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Corporate Governance and Financial Performance of Nepalese Commercial Banks

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ABSTRACT
Background: Corporate governance is the process of balancing and protecting the interest of all stakeholders through rules, regulations, code of conduct, systems, procedures and activities. This paper focuses on examining the influence of corporate governance on banks performance measured by return on assets (ROA) of Nepalese commercial banks. Methods: This study utilized quantitative research approach with causal comparative research design. Total sample of this study consists of 12 commercial banks for the 11 years period from 2009/10 to 2019/20 out of currently operating total commercial banks of 20. Result: The corporate governance is considered as leverage ratio, ownership concentration, board meetings, audit committee size had mixed impact on banks performance. Leverage ratio, ownership concentration, firm size and net interest margin have significant positive influence on ROA. However, age of the firm has negative influence on firm performance. This study utilized ordinary least square (OLS) method and documented that the corporate governance had significant impact on the financial performance of Nepalese commercial banks. Finally, evidence supports those Nepalese commercial banks can ensure their better financial performance by ROA by enhancing effective corporate governance practices.

Keywords: *Banks, Board, Corporate governance, Performance, Return and Value*

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INTRODUCTION

Corporate governance refers to the structure, processes, procedures, and mechanisms that guide a firm's direction and management, ensuring long-term shareholder value through accountability, responsibility, equity, and discipline (Strine, 2010). Shleifer and Vishny (1997) define it as the system by which institutions are controlled, balancing stakeholder interests. The rising global interest in corporate governance is attributed to privatization, pension fund reforms, capital market integration, and economic crises (Brekman et al., 2002). Effective corporate governance minimizes conflicts between stakeholders, enhancing firm value (Shleifer & Vishny, 1997). Essentials for good governance include transparency, fairness, accountability, and responsibility (Ehikioya, 2009). Aras and Crowther (2008) highlighted its benefits, including improved performance, risk management, and enhanced corporate reputation, with broader societal advantages such as fighting corruption and fostering sustainable growth.

In Nepal, corporate governance practices are increasingly important for financial sector performance. Nepal Rastra Bank (NRB) and the Bank and Financial Act (Borghesi, 2017) regulate corporate governance, emphasizing its significance for financial stability. Studies in Nepal (Poudel & Hovey, 2013; Pradhan, 2015; Gnawali, 2018) shows that good governance positively impacts financial performance, but debates continue about its effects in Nepal's regulated banking sector. This study examines corporate governance's impact on

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the financial performance of Nepalese commercial banks, particularly through Return on Assets (ROA).

METHOD

This study adopted quantitative research approach and utilized descriptive and causal-comparative research design to examine the impact of corporate governance on financial performance of Nepalese commercial banks. The total population of the study is the total number of commercial banks currently operated in Nepal (20 commercial banks till January, 2024) licensed by NRB. Twelve commercial banks were considered as a sample for the study based on following criteria like operation of banks of more than ten years (till FY 2019/2020), not incurred losses during the study period, non-inclusion of government banks due to direct or indirectly influenced by the government and they have not negative net worth till the study period. This study utilized the secondary type of data collected from their annual reports through downloading from their websites and also some necessary data were collected from NRB websites like name list of banks and their date of operation date. The collected data were analyzed by utilizing descriptive statistics, regression analysis, and hypothesis testing. The SPSS version 25 and Microsoft Excel were utilized for computation of results. Finally, the basic model of this study is;

Financial Performance = f (Corporate Governance, and Control variables)

In this study leverage ratio (LR), board meeting (B Meeting), audit committee size (AC Size) and ownership concentration (OWC) were considered as independent variables. Similarly, firm size (F Size), net interest margin (NIM) and age of the firm from establishment (age) werer incorporated as control variables. The financial performance of commercial banks is measured by ROA. Finally, the error terms were also incorporated for the purpose of examining the impact of other variables which were not considered (or ignored) in this study.

Finally, following regression equations was developed and utilized to examine the impact of corporate governance on financial performance of Nepalese commercial banks.

Symbolically,

$$ROA = \beta 0 + \beta 1\ LR + \beta 2\ B\ Meeting + \beta 3\ AC\ Size + \beta 4\ OWC + \beta 5\ F\ Size + \beta 6\ NIM + \beta 7\ Age + \varepsilon i$$

The fitted model was appraised using F-statistics, R square, adjusted R Square, VIF, D-W test for auto-correlation and p value. Similarly, normality test is conducted by utilizing K-S test of residuals.

This study is practicable for the commercial banking sectors. So, the results might or might not be applicable in other banking sectors of Nepal expect the commercial banking sectors and use of proxy variables might lose to capture of the actual value.

RESULT

The results of sample of twelve commercial banks for ten-year period of 2009/10 to 2019/20 are presented. The ROA, LR, OWC and NIM are presented in fraction. F Size is measured in natural logarithm of the total assets. Audit committee size, board meetings and age of the firms are presented in absolute term.

Table 1. Descriptive Statistics of Selected Variables of the Study

Variables	Min.	Max.	Mean	SD
Return on Assets	0.00	0.03	0.02	0.01
Leverage Ratio	0.83	0.95	0.90	0.02
Board Meeting	12.00	47.00	20.35	8.59
Audit Committee Size	3.00	6.00	3.65	0.71
Ownership Concentration	0.00	3.00	1.74	0.66
Firm Size	4.11	5.24	4.69	0.27
Net Interest Margin	0.01	0.05	0.03	0.01
Age of the Firm	2.00	34.00	17.05	8.88

It measures the degree of movements among the variables with directions. In this section, the correlation coefficient among corporate governance, financial performances and control variables of Nepalese commercial banks are considered. The detail of correlation coefficient among variables is presented in Table 3.

The relationship of ROA with ownership concentration, firm size, net interest margin and age is positive and significant which indicates that these variables are related positively related to ROA.

The correlation coefficient among all variables

Table 2. Correlation Coefficient among the Variables of the Study

Variables	ROA	LR	B Meeting	AC Size	OWC	F Size	NIM
LR	0.451**	1					
	-0.001						
B Meet	-0.249	-0.203**	1				
	-0.109	-0.033					
AC Size	-0.089	0.119	-0.034	1			
	-0.355	-0.214	-0.726				
OWC	0.031**	0.276*	-0.632**	0.117	1		
	-0.012	-0.039	<0.001	-0.087			
F Size	0.512**	-0.349**	-0.128*	-0.230*	0.389**	1	
	<0.001	<0.001	-0.027	-0.016	<0.001		
NIM	0.542**	-0.043	-0.123	0.327**	0.227*	0.179*	1
	<0.001	-0.688	-0.241	-0.009	-0.031	-0.047	
Age	-0.423**	-0.101	0.192	-0.111	0.371*	0.792**	0.491**
	<0.001	-0.293	-0.097	-0.25	-0.021	<0.001	<0.001

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

** Correlation is significant at the 0.05 level (2-tailed).*

Note: Figure in parentheses are P-values

Table 3. ROA and Regression

Variables	Model 1	2	3	4	5	6	7
Constant	2.37	2.25	2.13	2.35	2.58	2.79	2.08
	0.00	0.00	0.00	0.00	0.00	0.00	-0.03
LR	0.04	0.05	0.07	0.05	0.08	0.08	-0.03
	-0.02	-0.02	-0.01	-0.02	0.00	0.00	-0.02
VIF	1.11	1.41	1.13	1.48	1.69	1.16	1.15
B Meet		0.00	0.00	0.00	0.00	0.00	0.00
		-0.28	-0.22	-0.12	-0.23	-0.18	-0.27
VIF		2.14	1.86	1.53	1.17	1.49	1.77
AC Size			0.00	0.00	0.00	0.00	0.00
			-0.30	-0.37	-0.99	-0.95	-0.96
VIF			1.79	1.12	1.35	1.87	1.95
OWC				0.03	0.02	0.03	0.00
				-0.02	-0.02	-0.03	-0.02
VIF				1.78	1.46	1.91	1.07
Age					0.00	0.00	0.00
					0.00	0.00	0.00
VIF					1.18	1.19	1.19
F SIZE						0.01	0.01
						0.00	0.00
VIF						1.17	1.86
NIM							0.40
							0.00
VIF							1.99
R^2	0.10	0.15	0.19	0.33	0.44	0.52	0.62
Adj. R^2	0.09	0.13	0.17	0.29	0.42	0.50	0.59
F Value	2.00	3.04	4.55	5.28	12.59	13.73	22.08

1.The results were based on pooled cross-sectional data of 12 commercial banks with 132 observations for the period of 2009/10 to 2019/20 by utilizing OLS model. The model is:
$ROA = \beta 0 + \beta 1\ LR + \beta 2\ B\ Meet + \beta 3\ AC\ Size + \beta 4\ OWC + \beta 5\ F\ Size + \beta 6\ NIM + \beta 7\ Age + \varepsilon i$
2. Figure in parentheses are P-values

3. Dependent variable is Return on Assets

is less than 0.70 indicates that there is no signal of multicollinearity (Sekaran & Bougie, 2016). The correlation coefficient between ROA and board meeting is significantly negative which shows that change in board meeting affect the ROA negatively. However, the correlation between ROA and leverage ratio and ROA as well as ROA and audit committee size have negative but the relationship is insignificant.

ROA and OLS Result

By utilizing ordinary least square (OLS) model, the minimum variation of ROA explained by all independent variables is 9.60 percent in model 1 and the maximum variation is 61.50 percent in model 7. The exact explained by all independent variables is represented by adjusted 'R' square is 8.90 percent to 58.70 percent. The p value of model 2 to model 7 is less than 0.05 indicates that the fitted models are significant. There is no problem of multicollinearity due to VIF is less than 10 of all coefficients. Based on Durbin-Watson (DW) test, there is no serious autocorrelation. Finally, the residual of the fitted model (inclusion of all variables) is appraised using K-S test. The detailed of results of ROA and OLS results were presented in the Table 4. The coefficient of debt capital is positive and significant at 5 percent level which indicates that debt capital positively influences the ROA which might be debt capital is the lowest cost source and tax advantage facility. The ownership concentration has significant positive influence on ROA of Nepalese commercial banks that might be block-holders are the major shareholders and focus on making adequate decision for better performance. The age of the firm operation from establishment has negative influence on firm performance which might due to new commence firm utilized new strategy and increase their competitive power compare to higher age firm. The coefficient of firm size is positive indicates that larger the firm size higher will be the firm performance measured by ROA. This result might be larger firm will have more competitive strength and economies of scale compare to small firm as well as higher access in the market place. The NIM has significant positive influence on firm performance of ROA. Higher the NIM, higher will be the ROA due to banks profitability is mainly depend upon interest earning. Higher the difference between interest earning and interest expenses, higher will be the NIM that leads to higher ROA. However, number of board meeting and number of audit committee size have no significant influence on ROA. Finally, the residuals are normally distributed due to p value of residual is higher than 0.05 (the p value of K-S test is 0.419 of model 7) and there is no any pattern of residuals. So, residuals are random.

DISCUSSION and CONCLUSION

This study focusses on examining the influence of corporate governance on financial performance of Nepalese commercial banks measured by ROA. This study utilized twelve commercial banks as sample based on operation more than 10 years among 20 commercial banks till January, 2024. This study adopted descriptive and analytical research design and utilized the secondary source of data of banks till 2019/20 by downloading form their websites. Finally, evidence justified that corporate governance has significant influence on financial performance measured by ROA of Nepalese commercial banks. The debt capital has significant positive influence on ROA of Nepalese commercial banks due to leverage has positive influence due to interest is a tax-deductible source as well as low-cost source. This finding is consistent with the finding of (Abor, 2005; AlSagr et al., 2018). However, this result is contradicting with the finding of (AlGhusin, 2015; Saidat et al. 2018) due to debt is the low-cost source of capital. The OWC has positive influence on ROA due to it minimize the agency problems and block-holders make adequate decision for better performance of the firm. This result is similar finding of (Saidat et al., 2018). But this finding is contradicted with the finding of Abobakr (2017). Bank size is measured by total assets of banks has positive influence on ROA. This finding is consistent with the finding of AlSagr et al. (2018) and Saidat et al. (2018) due to larger firm has more access in external financing as well as they have obtained economies of scale. NIM is the ratio of net interest income and total assets has positive influence on ROA due to interest income is the major source of banking earning that determines the net interest income as well as NIM is the basic earning of the banks. This finding is consistent with the finding of (Poudel et al., 2012; Lartey et al., 2018). Age is the number of operations of the banks from their establishment has negative influence on ROA due to older firm have more challenge in obtaining diversity and new strategy compared with new one and this finding is consistent with the finding of Elif (2016) and contradict with the finding of (Anasweh, 2021). Finally, board meeting and audit committee size have no any significant influence on ROA of the Nepalese commercial banks.

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