



IMPACT OF CORPORATE GOVERNANCE ON BANKS EFFICIENCY USING VALUE ADDED APPROACH: THE CASE FROM TANZANIA

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Abstract

Corporate governance became one of the most important pillars in the financial industry. Good corporate governance in a developing country like Tanzania is essential for the survival of its economy. This study examines the impact of corporate governance on the efficiency of Tanzanian commercial banks by using a panel data analysis. The sample used in the study was 11 commercial banks covering the period 2010-2019. Corporate governance variables are represented by board size, board composition, number of committees, number of board meetings, and the size of audit committees. Bank efficiency has been given attention recently because traditional accounting and market performance measures are questionable in the appropriateness of measuring the banking industry's actual performance. In this study, Technical efficiency was used as dependent variables and was measured by using Data Envelopment Analysis (DEA) and regression analysis was used for finding out whether there is an effect of corporate governance on bank efficiency. The result shows that only two variables; board size and board composition have a statically significant impact on the efficiency of the banks.

Keywords: Bank efficiency, corporate governance, regression analysis, data envelopment analysis, Tanzania

INTRODUCTION

In every nation, the financial sector plays a significant role in the country's economy. After reform and transition in the early 1990s, the financial sector in Tanzania has undergone a significant structural change, the financial asset has expanded rapidly, driven by growth in private investors. Hence, the financial sector's contribution to the overall economy of Tanzania, cannot be overemphasized; for example, over the past few years commercial banks, mostly in developing countries have been called upon, to help and accomplish certain socio-economic objectives laid down by the state. Thus, banks help the state to develop trade and industry in the country, by the same token banks inspire habits of good management and saving. Banks help capital formation in the country, and it lends money to traders and manufacturers. Nowadays, banks are considered not just as dealers in money, but also leaders in economic development (Raphael, 2012).

In 2016 and 2017 Tanzania's commercial banking sector has begun to steady after many of the banks had to keep vast sums of money for impairment losses and bad loans. However, some of the banks operating in Tanzania such as CRDB Banks, NMB Bank, Barclays in Tanzania were left shocking after loans they made to the real estate sector between 2010 and 2015 started to sour, as plunging commodity prices contributed to a wider downturn in the economy. According to the International Monetary Fund (IMF), this overexposure to the real estate sector led to a jump in the industry-wide non-performing loan (NPL) ratio, which peaked at 11.5% in 2017, up from 6.8% in 2014. According to the Central Bank of Tanzania, 24 banks still had ratios exceeding 10% by the end of 2017. Though, the industry saw some development, with the overall ratio declining to 10.4%, by the end of 2018 (Mitchell, 2019).

All public companies in Tanzania are regulated by the Company Act 2002 (Melyoki, 2013). According to Part II of the Companies Act (CA, 2002), registration or incorporation of new companies is also provided for by the presentation to the Registrar of Companies, a Memorandum, and Articles of Association under section 14. This company Act 2002 gives a framework for the governance of corporations in Tanzania. The majority of the laws being used in Tanzania for the governing of companies are adopted from other nations, specifically European countries.

Tanzania is a country ruled by the former British colony which became independent in 1961. The British company law of 1929 was incorporated in Tanganyika in 1932. This law set the framework for the Anglo-Saxon model of corporate governance in Tanzania. This is showing that corporate governance existed long before Tanganyika gained its independence. Over the past decades, corporate governance practices in Tanzania have been discussed in the situation of state ownership of corporations where corruption, managerial incompetence, political

interference, and government subsidization of failing enterprises have been the defining features. (Kihyo, H., 2002)

This law was repealed in 2002, but some aspects of the old law continued to remain, including how the company is conceptualized, reflecting the original ideas of Great Britain in Nineteenth-century. The model which make out shareholder as the key constituency in corporations, (CA, 2002).

Also, within Company Act 2002, it does not specify a company should be made up of how many numbers of directors, but the practice on the ground is to create a single-tier board. The directors' roles are outlined in section VII of CA 2002. It requires that the company be held accountable to shareholders. This corporate responsibility will be achieved through the submission of annual financial reports at shareholder's meetings to enable shareholders to evaluate performance and make decisions as required. Moreover, in 2002, the Capital Markets and Securities Authority (CMSA) and the Corporate Governance Steering Committee in Tanzania declared separation, but in similar sets of principles for good corporate governance, which companies are expected to implement and execute.

The main target is to examine the effect of corporate governance on the banking efficiency in Tanzania. Corporate governance has been an important research area that deals with the different governance structures used to manage the company to maximize the resources of shareholders (owners). Some literature highlights, the significance issues of conflict of interest between shareholders and management (Jensen & Meckling,, 1976). When there are asymmetric information problems and the inconsistent contractual relationships between managers and shareholders, managers have opportunities to follow their interests at shareholders' expense.

Currently, corporate governance of banks appears to be more important than other industries, because the banking sectors play a crucial financial intermediary role in any economy, mostly in developing countries. Poor corporate governance of the banks can push the market to lose self-assurance in the ability of a bank to accurately manage its assets and liabilities, together with deposits, which could in turn cause a liquidity crisis and then it may cause the economic crisis in a country and create a huge systemic risk to the society (Cebenoyan, 2001).

In financial institutions, corporate governance is the collection of principles and guidelines used to establish a system in financial intermediaries. It sets up how financial institutions are directed and controlled, commonly through principles set for the conduct of the governing body and senior administration. Independent legal frameworks fluctuating from nation to nation cause noteworthy contrasts in corporate governance practices.

Corporate governance practices are extraordinarily vital in phrases of attaining high-efficiency stages for banks due to the fact of their extraordinary traits and complicated operations. The aim is to make contributions to the corporate governance literature with the aid of investigating the relationship between bank efficiency and corporate governance practices in Tanzania with a dataset consisting of the 2010-2019 period. Since there is no confined study evaluating the effect of corporate governance on Tanzania's banking sector, the purpose of this paper is therefore to bridge this gap in the literature.

LITERATURE REVIEW

Most studies has admitted that corporate governance can help firms to control agency problems (Daily & Cannella, 2003). The board of directors is one of the major corporate governance mechanisms. The board of directors is selected according to their professional and their experience of the operating activities of the firm or their network with outside parties. Therefore, managers are concerned with the recognition of situational and psychological variables aligning their interests with those of the principals (Davis, J. H., Schoorman, F. D., & Donaldson, L., 1997). The organization and its managers have special commitments to guarantee that the shareholders receive a fair return on their investments, and has special commitments to other stakeholders, this goes above and beyond those required by law (Freeman, R. E., 1989). On the other hand, (Dao, B. T. & Giang, H. T. H, 2012) oppose that the parties which are going to be affected in the company can be divided into two major groups; internal and external stakeholders. Internal stakeholders include executives, the board of directors, and employees whereas the external ones contain customers, suppliers, debt creditors, trade creditors, and shareholders. All these stakeholders are supposed in handling the development of the firm's performance in different ways with different purposes. The executive board, shareholders, and board of directors are all three parties who directly and substantially influence the company's success (Dao, B. T. & Giang, H. T. H, 2012) . The Corporate Governance functions have special obligations to ensure that the shareholders receive a fair return on their investment while at the same time ensuring the firm satisfies the obligations to the other stakeholders (Ondigo Herick Ochieng , 2003).

According to Muhammad Sheila et al (2011), the influence of corporate governance was investigated by the corporate governance mechanism. Bank efficiency was used to measure the performance of the banks due to the suitability of capturing the actual performance of the banking industry and efficiency seems to be given more attention recently. The results suggest that the performance of Malaysian banks is improved by a greater percentage of block ownership and a smaller board size. Also, (Cheema, K. U. & Din, M. S, 2013) used three

corporate governance variables; board Size, family controlled firms, and CEO duality to measure the financial performance in the Cement industry of Pakistan. The result came with a positive result that there is a positive significant relationship between corporate governance and firm performance. However, (Okere, W. & O. I., 2019), revealed that there is a positive and significant relationship between corporate governance (board size, board independence, and audit committee independence) and investment decisions of shareholders. On the other hand, Staikouras, et al.,(2007), argue that that performance is negatively connected to the size of the Board of Directors, while the impact of the Board composition mostly is insignificant.

Ibrahim (2019), examine the relationship between SMEs corporate governance, the structure of capital, and the structure of ownership in Ghana. The study showed that a positive relationship exists and the ownership structure is found to be positive and substantially linked to the capital structure across all corporate governance variables, except for board size. However, (Abdulazeez , Ndebel, & Mercy., 2016), found that a larger board size contributes positively and significantly to the financial performance of deposit money in Nigeria banks. Though, (Odili, Ikenna, & Orikara , 2015), revealed that Board Independence, directors' shareholding, and audit committee meetings had positive and significant effects on the banking sectors' performance, while Board Size showed a negative and significant effect on the Nigeria Banks 'performance.

RESEARCH METHODOLOGY

For the study; a two-step method has been employed. Primarily; Data Envelopment Analysis Program (DEAP) has been used to test the efficiency using Data Envelopment Method (DEA) to measure the efficiency of Tanzania commercial banks during 2010-2019. Then; a multiple regression model has been derived and analyzed by the panel data analysis to test the relationship between dependent variables and independent variables of this study. The table 1 represents the code used to represent the banks in this study.

Table 1: Decision-Making Units (Banks) and Their Codes

	Tanzania Commercial Banks	Code
1	NMB Bank	B1
2	CRDB Bank	B2
3	Exim Bank	B3
4	Azania Bank	B4
5	I and M Bank Tanzania	B5
6	Akiba Commercial Bank	B6
7	CBA Bank	B7
8	Mkombozi Commercial Bank	B8
9	ICB Banks	B9
10	DTB Bank Tanzania	B10
11	DCB Bank Tanzania	B11

Determining input-output which is utilized to calculate efficiency is one of the paramount phases either when utilizing a parametric method or nonparametric method. There are several concepts which conventionally utilized in determining the relationship of input-output, the operating approach, the intermediation approach, and more recently, the revenue or (value-added) approach. This research will incorporate the proposed value-added Approach (Drake et.al, 2006). The value-added approach recognizes the balance sheet category accounts as outputs that contribute to the bank value-added.

Deposits and loans are treated as outputs in this approach since these balance sheet variables are responsible for generating value-added (Eltivia, 2013). To apply with this approach the study decides to choose two inputs (Capital and Interest expenses) and two outputs (Deposit and Loans).

Table 2: Value Added Approach-Inputs and Outputs

Approach	Input	Output
Value Added	Capital	Loans
	Interest Expenses	Deposits

Empirical Model and Sample Selection

The dependent variable used in this study is the technical efficiency of the banks which was measured using the DEA analysis model. The input and output variables that are used to calculate technical efficiency were adopted from (Eltivia, 2013); whereby capital and interest expenses were used as input and deposit, and loans were used as output. There are six independent variables; board size, board composition, number of meetings held during the year, number of committees, and the size of audit committee. Finally, the empirical model of the study also includes two control variables; firm size and leverage. The comprehensive empirical model is as follows:

$$\text{EFFICIENCY} = \beta_0 + \beta_1 \text{BS} + \beta_2 \text{BC} + \beta_3 \text{NBM} + \beta_4 \text{NC} + \beta_5 \text{ACM} + \beta_6 \text{TA} + \beta_7 \text{CL} + \epsilon_{it}$$

Where,

Efficiency Performance is measured using two inputs and two outputs from the balance sheet of the banks; where; capital and interest expenses were used as input and deposit and loans were used as output. BS -Board Size; it represents the number of board of directors during the year. BC represents board composition this represents the percentage of non-executive director in the banks during the year; and is calculated by taking the number of non-executive director divide by the total number of directors. NBM represents the number of board meetings held during the year. NC represents the Number of the committee during the year. SAC represents

the Size of the audit committee during the year .TA represents Firm size, measured by Log of total assets CL represents Leverage, measured by total assets over total equity.

The Sample used in this study were eleven commercial banks both listed and unlisted. We include those listed and unlisted because the availability of only listed commercial banks in Tanzania is few in numbers. Also, the availability of annual financial statements of the banks was very hard. Sample data have been collected from 2010 until 2019. The time period was selected after the global financial crisis. With believing that global financial crisis enforce not only Tanzanian banks but all over the world to improve their corporate governance practices. The total number of observations is 110 observations. Data were collected from the annual reports of the companies. The statistical method used in this study is panel data analysis (generalized least square method). The generalized least square method is used because the sample data are not normally distributed and the data have either a heteroskedasticity problem, autocorrelation problem, or both. According to (Gujarati D. , 2003), using a generalized least square method will overcome all these problems. The study used lag variables to correct autocorrelation problems and to provide robust estimates of the impact of independent variables. The lag variables form the model to be as follow:

$$TE = C(1) + C(2)*TE(-1) + C(3)*BS(-3) + C(4)*NEDS(-3) + C(5)*NBM(-3) + C(6)*NC(-3) + C(7)*SAC(-3) + C(8)*LLEVERAGE(-3) + C(9)*LBANK_SIZE(-3) + [CX=F]$$

Hypotheses Development

The hypotheses of this study are going to be tested to measure the technical efficiency of the banks. DEAP software has been used to test the efficiency using DEA analysis of the banks in each year and then regression analysis used to test the relationship between dependent variables and independent variables of this study.

The study develops the following hypotheses:

- The board size has a positive significant impact on bank efficiency
- The higher ratio of non-executive directors has a positive impact on bank efficiency.
- The frequency board meetings have a positive significant impact on bank efficiency.
- The higher the number of committees has a positive significant on bank efficiency
- The size of audit committees has a positive significant on bank efficiency

FINDINGS

Table 3 represents the DEA result which shows the efficiency score of the banks for each year. Table 4 represents the descriptive statistics of the study and Table five represents the regression result of the study.

DEA Result

The technical efficiency results or efficiency score range between 0 and 1. When the banks have 1 it's seems that year the banking has got the highest efficiency score. In this study, the highest efficiency score varies from bank to bank and from year to year. For instance, the table shows that B1 has got the highest efficiency score for 7 years continuously.

Table 3: Efficiency Score of Decision Making Units (Banks)

2010		2011		2012		2013		2014	
DMU	Score	DMU	Score	DMU	Score	DMU	Score	DMU	Score
B1	1	B1	1	B1	1	B1	1	B1	1
B2	1	B2	1	B2	1	B2	1	B1	1
B3	1	B4	0.891	B5	0.925	B5	0.995	B5	1
B10	1	B5	0.665	B3	0.786	B7	0.912	B7	1
B4	0.891	B10	0.619	B7	0.781	B4	0.842	B9	1
B6	0.816	B6	0.594	B4	0.769	B10	0.799	B4	0.934
B11	0.776	B3	0.584	B10	0.759	B9	0.794	B10	0.894
B7	0.763	B9	0.529	B9	0.730	B6	0.703	B6	0.890
B5	0.737	B11	0.496	B6	0.724	B3	0.656	B8	0.603
B9	0.736	B7	0.479	B11	0.482	B8	0.642	B3	0.558
B8	0.626	B8	0.387	B8	0.456	B10	0.448	B11	0.435
2015		2016		2017		2018		2019	
DMU	Score	DMU	Score	DMU	Score	DMU	Score	DMU	Score
B1	1	B1	1	B10	1	B4	1	B4	1
B1	1	B2	1	B2	0.973	B1	0.940	B8	1
B5	1	B4	1	B5	0.961	B2	0.826	B2	0.982
B6	1	B5	1	B1	0.919	B8	0.825	B10	0.922
B4	0.984	B10	0.898	B8	0.897	B10	0.787	B1	0.786
B7	0.938	B6	0.832	B3	0.859	B5	0.768	B6	0.772
B9	0.903	B3	0.774	B4	0.769	B3	0.757	B3	0.677
B10	0.848	B9	0.741	B6	0.665	B6	0.634	B7	0.617
B8	0.670	B8	0.722	B7	0.581	B11	0.586	B5	0.497
B3	0.648	B7	0.689	B11	0.586	B9	0.551	B9	0.426
B11	0.460	B11	0.521	B9	0.568	B7	0.482	B11	0.339

Descriptive Statistics Result

The statistics for board size show that in general, the mean board size is eight directors, with a minimum of five and a maximum of thirteen for the whole sample of the 11 commercial banks which are used in this study. When considered the company act of Tanzania; every company shall have at least two directors. According to the study it is possible to say that this value may be measured as an indicator of effectiveness.

As shown in the table, an average of 78% of board members is non-executive directors, ranging from 50% to 92%. Most of the previous studies have shown that the more non-executive directors presented in the board, the more independent the board is, with congruently condensed information asymmetry between shareholders and managers (Black et al. 2006).

The average composition of boards having 78% is appropriate according to the corporate governance code of Tanzania and international norms. The average number of board meetings and number of committees held during each financial year is 6.6% and 3.6% respectively. The mean value of the size of the audit committee is 4.3%. The average of banks' efficiency scores is 0.78. According to the inputs and outputs used in the DEA method; it is possible to say that this score may be considered as a high score for the banks analyzed in this study. The table below shows the result of the descriptive statistics before the lag variables. Finally, the mean of bank size and leverage are 26% and 7.3% respectively.

Table 4: Descriptive Statistics Results

Variables	Observation	Mean	Median	Std. Dev.	Min	Max
TE	110	0.784664	0.786500	0.189395	0.339000	1.000000
BS	110	8.454545	8.000000	1.815511	5.000000	13.000000
NEDS	110	0.788479	0.800000	0.087327	0.500000	0.923077
NBM	110	6.690909	6.000000	3.094077	4.000000	19.000000
NC	110	3.681818	4.000000	1.203449	1.000000	7.000000
SAC	110	4.327273	4.000000	1.109666	3.000000	8.000000
Bank size	110	26.70072	26.55536	1.486889	22.41498	29.51140
Leverage	110	7.387055	7.387055	1.804376	3.961651	13.91519

Table 5: Results of Fixed Effect Model and the TE as Dependent Variable

Independent Variables	Coefficient	t-statistics	P-Value
C	1.729184	2.706417	0.0089
LAG1TE	0.587913	5.046496	0.0000
LAG3BS	-0.043836	-2.758662	0.0078
LAG3NEDS	-0.504374	-2.006564	0.0495
LAG3NBM	-0.000946	-0.096945	0.9231
LAG3NC	-0.015731	-0.951945	0.3451
LAG3SAC	0.015612	0.807265	0.4228
LAG3LBank_Size	-0.019413	-0.886382	0.3791
LAG3LLEVERAGE	-0.018175	-2.115666	0.0387
R-Square	0.738444		
Adjusted R-Square	0.657272		
F- Statistics	9.097236		
P.Value	(0.0000)		
Hausman Test			
Chi-Square Stat.	21.171364		
Probability	(0.0067)		
Likelihood Ratio Test	2.445412		
	(0.0164)		
Durbin-Watson Stat	2.039876		
Imtest, White (RESID^2)	0.1797 - 0.5060		
Multicollinearity			
VIF Test	1.026628 - 1.222792		
Normality test			
Jargue-Bera	1.585309		
Probability	0.452642		
Levin-Lin-Chu Unit-Root Test			
*Panels are stationary (p-value)	0.000		

Table 5 represents the fixed effect regression model for the ratio of efficiency score and corporate governance variables. In panel results, the Hausman specification test was used to select between the fixed effect model and the random effect model. According to Hausman test statistics results; it is seen that there is a fixed effect in the regression model. Therefore; the random-effects model was not appropriate in this model. However, the likelihood ratio test was performed in predicting whether the fixed-effects model is better than the pooled Ordinary Least Square (OLS) for the model. Test results have shown that the fixed-effects model is more reasonable for the model.

Finally, to predict the outcomes of the model; the imtest, white has been performed to detect the presence of heteroskedasticity; the model p-value ranges from 0.1797 to 0.5060 this means that the model is homoscedasticity. According to the Durbin-Watson stat autocorrelation test when the Durbin Watson is less than 2 the model has a presence of autocorrelation. In this model, the presence of autocorrelation has been corrected using lag variables. For the variables used in the model, the variance inflation factors (VIF) is between (1.02 and 1.22). This suggests that there are no issues with multicollinearity in the model, as all VIF values are less than 10 (Gujarati D. N., 2003). Thus, it can be concluded that between the independent variables there is no multicollinearity problem. The Jaque-Bera result statistic result is 1.585309 and the probability is 0.452. Therefore the hypothesis is not rejected and the normality test was normally distributed.

The regression model which include five independent variables and two control variables; its result in R-square of 73.8 percent and Adjusted R-square of 65.7percent for the efficiency model. This means that all variables used can explain 65.7 percent of the variation of efficiency of Tanzania commercial banks that are scrutinized in this study. The model's P-Value is 0.000 which indicates that the dependent and independent variables have a statistically significant relationship.

Distinctly, all of the variables except board composition (Non-executive directors) and board size are statistically insignificant. The results have shown that number of the board meeting held during the year and the number of the committees have a negative and insignificant impact on the efficiency of the banks. As for the size of the audit committee have a positive and insignificant impact on banks' efficiency. Board size and board composition have been found to have a negative significant impact on bank's efficiency. Bank size used as a control variable has a negative and insignificant impact while leverage has a negative significant impact on banks 'efficiency.

CONCLUSION

The result of this study found out about have substantial implications for banks in Tanzania on the description that only board composition (non-executive directors) and board size variables persistently appear to have higher efficiency. More recent studies (Vo & Nguyen,, 2014) for Vietnamese firms; (Palmberg, 2015) for Swedish firms, and (Issarawornrawanrch, 2015) for Thai firms found the significant relationship between the proportion of non-executive directors and the firm performance.

Most of the previous studies show that the higher proportion of NEDs in a board indicates better oversight and therefore decreased agency problems (Fama & Jensen, 1983; Shleifer, & Vishny 1997), however this study shows the opposite. The smaller the number of non-executive directors brings about higher efficiency to the company, thus companies should have limited/lower number of the non-executive directors for higher efficiency. Most of African companies interchange non-executive directors this cause the idea of independency in decision making not to work. The result support the idea of having limit number of non executive directors so as to avoid the problem of independency in decion making. On the other hand, bank size appears to have a negative significant relationship on the bank's efficiency; this means that the smaller body size, the higher its influence on banks' efficiency. The rest of the corporate governance variables do not appear to have an extensive and constant effect on banks' efficiency.

This study would help to develop and improve good corporate governance practice in Tanzanian Commercial banks. Optimistically this study will be an alarm of creating awareness amongst practitioners, researchers, academics, politics, investors, and the nation at massive which in turn will assist to enhance the country's competitiveness in attracting overseas investments, as properly as encouraging local entrepreneurs to make investments. Finally, the study intended to contribute to knowledge and further study of reputable knowledge in corporate governance performance. The following recommendations are made on the basis of the study findings:

1. Some factor such as corruption, managerial incompetence, and political obstruction cause the powerless system of corporate governance in Tanzania (S.E, 2014). Further enhancement of the Tanzanian Guidelines for Corporate Governance and corporate governance laws for banks will be a major achievement in the commitment towards sifting through and safeguarding the situation.
2. The study is limited to eleven commercial banks in Tanzania and based on data for ten years after the financial crisis period from 2010-2019. Another limitation is concerning the availability of data; only eleven banks' financial statements were available during the

study. Therefore; diversifying the sample and increasing the observation period maybe provide more consistent results for further studies. Since this study focuses on the impact of corporate governance on banks efficiency, future studies should also concentrate on the other Board of Directors' competencies, technical skills and examine the decision-making process of corporate governance and the environmental factors that can influence corporate governance system.

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