Corporate Governance Practices

"The Case of Ethiopian Private Insurance companies"

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Declaration

I hereby declare that the project work entitled ***"Corporate Governance Practices "The case of Ethiopian Private Insurance Companies*** "submitted towards the fulfillment of the requirements for the award of Doctor of Philosophy (PhD) is my original work and the dissertations has not formed the basis for award of any degree, associate ship, Fellowship or any similar title to the best of my knowledge

Mulualem Berhane Asfaw

Signature_________

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Abstract

As a corner stone of any good business, corporate governance encompasses the process, practices and policies that a company relies on to make formal decisions and to manage the company. Corporate governance is believed to be important as it creates a system of rules and practices that determine how a company operates and how it aligns the interest of all of its stakeholders. Corporate governance has received the attention of researchers following the corporate scandals and global financial crisis. Though a large number of studies have been conducted globally and nationally, a significant gap exists in the understanding on the concept of corporate governance, the factors affecting corporate governance practices and their impact on overall governance practices in light of globally accepted principles of corporate governance. It is also worth noting that there is a gap in understanding the effectiveness and acceptance of the regulatory organ in supervising insurance companies.

Most of the previous studies focused on board structure emphasizing on the importance of board committee and board independence with less emphasis to board composition and board compensation as well as on the effectiveness of the regulatory organ. This research, among others, explained the factors affecting corporate governance practices and their impact on the performance of Ethiopian private insurance companies. An attempt is also made to assess the effectiveness of the regulatory organ in supervising these companies and their response to the assessment of the regulatory organ. Moreover an assessment is made on the current board practices of Ethiopian private insurance companies in light of the globally accepted principles of corporate governance- (the OECD principles, 2004 and the Cadbury report, 1992). Finally the board structure (board composition, board compensation, board independence and board committee) of Ethiopian private insurance companies and its impact on the performance of the companies is explored.

Qualitative data collected through document analysis, survey questionnaire and interview were statistically analyzed to identify findings, key issues, the way forward, conclusion and recommendations. The research, among others, has revealed that the board composition of Ethiopian private insurance companies which is in favor of 100% non-executive directors is not in line with the OECD (2004) principles and the Cadbury report (1992). The Board compensation, which is fixed by the regulatory organ, as opposed to what the Ethiopian commercial code states, is found to be insufficient to attract experienced and professional candidates to board directorship. The attention given by the regulatory organ to supervise private insurance companies seems to be inadequate. Since the regulatory organ is responsible to the prime minster and the governor is a political nominee, it is said to be relatively not independent. Moreover there are no standard codes of corporate governance and bench marks against which the corporate governance practices of Ethiopian private insurance companies is assessed.

Thus it can be concluded and suggested that more and more researches have to be conducted on corporate governance practices of Ethiopian insurance companies to deepen the study on the relationship between board structure and performance, factors affecting the corporate governance , effectiveness of the regulatory organ (NBE) in supervising insurance companies and finally asses the exiting board practices in light of the OECD principles of corporate governance and other globally accepted best practices with the intention of improving the current governance practices in Ethiopia in general and the insurance companies in particular.

List of Acronyms

CG- Corporate Governance
CEO- Chief Executive Office
FDRE- Federal Democratic Republic of Ethiopia
ROA- Return on Assets
OECD- Organization for economic cooperation and developing organization
IOSCO- International organization of securities commission
NBE- National Bank of Ethiopia
RDT- Resource Dependency Theory

Chapter 1- Introduction

1.1. Introduction to Corporate Governance-

Corporate governance has become popular attracting the attention of investors, academicians, and policy makers in the last two decades mainly after the Asian Financial crisis of 1990s, the collapse of Enron (2001) and world com in 2005 and the subsequent financial scandals of some companies in different countries (Mallin, 2010). The need for corporate governance emanates when investors (people and companies) agreed to contribute capital and have a company of different sizes, purpose, process and structure. Such investors realized that they cannot manage and control the company in which they have invested their capital and they always question the gap between ownership and management. This gap has to be filled by an appropriate body that can manage and control the company to the best interests of the investors/owners, justifying the need for corporate governance (Galg, 2007).

Corporate governance is the collection of mechanisms, processes and relations used by various parties to control and to operate a corporation (Shailer Creg, 2004). Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the Board of directors, managers, shareholders, creditors, auditors, regulators and other stakeholders) and include the rules and procedures for making decisions in corporate affairs (Lin. Tom C.W , 2011)

Corporate governance has also been narrowly defined as a system of law and sound approaches by which companies are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby, mitigating agency risks which may stem from the misdeeds of corporate officers. (Sifuna, Anacett Pacy, 2012).

The organization for Economic Cooperation and Development- OECD (2004) defines corporate governance as procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization-such as the board of directors, managers, shareholders and other stakeholders- and lays down the rules and procedures for decision making”

Corporate governance is a key element not only in enhancing the confidence of investors but also in improving the efficiency and growth of an economy. The presence of an effective corporate governance system helps to provide a degree of confidence that is necessary for the proper functions of an economy (OECD, 2004). Corporate scandals of various forms have maintained public and political interest in the regulations of corporate governance including scandals surrounding Enron and MCI inc. (formerly Word com). Their demise led to the enactment of the Sarbanes- Oxlay Act in 2002(Greg, 2008). Such problems of today's business are urging companies to give due attention to the importance of corporate governance in which regulators were also forced to develop more regulations and codes and that is why corporate governance as a mechanism to influence company performance has gained importance from researchers (Gupta, 2007).

The Cadbury report (1992) defines corporate governance is a system by which companies are directed and controlled. It states that boards of directors are responsible for the governance of the companies. The shareholders role in governance is to appoint directors and auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on the stewardship such that the board's actions are subject to laws, regulations and the shareholders in general meeting.

This research basically examines corporate governance as a system by which companies are directed and controlled. It will analyze the internal and external factors that affect the corporate governance practices of the Ethiopian private insurance companies, the impact of corporate governance mechanisms on the performance of private insurance companies ,the effectiveness of the regulatory organ, *the National Bank of Ethiopia (NBE),* and the response of the private insurance companies to the assessments of the regulatory organ and finally the current board practices of Ethiopian private insurance companies in line with the global best practices of corporate governance.

1.2. Overview of Corporate Governance in Ethiopian private insurance companies

Currently there are 17 privately owned insurance share companies operating in Ethiopia. Nine of these insurance companies are providing general insurance products only. There is also a domestically established reinsurance company called Ethiopian Reinsurance Share Company. Generally the financial sector of Ethiopia is still closed to foreign investors and thus all private insurance companies are fully owned by Ethiopian investors or shareholders. The National Bank of Ethiopia (NBE) is responsible for regulating the financial institutions including the private insurance companies. The NBE is empowered to issue licensee & conduct supervision task through the insurance supervision directorate accountable to the vice – governor.

Almost all of the privately owned insurance companies in Ethiopia are non-listed medium sized businesses and hence corporate governance under such circumstances will be second to none. Some of the many reasons for Ethiopian insurance companies to have well-established corporate governance are that they will help to cultivate the culture of integrity that will lead to better performance and growth and also insures accountability (Rossolucu, 2005).

The concept and practice of corporate governance in Ethiopia is as old as in many other countries in the world. But perhaps, a more appropriate point of departure to study its development may be the time Imperial Ethiopia adopted its modern Commercial Code back in 1960. However not much has been written on the subject of corporate governance in Ethiopia in general and the privately owned insurance companies in particular. It was during the last part of the 1990's that the subject began to attract the attention of economists, business executives, development bankers and corporate managers as well as researchers and academicians.

According to Negash (2008), the history of the establishment of share companies in Ethiopia dates back to 1960 during the Imperial regime and became routine between 1960 and 1973. For the first time it was in 1960 that the legal framework for corporate governance was laid when the two legal institutions, Commercial Code and Civil Code, were proclaimed. The Imperial regime, which for the first time recognized the role of the private sector in the economy, hardly created the necessary enabling environment. This however did not last long due to a regime change in 1974 when the Imperial regime, which had feudo-capitalist orientation, was replaced by a Military rule (socialist orientation) which brought an end to corporate governance practices.

The Military rule (1974-1991) nationalized and transferred all private enterprises and put them under state ownership. It set a capital ceiling that impeded the growth and expansion of private businesses. The nationalized enterprises fell under the central command economy and were run by government appointees. This brought to cessation of the Practice of corporate governance until a regime change in 1991 that led to later revival. This had a far-reaching effect for the current weak status of private business in the country. The 1991 regime change brought a radical change in the economic orientation from central command economy to a liberalized free market economy that led to privatization of some nationalized companies and appearance of new share companies including banks and insurance companies (Negash, 2008)

The provisions of Ethiopia's Commercial Code of 1960 under **Title VI - Companies Limited by Shares** start with Article 304 which defines a share company and finishes with Article 509 which lays down the rules for its Dissolution and Winding-up. Close observation of the 1960 commercial code of

Ethiopia shows amazingly high similarity between the most recent OECD principles of good corporate governance and the relevant provisions in the Commercial Code of Ethiopia. The law stipulates that a company would have properly differentiated governance organs (General Meeting of Shareholders which must meet at least once a year; a minimum of 5 and a maximum of 12 Board Directors elected by shareholders for maximum of 3 years at a time and for not more than two consecutive terms; a Chairman of the Board who must be a shareholder and is elected by the Board directors; CEO who is appointed by the Board and must meet minimum requirements established by the Supervisory Authority, External Auditor(s) appointed by and reporting to the General Meeting of Shareholders). Such companies were required to publish and publicize their audited Balance Sheets and Profit & Loss accounts in newspapers every year.

Starting from the Imperial time till now there are as many of share companies as defined under Articles 304 to 307 of the commercial Code : 1) one whose capital is fixed in advance and divided into shares and whose liabilities are met only by its assets; 2) whose members shall be liable only to the extent of their shareholding; 3) whose minimum capital shall not be less than 50,000 Ethiopian dollars (birr); 4) the par value of each share not to be less than 10 Ethiopian dollars(birr); and, 5) which may not be established by less than five members.

Except in very few areas where the very concepts themselves were not considered as issues then, and about which no specific provisions are found, the Code which was modeled after European (French) laws, was thought to be advanced for the society then. With certain amendments, harmonization or alignment to take into account the fundamental societal changes which had occurred over the last six decades, the legal framework for good corporate governance as contained in the Code, appears quite adequate.

In market economies company law plays a significant role in setting the legal environment for the creation and continuing operation of privately owned businesses (USAID, 2007). It can encourage new investment and provide investor protection by setting forth clear and objective rules for a company's internal governance. It can also enhance entrepreneurship by making it easy to start up and register a company, and encourage businesses to come out of the underground economy into the publicly registered, taxpaying economy. (Ibid)

Per the Ethiopian commercial code of 1960, publicly held companies are referred to as "share companies". Even though all companies (including financial institutions) have to adhere to the provisions of the Commercial Code to operate in the country, financial companies have other proclamations and subsidiary directives that require them to comply with additional requirements. Accordingly, share companies engaged in insurance business have to comply with the Licensing and Supervision of Insurance Business Proclamation No.86/1994 and directives and procedures of the NBE.

According to the Association of Ethiopian insurance finance sector Roadmap, the Ethiopian insurance industry has one of the lowest numbers of participants in all categories compared to South Africa, Kenya, Tanzania, Uganda, Rwanda and Mauritius. The attention given by the supervisory body (the NBE) is also inadequate and the industry is suffering from lack of diversified qualification and expertise. The major challenge and bottle necks of the insurance industry are cited as absence of National policy to guide development of the industry,) absence of appropriate direction and guide, Lack of financial literacy, Lack of adequate policy instruments to encourage insurance business

1.3. Objectives of the Research

The research is intended to achieve the following objectives:

- To assess the factors affecting corporate governance practices in Ethiopian private insurance companies
- To assess the impact of corporate governance mechanism in Ethiopian private insurance companies.
- To assess the relationship between board structure and performance of Ethiopian private insurance companies
- To assess the effectiveness of the regulatory organ in supervising Ethiopian private insurance companies
- To assess the current practices of board of directors of Ethiopian private insurance companies in light of globally accepted principles of corporate governance

1.4. Significance of the Research

Following the downfall of the military government of Ethiopia in 1991 which was followed by the liberalization of the economy, the private sector has been flourishing with many corporate sectors, particularly private insurance companies. Correspondingly the government using the regulatory organ, the NBE, started to introduce appropriate corporate governance system which was a necessity for the smooth operation of the Ethiopian economy in general and the insurance industry in particular (Negash, 2008).

The main purpose of the government during that time was to attract investment, build investors' confidence, ensure transparency and disclosure, protect shareholders and stakeholder's rights, and fight scandals, among others. The introduction of corporate governance is a recent phenomenon as most of the international corporate governance studies generally focused on developed economies neglecting the relevant state of affairs in emerging economies like Ethiopia (Zeitun & Tian, 2007).

Ethiopia as an emerging free market economy should put in place necessary policies targeting best practices of corporate governance so as to attract and protect investors. In this regard, the research will fill the gap surrounding how corporate governance functions in the context of Ethiopian economy in general and the insurance industry in particular. Thus the research will reveal a very good understanding of the experiences of corporate governance in the Ethiopian private insurance context helping policy makers, board of directors, top management teams, and other stakeholders to have greater understanding of governance factors that can positively affect company performance. This research will also contribute its share in identifying the gaps in the current governance practices and forward recommendations for improving corporate governance practices of Ethiopian insurance companies.

1.5. Scope of the Research

Corporate governance is a broad concept that covers a wide range of sectors and institutions. This research, however, is limited to the Ethiopian insurance industry that includes the privately owned insurance companies whose primary objective is profit making or wealth maximization. Compared to other sectors in the country, the insurance industry is growing and experiencing better consolidated corporate governance. The unit of analysis for this research is the Ethiopian private insurance companies.

The respondent groups to this research include former and existing boards of directors, Board secretaries, and top management members including the CEOs and deputy CEOs, and other stakeholders.

1.6. Limitations of the research

The research employed survey questionnaire, interviews, and document review as methods of data collection. Thus the limitations that are associated with these methods do also apply to this research. The research covers only the privately owned Insurance sector in Ethiopia because it is considered to have more consolidated corporate governance practices as it is closely supervised by the NBE, the regulatory organ of the country,. Thus, the results obtained in this research may not be used to make generalizations about other sectors. Ethiopia has no standard codes of corporate governance against which corporate governance practices of companies can be assessed. Although benchmarking corporate governance practices of the Ethiopian private insurance companies with the OECD may not exactly represent their status of governance practices, it has been used as a bench market in developing corporate governance practices.

This research limits itself to assess the factors affecting the corporate governance, the impact of corporate governance practices on the performance of private insurance companies and the effectiveness of the regulatory organ. Moreover it is limited to assess whether proper board structure (composition, independence, and committee) influences company board performance and asses the current practices of board of directors of Ethiopian private insurance companies in light of globally accepted principles of corporate governance. Emphasis is given only to the above structural components as there are no CEO duality and executive (insider) directors in the Ethiopian insurance context.

1.7. Organization of the research

This research is organized in five chapters. Chapter one deals with the Introduction to Corporate Governance, overview of Corporate Governance in Ethiopian Private Insurance Companies, objectives, significance, scope and, limitations and of the Research. Chapter two covers overview of corporate Governance, theories of corporate governance including the agency theory, stewardship theory, resource dependency theory, stakeholder's theory and the transaction cost theory. The Cadbury Report and the Organization for Economic Cooperation and Development (OECD) Principles, regulation Practices of Insurance Companies, Corporate Governance Structure including, Board Composition, Board independence, Board Committee and Board compensation are also addressed in this chapter.

In chapter three the problem statement, research approach and strategy, timing and Sampling and data collection mechanism are discussed. Chapter Four deals with the findings, key issues and the way forward related to governance practices of private insurance companies in Ethiopia. It dwells with the detail document survey, interview and survey questionnaire findings and analysis including the factors affecting corporate governance practices in Ethiopian private insurance companies, the impact of corporate governance practices in Ethiopian private insurance companies, the effectiveness of the regulatory organ in supervising Ethiopian private insurance companies, the current practices of board of directors of Ethiopian private insurance companies in light of globally accepted principles of corporate governance and finally the relationship between board structure and performance of Ethiopian private insurance companies are addressed the Final chapter of the research address the conclusion and recommendation.

Chapter Two
Literature Review

2.1. Corporate Governance – Overview

Corporate governance (CG) is the system of rules, practices and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financers, the government and the community (James Chen, 2021).

Corporate governance has been one of the topical and most widely discussed issues in both the academic literature and the business press over the last two decades especially after the corporate scandals and financial crises of the recent times (Mallin, 2010). Most of the scholarly research on the subject has focused on examining or linking corporate Governance mechanisms or variables to accounting measures of performance such as the chief executive Officer (CEO) duality, Board size, and CEO compensation with return on Assets (ROA) as measure of performance (Zeitun & Tian, 2007).

Good Corporate governance is necessitated by the need for the accountability due to deregulation and lesser governmental control. Good corporate governance promotes economic growth and development. The benefits of good corporate governance practice in a firm among others, include: facilitating greater access to finance, lower cost of capital, better performance and favorable treatment of stakeholders (Claessens, 2002)

The need for corporate governance becomes evident in corporate forms of organizations where ownership and control are separate giving rise to the agency problem. The agency problem occurs because of dispersal of shareholding ownership in corporate forms of organizations, in which a typical shareholder may not show interest in the day-to-day affairs of a company. Likewise thousands of shareholders that make up the majority of owners may demonstrate the same behavior as the typical shareholder, resulting in agency cost. The agency cost results when those who are directly interested in day-to-day affairs, the management, have the ability to manage the resources of companies to their own advantage without effective shareholder control (Berle & Means, 1932).

The agency problem that makes both accountability and governance assume a greater significance and has emphasis in corporate organizations. It is this context that brought boards into play as one major internal governance mechanism to overcome the agency problem and thereby maintain effective organization (Fama & Jensen, 1983). These authors also view the board of directors as the top most important internal decision control system of firms. Furthermore, the resource dependence theory views outside board of directors as key board members that link the firm with the environment and help bring important resources which may not be available in the firm. They also provide services in the form of advice and counsel based on their experience and exposure. Their networking with the environment, in addition to resource generation, enhances corporate image and reputation (Daily &Danton, 1993).

Corporate Governance is typically perceived as leading with **"problems that results from the separation of ownership and control".** From this perspective corporate governance would focus on; the internal structure and rules of the board of directors; the creation of independent audit committees; rules for disclosure of information to shareholders and creditors; and control of the management. (A.C.Fernando, 2013)

Corporate governance is the interaction between various participants (shareholders, board of directors and company management) in shaping corporation's performance and the way it is proceeding towards. Corporate governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the board of directors. Corporate governance systems vary around the world, scholars tend to suggest three board versions (Ibd)

1. The Anglo American Model
2. The German model
3. The Japanese model

The Anglo American model is also known as **unitary board model** in which all directors in a single board comprising of both executive and non-executive directors in varying proportions. This approach to governance tends to be shareholders-oriented. It is also called "Anglo-Saxon approach to corporate governance, being the basis of corporate governance in America, Britain, Canada, Australia and other common wealth countries including India.

In the German model, also known as the **two tier board model**, corporate governance is exercised through two boards, in which the upper board supervises the executive board on behalf of stakeholders. This approach to governance is typically more societal-oriented and is sometimes called the continental European approach, being the basis of corporate governance adopted in Germany, Holland, and to an extent France.

The Japanese model is the **business network model**, which reflects the cultural relationships seen in the Japanese Keiretsu network, in which the board tends to be large, predominantly executive and often ritualistic. The reality of power in the enterprise lies in the relationships between top management in the companies and the Keiretsu network. In the Japanese model, the financial institutions play a crucial role in governance. The shareholders and the main bank together appoint the board of directors and the president.

2.2. Theories of Corporate Governance

There are several theoretical perspectives on corporate governance available to scholars in exploring the issues of corporate governance. Although there are many theories of corporate governance, only 5 of the most important ones including the agency theory, stewardship theory, Stakeholders theory, resource dependence theory and transaction cost theories are discussed below.

2.2.1. Agency Theory

Agency theory focuses on separation of ownership and control (Bhimani, 2008). It highlights relationship between the principals (e.g. Shareholders), the agents (e.g. company executives and the managers). This theory advocates that shareholders (who are the owners or principals of the company) hire agents to perform work; but, the principals delegate the running of the business to directors or managers (who are the shareholder's agents) (Clarke, 2004). Thus, agency problems can arise when one party (the 'principals') contracts with another party (the 'agents') to make decisions on behalf of the principals. Agency problems may occur as agents can hide information and manage firms' in their own interest.

In the modern corporation, where share ownership is widely held, managerial actions depart from those required to maximize shareholders return. In agency theory terms, the owners are the principals and the managers are the agents and there is agency loss, which is the extent to which returns to the owners fall. Agency theory specifies mechanisms that reduce agency loss (A.C Fernando, 2013). Roberts (2004) argues that the remedy to agency problems within corporate governance involve acceptance of certain agency costs as either incentives or sanctions to align both the executives' and shareholders' interests. In essence, agency theory highlights the significant role of corporate governance to facilitate compliance by curtailing executives' self-serving inclinations to compensate their risk through opportunistic means.

A,C Fernando (2013) argues that there are two broad mechanisms that help reduce agency cots and hence improve corporate performance through better governance ;(1) fair and accurate financial disclosures and (2) efficient and independent board of directors. Financial and non-financial disclosures, relate to the role of the independent, statutory auditors appointed by shareholders to audit a company's accounts and present a "true and fair" view of the financial health of the company. A company that discloses nothing can do anything. Improving the financial accuracy and financial disclosures not only ensures corporate transparency among a wide group of investors, analysts, and the informed intelligentsia, but also persuades companies to minimize value-destroying deviant behavior. A joint stock company owned by the shareholders, who appoint directors to supervise management ensures that it does all that is necessary by legal and ethical means to make the business grow and maximize long term corporate value. Directors are fiduciaries of the shareholders, not of the management. They are accountable only to the shareholders. “Independence” has of late become a critical issue in determining the composition of any board.

2.2.2. Stewardship Theory-

According to A.C,Fernanao (2013) the stewardship theory assumes that managers are basically trustworthy and attach significant value to their own personal situations in which managers are stewards whose motives are aligned with the objectives of their principles. A steward’s behavior will not depart from the interests of his/her organization. Control can be potentially counterproductive, because it undermines the pro-organizational behavior of the steward by lowering his/her motivation. The responsibility of the board to the shareholders in terms of stewardship cannot be overemphasized. This concept of stewardship is not new.

Stewardship theory assumes that managers are motivated by a desire to achieve and gain intrinsic satisfaction by performing challenging tasks; hence, their motivation exceeds mere monetary considerations. Stewardship theory recognizes the need for executives to act more autonomously to maximize the shareholders returns. Consequently, managers require authority and desire recognition from peers and bosses to effectively perform their tasks. Hence, shareholders must authorize the appropriate empowering governance structure, mechanisms, authority and information to facilitate managers’ autonomy, built on trust, to take decisions that would minimize their liability while achieving firm’s objectives (Donaldson and Dave, 1991).

Managers are expected to maximize investors profit and to establish a good reputation to enable them retain their positions. Thus, stewardship theory advocates unifying the role of the CEO and the chairman to reduce agency costs (Abdullah and Valentine, 2009). Donaldson (1997) stated that the owners and managers relationship depends on the behaviors adapted by each of them. Managers chose to act as agents or as stewards according to certain personal characteristics and their own perceptions of particular situational factors. Principals choose to create a relationship of one type or the other depending on their perceptions of the same situational factors and of their managers’ psychological mechanisms. The following tables set out these variables and the differences between the two theories-

Table 1- Behavioral differences of the Agency and Stewardship theories

	Agency theory	Stewardship theory
1	Mangers act as agents	Mangers act as stewards
2	Governance approach is mechanistic	Governance approach is sociological and psychological
3	Behavioral pattern is : - Individualistic - Opportunistic - Self-serving	Behavioral pattern is- - Collectivistic - Pro-organizational - Trustworthy
4	Mangers are motivated by their own objectives	Mangers are motivated by the principals objectives
5	Interests of the managements and principals differ	Interests of the managers and principals converge
6	The role of the management is to monitor and control	The role of the management is to facilitate and empower
7	Owners' attitude is to avoid risks	Owners' attitude is to take risks
8	Principal –managers relationship is based on control	Principal-Manager relationship is based on trust

Adopted from "Development of corporate Governance system: Agency theory versus stewardship theory in welsh Agrarian Cooperative societies." By Dr. Alfonzo Varga Sanchez

Table 2- Psychological mechanisms of the agency and stewardship theories

	Agency Theory	Stewardship Theory
1	Motivation revolves around- - Lower order needs - Extrinsic needs	Motivation revolves around - Higher order needs - Intrinsic needs
2	Social comparison is between compatriots	Social comparison is between principals
3	There is little attachment to the company	There is great attachment to the company
4	Power rest with the institution	Power rests with the personnel

Adopted from "Development of corporate Governance system: Agency theory versus stewardship theory in welsh Agrarian Cooperative societies." By Dr. Alfonzo Varga Sanchez

Table 3- Situational mechanisms of the agency and stewardship theories

	Agency Theory	Stewardship theory
1	Management philosophy is control oriented	Management philosophy is involvement Oriented
2	To deal with increasing uncertainty and risks, the theory advocates exercise of - Greater controls - More supervision	To deal with uncertainty and risk, the theory advocates exercise of - Training and empowering people - Making jobs more challenging and motivating
3	Risk orientation is done through system of	Risk orientation is done through trust

	control	
4	Time frame is short term	Time frame is long term
5	The objective is cost control	The objective is improving performance
6	Cultural differences revolve around - Individualism - Large power distance	Cultural differences revolve around - Collectivism - Small power distance
Adopted from "Development of corporate Governance system: Agency theory versus stewardship theory in welsh Agrarian Cooperative societies." By Dr. Alfonzo Varga Sanchez		

2.2.3. Resource Dependency Theory

Board of directors enhance organizational function through accessibility to resources and through linkages with the external environment to appropriate resources and create buffers against adverse external changes by promoting organizational interlocking directorates and through social and professional networking. (Daily *et al.*: 2003); Abdullah and Valentine (2009) classify directors into four categories: ***insiders, business experts, support specialists and community influential***. While insiders' are current and former executives that provide expertise in specific areas of the firm, business experts are current and former senior executives and directors of other large for-profit firms that provide expertise on business strategy, decision-making and problem solving. While support specialists' are specialists like lawyers, bankers, insurance company representatives that provide support in their individual specialized field, community influential are political leaders, university faculty, members of clergy, and leaders of social or community organizations. Outside directors play positive role in monitoring and control function of the board, because a firm's value increases with the number of outside directors.

Resource dependency theory (RDT) draws from both sociology and management and states that how the external resources of the firm affect the behavior of the firm and takes a strategic view of corporate governance. Therefore the acquisitions of external resources are vital for strategic management of any organization. Every corporation depends on the resources. Hence, RDT recognized the administrative body of any firm as the cornerstone among the firm and the resources that are required to accomplish the goals (Tricker, 2012).

The resources emanate from the environment consist of other firms. We can say that the resources are in the hand of other firms. Therefore, firms depend on each other and exchange resources. This is why resources are the basis of power for firms because the resources are valuables, costly to imitate, rare and no substitutable (Hitt et al., 2012).In other words, resources and power are directly linked. Those firms who have resources can be considered more powerful as compared to their competitors than those who don't have access to that. The dependence on other firms normally affects the productivity of firms. The scarcity of resources leads to uncertainty for organizations. Firms always seek to find ways to exploit the resources for the safeguard of its own long term survival.

2.2.4. Stakeholder Theory

The stakeholder theory advocates that managers in organizations have a network of relationships to serve; this include employees, shareholders, suppliers, business partners and contractors. The theory is at variance with agency theory which advocates that there is contractual relationship between managers and shareholders; whereby managers have the sole objective of maximizing shareholders wealth. Stakeholder theory considers this view to be too narrow, as managers actions impact other interested parties, other than shareholders. In essence, the stakeholder theory emphasizes the need for managers to be accountable to stakeholders. Stakeholders are "any group or individual that can affect or is affected by the achievement of a corporation's purpose" (Freeman, 1984).

To ensure adequate protection of stakeholders' interest, stakeholder theory proposes the representation of various interest groups on the organization's board to ensure consensus building, avoid conflicts, and harmonizes efforts to achieve organizational objectives (Donaldson and Preston, 1995). Stakeholder theory have been criticized for over burdening managers with responsibility of being accountable to several stakeholders without specific guidelines for solving problems associated with conflict of interests. However, Freeman (1984) contends that the network of relationships with many groups can impact decision making processes, as stakeholder theory is concerned with the nature of these relationships in terms of processes and outcomes for the firm and its stakeholders. Likewise, Donaldson and Preston (1995) assert that stakeholder theory focuses on managerial decision making and interests of all stakeholder have intrinsic value, and no sets of interests is assumed to dominate the others. This suggests that managers are expected to consider the interests and influences of people who are either affected or may be affected by a firm's policies and operations (Frederick *et al.*, 1992). Similarly, Jensen (2001) asserts that managers should pursue objectives that would promote the long-term value of the firm by protecting the interest of all stakeholders.

2.2.5. Transaction Cost Theory

Transaction cost theory which was initiated by Cyert and March (1963), and subsequently examined by Williamson (1996) states that firms and markets are alternative modes of governance; and the allocation of activity between firms and markets is not taken as given, but is something to be derived. Transaction cost theory uses explicit concept of governance to explain undertaking of economic transactions through the efficiency of the chosen governance structures, tailored to undertake the transactions at hand (Wieland, 2005).

Williamson (1996) considers transaction cost economics as **"the study of governance concerned with identification, clarification, and mitigation of all forms of contractual hazards".** Hence, the theory advocates that a firm is a comparatively efficient hierarchical structure, formal and informal, which enhances the accomplishment of contractual relationships. Hence, Williamson (1996) argues that the problem of transaction-cost economics associated with corporate governance is not the protection of ownership rights of shareholders; but it is effective and efficient accomplishment of transactions by firms in their cultural and political environment.

Table 4- Comparing Corporate Governance Theories

Basis	**Agency**	**Transaction cost**	**Stewardship**	**Stakeholders**	**Resource Dependency**
Focus	Reciprocity (Self Interest)	Transactional costs	Shareholders interest	Stakeholders Interest and relationship building	Firm Resource and power
Objective	Minimize agency cost	Reduce transaction cost	Maximize productivity	Long term relationship	Acquire and exploit resources
Base	Normative	classical idea	classical idea	Normative	Classical idea
Model	Individualistic	Individualistic	Collectivistic	Collectivistic	Collectivistic
Time Horizon	Short term view	Long term view	Long Term View	Long Term View	Long term View
Rooted	Economics	Micro economics	Law	Management	sociological and management
Behavior	opportunistic	Opportunistic	Pro-Organizational	Pro-social	Pro-Organizational
Approach	Economic	Economic	Sociological and Psychological	Societal level	Strategic
Main Theme	Goal Congruence	Goal alignment	Goal alignment	Goal alignment	Goal congruence

Cultural sustainability	High distance power	Mixed	Lowe power distance	Low power distance	Mixed
Model of man	Economic man	Economic man	Self-actualizing man	Self-actualizing man	Economic man
Motivated by	Self-objectives	Self-objectives	Principals objectives	Shareholders and other stakeholders objectives	-
Motivation	Extrinsic	Extrinsic	Intrinsic	Intrinsic as well as extrinsic	Intrinsic as well as extrinsic
Structure	Monitor and control	Monitor and control	Facilitation and empowerment	Facilitation and empowerment	Monitor and control
Need	Economic need (lower order)	Economic need (lower order)	Growth achievement	Economic and long term firm growth	Economic and long term firm growth
Principal & agent interest	Diverge	Diverge	Converge	Converge liaison	Converge
Management Philosophy	Control oriented	Control oriented	Trust mechanism	Trust mechanism	Control mechanism
Attitude towards risk	Risk aversion	Risk aversion	Risk propensity	Risk propensity	Risk averse
Power	Institutional base	Institutional base	Personal base	Institutional base	Institutional base
Commitment	Low level commitment	High level(shared) commitment	High level(shared) commitment	High level(shared) commitment	High level(shared) commitment
Relationship	Contract base relationship	Contract base relationship	Trust base relationship	Trust base relationship	Contract base relationship
Source- Abid, GKhan, B Rafiz and Ahmed A 2014					

2.3. The Cadbury Report

2.3.1. Overview

The 1992 report was first produced as draft report by the committee on the financial aspects of corporate governance (Cadbury report) in May 1991 to address the concerns cited about financial reporting and accounting of the publicly listed companies in United Kingdom. The final version of the report was first published in December 1992. It was without doubt, that the Cadbury report 1992 has legitimately provided a framework for the corporate governance rhetoric underpinning the governance evolution. The recommendations, which largely reflected perceived best practices at the time, included separating the role of CEO and chairman, having a minimum of three non-executive directors on the board and the formulation of audit committee. The recommendation of the report was enshrined in a code of best practice on corporate governance. This code of best practice has been built to form the current combined code on corporate governance.(Cadbury Report ,1992)

The Cadbury report (1992) has provided us with the legacy of definition of corporate governance as the **"system by which companies are directed and controlled",** voluntary adoption of the governance best practices and the "comply or explain" principle. It identifies three themes to strengthen the unitary board system of all listed companies and summarizes their recommendations in a code of best practices; the structure and responsibilities of board of directors; the role of auditors and recommendations to the accountancy profession; and the rights and responsibilities of shareholders.(Ibd)

Since the Cadbury report, over 90 countries have instated national codes of corporate governance. The two main goals of every code suggest are convergence in areas of improving the quality of companies' governance and raising the accountability of companies to shareholders while maximizing shareholders value (Aguilera and Jackson, 2010). The Cadbury report has contributed to the "strong governance culture" among the listed companies on the London stock exchange, thus assuring investors on the information they receive from the board being fair, balanced and understandable (FRC, 2014)

The Cadbury report formed the framework for the development of international corporate governance provided by the international institution, for example, OECD, the common wealth and California public employees Retirement System, international fund and asset management association (Demirag and Solomon, 2003)

2.3.2. Recommendations of Cadbury Report best Practices

A.C. Fernando (2013) in his book-_**Corporate Governance Principles, Policies and Practices,** indicated that the objective of the Cadbury committer was" to help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes is expected of them. The committee investigated the accountability of the board of directors to the shareholders and to the society. It submitted its report and associated **code of best practices** in December 1992 where in it spelt out the methods of governance needed to achieve a balance between the essential powers of the board of directors and its proper accountability. The stress in the Cadbury report is on the crucial role of the board and the need for it to observe the code of best practices.

The Cadbury report best practices had 19 recommendations. The recommendations are in the nature of guidelines relating to the board of directors, non-executive directors, executive directors, and those on reporting and control. Its important recommendations include the setting up of an audit committee. (ibid)

The following were the recommendations relating to the board of directors

- The board should meet regularly, retain full and effective control over the company and monitor the executive management.
- There should be a clearly accepted division of responsibilities at the head of the company, which will ensure balance of power and authority, such that no individual has unfettered powers of decision making. In companies where the chairman is also the chief executive officer, it is essential that there should be a strong and independent director on the board, who is a recognized senior member
- The board should include non-executive directors of sufficient caliber and number, for their views to carry significant weight in the board's decisions
- The board should have a formal schedule of matters specifically reserved to it for decisions to ensure that the direction and control of the company is firmly in its hands
- There should be an agreed procedure for directors in the furtherance of their duties to take independent professional advice, if necessary, at the company's expenses
- All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are compiled with. Any question of the removal of company secretary should be a matter for the board as a whole.

The following were the recommendations relating to the non-executive directors

- Non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments and standards of conflict.
- The majority should be independent of the management and free from any business or other relationship, which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding. Their fees should reflect the time, which they commit to the work of the company.
- Non-executive directors should be appointed for a specified terms and reappointment should not be automatic
- Non-executive directors should be selected through a formal process.

This process and their appointment-should be a matter for the board as a whole.

The following were the recommendations relating to the executive directors

- Directors service contracts should not exceed 3 years without shareholders' approval
- There should be full and clear disclosure of their total emoluments and those of the chairman, including pension contributions and stock options. Separate figures should be given for salary and performance related elements and the basis on which performance is measured should be explained.
- Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors.

The following were the recommendations relating to reporting and control

- It is the boards duty to present a balanced and understandable assessment of the company's position
- The board should ensure that an objective and professional relationship is maintained with the auditors
- The board should establish an audit committee of at least three nonexecutive directors with written terms of reference, which deal clearly with its authority and duties
- The directors should explain their responsibility for preparing the accounts next to a statement by the auditors about their reporting responsibilities.
- The directors should report on the effectiveness of the company's system of internal control
- The directors should report that the business is a going concern, with supporting assumptions or qualifications, as necessary.

2.4. The Organization for Economic Cooperation and Development (OECD) Principles

The OECD principles were originally issued in 1999 and have since become the international benchmark for corporate governance, forming the basis for a number of reform initiatives both by the government and private sector. The principles were revised in 2003 to take into account developments since 1999, through a process of extensive and open consultations, and drawing on the work of the regional corporate governance round tables for non OECD countries. The new principles were agreed by OECD governments in April 2004.(OECD,2004)

A.C. Fernando (2013), in his book- corporate governance principles, policies and practices, stated that OECD was one of the earliest non-government organizations to work on and spell out principles and practices that should govern corporates in their goal to attain long-term shareholders value. A useful first step in creating or reforming the corporate governance system is to look at the principles laid out by the OECD and adopted by its member governments. In summary, these principles include the following elements-

OECD Principle 1- Ensuring the basis for an effective Corporate Governance framework-

The Corporate Governance frame work should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Supervisory, regulatory and enforcement of authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained. In short the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

OECD Principle 2- The rights and equitable treatment of of shareholders-

The rights of shareholders include a set of rights to secure ownership of their shares, the right to full disclosure of information, voting rights, participation in decisions on sale or modification of corporate assets, mergers and new share issues. The guidelines go on to specify a host of other issues connected to the basic concern of protecting the value of the corporation

Per the OECD (2004) principle shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as (1) amendments of the statutes, or article of incorporation or similar governing documents of the company;(2) the authorization of additional shares; and (3) extra-ordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

Shareholders should have the opportunity to participate effectively and vote in in person or in absentia in general shareholders meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings. They should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. They should have the opportunity to ask questions to the board relating to annual external audit, to place items on the agenda of genera meetings and propose resolutions, subject to reasonable limitations. They should be able to make their views on the remuneration policy for board members and key executives

In general basic shareholders right should include to (1) secure methods of ownership registration, (2) convey or transfer shares (3) obtain relevant and material information on the corporation on a timely and regular basis;(4) participate and vote in general meetings;(elect and remove members of the board ;and (6) share in the profits of the company.

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. According to the OECD (2004) all shareholders of the same series of a class should be treated equally. All shares should carry the same rights within any series of a class. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares. Impediments to cross boarder voting should be eliminated. Process and procedures for general shareholders meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes. Moreover insider trading and abusive self-dealing should be prohibited and finally members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company.

OECD Principle 3- OECD Principle 6- The responsibilities of the board-

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders

OECD Principle 4- The role of stakeholders in corporate governance-

The OECD recognizes that there are other stakeholders in companies in addition to shareholders. Bankers and workers, for example, are important stakeholders in the way in which companies perform and make decisions. The OECD guidelines lay out several general provisions for protecting stakeholder's interests. The rights of stakeholders that are established by law or through mutual agreement have to be respected. Where stakeholders' interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights. Performance enhancing mechanisms for employee participation should be permitted to develop. Where stakeholders participate in the corporate governance process, they should have access to relevant and reliable information on a timely and regular basis.

Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concern about illegal or unethical practices to the board and their rights should not be compromised for dealing this. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights. In short, the corporate governance framework recognizes the rights of shareholders established by law or through mutual agreements and encourage effective cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

OECD Principle 5- Disclosure and transparency-

The OECD lays down a number of provisions for the disclosure and communication of key facts about the company ranging from financial details to governance structures including the board of directors and their remuneration. The guidelines also specify that independent auditors in accordance with high quality standards should perform annual audits. The OECD guidelines provide a great deal of details about the functions of the board in protecting the company and its shareholders. These include concerns about corporate strategy, risk management, executive compensation and performance as well as accounting and reporting systems.

Disclosure should include, but not limited to, material information on (1) the financial and operating results of the company (2) company objectives (3) major share ownership and voting rights (4) remuneration policy for members of the board and key executives, and information about board members including their qualification, the selection process, other company directorship and whether they are regarded as independent by the board (5) related party transactions (6) forecast able risk factors (7) issues regarding employees and other stakeholders (8) governance structure and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented

Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure. An annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit. In short the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

OECD principle 6- The institutional investors, stock markets, and other intermediaries-

The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance; all shareholders of the same series of a class should be treated equally, insider trading and abusive self-dealing should be prohibited and members of the board an key executives should be required to disclose the board whether they, directly, indirectly or on behalf of third parties, have a material interests in any transaction or matter directly affecting the corporate.

2.5. Regulation practices of Insurance Companies

A dictionary definition of regulation is a "rule or order prescribed by authority… a governing direction of law". According to insuranceopedia insurance regulation refers to the government overseeing the insurance market to ensure fairness and professionalism among those working for the insurance industry to prevent the market from collapsing, and to democratize insurance. Laws are created for the industry and an agency is put up to make sure these laws are observed. Insurance regulatory law is the body of statutory law, administrative regulations and jurisprudence that governs and regulates the insurance industry's business. The regulatory law is primarily enforced through regulations, rules and directives by state insurance departments as authorized and directed by statutory law enacted by the state legislations (en, Wikipedia. org)

According to A.C. Fernando, 2013, insurance is regulated by the government. The system of regulation stems from Me Carran- Ferguson Act of 1945, which describes state regulation and taxation of the Industry as being in “the public interest” and clearly gives it prominence over the Federal law. Each state has its own set of statutes and rules. Almost all countries have similar regulation practices. The following are some of the examples of the regulatory practices all over the world-

Italy- Italian instituto per La vigilanze sulle assicurazioni (IVASS) is an independent authority in charge of regulating the practices of all insurance and reinsurance companies on the Italian market.

UK- the Prudential Regulatory Authority (PRA) which is part of the Bank of England promotes the society and soundness of insurers and the protection of policy holders. The financial conduct authority (FCA) regulates how these firms behave, as well as more broadly the integrity of the UK’s financial markets.

Germany- under the German insurance supervisory act, all insurers are subject to the continuous legal and financial supervision by the federal financial supervisory authority (BaFin), in order to ensure that the insurer complies with the law, is solvent and continuous to be able to fulfill its obligations

France -The French supervisory authority (ACPR- Autorite de controle prudential et de resolution) ensures a permanent supervision of all the undertaking of the insurance sector by controlling the respect of the current laws and regulations

India - The insurance Regulatory and Development authority of India- (IRDA), is a statutory body formed under Act of parliament- i.e Insurance Regulatory and Development Authority Act, 1999(IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.

USA - The National Association of Insurance Commissioners (NAIC) is the U.S. standard setting and regulatory support organization created and governed by the Chief Insurance Regulations from the 50 states, the District of Columbia and five US territories. Established in 1871, the NAIC functions as an advisory body and service provider for state insurance departments, Commissioners use the NAIC to pool scarce resources, to discuss issues of common concern and to align their over site of the Industry. Each state, however, ultimately determines what actions it will take.

There are four main reasons for insurance regulation including ***solvency,***

unequal knowledge and bargaining power, unique problem of insurance pricing and promotion and social goals. Promoting insurer solvency is the most important goal of insurance regulations. Solvency makes the result of the insurance transaction certain and predictable. The first reason for extensive regulation to promote insurer solvency is that individual insured customers are not capable of self-protection in this transaction. Insurance is nothing more than a contingent promise to be delivered in the future. The promise is worth no more than the company standing behind it. (Dorfman, 2005)

A second reason for the importance of solvency regulation is that if an insurer becomes insolvent, the problem for insured customers can be very serious. The potential results of insurance companies insolvency include houses destroyed with no funds to rebuild, liability suits with only personal assets available to satisfy judgments or widow left with dependent children and unfulfilled financial plans. A third explanation for solvency regulations is that life insurance companies (and to a much smaller extent, property insurance companies) are responsible for sizeable amounts of consumer savings. Legally, the relationship between insurer and insured is comparable to that of debtor and creditor, but the relationship bears a close resemblance to the fiduciary arrangement found between a bank and its depositor. Because insurers operations parallel those of fiduciaries the insurer's solvency is a subject for public regulation (ibid)

Dorfman, 2005 has also identified other reasons for regulating insurers including unequal knowledge and bargaining power, unique problem of insurance pricing and promotion and social goals. The details of each reason is discussed below-'

Unequal knowledge and bargaining power- An insurer has enormous advantages in technical expertise compared to the typical consumer. Therefore, one purpose of insurance regulation is to compensate for this imbalance. Part of the imbalance in knowledge between insurer and insured is explained by the complexity of the insurance contract. Most contracts are long and contain words meaningful to lawyers but often not to the public. More than a college education is needed to understand the meaning of most insurance contracts. Regulation is needed to prevent dishonest insurers from taking advantage of the consumer's relatively uninformed position by eliminating inherently unfair contracts from market places.

Unique problem of insurance pricing- one of the problems with competition in insurance is that insurers must set prices before costs are fully known. Although lacking the complete details of cost is not unusual in manufacturing, the life insurer or liability insurer might have to wait 50 or more years to learn them. If an insurer overestimates its costs, the company makes money. If the insurer underestimates its costs, ultimately the company becomes insolvent.

The consumer would be worse off if the insurance was purchased from a company that underpriced its insurance and become insolvent than if too much was paid for protection.

Promotion and social goals- Some insurance regulation is designed to promote social objectives such as making insurance more widely available or ending undesirable discrimination. Some people believe the public should have the right to purchase insurance at an affordable rate. This belief has led many states to pass laws forcing insurers to accept applicants they would otherwise have rejected. Moreover, in many cases, insurers have been forced to use rates lower that they otherwise would have chosen. Such compulsion has been applied in automobile, health and commercial and personal property insurance.

2.6. Corporate Governance Structure

Corporate governance is the system by which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different stakeholders such as the board, managers or shareholders, and spells out the rules and procedures for decision-making in corporate affairs (OECD, 2004).

Clear roles and responsibilities at each level (from the board to the management, staff and stakeholders) are essential for an organization to function efficiently and to ensure that each level is held by a system of checks and balances. Clarifying corporate governance structures means establishing a system of sound approaches by which organizations are directed and controlled, focusing both on internal and external corporate structures. Clear corporate governance structures allow monitoring of the actions of management and directors and thereby mitigate agency risks that may stem from the misdeeds of staff members (en, Wikipedia,)

Governance structure and principles identify the distribution of rights and responsibilities among different participants in a corporation such as board of directors, managers, shareholders, creditors, auditors, regulators and other stakeholders and include the rules and procedures for making decision's in corporate affairs. The board of directors seldom appears on the management organizational chart yet it is the ultimate decision making body in the company. The role of management is to run the enterprise while the role of the board is to see that it is being run well and in the right direction. (A.C.Fernando, 2013)

2.6.1. Rights and responsibilities of the board

The OECD Principles of Corporate Governance (2004) describe the responsibilities of the board as summarized below:

- Board members should be informed and act ethically and in good faith, with due diligence and care, in the best interest of the company and its shareholders.
- Review and guide corporate strategy, objective setting, major plans of action, risk policy, capital plans, and annual budgets.
- Oversee major acquisitions and divestitures.
- Select, compensate, monitor and replace key executives and oversee succession planning.
- Align key executive and board remuneration (pay) with the longer-term interest of the company and its shareholders.
- Ensure a formal and transparent board member nomination and election process.
- Ensure the integrity of the corporation's accounting and financial reporting systems, including their independent audit.
- Ensure appropriate systems of internal control are established.
- Oversee the process of disclosure and communications.
- Where committees of the board are established, their mandate, composition and working procedures should be well-defined and disclosed.

According to the Licensing & Supervision of insurance business, corporate governance directive number SIB/42/2015 issued by the National Bank of Ethiopia, without prejudice to the duties and responsibilities stated in their laws, regulations, NBE directives, article and memorandum of association as well as resolution of shareholders of an insurer, the board of directors of insurance companies shall at least have the following responsibilities:

- Developing and submitting to the ordinary general meeting of shareholders for approval of transparent rules and procedures for nomination of potential candidates for the board membership taking due consideration to industry standards and the relevant directives of NBE.
- Appointing directors in case one or more of the directors leave the board before completing their term, in accordance with commercial code of Ethiopia, within 30 working days from the date of resignation and presenting the case to the next ordinary general meeting of shareholders for its action
- Proposing external auditors and their service fee to the general meeting of shareholders
- Selecting and appointing chief executive officer and senior executive officers, who are qualified and competent with integrity, to administer the

affairs of the insurer effectively and efficiently, removing the same where they fail to be fit and proper

- Ensuring that the operation of the insurer is run prudently and in accordance with relevant laws, policies , and procedures
- Approving equity investment decisions or agreements related to acquisition and disposal of fixed assets and technology which have material nature.
- Ensuring that the NBE's examination report is considered as confidential by the directors and/or an employee of the insurer
- Ensuring that there are appropriate concerns and instructions of the onsite examination and offsite surveillance reports of NBE, external auditor, internal audit and risk management departments
- Establishing and ensuring the effective functioning of various board sub-committees including , but not limited to, Audit committee, Risk and Compliance committee and Human resources affairs committee which shall have to convene at least once in a month and report their resolution to the full board
- Assessing semi-annually the effectiveness of the board, its sub – committees, and individual directors in carrying out their responsibilities and reporting the outcomes to the annual ordinary general meeting of shareholders and the NBE
- Ensuring the capital adequacy of the insurer on an ongoing basis
- Ensuring minutes of the general meeting of shareholders are delivered to the NBE within 20 working days from the date of such meetings of shareholders for approval and following up timely registration of the same with the appropriate government organ
- Preventing conflict of interest in the insurer by putting in place sound policies and implementing them, where conflict of interest refer to a circumstance where one of a person's activities or interests are advanced at the expense of the insurer
- Reviewing and approving strategies, policies, systems, annual business plans & budgets
- Monitoring performance by setting key performance indicators
- Reviewing and approving clear lines of responsibilities, delegating authorities, segregating duties and accountabilities for board of directors and senior management members
- Reviewing and approving code of conduct for the board and senior management
- Ensuring the establishment of code of conduct for the employees of the insurer
- Approving human resources development strategy and succession plan for CEO and senor executive officers and effectively monitoring their implementation
- Ensuring that the insurer puts in place comprehensive risk management program

- Ensuring an effective internal control/audit system, staffed with qualified personnel to perform internal audit functions (covering at least financial, operational, Legal, technological, and management audit) is put in place.
- Ensuring that appropriate management information system is established to produce accurate, complete, relevant and timely information on the performance of the insurer

Moreover the Cadbury report recommends the following regarding board rights and responsibilities

- The board should meet regularly and exercise full and effective control over the company and monitor the executive management
- There should be a clear division of responsibilities at the head of a company; which will ensure balance of power and authority, such that no individual has unfettered power of decision. In companies where the chairman is also the CEO, it is essential that there should be a strong and independent element on the board, with a recognized senior members
- The board should include both executive and non-executive directors of sufficient caliber and number for their view to carry significant weight in the boards decisions
- The board should have a formal schedule of matters specifically reserved to it for lessons to ensure that the direction and control of the company is firmly in its hands
- There should be an agreed procedure for directors in the furtherance of their duties to take independent professional advice if necessary, at the company's expense
- All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are compiled with.
- Non-executive directors should be selected through a formal process and both , their process and their appointment, should be a matter for the board as a whole
- The majority of the non-executive board directors should be independent of the management and free from any unnecessary interference. They should also be appointed for a specified terms and reappointment should not be automatic

2.6.2. Rights and responsibilities of Managers

According to Stephen P. Robbins and Mary coulter (2006) managers perform certain activities or duties as they efficiently coordinate the work of others. The four basic and very important responsibilities of managers include **planning, organizing, leading and controlling.** Planning refers to managerial function that involves defining goals, establishing strategies for achieving those goals, and developing plans to integrate and coordinate activities. Organizing refers to managerial function that involves determining what tasks are to be done, who is to do them, how the tasks are to be grouped, who reports to whom, and where decisions are to be made. Leading refers to the managerial function that involves motivating subordinates, influencing individuals of teams as they work, selecting the most effective communication channels, or dealing in any way with employee behavioral issues. Finally controlling refers to monitoring actual performance, comparing actual performance to standards and taking corrective actions, if necessary.

Thus it can be concluded that while board and management hold ties to one another, their duties and responsibilities are distinctly different. A board is an organized group of people with collective authority to control and foster an institution that is usually administered by a qualified executive and staff. If we look at it simplistically, the board makes the decision and management carries them out. Due to litigious nature of our society, boards are taking a stronger interest in day to day management activities because of the insuring impact on its fiduciary responsibilities. Boards need to be informed of how the organization is being managed to protect its legal responsibilities, but the board's role should not cross over the performing management duties.(ibd)

Per the Ethiopian commercial code of 1960 Art-338, the General Manager is responsible for the general day to day management of the company, he/ she, in the absence of a provision to the contrary in the memorandum of association, represents the company in its dealing with 3rd parties. Without prejudice to the above he/she shall have the duties to sign and transfer negotiable instruments especially commercial instruments, transferable securities and documents of title to goods. He/she has the duty to discharge responsibilities entrusted to him/her by the board of directors and implement its decisions, to prepare annual work plan and budget of the company and implementing the same up on approval of the board of directors and to hire, manage and fire employees of the company as necessary.

2.6.3. Rights and responsibilities of the shareholders-

Shareholders are owners of a company who provide financial backing in return for potential dividends over the life time of the company. A shareholder does not manage the day to day business of the company as this is handled by the board of directors and the management. However decisions in relation to the company's goals and overall performance often require shareholders' approval which include, but not limited to, changing the constitution of the company, declaring dividend, approving the financial statements and winding up of the company by way of voluntary liquidation (en, Wikipedia)

Per the commercial code of Ethiopia article 363, important rights of shareholders are cited including the rights inherent in membership, the right to inspect or take documents, the right to access additional information and the voting rights. No shareholders may be deprived without his consent of the rights inherent in membership. This includes the right to be a member, to vote, to challenge a decision or to receive dividends and a share in winding up. Every shareholder may at all times inspect and take copies of documents including balance sheet, profit and loss statement, inventories, reports submitted by board of directors and auditors to the general meeting.

2.7. Mechanisms of Corporate Governance

According to A.C. Fernanado, (2013) Companies need to be governed as well as managed. Corporate governance is concerned with this need. The board of directors is central and its structure and process are fundamental, so are the board relationships with the company's shareholders, regulators, auditors, top management and other legitimate stakeholders. Effective corporate governance is essential if a business wants to set and meet its strategic goals. A corporate governance structure combines controls, policies and guidelines that drive the organization toward its objectives while also satisfying stakeholders' needs. A corporate governance structure is often a combination of various internal and external mechanisms.

Corporate governance mechanisms are a set of instruments that are instituted to control and reduce inefficiencies and malpractices in corporate forms of organizations. It includes board of directors, internal controls, balancing power, market forces and compensation (Dalwai, 2015).

2.7.1 Internal Mechanism

The foremost sets of controls for a corporation come from its internal mechanisms. These controls monitor the progress and activities of the organization and take corrective actions when the business goes off track. The objectives of maintaining the corporation's larger internal control fabric include smooth operations, clearly defined reporting lines and performance measurement systems. Internal mechanisms include oversight of management, independent internal audits, structure of the board of directors into levels of responsibility, segregation of control and policy development.(ibid)

2.7.2 External Mechanism

External control mechanisms refer to those of outside an organization and serve the objectives of entities such as regulators, governments, trade unions and financial institutions. The objectives include adequate debt management and legal compliance. External mechanisms are often imposed on organizations by external stakeholders in the forms of union contracts or regulatory guidelines. External organizations, such as industry associations, may suggest guidelines for best practices, and businesses can choose to follow these guidelines or ignore them. Typically, companies report the status and compliance of external corporate governance mechanisms to external stakeholders. An independent external audit of a corporation's financial statements is part of the overall corporate governance structure. An audit of the company's financial statements serves internal and external stakeholders at the same time. An audited financial statement and the accompanying auditor's report helps investors, employees, shareholders and regulators determine the financial performance of a corporation. This exercise gives a view of the organization's internal working mechanisms and future outlook (A.C.Fernando, 2013)

2.8 Board Structure

Board structure refers to the design and style in governance that matches the intended function of a corporation that is usually determined by the needs of the organization (Mallin, 2010).

2.8.1 Unitary Versus Dual Boards

The OECD (2004) classifies board structure as unitary board and dual board structures. According to Tricker (2009), the unitary board model has four possible structures;(a) a board composed of only executive directors, (b) a board composed of majority of executive directors (c) a board with a majority of non-executive directors and (d) a board with only non-executive directors. The dual board structure is a two tier board structure having supervisory board and lower management board where the supervisory and the management board are composed of non-executive and executive directors respectively (Gillette and Rebello, 2008).

The supervisory board which is elected by shareholders is responsible for overseeing the direction of the business and assesses the performance having the power to appoint and remove the executive board of management. The executive board of management on the other hand has the responsibility of formulating and presenting strategies, plan and budgets to the supervisory body for approval (Mallin, 2010, Tricker, 2009)

In the Ethiopian case there is only one type of structure which is the unitary board model that is in favor of only non-executive directors. Directive No. SIB/46/2018 of the supervisory organ, ***limits on board remuneration and number of employees who sit on the board of insurer,*** prohibits any employee from being elected to or becoming a director of an insurance company

2.8.2. Board Composition

Fauzi and Locke (2012) have discussed how large a board should be and indicated that from the perspective of the agency and resource dependency theory, it is preferable to have large boards in order to minimize the agency problem. Many have the feeling that fewer numbers, usually less than 12, may allow the group to control and manipulate the board while more directors, usually greater than 15, may be difficult to manage (Colley, Doyle, Logan, Stettinius &Virginia, 2003)

Per Article 347of the 1960 commercial code of Ethiopia, (1) only members of a company(shareholders) may manage the company (2) A company shall have not less than three nor more than twelve directors who shall form a board of directors(3) where the memorandum of association does not specify the number of directors but fixes only a maximum and a minimum, the meeting of subscribers shall decide the number of directors to be appointed and (4)bodies corporate may be directors, but the chairman of the board of directors shall be a natural person

Article 5 of the Ethiopian insurance corporate governance directive No.SIB 42/2015 issued by the regulatory organ, the NBE, states that an insurer is expected to have at least **nine directors**. The board is expected preferably comprised of directors who as a group provide a mixture of gender and core competencies such as finance, accounting, legal, business administration, auditing, information technology and investment management. The board of an insurer shall comprise of non-influential shareholders whose number shall not be less than (a) one-third (1/3rd) of the total board members elected separately by such shareholders provided that such shareholders hold at least 30% and above of the subscribed capital of the insurer; or (b) one –fourth (1/4th) of the total board members elected separately by such shareholders provided that such shareholders hold less than 30% of the subscribed capital of the insurer no matter what the proportion of their shareholding in the insurer is.

2.8.3. Board Independence

There have been a lot of discussions and debates going on in corporate circles and among academicians in recent times on the need for, role of, and importance of independent directors. An independent director is defined as a "non-executive director who is free from any business or other relationship which could materially interfere with the exercise of his/her independent judgment" (A.C. Fernando, 2013)

Each company creates its own definition of significant. Board independence was given legal definition and direction in 2002 in the Sarbanes–oxley legislation, a relatively new concept in corporate governance that calls for a majority of board members to be independent from the company. Independence occurs when a board member has not been and is not currently employed by the company or its auditors and the board members employer does not do a significant amount of business with the company. The Cadbury report also identifies two areas where non-executive directors can make an important contribution to the governance process as a consequence of their independence from executive responsibility. First, reviewing the performance of executive management and second, taking the lead where potential conflicts of interest arise.

The OECD principle VI.E.1 suggest, independent non-executive board members can contribute significantly to the board's decision-making process, in particular by bringing an objective view to the evaluation of management and also by providing additional assurance to market participants that their interests are defended in areas where the interests of management, the company and its shareholders diverge. Boards should be able to exercise objective, independent judgment on corporate affairs and to achieve this objective; it is recommended that boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential conflict of interest.

Per the IOSCO financial technical committee report on how OECD principles are implemented in practice and how each jurisdiction addresses OECD principle VI.E with particular focus on the applicable standards as designated to promote and facilitate the boards exercise of objective and independent judgment, it is generally believed that individuals who do not face material conflicts of interest are more likely to find it easier to exercise objective, independent judgment than those who do face such conflicts. Accordingly, many jurisdictions adopt standards for independence that specify certain relationships, circumstances or conditions that will give rise to a negative presumption or a conclusive determination that a board member should not be considered independent. Some of the qualities that some jurisdictions identify as desirable for independent board members are-

- Having an adequate professional background
- Being able to furnish their experience and knowledge in furtherance of the governance of the company
- Showing integrity and the highest ethical standards
- Having strong interpersonal skills
- Possessing sound judgment and an inquiring mind
- Questioning in a constructive way the strategy of the company and contributes to the strategy's implementation

Most jurisdictions use slight variations of the same basic set of negative criteria for board members to qualify as "independent". These criteria relate to links between the board member and the company or its executives (family relationships, employments relationships, economic or business relationships and relationship with external auditor). Few jurisdictions also set limit on the length of time an individual can serve on a company board and still be considered to be independent.(IOSCO,2007)

2.8.4. Board Committee

Most boards have audit, remuneration, and Nomination committee as principal standing committees. Moreover depending up on corporate constitutions, other committees such as executive committee, risk management committee, and governance committee could be formed as need be to meet specific corporate demands (Tricker:2012). In Ethiopian insurance practices, the insurance corporate governance directive No SIB 48/2015 which was issued on 1st day of October 2015 by the regulatory organ, the NBE, suggests four basic committees namely audit committee, Risk management and compliance committee, Human resource affairs committee as well as the Nomination and Election committees as principal standing committees. The detail objective's and responsibilities of these different committee as specified in the directive is indicated below-

2.8.4.1. Audit Committee

The audit committee, comprised of 3 directors, has an explicit authority to investigate any matter within its terms of reference, full access to and cooperation by management and full discretion to invite any director or executive officer to attend its meetings, and reasonable resources to enable it to discharge its functions properly. The audit committee has full and unrestricted access to information and be able to obtain independent professional advice.

The audit committee, among others, is responsible to ensure fair and transparent reporting and prompt publication of financial accounts, review the scope on internal audit program, internal audit findings and recommend actions to be taken by management. It appoints, set compensation, evaluate performance and decide the transfer and dismissal of the chief internal auditor provided the full board has no obligation. It also recommends the appointment of external auditors and ensures that there are proper checks and balances in place so that provision for non-audit services does not interfere with the exercise of independent judgment of the auditors.

2.8.4.2. Risk Management and Compliance Committee

The objective of this committee, comprised of at least 3 directors, is to oversee senior management's activities in managing credit, market, liquidity, operational, legal and other risks and to ensure that the risk management process is in place and functioning. The committee is responsible at least for reviewing and recommending risk management strategies, polices and risk tolerance limits for board approval, reviewing and assessing adequacy of risk management policies and framework in identifying, measuring, monitoring and controlling risk and the extent to which these are operating effectively.

The committee is also responsible for ensuring that infrastructure, resources and systems are in place for risk management, ensuring that the staffs responsible for implementing risk management systems perform those duties independently of the insurers risk taking activities. It reviews management's periodic reports on risk exposure, risk portfolio composition and risk management activities.

2.8.4.3. Human Resource Affairs Committee

The primary objective of the human resources affairs committee is to provide formal and transparent proposal on the employment and removal of senior management members if they are ineffective, errant or negligent in discharging their responsibilities and on the overall compensation or benefit systems of the insurer. The committee is responsible at least for recommending to the whole board on hiring, replacing and removal of the members of senior management, recommending and monitoring of salaries and benefits of senior management members and overall benefit packages of the insurer.

It is also responsible for overseeing management succession planning and performance evaluation of senior management members as well as ensuring that all Nomination and Election Committee members get training on approved "procedure for Nomination and Election of board directors" and elected directors receive an appropriate induction and continuous training in order to keep abreast with the latest development in the industry.

2.8.4.4. Nomination and Election Committee

The nomination and election committee is responsible for handling the whole nomination and election process of board of directors, ensuring that all board nomination and election pass through the insurer's defined process, shortlisting candidates on the basis of the nomination votes they obtained and ensuring that they meet the requirements set under relevant directives of the regulatory organ.

2.8.5. Board Compensation

OECD (2004) states that one of the board's key functions involves aligning board remuneration (as well as key executive remuneration) with the longer term interests of the company and its shareholders. The annotations to this Principle note that, in an increasing number of countries it is regarded as good practice for boards to develop and disclose a remuneration policy statement that covers board members (and key executives), specifies the relationship between remuneration and performance, includes measurable standards that emphasize the company's longer run interests over short term considerations and addresses such matters as holding and trading of company stock, and granting and re-pricing of stock options.

Compensation of board members is related to the board's capacity to act objectively for at least two reasons: The actual level of compensation may be relevant to assure, on the one hand, that qualified candidates are attracted to the job, and on the other, to make sure that an excessive level of remuneration is not impairing board members´ objectivity, *e.g.* by making them captive to the interests of those who play a significant role in the nomination (or re-nomination) of board members or determination of remuneration packages. Remuneration should be structured so as to link rewards to corporate and individual performance". In a similar way the Ethiopian commercial code of 1960- Articles 353 recommends that-

- Directors may receive a fixed annual remuneration, the amount of which shall be determined by a general meeting and charged against general expenses

- The articles of association may provide that the directors may receive a specified share in net profits of a financial year

- The fixed remuneration and share in the profits to be allocated to the board of directors shall be allocated in one sum. The board shall arrange the distribution among its members in such proportion as it deems fit
- The amount of the share in the net profits may not exceed 10%, This share is calculated after deduction of (a) amounts allocated to reserve funds provided by law or the articles of association, (b) the statutory dividend, when provided in the articles of association, or when not provided, a sum representing 5% of the paid up value of shares which have not been redeemed, (c) amounts allocated to reserve funds established by resolution of a general meeting and (d) amounts carried forward ,
- In fixing the share under sub- articles 4, regard may be made to amounts distributed or capitalized and charged in a previous balance sheet, with the exception of those arising in a financial year closed before the coming into force of this code
- The directors share in the net profit shall not be paid where no dividend has been distributed to the shareholders and
- The ministry of commerce and industry, taking into account the special benefits which have been provided to directors having the status of founders and having regard to the positions of the company and to the salaries and benefits of its employees, may, on the position of

shareholders representing not less than 10% of the capital, order the reduction of the remuneration of the directors where it considers it excessive.

Chapter Three- Research Methodology

3.1. Problem Statement

Despite the frequent revision of codes, proclamations, planned and unplanned inspections made by the supervisory organ (NBE), corporate governance in the insurance industry in Ethiopia is still at its infant stage. Pervious researches conducted in relation to this issue are also not adequate as compared to its importance.

Though the performance of Ethiopian private insurance companies is increasing year after year, more could have been done in maximizing the profitability and shareholders value. The existing corporate governance can be categorized as one of the main concerns that need the attention of the board of directors, shareholders and the supervisory organ of the government. Thus we need to go deep into the corporate governance practices of Ethiopian private insurance companies to establish the following problem statements-

- The current governance practices of Ethiopian private insurance companies are not in line with the best practices of corporate governance
- There is a strong relationship between the existing Board structure (board composition, board compensation, board independence and the board committees) and performance of Ethiopian private insurance companies
- The practice of the regulatory organ (The National Bank of Ethiopia) in supervising the private insurance companies and effectiveness of the Private Insurance companies in responding (providing feedback) to the assessments of the regulatory organ is not adequate
- There are internal and external factors that affect the corporate governance practices of Ethiopian private insurance companies.
- The impact of corporate governance mechanism on the motivation of the board and on the performance of private insurance companies is notable.

3.2. Research Approach and Strategy

The purpose of the research is to collect, explore, asses, and analyze pertinent information about (1)the factors affecting corporate governance practices in Ethiopian private insurance companies, (2) impact of corporate governance practices in Ethiopian private insurance companies, (3) the effectiveness of the regulatory organ in supervising Ethiopian private insurance companies, (4) the current governance practices of Ethiopian private insurance companies in light of globally accepted principles of corporate governance and (5) the relationship between board structure and performance of Ethiopian private insurance companies and then draw a conclusion and recommendation.

The design of the research is basically descriptive as it describes the corporate governance, identifies problems, demarcates the population in that only privately owned insurance companies will be addressed and representative samples are taken from the population. To do so data is collected, organized, analyzed and presented to draw conclusion and recommendation. The research method employed in this study is qualitative method in that an inquiry is made aiming at understanding the reality by collecting data from those who are part of the subject under study and those who understands it much better than others who are external to it.

3.3. Timing and Sampling

Most of the respondents to this research are demanding, celebrity personnel who are bearing multiple private and public responsibilities. It was very tedious to meet them and spare sufficient time to discuss, interview, deliver and collect questionnaires. Two months' time was given to the respondents to complete the questionnaire and most of them have submitted on or before the due date. Out of the different types of sampling procedures, the simple random sampling technique is adopted because of the homogeneity of the population where all the elements of the population are known. Sample private insurance companies were selected by using lottery techniques. For this research the unit of analysis is the private insurance companies in Ethiopia and the target population is the board of directors, the CEOs, deputy CEOs and Board secretaries. These groups of people are considered to be well-informed about corporate governance issues as they are in a better position to report about corporate governance. The research involves privately owned insurance companies where ownership is used as a basis for stratification.

The numbers of private insurance companies currently operating in Ethiopia are seventeen out of which ten were randomly selected for the study. Government owned insurance companies are excluded from the study and only private insurance companies are targeted because these insurance companies are exposed to governance problems, they are sectors where ownership and control is separated, they have board of directors with different motivation, they have better and organized data for further study and they are relatively free from political intervention as the board of directors are not appointed by the government but rather elected by and at the shareholders annual general assembly.

3.4. Data Collections Mechanisms

The study used both primary and secondary sources in gathering data for the analysis. The most important primary sources were the current and former board directors, Chief executive officers, deputy chief executive officers and board secretaries. Primary data collection tools included survey questionnaire and interview. Accordingly, survey questionnaire was prepared and distributed to board members, board secretaries, CEOs, and deputy CEOs of the private insurance companies under study. The questionnaire had contained the following issues

- Background information, which included questions on the profiles of the respondent and the insurance company.
- Factors affecting the corporate governance practices
- Impact of corporate governance mechanisms on the performance of Ethiopian private insurance companies
- Effectiveness of the regulatory organ(NBE) in supervising private insurance companies and their response to the assessment reports of the regulatory organ
- Current board practices of Ethiopian private insurance companies in light of the globally accepted principles of corporate governance
- Board structure including board composition, bard compensation, board independent and the importance board committees and their relationship with the performance of the insurance company.

Another data collection mechanism, interview, is also employed in the data collection process. Unstructured interviews were conducted with different groups of key personnel of the targeted Insurance companies. The interview questions included the respondents understanding of the factors affecting the corporate governance, board structure and the impact of corporate governance mechanisms on the company performance. Moreover their understanding on the effectiveness of the regulatory organ and response of the insurance companies to the assessment reports of the regulatory organ of the government is discussed in detail. Finally they were invited to suggest their recommendations for improving the corporate governance of the Ethiopian insurance industry.

Secondary data sources such as the commercial code of Ethiopia, different proclamations and directives of the regulatory organ, statistical reports, annual reports, journals, articles and books, official reports of regulatory organ, newspapers, and periodicals were collected and analyzed through desk review. In regard to those documents that have been collected, an attempt was made, as much as possible, to evaluate the accuracy and consistency of the documents and records before using them as source of secondary date f this research.

Chapter Four-

Research Findings and Analysis

4.1. Research Findings and Analysis

4.1.1. Governance Practices of Private Insurance Companies in Ethiopia

Proclamation 746/2012- ***Insurance business proclamations*** defines insurance as an undertaking by an insurer to indemnify another person, in exchange for consideration called premium against damage, destruction, loss or liability in respect of a certain risk or peril to which the object of the insurance may be exposed or to pay a sum of money or other thing of value depending upon the happening of a certain event.

According to this proclamation, it is prohibited to transact insurance business in Ethiopia without obtaining an insurance business license from the supervisory organ i.e. the NBE. No person may use the word "insurance" or "insurer" or its derivatives as part of the name of any financial business unless it has secured a license from the NBE. Moreover without the prior written approval of the NBE, no insurer may-

- Carry on insurance business at any place other than that authorized by the NBE, or close an existing place of business
- Introduce new insurance products
- Merge with or takeover the business of another insurer
- Transfer all or significant portion of its policies or enter into any agreement for the sale or disposal, by amalgamation or otherwise, of its business, or effect major changes in its line of business
- Transfer or otherwise dispose of the whole or any part of its property, whether inside or outside Ethiopia, other than in the normal course of conducting business
- Redeem its own shares or effect a reduction of its capital other than reduction through operating loss
- Amend its memorandum or articles of association or,
- Alter the name under which it is licensed to carry on insurance business

Where the regulatory body (NBE) has a reason to believe that a person, in contravention of the proclamation, is advertising for or carrying on insurance business, it may, in order to ascertain the situation, require that all books, minutes, accounts, securities, records, vouchers and other documents which are in the possession or custody of such person be submitted to it and inspect same or cause same to be inspected. Where any person undertake insurance business without obtaining license and has received premiums or become obliged to perform under a contract of insurance, the NBE may apply to the court for ordering the speedy and efficient return of such premiums or the performance by such person of his contractual obligations.

The regulatory body decides on an application to carry on insurance business within 90 days from the last date of receipt of all information to be submitted by the applicant. It may, at any time, amend the license of an insurer by imposing any condition or limitation thereto. It may issue directive prescribing the manner of licensing of reinsurer and reinsurer broker. A licensed insurer shall put in place, before commencing operation, sound information management and internal control system, risk management policies and procedures and staffing requirements and such other requirements essential for running insurance business as prescribed by directive and commence its operations within 12 months from the date of issuance of the license. Foreign national or organizations fully or partially owned by foreign nationals are not allowed to own insurance company or carry on insurance business or operate branch offices or subsidiaries of foreign insurers in Ethiopia or acquire Ethiopian insurers.

Insurance business of privately owned insurance companies of Ethiopia is regulated by the National Bank of Ethiopian (NBE). The NBE was established in 1963 by order NO 30/1963 and continue to exist as an autonomous institution governed by proclamation 591/2008. It has its own juridical personality, and in particular, the capacity to contract, sue and be sued and acquire own, possess and to dispose its property by sale or in any other manner. Its head office is in Addis Ababa, the capital city of Ethiopia, and may establish and close branch offices in Ethiopia and designate, and revoke the designation of agents and correspondents in Ethiopia and abroad.

AS Per Proclamation No 591/2008- ***The National Bank of Ethiopia Establishment-***, the NBE is accountable to the prime minster of the Federal Democratic republic of Ethiopia and has board of directors, governor and vice governor appointed by the government and the necessary staff. One of the powers and duties of the NBE as indicated under article 5 of the above proclamation is to license and supervise banks, insurers and other financial institutions, create favorable conditions for the expansion of banking, insurance and other financial services, The relationship between the NBE and insurance companies and other financial institutions include, but not limited to, the following;

- The NBE Licenses and regulates banks, insurance companies and other financial institutions in accordance with the relevant laws of Ethiopia
- The NBE is empowered to collect any information from banks, insurers, micro-finance institutions and any other persons as it may deem appropriate to carry out its duties and responsibilities
- The NBE issues directives necessary for the implementation of the proclamation and regulations issued

The NBE is also regulating the appointment of directors and officers of Ethiopian private insurance companies. Article 16 of proclamation number of 746/2012 stated that a director, CEO, and senior executive officer of an insurer shall be a natural person with honesty, integrity, diligence and reputation to the satisfaction of the NBE. Appointment of board of directors, CEO or senior executive officers of an insurer at the time of licensing or at any time thereafter may not be valid unless written approval is granted by the NBE. The term of office of outgoing directors of an insurer may not terminate until written approval for the incoming director is granted.

The NBE issues directives on qualification criteria to be fulfilled by directors, CEO and senior executive officers of an insurer. It also issues directives regarding the minimum number of directors who serve as member of the board of an insurer, the duties, responsibilities and good corporate governance of the directors. Moreover it issues directives related to the maximum number of years a director may serve an insurer and the conditions for re-election of a director, the maximum remuneration of directors and the maximum number of employees of an insurer who may sit on the board of the same insurer which employed them as well as directives related to prohibitions, suspension and removal measures.

Taking the above authorities, the power given to the NBE is very sufficient to meet its objectives. However if the central bank is responsible to the legislative body, it is relatively said it is independent. Where as in the Ethiopian case, since the National bank of Ethiopia is responsible to the executive body especially to the prime minster it is said to be relatively not independent. The governor of the NBE is a political nominee where its term is not decided by a predetermined rule and can have a chance to be evaluated on a political ground and may not be in its performance. Different instruments are applied by the NBE to regulate and supervise the activities of the insurance companies. The main regulatory and supervisory instruments applied in Ethiopia include: regulating the activities of insurance companies and banks, board directors, and managers, controlling foreign ownership of insurance companies and banks, controlling concentration of credit, credit and interest rate control, capital requirement, limiting board directors and managers benefit package, limiting voting right and suspending directors and managers are some of them. The supervisory instruments are compliance oriented approach where the supervisory authority is given the power to follow if the regulatory instruments are fulfilled by insurance companies otherwise punishes them.

4.1.2. Data Analysis

This section deals with the findings and analysis of the survey questionnaires. The data for this analysis were collected from Ethiopian private insurance companies' board of directors, board secretaries, CEOs and deputy CEOs using a survey questionnaire (see appendix I). In addition to the opinion survey questions five open ended questions were included in it and the respondents were asked to (1) indicate important factors that are currently affecting the corporate governance practices of the Ethiopian insurance companies (2) Indicate their observation on the effectiveness of the regulatory system and forward recommendation to improve the current regulatory system of Ethiopian insurance companies. (3) indicate their observation on the current practice of the board of directors of insurance companies and forward their recommendation to improve the current practices (4) indicate important governance mechanisms that are currently affecting the performance of private insurance companies and (5) Indicate their observation on the board structure and its impact on corporate governance and forward their recommendations to improve the current board structure of insurance companies.

A total of 100 questionnaires were distributed to these target groups. Out of the distributed questionnaires 82 were collected indicating a return rate of 82% percentage. A preliminary assessment of the questionnaires showed that only one questionnaire were found to be incomplete and was excluded from the analysis. The data were carefully coded and entered into SPPS software. The result of the findings and analysis indicates that 88% of the respondents are male and only12% of them are female. About 17.3% of the respondents are above 60 years old and 61.5% of them are between 41 and 59 years old while the remaining 21% of the respondents are between 30 and 40 years old. There is no respondent who is below 30 years old. As far as the service years is concerned 44.4% % of the respondents have served below 5 years, 23.5% of them have served between 6 to 10 years while 32.1% of them have served their respective insurance companies for more than 10 years. The educational back ground of the respondents indicates that 2.5% of them have diploma, 32.1% of them hold BA degree, 61.7% of them hold master's degree and 3.7% have PHD degree in the areas of accounting and finance, business administration, law and economics.

The following are the major points that are analyzed using the data collected through the survey questionnaire-

4.1.2.1. - Factors affecting the corporate governance Practices in Ethiopian Private Insurance Companies

This part of the chapter deals with the analysis of the respondents about the factors that affect the corporate governance practices of Ethiopian private insurance companies. The analysis is done on the effectiveness of board of directors in exercising their role to improve the performance of the insurance companies, the devotion and compensation of board of directors, the existence of adequate policies and procedures, shareholders impact on board decisions, influence of CEO on board decisions, board evaluation and control, participation of senior management members in corporate governance, conflict of interest, board chairman influence, adequacy of standing committee, board responsibility and government's involvement in corporate governance.

Table 5-Factors affecting corporate Governance practices in Ethiopian insurance companies-

No	Factors affecting corporate Governance.	1 #(%)	2 # (%)	3 #(%)	4 # (%)	5 # (%)
1	Board of directors are exercising their role effectively to improve the performance of the company	23(28.4)	42(51.9)	7(8.6)	8(9.9)	1(1.2)
2	The board of directors are devoting adequate time to evaluate the operation and performance of the insurance Company	21(25.9)	40(49.4)	10(12.3)	9(11.1)	1(1.2)
3	The board compensation paid to the board of directors is adequate and compatible with their responsibility	4(4.9)	13(16)	13(16)	29(35.8)	22(27.2)
4	The board of directors and the management of the company have developed and implemented adequate policies and procedures	26(32.1)	43(53.1)	6(7.4)	4(4.9)	2(2.5)
5	Shareholders pressurizes the insurance company to make baized decisions	3(3.8)	9(11.2)	15(18.8)	32(40)	21(26.2)
6	The CEO has significant influence on the performance of the insurance company	44(54.3)	33(40.7)	2(2.5)	1(1.2)	1(1.2)
7	The board of directors are effectively evaluating and controlling the performance of the insurance company	13(16)	46(56.8)	13(16)	7(8.6)	2(2.5)
8	Senior management members are actively participating in the governance of the insurance company	24(29.6)	37(45.7)	11(13.6)	7(8.6)	2(2.5)

9	There is visible conflict of interest that is observed in the activities of the board of directors	1(1.2)	2(2.5)	20(24.7)	37(45.7)	21(25.9)
10	The board chairman influence on the performance of the CEO is acceptable	7(8.6)	15(18.5)	18(22.2)	24(29.6)	17(21)
11	There are adequate number of standing committee and are effectively performing	24(29.6)	32(39.5)	11(13.6)	11(13.6)	3(3.7)
12	Board of directors are adequately informed and are knowledgeable about their role, responsibilities and function	19(23.5)	38(46.9)	15(18.5)	7(8.6)	2(2.5)
13	The board of directors actively participate during the preparation and implementation of strategic and operational plan of the insurance company	30(37)	36(44.4)	6(7.4)	9(11.1)	-
14	Board of directors are accountable and responsible for situations that may cost them to the extent of relinquishing their position	20(25)	41(51.2)	13(16.3)	5(6.2)	1(1.2)
15	The Involvement of the government through different stake holders is at an acceptable/tolerable level	5(6.2)	24(29.6)	19(23.5)	27(33.3)	6(7.4)
	1= Strongly agree, 2= agree 3= Neutral 4= Disagree 5= strongly disagree					

As can be seen from the table above, 80.3% of the respondents have agreed that the boards of directors are exercising their role effectively to improve the performance of the insurance companies. 75.3% of them have also agreed that the board of directors are devoting adequate time to evaluate the operation of the insurance companies.70.4% of the respondents have agreed that the board of directors are adequately informed and are knowledgeable about their roles , responsibilities and functions.

One of the factors that affect the corporate governance practices is the existence and implementation of adequate policies and procedures. Another factor is also the existence of adequate number of standing committees that perform different board activities of strategic attention. The findings of the research indicated that 85.2% of the respondents have agreed that the board of directors and the senior management of insurance companies have developed and implemented adequate policies and procedures. However only 69.1% of the respondents have agreed on the availability and the effectiveness of standing committee indicating that the number of standing committee which are currently operational may need revision so that additional standing committee will be instituted and thus the regulatory organ may also be required to evaluate the effectiveness of the existing standing committee and asses the need for additional ones.

The shareholders pressure on the governance practices of insurance companies that may lead to biased decisions shall be kept minimal. To this end the findings of the research indicated that 65.4% of the respondents have disagreed on the existence of such shareholders pressure which may affect insurance companies to make biased decisions. However 18.5% of the respondents are found to be neutral. The existence of conflict of interest also affects the activities of the board of directors but 70.4% of the respondents have disagreed on the existence of visible conflict of interest. This may be the result of the existing board composition which is in favor of100% non-executive directors. Moreover 75.3% of the respondents have agreed that the boards of directors are accountable and responsible for situations that may cost them to the extent of relinquishing their position.

Another factor that can affect the corporate governance practice is the involvement of the government organs. In this regard there is significant difference relating the acceptance of the involvement of the government in the governance structure of insurance companies. 40.7% of the respondents have disagreed that the involvement of the government in the governance structure through different stakeholders is acceptable. 23.5% of them are neutral while 35.8 of them have agreed that the involvement of the government in the governance structure of Ethiopian insurance companies through different stakeholders is at an acceptable or tolerable level.

The influence of the CEO on the performance of the insurance companies is significant. Senior management members are expected to actively participate in the governance practice of the insurance companies. Moreover the board chairman's influence on the performance of the CEO shall be at an acceptable level. Board of directors is also expected to participate during the preparation and implementation of strategic and operational plan of insurance companies. The findings of the research in this regard indicated that 95% of the respondents have agreed that the influence of the CEO on the performance of insurance companies is significant but only 27.1% of them have agreed that the influence of the board chairman on the performance of the CEO is acceptable. Interestingly 72.8% of the respondents have agreed that the board of directors is actively participating during the preparation and implementation of strategic and operational plan. Moreover 75.3% of the respondents have agreed that the senior management members are actively participating in the governance practice of insurance companies

Conclusion-

There is a confidence on the side of the respondents that the boards of directors are exercising their role effectively and devoting adequate time to evaluate the operations and improve the performance of the insurance companies. They are also informed and knowledgeable about their roles, responsibilities and functions. The existence of conflict of interest on the side of the board of directors is believed to be minimal. Shareholders pressure on the governance practices is also insignificant and thus the chance of making biased decisions by senior management is also minimal.

The availability and effectiveness of board standing committee is believed to be adequate except that additional committee including the remuneration and investment committee be included in the governance practice, The involvement of the government seem to be unacceptable in that it shall only focus on issuing regulation and building the capacity of the board of directors and senior management members of the insurance companies.

The influence of the CEO on the performance of the insurance companies seems to be significant and thus demands the attention and devotion of the board of directors in selecting and evaluating the performance of the CEO. The influence of the board chairman on the performance of the insurance company is currently at its lower level which may demand the attention and devotion of the board of directors in electing their chairman who will have an acceptable influence on the performance of the CEO and the company.

4.1.2.2 Impact of corporate governance mechanisms on the performance of Ethiopian private insurance companies.

The main points addressed in this section include the board size, board composition, CEO's turnover, regularity of reports, rights and interests of stakeholders, board directors instrumentality, impact of good corporate governance on profitability and its contribution to customer satisfaction and employees motivations. Finally the role of good corporate governance in building the image of private insurance companies is assessed.

Table 6- Impact of corporate governance mechanisms on the performance of private insurance companies

Impact of corporate governance mechanisms on the performance of private insurance companies						
No		**1** **# (%)**	**2** **# (%)**	**3** **# (%)**	**4** **# (%)**	**5** **# (%)**
1	Board size has positive impact on the performance of the insurance company	44 (54.3)	26 (32.1)	5 (6.2)	4 (4.9)	2 (2.5)
2	The board composition (being Non-Executive board in Ethiopian case) has positive impact on the performance of the insurance company	34 (42)	17 (21)	8 (9.9)	14 (17.2)	8 (9.9)
3	Good corporate governance contributes a lot in building trust and confidence on customers, reinsurers and other stake holders	65 (80.2)	16 (19.8)	-	-	-
4	The turnover of the CEO and senior management members has positive impact on the performance of the insurance company.	10(12.3)	9 (11.1)	9(11.1)	32(39.5)	21 (25.9)
5	Board of directors are receiving regular reports on the effectiveness of the internal controls	26 (32.1)	36(44.4)	11 (13.6)	5(6.2)	3(3.7)
6	Effective corporate governance framework imposes appropriate standards to recognize and protect the rights and interests of stakeholders	37 (45.7)	37(45.7)	7 (8.6)	-	-
7	Board of directors as corporate governance mechanism are important instruments to maximize shareholders wealth	52(64.2)	28(34.6)	1(1.2)	-	-
8	Good corporate governance has a positive impact on profitability of the insurance company	56(69.1)	18(22.2)	7(8.6)	-	-
9	Good corporate governance contributes to customer satisfaction and employees motivation in the insurance company	57 (70.3)	16 (19.8)	8 (9.9)	-	-
10	Good corporate governance plays an important role in building the image of insurance companies	63 (77.8)	17(21)	1(1.2)	-	-

1= Strongly agree, 2= agree 3= Neutral 4= Disagree 5= strongly disagree

The size of the board has a notable impact on the corporate governance practices of insurance companies. Per the Ethiopian commercial code (1960) Article 347(2) the minimum and the maximum number of board of directors is clearly stipulated to be three and twelve respectively. The findings of the research indicated that 86.4% of the respondents have agreed that the board size has a positive impact on the performance of insurance companies. It is recalled that in the previous section (table-5), 95% of the respondents have agreed that the influence of the CEO on the performance of insurance companies is significant. However 65.4% of the respondents in this section have disagreed that the turnover of the CEO and senior management members has positive impact on the performance of insurance companies. Only 23.4% of the respondents have agreed that the turnover of the CEO and senior management members has a positive impact on the performance of insurance companies.

Board of directors should seek regular reports on the effectiveness of internal control system directly from the audit and risk & compliance committee as well as from the top management of the company. Correspondingly 76.5% of the respondents have agreed that the boards of directors are receiving regular reports on the effectiveness of the internal control system. Per the shareholders theory there is significant correlation between corporate governance and profitability suggesting that when organization employees adhere to good corporate governance, there is likely hood that a company's performance will be improved. Similarly 91.3% of the respondents have agreed that board of directors as corporate governance mechanism have positive impact on profitability of Ethiopian insurance companies. Moreover 90.2 of the respondents have agreed that good corporate governance contributes to customer satisfaction and employee's motivation while 98.8% of the respondents have also agreed that good corporate governance plays an important role in building the image of insurance companies. Furthermore 81% of the respondents have also agreed that good corporate governance contributes a lot in building trust and confidence on customers, reinsurers and other stake holders.

Conclusion-

Board size is believed to have positive impact on the performance of insurance companies. Though the influence of the CEO on the performance of insurance companies is believed to be significant, there seems some disagreement on the turnover of the CEO and senior management members to have significant impact on their performance. Good corporate governance mechanism is believed to have a positive and contributory impact on profitability, customer satisfaction, employees' motivation and building the image, trust and confidence of customers, reinsurers and other stakeholders.

4.1.2.3.- The Effectiveness of the regulatory organ (NBE) in supervising private insurance companies

The main issues addressed in this section include the existence of clear insurance proclamations, guidelines as well as directives and timely revision of these documents. The adequacy of the time, resource and attention given by the regulatory organ to supervise the insurance companies is analyzed. The correctness and acceptance of the recommendations given by the regulatory organ regarding the board composition and relationship between the board and the regulatory organ is assessed. Moreover the objective and professional relationship between the board of directors and the auditors, the intention and completeness of insurance companies' response to the onsite and offsite assessment report of the regulatory organ, the importance of the existing regulations to prevent dishonest insurers and finally the regularity of the board reports on the effectiveness of internal control system of Ethiopian private insurance companies is addressed.

Table 7- Effectiveness of the Regulation practices of NBE in supervising private insurance companies

No	effectiveness of the Regulation practices of NBE	1 # (%)	2 # (%)	3 # (%)	4 # (%)	5 # (%)
1	There are clear proclamations, guidelines and directives issued by the NBE to ensure corporate governance in the insurance companies	10(12.3)	47(58)	13(16)	11(13.6)	-
2	Proclamations, guidelines and directives are updated and revised at an acceptable range of time	6(7.4)	18(22.2)	20(24.7)	35(43.2)	2(2.5)
3	Adequate time, resources and attention is given by the regulatory organs of NBE to the regulate the insurance companies	3 (3.7)	17(21)	15 (18.5)	38(46.9)	8(9.9)
4	Insurance companies should not be regulated by NBE but rather need separate regulatory body	40(49.4)	25(30.9)	8(9.9)	7(8.6)	1(1.2)
5	The recommendation of NBE about the composition of board of directors which is totally in favor of non-executive directors is correct and acceptable by the Ethiopia's insurance companies	6(7.6)	18(22.8)	16(20.3)	31(39.2)	8 (10.1)
6	There is an objective and professional relationship between the board of directors and the auditors of the insurance company	21(25.9)	38(46.9)	15(18.5)	6(7.4)	1(1.2)
7	The board/ Management is responding to the assessment of the regulatory body with good intention, completeness and established an audit committee that clearly deals with its duties and authorities	26(32.1)	42(51.8)	11(13.6)	2 (2.5)	-
8	The board regularly reports on the effectiveness of the insurance company's internal control system to the regulatory	11(13.6)	34(42)	16(19.8)	18(22.2)	2(2.5)

	organ (NBE)					
9	The most important goal of insurance companies is promoting the solvency of the company	19(24.4)	35(45)	11(14)	11(14)	2(2.5)
10	Regulation is important to prevent dishonest insurers from taking advantage of consumers relatively uninformed position by eliminating inherent unfair contracts from market places	38(46.9)	36(44.4)	3(3.7)	4(4.9)	-
1= Strongly agree, 2= agree 3= Neutral 4= Disagree 5= strongly disagree						

As an instrument to the regulation system there should be clear proclamations, guidelines and directive. Moreover such proclamations and guidelines have to be revised and updated at an acceptable range of time. The survey have indicated that 70.3% of the respondents have agreed that there are clear proclamation, guidelines and directives issued by NBE to ensure corporate governance in the insurance companies. However there is no common understanding relating the revision or timely update of the proclamations, guidelines and directives issued by the regulatory organ. 45.7% of them have disagreed and only 29.6% of them have agreed that these proclamations, guidelines and directives are updated and revised at an acceptable range of time. As far as the dedication of the regulatory organ is concerned only 24.7% of the respondents have agreed that adequate time, resource and attention is given by the regulatory organ to regulate insurance companies. But 56.8% of the respondents believed that adequate time, resources and attention is not given by the NBE to regulate insurance companies.

91.3% of the respondents have agreed that regulation is important to prevent dishonest insurers from taking advantage of customers who are relatively in un informed position by eliminating inherent unfair contracts from market places. However there is no common understanding as to who should regulate the insurance companies as 80.3% of the respondents have agreed that insurance companies should not be regulated by the existing regulatory organ, the NBE, but rather prefer to a separate, independent and professional regulatory body. Interesting findings of the survey indicated that 72.8% of the respondents have agreed that there is an objective and professional relationship between the board of directors and the auditors of insurance companies. Moreover 84% of them have agreed that the board of directors and the management are responding to the assessment reports of regulatory body with good intention and completeness by establishing an audit and risk & compliance committee that clearly deal with its duties and authorities.

Conclusion

Though there are clear proclamations, guidelines and directives in place, the regulatory organ is not effective in updating and revising them at an acceptable range of time. Moreover adequate time and attention is lacking from the side of the regulatory body to regulate the insurance companies despite board of director's commitment to establish board committee and respond to the assessment reports with good intention and completeness. Furthermore there is clear objection that the NBE should not regulate insurance companies but rather a separate independent and professional regulatory body is necessitated to be in place.

4.1.2.4.- The current Practices of Board of directors of Ethiopian Private Insurance Companies in light of the globally accepted principles corporate governance

The important issues addressed in this section are the comparison between previous times and current corporate governance practices in the private insurance companies, existence of sound relationship between board and top management members, relationship between the board and the CEO, value addition activities of boards to shareholders value, acceptability of board tenure to a maximum of six years, independence of board members from the board chairman, effectiveness of board of directors in selecting, monitoring and replacing of the CEO, protection of minority shareholders interest, shareholders right to full disclosure of information and voting rights as well as insider trading prohibition. Moreover the strategic focus of the board of directors and regularity of their meetings and the effectiveness of Board of directors to ensure proper disclosure and communication with shareholders is assessed. Finally the concern of the brad of directors in the corporate strategy, risk management, executive compensation and performance of the insurance companies is addressed.

Table 8-Current Practices of the board of directors of Ethiopian insurance companies

No	**Current Practices of the board of directors of Ethiopian insurance companies**	**1** # %	**2** # %	**3** # %	**4** # %	**5** # %
1	The Current corporate governance practices in your insurance company is much better compared to those of the previous years	22(27.2)	34(42)	19(23.5)	6(7.4)	-
2	The relationship between the board and the CEO is smooth but not healthy	10(12.3)	11(13.6)	19(23.5)	32(39.5)	9(11.1)
3	Many of the issues that the board deals with add value to the shareholders	22(27.2)	43(53.1)	10(12.3)	5(6.2)	1(1.2)
4	The board is more involved in strategic matters than routine activities	16(20)	41(51.3)	8(10)	12(15)	3(3.7)
5	Limiting the tenure of the board of directors to be a maximum of 6 years is acceptable by the board and shareholders of the company	12(14.8)	34(42)	13(16)	8(9.9)	14(17.3)
6	Board of directors are independent of the influence of the board chairman	29(36.3)	32(40)	13(16)	3(3.8)	3(3.8)
7	Board of directors are effective in selecting, monitoring and replacing the CEO/President	21(26.3)	20(25)	25(31.2)	8(10)	6(7.5)
8	Having one re-insurance company at a national level is enough to the existing insurance companies operation	2(2.5)	13(16.5)	5(6.3)	48(60.8)	11(13.9)
9	Board of directors ensure proper disclosure and communicate with shareholders	19(23.4)	29(35.8)	16(19.8)	17(21)	-

	actively and effectively					
10	The board of directors meets regularly, retain full and effective control over the company and monitor the executive management team	24(29.6)	38(46.9)	13(16)	6(7.4)	-
11	Shareholders have the right to full disclosure of the information, voting rights, issuance of new shares, merger etc	34(42)	33(40.7)	9(11.1)	5(6.2)	-
12	Interest of minority shareholders is protected by setting up systems that keep insiders from taking advantage of their roles	17(21)	34(42)	18(22.2)	5(6.2)	7(8.6)
13	Insider trading is explicitly prohibited and directors disclose any material interest regarding transactions	23(28.8)	27(33.7)	23(28.8)	5(6.2)	2(2.5)
14	The board is concerned about corporate strategy, risk management, executive compensation and performance of the insurance company	38(47.5)	30(37.5)	6(7.5)	6(7.5)	-
15	Shareholders have access to the audited financial statements of the company	42(52.5)	30(37.5)	4(5)	4(5)	-
1= Strongly agree, 2= agree 3= Neutral 4= Disagree 5= strongly disagree,						

Corporate governance practice is not a one-time activity. It is rather an activity expected to pass through continuous improvements. In line with, this 69.2% of the respondents have agreed that the current corporate governance practices in their respective insurance company is much better compared to those of previous years. It is also interesting that 80.3% of the respondents have agreed that many of the issues that the board of directors deals with add value to the shareholders.

The Board of directors and the management of the companies are expected to work coherently as a team for a common goal of maximizing shareholders value. Board of directors are expected to work closely with the management and the board of directors rely on top management for reliable and up-to-date information for strategic and policy initiatives. In line with this argument, 71.3% of the respondents have at least agreed that the boards of directors are more involved in strategic matters than routine activities. Moreover 76.5% of them have agreed that the board meets regularly, retain full and effective control over the company and monitor the performance of the executive management team.

Furthermore 85% of the respondents have agreed that the board is concerned about corporate strategy, risk management, executive compensation and performance of insurance companies. However only 25.9% of the respondents have greed while 50.6% of them have disagreed that the relationship between the board and the CEO is smooth but unhealthy. This particularly demands the attention of the regulatory body to assess the reason for such relationship between the board and the CEO as it may indicate existence of unhealthy operations.

Corporate governance as a system of rules, practices and process essentially involves balancing the interest of a company's many stakeholders such as shareholders, senior management executives, customers, suppliers, financers and the community. A.C. Fernando (2013) argued that there are two board mechanisms that help reduce agency costs and hence improve corporate performance through better governance (1) fair and accurate disclosures and (2) efficient and independent board of directors. One of the principles of the OECD is that the rights of shareholders include a set of rights to secure ownership of their shares, the right to full disclosure of information. Findings of this research indicated that 82.7% of the respondents have agreed that shareholders have the right to full disclosure of the information, voting rights , issuance of new shares, mergers, etc. 90% of them have also agreed that shareholders have access to the audited financial statements of the company. However only 59.3% of the respondents have agreed that board of directors ensures proper disclosure and communicates with shareholders actively and effectively though 19.8% of the respondents are neutral, 21% of them have disagreed with it. Such significant difference among respondents may indicate that more disclosures are fairly and accurately expected from the board because improving the financial accuracy and disclosures not only ensures corporate transparency among a wide group of investors and analysts but also persuades companies to minimize value destroying deviant behaviors.

The OECD is concerned with protecting minority shareholders' right by setting up systems that keep insiders from taking advantage of their roles. Insider trading, for example, is explicitly prohibited and directors should disclose any material interest regarding transactions. In line with this principle 63% of the respondents have agreed that the interest of minority shareholders is protected by setting up systems that keeps insiders from taking advantage of their roles. However 22.2% of them are neutral on this issue. Though 62.5% of the respondents have agreed that insider trading is explicitly prohibited and directors disclose any material interest regarding transactions, still 28.8% of them are neutral regarding the matter. Such huge amount of neutrality demands the attention of the board in making more disclosures regarding shareholders right and insider trading.

The final issue addressed in this section was the tenure of board of directors and their effectiveness in selecting, monitoring and replacing the CEO of insurance companies. Per the insurance corporate governance directive No. SIB/42/2015 issued by the regulatory body -NBE-, a person may not serve either on his own or representing any other shareholders as agent, or by whatsoever means as a director of the insurance company for more than six years. He/she may be reelected after lapse of six consecutive years. However the directive seems to lack full support of respondents as only 56.8% agreed and 27.2% of them disagreed that limiting the tenure of the board of directors to be a maximum of 6 years is acceptable by the board and shareholders.

According to the OECD (2004) principles of corporate governance, one of the responsibilities of the board of directors is to select, compensate, monitor and replace key executives and oversee succession planning. Interestingly while 31.32% are found to be neutral, 51.3% of the respondents have agreed that the board of directors is effective in selecting, monitoring and replacing the CEO of insurance companies. Recalling to table

6, No.4 where 65.4% of the respondents agreed that the turnover of the CEO and senior management have negative impact on the performance of insurance companies coupled with 31.3% of neutrality is a clear indication that the board of directors need to review or evaluate the current practice of selecting, monitoring and replacing the CEO of their respective insurance companies.

Conclusion-

There is almost unanimous agreement that corporate governance practices are improving from time to time. The Board of directors seems to add value to shareholders as they are more involved in strategic matters than routine activities. They are also conducting regular meeting retaining full and effective control over the company. However limiting the tenure of BOD to a maximum of 6 years seems to be unacceptable by major part of the population targeted in this research. The existing smooth but not healthy relationship between the BOD and the CEO demands the attention of the regulatory body. It is quite encouraging that shareholders have the right to full disclosure of the information and have access to audited financial statements. Moreover as the turnover of the CEO is believed to have negative impact on performance, the BOD need to ensure that their current practice of selecting, monitoring and replacing the CEO of insurance companies is effective or not.

4.1.2.5. The Relationship between board structure and performance of Ethiopian private insurance companies

The main issues addressed in this section include the Board structure including the board Composition, board compensation, board independence and the board committee of insurance companies and its impact on the performance of insurance companies.

Table 9- Relationship between board structure and performance of Ethiopian private insurance companies

No	Relationship between board structure and company performance	1 # %	2 # %	3 # %	4 # %	5 # %
1	The existing compensation of the board of directors is not commensurate with their responsibility	15(18.5)	27(33.3)	12(14.8)	25(30.9)	2(2.5)
2	The existing compensation of the board of directors have negative impact on the performance of the insurance companies as it is not motivating and commensurate with their responsibility	3(3.7)	26(32.1)	27(33.3)	21(25.9)	4(4.9)
3	Compensation of board of directors should not be decided by the regulatory organ of the NBE. It should rather be decided by the shareholders following the commercial code of Ethiopia.	36(44.4)	21(25.9)	15(18.5)	7(8.6)	2(2.5)
4	The existing directive of NBE relating to the	2(2.5)	35(43.2)	18(22.2)	24(29.6)	2(2.5)

	board composition (all being non-executive directors) has negative impact on the performance of the insurance company					
5	Ethiopian private insurance companies need to have executive board of directors with a majority of non-executive board of directors so that the performance of the company will be improved as the finance, IT and marketing activities will get enough attention of the board.	22(27.5)	33(41.3)	16(20)	7(8.7)	2(2.5)
6	The existing board compensation is not attractive and as a result qualified candidates are not attracted or motivated to serve as board of directors of insurance companies	10(12.3)	17(21)	23(28.4)	24(29.6)	7(8.6)
7	The existing board compensation is not attractive and is negatively affecting the independence of the board of directors, which in turns is may negatively affect the performance of the insurance companies	3(3.8)	27(33.8)	23(28.7)	23(28.7)	4(5)
8	Existing board compensation should be revised so as to link rewards to company and individual performance	29(35.8)	38(46.9)	8(9.9)	5(6.2)	1(1.2)
9	The existence of independent board of directors enhances the performance of private insurance companies	26(32.9)	45(57)	7(8.8)	1(1.2)	-
10	The audit committee is the most important board committee which is playing a critical role in ensuring the protection of shareholder interest and thereby improve the performance of the insurance company	19(23.5)	34(42)	15(18.5)	11(13.5)	2(2.5)
11	The audit committee is working closely with the external auditor and has the responsibility to ensure the accuracy of the financial statements and report properly to outsiders.	18(22.2)	24(29.6)	14(17.3)	18(22.2)	7(8.6)
12	The absence of remuneration committee that deals with the compensation and benefits of board members and executives is negatively affecting the compensation system and the performance of the insurance company	5(6.2)	29(35.8)	27(33.3)	18(22.2)	2(2.5)
13	The existing board committee are allowing the board to have division of work and thereby maximizing the performance of the board and the insurance company	25(30.9)	37(45.7)	12(14.8)	6(7.4)	1(1.2)
14	The existing number of board committee such as the HR, Audit ,Risk etc are quite enough for the smooth operation and performance of the insurance company	18(22.2)	33(40.7)	9(11.1)	21(25.9)	-
15	Board of directors are independent of the influence of the CEO/President	25(30.9)	32(39.5)	13(16)	10(12.3)	1(1.2)

1= Strongly agree, 2= agree 3= Neutral 4= Disagree 5= strongly disagree,

Board Composition - Per the Ethiopian insurance governance directive Number SIB/42/2015 issued by NBE, insurance companies are expected to have at least nine directors. Moreover directive number SIB/43/2016 regarding the limit on board remuneration and number employees who seat on the board of an insurance company clearly stated that no employee of an insurer be it permanent or contractual, shall have a seat on the board of an insurance company. A survey was conducted to collect an opinion of respondents whether such a directive which is in favor of 100% non-executive board of directors have negative impact on the performance of insurance company and whether such companies need to have executive board of directors in their board composition.

The survey indicated that there is significant difference among respondents regarding the acceptability of the existing directives. 45.7% have agreed, 22.2.% remained neutral and 32% of them have disagreed that the existing directives relating to the board composition which are in favor of 100% non-executive board of directors have negative impact on the performance of insurance companies. However 68.8% of the respondents have agreed that Ethiopian private insurance companies need to have executive board of directors in the board composition so that the performance of insurance companies will be improved as the finance, IT, marketing and other functions will get enough attention.

Board Remuneration - OECD principle VI.D.4 states that one of the board's key functions involves aligning board remuneration (as well as key executive remuneration) with the longer term interests of the company and its shareholders. There are two opposite risks when setting the level of remuneration of board members ; setting too low may limit the ability of companies to attract and retain qualified and experienced Individuals; but if it is too high and entail over compensation, it may impair board members' independence. In addition, remuneration is one of the areas where executive board members may have a conflict and thus, where particular account should be taken of the interest of the company and shareholders in general.

The findings of the research indicated that 37.6 % of the respondents have agreed, 28.7% are neutral while 33.7% of them disagreed that the existing compensation of board of directors is not commensurate with their responsibility. In the Ethiopian insurance companies, board remuneration is fixed by the regulatory body. Article 4.1 and 4.2 of the Directive No-SIB/43/2016 regarding the limits on board remuneration and number of employees who seat on the board of insurers states that annual compensation to be paid upon the decision of ordinary general shareholders meeting to a board of director shall not exceed birr 150,000 which is equivalent to 3,400 dollar and monthly allowance not to exceed birr 10,000 which is equivalent to

230 dollar. Moreover no insurer shall pay any financial or otherwise remuneration or benefits, to its directors any time.

Unlike the above directive 70.3% of the respondents have disagreed that directors' remunerations should be decided by the regulatory body. They have rather agreed that board remunerations should be decided by the shareholders following the article 347 of the Ethiopian commercial code. More interesting is that only11.1% of the respondents stood against while 18.5% of them remained neutral. Another interesting finding is that though most of the respondents oppose the involvement of the regulatory body in fixing boards' remuneration, their perception on the impact of the remuneration on board performance, attractiveness and motivation and its impact on independence and company performance is significantly different. 35.8% of them have agreed, 33.3% remained neutral and 31% of them have disagreed that the current board remuneration have negative impact on the performance of the board of directors though it is not motivating and commensurate with their responsibility.

Moreover 29.6% agreed, 28.4% became neutral and 21% of the respondents have disagreed that the current board remuneration is not attractive and as a result qualified candidates are not attracted or motivated to serve as board of directors of insurance companies. Furthermore 37% of the respondents agreed, 28.4 became neutral and 33.3% of them have disagreed that the current board remuneration is not attractive and is negatively affecting the independence of board of directors, which in turn may negatively affect the performance of insurance companies. Another interesting finding is that 82.7% of the respondents have agreed that the current board remuneration should be revised so as to link it to company and board performance.

Board Independence - The Cadbury report 1992 section 4.4 of the report "Financial" states that whilst it is the board as a whole which is the final authority, executive and non-executive directors are likely to contribute in different ways to its works. Non-executive directors provide a creative contribution to the board by providing independent oversight and constructive challenge to the executive directors. According to the OECD (2004) Principle of corporate governance, sufficient number of Board of directors should be independent of the management. Moreover the role of the CEO and the board chairman has to be separated. Such a situation is considered to ensure board independence.

In the Ethiopian context employees of insurance company are not allowed to seat on the board of directors. The board composition of Ethiopian insurance companies is 100% of non-executive shareholder directors and thus board independence may not be as important as that of board remuneration. In line with this 70.4% of the respondents have agreed that board of directors are independent of the influence of the CEO and 90% of them have also agreed that the existence of independent board of directors enhances the performance of private insurance companies.

Board committee - The board of directors accomplish much of its role though different committees, which undertake different tasks delegated by the board, make recommendations to the board for discussion and action, and enhances board productivity. To this end 76.6% of the respondents have agreed that the existing board committees are allowing the board to have division of work and thereby maximizing the performance of the board of directors in particular and the insurance companies in general.

Tricker (2009) stated that most boards have audit, remuneration and nomination committee as principal standing committee. Moreover, depending up on the corporate constitution, other committee such as executive committee, risk management committee and governance committee could be formed as need be to meet specific corporate demands. Per the directive No.-SIB/48/2015 of the regulatory body of Ethiopian insurers demands all insurance companies to establish four basic committees namely the audit committee, risk management and compliance committee, Human Resources affairs committee as well as nomination and election committee. Thus it is clear from this directive that no attention is given to the remuneration committee.

The survey made in this regard showed that there is significant difference among the respondents. 42% of them agreed, 33.3% remained neutral and 24.7% of them disagreed that the absence of remuneration committee which deals with the remuneration and benefits of board of directors and executives is negatively affecting the remuneration system and the performance of insurance companies. According to Mallin (2010) and Klein (1998), the audit committee is the most important subcommittee that plays a crucial role in ensuring the protection of shareholders interest in matters pertaining to financial reporting and internal control. It serves as a bridge between the board and both internal and external auditors and ensures that the board gets all relevant audit information. The committee works closely with external auditing firms and has the responsibility to ensure the accuracy of the financial statements and report properly to outsiders.

In line with the above statement 65.5% of the respondents have agreed that the audit committee is the most important board committee which is playing a critical role in ensuring the protection of shareholders interest and thereby improve the performance of insurance companies. Moreover 51.8% of them have agreed while 30.8% of them have disagreed that the audit committee is working closely with the external auditors and has the responsibility to ensure the accuracy of the financial statements.

Conclusion-

There is a need for inclusion of executive board of directors in the board composition of insurance companies. There is no uniform understanding among respondents regarding the impact of board remuneration on the performance of insurance companies. The existing board remuneration is believed to be insufficient and not commensurate with the responsibility of the board of directors. The involvement of the regulatory body in fixing board remuneration is not acceptable. Such issue should rather be decided by shareholders following the commercial code of Ethiopia. There is no agreement on whether the existing board remuneration is negatively affecting the independence of the board of directors and the performance of the insurers.

However, part of the directive number SIB 46/2018 that sets remuneration for board of directors has remained the subject of concern for most of the respondents. Apart from the monthly allowance, the fixed annual remuneration determined by the NBE is by no means adequate given the huge responsibilities that the directors shoulder. The remuneration lacks to take into consideration the size of the financial institution (as risks and responsibilities increase with the width and breadth of the company) and the economic situation of the county in which the insurance company is operating. Thus it is recommended that the NBE put in place a system that would allow payment of board of directors remuneration linked to a given range of percentages to be computed, as a basis, on the annual net profit so that the shareholders would have the latitude to make remuneration decision that would more properly compensate the performance of the board of directors.

There is no big concern regarding the independence of board of directors of Ethiopian insurance companies which is composed of 100% non-executive directors and such an independent board is believed to enhance the performance of insures. It seems that the existing board committees are quite enough for the smooth operation of insurers. There is no remuneration committee as it is ignored by the regulatory body in its directive No-SIB/48/2015. The importance of this committee is to assist and advise the board on matters relating to the remuneration of the board and senior executives. However in Ethiopia board remuneration is fixed by the regulatory body and thus the importance of the remuneration committee is not appreciated and there is also significant difference among respondents regarding its impact on the remuneration system of insurance companies. However the audit committee is believed to be the most important board committee. It is moderately agreed that this committee is working closely with external auditors and ensuring the accuracy of financial statements.

4.2. Interview-

In addition to document scanning and conducting the survey questionnaire an interview was also used as another method of data collection. Unstructured interview was confidentially made with two board chairmen, two board secretaries and two CEOs. They were selected based on seniority in the field on the assumption that they are sources of apposite information from their past challenges and practical experiences. The interview questions mainly focused on board structure (composition, independence or conflict of interest, compensation) and the role of the regulatory organ.

Board composition

Most of the respondents are comfortable with the establishment of the Nomination and election committee by the NBE. They believe that the criteria set in the nomination and election committee directive issued by the regulatory body are acceptable. However all of the board of directors expected to be nominated are nonexecutive directors which totally excludes the nomination of employees or executive staff as executive directors. They put their reservation on the genuine behavior of the major shareholders in the voting process as most of them vote for those whom they are family members, friends or any other affiliated director. Almost all respondents have agreed that non-executive directors are independent although they may not be as informed as the executive directors regarding the internal affairs of the insurance companies.

Almost all respondents have agreed that the existing board composition that is composed of 100% non-executive board of directors is not acceptable in that limited number of executive (employees) shall be included in the board of insurance companies. They have stressed that the inclusion of executives in the board of directorship can help as sources of reliable and fast information to make informed decisions. Hence all of them have recommended the inclusion of executive directors in the board composition of Ethiopian private insurance companies.

Board Independence-

Almost all of the respondents have agreed that non-executive directors are expected to be independent and thus there may not be visible conflict of interest. However one interviewee have stressed that the inclusion of the executive directors may not affect the independency of the board as a whole and thus stressed that having 100% non-executive directors may not guarantee 100% board independence. They have also indicated the existence of some non-executive board of directors who are not capable and aware of their duties and responsibilities. Such BOD are elected not based on their merit but based on their relationship with some of the major shareholders.

Board Compensation-

Almost all of the respondents have clearly indicated that the Board compensation which is fixed by the regulatory organ is not attractive and has a negative impact on the performance of the board in particular and the company performance in general. They have agreed that it is not motivating and proportionate with the responsibility carried by the board of directors. The responses of all the interviewee have also indicated that the board compensation is not only insufficient and should not also be fixed by the regulatory organ. The fact that board compensation is insufficient may encourage board of directors for search of indirect benefits from the insurance company. Most interesting response from most of them was that talented and well experienced candidates may desist from board directorship and thus the commitment and capacity of the elected board of directors may not be adequate to direct and control the insurance company. Such inadequacy in directing and controlling the company will in turn negatively affect the corporate governance practices of the insurance company in particular and the insurance industry in general.

Regulation of Insurance Companies-

The current practices of the regulatory organ is to set criteria for nomination and election of board of directors and senior management, to approve the election and removal of board of directors, to fix the maximum remuneration of board of directors, to regulate and protect the rights of shareholders and limit the acquisition of shares; to regulate transactions that could give rise to possible conflicts of interest; to ensure that insurance companies disclose material information such as financial statements and other reports to the public; and to inspect any insurance company periodically or at any time so that it will comply with the regulations issued by the regulatory (governing) body (www.nbe.gov.et). However the most important concern raised by the respondents is that the capacity of the regulatory organ to do so is inadequate. Almost all respondents have agreed on the existence of strong proclamations and directives but their implementation is impeded because of the low capacity and attention given to insurance companies' supervision by the regulatory organ. Most of them have agreed on the establishment of insurance commissioner as an independent organ that will be responsible for supervising the activities of insurance companies. They have also proposed for the introduction of stock market so as to have an institution that will serve as a forum where regular activities of buying, selling and issuance of shares of insurance companies will take place.

4.3. Key issues and the way forward

The analyses of the comments obtained from the document review, survey questionnaire and interview questions indicated the following key issues and suggested the way forwards.

4.3.1. Key Issues

- No person may use the word insurance or insurer or its derivatives as part of the name of any financial business unless it has secured a license from the regulatory body (NBE)
- A licensed insurance shall commence its operation within 12 months from the date of issuance of the license.
- Though there are clear proclamations, guidelines and directives in place, most proclamations and directives issued by the regulatory body are not updated to coup up with the demand of the insurance industry, the OECD principles and the Cadbury report.
- Foreign nationals or organizations fully or partially owned by foreign nationals are not allowed to own insurance companies or carry on insurance business or operate branch offices or subsidiaries of foreign insurers in Ethiopian or acquire Ethiopian insurers
- Appointment of BOD, CEO and senior executives of an insurance company at the time of licensing or at any time thereafter may not be valid unless written approval is granted by the regulatory body
- The existing board remuneration is believed to be insufficient and not commensurate with the responsibility of the board of directors and the involvement of the regulatory body in fixing board remuneration is found to be unacceptable among the insurance family.
- The incompatible remuneration of board of directors is demotivating capable candidates to compete for board membership to serve as board of directors of insurance companies
- The audit committee is believed to be the most important board committee which is playing a critical role in ensuring the protection of shareholders interest and thereby improve the performance of insurance companies.
- It seems that the existing board committees are quite enough for the smooth operation of insurers. However there is no remuneration committee in all privately owned insurance companies as it is ignored by the regulatory body in its directive No-SIB/48/2015.

- Though there is almost full agreement on the importance of regulation to prevent dishonest insurers, there is significant disagreement on who to regulate the system as NBE is said to be independent.
- There is unnecessary intervention by the regulatory organ regarding board composition and compensation
- The regulatory body (NBE) is said to be not independent as it is responsible to the legislative body especially to the prime minister and as the governor of the NBE is also a political nominee.
- The regulatory system is neither effective nor capable to properly regulate the insurance industry as the attention of NBE is more to banks than insurance companies
- The insufficient attention given by the regulatory organ (NBE) to supervise the governance practices of Ethiopian private insurance companies is leading the insurance companies to demand for separate, independent and professional regulatory body.
- The absence of capital market is another factor affecting the corporate governance practices of insurance companies
- The knowledge and experience of board of directors and senior management of insurance companies on corporate governance is limited
- There is limited capacity building practice by the companies, board of directors and the regulatory organ
- There is no code of corporate governance practice at company and (National) country level
- There are not executive directors on the board composition of insurance companies as the regulatory organ directives are in favor of board of directors which are 100% composed of non-executive directors
- There is lack of adequate experience of board of directors in the field of finance in general and insurance governance system in particular.
- There is almost unanimous agreement among the insurance community that existence of good corporate governance mechanism is believed to have a positive and contributory impact on profitability, customer satisfaction, employees' motivation and building the image, trust and confidence of customers, reinsurers and other stakeholders.

4.3.2 The way forward

-
- The decision on board compensation shall be taken out of the blessing of the regulatory organ. It must be left to the decision of the shareholders to

make it attractive enough to invite and retain competent board candidates.

- The regulatory organ or the Ethiopian insurance association shall launch a financial sector capacity building center
- Although, in principle, the intervention of the regulatory organ is acceptable, the level of the intervention should consider the organizational setup and level of development of the insurers
- The regulatory body should refrain from regulating and supervising insurance companies and focus on the banking industry. Insurers should design and enforce self-regulatory standards through their association(commission) to be led by major shareholders as its board of directors
- There should a national code of practice that can be initiated by the Ethiopian insurance association and may be approved by the regulatory body
- There should be sufficient and continuous need based training and other capacity building in place. This can be done by the individual company or the insurance association or the regulatory body or by consortium.
- All necessary effort has to be made to establish a capital market to control the market but the involvement of the regulatory body should be limited to issuing rules and regulations which protect investors.
- The directive of the regulatory body which demands for the establishment of audit, risk management & compliance, human resources affairs as well as nomination & election board committee shall also give due attention to the establishment of the remuneration committee.

Chapter Five
Conclusion and Recommendations

5.1. Conclusions

Following the research findings, it can be concluded that corporate governance is relatively new phenomenon in Ethiopia. The legal and regulatory system is under developed. The regulatory organ which is mainly focusing on banks lacks adequate capacity and time to regulate insurance companies. The Ethiopian insurance industry is operating in an environment where there is no capital market, no national code of corporate governance, insufficient board remuneration which is fixed by the regulatory organ, executives are not allowed to be part of the board of directors, regulation is believed to inadequate and the industry is closed to foreign nationals. Moreover the points will be worth noting to have a complete figure on the conclusion-

- Demographically the participation of women in the board of directors is still at its infant stage
- Participants in the Ethiopian insurance industry are few in number compared to neighboring countries. Only 17 private insurance companies are operating in Ethiopian with a total population of above 100 million.
- The attention given to regulating the Private insurance companies seem to be inadequate as the authority to regulate the insurance companies is not separated from the National Bank of Ethiopia (NBE) and not established as separate and as big as the NBE
- There are no standard codes of corporate governance and benchmarks against which the corporate governance practices of insurance companies are assessed
- All private Insurance companies in Ethiopia are established as a share company with no room for the establishment of a private Limited Insurance company. Moreover all the privately owned insurance companies in Ethiopia are non-listed medium sized business and hence corporate governance under such circumstances need serious attention of the boards and the regulatory organ.
- The regulatory organ (NBE) is not in a position to regulate the competition by cutting prices especially n motor insurance and hence most motor insurers are in danger as almost all insurance companies are underpricing the motor insurance premiums

- There are enough and clear guidelines on corporate governance of private insurance companies of Ethiopia. However most of the guidelines are not properly understood, internalized and implemented
- There is no capital market along with the auxiliary bodies including analysts and the listing requirements of not only members but also companies whose shares shall be offered in such market
- Ethiopian insurance companies corporate governance system is a one-tier system composed of 100% of non-executive directors which devote insufficient time to lead and exercise effective control over the senior management of the companies.
- Unlike the OECD (2004) and the Cadbury Report (1992), all of which advocate for both executive and non-executive directors but with a majority of non-executive board of directors, the recommendation by NBE about the composition of insurance boards is totally in favor of a non-executive (outside) board of directors (Ethiopia Proclamation no. 86/1994, 1994)
- Disclosure and transparency can be viewed at an acceptable level which demands additional effort to improve the current governance practice of insurance companies.
- Little attention is given by the regulatory organ and the board of directors of insurance companies to the formation of an important board committee –the **remuneration committee**. Rather better attention is given to the election and nomination committee where the decision regarding remuneration is held by the regulatory organ which is found to be un acceptable by most of the insurance companies
- The power given to the NBE is very sufficient to meet its objectives. However if the central bank is responsible to the legislative body, it is relatively said it is independent. Where as in the Ethiopian case, since the NBE of Ethiopia is responsible to the executive body especially to the prime minster it is said to be relatively not independent. The governor of NBE is a political nominee where its term is not decide by a predetermined rule and can have a chance to be evaluated on a political ground and may not be in its performance.

- The impact of corporate governance on the performance of insurance companies is found to be immense leading to employees' satisfaction, building management confidence, improving the conduct of board and senior management members.

- All private Insurance companies in Ethiopia are established as a share company with no room for the establishment of a private Limited Insurance company. Moreover all the privately owned insurance companies in Ethiopia are non-listed medium sized business and hence corporate governance under such circumstances need serious attention of the boards and the regulatory organ.

5.2. Recommendations

- Women shall increasingly fill the list of board of directors. The election and nomination committee shall seek board member recruits who have demographic diversity of other groups of people that may represent the organization's mission in an important way.

- Ethiopia as a nation, need to have an independent insurance regulatory authority. This authority has to be separated from the National Bank of Ethiopia (NBE) and be established as separate and as big as the NBE.

- Ethiopia having an emerging free market economy shall put in place updated policies targeting the best practices of corporate governance so as to attract and protect local and foreign investors in the insurance business.

- There should be national policy to guide development of the insurance industry, foster the literacy of financial sector and open the insurance sector to foreign investors.

- It is time to develop standard codes of corporate governance and bench marks against which the corporate governance practices of insurance companies can be assessed.

- The government of Ethiopia shall not be reluctant to put in place the necessary legal framework to enable the private sector in general and the private insurance industry in particular to make a modest beginning in the establishment of capital market.

- The recommendation by NBE about the composition of insurance companies' boards which is totally in favor of a non-executive (outside) board of directors (Proclamation no. 86/1994, 1994) has to be revised so that non-executive board of directors be include in the board composition which is in line with the OECD (2004) and the Cadbury Report (1992), all of which advocate for both executive and non-executive directors but with a majority of non-executive board of directors.

- The NBE shall revise the fixed amount of board remuneration which is currently paid to the board of directors so that it will be in line with the commercial code of the country and the recommendation of the Cadbury report. The Commercial Code of Ethiopia allows directors to receive an annual remuneration the amount of which shall be fixed by a general meeting and charged against general expenses. Per this commercial code, the general meeting of the company may decide to give the directors a specified share in the net profits of a financial year that may not exceed 10%(ten percent) of the amount that may be distributed as dividend in that fiscal year which may be paid only where dividend has been distributed to the shareholders in that year..

- In addition to the currently functioning board committees ,it is highly recommended that there should be an additional and important board committee called **remuneration committee** consisting of wholly or mainly of non-executive directors and chaired by a non-executive director, to recommend the remuneration of board of directors to the board and the supervisory organ.

- **Investments committee** which is composed of board of directors, CEO,CFO and other important members shall be introduced .This subcommittee will be responsible to recommend investment policy and lay down the operational framework for the investment operations of the insurance companies with due attention to the liquidity for smooth operation, compliance with prudential regulatory norms on investments, risk management to ensure commensurate return on investments

- Proclamations issued by the regulatory organ, policy & procedure manuals as well as guidelines related to corporate governance have to be internalized by the board of directors and management staff of the companies. Most of the regulations issued by the regulatory organ have to be revisited for possible correction and amendments. To this end an initiative should be taken by the NBE to educate and train all the board of directors, management staff and the employees at large.

- The government is highly expected to expedite the introduction of effective corporate governance framework by not only by introducing capital market or stock exchange markets but also by establishing responsible institution to handle the development of laws and regulations, capacitating professional associations such as the accounting & auditing, chamber of commerce and others

- The final recommendation of this research is that more researches on corporate governance of Ethiopian insurance (private and public) companies have to be conducted to study the relationship between board structure and performance of private insurance companies in Ethiopia, to study the factors affecting the corporate governance practices and the impact of corporate governance mechanisms on the performance of private insurance companies, to study the effectiveness of the regulatory organ (The NBE) in supervising the insurance companies and how private insurance companies are responding to the assessments of the regulatory organ and to study the current board practices of Ethiopian private insurance companies practices in light of the OECD principles of corporate governance and other global best practices.

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Annexes1-

Questionnaire-

Dear Sir/ Madam

I very well understand that you are very busy but excellent at managing your time and share a fraction of your precious time to a friend like me who is in need of your devotion. Cognizant to that I am hereby politely requesting you to share me a fraction of your time in completing this questionnaire which is extremely helpful to my study/research

The Objective of my research is to study (1) the factors affecting the corporate governance practices (2) the impact of corporate governance mechanisms on the performance of private insurance companies (3) the effectiveness of the regulatory organ (The NBE) in supervising the insurance companies and how the private insurance companies are responding to the assessments of the regulatory organ and (4) the current board practices of Ethiopian private insurance companies in light of the globally accepted principles of corporate governance and learn from the experiences.

The result of this study will help private insurance companies to improve their performance and it will also be used as a benchmark/reference for subsequent studies and researches on corporate governance practices of Ethiopia.

The data which will be collected using this questionnaire is going to be used for the intended purpose with strict confidentiality.

Your Prompt action in completing the attached questionnaire is highly appreciated.

Sincerely Yours

Mulualem Berhane
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Ethiopia

Questionnaire

Part I. General –Please Answer the following Questions

1. Educational Back ground(Highest level of education) ________________
2. Position in your respective Insurance Company______________________
3. Gender____
4. Age____
5. Service years as a board, CEO, Senior management member___________

Part II Factors affecting the corporate governance of Ethiopian insurance companies						
Please rate the extent to which you agree or disagree with the statement by putting a tick mark on one of the followings – strongly agree, agree, Neutral, disagree, strongly disagree						
No	**Factors affecting corporate Governance**	**Strongly Agree**	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
1	Board of directors are exercising their role effectively to improve the performance of the company					
2	The board of directors are devoting adequate time to evaluate the operation and performance of the insurance Company					
3	The board compensation paid to the board of directors is adequate and compatible with their responsibility					
4	The board of directors and the management of the company have developed and implemented adequate policies and procedures					
5	Shareholders pressurizes the insurance company to make baized decisions					
6	The CEO has significant influence on the performance of the insurance company					
7	The board of directors are effectively evaluating and controlling the performance of the insurance company					
8	Senior management members are actively participating in the governance of the insurance					

	company					
9	There is visible conflict of interest that is observed in the activities of the board of directors					
10	The board chairman influence on the performance of the CEO is acceptable					
11	There are adequate number of standing committee and are effectively performing					
12	Board of directors are adequately informed and are knowledgeable about their role, responsibilities and function					
13	The board of directors actively participate during the preparation and implementation of strategic and operational plan of the insurance company					
14	Board of directors are accountable and responsible for situations that may cost them to the extent of relinquishing their position					
15	The Involvement of the government through different stake holders is at an acceptable/tolerable level					

Please indicate any other important factors that are currently affecting the corporate governance practices of the Ethiopian insurance companies-

Part III- Impact of corporate governance mechanisms on the performance of Ethiopian Insurance Companies

	Impact of corporate governance mechanisms on company performance	**Strongly Agree**	**Agree**	**Neutral**	**Disagree**	**Strongly Disagree**
1	Board size has positive impact on the performance of the insurance company					
2	The board composition (being Non-Executive board in Ethiopian case) has positive impact on the performance of the insurance					

	company					
3	Good corporate governance contributes a lot in building trust and confidence on customers, reinsurers and other stake holders					
4	The turnover of the CEO and senior management members has positive impact on the performance of the insurance company.					
5	Board of directors are receiving regular reports on the effectiveness of the internal controls					
6	Effective corporate governance framework imposes appropriate standards to recognize and protect the rights and interests of stakeholders					
7	Board of directors as corporate governance mechanism are important instruments to maximize shareholders wealth					
8	Good corporate governance has a positive impact on profitability of the insurance company					
9	Good corporate governance contributes to customer satisfaction and employees motivation in the insurance company					
10	Good corporate governance plays an important role in building the image of insurance companies					

Please indicate any other important governance mechanisms that are currently affecting the performance of private insurance companies

Part Iv- The Effectiveness of the regulatory organ (NBE) in supervising private insurance companies and how the companies are responding to the assessment of the regulatory organ

No	effectiveness of the Regulation practices of NBE	Strongly Agree	Agree	Neutral	Disagree	Strongly disagree
1	There are clear proclamations,					

	guidelines and directives issued by the NBE to ensure corporate governance in the insurance companies					
2	Proclamations, guidelines and directives are updated and revised at an acceptable range of time					
3	Adequate time, resources and attention is given by the regulatory organs of NBE to the regulate the insurance companies					
4	Insurance companies should not be regulated by NBE but rather need separate regulatory body					
5	The recommendation of NBE about the composition of board of directors which is totally in favor of non-executive directors is correct and acceptable by the Ethiopia's insurance companies					
6	There is an objective and professional relationship between the board of directors and the auditors of the insurance company					
7	The board/ Management is responsding to the assement of the regulatory body with good intention, completeness and established an audit committee that clearly deals with its duties and authorities					
8	The board regularly reports on the effectiveness of the insurance company's internal control system to the regulatory organ (NBE)					
9	The most important goal of insurance companies is promoting the solvency of the company					
10	Regulation is important to prevent dishonest insurers from taking advantage of consumers relatively uninformed position by eliminating inherent unfair contracts from market places					

Please indicate your observation on the regulatory system and forward any recommendation that may improve the current regulatory system of Ethiopian insurance companies						
Part v- The current board practices of Ethiopian Private Insurance Companies in light of the globally accepted principles corporate governance						
No	**Current Practices of the board of directors of Ethiopian insurance companies**	**Strongly agree**	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
1	The Current corporate governance practices in your insurance company is much better compared to those of the previous years					
	There is sound relationship between the board and top management members of your insurance company					
2	The relationship between the board and the CEO is smooth but not healthy					
3	Many of the issues that the board deals with add value to the shareholders					
4	The board is more involved in strategic matters than routine activities					
5	Limiting the tenure of the board of directors to be a maximum of 6 years is acceptable by the board and shareholders of the company					
6	Board of directors are independent of the influence of the board chairman					
7	Board of directors are effective in selecting, monitoring and replacing the CEO/President					
8	Having one re-insurance company at a national level is enough to the existing insurance companies operation					
9	Board of directors ensure proper disclosure and communicate with shareholders actively and					

	effectively					
10	The board of directors meets regularly, retain full and effective control over the company and monitor the executive management team					
11	Shareholders have the right to full disclosure of the information, voting rights, issuance of new shares, merger etc					
12	Interest of minority shareholders is protected by setting up systems that keep insiders from taking advantage of their roles					
13	Insider trading is explicitly prohibited and directors disclose any material interest regarding transactions					
14	The board is concerned about corporate strategy, risk management, executive compensation and performance of the insurance company					
15	Shareholders have access to the audited financial statements of the company					

Please indicate your observation on the current practice of the board directors of insurance companies and forward your recommendations to improve the current practices of the board of Ethiopian insurance companies

Part VI. Board structure (Composition, compensation, independence , board committee) of insurance companies and its impact on the performance of insurance companies

No	Relationship between board structure and company performance	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
1	The existing compensation of the board of directors is not commensurate with their responsibility					
2	The existing compensation of the board of directors have negative					

	impact on the performance of the insurance companies as it is not motivating and commensurate with their responsibility					
3	Compensation of board of directors should not be decided by the regulatory organ of the NBE. It should rather be decided by the shareholders following the commercial code of Ethiopia.					
4	The existing directive of NBE relating to the board composition (all being non-executive directors) has negative impact on the performance of the insurance company					
5	Ethiopian private insurance companies need to have executive board of directors with a majority of non-executive board of directors so that the performance of the company will be improved as the finance, IT and marketing activities will get enough attention of the board.					
6	The existing board compensation is attractive and as a result qualifies candidates are not attracted or motivated to serve as board of directors of insurance companies					
7	The existing board compensation is not attractive and is negatively affecting the independence of the board of directors, which in turns is may negatively affect the performance of the insurance companies					
8	Existing board compensation should be revised so as to link rewards to company and individual performance					
9	The existence of independent board of directors enhances the performance of private insurance					

	companies					
10	The audit committee is the most important board committee which is playing a critical trole in ensuring the protection of shareholder interest and thereby improve the performance of the insurance company					
11	The audit committee is working closely with the external auditor and has the responsibility to ensure the accuracy of the financial statements and report properly to outsiders.					
12	The absence of remuneration committee that deals with the compensation and benefits of board members and executives is negatively affecting the compensation system and the performance of the insurance company					
13	The existing board committee are allowing the board to have division of work and thereby maximizing the performance of the board and the insurance company					
14	The existing number of board committee such as the HR, Audit ,Risk etc are quite enough for the smooth operation and performance of the insurance company					
15	Board of directors are independent of the influence of the CEO/President					

Please indicate your observation on Board structure (Composition, compensation, independence , board committee) of Ethiopian insurance companies and its impact on the performance of insurance companies and forward your recommendations to improve the current board structure that is currently in place-

Annex 2 -Interview questions

TOPICS	Interview Questions
Board composition	• Does the insurance company have board nomination committee? How does it work? • Are you comfortable with the establishment of the Nomination and election committee? • How is the composition of the Board of Directors determined? • Do you think that the current structure of boards is acceptable? If not what do you think should be the right s mix? • Do you believe it is important to have both executive and non-executive directors on the board? • Do influential shareholders influence the nomination and selection of board members?
Board compensation	• Does the current level of remuneration of boards" impact on directors "performance? • Do you agree that the current board remuneration is attractive and shall be fixed by the regulatory organ? • Do you agree that the current remuneration package has negative impact on the performance and motivation of the board of directors?
Board independence	• Do you agree that non-executive directors are independent? • Do you agree that there is conflict of interest among the board directors?
Regulatory system	• Do you think that the proclamations and directives issued by the regulatory organ are strong? • Do you think that the regulatory organ is conducting strict control and adequate supervision on the

	insurance company's activities? • Do you thing the regulatory organ is working hard on the capacity building of its self, board of directors and senior management staff of the insurance companies? • What kind of training do you propose for the regulatory organ staff and the board of directors as well as senior staff of insurance companies?

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