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The Effect of Corporate Governance on Financial Performance: Evidence from Commercial Banks in Ethiopia

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Abstract

The main objective of this study was to examine the effect of corporate governance on the financial performance of commercial banks in Ethiopia during the period 2015-2020. The study employed an explanatory types research design. Return on asset (ROA) was used to measure the financial performance of the banks. The study employed both primary and secondary sources of data. Secondary data was obtained from the audited financial statement of the bank from 2015 to 2020 from the National Bank of Ethiopia (NBE). Primary data was collected through self-administered questionnaires distributed to each bank's board secretary. The target group of the studies incorporated all (17) commercial banks operating in the country during the study period. The studies found that Chief executive officer tenure and recruitment of the Chief executive officer internally had positive and significant effects on financial performance, and board meeting frequency, legal reserve ratio, and leverage had adverse and significant effects on the bank's financial performance. Accordingly, the study concludes that Ethiopian commercial banks need to pay due attention to the frequency of meetings with board directors, the internal hiring of chief executive officers, and chief executive officer tenure to improve their financial performance.

Keywords: corporate governance; financial performance; Commercial banks CEO tenure.

1. INTRODUCTIONS

Corporate governance is related to the ownership structure, the composition of the board of directors, the board's size, and the board's independence, among others. Corporate boards are critical in offering direction and guidance to any corporate entity (Kyereboah & Biekpe, 2007). Corporate governance is an instrument to structure, operate, and control a company to achieve long-term strategic goals, safeguarding the interests of shareholders and stakeholders. Besides meeting the environmental and local community needs, corporate governance aims to govern the firms by complying with the legal and regulatory requirements. It is concerned with adequately implementing policies and procedures by a company to satisfy its related parties, including shareholders, employees, customers, suppliers, regulatory authorities, and the community at large (Kaur, 2014).

Effective corporate governance is critical to properly functioning the banking sector and the economy. It enhances investors' confidence in the companies and positively contributes to the overall business environment (Tura, 2012). It has received attention because of the global financial crisis and significant corporate failures that shocked significant financial centers of the world (Imam & Malik, 2007). Corporate governance processes are complex frameworks. The governance framework encompasses stakeholders like the bank's stockholders, depositors, managers and other employees, and the board of directors. Banks further operate under a unique system of public oversight through bank supervisors and a comprehensive body of banking laws and regulations. Corporate governance aims to facilitate effective monitoring and efficient control of business. Its essence lies in fairness and transparency in operations and enhanced disclosures to protect the interests of different stakeholders (Arora & Bodhanwala, 2018).

Moreover, corporate governance structures are expected to help the firm perform better through quality decision-making (Shivani et al., 2017). In general, corporate governance is considered a significant variable influencing the growth prospects of an economy because best governance practices reduce risk for investors, improve financial performance, and help attract investors

(Spanos, 2005). Monda et al. (2013) also documented that better corporate governance results in higher market valuation and financial performance measured by ROA

Various theories deal with corporate governance, and there is an ongoing debate on the relationship between corporate governance structure and the financial performance of banks. The first agency theory claims that information asymmetries are more prevalent in financial industries, particularly in banking, than in nonfinancial industries due to the liquid nature of their assets and a lack of regulatory oversight. The more significant information asymmetry between insiders and outsiders has severe difficulties acquiring information and monitoring bank activities, intensifying the agency problem. From an agency theory viewpoint, corporate governance helps to improve corporate performance by resolving agency problems through monitoring management activities, controlling self-centered behaviors of management, and inspecting the financial reporting process (Habbash, 2010). The second theory is the Stakeholder Theory, which claims that managers in organizations have a network of ties to serve any group or individual who affects or is affected by the corporation's performance, which primarily includes suppliers, employees, depositors, and business partners. In contrast to agency theory, stakeholder theory considers a broader range of stakeholders rather than focusing on a single group (Mallin, 2013). Therefore, this study aimed to investigate the effects of corporate governance, which arises from the internal and external influence of corporate governance on the financial performance of Ethiopian commercial banks.

2. LITERATURE REVIEW

Corporate governance is a vast subject that enjoys a long and rich history. It is a topic that incorporates managerial accountability, board structure, and shareholder rights. Several theories, including resource dependency, agency, and stakeholder theories, explain the interactions between financial performance and corporate governance. According to Zgarni et al. (2016), these theories have been widely recognized as the theoretical basis underpinning research in the financial sector. Corporate governance is the process and structure used to direct and manage the business and affairs of a bank toward enhancing business prosperity and corporate accountability with the ultimate objectives of realizing long-term shareholder value as well as customers and other stakeholder interests (Ethiopian Bank Corporate Governance Directives No. SBB/62/2015).

In a modern public corporation, it is usually difficult for principals to be responsible for corporate activities, so they delegate agents to oversee operations in their interest. Naturally, in this lead's governance, problems, such as conflicts of interest, occur, particularly if shareholders are disappointed by their return on investment. Principals must weigh the costs of monitoring and controlling agents (agency costs) against the costs they are likely to incur from negative managerial behaviors in the absence of efficient monitoring and control.

2.1.1 Theoretical Review

2.1.2 Agency Theory

The adoption of Agency theory and stakeholder theory for this study is grounded on the premise that a review of the theoretical dimensions showed that studies on corporate governance and the financial performance of firms could aptly be elucidated through the principles of theory. Again, because the study exhibits a principal-agent link form, applying agency theory principles is unquestionably a potent theory to be used. The stakeholder theory is an extension of agency theories that focus on shareholder interest and incorporate different stakeholder interests. Agency theory is premised because practically a sizeable number of corporate managers are not owners; instead, they are agents of the owners who manage the company on the managers" behalf (Ujunwa et al., 2012).

2.1.3. Stakeholder Theory

Stakeholder Theory is a view of capitalism that stresses the interconnected relationships between a business and its customers, suppliers, employees, investors, communities, and others with a stake in the organization. The theory argues that a firm should create value for all stakeholders, not just shareholders. The stakeholder theory stipulates that a multipurpose corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). Stakeholder theory can be defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholders' theory suggests that managers in organizations have a network of relationships to serve the suppliers, employees, and business partners. It was argued that this group of networks is essentially other than the owner-manager-employee relationships as in agency theory. Sundaram and Inkpen (2004) contend that stakeholder theory addresses the group of stakeholders who deserve and require management's attention. According to stakeholder theory, the firm's purpose is to serve and coordinate the interests of its various stakeholders, such as Shareholders, employees, creditors, customers, suppliers, government, and the community at large.

2.1.4. Upper Echelon Theory

This theory was first developed by Hambrick and Manson (1984). The theory postulates that top management demographics partially provide and influence institutional performance and strategy choices. It suggests that decisions made by management do not always have rational reasons but are primarily affected by the natural limits of executives as human beings (Nielsen, 2010). Diverse tenure benefits from different experiences and perspectives brought by the individual CEO and positively impacts financial performance. Thus, to explain organizational outcomes and, eventually, financial outcomes, it is necessary to know the characteristics of the top management. The upper echelon theory deals with senior management demographics, including age, educational background, tenure, and financial positions (is a part of the demographics element of senior management (Niesen & Nieslon, 2013)

2.2. Empirical Literature Review

Board Size and Financial Performance

The board of directors is one of the governing bodies of the organization. Its primary responsibility is ensuring the organization achieves the shareholders' goal. The board of directors can hire, terminate, and compensate top management (Johnson et al., 2008). The board of directors is the center of control in the company, and this board has ultimate responsibility for the company's health, long-term success, and survival. Board size refers to the number of directors who serve on the board. The relationship between board size and prior studies' financial performance has not been conclusive. The findings range from positive to negative and concave (Salim et al., 2016). According to Rouf (2012), small board size is generally considered to improve the firm's value because larger groups' poorer communication and decision-making abilities outweigh the benefits of increased monitoring by larger boards.

On the other hand, the higher the size of a company's board of directors in a company, the better will be the company's performance through directions to specialize, increased exports, and greater monitoring capacity (Klein, 2002). Walczak (2013) concludes that the behavior of members has a decisive impact on the mechanisms of corporate governance. Large boards are claimed to be superior to small ones because larger groups have more capabilities, skills, expertise, and resources and broader external contracting relationships.

Meeting Frequency and Financial Performance

Meeting frequency refers to the number of meetings and how much time the board meets in a year during the period under review. The literature on the nature of the association between board activity intensity and firm performance is not clear. Some contend that board meetings benefit shareholders, and others are not required. They find that the number of board meetings positively impacts the bank's performance (ROA). Similarly, in Australian banks, Salim et al. (2016) find a positive effect of the frequency of board meetings on bank performance. Consistent with agency theory, Grove et al. (2016) used a dataset of US commercial banks to examine corporate governance and performance during the financial crisis.

However, Lipton and Lorsch (192) argue that various routine tasks, including the presentation of management reports and other formalities, take up much of the meeting time and reduce the time that should be available for directors to monitor management effectively. Similarly, Vafeas (1999) adds that refreshments, travel expenses, and meeting fees, which are associated with the meetings, increase agency costs. These, in turn, could adversely affect firm performance. Recent scholars find that board meeting is negatively related to investment decisions (Agyei-Mensah, 2021) and firm performance (Rodriguez-Fernandez et al., 2014)

Board Gender Diversity on Financial Performance

Gender diversity is one part of the broader concept of board diversity. It refers to the inclusion of women in the composition of boards. They provided diverse benefits and perspectives. Women's board representation provides additional skills and perspectives that may only be possible with some male boards (Boyle & Jane, 2011). And also, the management may be less able to manipulate a more heterogeneous board to achieve their personal interests.

Empirical studies such as Adams et al. (2007), Rose (2007), Singh (2008) support this in that the existence of female directors on the board positively affects profitability because of controlling function. It could be one of several tools used to minimize potential agency. This shows that female directors significantly impact board inputs and firm outcomes. However, they have inconsistent findings regarding board gender diversity. Some scholars suggest no significant direct contribution to gender diversity on the board's financial performance. Rose (2007) revealed an insignificant association between the number of women directors on the board and firm performance.

Chief Executive Officer Tenure and Financial Performance

The CEOs of firms have a fundamental role in global economic prosperity. CEO tenure refers to the number of years since the appointment of the CEO. Empirical study results such as Kyereboah-Coleman (2008) and Luo et al. (2013) concluded that CEO tenure in the office improves the firm's profitability because of gaining knowledge and experience and soon launching initiatives that boost the bottom line. They should know that long-tenured CEOs may be skilled at employee relations but less adept at responding to the marketplace. These leaders may be great motivators but weak strategists, unifying workers around a failing course of action (Lou et al., 2013).

Similarly, this contradicts studies that have shown that a long tenure does not predict good performance as the CEO spends energy and time building an empire to control (Abor, 2006). On the other hand, according to Finkelstein and Hambrick (1989) and Hambrick et al. (1993), there is no significant relationship between CEO tenure and a firm's performance.

Chief Executive Officer Recruitment and Financial Performance

CEOs are top executives who provide overall direction and strategy to companies under the supervision of a Board of Directors or other governing body. As the top leadership level for strategic decision-making, they are ultimately held responsible for all aspects of company performance. So, hiring a new Chief Executive Officer (CEO) is one of the most critical decisions the board of directors faces. The board's choice of CEO can lead to wealth creation or destruction on a vast scale Huson et al. (2004). There has been an ongoing debate about whether outsiders or insider candidates should fill vacant CEO positions. CEOs who hire insider CEOs drive up the firm's profitability (Zajac, 1990). Since the information asymmetry problem is less severe between insider CEOs and the Board of Directors (BODs) than between outsider CEOs and the BODs, firms hiring insider CEOs often perform better than those hiring outsider CEOs. This gives companies a strong incentive to hire insider CEOs. (Zajac, 1990). Internal successors have an intimate working knowledge of an organization and are embedded in its culture. With the selection of an internal candidate, it is usually assumed that the board is signaling a continuation of the mission and that the organization's competitive advantage is sound. That significant organizational change is optional.

One side supports hiring outsider CEOs because they are more likely to generate innovative ideas, empirical study indicates (Murphy & Zabojnik, 2004; Mooney et al., 2007). These studies **d**escribe that the chief executive officer hires externally to provide greater total profits than the passed-over internal candidates. When replacing a CEO, the Board of Directors seeks experienced and reputable individuals to lead organizations over the long term.

Legal Reserve Ratio and Financial Performance

A high cash reserve ratio reduces the cash for lending, and a low cash reserve ratio increases the funds for lending. A reduction in the money supply affects the ability of commercial banks to create new money by giving loans to their customers. Since extending the loan is the primary source of income for commercial banks and the cash reserve ratio does not earn any income for the commercial banks, it drains the profitability of the commercial bank. Kibrysfaw (2013), Kwee and Rasiah (2010) Tandelilin et al. (2007) also used this variable as a corporate governance proxy. According to Eden (2014), reserve requirements had a negative and insignificant impact on profitability. On the contrary, Gemechu (2016) stated that reserve requirement is inverse to bank profitability.

Depositor Influence and Financial Performance

According to Tandelilin et al. (2007), using a total deposit to total asset ratio to measure depositors" influence was essential. Therefore, this study also used these measurement tools. A lower value of this ratio indicates reduced depositor support for investment, probably because of perceived higher risk. If commercial banks know that deposit withdrawal or high funding costs threaten their survival, they will avoid excessive risk-taking and engage in far-sighted management (Hosono, 2007). Many empirical results support this hypothesis. Ebiad (2009) indicates that higher debt levels in the firm's capital structure are directly associated with higher performance. Similarly, in the existence of taxes, Modigliani and Miller (1963) suggested that firms should use as much debt capital as possible to maximize their value by maximizing the interest tax shield. Therefore, for the above reason, the researcher expects a positive relationship between total deposit to total asset ratio and commercial bank financial performance.

2.3 Conceptual framework

The following conceptual framework depicts the relationship between the dependent variable profitability, which ROA and the dependent variables measure: board size, meeting frequency, gender composition, CEO tenure, hiring of CEO either insider/external, depositor influence, and legal reserve ratio. Two variables, leverage and bank size, are taken as control variables. Figure 1 depicts the r/ship between the variables.

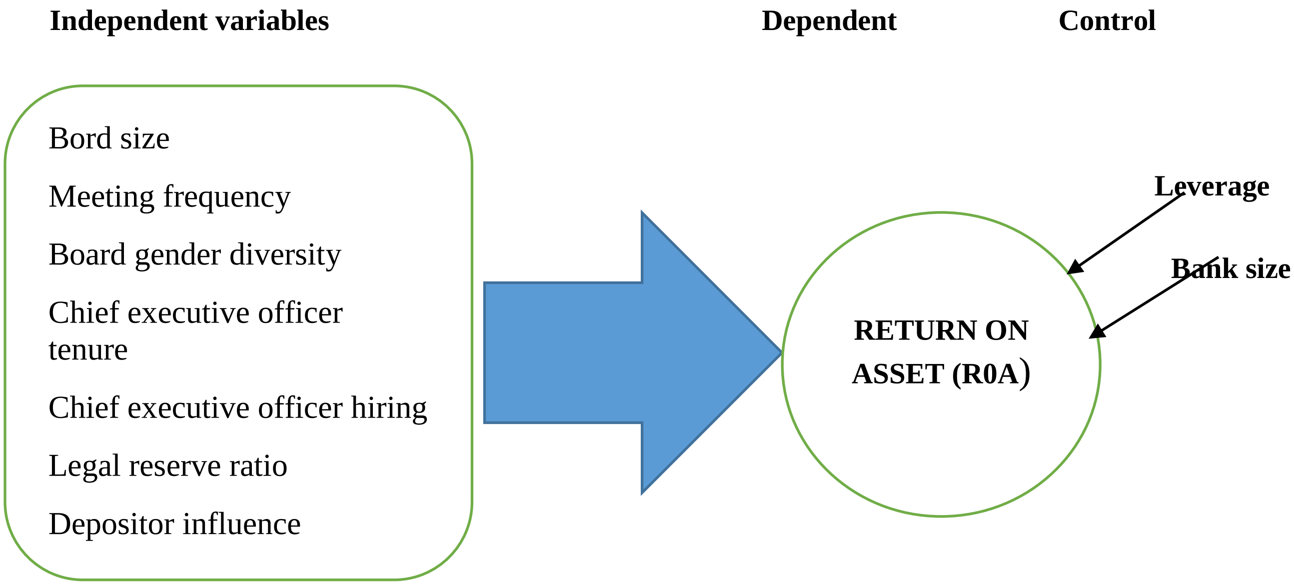

Figure 1: Conceptual Framework

3. METHODOLOGY

This study employed explanatory research design to analyze the cause-and-effect relationship between corporate governance variables and financial performance. The study's target population was all Ethiopian commercial banks during the study period. The total population of the study consists of seventeen (17) commercial banks operating in Ethiopia, including state-owned commercial banks, and the remaining sixteen are private banks (NBE, 2016). The time frame was considered for 2015 to 2020 (six years). Regarding data sources and collections, this study employed secondary and primary data sources. A secondary source of data is obtained from audited financial statements of banks and unpublished summaries that banks were to store about financial performance and corporate governance data to support their operations. The primary data was collected through a structured questionnaire from each bank as supportive data.

3.1. Model specifications

A general panel data regression model was used to estimate the impact of corporate governance on the financial performance of commercial banks in Ethiopia. The estimation was based on the investigation conducted by Belete (2015), and the regression model was customized to fit the specific issue being analyzed (Firehiwot, 2016; Kokeb (2017). Accordingly, these researcher employ the following panel data model;

$ROA_{i,t}=\beta_0 + \beta_1 BS_{it} + \beta_2 BGD_{it} + \beta_3 Ten_{it} + \beta_5 MFBit + \beta^6 Ch_{it} + \beta_7 Dpi_{it} + \beta_8 LRR_{it} + \beta_9 L_{it} + \beta_{10} BSZ_{it} + \beta \varepsilon it$

Where: Y_{it} represents the dependent variable (ROA) of a bank I for some time t

β_0 is the intercept of the model

✓ X_{it} represents the independent or explanatory and control variables BS, BGD, MFB, Ch Ten, DRI, RES, BSZ, and lev) of the commercial bank i for the time period t

The measurement of variables and expectations are depicted

Dependent variables of the study's financial performance were measured by return on asset

$$ROA = \frac{\text{Profit After Tax(PAT)}}{\text{TOTAL ASSET(TA)}}$$

Dependent variables

Board size: is the number of board of directors the corporatization measured by the number of individuals on the board

Meeting frequency: the number of meetings and how much time the board meets in a year during the period under review.

Board gender diversity refers to including women on the board of directors and is measured by the number of females.

Chief Executive Officer Tenure: the number of years a CEO takes a position as a chief executive officer.is measured by the number of years served by the CEO.

Chief Executive Officer Recruitment: refers to a company leader who makes many business decisions. It is measured by dummy variables hired internally or externally.

Legal reserve ratio: the minimum fraction of deposits that banks are mandated to keep as cash themselves. It is measured by the Total reserve kept by each bank compared to its total assets.

Depositor influence: Deposit to asset ratio Bank size Natural logarithm of the value of total assets

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

This section discusses the summary statistics of each variable in the study based on balanced panel data of the Ethiopian commercial banks from 2015 to 2020. Table 1 presents the mean, standard deviation, minimum, and maximum values of regression variables.

T**able** 1 Descriptive Statistics Result

Variables	Mean	St. deviation	Min	Maxi
ROA	0.0241787	.0063607	0.0037	0.0401
Bord size	10.40196	1.291709	8	12
Meeting Frequency	19.79412	6.439879	12	48
Board gender diversity	0.168549	0.1327228	0	0.636
Chief executive Tenure	3.421569	3.154241	0	10
Chief executive hiring	.6862745	.4662977	0	1
Legal reserve ratio	.0263304	.0116028	0.0092	0.078
Depositor influence	.769198	.045766	0.64	0.847
Bank size	23.56539	1.304228	20.82	27.43
Leverage	.8526186	.0445513	0.691	0.951

Source: Financial statement, questionaries, and Stata 14 version result (2021)

As presented in Table 1, the banks' average mean values of return on assets were 2.42% or mean value of 0.0241787 with a maximum and minimum value of 4.01% and 0.37%, respectively. This means, on average, Ethiopian commercial banks earned 2.42 cents for each birr invested in the total assets. This indicates that commercial banks are attractive to investors, shareholders are getting more dividends, and the investors can be confident. The management is efficient in its utilization of assets and can generate more returns, and it also attracts depositors, creditors, and other stakeholders to invest.

About explanatory variables, board size, on average, the number of board of directors in commercial banks in Ethiopia is 10 (mean=10.40196) with a minimum and maximum number of board of directors of 8 and 12, respectively, and the Standard deviation of board size in commercial banks is 1.3 (SD=1.291709). This implies that there was a slight variation in the mean value. The number of board directors in commercial banks is above the minimum requirement set by the National Bank of Ethiopia, which requires that a bank have at least nine boards of directors (NBE corporate governance directive document, 662/2015). However, there are differences in the size of board members for the banks, such as minimum, maximum, and standard deviation, as indicated. Regarding board meeting frequency, as it can be seen in the 4.1 table, the mean value of meeting frequency of the board, as measured by the number of board meetings conducted by the board of directors for the past six years, has (a mean value of 19.79412)20 minutes per year, with a maximum of 48 minutes held per annum and a minimum of 12 minutes held per annum. The standard deviation is 6.439879 from the mean of 19.79412. This result implies that the board directors of the bank held meetings greater than the minimum requirement of the National Bank of Ethiopia directive, which was that the board meeting should be held at least once a month (12 a year). A director shall attend at least 75 percent of the board meeting of a bank in person within a fiscal year. However, there is a high variation in meeting frequency among commercial banks in Ethiopia; even if they are involved in the same business activity, they face different environmental uncertainties/situations that require urgent meetings.

Also, regarding board gender diversity, on average, the proportion of female board of directors is from the total board of directors. On average, 17% or a mean value of 0.168529 of the commercial banks' directors are females as measured by the percentage of female directors divided by the total number of directors, which is a considerably unsatisfactory figure, but they have improved in the past. The percentage of female directors in commercial banks ranges from 0 to 63.63% representation of women on the commercial banks' boards with a standard deviation of 0.1327228. This shows high variations in several female board directors of commercial banks. The result shows a low composition of the board of directors related to gender diversity in commercial banks in Ethiopia, meaning that the participation of females in board structural activity is very low compared to males.

CEO tenure is operationalized by the number of years that have elapsed since the CEO's appointment. On average, CEO tenure in the sample period of the Ethiopian commercial banks was (3.421569) 3.4 years (approximately four years). The standard deviation of CEO tenure is

3.15424, with a maximum of 10 years. On average, the years of CEO (tenure) appointment deviate from the mean value by three years. This result implies that, on average, a CEO stays in the organization for four years.

Also, the recruitment of a CEO is a dummy variable that hires internally (promoted within the company) or externally. On average, hiring the CEO internally in the sampled period had a mean value of 69 percent (0.6862745) and standard deviations of 0 .4662977 variations from the mean value. This result implies that 69% of CEOs hired internally (promoted) compared to hired outsiders (externally). Therefore, most of Ethiopia's commercial banks hire CEOs internally by promoting them within the organizations.

On average, during the sample period, Ethiopian commercial banks finance 77% (mean = 0.769198) of their asset through deposits as measured by the total deposit-to-asset ratio, a maximum of 0.847 and a minimum of 0. 64. The standard deviation of the commercial banks' deposits vary by 0.0450766 from the average mean value of 0.769198. It is known that increasing the deposit-raising capacity is a signal to improved corporate governance. Financing most commercial bank assets using deposits gave depositors a chance to govern the behavior of commercial bank managers by withdrawing their deposits from riskier commercial banks and depositing their money in less risky commercial banks. In addition, using more deposits to finance their assets in commercial banks may create a riskier environment for the depositor. If commercial banks face sudden crashes, the chance of losing their money will be high. Therefore, if commercial banks face unexpected disasters, the disaster level faced by depositors will be minimized since the central bank sets different regulations.

The average legal reserve ratio maintained by Ethiopian commercial banks was far more than that of Ethiopian commercial banks, who kept their 2.63% asset as a reserve in the National Bank of Ethiopia. The standard deviation (dispersion) is 11.6% from the mean of 0.0263304. With maximum and minimum 0.078 and 0.0092 respectively. This result implies that, on average, Ethiopian commercial banks reserve 2.63 cents from one birr of total assets. The standard deviation indicates that the variation of 1.16 percent in the legal cash reserve ratio among banks results from the variation of the total asset amount of commercial banks.

4.2. Regression Results Analysis

A statistical technique called multiple regression analysis was employed to test the relationship between firms' financial performance, measured by return on assets and corporate governance variables.

Table 2 Random Effect Regression Result

```
Random-effects GLS regression                   Number of obs     =        102
Group variable: bankid                          Number of groups  =         17

R-sq:                                           Obs per group:
     within  = 0.5053                                         min =          6
     between = 0.5733                                         avg =        6.0
     overall = 0.5310                                         max =          6

                                                Wald chi2(9)      =      97.21
corr(u_i, X)   = 0 (assumed)                    Prob > chi2       =     0.0000
```

roa	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
bs	-.0004615	.000534	-0.86	0.387	-.0015082	.0005852
mf	-.0001823	.0000879	-2.07	0.038	-.0003546	-.00001
bgd	-.0057196	.0045554	-1.26	0.209	-.0146481	.003209
ten	.0004268	.0001952	2.19	0.029	.0000442	.0008093
hc	.0033206	.0014134	2.35	0.019	.0005503	.0060908
lrr	-.1941294	.047653	-4.07	0.000	-.2875275	-.1007313
dpi	.0202946	.0107437	1.89	0.059	-.0007627	.0413519
bsz	-.0002915	.0004628	-0.63	0.529	-.0011986	.0006157
lev	-.074691	.0151653	-4.93	0.000	-.1044145	-.0449675
_cons	.0898656	.0157426	5.71	0.000	.0590107	.1207204
sigma_u	.0027404					
sigma_e	.00382236					
rho	.3394991	(fraction of variance due to u_i)				

Table 2 shows the regression result for the study. The regression is conducted using the Breusch-Pagan/Cook-Weisberg test for heteroskedasticity test was conducted. The fixed effects and random effects estimations were conducted, and based on the Hausman test, the preferred estimation (random effects (RE) estimation) was selected and used to discuss the results and hypotheses testing.

The result of board meeting frequency shows a negative coefficient of -0001823 and a statistically significant impact at the 5 level (p=-0.038) on the firm's financial performance. This indicates that frequently scheduled meetings reduce the firm's financial performance because they consume management time, cash costs for traveling, and allowances for the board members.

The result revealed that CEO tenure on this regression has an apparent positive effect on ROA, and the outcome is significant. As expected, a CEO tenure positive (Coefficient =0.0004268) and significant p-value of (0.029<0.05) association is found between CEO tenure and return on asset. This result implies that while other things remain constant, the 1-year increase of a CEO in the positions, the bank's financial performance (ROA) increases by 0.043%. This means that the longer retention of directors in the organizations will lead to higher financial performance for commercial banks (as measured by return on asset) in Ethiopia.

The result revealed that internally, CEO recruitment (hiring) has a positive and significant effect on the financial performance of banks. As the proposed alternative hypothesis, hiring a CEO internally has a positive and significant effect on financial performance with a coefficient of 0.0033206 and p-value (0.019> 0.05). This result implies that when CEOs are hired internally (promoted within the company), they enhance their financial performance because they are more familiar with and understand the company's background. Moreover, it does not face information asymmetric problems with the board of directors. The result of the legal reserve ratio shows that a hostile and statically significant coefficient of -.1941294 and p-values of 0.000 are significant at 1%. The result of this study shows that as 1% of their asset is kept in NBE as a reserve balance, the commercial bank tends to lose 19.5% from its ROA**.** The negative relationship exhibited may be due to the high reserve balance reducing the cash for lending, and this reduction in money supply affects the ability of Ethiopia commercial banks to create new money by giving loans to their customers.

5. CONCLUSIONS

This study intended to examine effect of corporate governances on Ethiopian commercial banks' financial performance. In order to achieve this objective, an explanatory research design was employed. The researcher applied a mixed research approach to get information about the selected variables. They explicitly reviewed the commercial bank documents and structured questionnaires. This study concluded that a positive relationship exists between firms' financial performance, CEO tenure, and the hiring of a CEO internally. CEO tenure was statistically significant and positively affected the bank's return on assets. This result implies that when a CEO has long served in the company, it increases the bank's profitability. Thus, the study concludes that a CEO requires time to make a difference or to enhance financial performance.

Internal recruitment of a CEO has a positive and statistically significant effect on commercial banks' return on assets (ROA). The study concludes that hiring a CEO internally can improve the bank's financial performance. Meanwhile, board meeting frequency is statistically significant and negatively affects the return on assets of Ethiopian commercial banks. These concluded that frequently scheduled board meetings reduce the bank's financial performance. So, the study concludes that the board of 63 directors held meetings consistent with the minimum requirement set by the National Bank of Ethiopia (NBE) held once a month (12) times a year.

Commercial banks should give due attention to reserve ratio to control the overlooking behavior of managers for keeping the interest of stakeholders and improve commercial banks' financial performance by creating solid confidence in the minds of bank stakeholders to balance the interest of managers with depositors' influence in banks' and consider the regulation of National Bank Ethiopia (NBE) through minimum legal reserve requirement that can mitigate the conflict of interest between the managers and stakeholders, and help to sustain the bank performance.

6. RECOMMENDATIONS

Based on the findings of this research, several recommendations can be made to the stakeholders in this field of corporate governance vis-à-vis the performance of an institution. There is a need to pay attention to corporate governance features that positively impact firm performance, such as CEO tenure. If a CEO has long served in the organization, it is advisable to enhance financial performance because tenure increases and the firm's value will increase.

Commercial banks in Ethiopia should recruit CEOs internally because those internally promoted CEOs have less information asymmetry between the board of directors, and the board of directors learns about inside hires before they take office. At the same time, they are discouraging those features which hurt corporate governance and financial performance. For example, meeting frequency has a significant negative impact on the financial performance of banks. On average, the bank's board of directors has been conducting 20 meetings per year more than the regulatory requirement (i.e., at least 12 per year), resulting in inefficiencies and maybe duplications of roles and responsibilities with the roles of bank executives. Hence, the bank's board of directors should limit the frequency of board meetings to a minimum level to generate superior financial performance.

7. DIRECTIONS FOR FUTURE RESEARCHER

By taking this study as a standing point, it could be possible to develop a better insight, and several extensions to this study are possible. Considering the available time and resources, the outcome of this study can be more robust if future researchers conduct a study in this area. First, the study population and sample size should be further increased for the financial sector. Second, evidence from other industries should be taken, and observations should be increased using large sample sizes and long years of data. The relationship between corporate governance variables and firms' financial performance can also be further explained if future researchers study including more corporate governance variables.

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