



**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES  
THE EFFECT OF CORPORATE GOVERNANCE ON  
PERFORMANCE OF MFIs IN ETHIOPIA**

**BY  
ABRHAM HAGOS TEFASELASIE**

**JUN, 2021  
ADDIS ABABA, ETHIOPIA**

**THE EFFECT OF CORPORATE GOVERNANCE ON  
PERFORMANCE OF MFIs IN ETHIOPIA**

**BY**

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## **DECLARATION**

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Dr. DjeneMamo. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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**ENDORSEMENT**

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

Dr. Dejene Mamo \_\_\_\_\_

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**Jun, 2021**

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## **LIST OF ABBREVIATIONS/ACRONYM**

ACSIZ	Audit committee size
AMFI	Association of Microfinance Institution
BEQ	Board member educational qualification
BGD	Board gender diversity.
BSIZ	Board Size.
CG	Corporate Governance.
FOBM	Frequency of Board Meeting
FP	Financial Performance
MFAG	Age of Microfinance.
MFI	Microfinance Institution.
MFISZ	Size of micro finance.
NBE	National Bank of Ethiopia
NCC	Number of credit client
NED	Non-executive directors
ROA	Return on asset
SP	Social performance

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## **ABSTRACT**

*The main objective of the study was to examine the effect of corporate governance on Financial performance (sustainability) and Social performance (outreach) of Microfinance institution in Ethiopia from (2016- 2020). Explanatory research design has been used to investigate the causal association between the independent and dependent variable. The study was based on both primary and secondary data, and the primary Data was collected via Questionnaires that targets chief executive directors and other relevant high officials of sample microfinance institution, whereas, the secondary data was collected from national bank of Ethiopia and Association of Microfinance Institution (AEMFI). Corporate governance variable used in this study was board Size, gender diversity, frequency of meeting, board member educational qualification, and board experience in finance and, audit committee size. The study also used MFI size and AGE as a control variable. Return on asset and Number of credit client was used as a proxy for financial and social performance respectively, based on Random effect GLS regression, The result shows that board size, educational qualification, and board experience are better for enhancement of financial performance, whereas gender diversity and frequency of meeting are better in reaching poor client. Therefore the study recommends that board size should be occupied with a range of expertise, skill, and competency with proportional number of female to make better decisions and to monitor managers for better financial performance of the institutions, simultaneously to reach poor clients.*

**Keywords: Corporate Governance, financial performance, Social Performance, Microfinance institution, Ethiopia**

## CHAPTER ONE

### 1. INTRODUCTION

#### 1.1. Back Ground of the Study

Microfinance is the provision of financial services, typically savings and credit to the poor and low-income households otherwise to those who do not have access to conventional commercial banks (Rock et al., 1998). In contrast to the formal financial institution, most MFIs choose dual objectives of outreach to poor customers (social performance), while covering their costs and being financially sustainable (Hermes & Lensink, 2011). Governance is about attaining corporate goals. The basic intention of MFIs is to contribute to a country development, this requires reaching out to more clients, particularly the poor (Helms, 2006). Amha (2008) stated that the goal of most MFIs is to alleviate poverty by targeting clients who previously have denied access to conventional financial institutions.

However, as the dimension of the outreach and saving mobilization from the public increases, there is an inspiration to assure transparency, accountability and good governance in the microfinance sector (Amha, 2008). The reason stated by Amha was Ethiopian MFIs obtain deposits from the public, and any mismanagement of this asset, and resources considered as consumption of savings of the poor people, moreover the outreach of MFIs in Ethiopia has profoundly increased in the last decade which forced them to take loans from commercial sources such as local commercial banks and rural financial intermediation program, again managing the significant growth of MFIs in Ethiopia requires effective governance, involving both the board and management. 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).

According to Kassa (2010) Ethiopia is among the countries that have established a specific regulatory and supervisory framework for microfinance business. Licensing and supervision of microfinance institutions proclamation number 40/1996 which was canceled and replaced by proclamation no. 626/2009 and subsequent directives issued by the national bank of Ethiopia have helped to set general principles, rules, and standards that have to be compiled by MFIs. Being regulated by national bank Ethiopia, MFI has drawn a lot of remuneration. Among other things, it created environment for establishment of specialized financial institutions for those who were believed as un-bankable, enabled MFIs to offer a wide range of products such as saving and money transfers, promoted standardization and transparency in the sector, enabled MFIs to borrow from banks, shifted the practice of

microfinance from subsidized credit delivery to commercial finance, created ability for MFIs to achieve growth and outreach and contributed improvement of overall performance of MFIs. With wider access to various sources of funds (savings, loans, and others), the regulation has enabled them to increase their outreach (Kassa, 2010).

In the field of microfinance, governance is considered as a method of guiding an institution to achieve its primary objective, while being sustainable. According to Hartarska (2005) governance is a means through which donors, equity investors and other providers of fund ensure themselves that their funds are used according to the intended purpose.

Several studies have responded to the call for more research on the governance of MFIs (Hartarska, 2005; Mersland&Strøm, 2009; Hartarska&Mersland, 2012;Moriet al., 2013). But their studies where more or less focus on the developed country. Similarly, So far few pieces of research have been done on corporate governance and MFIs performance in Ethiopia(Melkamu, 2016; Zegeye, 2015) however their study where focused on corporate governance and financial performance only. Mersland et al., (2018) tries to examine sustainability and outreach with governance, but, they investigate at how boards are structured and formed in terms of who sits on the board especially their target where board committee structure and performance.

Based on agency theory which was a widely used framework to conceptualize the relationship between governance and performance of firm (Denis& McConnell, 2003).This research, therefore, attempts to examinethe effect of corporate governance on financial (sustainability) and social performance (outreach) of a microfinance institution in Ethiopia.

## **1.2.Statement of the problem**

It is clear that good corporate governance has many benefits for companies, and institutions (Claessens et al., 2003), the most important benefits are increasing business performance, easy access to low capital financial sources, efficient using of sources, positive image for company providing security to investors, prevention conflict of interest and providing sustainability.In literature of MFIs, good governance have been emphasized as the key elements for strengthening stewardship, achieving MFIs' primary objectives and promoting further development of the industry (Cull, Demirgüç-Kunt, &Morduch, 2007; Hartarska, 2005; Labie, 2001; Mersland&Strøm, 2009; Rock et al., 1998). On the other hand, poor corporate governance leads to corporate failure and also reasons for macroeconomic crises, for example the downfall of Enron, conviction of Arthur Anderson, and bankruptcy of WorldCom has been called a notable period of corporate hunger, exceptional fraud, failure, and organizational miss Governance” (Coffee, 2004; Gordon, 2002; Langevoort, 2003; Ribstein, 2002 cited in (Laufer, 2006,)).

In Ethiopia, it has been recorded that weak governance, poor risk management practices, weak internal control system and weak regulatory and supervisory systems contributed to the collapse of microfinance institutions (Mekonen, 2007) This can be evidenced by Asser MFI which had similar weakness and liquidated in Ethiopia (Amha, 2008).Therefore the aim of this research is to examine the link between corporate governance and performance of MFIs. Different studies carried out concerning the effect of corporate governance and firm performance globally. Such as, (Bassem, 2009;Hartarska, 2005; Keyereboan&Osei, 2008;Mohamed et al., 2014; Roy Mersland& R. ØysteinStrøm, 2009; Vishwakarwa, 2015). Yet their result cannot be generalized for developing country like Ethiopia,due to the fact that majority of MFIs in Ethiopia has unique characteristics mainly governmental owned and operate in instable political

Having this fact In Ethiopia few studies were carried out to investigate the relationship between corporate governance and firms' performance. (Amanueal, et al, 2015; Freed,2012;Getachew, 2014; Techan, 2012). But their researches were focused on the governance and performance of bank and insurance business. Another local study (Melkamu, 2016; Zegeye, 2015;Merslandet al., 2018) investigate corporate governance and performance of microfinance institutions specifically. Yet, both Melkamu and Zegeye link governance only with financial performance of MFIs. Thesample size (number of observation) used by those researches were too small, for example, Melkamu, (2016) and Zegeye, (2015) observe only five MFI and 10 MFIsrespectively.Merslandet al. (2018) also studies the link between board committee and performance of MFIs. But theirstudy exclude important governance variables, such as frequency of board meeting, board competency and board experience in finance.Given this gap,this study contribute to the existing body of knowledge and fill the gap by increasing the number of sample sizes and the number of observations which was not covered by the above researchers,and it also include the variable missed by Mersland., (2018) Hence, this research is dissimilar from the preceding studies conducted in Ethiopia, because it examines corporate governance and its effect on sustainability and outreach of microfinance institutions operating in Ethiopia.

### **1.3. Objective of the study**

#### **1.3.1 General objective**

The general objective of the study is to examine the effect of corporate governance on the performance of Microfinance Institutions operating in Ethiopia.

#### **1.3.2 Specific objectives**

The specific objective of the study aims to



- ❖ Investigate the effect of board size, on the performance of MFI.
- ❖ Ascertaining the effect of board gender diversity, on the performance of MFI.
- ❖ Find the influence of frequency of board meeting on the performance of MFI.
- ❖ Show the effect of board educational qualification on the performance of MFI.
- ❖ Examine the effect of board experience in finance on the performance of MFI.
- ❖ Find out the influence of audit committee size on the performance of MFI.

#### **1.4. Hypotheses of the Study**

H1. Board size has significant negative effect on financial and social performance MFI.

H2. Gender diversity has significant positive effect on the financial and social performance of MFI.

H3. The frequency of meeting has significant positive effect on the financial and social performance of MFI.

H4. Educational qualification of the board has significant positive effect on the financial and social performance of MFI.

H5. Board experience in finance has significant positive effect on financial and social performance.

H6. Audit committee size has significant negative effect on the financial and social performance of MFI.

#### **1.5. Significant of the study**

As indicated in the introduction part of this study, corporate governance has its benefit, the most important benefits are increasing business performance, easy access to low capital financial sources, efficient using of sources, positive image for company and country, providing security to investors, providing internal auditing to company, prevention of interest conflict and providing sustainability, they also state that poor corporate governance not only causes low company performance but it can be Also the reason for macroeconomic crises.

In line with the above facts, the study will be:

- Important to show the related corporate governance mechanism and financial and social performance of MFI
- Useful as a base or reference to make further research on the topic.
- Significant input for the regulatory body when revising the governance policy and procedures of the MFI.

## **1.6 Scope of the study**

The scope of this study was delimited to examining the effect of corporate governance on the financial and social performance of microfinance in Ethiopia for five years only. The governance variables delimited to board size, board gender diversity, board educational qualification (core competency), and frequency of board meeting, board experience in finance and audit committee size. The financial performance is delimited to return on asset, while the social performance is delimited to a number of credit clients only.

## **1.8 Organization of the Paper**

This paper consists of five chapters; Chapter 1 introduces the background of the study and statement of the problem. Also, the objectives, significance of the study the scope and. Chapter 2 reviews literature about the concept of CG, MFI performance, different theories in corporate governance. Besides, the chapter discusses empirical evidence related to the relationship between corporate governance with financial and social performance. Chapter 3 describes the research design and research approaches, methods of sample selection, data collection and data analysis that was used in the study. Chapter 4 presents descriptive statistics, model diagnosis and discusses study results in detail. Finally, chapter 5 provides summary, conclusion, recommendation, and suggestion for farther research.

## CHAPTER TWO

### 2. LITERATURE REVIEW

#### 2.1 Background of Microfinance in Ethiopia

During the imperial government of Haileselassie, the Ethiopian economy has been controlled by state through a series of industrial development plans. During the Derg regime (1974-91) financial institutions were directed to finance some public projects that may not have passed proper financial appraisal (Yesuf, 2010). After the political changes in 1991 consequent policy changes have been made towards a free market economy, agriculture-focused development and to liberalize the financial sector. To this effect, Proclamation No. 84/94 was issued, which allows private domestic investors to participate in banking and insurance activities, which were previously monopolized by the government. However, the issuance of this proclamation alone did not solve the financial problem of the economically active poor people in rural and urban areas (Seifu, 2002). Another Proclamation, No. 40/96 was issued to solve the problem of the delivery of financial services to the poor. Following the issuance of this proclamation different NGOs have shifted themselves into microfinance institutions raising the number of MFIs in Ethiopia to 35 in 2016/17 (National bank of Ethiopia, 1996) consequently, the microfinance industry of Ethiopia showed remarkable growth in terms of outreach and sustainability. Furthermore, the National Bank of Ethiopia issued a new directive on May 2002 to improve the regulation limits on loan size (Br. 5000), repayment period (one year), and lending methodology (social collateral). (Alamirew, 2006) Thus, the formal Microfinance industry in Ethiopia was started in 1994/5. In particular, the Licensing and Supervision of Microfinance Institution Proclamation of the government encouraged the spread of Microfinance Institutions (MFIs) in both rural and urban areas as it authorized them among other things, to legally accept deposits from the general public (hence diversify sources of funds), to draw and accept drafts, and to manage funds for the micro-financing business. (Getaneh, 2005).

The rise of microfinance institutions could indicate the emphasis given to the strategy to struggle against poverty in the country. Microfinance initiatives are prime components of the new development strategy, they can create an enabling environment for the poor to increase output and productivity by inducing technology adoption, improving input supply, and increasing income, reducing hunger and thereby reducing poverty (Wolday, 2002)

#### 2.2. Measuring performance of Microfinance Institution

Since MFIs have a dual mission of reaching poor clients and being financially sustainable, (Cull et al., 2007). Their performance measured through financial and social performance

### **2.2.1 Measuring financial performance of MFIs**

Performance refers to the degree to which organizations goals and objectives are realized efficiently and effectively (Wanjau, 2007). Financial performance is an indicator of how profitable a company is relative to its total assets Hassan et al., (2011) identified two broad categories of financial performance measures; investor returns and accounting returns. The basic idea of investor returns is that the return should be measured from the perspective of shareholders. Whereas accounting returns measures of financial performance focus on how firm earnings respond to different managerial policies. Accounting-based performance measures are; return on assets (ROA), total assets, sales growth, asset growth, and operating income growth. Investment based returns measures are dividend yield, the price-earnings ratio among others. Wanjau (2007) identified four indicators namely; market share, turnover or disbursement, portfolio quality, and profitability as measures of microfinance performance. Unlike other accounting measure such as return on equity or return on sales, ROA is consistently argue as a valid measure of financial performance and Berman et al.(1999) explain that ROA is not affected by the differential degree of leverage present in firms, because ROA is positively correlated with the stock price, a higher ROA implies higher value creation for shareholders. The ROA measures not only the profit aspect but also those related to assets employed, to generate the profit. USAID Microenterprise Development Office in its, "Financial Reporting Standards" recommends the use of ROA as measures of MFI profitability. Therefore this research used ROA as a proxy for financial performance of MFIs.

### **2.2.2. Measuring social performance of MFIs**

According to Helms (2006) and Johnson et al. (2006) the first goal of MFI is to reach more clients and poorer population strata, the second goal is being financial sustainability.

The social performance of MFIs could be measured by how much MFI reach the poor (outreach). Navajas et al.(2000) Mentions six aspect of measuring outreach; depth, worth of users, the cost to users, breadth, length, and scope. Where, depth of outreach refers to "the value the society attaches to the net gain from the use of the microcredit by a given borrower," (Navajas et al., 2000). This measure is to identify poor clients. Because, the poor are the one who fails to get credit access from conventional financial institutions such as traditional banking business and, worth of outreach to users refers to "how much a borrower is willing to pay for a loan," (Navajas et al. 2000). Similarly, cost of outreach to user refers to "cost of a loan to a borrower," (Navajas et al., 2000). These costs to users might consist of prices like interest rates and various payments that they have to pay, which could be revenue to the lender, and other loan-related transaction costs like expenses on documents, transport,

food, taxes, etc. (Navajas et al.,2000). Finally, "breadth of outreach is the number of users. The length of outreach is the time frame in which a microfinance organization produces loans," and "Scope of outreach is the number of type of financial contracts offered by a microfinance organization," (Navajas et al., 2000). Therefore this study used to number of credit clientas a measure social performance(outreach).

### **2.3. Concept of Corporate Governance**

Otieku(2010) states thatGovernance is concerned with how rules and regulations are applied and followed, the relationship that these rules and regulations determine or create and the nature of those relationships.Tilahun and Kibre (2007) explain the term corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administered or controlled and defines the relationships among the various stakeholders. In the real world, all enterprises, irrespective of size and ownership structure, need some principles and guide to conduct a business. Good governance refers to government agencies' conduct in implementing new policies and programs to increase the quality of public service with the ultimate aim of increasing economic growth (Liddle&Mujani, 2005). Good governance leads to good management, good stewardship of public money, good public engagement and, ultimately, good outcomes for citizens and service users. Good governance enables an authority to follow its vision effectively as well as supporting that vision with tools for management of risk (OECD, 2004). It is concerned with creating a balance between financial 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(Chenuos, Mohamed, &Bitok, 2014).

### **2.4 Theoretical literature Review**

#### **2.2.1 Agency Theory**

Agency theory is based on problems related to the separation of ownership and controllability. The fundamental premise of agency theory is that the managers who possess superior knowledge and expertise about the firm are in a position to pursue self-interests rather than shareholders (owners) interests (Fama& Jensen, 1983). Eisenhardt (1989) explains that agency problem arises if the goals of the principal and agent are in conflict and it is difficult or expensive for the principal to verify what the agent is doing. Consequently, the monitoring of management activities is seen as fundamental. Scholars have suggested various governance mechanisms to address agency problems. The governance mechanisms are designed to protect shareholder interests, minimize agency costs and ensure agent-principal

interest alignment (Davis et al., 1997). The important governance mechanisms used for this purpose are the board of directors to align the interests of both the agent and the principal, the main duty of a board is to monitor management activities so that agency problems can be minimized and superior organizational performance can be achieved. The ability of management to devise and implement strategic decision making is key to financial performance. Motivating managerial personnel through good compensation and remuneration packages is consistent with the provision of agency theory that managers are prone to act in their interests, potentially at the expense of the interests of firms/shareholders, if their objectives are misaligned due to inadequate monitoring, bonding, and compensation (Fong & Liu, 2010).

The overarching interest of shareholders is value maximization. The agency theory is concerned with reducing the agency problem which will lead to increase value maximization. It provides a direct link between corporate governance and financial performance. In agency theory, corporate governance mechanisms play an important role in ensuring the alignment of the interests of the principal and the agent, thus enriching the firm's capability to maximize shareholder wealth and thereby improve financial performance. The ownership structure of firms, particularly in terms of the board of directors, is the main feature mitigating the inherent dichotomy between principals and agents to improve financial performance (Harrison, 2014). Organizational factors affecting financial performance include board size, CEO duality and the presence of non-executive directors, Audit committee size, and frequency of meetings and others. As board size increases, the problems of coordination and communication also increase, consequently decreasing the ability of the board to monitor the management and thereby worsen the agency problem (Eisenberg et al., 1998).

### **2.2.2 Stakeholders Theory**

Stakeholder theory expands the narrow focus of agency theory on shareholders interest to stakeholders to take into account the interests of many different groups and individuals, including interest groups related to social, environmental and ethical considerations (Freeman et al., 2004). Stakeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business (Freeman et al., 2004). It asks managers to articulate the shared sense of the value they create, and what brings its core stakeholders together. It also pushes managers to be clear about how they want to do business, specifically what kinds of relationships they want and need to create with their stakeholders to deliver on their purpose. Habbash (2010) explains that stakeholder refers to anyone whose goals have direct or indirect connections with the firm and influenced by a firm or who exert influence on the firm's goal

achievement. These include management, employees, clients, suppliers, government, political parties, and the local community.

Again this theory states that stakeholders in corporate governance can create a favorable external environment that is conducive to the realization of corporate social responsibility. Moreover, the stakeholders in corporate governance will enable the company to consider more about the customers, the community and social organizations and can create a stable environment for long term development. The benefit of the stakeholder model emphasis on overcoming problems of under-investment associated with opportunistic behavior and in encouraging active co-operation amongst stakeholders to ensure the long-term profitability of the business firm (Maher and Anderson, 1999). According to Coleman (2007) management receives capital from shareholders, they depend upon employees to accomplish the objective of the company. External stakeholders such as customers, suppliers, and the community are equally important, and also constrained by formal and informal rules that businesses must respect. Stakeholder's theory also believes that the best firms are ones with committed suppliers, customers, and employees and management. In recent time, stakeholder theory has got great attention than earlier because researchers have acknowledged that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders (Coleman, 2007). Companies exist within society it has responsibilities to the stakeholders rather than only too shareholders alone. However, most researchers argue that it is an impractical task for managers (Sanda et al., 2005).

### **2.2.3 Resource Dependency Theory**

According to the resource dependency theory, directors bring resources to the firm such as information, skills, key constituents (suppliers, buyers, public policy decision-makers, social groups) and legitimacy that will reduce uncertainty. (Yusoff, & Idris, 2012). This, in turn, reduces transaction costs and the potential of linking the organization with the external networks. This provides an opportunity to gather more information and even skills in various specialties. (Lawrence & Lorsch 1967) link the resource dependency theory as an environmental influence on corporate governance and they argue that successful organizations possess internal structures that match external environmental demands. (Pfeffer, 1972) Confirm the above argument and explained that board size and its composition is a rational organizational response to the conditions of the external environment. Since board of directors are believe as resource providers to firm, experience, and qualification of the board become important for the achievements of the firm.

## **2.2.4 Stewardship Theory**

According to the stewardship theory, Corporate Governance is necessary to ensure that the organization is headed in 'the right direction, with this direction referring to the interests of stakeholders (Donaldson, 1990). Saltzman et al. (2000) argue, stewardship theory revolves Around the notion that leaders can instill a common set of values and understanding within an Organization and that stewardship can subsume and incorporate concerns about efficiency into

Amore socially responsible, normative framework. Stewardship theory finds a strong Relationship between stewards and the performance of the firm and as a result, the stewards protect the organization and maximize the performance by trying to satisfy most of the stakeholder groups in the organization. According to stewardship theory, the position of CEO and Chairman are held by a single person and the power to determine strategy, and the Future of the organization is the responsibility of a single individual. According to Davis, and Donaldson (1991), the focus of stewardship theory is on structures that facilitate and empower rather than monitor and control. As such, this theory has a weak view of the separation of the Role of chairman and CEO which supports the appointment of the CEO as the chair of the Governing board with dual leadership and a majority of executive directors rather than non-executive directors (Clarke, 2004).

## **2.5. Corporate governance and performance of microfinance institutions**

### **2.5.1 Board Size and firm performance**

As explained by (Thrikawala et al., 2013; Estapé-Dubreuil, & Torreguitart-Mirada, 2015) Board size is the number of board members serving on the board of an MFI. A number of conflicting kinds of literature shows the effect of board size on the performance of microfinance institutions (Tchuigoua, 2013), some literature reveals that the larger the size of the board in an MFI, the better the performance of the institution (Bassem, 2009). It is believed that each member of the board will come to the board with a different experience and qualifications, thereby, increasing the quality of decisions taken, which eventually adds to the overall effectiveness of the board (Adams and Mehran, 2011). (Fauzi, and Locke, 2012), Argues that even though larger boards are likely to have more knowledge and experience that can improve the performance of the firm; the abundance of perspective can also cause 'cognitive conflict' within the board. In the same manner, there are empirical studies that show a large board will become ineffective due to coordination and communication problem, thus, it becomes easier for the CEO to take advantage of the board ineffectiveness to capture and control the Board (Jasen, 1993), the study further stress that keeping the board small will



improve the performance of the institutions. (Jasen, 1993; Hartarska&mersland, 2012) argues that efficiency increase up to eight and nine members, after that it will become less efficient and prone to the CEO control. Furthermore, (Uwuigbe&Fakile, 2012) in their study argues that large board size is less effective. The results of their findings show that there is a negative relationship between the size of the board and the performance of firm this underscores the point that the bigger the board size, the slower the decision-making process and, this invariably reduces the effectiveness of the Board.

Based on the above finding this study suggest the following hypotheses

H1 board size is negatively related to financial and social performance MFI.

### **2.5.2 Gender Diversity and firm performance**

Board Gender Diversity is the number of women represented on the board. Some research indicates that the existence of women on the board of an organization positively affects the Performance of the organization (Mersland& Strom, 2008; Vishwakarwa, 2011; Techan, 2012; Getachew, 2014). Studyconducted by Kyereboah-Coleman (2006) shows that having women inMFI boards enhance performance and alsothe more women there are on the board, the better theperformance will be. Moreover, having a high proportion ofwomen on the board would help the MFI understand itscustomers better to separate the good risk fromthe bad (Mersland& Strom, 2007). Therefore it is very important to further investigate the effect of board gender Diversity on PerformanceMicrofinance.

This study develops the following hypothesis.

H2; Gender diversity has a significant and positive effect on the financial and social performance of MFI.

### **2.5.3 Frequency of Board Meeting and Firm Performance**

Theoretically, the Frequency of board meetings improves board effectiveness, board effectiveness is the ability of the board of directors to carry out their core functions effectively and this can be achieved through management oversight, strategic direction, and policy development (Collins and Kofi, 2011). An active board is a board that clearly defines its corporate roles and responsibility and the individual function of the directors (Dutra, 2012) Board meetings are crucial to the success of microfinance institutions, this evidenced by A study carried out by (Collins& Kofi, 2011; Getachew, 2012; Techan; 2014) they argued that there is a significant and positive relationship between the frequency of board meeting and firm performance, which indicate that when the board of directors meets frequently the performance of the company will be better.Again Regular board meetings are important because they provide a means to cope with the difficult times experienced by firms. Vafeas

(1999) and Ntim(2009) found that frequent board meetings result in good management and supervision quality and therefore positively influence the performance of firms.

Therefore for these researches propose the following hypothesis

H3; Frequency of meeting has a significant and positive effect on the financial and social performance of MFI.

#### **2.5.4 Educational qualification Board member and firm performance**

Education is important for building people's skills in any field. The expertise, competence, and quality of a firm's board certainly have an impact on performance. The higher the quality, the better will be the financial and social performance of the firm (Campion, 1998; Hartarska, 2005) they also argue that the skills board members bring to the MFI board matter. Higher qualifications Board members would expand knowledge base and stimulate board members to consider other alternatives and enhance a more thoughtful processing of problems (Cox & Blake, 1991).

According to Westphal and Milton (2000) qualified members will give a rich source of innovative ideas to develop policy initiatives with analytical depth and rigor necessary for offering unique perspectives on strategic issues. On the contrary, lack of diversity and qualified members on the board would result in lack of critical thinking and innovation (Mattis, 2000).

Consequently, the hypothesis is stated as follow

H4: Educational qualification of the board has a significant positive effect on the financial and social performance of MFI.

#### **2.5.5 Board Experience in Finance and firm performance**

Board experience in finance refers to a board member who had any finance-related work experience. In Ethiopia, Board members of most MFI do not have awareness and hence do not apply best practice corporate governance in their MFIs (Ayalew, 2007). Appointing directors with relevant skills and knowledge is important to perform 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 thesis argues that experience of directors enables them to guide, 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 firm performance.

Therefore the study makes the next hypothesis based on the above discussions.

H5: Board experience in finance has a significant positive effect on financial and social performance.

### **2.5.6 Audit committee size and firm performance**

*Audit committees are sub-committees of the board member. It is one of the very vital corporate governance mechanisms to improve the trustworthiness and reliability of financial information produced by the company and to increase public confidence in the financial statements.* The establishments of the audit committee in affirm would lead to superior corporate performance. The study conducted by Bahreni and Zain (2013), indicates that when audit committee size is larger, the effectiveness of the audit committee is more and it helps the members of the audit committee to solve and discuss issues more effectively. Arguments supported by other researchers showed that problems in communication, solving issues, coordination and decision making will increase when the audit committee size is larger. Aldamen et al. (2011) reveal that smaller audit committees with more experience and better educational qualifications are more likely to be associated with positive firm performance. In Ethiopia banking industry, Ferede (2012) found that a large number of the audit committee has a negative and significant effect on financial performance. He additionally state that limiting audit committee size to a reasonable number improves audit committee effectiveness. Therefore the study develop the following hypotheses

H6: Audit committee size has a significant negative effect on financial and social performance.

## **2.6 Review of Previous Studies**

### **2.6.1 Empirical Study Abroad**

Bassem (2009) observed the relation between governance mechanisms and the performance of Euro- Mediterranean microfinance institutions (MFIs) in terms of outreach and sustainability using both internal corporate governance (such as board size, proportion of non affiliated outsider on the board, director compensation, board diversification, and MFI internal auditor reporting directly to the board and external corporate governance mechanism ( which include MFI financial statement audit, rating, and regulation) the results identified that trade-offs between MFIs outreach and sustainability depending on larger board size, and a higher proportion of unaffiliated directors. Moreover, the study also showed that the more women there are on the board the better the performance, and additionally external governance mechanisms help MFIs to achieve better financial performance.

Friday (2017) examine the effect of corporate governance practice on microfinance institutions Performance, primary and secondary data was used, primary data collected through purposive sampling and secondary data from the MIX market and the central bank of Nigeria (CBN).The independent variable used for this study were board size, board gender diversity, and frequency of meeting whereas ROA and number of credit client are used as a proxy of financial and social performance the findings in his research have empirically shown that board size and board gender diversity have no significant to the financial performance of MFIs but have a significant effect on the social performance of MFIs while frequency of meeting has no significant on both financial and social performance of MFIs in Nigeria.

Hartarska(2005) examine the impact of governance on performance of MFI in central and Eastern Europe, and the newly independent state, using surveyed data from small sample of MFI, governance variable used in his study were managerial compensation, board size, gender, and skill, prudential regulation, external rating and auditing, whereas performance of MFI measured using financial performance measured by Return on asset and outreach measured by number of borrower and depth of outreach. And his finding indicates that performance-based compensation of manger is not associated with better performing MFI.

Joel (2012) investigate the relationship between corporate governance mechanisms such as educational qualification of the board members, gender diversity, representation of non-executive directors on the Board and board size on one side as independent variables and performance of microfinance institutions was measured by return on equity (ROE) as dependent variable on the other side. Accordingly, Board size is found to be positively associated with firm performance, indicating the value of large board for the firm. Board members with education qualification below first degree had a negative relationship with firm performance, which shows that these board members contributed less or nothing towards the microfinance institutions' financial performance and growth. Gender diversity is found to be significantly associated with firm performance. However, the presence of women in a larger board is positively related to firm performance.

Keyereboan and Osei (2008) study their research on the effect of selected governance indicators on profitability and outreach of MFI in Ghana firm. The studies adopt a quantitative approach based on both primary and secondary data from conveniently sampled MFI and the panel data technique was employed. The research finding indicates that governance plays a critical role in the performance of MFI and that independence of the board and a clear separation of the position of CEO and board chairperson have a correlation with performance measure both profitability and outreach.

Mohamed et al. (2015) conduct their research on the effect of corporate governance on microfinance institution financial sustainability, explanatory research design was used to show the causal effect relationship between corporate governance variables such as board size, CEO duality, composition of gender and the financial sustainability of MFI was measured using ROA Target population of the study was 41 registered MFI where a random sample of ten institutions were selected using cluster sampling. The finding of the study shows that board diversity of moderate size with a considerable number of women is better placed to ensure the independence of the board and hence boosting financial sustainability.

Ngure(2007) used a survey design surveyed the relationship between corporate governance and performance in microfinance institutions in Kenya. The study found out that 70 percent of MFIs have boards consisting of up to 10 members while 30 percent of the MFIs have over 10 members in their board of directors. When the relationship between corporate governance and performance was explored using financial aspects of the MFIs, the study found out that there exist a relationship between different aspects of corporate governance and firm performance. Specifically, the study found out that board size was positively correlated with the firm's performance.

Roy Mersland and R. ØysteinStrøm (2009) investigateon the relationship between firm performance and corporate governance in microfinance institutions (MFI) using a self-constructed global dataset on MFIs collected from third-party rating agencies. Using random effects panel data estimations; they investigate the effects of the board and CEO characteristics, firm ownership type, customer-firm relationship, and competition and regulation on an MFI's financial performance and outreach to poor clients. Their study found that financial performance improves with local rather than international directors, an internal board auditor, and a female CEO. The number of credit client's increase with CEO/chairman duality. Outreach is lower in the case of lending to individuals than in the case of group lending. They also discover no difference between non-profit organizations and shareholder firms in financial performance and outreach; also, bank regulation does not affect.

Vishwakarwa (2015 )conduct his research on the effect of corporate governance on the performance of selected Indian MFI the study was based on secondary data on governance and financial performance, covering the period from 2009- 2013 and the data have been collected from mix market base. The corporate governance variable under study was (board size, female board, the proportion of independent directors' number of the board meeting, CEO duality, and board committee) ROA was used as a measure of financial performance. Based on descriptive statistics data analysis the result indicates that large boards are better for

MFI performance, board gender diversity also enhances the performance of MFI and the more females are on the board the better the performance of MFIs.

### **2.6.2 Empirical Study in Ethiopia**

Amanuel et al. (2015) examine the impact of corporate governance mechanisms on the performance of Ethiopian insurance Companies using a panel data model for the period covering from 2009 to 2013. Both descriptive and regression analyses were conducted on the selected samples of 10 insurance companies out of 15 operating in the market. The findings from the study indicated that board meeting and board compensation had a statistically significant positive impact on return on equity (ROE) of the Ethiopian insurance Industry. But the research finding doesn't show the significant impact of board size, audit committee, and gender diversity on the proxy of companies' performance. Moreover, the Size of the companies had a significant positive impact on ROE, but the Age of the firms did not reveal any significant impact on ROE.

Freed (2012) conduct his research on the impact of corporate governance on firm performance evidence from a commercial bank in Ethiopia, the variable used in his study was board size, board gender diversity, board member educational qualification, board member business management, and industry-specific experience and audit committee size. The variable used as a measure of financial performance was (ROA, ROE, and NIM). The finding of the study reveals that board size has a significant effect on ROE but, has a negative effect on ROA and NIM. Industry-specific experience of the board of director has positive and significant influence on ROA and negative and significant with the other two, and audit committee size has negative relationship with all of the financial performance variable but significant with ROE finally board business management and industry-specific experience has significant and positive influence on financial performance of commercial band however there is no significant relationship with board gender diversity.

Getachew (2014) and Techan (2016) studies the relationship between corporate governance mechanism and firm performance in the selected insurance company from 2008-2012 using panel data, multiple regressions and pooled OLS regression analysis respectively. Their research outcome indicated that board size has a significant negative effect on the financial performance of a firm whereas board gender diversity and frequency of meeting has a significant positive effect on the performance of the firm.

Melkamu(2016)explore the effect of corporate governance on financial performance of five microfinance institution selected via a purposive sampling technique, the variable used a measure of corporate governance mechanism are board size, board gender diversity, audit committee size, educational qualification of the board, business management and industry

experience of the board, financial performance was measured through return on asset and return on equity, the study also uses control variable such as leverage, growth, and capital adequacy ratio. The finding of his study show that there is a negative relationship between board size and financial performance of MFI as measured by ROA and ROE however significant for ROA and insignificant for ROE, board gender diversity has no statistically significant relationship financial performance as measured by ROA but it has statistically negative relationship ROE, in addition there is a positive and significant relationship between educational qualification and industry-specific experience of the board with financial performance of MFI as measured by ROA but in relation to ROE there is positive and significance with board educational qualification and positive and insignificant with industry-specific experience finally there is an inverse relation between audit committee size and ROA and ROE.

**Table 1 Summary of empirical research**

<b>An empirical study Abroad</b>				
Authors Name and year	Area of study and period covered	Research approach and Model used	Findings	
Bassem (2009)	MFI In Mediterranean country	Descriptive design and multiple Regression model	The study shows that the more women there are on the board the better the performance, and reveals that external governance mechanisms help MFIs to achieve better financial performance.	
Friday (2017),	Nigeria MFI	a longitudinal study with descriptive and quasi-experimental Methods, and multiple Regression	Board Size and Board Gender Diversity have no significant to the FP of MFIs but have a significant effect on the SP of MFIs while the frequency of meeting has no significant on both FP and SP of MFIs in Nigeria.	
Hatraska (2005)		Random effect regression model	Managerial compensation, board size, gender, skill improve performance of firm.	

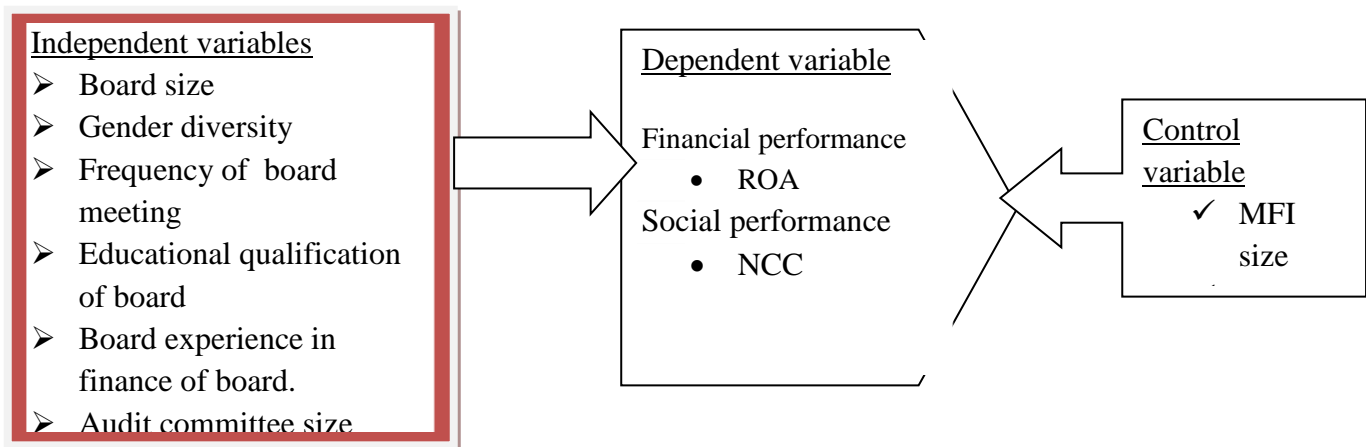
Joel (2012)	Ghana MFI	Explanatory research design	There is a Positive relationship between corporate governance mechanisms and the financial performance of microfinance institutions.
Keyereboan and Osei (2008)	Ghana MFI	Quantitative approach and Panel data technique	Governance plays a critical role in the performance of MFI and that independence of the board and a clear separation of the position of CEO and board chairperson correlate with performance measure both profitability and outreach.
Mohamed abadi et al, (2014)	Kenya MFI from 2000 to 2011	Explanatory research design and multiple regression models.	Board diversity of moderate size with a considerable number of women is better placed to ensure the independence of the board and hence boosting financial sustainability.
Ngure (2007)	Kenya MFI	Descriptive statistics	the study found out that board size was positively correlated with a firm's performance
Roy mesland&R,Øy steinStrøm( 2009)		Random effect panel data regression	The financial performances improve with local than international director and outreach increase with CEO duality.
RachanaVishwa karwa (2011).	India MFI from (2009 to 2013 )	Descriptive approach and correlation and regression model.	Larger boards are better for MFI performance; board gender diversity also enhances the performance of MFI.
<b>An empirical study in Ethiopia</b>			



Amanuel, et al (2015).	Insurance company in Ethiopia ( 2009 to 2013)	Descriptive and regression analysis	The findings from the study indicated that board meeting and board compensation and the Size of the companies had a statistically significant positive impact on return on equity (ROE). But the Age of the firms did not reveal any significant impact on ROE.
Freed, (2012)	a private commercial bank in Ethiopia from (2007 to 2011)	Explanatory research design and multiple panels linear Regression.	The finding from this study reveals that board size has a significant effect on ROE but it has a negative effect on ROA and NIM. Audit committee size has a negative relationship with the financial performance variable but significant with ROE finally board business management and industry-specific experience has a significant and positive influence on the financial performance of commercial Bank and however, there is no significant relationship with board gender diversity.

Melkamu (2016),	Five MFI in Ethiopia (2005 to 2014)	Explanatory research design and multiple regression statistical too	there is a negative relationship between board size, audit committee size and financial performance of MFI as measured by ROA and ROE however board gender diversity has no statistically significant relationship with financial performance as measured by ROA but it has negative relationship ROE, in addition, there is a positive and significant relationship between educational qualification and industry-specific experience of the board with financial performance of MFI as measured by ROA and but insignificant with industry-specific experience as measured by ROE.
Getachew (2014),  Techan (2012)	Insurance company in Ethiopia (2008 to 2012)	Multiple regression models.  Pooled OLS regression model.	Their research outcome indicated that board size has a significant negative effect on the financial performance of the firm whereas board gender diversity and frequency of meeting has a significant positive effect on the performance of the firm.

Figure 2. 1 Conceptual frame work



Source: Researcher's own design, 2021

## CHAPTER THREE

### 3. METHODOLOGY OF THE STUDY

#### 3.1 Research approach/Design

Research design is an outline that identifies the methods and procedures for collecting and analyzing the required information. It is a structure for investigating so conceived as to obtain answers to research questions and for testing hypotheses (Kothari, 2004).

As stated by Creswell (2003) there are three familiar approaches to business and social research specifically, quantitative, qualitative and mixed methods approach. Quantitative research is a means for testing objective theories by examining the relationship among variables, on the other hand, qualitative research approach is a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem with the intent of developing a theory or pattern inductively and the mixed methods approach is the combination of Qualitative and quantitative approach.

For a similar study (Amanuael et al., 2015; Basem, 2009; Ngure, 2007; Vishwakara, 2011) have employed a descriptive approach. (Freed, 2012; Getachew, 2014; Melkamu, 2016; Mohammed et al., 2014; Techane, 2012) Have applied explanatory were as (keyereboach and osei, 2008; Friday, 2017) used a quantitative approach.

Thus, to achieve the objective of the research, the study had used an explanatory type of research design with a quantitative approach which helps to identify and evaluate the link between the independent and dependent variable under considerations (Creswell, 2003).

#### 3.2 Target population

The population is the complete set of cases from which a sample is drawn (Saunders et al, 2003) According to national bank of Ethiopia, As of June 2020, 35 microfinance institutions are operating in the country, with an aggregate capital of 10.5 billion birrs, and more than 4 million active borrowers (NBE, 2020). The target population of this study, therefore, were all microfinance institutions operating in Ethiopia.

#### 3.3. Sampling technique and sample size

The sample design is a definite plan for obtaining a sample from a given population. It refers to the technique or the procedure that the researcher would adopt in selecting items for the sample (Kothari, 2004). For the same study (Freed, 2012; Melkamu, 2016; Techane, 2015) have used non-probability purposive sampling but Mohammed., et al (2014) and Momayi (2018) used cluster sampling and census study respectively to select sample MFI.

The outcome of this research had been more comprehensive if the total microfinance institution were used, but due to the unavailability of data and lack of willingness to provide information regarding corporate governance variable, the researcher forced to take only 18 microfinance institution which comprises (51.4%) of the total MFIs. This was done by considering the year of establishment, availability of the data. Therefore the number of observations (sample size) for this study used 90 observation which consist of 18 MFI with five years (2014-2018) consecutive data.

### **3.4 Data type and Collection instrument**

A similar study conducted by (Freed, 2012; Melkamu, 2016; Mohammed., et al, 2014;Techane, 2015) has used both primary and secondary data whereas (Vishwakarwa, 2015; Thrikawala et al, 2013) used only secondary data.

For this study, the data was collected from both primary and secondary data. The primary data was collected via administered questionnaires that targeted the Chief Executive Officers since he or she is in a better position to have all the information about corporate governance in his or her organization. The questioner was developed to collect the required data on the corporate governance variables. The secondary source of data was audited financial statements of selected microfinance institutions,obtained from the national bank of Ethiopia (NBE) and the Association of Microfinance Institution (AEMFI).

### **3.5. Method of Data analysis**

According to Kothari (2004), Data analyses incorporate Editing, Coding and, Tabulation of collected data.For parallel study (Freed, 2012; Melkamu, 2016; Vishwakarwa, 2015) have used descriptive statistics (such as mean) and inferential statistics (such as correlation and multiple regressions).In the way (Mersland, 2008; Techane, 2015) have used descriptive statistics and inferential statistics (such as GLS multivariate regression and pooled OLS estimation respectively).

Hence this research had used descriptive statistics such as mean, and standard deviation, to describing and analyzing the important features of the corporate governance variable used during the study period. To shows, the relationship between dependent and independent variable this research was used correlation matrix.Since the data is a combination of cross-section and time serious. Therefore the appropriate technique for this research the data is 4 years (time serious) and 18 microfinance institution (cross section) or it is a panal data and the panel data regression technique is used. According to Gujarati (2003), fixed effect and random effect are frequently used estimation techniques for panel data regression.To use a fixed effect or random-effect model, the Hausman test model specification was used and

based on the Hausman test specification, Random effect GLS regression was used. To simplify the analysis process, the study used STATA version-14 software.

### 3.6. Selection of econometric model for panel data

According to Gujarati (2003) there are three types of panel data regression model these are pooled OLS, fixed effect model and random effect model. The pooled OLS estimator ignores the panel structure of the data. The major problem with the Pooled model is that it does not distinguish Variation between entities (MFIs). In other words, by combining the entire sample MFIs, it rejects the heterogeneity or individuality that may exist among sample MFIs. Here the assumption is that the coefficients in the intercept are the same for all MFIs. This may be an inappropriate assumption.

In a fixed-effect model, it assumes that something within the individual may impact or bias the predictor or outcome variables and we need to control for this (Bun and Carree, 2005). This is the rationale behind the assumption of the correlation between an entity's error term and predictor variables (Oscar, 2007). This method removes the effect of time-invariant characteristics. Therefore, we can assess the net effect of the predictors on the outcome variable (Harris, 2009). Those time-invariant characteristics are unique to the individual and should not be correlated with other individual characteristics.

The rationale behind the Random effects model is that the variation across entities is assumed to be random and uncorrelated with the independent variables included in the model (Oscar, 2007).

Therefore it is necessary to determine whether the fixed effect or random effect approach is appropriate. A frequent practice in corporate governance research is to choose between fixed effect and Random approaches by running a Hausman test. Based on the Hausman test result this study used a random effect model.

### 3.7. Model Specification

This section presents the empirical model of the study. The model was adopted from Hartarska (2005) and Basem (2009).

The complete Panel model is as follows:

$$y_{it} = \beta_0 + \beta_1 X_{it} + \dots + \beta_k X_{kit} + \mu_{it} \dots \dots \dots eq1$$

Where:  $Y_{it}$  = dependent variable where  $i$  = MFI and  $t$  = Time.

$\beta_0$  = Constant

$X_{kit}$  represents independent variable

$\beta_1 - \beta_k$  = Coefficients for independent variable

$$\mu_{it} = \alpha_i$$



### 3.8.1 Description of Dependent Variables and measurement

The dependent variable was measured by using two performance indicators, one for financial performance measured by Return on assets (ROA). The other for social Performance (outreach) measured by the number of credit. The major financial performance (sustainability) variable often used to assess the effect of corporate governance in Microfinance Institutions is ROA (Rients et al. 2012). It can be calculated by the following formula;

$$\text{ROA} = \frac{\text{Net operating income}}{\text{Average annual asset}}$$

Average annual asset

ROA measures the ability of an MFI to yield income or generates profit from its asset (Rients et al. 2012). The social performance was measured by the number of credit clients. The number of credit clients Measures the social performance of MFI (Mersland and Strom, 2008; Friday, 2017).

The study used a logarithm of a number of credit client to measure outreach of MFIs.

### 3.8.2 Description of independent, control variables and measurements

**Table 2 Definition and Measurements of independent, and control variables**

Independent variable	Definition	Measurement
Board Size( B size)	Board size defined as the total number of board of director in the board	Total number of directors serving on the board of directors
Gender Diversity ( GDIV)	Board Gender Diversity is the number of women represented on the board.	a total female board divided by Total number of board member
Frequency of board Meeting (FOM)	Frequency of board meeting means the number of a meeting held by the board during the year.	The number of time that aboard Meeting held per year
Board Educational qualification (BEQ).	the level of educational qualification of MFI board Members.	The proportion of board member who has a college degree and above.
Audit Committee Size	Size of an audit committee in a board refers to the total number	Number of audit committee over the total

	of MFIs' audit committee members out of the total number of board of directors.	Board size.
Board member experience in finance	A board member with finance and related work experience.	The proportion of board members with finance Experience.
MFI size	It is the size of the microfinance institution.	The logarithm of the year-end total assets.
MFI age	The age of MFI from the time when It is established.	Number of Years from their commencement.

### **3.8. 3. The operational definition of variables.**

Corporate governance refers to the internal governance structure used in creating a balance between financial and social goals.

Financial performance represents financial sustainability and measured by Return on asset.

Social performance represents outreach and measured by the number of credit clients.



## CHAPTER FOUR

### 4. DATA ANALYSIS AND DISCUSSION

#### 4.1. Descriptive Statistics for the dependent, Independent and control variable

This section presents the descriptive statistic results for the dependent variables, such as ROA and NCCasa ameasureoffinancial and social performance respectivelyand the independent variables are board Size, gender diversity, frequency of board meeting, board experience in Finance, educational qualification of board member,audit committee size and two control variable such as MFI age and MFI size.

**Table 3**Descriptive Statistics

variables	Obs.	Mean	Standard deviation	Minimum	maximum
ROA	90	0.156	.406	-.322	2.776
NCC	90	9.46	2.503	5.236	14.210
BSIZ	90	6.311	1.186	4	9
GDIV	90	0.288	0.230	0	1
FBM	90	5.889	2.869	2	13
BEF	90	3.278	1.499	1	7
BEQ	90	.924	.118	.5	1
ACSIZ	90	1.767	1.289	0	4
MFI AGE	90	13	5.559	1	24
MFI SIZE	90	11.999	2.514	6.438	17.113

**Source: Stata descriptive statistics result based on the data obtained from sample MFI, 2021**

As shown in Table 3 On average, the MFIs recorded a return on assets of 0.156While the minimum was -.322, the maximum performance was 2.776this indicates that for 1 birr investments sampled MFI earns about 15.6%.The studied MFIs have on average 9.467number of credit clients with respectively a minimum and a maximum of 5.236 and 14.210and a standard deviation of 2.503.

The average number of board member in Ethiopian MFIwas 6 persons together with a maximum board size of 9 members and a minimum board size of 4 members.

On average the percentage of female board was28.78%, with a minimum of null and maximum of 1(100%). Showing that MFIs boards are male dominated.Theaveragenumber of

director with finance related experience were 3 with a minimum of 1 and maximum of 7 board members.

In terms of educational qualification of the board, the table also shows that 92.4% of the board members are a degree holder and above with minimum and maximum of 50% and 100% respectively, these shows Ethiopian MFIs board members are capable and knowledgeable for sampled MFI. Furthermore, on average Board of directors hold meeting approximately 6 times per year with a minimum of 2 and a maximum of 13 meetings and the standard deviation is 2.869. However, NBE stimulate that board members to hold board meetings once per month which means twelve times per year nevertheless the majority of MFI hold Board meetings below the requirement NBE. The average audit committee size for the Ethiopian MFIs were about 2 with a minimum of null and a maximum of 4 audit committee members. The standard deviation is 1.289 from the mean.

Finally, the mean value of MFI size as measured by the natural logarithm of the total asset is 11.999 with a maximum value of 17.114 and minimum values of 6.439. The average age sample MFI is 13 and the minimum and maximum of 1 and 24 respectively.

#### **4.2. Correlation Matrix**

The correlation matrix shows an association among the independent and the dependent Variables and also the relationship with all pairs of independent variables themselves. It is Vital in discerning the degree of association among all variables as excessive correlation could lead to multicollinearity, which might accordingly result in misleading findings and conclusions.

The following Table Shows the correlation matrix for dependent, independent and control variables.

**Table 4 Correlation matrix**

Variable	ROA	NCC	BSIZ	GDIV	FBM	BEF	EQB	ACSIZ	MFIAGE	MFISIZ
ROA	1.0000									
NCC	0.0746	1.0000								
BSIZ	0.3152	0.3366	1.0000							
GDIV	0.0586	0.3331	0.3385	1.0000						
FBM	0.2045	0.2201	0.1786	-0.0430	1.0000					
BEF	0.1672	0.3767	0.4246	0.3260	0.3833	1.0000				
EQB	-0.0738	-0.0345	-0.2201	-0.2737	0.1876	0.1453	1.0000			
ACSIZ	0.1603	0.2553	0.5692	0.2990	0.1083	0.3128	0.0493	1.0000		
MFIAGE	0.0572	0.1867	-0.1022	-0.3178	0.1838	0.1995	0.1812	-0.2570	1.0000	
MFISIZ	-0.0315	0.1985	0.4315	-0.0598	0.0387	0.3211	0.0207	0.1859	0.5772	1.0000

**Source: Correlation Matrix from Stata 14 Result based the data obtained from sample MFI 2021**

If the correlation coefficient between two independent variables is above 0.80 or eighteen percent, it is considered as excessive and therefore the variables are highly correlated. (Gujarati and Porter, 2009) thus some steps are vital to correct that inconsistency in the data.

From the above table, it is obvious that all correlation coefficients are below 80% signifying that the variables are well selected and can fit in the same regression model.

The table also discloses that there is a positive relationship between the dependent variable such as ROA, and independent variables such as board size, gender diversity, board frequency of meetings and board experience in finance and audit committee size with the coefficient of 0.3152, 0.1672, 0.2045, and 0.0586 and, 0.1603 respectively, which confirm that all of the above mentioned independent variable and the dependent variable move in similar direction. However, the correlation matrix shows that there is a negative relationship between the Educational qualification of the board and ROA with a coefficient of -0.0345.

The table also shows a positive link between NCC and independent variables like Board size, gender diversity, Board Frequency of Meetings and board experience in finance and audit committee size with the coefficient of 0.3366, 0.3331, 0.2201, 0.3767, and 0.2553 correspondingly. But educational qualification also has an inverse relationship with NCC with the coefficient of -0.0345.

Concerning control variable age of MFIs and their size are positively and negatively related with ROA with the coefficient of 0.0572 and 0.0315 whereas with NCC both age of MFIs and size of MFIs are positively related with a coefficient of 0.1985, and 0.1867 respectively.

### 4.3. Regression Results and Discussion

#### 4.3.1 Test for fixed effect vs Random effect model

**Table 5** Result of Hausman Test

Hausman test for ROA( model one)		Hausman test for NCC( model two)	
chi2(8)	= 12.46	chi2(8)	2.15
Prob>chi2	= 0.1317	Prob>chi2	0.9759

The above Hausman test in table 5 shows that in both model one and model two, random effect is appropriate since the p-value in both models is greater than 0.05. (See Appendix II)

#### 4.3.2 Model Diagnosis

The data sets were tested for diagnostics tests that are required in random effect model (see appendix II). Tests were conducted for the valid test of the hypothesis and valid estimation of the coefficient.

##### 4.3.2.1 Testing for random effects Breusch-Pagan Lagrange multiplier (LM)

The LM test was run to choose between a random-effects GLS regression and a simple OLS regression. The null hypothesis in the LM test is that variance across entities is zero. This means there is no significant difference across the panel. However, the LM test shows that the variance across the entities is different from zero for the two models, with the p-value of 0.0000 and  $\chi^2(01)$  of 44.76 and 73.49 respectively this indicates random effect GLS regression is appropriate than simple OLS (see Appendix II).

##### 4.3.2. 2. Testing for heteroscedasticity

The next important assumption is that the disturbances appearing in the population regression are homoskedastic that means the variance of the error term is consistent. If errors do not have constant variance (not homoskedastic), they are said to be Heteroskedastic Brooks, (2008). The justification of the null hypothesis that the error terms are homoskedastic is necessary because the existence of heteroscedasticity makes the standard errors incorrect and as a result, any inferences made could be misleading. To make sure that this hypothesis is no longer violated, the researcher used the Breusch-Pagan / Cook-Weisberg test for heteroscedasticity based on the following null and alternative hypothesis.

HO: The error term is homoskedastic in the model

HI: The error term is heteroscedastic in the model

**Table 6. Heteroscedasticity test for ROA (model one)**

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity	
Ho: Constant variance	
Variables: fitted values of ROA	
chi2(1) =	0.04
Prob> chi2 =	0.8417

**Table 7. Heteroscedasticity test for NCC (model two)**

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity	
Ho: Constant variance	
Variables: fitted values of NCC	
chi2(1) =	0.03
Prob> chi2 =	0.8689

In both tables 6 and 7 above, stata presents the same conclusion that there is no evidence for the presence of heteroscedasticity, for the model since the p-values are higher than 0.05. (See Appendix II)

#### 4.3.3 Testing for multicollinearity

Multi-collinearity is the existence of an exact, linear relationship between some or all explanatory variables of a regression model (Gujarati, 2004). The researcher used the variance inflation factor and tolerance value to check whether there is the problem of multi-collinearity or not among the explanatory variables in the model.

**Table 8 Test for Multicollinearity**

Variable	VIF	1/VIF
MFISIZ	2.62	0.381639
BSIZ	2.51	0.397639
MFIAGE	2.51	0.399057
BEF	1.81	0.552315
ACSIZ	1.76	0.567523
GDIV	1.55	0.644177
FBM	1.35	0.740726
EQB	1.34	0.746111
Mean VIF	1.93	

**Source: Multicollinearity test result from stata 14**

The above Table indicates the absence of multicollinearity problem since the value of VIF and TV are constantly found to be below 10 and larger than 0.10 respectively (see Appendix II).

**Table 9 Random-effects GLS regression results for Model One (ROA) and model two (NCC)**

Variables	ROA		NCC	
	Coef.	Std. Err.	Coef.	Std. Err.
BSIZ	0.245***	0.048	-0.476**	0.239
GDIV	0.128	0.277	6.059***	1.432
FBM	-0.011	0.011	0.291***	0.054
BEF	0.103***	0.036	-0.502***	0.181
EQB	1.600***	0.326	-0.302	1.602
ACSIZ	0.011	0.026	-0.180	0.125
MFISIZ	-0.023	0.036	0.150	0.191
MFIAGE	-0.003	0.014	-0.116	0.074
_cons	-2.882	0.498	10.963	2.562

**Table 10 Test**

<p>Wald chi2(8) = 65.11 Wald chi2(8) = 54.53</p> <p>Prob&gt; chi2 = 0.0000 Prob&gt; chi2 = 0.0000</p> <p>rho = 81.4% rho = 87.4%</p> <p>R square; within = 0.6003 R square; within = 0.5279</p> <p>Between=0.0183 Between= 0.0112</p> <p>Over all= 0.0671 Over all= 0.0022</p> <p>N.B *significant at 10%, **significant at 5%,</p> <p>*** significant at 1%</p>
--

**Source: Stata 14 regression results based on data obtained from sample MFIs. 2021**

The above table 8 shows regressions result for model one (ROA) and model two (NCC).

Random-effects GLS regression results show that R-Squared of the model is 60.03% and 52.79% for both models, these indicate that about 60.03% and 52.79% of the variations in ROA and NCC were explained by the explanatory variables used in the model respectively. The remaining 39.07% and 41.21% of the change in ROA and NCC are explained by other factors that are not included in the model. The Wald  $\chi^2$  of 65.11 and 54.53 for both models is significant with a p-value of 0.0000 which shows that all the coefficients in the model are different from zero. This indicates that the variation in the dependent variable was well explained by the independent variables of the model. The Rho for both models indicates that around 81.4% and 87.4% the variance was due to difference across the panel.

### **Board Size and Performance of MFI**

The study found a positive and statistically significant relationship between board size and ROA at 1% level of significance. This means other variables remain constant, as a board size increases by 1 member ROA increases by 24.5%, this implies that the higher the number of board members, the higher the financial performance of MFIs will be and vice versa. This is due to the fact that large boards are occupied with different qualified people, and this helps to make a better decision in turn help to get better sustainability. This result supports the findings of (Bassem, 2009; Mersland and Strøm, 2009) but against with those of (Freed, 2012; Jensen, 1993; Ngure, 2007; Uwuigbe and Fakile, 2012). The result does not support the expected hypothesis. On the other hand, as expected, board size has a negative and statistically significant effect on outreach at 5% level of significance. This means as board size increases by 1 board, the number of credit clients served by MFIs decrease by 47.6%, keeping other variables constant. This indicates that when the number of board size increases the number of credit clients served by MFI will decrease and vice versa. The result points out small boards are more effective in reaching the poorer client. The finding is in line with agency theory which states that as board size increases, the problems of coordination and communication also increase. The result is inconsistent with (Bassem, 2009; Hartarska, 2005).

### **Gender Diversity and Performance of MFI**

The relationship between board gender diversity (GDIV) and financial performance is not as it was expected. As indicated in table 8 there is no significant relationship between gender diversity and ROA. In contrast, gender diversity has positive and significant influences on number of credit clients served by MFIs at 1% level of significance, other variables remain constant, as the number of women increases by 1% in the board, the number of credit clients served by MFI increase by 12.8%, and this means a woman has the ability to reach the poorer clients. Because they may help the MFI to understand its customer better and to design

an appropriate product to them (Mersland and Strom,2007). (Kilic, 2015)confirm thatwomen in management contribute significantly to MFIs performance, the argument for his study was women leaders are more sensitive and are more likely to make quality decisionsthan their male counterparts; they also have the ability of multitasking.Thisfinding is also in line withthose of (Bassem, 2009; Gohar&Batool, 2015; Hartarska, 2005).

### **Frequency of Board Meeting and Performance of MFI**

The above table 8 shows insignificance effect of Frequency of board meetings on the financial performance of MFIs. However,,thefrequency of board meeting has a positive and significanceeffecton social performance (outreach) of MFIs at 1% level of significance. The result indicates that when board members meet one times, the number of credit client increase by 29.1%, keeping other variable remainsconstant.This means MFIboards that meet more frequently has a tendency to generate higher Social performance (outreach).It is in line with agency theory, which suggests that corporate boards that meet more frequently have increased capacity to effectively advise, monitor and discipline management, and thereby improving performance.

### **Board Experience in Finance and Performance of MFI**

As expected,board members with finance experience has a positive and significance effecton ROAat 1% level of significance. This indicates, as the number board with finance experience increases by 1 member the ROA increase by 10.3%. Thisshows that an increaseinthe proportions of directors who had finance experience will increase the financial performance (as measured by return on asset) and vice versa.This is maybe because of the nature of their work,aboard member with financial skill contribute a lot towards the sustainability of MFI,since they had previous work experience, it is easy to share their experience, the challenges they faced and the events they look in their earlier work.It also indicates the acquired experience allows MFIs to produce better sustainability (Bassem, 2009). In line with the finding of (Freed, 2012; Melkamu, 2016) both found a positive association between finance experience board and financial performance.

On the other hand, board experience in finance has a negative and significant effect on social performance (outreach) MFIs that is significant at 1% level of significance. This means as the number of the board with finance experience increase by 1 the number of credit client served by MFIs decrease by 50.2%. This indicates as a boardmember with finance experience increases, the MFI ability to reach more client decrease. This might be due to the fact that board members are selected based on financial skill rather than social skill to satisfy the



requirement of NBE. The result is in line with the finding of Haterska (2005) Therefore Result rejects the hypothesis for social performance.

### **Board Educational Qualification and Performance of MFI**

The finding shows that board educational qualification has a positive and significant effect on financial performance (ROA) at 1% level of significance. This means when the educational qualification of the board is high, the MFIs ROA increased by 160%, it is found that the higher the competency of the board member, the better will be the financial performance of the MFIs. The finding is consistent with the resource dependency theory that states qualified and skillful board members can be considered as a strategic resource to provide a strategic linkage to different external resources. It is also in line with the finding of Ferde (2012); Joel (2012) and Yasser (2011) they argue that director with higher education's are better in managing the business operation and critically analyzing managements' plans and reports, and controlling agency problem than less educated counterparts.

With regards to social performance, the educational qualification has negative and insignificant with a p-value of 0.851.

Whereas the effect of audit committee size on financial and social performance MFI is positive and negative respectively, however, the effect is insignificant for both measures of performance.

**Table 11 Summary of Expected and Actual Relationships.**

Independent Variables	Dependent Variable	Expected R/ship	Actual R/ship	Significance at 1% & 5% and 10%		Accept/Reject	
				ROA	NCC	ROA	NCC
		ROA/ NCC	ROA/ NCC				
BSIZE	ROA and NCC	-	+/-	Sig at 1%	Sig at 5%	reject	Accept
BGDIV	ROA and NCC	+	+/+	Insig	Sig at 5%	accept	Accept
FOBM	ROA and NCC	+	-/+	Insig	Sig at 5%	reject	Accept
BEQ	ROA and NCC	+	+/-	Sig at 1%	Insig	accept	Reject
BEF	ROA and NCC	+	+/-	Sig at 1%	Sig at 5%	accept	Reject
ACSIZE	ROA and NCC	-	+/-	Insig	Insigt	Reject	accept

## CHAPTER FIVE

### 5. SUMMARY, CONCLUSION, AND RECOMMENDATION

#### 5.1 Summary

In contrast to the formal financial institution, microfinance is the provision of financial services, especially savings and credit to the poor and low-income households otherwise to those who do not have access to conventional commercial banks (Rock et al., 1998). Governance is considered as a method of guiding an institution to achieve its primary objective while being sustainable.

Therefore this research is to examine the effect of corporate governance (board size, board gender diversity, frequency of meeting, board educational qualification, board experience in finance, and audit committee size) on financial performance (sustainability) and social performance (outreach) of Microfinance institutions in Ethiopia from (2016- 2020). The study was based on both primary and secondary data; primary data was collected from CEO of the individual microfinance institution, whereas secondary data was collected from national bank of Ethiopia, and Association of the microfinance institution. To describe the important feature of corporate governance variable this study used descriptive statistics. Correlation matrix also used to show the relationship between the independent and dependent variable. The study used random effect GLS regression analysis.

Based on descriptive statistics On average, the MFIs recorded a return on assets of 0.156. While the minimum was -.322, the maximum performance was 2.776. The average, board member of Ethiopian MFIs were 6 persons with a maximum board size of 9 and a minimum board size of 4. On average 28.78% of all boards are made up of women, with a minimum of null and maximum of 1 (100%). The average number of the board of director with finance related experience of sample MFIs are 3 with a minimum of 1 and maximum of 7. Around 92.4% of the board members are a degree holder and above with minimum and maximum of 50% and 100% respectively. On average the sample MFIs Board of directors hold meeting approximately 6 times per year with a minimum of 2 and a maximum of 13 meetings. The average audit committee size standing for the MFI is about 2 with a minimum of null audit committee and a maximum of 4 audit committee members. Finally the average age sample MFI is 13 and the minimum and maximum of 1 and 24 respectively.

The correlation matrix reveals a positive relationship between the dependent variable such as ROA and NCC with independent variables like board size, gender diversity, board frequency of meetings, board experience in finance and audit committee size. However, the correlation

matrix shows that there is a negative relationship between the Educational qualification of the board and ROA and NCC.

Based on random effect GLS regression result, board size and board experience and educational qualification of the boards have a significant positive effect on return on asset while they have a negative significant effect on outreach. On the other hand, Board gender diversity and frequency of board meetings have significantly associated with social performance measured by number of credit client.

## **5.2 Conclusions**

These papers examine empirically the relationship between corporate governance and Ethiopians MFIs performance in terms of outreach and sustainability while taking primary data from individual microfinance institutions, and secondary data from the national bank of Ethiopia, and association of microfinance institutions (AEMFI). The study used both agency and resource dependency theory. The results show that board size, educational qualification, and board experience are better for enhancement of financial performance, together this result shows large size boards are occupied by different qualified and experienced board helps to make a better decision and contributing a lot towards the profitability of MFI. Whereas board size and financial experience of the board affect the social performance of MFIs negatively. This is possibly because of the board of director is selected based on financial skills and background rather than the social skills of the Board to fulfill the requirement of national banks Ethiopia. The study also found that gender diversity and frequency of meeting are better in reaching the poor client. This indicates that women's have the ability in reaching the poor client and MFI Board that meets more frequently tends to generate higher Social performance (outreach). This shows the MFIs board has been contributed their effort and time properly as required by the company.

## **5.3 RECOMMENDATION**

Based on the above findings and conclusions, the researcher forwarded the following recommendations to MFIs and NBE.

- Microfinance Institutions board size should be occupied with a range of expertise to help to make better decisions to monitor managers in turn help to get the better financial performance of the institutions.
- the regression result shows that the more women's are on the board the higher the number of clients served by MFI therefore by considering their significant contribution to the social mission of the institution, Ethiopian MFIs should improve the number of women on the board by considering their experience and ability of reaching poor.

- Frequency of meeting has a significant positive effect on the social performance of MFI. It is remarkable, but care should be taken on the quality of the agenda unless the frequency of meeting results in agency cost.
- According to National Bank of Ethiopia corporate governance directive the minimum competency requirement for board member is diploma whereas for chief executive director the minimum competency requirement is bachelor degree, because of the board competency requirement is less than general manager, therefore, the board member may not be able to monitor the activities of general manager, hence NBE should change the competency requirement for MFI board member.

#### **5.4.SUGGESTION FOR FURTHER RESEARCH**

The study has provided a road map for further research in the following areas:

- ✓ The study excludes some important corporate governance variables such as CEO/Chairman Duality, board independency, Female CEO, experience and qualification of CEO, ownership structure. Therefore future researchers should consider these variables in their study.
- ✓ The study also used only two performance variables; return on asset and number of credit clients, exclusion of the return on equity, operational self-sufficiency, average loan size, and number of branches. It is therefore suggested that future researcher should also consider about governance and performance MFIs using efficiency as a measure of performance.
- ✓ The study used only 18 MFIs because of challenge in getting data from the MFIs. It is therefore suggested that future researchers should include more MFIs in their sample.

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## **Appendix**

### **Appendix I**

**ST.MARY'S UNIVERSITY**

**SCHOOL OF GRADUATE STUDIES**

**DEPARTMENT OF ACCOUNTING AND FINANCE**

#### **RESEARCH QUESTIONNAIRE**

Dear, respondent the purpose of this questionnaire is to conduct a study on Corporate Governance and Its effect on performance of Micro Finance Institutions in Ethiopia for Partial fulfillment of the requirement for Master of Art in Accounting and Auditing (M.A). You are selected to participate in the research based on your work relationship with the corporate governance of MFI. Your response supposed to have a vital contribution for the success of the study therefore I would like to request your genuine responses for each questions. I would like also to assure you that the information provided here will be used only for academic purposes and thus will be treated with maximum confidentiality.

#### **Direction:**

- No need to write your name.
- Please kindly put this mark (√) on the correct box for the general questions.
- In case you have doubt on any of the given questions, please don't hesitate to contact me via the following address.

E-mail:- [abrshblockcon@gmail.com](mailto:abrshblockcon@gmail.com)

Phone number +251-912-45-51-82

**Thank you in advance for your co-operation**

## Part 1. General Information

1. Name of the Microfinance Institution

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2. Educational qualification of CEO

3. Diploma  College degree  Master degree  Above

4. Gender Male  Female

5. For how many Years you have served in the organization

Below 5 years  5-10  10-15  15-20  Above 20

6. How long the firm has been in existence?

Below 2 years  3-5 year's  5-7 year's  above 7 years

7. Do you sit on Board as a member? Yes  No

**PART II Composition and experience of the board(please indicate numerically)**

S.N		Fiscal Year in Gregorian Calendar				
		2016	2017	2018	2019	2020
. 7	Total number of directors sitting on the board					
8	How many times do you hold board meetings annually?					
9	How many of the board member are women?					
10	How many of the boards are audit committee member?					
11	How many of the board of directors have finance relatedexperience?					

**13. Educational qualification of the board member**

	Diploma holder	B.A degree	M.A/Msc holder	PhD Holder
2016				
2017				
2018				
2019				
2020				

## Appendix II

### Descriptive Statistics

Variables	Obs.	Mean	Standard deviation	Minimum	maximum
ROA	90	0.156	.406	-.322	2.776
NCC	90	9.46	2.503	5.236	14.210
BSIZ	90	6.311	1.186	4	9
GDIV	90	0.288	0.230	0	1
FBM	90	5.889	2.869	2	13
BEF	90	3.278	1.499	1	7
BEQ	90	.924	.118	.5	1
ACSIZ	90	1.767	1.289	0	4
MFI AGE	90	13	5.559	1	24
MFI SIZE	90	11.999	2.514	6.438	17.113

**Source: Stata descriptive statistics result based on the data obtained from sample MFI, 2019**

### Table Correlation matrix

Variable	ROA	NCC	BSIZ	GDIV	FBM	BEF	EQB	ACSIZ	MFIAGE	MFISIZ
ROA	1.0000									
NCC	0.0746	1.0000								
BSIZ	0.3152	0.3366	1.0000							
GDIV	0.0586	0.3331	0.3385	1.0000						
FBM	0.2045	0.2201	0.1786	-0.0430	1.0000					
BEF	0.1672	0.3767	0.4246	0.3260	0.3833	1.0000				
EQB	-0.0738	-0.0345	-0.2201	-0.2737	0.1876	0.1453	1.0000			
ACSIZ	0.1603	0.2553	0.5692	0.2990	0.1083	0.3128	0.0493	1.0000		
MFIAGE	0.0572	0.1867	-0.1022	-0.3178	0.1838	0.1995	0.1812	-0.2570	1.0000	
MFISIZ	-0.0315	0.1985	0.4315	-0.0598	0.0387	0.3211	0.0207	0.1859	0.5772	1.0000

**Source: Correlation Matrix from Stata 14 Result based the data obtained from sample MFI**

### Result of Hausman Test

Hausman test for ROA( model one)			Hausman test for NCC( model two)	
chi2(8)	=	12.46	chi2(8)	2.15
Prob>chi2	=	0.1317	Prob>chi2	0.9759

### Heteroscedasticity test for ROA (model one)

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity	
Ho: Constant variance	
Variables: fitted values of ROA	
chi2(1) =	0.04
Prob> chi2 =	0.8417

### Heteroscedasticity test for NCC (model two)

Breusch-Pagan / Cook-Weisberg test for heteroscedasticity	
Ho: Constant variance	
Variables: fitted values of NCC	
chi2(1) =	0.03
Prob> chi2 =	0.8689

### Test for Multicollinearity

Variable	VIF	1/VIF
MFISIZ	2.62	0.381639
BSIZ	2.51	0.397639
MFIAGE	2.51	0.399057
BEF	1.81	0.552315
ACSIZ	1.76	0.567523
GDIV	1.55	0.644177
FBM	1.35	0.740726
EQB	1.34	0.746111
Mean VIF	1.93	

Source: Multicollinearity test result from stata 14

### Random-effects GLS regression results for Model One (ROA) and model two (NCC)

Variables	ROA		NCC	
	Coef.	Std. Err.	Coef.	Std. Err.
BSIZ	0.245***	0.048	-0.476**	0.239
GDIV	0.128	0.277	6.059***	1.432
FBM	-0.011	0.011	0.291***	0.054
BEF	0.103***	0.036	-0.502***	0.181
EQB	1.600***	0.326	-0.302	1.602
ACSIZ	0.011	0.026	-0.180	0.125
MFISIZ	-0.023	0.036	0.150	0.191
MFIAGE	-0.003	0.014	-0.116	0.074
_cons	-2.882	0.498	10.963	2.562
<p>Wald chi2(8) = 65.11  Prob&gt; chi2 = 0.0000  rho =81.4%  R square; within = 0.6003  Between=0.0183  Over all= 0.0671</p> <p>N.B *significantat10%,**significant at 5%,  *** significant at 1%</p>			<p>Wald chi2(8) = 54.53  Prob&gt; chi2 = 0.0000  rho = 87.4%  R square; within = 0.5279  Between= 0.0112  Over all= 0.0022</p>	

**Source: Stata 14 regression results based on data obtained from sample MFIs.**

### **Appendix III**

#### List of Sample Microfinance Institution

1. Amhara credit and saving institution
2. Addis Credit and saving Institution
3. Addeday Microfinance Institution
4. Agar Microfinance Institution
5. BunssaaGufa Microfinance Institution
6. Dedebit Credit and saving institution
7. Lefayda Microfinance Institution
8. Leta Microfinance Institution
9. Nisir Microfinance Institution
10. Oromia Credit and Saving Institution
11. Peace Microfinance Institution
12. Specialized Microfinance Institution
13. Tesfa Microfinance Institution
14. Vision Fund Microfinance Institution
15. Dynamic Microfinance