

Stakeholders' View on Role of Corporate Governance Practices on Financial Performance of Financial Institutions in Nepal

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Abstract

This study aims to examine the influence of corporate governance (CG) practices on the financial performance (FP) of the financial institution in Nepal, as well as the mediation effect of commitment to effective CG within the relationship. The structured questionnaire was used to administer the cross-sectional survey with 386 key stakeholders. The survey followed a convenience sampling technique. The study analyzes the hypothesized relationship among variables by using the partial least square structural equation modeling (PLS-SEM). Results show that CG practices, including board responsibility and accountability, and equitable treatment of shareholders, have a direct effect; however, disclosure and transparency have only an indirect effect on improving financial performance. The study found the mediating role of commitment to effective CG in the association between CG and FP. The study offers valuable insights for regulators and practitioners regarding how to improve performance through strengthening the CG practices and commitment.

Keywords: Board responsibility, Corporate governance, Disclosure and transparency, Equal treatment of shareholders, Financial institutions

Introduction

Corporate governance is a dynamic notion that is evolving to address the needs of corporate managers and getting attention as a primary area of research (Affes & Jarbou, 2023). It involves the processes and structures that ensure the fulfillment of stakeholders' interests and a firm's overall well-being. Good corporate governance is centered on the principles of "accountability," "transparency," "fairness," and "responsibility" in the management of the firm (Aras & Crowther, 2008). According to the OECD Principles (OECD, 2004), corporate governance comprises a set of relationships among the management, board of directors, controlling shareholders, minority shareholders, and other stakeholders. Moreover, it emphasizes the duties and responsibilities of the board and the dynamics of the board with shareholders (Zelalem et al., 2022). The board plays a crucial role by giving advice to management, monitoring managerial actions, and providing access to key resources in the corporate firm (Ntim, 2015). Hence, the policies, procedures, and practices that guide the operation and management of the firm are referred to as corporate governance (CG) (Bui & Krajcsák, 2023). In short, corporate governance develops a system of directing and controlling the corporate firms.

Financial institutions are subject to "legislative and prescriptive procedures," "policies," "rules and regulation," which limit the board of directors' discretionary power; that is especially true in regulated financial systems (Zelalem et al., 2022). Strong corporate governance should be encouraged to serve the interests of all stakeholders that ultimately contribute to the value creation of the bank (Boachie, 2021). However, corporate governance characteristics are evolving, which may also impact the financial performance of the firm (Singh & Rastogi, 2022). In this context, the study indicates that rather than maximizing CG alternatives only, corporate firms should endorse the

best use of CG (Tshipa et al., 2018). In contrast, Pintea et al. (2020) claim no effect of corporate governance on the financial performance of the firm. Hence, in this conflicting situation, Akinleye et al. (2019) argue that it is necessary to understand the corporate governance dynamics and act accordingly to produce the intended results instead of focusing on the numbers alone.

According to Jamil et al. (2020) corporate governance refers to a network of regulations through which companies, management, and shareholders regulate their conduct. Corporate governance would gain an economic advantage when it was able to reduce agency costs and risks while enhancing the financial performance of the firm (Bui & Krajcsák, 2023). Specifically, corporate governance could support top management in efficiently distributing their scarce resources during strategic planning and decision-making processes (Lu, 2021). Moreover, sound corporate governance practices produce better financial performance by improving the sustainability performance of the firm (Donnir & Tornyeva, 2024). In this context, Aras and Williams (2016) emphasize that the causes that reduce the credibility of corporate firms and financial markets are inadequate internal controls, weaknesses of board oversight, and a lack of effective supervision in corporate governance. After suffering from the huge global economic crisis in 2008, researchers have increasingly recognized the need for proper governance of organizations (Aras et al., 2017). Researchers argue that agency problems and information asymmetry are creating problems in a firm's performance due to the absence of robust corporate governance practices (Singh & Rastogi, 2022). In this situation, countries are reassessing their laws and regulations regarding governance structure to safeguard the businesses and protect them from bankruptcy (Aras & Williams, 2016).

Good financial performance is a prerequisite for the sustainability and stability of banks. Many prior studies have established the direct association between CG and a firm's performance; however, study results are not conclusive. In addition, there is a lack of studies based on primary data since the majority of the prior studies are based on the secondary data. The lack of a valid measurement scale for corporate governance and performance and the use of various methods and techniques in this regard created inconsistencies in the results of the prior studies (Pintea et al., 2020). Hence, this study fills this gap. Furthermore, as corporate governance characteristics are evolving, it seems essential to study the CG practices and their effect on performance in the Nepalese context, where the CG practices are still evolving. Moreover, factors such as industry-specific differences and world economic status influence the relationship between CG and firm performance (Tshipa et al., 2018). Therefore, it also creates a need to conduct a study. Likewise, this study exclusively chooses the variable "commitment to corporate governance" that is not widely studied, and the mediating effect of commitment to corporate governance has not been explored yet in the context of developing countries like Nepal. Focusing on these issues, the study raises the following research question: Do corporate governance practices contribute to enhancing the financial performance of financial institutions in Nepal? Whether the commitment to corporate governance mediates the relationship between corporate governance practices and financial performance of financial institutions in Nepal or not? Hence, this study has been carried out to investigate the impact of CG practices (board responsibility and accountability, equal treatment among shareholders, and disclosure and transparency) on commitment to CG and the financial performance of the financial institutions in Nepal as well as the mediating impact of commitment to CG within the relationship of CG practices and financial performance.

Literature Review

Corporate Governance

This section provides a review of the relevant prior studies and shows that there are inconsistencies in the study results; hence, the study is inconclusive. Many researchers have been contributing to the field of corporate governance and firm performance considering different corporate governance characteristics with industry-specific and country-specific features. A firm with an effective corporate governance system encourages the efficient use of available resources, can lower the overall cost of capital, and fosters growth (Organization for Economic Co-Operation and Development [OECD], 2004). Corporate firm can improve their financial performance through the effective corporate governance practices; however, firm size matters significantly in this regard (Farooq et al., 2021). Sound corporate governance reduces the operational risk as well as monitoring and controlling the cost of the firm (Denis & Kruse, 2000). In this sense, it can be said that, by improving corporate governance practices, corporate firms can take advantage of increased financial performance (Farooq et al., 2021).

There is a direct as well as an indirect positive impact of corporate governance on financial performance (Aslam & Haron, 2020; Mahrani & Soewarno, 2018). CG attributes such as "non-executive directors," "audit independence," "CEO duality," and "bank size" all contribute to improving a firm's performance, including "foreign ownership"

(Boachie, 2021). It shows board responsibility and transparency practices influence the performance of the bank. The role of corporate governance disclosure has been studied widely and found to have a great impact on the bank's financial performance (Abang'a et al., 2021; Marselino et al., 2023). Singh and Rastogi (2022) claimed that CG features such as ownership concentration do not affect the financial performance of small and medium enterprises (SMEs) in India; however, financial performance and information disclosure have a negative relationship.

Corporate governance significantly influences the firm's financial performance (Umar et al., 2024). Conversely, the study from Nigeria unambiguously shows that corporate governance significantly reduces the return on assets (ROA), but it does not affect the growth rate of multinational corporations (Akinleye et al., 2019). There is no association between corporate governance and financial performance in the case of Egyptian firms, while corporate governance practices are found to be weak (Shahwan, 2015). Conducting a cross-sector study, Affes and Jarboui (2023) assert that the adoption of sound corporate governance practices facilitates the improvement of the financial performance of the corporate firm in the United Kingdom. In the context of Jordan, corporate governance mechanisms, including the audit committee, features of the board of directors, and ownership structure, have a significant and positive relationship with financial performance (Alodat et al., 2021). Hence, it can be seen that the results of the previous studies are inconclusive, indicating positive and negative impacts that differ with industry-specific and country-specific factors.

Theoretical Review

Agency Theory: The key focus of agency theory is the problem that occurs in agency relationships, as the agent may be driven by self-interest rather than a desire to maximize the profits for the principal (Jensen & Meckling, 1976). The agency theory recognizes the role of sound corporate governance to enhance the firm's performance and value (Shleifer & Vishny, 1986). Fama and Jensen (1983) explain the various causes of conflict between management and shareholders and the costs shareholders have to bear to resolve them. In sum, in agency theory, corporate boards are expected to monitor and control the acts of management, reducing information asymmetry and maintaining transparency in decision-making to protect the rights of stakeholders.

Stewardship Theory: Stewardship theory states that the board of a corporate firm should act as stewards and strive to achieve the objectives of the firm (Davis et al., 1997). Moreover, the theory focuses on non-economic influences that guide managerial activity (Mason et al., 2007). The theory suggests that managers guard the rights of shareholders and work to fulfill their best interests, aligning their self-interests with corporate objectives (Davis et al., 1997). Hence, corporate managers act as stewards, naturally aligning their aims with corporate objectives and the interests of corporate owners (Singh & Davidson III, 2003).

Stakeholder Theory: According to Freeman (2010), stakeholder theory challenges the traditional and narrow concept of serving only shareholders in a corporate firm, emphasizing the interest of all the parties who will be affected by the firm's operation. Franklin (2020) argues that a corporate firm can improve its value and performance if it aligns the interests of all its stakeholders. In particular, stakeholder theory emphasized the need to shift the priority of corporate firms from shareholders to stakeholders.

The review of literature and theories proposes the conceptual model for the study that is presented in Figure 1. The study incorporates board responsibility and accountability, equal treatment of shareholders, and disclosure and transparency practices to measure corporate governance practices of financial institutions in Nepal.

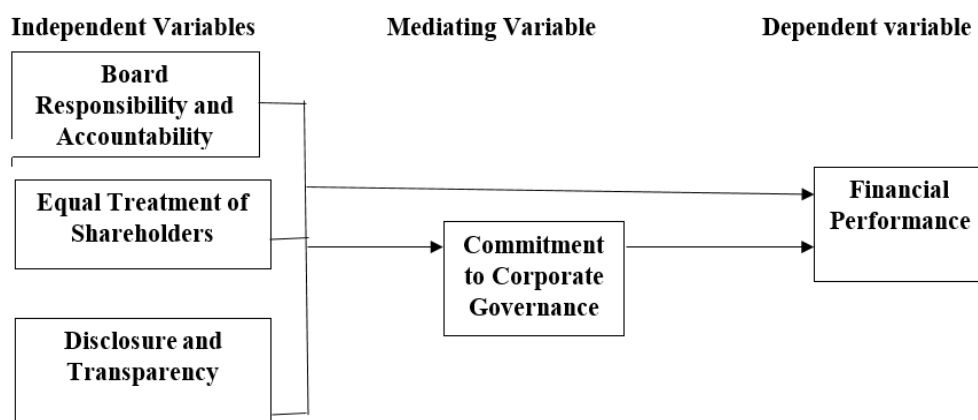


Figure 1: Conceptual Framework

Hypothesis Development

Responsibility and Accountability of Board and Financial Performance

Considering the relationship between corporate governance practices and financial performance, Alatassi and Pillai (2024) emphasized the board's responsibility in managing risk that ultimately influences the performance of the bank. The features such as "board size," "management soundness," and "board remuneration" have a positive and significant impact on financial performance (Zelalem et al., 2022). Accordingly, "board skills," "managerial skills," and "board composition" significantly influence the firm's financial performance (Alley et al., 2016). Likewise, female participation on the board also contributes positively to the financial performance of the firm (Anqi & San, 2022). In contrast, according to Bui and Krajcsák (2023), there is no relationship between board responsibility and financial performance of the bank. Hence, the study is going to examine the following hypothesized relationship:

H1: Board responsibility and accountability is positively associated with financial performance.

H1a: Board responsibility and accountability has positive impact on commitment to corporate governance.

Equal Treatment to Shareholders and Financial Performance

According to Affes and Jarboui (2023), protection of shareholders' interests is beneficial for improving financial performance. Chi (2005) claims that preserving shareholders' rights is a strategic way for the corporate firm to reduce the agency cost and increase value. Stronger shareholder rights are significant to reduce the cost of equity capital (Cheng et al., 2006) as well. Stronger shareholder rights discourage earnings manipulation and aggressive financial reporting by managers; however, the impact would be weakened in the presence of inside ownership since shareholder's oversight would be ineffective in this condition (Huang et al., 2013). On the other hand, Bui and Krajcsák (2023) did not find any link between treatment among shareholders and financial performance of the firm. Cremers and Ferrell (2014) emphasized the significance of stronger shareholder's rights by claiming that restrictions on shareholder's rights have a negative impact on a firm's value. Hence, the study is going to examine the following hypothesized relationship:

H2: Equal treatment to shareholders is positively associated with financial performance.

H2a: Equal treatment to shareholders has positive impact on commitment to corporate governance.

Disclosure and Transparency, and Financial Performance

Many studies claim that transparency and disclosure influence the firm's financial performance positively and significantly (Abang'a et al., 2021; Bui and Krajcsák, 2023; Marselino et al., 2023). Specifically, financial disclosure has a positive and significant impact on financial performance (Zelalem et al., 2022). Higher financial disclosure is also beneficial to reduce the cost of equity capital (Cheng et al., 2006). In contrast, Singh and Rastogi (2022) argue that the relationship between the financial performance of the firm and information disclosure is negative. Hence, the study set the following hypothesis to examine the relationship between disclosure practices and financial performance:

H3: Higher disclosure and transparency is positively related with financial performance.

H3a: Higher disclosure and transparency has positive impact on commitment to corporate governance.

Commitment to Corporate Governance

Researchers study the mediating effect of many factors within the relationship between corporate governance and financial performance. The ethical commitment of the board positively influences the corporate performance (Salin et al., 2019). Ethical commitment strengthened the association of corporate governance with corporate performance (Salin et al., 2019). Effective corporate governance mechanisms and commitment to higher business ethics support reducing the cost of capital, thereby enhancing the value of the firm (Pae & Choi, 2011). According to Aslam et al. (2023) intellectual capital positively mediates the relationship of corporate governance with financial efficiency. Likewise, earnings management also has a significant impact on the relationship between sound corporate governance and financial performance (Aslam & Haron, 2020; Mahrani & Soewarno, 2018). Hence the study has developed the following hypothesis to investigate the direct and indirect role of commitment to corporate governance on financial performance:

H4: Commitment to corporate governance practices has a significant positive impact on financial performance.

H5: Commitment to corporate governance practices mediates the relationship between responsibilities and accountabilities of board, and financial performance.

H6: Commitment to corporate governance practices mediates the relationship between Equal treatment to shareholders and financial performance.

H7: Commitment to corporate governance practices mediates the association between disclosure and transparency, and financial performance.

Research Methods

This study is based on a quantitative research approach under the positivist paradigm. The population for the study comprises the key stakeholders, including employees working at the officer level and above, board members, and shareholders of the financial institution, such as commercial banks, development banks, and finance companies operating in Nepal. The structured questionnaire was used to administer the cross-sectional survey in Nepal by using the convenience sampling technique. Data were collected from 386 respondents. In addition, the study adopts both a descriptive and causal research design for further analysis.

“Board responsibilities,” “equal opportunity for shareholders,” and “transparency and disclosure” are three key variables used in the study to measure the corporate governance practices in Nepalese financial institutions. The study developed indicators of corporate governance practices based on the OECD principle of corporate governance (OECD, 2004). Furthermore, the measures of financial performance are based on indicators of operating profitability and market value. A 5-point Likert Scale was used to evaluate the perception of the respondents regarding the study variables, with response categories ranging from “Strongly Disagree” to “Strongly Agree.” The collected data was analyzed through PLS-SEM (Partial Least Square Model). Ethical consideration was undertaken during the research process. Prior informed consent has been taken from the respondents for the purpose of data collection. In addition, the study has assured the confidentiality and privacy of the information provided by the respondents.

Results

Descriptive Statistics

This study has considered the data collected from 386 respondents in total. Table 1 provides the profile of the respondents. It comprises gender, the type of financial institution the respondent belongs to, and the designation and experience of the respondent. It can be seen that 70.5 percent of participants are male. Respondents from commercial banks are slightly higher than development banks and finance companies, i.e., 39.6 percent. Similarly, designation of the respondents shows that respondents are diverse. The majority of the respondents are officer-level employees, followed by shareholders, managerial-level employees, and board members. In addition, the majority of the respondents have 5 to 10 years of experience.

Table 1: Description of Respondents

Components	Categories	Frequency	Percent
Gender	Male	272	70.5
	Female	114	29.5
Type of Institution	Commercial Bank	153	39.6
	Development Bank	127	32.9
	Finance Company	106	27.5
Designation	Officer Level	120	31.1
	Managerial Level	113	29.3
	Shareholder	114	29.5
Experience	Board member	39	10.1
	Less than 5 years	77	19.9
	5 years to 10 years	173	44.8
	More than 10 years	136	35.2
Total		386	100

Source: Field Survey

Measurement Model

The two steps of SEM comprise validating the measurement model and fitting the structural model. The measurement model is used to provide an assessment of measurement reliability and establish the validity of the constructs used in the study. The latent constructs are fulfillment of board responsibility and accountability (BRSACC), equal treatment

of shareholders (ETS), disclosure and transparency (DT), commitment to corporate governance (CCG), and satisfaction with financial performance (FP). The measurement model with all 22 aggregate items (representing the observed variables) for the 5 constructs was developed and analyzed as a confirmatory composite analysis (CCA) by using PLS-SEM.

Table 2: Item Loadings, Reliability and Convergent Validity

Construct/ Items	Λ	A	CR	AVE
BRSACC		.836	.884	.604
BRSACC1	.816			
BRSACC 2	.813			
BRSACC 3	.749			
BRSACC 4	.756			
BRSACC 5	.748			
ETS		.787	.861	.608
ETS1	.739			
ETS 2	.734			
ETS 3	.863			
ETS 4	.776			
DT		.902	.927	.716
DT1	.830			
DT 2	.856			
DT 3	.875			
DT 4	.853			
DT 5	.817			
CCG		.764	.850	.594
CCG1	.826			
CCG 2	.846			
CCG 3	.847			
CCG 4	.651			
Financial Performance (FP)		.838	.891	.674
FP1	.836			
FP2	.854			
FP3	.877			
FP4	.706			

Table 2 shows the results of the measurement model of PLS-SEM, containing “item loadings (Λ),” “Cronbach’s alpha (α),” “composite reliability (CR),” and “average variance extracted (AVE)”. These indexes show the extent to which data of the proposed 5-factor model is consistent and valid. In particular, the measurement model shows quality loadings of the manifest variables on the latent variables.

Factor loadings depict how well each item is associated with its particular construct. The preferable value of factor loadings is .70 and above to confirm that the items satisfactorily express the construct (Hair Jr et al., 2014). Regarding BRSACC, Table III shows that the factor loadings of each item exceed the threshold value, ranging from .748 to .816. It shows that all four items are strongly associated with the construct. Likewise, the factor loadings of all the items of construct ETS lie in the range of .734 to .863, indicating strong support for the construct.

Similarly, the factor loading of each item of DT is above .70, ranging from .817 to .875, which ensures a strong representation of the construct. While considering CCG, loading factors range from .651 to .847. It shows that the factor loading of CCG4 is slightly lower than the threshold value; however, it is significant and very close to the preferable value (Hair Jr et al., 2014). Hence, it is acceptable. In the case of FP, all items meet the criteria of the suggested value; hence, factor loadings are acceptable. Overall, all the factor loadings are significant, and there is no issue of cross-loading, indicating the validity of the study model.

Cronbach's alpha and composite reliability measure the reliability of the construct. Cronbach's alpha assesses the internal consistency of the data, indicating how well items measure the respective construct with the suggested value of .70 and above. Table II shows that alpha values of all the constructs lie in the range from .764 to .902, reflecting good internal consistency and adequate reliability. Likewise, composite reliability (CR) also evaluates the internal consistency of a respective construct with the recommended value of .70 and above (Hair Jr *et al.*, 2014). Table II indicates that the composite reliability of all the constructs exceeds the suggested value, demonstrating strong reliability since it ranges from .850 to .927. The result of Cronbach's alpha and composite reliability ensures the reliability of all the constructs in the study model. In the same manner, AVE measures the convergent validity with a suggested value of .50 and above. Table II depicts that the AVE of BRSACC, ETS, DT, CCG, and FP exceeds the threshold value of .50, confirming no issue exists regarding convergent validity. Hence, it shows that the variance in the construct is well captured by its indicators.

Table 3: Discriminant validity Fornell-Larcker Criterion and Discriminant validity (Heterotrait- Monotrait (HTMT) ratio)

	BRSACC	ETS	DT	CCG	FP
BRSACC	.777	.840	.711	.728	.810
ETS	.742	.780	.616	.528	.757
DT	.622	.518	.846	.831	.639
CCG	.588	.429	.716	.771	.700
FP	.691	.657	.595	.588	.821

Note. Diagonal values are square root value of AVE and off diagonal values are correlation between constructs.

Table 3 presents the result of the Fornell-Larcker criterion and HTMT ratio to assess the discriminant validity of the constructs in the measurement model. Discriminant validity ensures that items of different constructs are not strongly correlated; thus, study constructs are adequately distinct (Hair Jr *et al.*, 2014). The diagonal values in Table 3 are square root values of AVE, whereas off-diagonal values below the diagonal are the result of the Fornell-Larcker criterion that shows correlations between constructs. According to the Fornell-Larcker criterion, the diagonal values, which are the square root values of the AVE for a particular construct, should be higher than the correlation of that specific construct with other constructs (Fornell & Larcker, 1981).

Table 3 shows that the corresponding diagonal values are greater than the off-diagonal correlations; hence, it fulfills the Fornell and Larcker criteria and establishes the discriminant validity. Likewise, off-diagonal values above the diagonal in Table 3 are HTMT ratios, which also assess discriminant validity. To confirm the discriminant validity, according to HTMT ratios, all the ratios should be less than the suggested value of 0.85 (Henseler *et al.*, 2015). Table 3 depicts that all the ratios are acceptable and confirm the sufficient discriminant validity, confirming each construct is unique and assessing the distinct concepts. Thus, in the next section, the study proceeds with the specification of the structural model.

Structural Model

The structural model emphasized the nature and extent of the relationships between the endogenous and exogenous constructs. The results of the SEM path analysis are shown in Table 4 to evaluate the hypothesized causal relationship proposed in the theoretical model. Board responsibility, equal treatment of shareholders, and disclosure and transparency are exogenous constructs in the study. Likewise, satisfaction with financial performance and commitment to governance quality are endogenous, as the variables are being explained in the model by exogenous constructs.

Table 4: Size and Fit of Path Coefficients

Hypo	Relationship	O	M	STD	t Stat	p	2.50%	97.50%	Decision
H1	BRSACC -> FP	.262	.261	.062	4.200	.000	0.139	0.381	Supported
H1a	BRSACC ->CCG	.292	.292	.067	4.384	.000	.163	.423	Supported
H2	ETS -> FP	.310	.312	.046	6.685	.000	.208	0.392	Supported
H2a	ETS -> CCG	-.092	-.090	.054	1.692	.091	-.198	.013	Not Supported
H3	DT -> FP	.105	.104	.057	1.842	.066	-0.008	0.215	Not Supported
H3a	DT -> CCG	.584	.582	.043	13.448	.000	.496	.663	Supported
H4	CCG -> FP	.228	.228	.053	4.313	.000	.127	.330	Supported

Note: "Hypo= Hypothesis," "O= Original Sample Estimate," "M= Mean", "STD=Standard Deviation," "T Stat=T-Statistic," "p= P-value," "2.50% & 97.50% =Confidence Interval"

Table 4 reveals the results of the hypothesized relationship of H1, H2, and H3 of the structural model of the PLS-SEM. H1 assesses the impact of board responsibility and accountability (BRSACC) on financial performance (FP), whereas H2 evaluates the impact of equitable treatment of shareholders (ETS) on FP and presents that BRSACC ($\beta = .262$; $p < .05$) and ETS ($\beta = .310$; $p < .05$) both constructs have a strong positive impact on FP, as the path coefficients are significant and lie between +1 and -1. In addition, no true zero value exists in the interval, which further supports results. Hence, the hypothesized relationships of H1 and H2 are supported. While H3 assesses the impact of disclosure and transparency (DT) on FP and reveals that there is no significant impact of DT ($\beta = .105$; $p > .05$) on FP, as the path coefficient is insignificant and a true zero value exists in the interval. Hence, the hypothesized relationship of H3 is not supported.

In the same manner, Table 4 presents that BRSACC ($\beta = .292$; $P < .05$) and DT ($\beta = .584$; $P < .05$) have a significant positive effect on CCG. Hence, the hypothesized relationships of H1a and H3a are supported. However, H2a is not supported, indicating ETS has no impact on CCG ($\beta = -.092$; $P > .05$). On the other hand, Table 4 demonstrates that CCG has a significant positive impact on FP ($\beta = .228$; $P < .05$), supporting H4. Overall, the result shows that a responsible and accountable board and equitable treatment of shareholders positively influence financial performance. However, disclosure and transparency practices do not have any direct impact on the financial performance of the financial institutions in Nepal. Likewise, a responsible and accountable board and sound disclosure practices enhance the commitment to corporate governance in the financial institution in Nepal.

Table 5: Mediation Result

Hypothesis	Relationship	Indirect effect				Direct effect		
		β	t-value	p value		β	t-value	p-value
H5	BRSACC -> CCG -> FP	.066	2.857	.004	BRSACC ->FP	.262	4.200	.000
H6	ETS -> CCG -> FP	-.021	1.601	.109	ETS ->FP	.310	6.685	.000
H7	DT -> CCG -> FP	.133	4.292	.000	DT -> FP	.105	1.842	.066

Note: R^2 of FP=.580 and CCG = .551

Table 5 depicts results regarding the mediation role of commitment to corporate governance (CCG) on the relationship of BRSACC, ETS, and DT with FP. The result shows that the relationship between BRSACC and FP is mediated by CCG ($\beta = .066$; $P < .05$), confirming an indirect relationship and supporting H5. Similarly, the result also shows that BRSACC ($\beta = .262$; $P < .05$) has a direct impact on FP as well. Hence, the result confirms partial mediation of CCG, suggesting both the direct and indirect impact of BRSACC on enhancing FP.

Likewise, Table 5 depicts that CCG mediates the relationship between DT and FP ($\beta = .133$; $P < .05$) and supports the hypothesized relationship of H7. On the other hand, the result shows that DT does not have a direct impact on FP. Hence, the result confirms the full mediation of CCG, indicating DT improves FP only through strengthening CCG. While ETS has a significant positive impact on enhancing FP directly, Table V reveals that there is no mediation effect of CCG in the relationship between ETS and FP ($\beta = -.021$; $P > .05$); hence, the result does not support H6.

In the same manner, Table 5 shows the result of R^2 . R^2 indicates the deviation in the dependent variable caused by the independent variables. The R^2 value of .580 for FP reflects that 58 percent of the variation in FP is explained by the BRSACC, ETS, and DT, along with the mediation effect of CCG. Accordingly, the R^2 value of .551 for CCG indicates that 55 percent of the variation in CCG is explained by BRSACC, ETS, and DT. This confirms the strong predictive power of the model.

Discussion

The empirical findings postulate the significant role of a responsible and accountable board and equal treatment of shareholders in enhancing the financial performance of the financial institution. The study supports the agency theory of corporate governance that highlights the oversight role of the board (Fama & Jensen, 1983) and the assumption of the stakeholder theory of aligning the interests of all the stakeholders. The findings show that commitment to governance is the process by which exogenous variables (perceived board responsibility and perceived disclosure standard) can positively influence financial performance. Hence, the study also supports the stewardship theory that assumes corporate boards and managers guard the rights of shareholders and work to fulfill their best interests (Davis et al., 1997). The result of the study aligns with Alatassi and Pillai (2024), signifying a positive effect of board responsibility on the performance of the financial institution. Likewise, regarding the disclosure practices, the finding of this study is similar and consistent with Abang'a et al. (2021), Bui and Krajcsák (2023), and Marselino et al.

(2023). The result supports the claim of a significant positive impact of sound disclosure practices on improving the financial performance. However, the result differs from Singh and Rastogi (2022), who argue the negative impact of disclosure on financial performance. In the same manner, regarding the treatment of shareholders, the result aligns with Affes and Jarboui (2023), who found that protection of shareholders' interests is beneficial for improving financial performance; in contrast, the result is inconsistent with Bui and Krajcsák (2023). Indeed, the study confirmed the essential role of corporate governance in strengthening financial performance.

Conclusion

The aim of the study is to investigate the effect of corporate governance practices on the financial performance of financial institutions in Nepal. Board responsibility seems to be a crucial driver of better financial performance in Nepalese financial institutions. In particular, a responsible and accountable board contributes in either way to better financial performance, directly by providing the proper oversight or indirectly through improving commitment to corporate governance mechanisms. The result aligns with the assumption of agency theory that emphasizes the role of a responsible and accountable board. Likewise, offering equal treatment to shareholders and protecting fundamental rights is also beneficial for financial institutions to improve financial performance. Similarly, strong disclosure and transparency practices of corporate governance show the high commitment towards corporate governance that leads to the better financial performance of the financial institution in Nepal. The study found that an accountable board and prioritizing sound disclosure practices are key to strengthening the commitment to corporate governance practices that improve financial performance as well. Furthermore, the result reveals that the performance of the financial institution is highly dependent on commitment to corporate governance. Overall, the stakeholder's opinion indicates that the financial performance of the financial institution in Nepal largely depends on the corporate governance practices they adopt. This research enriches the understanding of how CG practices and commitment to CG strengthen financial performance. It suggests key insights regarding the role of commitment to CG within the relationship between CG practices and financial performance in the financial sector.

Implications, Limitations and Future Research Directions

The study offers valuable insights for both regulators and practitioners to strengthen corporate governance practices and to improve the performance of financial institutions in the competitive and ever-changing financial landscape. In addition, this study significantly contributes to the field of corporate governance, mainly to understand the practices of small economies.

The conclusion drawn from the study is subject to certain limitations. The study has been conducted, considering financial institutions only within the Nepalese context; indeed, the results may be relevant for financial institutions that operate in a small economy. In addition, the study is based on a limited sample and relies on self-reported information, which may create generalizability issues. Nevertheless, future studies may explore additional facets of corporate governance and analyze the mediating role of other potential variables within the relationship between corporate governance and financial performance. In addition, the longitudinal studies can be carried out to evaluate the changes in performance over the period with respect to the changes in corporate governance practices. Furthermore, a comparative study can be done to explore the differences and similarities in industry-wise outcomes.

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