey et al 1997 as sited on Vishwakarma, 2015).

2.1.2. The Concept of Microfinance

The concept of microfinance has gained grounds and has been regarded as a poverty reduction tool especially on account of the success story of the famous Grameen Bank in Bangladesh (Kyereboah-Coleman, 2007**).** While the concept has been used globally for centuries; it's Bangladesh's Muhammad Yunus who is credited with being the pioneer of the modern version of microfinance. While working at Chittagong University in the 1970s, Yunus began offering small loans to destitute basket weavers. Yunus carried on this mission for nearly a decade before forming the Grameen Bank in 1983 as a way to reach a much wider audience. The notation become known as microcredit, and as it spread to other countries, it is on the way of giving millions of people the opportunity to pull themselves out of abject poverty.

Microfinance has been variously defined in the literature. No single definition exists, variations are mostly a matter of emphasis Narrower definitions equate microfinance with microcredit, following early practice of NGO credit schemes. Microcredit is the provision of small loans to poor households and small business operators with or without guarantee (Obo, 2009).

Microfinance refers to the provision of formal financial services to poor and low-income (and, for credit, in particular, non-salaried) people, as well as others systematically excluded from the financial system. As noted, microfinance embraces not only a range of credit products (for business purposes, for consumption smoothing, to fund social obligations, for emergencies, etc.), but also savings, money transfers, and insurance (CGAP/World Bank, 2012). 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. Microfinance industry is the primary source of credit and saving to low income earners (Chenuos et al., 2014).

Therefore, Microfinance institutions are a formal (i.e., legally registered) entity whose primary activity is microfinance. Licensing and supervision of Microfinance Business Proclamation No. 626/2009 defines micro- financing business as the provision of financial services like accepting savings, extend credit, drawing and accepting drafts payable, providing money transfer services and others specified in the Article 3(2) of the proclamation (Government of Ethiopia, 2009). This definition of microfinance business does not confine microfinance business to only credit as done elsewhere in other countries. Therefore, it is in line with the best practice which defines Microfinance as the provision of a wide range of financial services to the low-income people and micro and small enterprises that usually lack access to formal financial institutions (Banks). Microfinance is not limited to borrowing but also includes other financial services such as savings, micro-insurance, local money transfer, capital goods leasing etc.

2.1.3. Agency Theory

The agency theory assumes that owners of an organization (principals) and those that manage the organization (agents) have different interests. Hence owners will face the problem that managers are likely to act according to their own interests rather than the owners' interests (Fama & Jensen., 1983). In this regard, boards are required to monitor managers on behalf of the owners. 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 mechanism 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 mechanisms affect financial performance. As a consequence, enhancing corporate governance mechanisms should result in improved financial performance. Taking agency theory into consideration, the study variables were identified with the aim of examining the relationships between corporate governance mechanisms and 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 mechanisms considered in this research include

Board Size, Board Composition, Board competency, Board experience in the sector, Meeting frequency of Board, Audit committee size, CEO duality and CEO gender.

2.1.4. Resource Dependency Theory

In addition to monitoring, board members are also required to provide organizations with resources (Hillman & Dalziel, 2003). The provision of resources is linked to the resource dependence theory. This theory holds that organizations are interdependent (Pfeffer & Salancik, 1978) in that they depend on each other and various actors for their survival as well as for resources. As a result, they need to find different ways of managing this dependence and ensuring they get the resources and information they need. From this perspective, the board is seen as one means of reducing uncertainty by creating influential links. Board members provide organizations with various resources through board members' skills, experience, and expertise. Pfeffer and Salancik (1978) also note that 'when an organization appoints an individual to a board, it expects the individual will come to support the organization, will concern himself with its problems, will invariably present it to others, and will try to aid it'.

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm (Abdullah & Valentine, 2009). According to this theory the primary function of the board of directors is to provide resources to the firm. Directors are viewed as an important resource to the firm. When directors are considered as resource providers, various dimensions of director diversity clearly become important such as gender, experience, qualification and the like. According to Abdullah and Valentine, directors bring resources to the firm, such as information, skills, business expertise, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Boards of directors provide expertise, skills, information and potential linkage with environment for firms (Ayuso & Argandona, 2007).

The resource based approach notes that the board of directors could support the management in areas where in-firm knowledge is limited or lacking. The resource dependence model suggests that the board of directors could be used as a mechanism to form links with the external environment in order to support the management in the achievement of organizational goals (Wang, 2009).

Diversity in the composition of boards is important if boards are to effectively provide advice and resources. Board members with different skills and experience and of both genders contribute to effective resource provision and to the beneficial performance of organizations. Moreover, qualified and skillful board members can be considered as a strategic resource to provide a strategic linkage to different external resources.

Both agency and resource dependency theories advocate that boards should have a diversity of competent members who are able to effectively monitor top managers and provide organizations with the resources they need. By performing these roles, board members are able to positively influence the performance of organizations.

2.1.5. Operational Definition of Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. The term is also used as a general measure of a firm's overall financial health over a given period. Financial performance is the company's financial condition over a certain period that includes the collection and use of funds measured by several indicators of capital adequacy ratio, liquidity, leverage, solvency, and profitability. Financial performance is the company's ability to manage and control its resources (IAI, 2016).

Financial performance is the financial achievement of the company; it is important to understand the managers of the company. The ratio of liquidity, solvency, profitability efficiency, leverage can be used as a benchmark of financial performance. The data can be extracted from the financial statements; cash flow, balance sheet, profit-loss and capital change. The financial statements are financial records covering cash flows, balance sheets, profit-loss and capital changes that become information for corporate managers in taking the company's financial policy. The financial statements are the financial condition of a company comprising the balance sheet of profit/loss calculation, and other financial information, such as cash flows and retained earnings (Didin, 2017).

Financial performance is a measure of how much a company’s ability to create profit, profit or revenue. How do I measure the company's financial performance in creating profit, especially companies in the financial industry such as Banking? This can be viewed from the financial statements. The financial statements consist of; Balance Sheet, Income, Cash flow,

Changes in capital. These financial statements are usually prepared and reported in annual, semester or trimester periods. It depends on his needs. Sometimes financial statements can be made different versions depending on their interests.

2.2.Empirical Literature Review

2.2.1. Corporate Governance and Microfinance Institutions Performance

Governance in microfinance refers to the mechanisms which ensure donors, creditors and equity investors, that their funds will be used according to the intended purposes. Good governance in the Ethiopian deposit taking MFIs plays an important role in increasing outreach, improving transparency, accountability, sustainability, profitability, efficiency, effectiveness, responsibility and responsiveness to the changing environments (Amha, 2008).

The ultimate goal of microfinance industry is to contribute to development and alleviation of poverty through reaching for low income productive poor people. To achieve this goal MFI in Ethiopia should be financially strong enough. Therefore, MFI profitability is a paramount. There are factors that lead MFI financial performance either weak or strong. Various researches have been done on such factors. One of the focuses was corporate governance. Even though many studies have been conducted to identify the relationship between corporate governance practices and firm performance, there are limited scholarly studies conducted for the microfinance industry in relation to corporate governance. The empirical analysis of good corporate governance practices in relation to MFIs is still at an immature stage and it is important to conduct more studies in this field to enhance MFIs' development (Thrikawala, 2013).

"The paramount risk facing the microfinance sector in Sub-Saharan Africa is that of governance, and more precisely risk governance. Within governance, there is a lack of appreciation and understanding of the role that risk management should play within a financial institution" (CSFI, 2014). According to Thrikawala (2013) there is need for further empirical research for MFIs using micro econometric techniques, such as regression analyses of panel data to support the conceptual literature currently available. His finding encourages MFIs to consider further significant governance factors which will improve and sustain the industry. Chenuos et al., (2014) found that good governance structure is important in the young and immature microfinance industry as it has an effect on the institution performance.

Danoshana and Ravivathani (2013) documented that corporate governance practices of Board Size, Meeting Frequency and Audit Committee Size have significant impact on firm performance and Board Size and Audit Committee are positively related with firm's performance but Meeting Frequency has negative relation. Further, researcher concluded that, corporate governance can be improved in Sri Lanka by companies maintain their board size to nine directors, meetings to once a month and audit committees to four members.

The board of directors is an internal governance mechanism that helps resolve the agency problems between owners and managers. Board members are elected by shareholders to monitor and advice managers on behalf of owners. The degree of alignment of board composition and shareholders' objectives is measured in the empirical corporate governance literature by the proportion of outside/independent directors (Hartarska, 2004).

In MFI, board Members are the ultimate decision maker and stewards of the shareholders' investment with fiduciary responsibility as well as the duty to balance the social mission and financial objectives of MFIs (Obo, 2009). Effective governance depends primarily on the skills and characteristics of the individual directors. Collectively, these attributes should represent a diverse set of experiences, backgrounds, area of expertise, ethnicity and gender (Ayalew, 2007).

In spite of the generally accepted notion that effective corporate governance enhances MFI performance, other studies have reported a negative relationship between corporate governance and MFI performance (Hutchinson, 2002). The corporate governance elements considered in this research include board size, board competency, board experience in the sector, meeting frequency of board and audit committee size.

2.2.2. Board Size and MFI Performance

Board size is the number of directors in a given Microfinance. A microfinance board should be large enough to incorporate the various skills, including audit skills, legal knowledge, knowledge of the target market and social perspective in order to complete their work effectively (without overburdening members), to provide continuity, and to ensure quorums for meetings (Council of Microfinance Equity Fund, 2012). It was further stated by the Council of Microfinance Equity Funds (2012) that it is important to have people in the board that are politically influential so that they can assist with political issues, tap funding, and to

enhance public image. However, determining an ideal size of the board has being an ongoing and controversial debate in corporate governance literature (Lawal, 2012). Whether large or small board help improve firm performance it is debatable issue and researchers found mixed result about the relation between board size and firm performance.

The size of the board is measured by the number of board members as has been done by many authors such as Hermalin and Weisbach (1999, 2002), (Ferede, 2012), (Akpan, 2015) and (Jensen & Meckling, 1976). In their various studies, the size of the board has been seen to have an inverse relationship with firm performance. Jensen (1993) argues that a larger board leads to less effective monitoring due to coordination and process problems inherent in large board size. Larger boards can be less participative, less cohesive, and less able to reach consensus. Small board size was favored to promote critical, genuine and intellectual deliberation and involvement among members which presumably might led to effective corporate decision making, monitoring and improved performance (Lawal, 2012). Moreover, Akpan (2015) found that board size and equity are also found to be negative and significant with company performance. Ferede (2012) also found that the numbers of board of directors are negatively related with Ethiopian commercial banks' financial performance. His result indicates that small boards are more effective in monitoring and controlling banks management and it help to reduce agency costs. Thus, it is expected that the size of the board would have a direct correlation with performance.

In contrast, 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 (Chenuos et al., 2014). Moreover, Klein (2002) suggested that larger boards able to promote effective monitoring due to their ability to distribute the work load over a greater number of observers. Moreover, results from Akpan and Amran (2014) study showed that board size has positive significant influence on company performance. Therefore, our alternative hypothesis is that board size has a significant positive relationship with MFI financial performance.

2.2.3. Board Competency and MFI Performance

Board Competency refers to Educational Qualifications 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. 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). Ayalew (2007) stated that in Ethiopia, Board members of most MFI do not have awareness and hence do not apply best practice corporate governance in their MFIS.

Several studies have found a positive relationship between competencies and firm performance. Directors' specialist knowledge will be valuable to the creation of a strong and informed board (Saat et al., 2011). Board of directors is vested with the responsibility of ensuring that the shareholders' money is not wasted, shareholders have a serious interest in ensuring that the board is staffed with well-educated and experienced directors (Gantenbein & Volonte, 2011). They also found that Educational qualification affects the oversight and monitoring role of boards of directors. Akpan (2015) found board education is positively significant impact on the firm performance. Moreover, Ferede (2012) found that the presence of qualified directors on the board plays an important role in carrying out the boards monitoring responsibility and in improving financial performance. Thus, board member's educational qualification has a significant positive effect on Ethiopian banks financial performance. Therefore, the study argues there is a significant positive association between Board competencies and MFIs financial performance.

2.2.4. Board Experience in the Finance Sector and MFI Performance

Board experience in the sector refers to board member who had any finance related work experience. Ayalew (2007) stated that in Ethiopia, Board members of most MFI 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). Their paper claimed that 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.

Moreover, Ferede (2012) found that a positive association is found between industry specific experience and return on asset and return on equity in Ethiopian Banking Industry. Thus, this paper argues that there is a significant positive association between board members experience in the sector and MFI financial performance.

2.2.5. Meeting Frequency of Board and MFI Performance

Meeting frequency refers to how much time Board meet on a year. For 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, 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 (Danoshana & 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 and Vefeas (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 and 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 statistically significant and positive association between the frequency of board meeting and corporate performance exist (Ntim & Osei, 2011). This implies that the board of directors in South Africa that meet more frequently tend to generate higher financial performance. Moreover, Ntim and 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. Thus, it is expected that there is a significant positive association between board members meeting frequency and MFI financial performance.

2.2.6. Size of Board Audit Committee and MFI Performance

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.

Internationally, the audit committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of the independent auditor, and receipt of audit results both internal and external. The committee assists the board of directors fulfill its corporate governance and overseeing responsibilities in relation to an entity’s financial reporting, internal control system, risk management system and internal and external audit functions. Its role is to provide advice and recommendations to the board within the scope of its terms of reference/charter.

Empirical findings on the effect of size of audit committee and corporate performance show mixed results. Danoshana and Ravivathani (2013) found that increasing Audit Committee Size will result high financial performance, because detailed discussion on the financial statement of the companies will lead to get more ideas regarding the reports and it will guide

to increase the firm's performance. However, in Ethiopia banking industry, Ferede (2012) found that large number of audit committee has a negative and significant effect on financial performance. He added that Limiting audit committee size to reasonable number improves audit committee effectiveness. Thus, it is expected that there is a significant negative relationship between size of audit committee and financial performance.

2.1.6. Financial Performance Measurement in MFIs

The financial performance of microfinance institutions measured through the most important indicators that, taken together, provide a reasonable overview of the financial condition of a microfinance institution with one of four main categories: portfolio quality, efficiency and productivity, financial management and profitability. One of the four main categories in which the financial performance measured is profitability.

Profitability measures, such as return on equity (ROE) and return on assets (ROA), tend to summarize performance in all areas of the company. If portfolio quality is poor or efficiency is low, this will be reflected in profitability. Because they are an aggregate of so many factors, profitability indicators can be difficult to interpret. The fact that an MFI has a high return on equity says little about why that is so. All performance indicators tend to be of limited use (in fact, they can be outright misleading) if looked at in isolation and this is particularly the case for profitability indicators. To understand how an institution achieves its profits (or losses), the analysis also has to take into account other indicators that illuminate the operational performance of the institution, such as operational efficiency and portfolio quality. The profitability analysis is further complicated by the fact that a significant number of microfinance institutions still receive grants and subsidized loans. "Comparing apples with apples" is always a problem in microfinance, because subsidies are still widespread and accounting practices vary widely.

Return on equity indicates the profitability of the institution. This ratio is particularly relevant for a private for-profit entity with real flesh-and-blood owners. For them, RoE is a measure of paramount importance since it measures the return on their investment in the institution. However, given that many MFIs are not-for-profit-organizations, the RoE indicator is most often used as a proxy for commercial viability.

Return on assets is an overall measure of profitability that reflects both the profit margin and the efficiency of the institution. Simply put, it measures how well the institution uses all its assets.

Portfolio yield measures how much the MFI actually received in cash interest payments from its clients during the period. A comparison between the portfolio yield and the average effective lending rate gives an indication of the institution's efficiency in collecting from its clients. It also provides insight into portfolio quality since most MFIs use cash accounting and portfolio yield does not include the accrued income that delinquent loans should have generated, but did not.

2.1.7. Summary of Literature and Research Gap

Mori (2014) explored the effect of board of directors' characteristics (age, gender, and education) on their ability to effectively perform their board roles (monitoring and resource provision). They used the agency theory and resource dependence theory by a survey conducted with 105 board directors representing 63 microfinance institutions from three East African countries (Kenya, Tanzania, and Uganda) to test the empirical relationship between directors' characteristics and boards' performance found that there is a positive relationship between directors' age and their ability to monitor and provide the board with resources. The study also revealed that the effect of directors' level of education on boards' performance is positive, while no evidence was found with regard to the effect of female directors on boards. The findings imply that board directors need to be appointed based on their personal characteristics and their ability to perform their roles.

Ferede (2012) studied the impact of corporate governance Mechanism on Bank performance in Ethiopia and concluded that large size board and audit committee negatively influences financial performance; board members educational qualification positively associated with financial performance; industry specific experience of director positively related with return on asset but it has a negative effect on net interest margin; and the percentage of female directors and board members business management experience does not have a significant effect.

However, according to Thrikawala (2013) there is need for further empirical research for MFIs using micro econometric techniques, such as regression analyses of panel data to

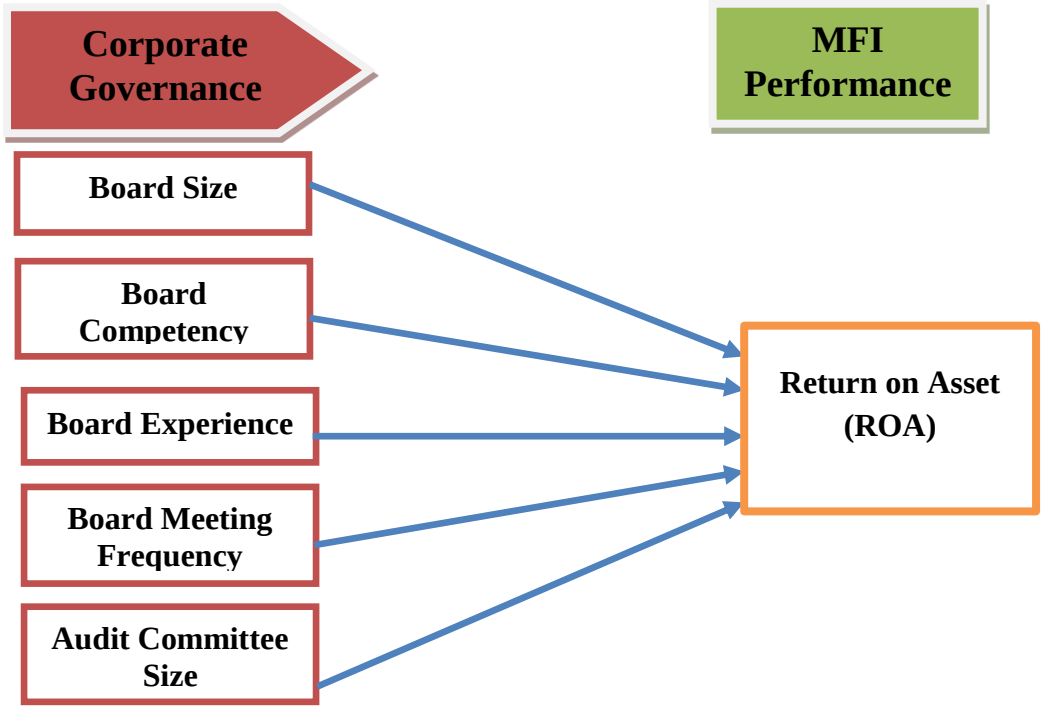
support the conceptual literature currently available. His finding encourages MFIs to consider further significant governance factors which will improve and sustain the industry. He added that empirical analysis of good corporate governance practices in relation to MFIs is still at an immature stage and it is important to conduct more studies in this field to enhance MFIs' development.

In addition, the results that the researcher discussed above will not be generally applicable to Ethiopia's Microfinance Institutions as most of the research conducted covering small period and the sample was from specific country. In addition to this, the peculiar nature of MFI in Ethiopia in terms of ownership structure and regulation makes Ethiopian MFIs different. Further the banking sector in Ethiopia is different from that of Microfinance Institutions in such a way that majority of microfinance Institutions have dual mission (being sustainable and social mission).

2.3.Conceptual Framework of the Study

Based on empirical literature on corporate governance and MFI performance above the researcher developed conceptual model as shown below

Figure 2.1: Conceptual Framework of the Study



Source: researcher own design

Operational Definition and Measurement of Variables

Give brief explanation on how each variable is going to be measured is important to know whether the independent variables have reasonable impact on influencing the dependent variable.

Board size variable measures the number of directors in any given MFI which have an impact positively or negatively. If the board size is very small or large enough both have negative impact on reaching common consensus in several issues need the agreement of the members on solving the problem and giving appropriate direction. But, if the board size is moderate it is believed that, this give a favorable condition to reach on common consensus among the board members and for giving proper direction to solve any problems encountered in the operation of the MFI. So, Board size measured with respect to financial performance of the MFI.

Board Competency variable measures the Educational Qualifications of individual board members in contributing the effective corporate governance for financial performance of the MFI. 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.

Board experience variable on MFI measures the board member who had any finance related work experience. In practice most MFI do not have awareness and hence do not apply best practice corporate governance in their MFIs. Measurement of BODs experience variable will measure experience in terms of number of years or using any other way, will you measure qualification in terms of years of schooling, etc.

Measurement of frequency of board meeting variable measures how much time Board meet on a year. For board to effectively perform its oversight function and monitor management performance, the board must hold a regular meeting. In addition, the frequency of board audit committee also measured as a variable on assessing the financial performance of MFIs.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This chapter explains about the collection, measurement and analysis of data. It includes decisions such as type of data to be found, sample design, techniques of data collection and way of data analyses (Kothari 2004). This chapter identifies the research methodology and also explains the population and sampling procedures that has been followed to derive the data for the analysis. The various data collection tools and methods of analysis used during the course of the analysis are also explained.

3.1. Research Design

Examining the effect of corporate governance variables on the financial performance of MFIs in Ethiopia is the primary objective of this study. To achieve this objective, survey of explanatory type of research design with a mixed approach, more of quantitative were employed. The explanatory type of research design was used to identify and evaluate the causal relationships between the different variables under consideration. Therefore, in this study the explanatory research design was employed to examine the relationship of the stated variables. It is believed that mixed methods research provides better (stronger) inferences. Therefore, by using a mixed approach it is able to capitalize the strength of quantitative and qualitative approach and remove any biases that exist in any single research method.

3.2. Sampling Design

According to Association of Ethiopian Micro Finance Intuitions (AEMFI), there are 46 microfinance institutions in the country and 34 are AEMFI members, of which nineteen are for profit MFIs while the rest are not for profit (NFP) MFIs and they are in different stages of development and exhibit high level of diversity in aspects such as ownership and leadership. For this study it was found appropriate to use a purposive sampling technique from which six MFIs, which are willing to provide data and had complete five-year data, were selected. The sampled MFIs selected from different structure of MFIs. From government affiliated MFIs; Oromia Credit and Saving Share Company (OCSSCO) and Addis Credit and Saving

Institution (AdCSI). From NGO backed MFIs; Vision Fund Micro Finance Institution and Poverty Eradication and Community Empowerment (PEACE) micro finance institution. From Private Commercial MFIs; Aggar Micro finance S.C., Dynamic Micro Finance S.C., and Nisir Microfinance Institution S.C.

Due to the nature of the subject matter, Board members, Audit committee of the board, Chief Executive Officers (CEOs), Deputy Chief Executive Officers (DCEOs), management members, internal auditors, accountants and credit and saving officers were participated on the questionnaire response.

In addition to this, in order to minimize the biasness for responding on the information with regards to their internal governance problem, cross checking relevant information and data were collected from the main stakeholders like from DBE staff and from regulatory body NBE staff.

3.3. Source of Data and Collection Methods

The necessary data for this study were collected both primary and secondary data from internal and external sources. For internal sources; Proclamations such as MFI establishment proclamation, Bylaw of each institution, Manuals and working Guidelines, minutes of management and board, etc. are included and examined. For external secondary data source such as Proclamation to the establishment of MFIs, NBE directives, etc. were used to acquire necessary information's.

As a secondary data from internal sources, audited financial statements of MFIs over a period of five years (2015-2019) were examined. To know the perception of each MFIs staff, data were collected through questionnaires as a primary source. The questionnaire was developed to collect the required data for this study such as size of board, educational qualification of board members, industry specific experience of board members, and size of audit committee, internal audit system and external audit system. The questionnaire was designed in such a way that it can identify the effect of corporate governance mechanisms in the financial performance of each MFI's and capture both the dependent and explanatory variables considered in the study. Questionnaires were distributed to each selected respondents of the MFIs.

3.4. Method of Data Analysis

Data analysis involves editing, coding and tabulation of collected data (Kothari 2004). The analysis process applies both qualitative and quantitative techniques of data presentation. It will also use tables and percentages.

The explanatory variables considered in this study were greater than two in number, so multiple regression statistical tools, which can reveal the relationship between the dependent variable and the effect of each independent variable as well as the multiple regression between the dependent and the collective effect of independent variables, was found to be appropriate to analyze the data collected from the survey. The survey response was analyzed to measure correlations and report statistics, coefficient of multiple correlations, and regressions. F test and t-test was also used to determine the significant of multiple correlations at 5% level of significance. In order to simplify the analysis process, SPSS version-21 software was used in the study.

3.4.1. Inferential Statistics Analysis

Hair et al. (2010) proposed that before any data analysis is performed, the assumptions correlating the size of the sample, scales of variables, multivariate normal distribution and outliers, and their multi collinearity should be checked first (Lee et al., 2010).

3.4.1.1. Pearson Correlation Analysis

In this study, Pearson's correlation coefficient or measure of associations was used to determine the relationships between corporate governance dimensions (board size, competence of board members, board experience, board meeting frequency and size of audit committee) and financial performance. The value of coefficient of correlation, a statistical measure of association between two variables, ranges from r = +1.0 for a perfect positive correlation to r = -1.0 for a perfect negative correlation. No correlation is indicated for r = 0. The correlation coefficient indicates the strength of the relationships of two variables and the direction of that relationship. As "r" approaches to 0 on either side there is a weak relationship between the dependent variable and independent variable (Hair et al., 2010).

3.4.1.2. Multiple Regression Analysis

In multiple linear regression, it is assumed that there is a linear relation between a variable Y (dependent variable) and K independent variables X_j (j = 1, 2, ..., K). It is a suitable method of analysis when the determination of the impact of two or more independent variables in a dependent variable is desired (Hair et al., 2010). In order to investigate the effect of corporate governance dimensions (board size, competence of board members, board experience, board meeting frequency and size of audit committee) on financial performance of the MFIs, the following multiple linear regression model were considered:

The specified model was as follows:

$$ROA = \beta_0 + \beta_1(BS) + \beta_2(CBM) + \beta_3(BE) + \beta_4(BMF) + \beta_5(SAC) + \varepsilon$$

Where:

ROA = Return on Asset

β_0 = Constant

$\beta_1, \beta_2 \ldots \beta_5$ = Slope (Regression Coefficients)

BS = Board Size

CBM = Competence of Board Members

BE = Board Experience

BMF = Board Meeting Frequency

SAC = Size of Audit Committee

ε = is the total error of prediction (residual)

However, before running this model, it is necessary to verify compliance with certain assumptions associated with linear regression models in order to check the model is valid. These are:

Checking for Outliers

Multiple regression is very sensitive to outliers (very high or very low scores). Checking for extreme scores is the second assumption and should be part of the initial data screening process. It is going to be done for all the variables, both dependent and independent, that would be used in the regression analysis. Outliers can either be deleted from the data set or, alternatively, give a score for that variable that is high, but not too different from the remaining cluster of scores. Outliers can be identified from the standardized residual plot that

can be requested or by looking at the values of skewness and kurtosis which should be between -2 and 2 (Hair et al., 2010).

Homoscedasticity Test

The second assumption concerns about homoscedasticity of residuals. Residuals are the differences between the obtained and the predicted dependent variable (DV) scores. The residuals must have a homogeneous variance around a null value average, and the value of residuals must be constant throughout the observation interval. This assumption was verified by observation of residuals scatterplots charts for the model, and if there is lack of pattern indicates equal variances. Homoscedasticity or simply the variance of the residuals about the predicted dependent variable scores should be the same for all predicted scores (Hair et al., 2010).

Normality Test

The third assumption refers to the normal distribution of residuals. The observation of the normal distribution of residuals chart concluded that the errors are normally distributed for the model. The values fall along the diagonal without substantial or systematic deviations, which indicates a normal distribution of errors or simply the residuals should be normally distributed about the predicted DV scores or simply the distribution mean should be 0 and standard deviation should be 1 (Hair et al., 2010).

Linearity Test

The Linearity assumption specified that the residuals should have a straight-line relationship with predicted DV scores or the small circles are close to the diagonal line (Hair et al., 2010).

Multi collinearity Test

The fifth assumption is the existence of multi collinearity, all the independent variables were checked for the existence of multi collinearity (i.e. Multi collinearity exists when there is a strong correlation between two or more independent or predictor variables in a regression model). To test whether there is multi collinearity the simplest diagnostic is to use the correlation coefficients, extreme collinearity being represented by a correlation coefficient of 1. The rule of thumb is that the presence of high correlations (generally 0.90 and above) indicates substantial collinearity (Hair *et al.* 2010). Other common measures include the tolerance value and the Variance Inflation Factor (VIF). Hair *et al.* (2010) recommend that a

very small tolerance value (0.10 or below) or a large VIF value (10 or above) indicates high collinearity. If there is high collinearity between the independent variables, the researcher will exclude one of the variables. After checking that there is no high collinearity between the independent variables, the researcher is going to analyze each of the independent variables with the dependent variable to know their individual effects they have on the dependent variable. The coefficient of determination (R^2) measures the amount of the total variance in the dependent variable that is accounted for by knowing the value of the independent variable. The coefficient of determination (R^2) ranges in value from 0 (when the estimated regression equation has none of variation on the dependent variable) to 1 (when all point lies on regression line) i.e. $\mathbf{0 \leq R^2 \leq 1.}$

Multiple linear regression analysis was performed with SPSS software using the Standard Multiple Regression method and the regression analysis was used to test the proposed hypotheses.

3.5. Operational Definition of Variables and Measurements

In this study, the variables were selected based on alternative theories and previous empirical studies related to corporate governance and firm performance. In accordance with the theory and empirical studies, the independent and dependent variables of the study were identified in order to investigate the status and impact of corporate governance on the financial performance of selected MFIs in Ethiopia.

3.5.1. Dependent Variable

The dependent variable considered in this study is a variable that is used to assess the effect of corporate governance in financial performance of selected MFIs and is defined as follows:

Dependent variable **(Financial Performance)** was measured by annual Return on Assets (ROA), which is a standard finance literature measure of performance. It shows how management of an entity has been able to turnover assets of the organization over-one-year. To a large extent, ROA also deal with operational sustainability of the selected MFIs (David & Olweny, 2013).

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

3.5.2. Independent Variables

The independent variables which were considered for this study are variables that are used as a determinant of corporate governance of MFIs. These are board's size, board members' educational qualification, board member's industry specific experience, board Meeting frequency and size of audit committee. The definition and measurements of the variables are as follows:

3.5.2.1. Board Size (BS)

Board size can be defined as the number of directors sitting on the board. According to 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 performance positively.

3.5.2.2. Competence of Board Members (CBM)

Board competence is qualifications of individual board members. The expertise, competence and quality of a firm's board inevitably impacts on performance (Rose, 2007). The higher the quality, the better will be the financial performance of the firm. The study used the number of board members who have received college degree education or above as a proxy for board quality and competence. Hence, the researcher expects this variable to have a positive correlation with Microfinance Institutions performance.

3.5.2.3. Board Experience in the Finance Sector (BE)

This was measured as the percentage of directors who have business management experience against the total number of board members. Prior researchers measured experience using proxy variables such as industry specific and generic experiences (Kroll et al., 2008). It is important for firms to have experienced directors on board since it helps them in undertaking their duties of monitoring and controlling the management in an effective and efficient way. Directors' experience of managing businesses will also increase their effectiveness since they fully understand the general business situation (Saat, et al., 2011).

3.5.2.4. Board Meeting Frequency (BMF)

Meeting frequency how much time Board meets on a year during the period under review. In fact, Sonnenfeld (2002) 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). The researcher expects the number of board meeting has a positive impact on Ethiopian microfinance institutions financial performance.

3.5.2.5. Size of Audit Committee in the Board (SAC)

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.

Table 3.1: Description of the Variables used in the Regression Model

Variable	Measures	Notation
Dependent Variable		
Financial performance	$\frac{\text{Profit After Tax}}{\text{Total Asset}}$	ROA
Independent Variable		
Board Size	Number of directors sitting on the board.	BS
Competence of Board Members	Number of directors who had college degree or higher.	CBM
Board Experience	Number of directors who served in other finance sector earlier in the same capacity.	BE
Board Meeting Frequency	Number of meeting in the year	BMF
Size of Audit Committee	Number of directors sitting on the board.	SAC

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATIONS

This chapter presents the results of the investigation by the researcher based on the methodology sated in chapter three. It includes the general background of the respondents and detailed discussion of the four specific objectives, analysis of statistics, and correlation and regression analyses through IBM SPSS version 21. The findings of the study were also discussed in a relation to the literature review.

4.1.Demographic Characteristics of the Respondents

The demographic characteristics of the respondent's encompass sex, respondent position, respondent work experience and academic qualification of board member's. Frequency and percentage of the respondents were presented below.

As shown in Table 4.1 below, the gender distribution of the respondents constituted 46 (76.7%) male respondents and 14 (23.3%) female respondents. From this we understand that the numbers of Male's are more than threefold that of their counterpart.

Regarding respondent position as shown in Table 4.1 below, 6(10%) respondents were CEOs, 17(28.3%) respondents were management members, 12(20%) respondents were non-management members, 14(23.3%) respondents were auditors, 10(16.7%) respondents were accountants and the rest 1(1.7%) were other staff.

Concerning the respondent work experience as shown in Table 4.1 below, the majority 43(71.6%) respondents have experience on MFIs with the range of 6 to 15 years. Respondents who have more than 15 years are 9(15%) and who have less experience which is 5 years and below are 8(13.3%).

The Table 4.1 presentation below also shows the academic qualification and experience of the board members. Those with accounting & finance experience represent a response rate of 19(31.7%), banking and insurance 16(26.6%), business management 15(25%). The remaining 6(10%) are represent experience in HRM and the least which represent a response rate of 4(6.7%) is as of legal. In general, the high rate of response in relation to financial related fields (accounting and finance, banking and insurance and business management) shows that most of the board members fall in this category.

Table 4.1: Gender Composition of Respondents

No	Indicators	Category	Frequency	Percent
1	Gender	Male	46	76.7
		Female	14	23.3
Total			**60**	**100.0**
2	Respondent Position	CEO	6	10.0
		Mgt member	17	28.3
		None Mgt member	12	20.0
		Auditor	14	23.3
		Accountant	10	16.7
		Other staff	1	1.7
Total			**60**	**100.0**
3	Respondent Work Experience	Up to 5 years	8	13.3
		6 to 10 years	23	38.3
		11 to 15 years	20	33.3
		16 years and above	9	15.0
Total			**60**	**100.0**
4	Academic Qualification of Board Member's	Accounting & finance	19	31.7
		Banking & Insurance	16	26.6
		Business mgt	15	25.0
		HRM	6	10.0
		Legal	4	6.7
Total			**60**	**100.0**

Source: SPSS Output (2021)

4.2. Statistical Description of the Study Variables

4.2.1. Size of Board Members (Board Size)

As shown in the Table 4.2 below, institutions which have board size less than 5 board members are 0(0%), those selected MFI's with board members from 5 to 7 were (66.7%) this means that most of the MFIs in this study had 5 to 7 board members. Institutions who have board members of 8 to 10 were 2(33.3%) and those with more than 10 board members are

0%, which means there is no MFI who have more than 10 board members. Beside this the mean ROA increased from 0.072 to 0.24 as the size of board members increased between 5 to 7 members to 8-10 members. This result indicated that as the size of the board members increased the ROA also increased, which in turn resulted an increase in the financial performance of the selected MFIs.

Table 4.2: Size of Board Members (Board Size)

Board Size	Frequency	Percent	Mean of ROA
Less than 5 members	0	0%	0
5 to 7 members	4	66.7%	0.072
8-10 members	2	33.3%	0.24
More than 10 members	0	0%	0
Total	**6**	**100.0%**	**0.312**

Source: SPSS Output (2021)

4.2.2. Board Member's Educational Background

With regards to educational background, as shown in Table 4.3 below, the majority 56.7 reveals that the board members have BA degree followed by 30% who have Master Degree. The higher and lower Board members educational background explained in the study is 3.3% for PhD and 10% for diploma holders. The majority 90% board members have educational background BA degree and above. The verification of the number of board members with BA degree and above permits the researcher to know the ability of the board to adequately understand financial reports and other company reports in order to know or better still make appropriate decisions that would help the institution grows. The Table 4.3 below also shows that only 10% of the sample has less than BA degree or board members with a college diploma. Beside this Table 4.3 below also showed that as the educational background of board members increased from diploma to BA degree, the mean of ROA increased 0.03 to 0.04, also ROA increased from 0.04 to 0.066 as the educational background of board members increased from BA degree to master degree. Finally, as educational background of board members increased from master degree to PhD degree the ROA increased from 0.066 to 0.19. This showed that as the educational background of board members or competency of

of board members increased the ROA increased, which in turn resulted an increase in the financial performance of the selected MFIs.

Table 4.3: Board Member's Educational Background

Educational Background	Frequency	Percent	Mean of ROA
Diploma	6	10.0	0.03
BA Degree	34	56.7	0.04
Master Degree	18	30.0	0.066
PhD Degree	2	3.3	0.19
Total	**60**	**100.0**	**0.92**

Source: SPSS Output (2021)

4.2.3. Financial Sector Experience

As shown in Table 4.4 below the financial sector experience of board members, indicated that out of the total respondents 38.3% response rate assure that the board members have potentially enough financial sector experience which is 10 years and above experience to oversee and lead the MFIs. 25% response shows that 7 to 9 years' experience which is moderate experience to lead the MFIs. In contrary, 21.7% are 4 to 6 years and 15% are 1 to 3 years. Table 4.4 below also indicated that as the the financial sector experience of board members increased from 1 to 3 years to 4 to 6 years, the mean ROA increased from 0.06 to 0.11, the mean ROA increased from 0.11 to 0.22 as the board members experience increased from 4 to 6 years to 7 to 9 years. Also, as the board members experience increased from 7 to 9 years to 10 to 12 years, the mean ROA increased from 0.22 to 0.29. Finally, for those MFIs who have board members experience above 12 years scored the highest mean of ROA 0.31. This shows that the board members who have enough potential financial experience lead have better financial performance in the MFIs.

Table 4.4: Financial Sector Experience of Board Members

Board Experience	Frequency	Percent	Mean of ROA
1 to 3 years	9	15.0	0.06
4 to 6 years	13	21.7	0.11
7 to 9 years	15	25.0	0.22
10 to 12 years	14	23.3	0.29
Above 12 years	9	15.0	0.31
Total	**60**	**100.0**	**0.99**

Source: SPSS Output (2021)

4.2.4. Frequency of Board Meeting

As shown in Table 4.5 below, the majority of the MFIs or 3(50.0%) of them have 10 to 12 times board meeting in a year, followed by 2(33.3%) of them having board meeting in a year 4 to 6 times and only 1(16.7%) have a schedule to have board meeting more than 12 times in a year. Table 4.5 below also showed that as the frequency of board meeting in a year increased from 4 to 6 times to 10 to 12 times, the mean ROA increased from 0.07 to 0.11, also as the frequency of board meeting in a year increased from 10 to 12 times to above 12 times, the mean ROA increased from 0.11 to 0.22. This showed that as the frequency of of Board Meeting increased the ROA also increased, which in turn resulted an increase in the financial performance of the selected MFIs.

Table 4.5: Frequency of Board Meeting

Board Meeting in a Year	Frequency	Percent	Mean of ROA
4 to 6 times	2	33.3	0.07
10 to 12 times	3	50.0	0.11
Above 12 times	1	16.7	0.22
Total	**6**	**100.0**	**0.40**

Source: SPSS Output (2021)

4.2.5. Size of Audit Committee

As shown in Table 4.6 below, the majority of the MFIs or 3(50.0%) of them have 2 members in their audit committee, followed by 2(33.3%) of them having 3 members in their audit committee and only 1(16.7%) have audit committee more than 3 members. Table 4.6 below also showed that as the audit committee members increased from 2 to 3, the mean ROA increased only from 0.10 to 0.11, also as the audit committee members increased from 3 to above 3, the mean ROA decreased from 0.11 to 0.10. This showed that the size of the audit committee members do not have any influence on the mean of ROA, which in turn does not have in the financial performance of the selected MFIs.

Table 4.6: Size of Audit Committee

Size of Audit Committee	Frequency	Percent	Mean of ROA
2 members	3	50.0	0.10
3 members	2	33.3	0.11
Above 3 members	1	16.7	0.10
Total	**6**	**100.0**	**0.40**

Source: SPSS Output (2021)

4.2.6. Statistical Description Summary of the Study Variables

Table 4.7 below provides a summary of the statistical summary of the dependent and independent variables for six MFIs for a period of five years from year 2015-2019 with a total of 30 observations. The table includes the mean, standard deviation, number of observations, minimum and maximum for the independent and dependent variables of the model. This was generated to give overall description about data used in the model and served as data screening tool to spot unreasonable figure.

As shown in chapter three, return on asset which gives an idea how efficient management is at using its assets to generate earnings was measured as net income after tax divided by total asset. The average value of return on asset for the sample Ethiopia MFIs is 11 percent (mean=0.11000) with a maximum and minimum value of 31 percent (0.31) and 4 percent 0.04) respectively. At the same time, the standard deviation is 0.078213 or 7.8 percent from the average value. This result indicates that most performing MFIs among the sampled MFIs earned 31 cents of profit after tax for a single birr invested in the assets of the firm. On the

other hand, less efficient MFI's during study period from the sampled MFIs earned 4 cents for each birr invested in the assets of the firm.

More additional, standard deviation statistics for return on asset was 7.8 percent which shows that how individual values of return on asset in a data set vary from the mean of return on asset over the last five years by 11 percent. Likewise, during the study period MFIs in Ethiopia generate 13 percent income on average from mobilizing their asset. The result implies that these MFIs need to optimize the use of their assets to increase the return on their assets.

Table 4.7: Statistical Summary of the Study Variables

Study Variables	N	Minimum	Maximum	Mean	Std. Deviation
Board Size	30	4.00	9.00	6.0667	1.41259
Competence of Board Members	30	1.00	4.00	2.4333	.81720
Board Experience	30	1.00	4.00	1.8333	.91287
Board Meeting Frequency	30	2.00	6.00	2.8000	1.15669
Size of Audit Committee	30	2.00	5.00	2.9000	.92289
Return on Assets	30	.040	.310	.11000	.078213
Valid N (list wise)	30				

Source: SPSS Output (2021)

Regarding explanatory variable there are some imperative statistics that have to be mentioned. Board size of sample MFIs which is measured as number of directors set on board. It is confirmed in the Table 4.7 above that the average board size for the sample MFIs was about 6 members (mean = 6.0667) with a maximum of nine and a minimum of four directors. Lipton and Lorsch (1992) recommend average board size of (i.e. between 8 and 10) for greater board efficiency and effectiveness but this data is not within this recommendation in contrast to this Brown and Caylor (2004) suggested a board size of between 6 and 15 further in Ethiopia case National Bank of Ethiopia currently propose corporate governance guidelines for Ethiopia MFIs with postulates minimum number board size for each MFIs should be nine. The standard deviation indicates that for the sampled MFIs board size varies

by 1.41259 or 1 directors from the average value of 6.0667 or 6 directors. This also indicates as there is low dispersion in the board size of the sample MFIs during study period.

More additionally educational qualified directors measured as number of directors who had college degree or higher is a mean value of 2.4333 or 2 directors which indicates on average directors who have collage degree or above was 1 people during study period sample MFIs. On the hand maximum and minimum value of statics is four and one respectively. This indicates that from sample MFIs there is a company which have maximum of qualified of four directors and at the minimum from the sample MFIs there is a company which have only one qualified directors during study period. These indicate that there were not enough qualified or competent Board Members in the MFIs of the study.

The above Table 4.7 also depicted directors who had prior financial business industry experience which was measured as number of directors who served in other financial business earlier in the same capacity and the statics shows as the mean value of directors in the boards of sample MFIs who have prior experience in insurance sectors are 1.8333 or 2 directors. This also suggests that only small number of directors in Ethiopia MFIs industry have specifically prior financial related experience. On the other hand, the standard deviation value of directors who had early financial experience is 0.91287 or one directors which indicate that there is very small variation in the industry in appointing directors who had early financial experience. Further the test statics indicates as maximum and minimum value of industry specific experience of directors is 4 and 1 respectively. Which conform that from sample MFIs there are MFIs which have appoint 4 directors who had early financial specific experience and at the minimum there are MFIs which have only one director who have early insurance experience during study period.

Furthermore, another interesting observation is that there was somewhat a higher variation in frequency of board meeting during study period which is measured as number of directors meeting in the year, on average is 2.8000 or 3. The standard deviation values of 1.15669 with the minimum of 2 and the maximum of 6. This result indicates that in sample MFIs during study period there is a MFI which conduct highly frequent meeting in a year at the maximum of 6 times however in sample MFIs there is a company which conducts meeting only two times during a year. The result further stipulates as there is low variation in conducting a

meeting among MFIs during study period by 1.15669 or 1 meeting times. Generally, the sample MFIs conduct meeting 2.8000 or 3 times on the average which is low when we compare with currently proposed corporate governance guidelines by National Bank of Ethiopia for MFIs which postulates as each MFIs should at least conduct meeting of 12 times in a year.

Lastly, as shown in Table 4.7 above, on average the size of audit committee was 2.9000 or 3. The standard deviation values of 0.92289 or 1 with the minimum of 2 and the maximum of 5. This result indicates that in sample MFIs during study period there is a MFI which have a maximum of 5 audit committee and a minimum of 2 audit committee. The result further stipulates as there is low variation in the number of audit committee among MFIs during study period by 0.92289 or 1 audit committees. Generally, the sample MFIs have 2.9000 or 3 audit committee on the average which is higher when we compare with currently proposed corporate governance guidelines by National Bank of Ethiopia for MFIs which postulates as each MFIs should at least have 2 audit committee.

4.3.Pearson Correlation Results

Correlation analysis is used to measure the association between independent and dependent variables. In this section, the correlation matrix of the factors is computed which provide the preliminary evidence of the relationship between corporate governance dimensions and financial performance. Pearson coefficient of correlation is the most widely used method for summarizing the degree and directions of relationship between two dependent and independent variables.

The value of correlation always lies between -1 and +1. The value of -1 indicates perfect negative correlation between the dependent and independent variables, value of 0 indicates no relationship between dependent and independent variables (corporate governance dimensions and financial performance) and the value of +1 indicates perfect positive relationship between dependent variable and independent variables (corporate governance dimensions and financial performance).

This correlation procedure has been subject to two tailed tests of statistical significance at two different levels, highly significant ($p < 0.01$) and significant ($p < 0.05$). To interpret the strength of the relationship between values 0 and 1, different authors suggest different

interpretations, however, Bhattacherjee (2012) suggested the following guidelines. These guidelines apply whether or not there is a negative sign out the front of your r value. The negative sign only refers to the direction of the relationship, not the strength.

Table 4.8: Rule of Thumb for the Strength of the Correlation Coefficient

If the Correlation Coefficient (r) Value in the Range of	The Strength of Relationship Would be
±0.81 to ±1.00	Very Strong
±0.61 to ±0.80	Strong
±0.41 to ±0.60	Moderate
±0.21 to ±0.40	Weak
±0.00 to ±0.20	None

Source: Bhattacherjee, (2012)

The results of the correlation matrix were presented in the following Table 4.9 below. As it is clearly shown in Table 4.9 below, the Pearson correlation result indicated that the highest correlation coefficient (i.e. r = 0.930) was between board size and financial performance (return on assets) which was significant at the 0.01 level ($p<0.01$). According to Bhattacherjee (2012) from Table 4.8, board size has a very strong and positive correlation with financial performance. The second highest correlation coefficient (r = 0.906) was between competence of board members and financial performance, followed by correlation coefficient (r = 0.884) between board meeting frequency and financial performance, which were significant at 0.01 level ($p<0.01$).

Again both competence of board members and board meeting frequency have a very strong and positive correlation with financial performance according to the rule of thumb from Table 4.8. Finally, board experience and size of audit committee have the same correlation coefficient of (r = 0.879) which was the last very strong and fourth correlation coefficient with financial performance, which all were significant at 0.01 level ($p<0.01$). According to

Bhattacherjee (2012) from Table 4.8, board size, competence of board members, board meeting frequency, board experience, and size of audit committee have a very strong and positive correlation with financial performance, which were statistically significant at 99% confidence level. This implies that at a 1 percent level of significance it was found that the board size, competence of board members, board meeting frequency, board experience, and size of audit committee have a positive and significant relationship with financial performance.

Table 4.9: The Correlation Result of Corporate Governance Dimensions and Financial Performance

Correlations							
		ROA	**BS**	**CBM**	**BE**	**BMF**	**SAC**
ROA	Pearson Correlation	1	.930**	.906**	.879**	.884**	.879**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N	30	30	30	30	30	30
BS	Pearson Correlation	.930**	1	.870**	.758**	.747**	.825**
	Sig. (2-tailed)	.000		.000	.000	.000	.000
	N	30	30	30	30	30	30
CBM	Pearson Correlation	.906**	.870**	1	.794**	.751**	.837**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	30	30	30	30	30	30
BE	Pearson Correlation	.879**	.758**	.794**	1	.784**	.757**
	Sig. (2-tailed)	.000	.000	.000		.000	.000
	N	30	30	30	30	30	30
BMF	Pearson Correlation	.884**	.747**	.751**	.784**	1	.853**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	30	30	30	30	30	30
SAC	Pearson Correlation	.879**	.825**	.837**	.757**	.853**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	30	30	30	30	30	30

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

Source: SPSS Output (2021)

4.4.Multiple Regression Results

Multiple regressions are a statistical technique that can be used to explore the relationship between one continuous dependent variable and a number of independent variables or predictors usually continuous variables (Julie, 2001). From the different types of multiple regression analyses, the researcher used the standard multiple regression type – which means that all the independent (or predictor) variables are entered in to the regression equation simultaneously. This is to mean that multiple regressions are used to investigate the effect of corporate governance dimensions on financial performance. As such the sole dependent variable in this investigation was financial performance and independent variables were corporate governance construct (board size, competence of board members, board experience, board meeting frequency and size of audit committee).

Assumptions of Multiple Regressions

The following assumptions were checked prior to running the regression model:

Checking for Outliers

Because multiple regression is very sensitive to outliers (very high or very low scores). The researcher checked for extreme scores at the initial data screening process by using Skewness and Kurtosis. The Skewness and Kurtosis of the 5 constructs are well behaved in term of normality. As described by Hair et al., (2010) the values of Skewness and Kurtosis are between the ranges of -2 and +2 indicates that there are no outlier or extreme values that might jeopardize the validity of the analysis as shown in Table 4.10 below.

Table 4.10: Skewness and Kurtosis Values of Corporate Governance Construct and Financial Performance

Corporate Governance Dimensions and Financial Performance	Data of MFIs	
	Skewness	Kurtosis
Board Size	0.818	-0.612
Competence of Board Members	0.635	-0.117
Board Experience	1.225	1.168

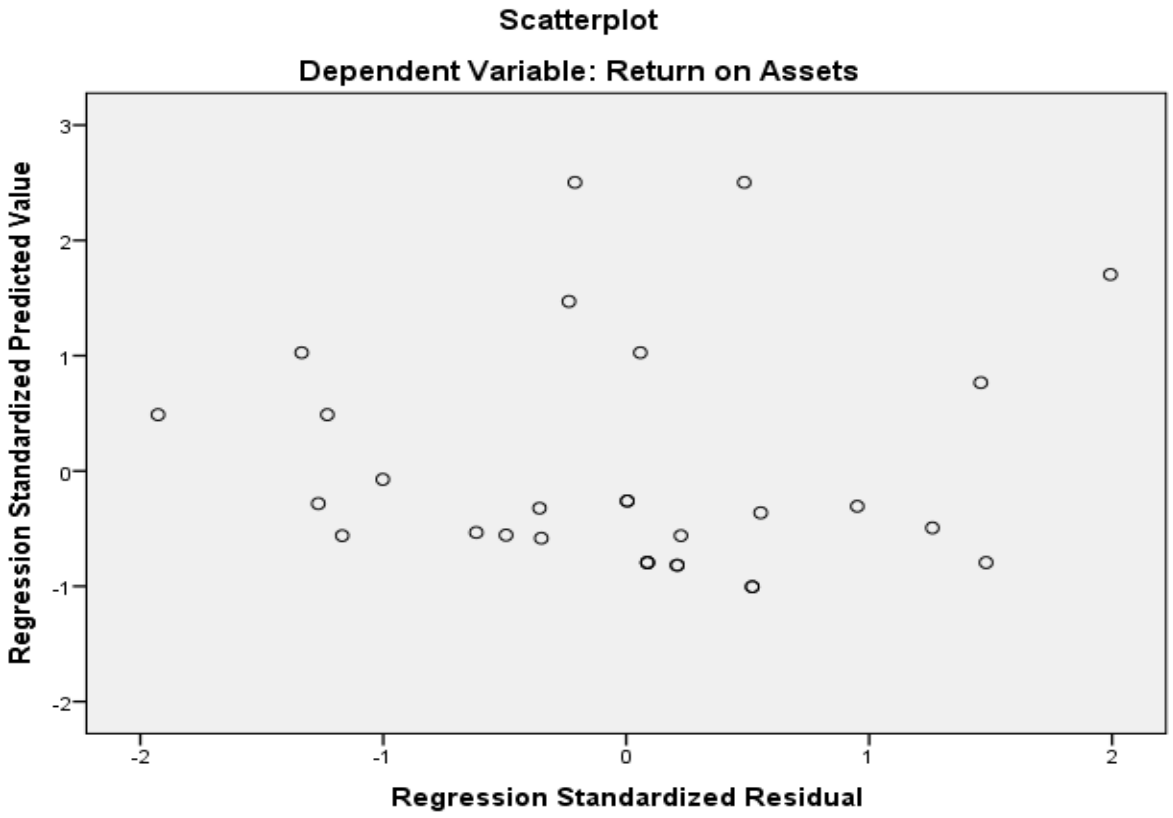
Board Meeting Frequency	1.564	1.043
Size of Audit Committee	0.773	-0.174
Return on Assets	1.461	1.145

Source: SPSS Output (2021)

Homoscedasticity Test

As shown in Figure 4.1, the small circles follow no pattern and they are randomly dispersed in the scatterplot so, the researcher assumed that the residuals have equal variances.

Figure 4.1: Scatterplot of Residuals of the Regression Model

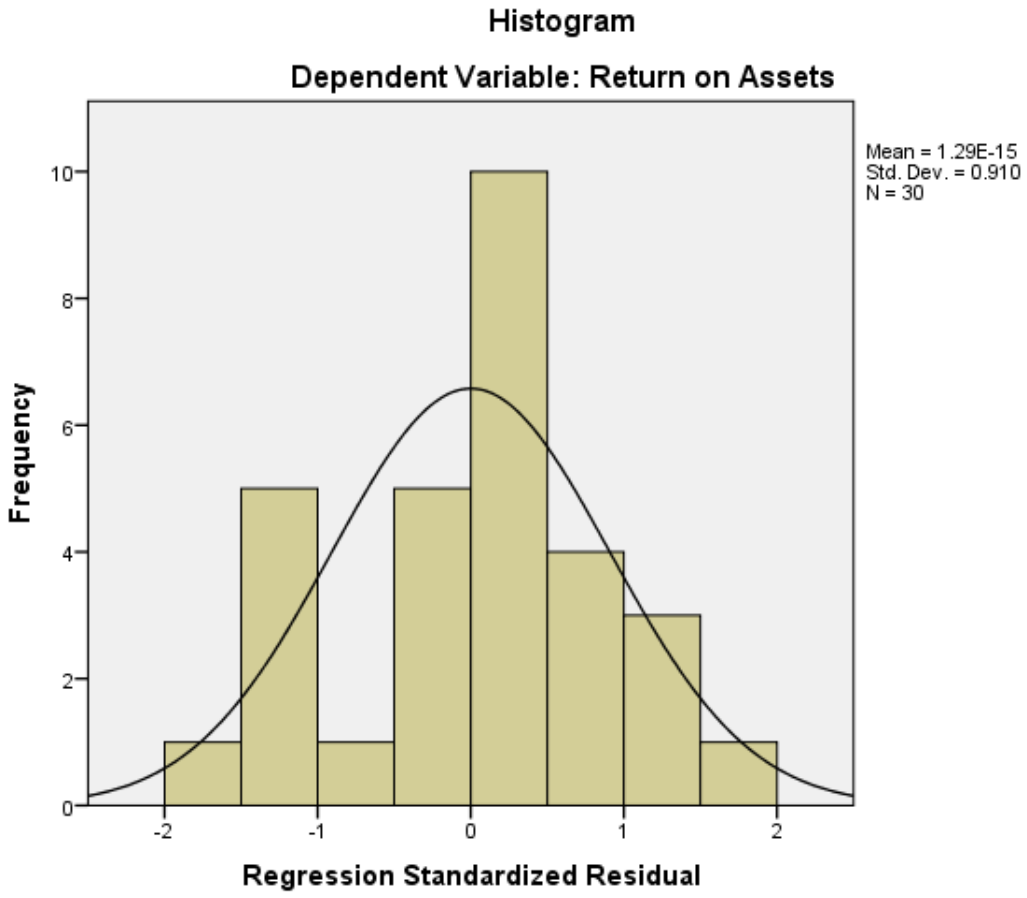


Source: SPSS Output (2021)

Normality Test

The histogram and P-P plot presented in Figure 4.2 below indicated reasonable normality of data, because the mean value was close to 0 (i.e., 1.29E-15) and standard deviation was close to 1 (i.e., 0.910), this shows the data was roughly close to normality.

Figure 4.2: Histogram of the Regression Model

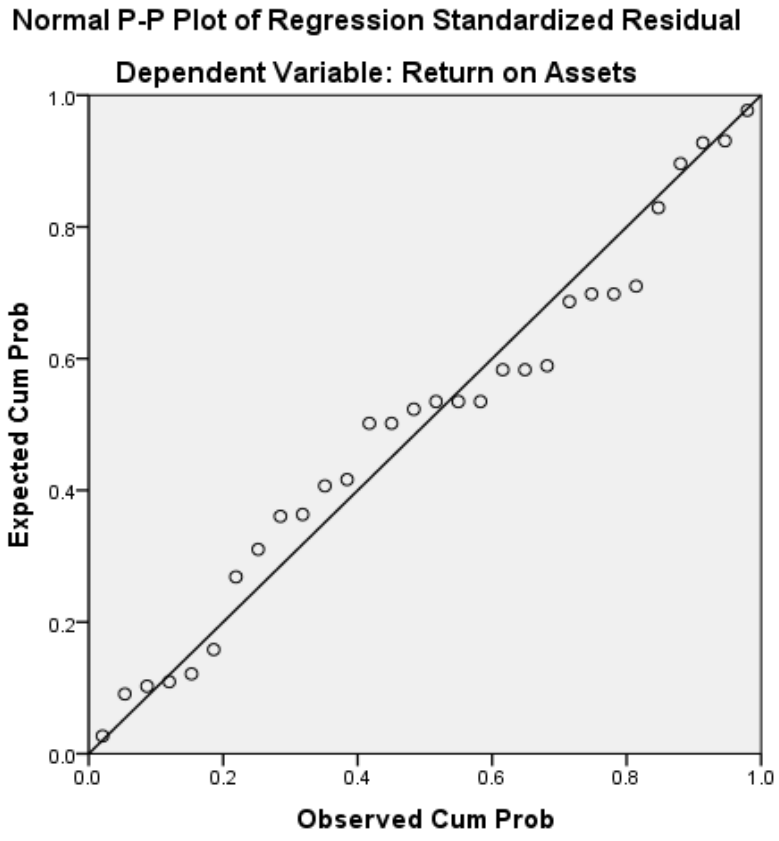


Source: SPSS Output (2021)

Linearity Test

Linearity is another condition to be met for valid regression analysis, P-P plot presented in Figure 4.3 below show that the small circles were close to the diagonal line, this shows the data was roughly close to linearity.

Figure 4.3: The Normal P-P Plot of the Regression Model



Source: SPSS Output (2021)

Multicollinearity Test

Multicollinearity exists when there is a strong correlation between two or more independent or predictors variables in a regression model. Multicollinearity of the regression result for the MoA ATVET Colleges was tested using Pearson correlation matrix, for each of the regression model correlation between the predicators variables were below 0.90 as shown in Table 4.9. This is also supported by the statistics of collinearity test results shown in Table 4.11 below also show that all the results from the model have a tolerance value greater than 0.1 and VIF less than 10 indicating that there was no serious multi collinearity in the panel data.

Table 4.11: Regression Analysis of Corporate Governance Construct with Financial Performance

Coefficients[a]								
Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**	**Collinearity Statistics**	
		B	**Std. Error**	**Beta**			**Tolerance**	**VIF**
1	(Constant)	-.154	.013		-11.835	.000		
	Board Size	.023	.004	.418	5.588	.000	.207	4.832
	Competence of Board Members	.016	.008	.169	2.097	.047	.178	5.610
	Board Experience	.018	.005	.210	3.302	.003	.286	3.498
	Board Meeting Frequency	.020	.005	.297	4.159	.000	.227	4.405
	Size of Audit Committee	-.002	.007	-.021	-.254	.802	.173	5.765
a. Dependent Variable: Return on Assets								

Source: SPSS Regression Output, (2021)

To find out the best set of predictors of financial performance (ROA), five predictors of multiple linear regression models was proposed. The five predictor variables were board size

(X_1), competence of board members (X_2), board experience (X_3), board meeting frequency (X_4) and size of audit committee (X_5). The equation of the proposed multiple linear regression model was as follows:

$$Y\ (ROA) = \beta_0 + \beta_1(X_1) + \beta_2(X_2) + \beta_3(X_3) + \beta_4(X_4) + \beta_5(X_5) + \varepsilon$$

Where: β_0 = Constant, ε = Error

To determine the best set of predictor variable in predicting financial performance (ROA), a standard multiple regression method was used. As indicated in the above Table 4.11 based on the standard multiple regression method used, only four independent or predictor variables were found to be significance in explaining financial performance (ROA). They are: board size (X_1), competence of board members (X_2), board experience (X_3), and board meeting frequency (X_4). But size of audit committee (X_5) is insignificant in explaining financial performance (ROA). Only four of the independent variables did contribute significantly to the variation of the dependent variable of financial performance (ROA).

As depicted in the Table 4.11, the estimated model is as below:

$$Y(ROA) = -0.154 + 0.023X_1 + 0.016X_2 + 0.018X_3 + 0.020X_4 + -0.002X_5$$

Therefore, from the regression result of unstandardized beta coefficients of board size, competence of board members, board experience, board meeting frequency and size of audit committee were 0.023, 0.016, 0.018, 0.020 and -0.002 respectively. In addition to this, Table 4.11 shows the largest positive and significant beta coefficient (0.023) for board size. This means that this variable makes the strongest unique contribution to explaining the dependent variable of financial performance (ROA), when the variance explained by all other predictor variables in the model is controlled for. It suggests that one standard deviation increase in board size is followed by 0.023 standard deviation increase in of financial performance (ROA). The Beta value for board meeting frequency 0.020 is the second highest positive and significant value. This implies that one standard deviation increase in customer focus is followed by 0.020 standard deviation increase in of financial performance (ROA). In the third place is board experience (0.018) was the third highest positive and significant value. It means that one standard deviation increase in information and analysis is followed by 0.018 standard deviation increases in of financial performance (ROA). The Beta value for competence of board members was the fourth and the least positive and significant value

(0.016). This implies that one standard deviation increase in competence of board members is followed by 0.016 standard deviation increase in of financial performance (ROA). Lastly size of audit committee has no significant effect on financial performance (ROA).

Table 4.12: The ANOVA Result of the Regression Analysis

ANOVA[a]						
Model		**Sum of Squares**	**Df**	**Mean Square**	**F**	**Sig.**
1	Regression	.172	5	.034	167.569	.000[b]
	Residual	.005	24	.000		
	Total	.177	29			
a. Dependent Variable: Return on Assets						
b. Predictors: (Constant), Size of Audit Committee, Board Experience, Board Size, Board Meeting Frequency, Competence of Board Members						

Source: SPSS Regression Output, (2021)

The ANOVA Table 4.12 revealed that the F-statistics (167.569) is large and the corresponding p-value is significant (0.0001) or lower than the alpha value of 0.05. This indicates that the slope of the estimated linear regression model line is not equal to zero confirming that there is linear relationship only between the four predictor variables (board size, competence of board members, board experience and board meeting frequency) and financial performance (ROA). This indicates that only the four predictor variables have a significant impact on financial performance (ROA).

Table 4.13: Model Summary of the Regression Analysis

Model Summary[b]				
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.940[a]	.883	.877	.96920
a. Predictors: (Constant), Size of Audit Committee, Board Experience, Board Size, Board Meeting Frequency, Competence of Board Members				
b. Dependent Variable: Return on Assets				

Source: SPSS Regression Output, (2021)

From the above Table 4.13 of the regression model one, the coefficient of determination (R^2) was 0.883 demonstrated that 88.3% of total financial performance (ROA) could be explained by the four dimensions of corporate governance construct (board size, competence of board members, board experience and board meeting frequency) while the rest (11.7%) of the variations could be accounted for the other factors, which could be beyond the scope of the study. It also represents that the model was reasonable fit and there was statistically significant relationship between corporate governance dimensions and financial performance (ROA).

4.5.Hypothesis Test Results

The multiple regression model in Table 4.11 was used to test hypotheses concerning the effect of corporate governance dimensions on financial performance (ROA) based on the unstandardized beta coefficient with 95% confidence level and p-value to test whether hypothesis is accepted or rejected.

Hypothesis - 1

H_{a1}: Board size has a positive and significant effect on financial performance (ROA) in the MFIs.

The regression analysis as shown in Table 4.11 confirms that the unstandardized beta coefficient for board size was positive and p-value was significant (β_1=0.023, p=0.000) showing that board size has a positive and significant effect on financial performance (ROA). It means that one standard deviation increase in board size is followed by 0.023 standard deviation increases in financial performance (ROA). Therefore, the null hypothesis was

rejected and the alternative hypothesis H_{a1} was accepted. This finding was similar with the finding of Akpan and Amran (2014).

Hypothesis - 2

H_{a2}: Competence of board members has a positive and significant effect on financial performance (ROA) in the MFIs.

The regression analysis as shown in Table 4.11 confirms that the unstandardized beta coefficient for competence of board members was positive and p-value was significant (β_2=0.016, p=0.047) showing that employee involvement has a positive and significant effect on financial performance (ROA). It means that one standard deviation increase in competence of board members is followed by 0.016 standard deviation increases in financial performance (ROA). Hence, the null hypothesis was rejected and the alternative hypothesis H_{a2} was accepted. This finding was similar with the finding of Ferede (2012) and Akpan (2015).

Hypothesis - 3

H_{a3}: Board experience has a positive and significant effect on financial performance (ROA) in the MFIs.

The regression analysis as shown in Table 4.11 confirms that the unstandardized beta coefficient for board experience was positive and p-values was significant (β_3=0.018, p=0.003) showing that board experience has a positive and significant effect on financial performance (ROA). It means that one standard deviation increase in board experience is followed by 0.018 standard deviation increases in financial performance (ROA). Hence, the null hypothesis was rejected and the alternative hypothesis H_{a3} was accepted. This finding was similar with the finding of Ferede (2012).

Hypothesis - 4

H_{a4}: Board meeting frequency has a positive and significant effect on financial performance (ROA) of MFIs.

The regression analysis as shown in Table 4.11 confirms that the unstandardized beta coefficient for board meeting frequency was positive and the p-value was significant (β_4 = 0.020, p=0.000) showing that board meeting frequency has a positive and significant

relationship effect on financial performance (ROA). It means that one standard deviation increase in board meeting frequency is followed by 0.020 standard deviation increases in financial performance (ROA). Hence, the null hypothesis was rejected and the alternative hypothesis H_{a4} was accepted. This finding was similar with the finding of Mangena and Tauringana (2008).

Hypothesis - 5

H_{a5}: Size of audit committee has a positive and significant effect on financial performance (ROA) in the MFIs.

The regression analysis as shown in Table 4.11 confirms that the unstandardized beta coefficient for size of audit committee was negative and p-values was insignificant (β_5=-0.002, p=0.802) showing that size of audit committee has a negative and insignificant effect on financial performance (ROA). Hence, the null hypothesis was accepted and the alternative hypothesis H_{a5} was rejected. This finding was different from the finding of Ferede (2012), which states there was a negative and significant relationship between size of audit committee and financial performance.

Table 4.14: Summary of the Hypothesis Results

Hypothesis		Proposed Effect	Actual Effect on Innovation	Supported or Not Supported
Board Size	H_{a1}	+	+	Supported
Competence of Board Members	H_{a2}	+	+	Supported
Board Experience	H_{a3}	+	+	Supported
Board Meeting Frequency	H_{a4}	+	+	Supported
Size of Audit Committee	H_{a5}	+	–	Not Supported

Source: SPSS Regression Output, (2021)

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

The aim of this study was to determine the relationship between corporate governance and financial performance. This was achieved through defining specific board characteristics of corporate governance (board size, board competency, board composition, frequency of board meeting, board committee, frequency of audit sub- committee and internal control system (internal and external audit system) and microfinance financial performance measures (dependent variable). The literature review revealed that there is currently a lack of an appropriate and publicly available corporate governance measurement tool in Ethiopia.

It is important to determine those corporate governance practices that have the greatest impact on the MFI performance and accordingly afford the potential to contribute the greatest significant impact on improving MFIs' performance in long run. In this chapter, the conclusion of the study was made followed by recommendations. In addition, recommendation for future research and policy amendment was included.

The overall results of this study indicate that the vast majority of board and audit related selected variables relating to corporate governance had a positive relationship with microfinance financial performance.

5.1. Conclusion

From this research, it is found that all the corporate governance elements do not affect the performance of MFIs in the same way. Based on the results of the statistics, correlation and regression analysis the researcher made the following conclusions.

Based on the statistical findings of the sampled Microfinances, board size ranges from 5 to 10 members. This indicates that almost all sample MFIs have complied the regulation of NBE which need to have not less than 7 board members.

With regards to educational background, the majority almost 90 percent reveal that the board members have BA degree and above up to PhD. This show that, the board members have better educational background adequately understand financial reports and other company reports in order to know or better still make appropriate decisions that would help the institution grows. 83.3% characterized by the presence of competence directors that majority of the directors have business related educational background.

The study shows around 63.3% board members have seven years and above experience in financial sector. This also contributes for better improvement of MFIs financial performance.

In the enquire of number of board different sub-committee establishment, the majority percent 83.3 explain that there is three different board sub-committee established in their respective MFI and the remaining 16.7% reveal that there is 4 different type of board sub-committee. This shows almost adequate board sub-committee is established in sample MFIs. With respect to the number of board audit sub-committee in all selected sample MFIs 100% reveal the same size and the number of audit sub-committee members are three.

The correlation analysis indicates that board size, competence of board members, board meeting frequency, board experience, and size of audit committee have a very strong and positive correlation with financial performance or Return on Asset. A 1 percent level of significance it was found that the board size, competence of board members, board meeting frequency, board experience, and size of audit committee have a positive and significant relationship with financial performance.

From the regression result, board size, competence of board members, board experience, and board meeting frequency significantly affect financial performance (ROA) of MFIs. But size of audit committee is insignificant in explaining financial performance (ROA). Only four of the independent variables did contribute significantly to the variation of the dependent variable of financial performance (ROA).

From the model summary above indicates that 88.3% of total financial performance (ROA) could be explained by the four dimensions of corporate governance construct (board size, competence of board members, board experience and board meeting frequency) while the rest (11.7%) of the variations could be accounted for the other factors, which could be

beyond the scope of the study. Out of the five only the four of the hypothesis were accepted and only one was rejected and the null hypothesis was validated.

5.2. Recommendations

This study examined the effect of corporate governance Microfinance Institution' financial performance by taking evidence from selected Microfinance Institutions in Ethiopia. On the basis of the findings and conclusions reached, the following recommendations were forwarded.

- Microfinance Institutions board size should be large enough with better competency to monitor managers through establishing different sub-committees and in turn help to improve financial performance of the institutions. But, too small or too large board size is also having negative impact on financial performance. So, board size on average 7 to 10 is better enough to MFIs.
- In all Microfinance Institutions qualified and competence board members (in educational back ground, qualification and business-related experience) should need due consideration for better result in MFIs profitability and sustainability.
- This research found that around 1/3 of the board members have limited numbers of financial sector 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 well experienced board members in other finance related area to improve their financial performance.
- In the research it's found that Meeting Frequency has a significant positive impact on ROA of MFI. Therefore, board of directors should meet at least once in a month frequently by having a good agenda to enhance the capacity of MFIs performance. But, the audit sub-committee frequency of meeting is not adequate and need due consideration to improve the internal control system in all MFIs.

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APPENDICES

Appendix 1: Instrument of Data Collection

School of Accounting and Finance

Department of Accounting and Auditing

Mekelle University

Addis Ababa, Ethiopia

March, 2020

Dear Respondent,

Request to complete a questionnaire

I am a student of the above university carrying out a research entitled **"Assessing the Status of Corporate Governance in Selected MFIs in Ethiopia (The case of Board of Directors and Auditing)"** Please complete the questionnaire as objectively as possible as this is aimed at improving effectiveness of internal audit in the micro finance industry of Ethiopia. Please be assured that any information volunteered will be highly appreciated and used solely for the purpose of the study while maintaining absolute confidentiality.

I remain indebted for your co-operation.

Yours sincerely,

Kidist Tsegaye

Research Questionnaire

Section 1: Personal Data of Respondents

Instruction: Please encircle in the letter with the answer you consider most appropriate.

1. What is your gender
    a. Male
    b. Female

2. Where do you work?
    a. Aggar MFI
    b. SFPI MFI
    c. PEACE MFI
    d. Metemamen MFI
    e. Vision Fund MFI

3. What is your status/ in what position you are working?
    a. CEO
    b. Mgt Member
    c. None Mgt Member
    d. Auditor
    e. Accountant
    f. Any other staff

4. How long have you worked in MFI?
    a. 0 – 5 years
    b. 6 – 10 years
    c. 11 – 15 years
    d. 16 years and above

Section 2: BODs Composition and BODs Sub-Committee Related Questions

Instruction: Please encircle in the letter with the answer you consider most appropriate.

1. Size of the board
    a. Less than 5 members
    b. 5 to 10 members
    c. 11 to 15 members
    d. More than 15 members
    e. If any out of this specify _____
2. Educational Background of Board members, how many of them have
    a. College Diploma
    b. BA Degree
    c. Master Degree
    d. PhD Degree
3. Academic qualification of each board member, how many of them have (tick as appropriate)
    a. Accounting and Financial management
    b. Banking and Insurance
    c. Micro-finance experts
    d. Business management
    e. Human resource management
    f. Legal
    g. Others specify it _____
4. Financial sector experience of each board member (tick as appropriate)
    a. 1-3 years
    b. 4-6 years
    c. 7-9 years
    d. 10-12 years
    e. > 12 years
5. What is the frequency of entire BODs meeting per annum?
    a. 1-3
    b. 4-6

c. 7-9

d. 10-12

e. > 12

6. How many members do your MFI Audit Committee Have?

   a. 2 members

   b. 3 members

   c. Above 3 members

Thank you very much for your time!!