Impact of Corporate Governance on Performance of Public Commercial Banks in Nepal

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Abstract

With regard to non-performing loans in Nepal, this research study seeks to investigate the effect of corporate governance on the profitability of public commercial banks. While several studies have examined the "Impact of Corporate Governance on profitability of commercial banks in Nepal," publicly traded commercial banks in the country have been the subject of far less investigation. By focusing just on Nepal's banking sector, this research aimed to address that void. The non-performing loan (NPL) is used as a dependent variable to measure performance, while the percentage of female directors, audit committee size, audit committee independence, board diligence, and board size all serve as independent variables in corporate governance. The study examined the governance procedures and their influence on the performance of public commercial banks in Nepal using panel data analysis. The data was collected from 2017/018 to 2021/022, and statistical methods such as descriptive statistics, correlation, multiple regression, and t-test were employed. Board diligence (DB) significantly and positively affects nonperforming loans (NPL), according to the empirical findings. Other factors (BS, FD AC, BI, ACI) did not significantly affect the return on assets (ROA) of Nepal's public commercial banks, according to the results.

Key words

Corporate governance, board side, board independence, audit committee size, board diligence

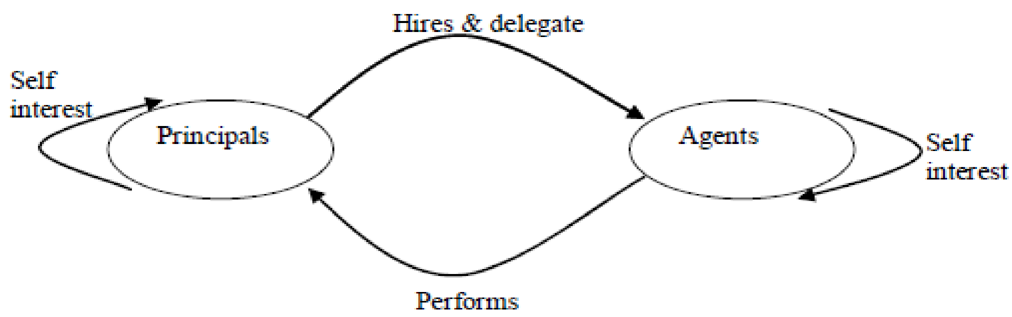
Introduction

In major commercial organisations, corporate-governance entails reaching choices and then putting those decisions into effect through several tiers of management. In corporate governance, the triad of accountability, credibility, and transparency is paramount. As was determined in the case of Salomon v. Salomon (Salomon v. A Salomon & Co Ltd. [1896] UKHL 1, 1897), the separation of "ownership and control" gave rise to the early arguments on agency concerns. The standards for corporate governance were issued in 2002 by the Nepal Rastra Bank, the country's national bank. Up to this point, Nepal Rastra Bank's regulatory norms have served as the gold standard for corporate governance. A number of rules and directives have been published by the Nepal Rastra Bank with the goal of enhancing corporate governance. The Nepalese commercial banking industry is currently grappling with the policy's apparent lack of ground-level execution, despite several directions, rules, and regulations issued by Nepal Rastra Bank. Corporate governance in Nepal's banking sector is crucial, as the country's real estate crisis has shown (NRB, 2011).

Literature Review

In large business organizations, ownership and management exists as two separate entities. Management works for the shareholders (ownership) as an agent. "In the organization, agency problem exits. Agency problem is the conflict of interest that is arose between the agents and principals in an organization. The theory discusses the principal appoints managers (the agents) to perform the activities and expects that the managers (agents) would take decisions keeping into view the interests of the principals. But in practice, managers are not truly interested to make decisions that are only in the interests of the principals. Rather agents also look for their self-interest. This theory believes that agents could be made responsible by applying rewards and punishments systems of management.

Figure: 1



Source: Theories of Corporate Governance: Agency, Stewardship etc. https://www.papertyari.com. 19 Aug 2018

Empirical Literature

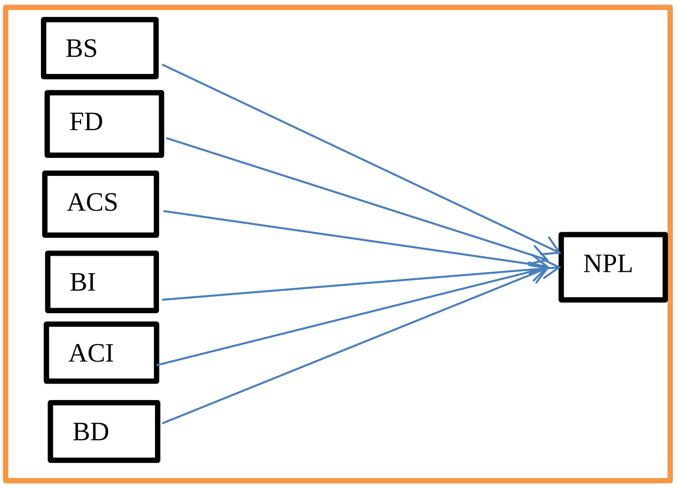
Md. Harun Ur Rashid, et al. (2020) in their research work entitled "Corporate Governance and banks' productivity: evidence from banking industry in Bangladesh" found that there is a positive relationship between the variables of corporate governance and the financial performance of commercial banks in Bangladesh. Also, he found that good corporate governance helps to balance the needs of agents (the managers) and owners (the shareholders). Ultimately it results in positive effect in the efficiency. Furthermore, he also found that banks should keep board sizes as small as possible, because a large board size needs more resources and can reduce efficiency of banks. He also found that independent directors, board size have no effect on the efficiency of commercial banks. Rudi Zulfikar, et al. (2020) in their research work entitled "Corporate Governance Compliance in Banking Industry: the role of board" has found that board size, high proportion of independent directors, more frequent board-meetings, all these variables have positive impact on improving corporate governance compliances and hence improve the financial performance in commercial banks in Indonesia. Himal Bhattarai, Dr Shinu Abhi and Dr U.M. Premalatha (2017) in their research work entitled "Effect of Corporate Governance on Financial Performance of banks in Nepal" found that bank size, independent directors are very closely correlated with financial performance of commercial banks. Progress Shungu, et al. (2014) in their research work entitled "Impact of Corporate Governance on the Performance of Commercial bank in Zimbabwe" summed up that board composition, board diversity has positive impact on financial performance of banks. Similarly audit committee and board size have negative impact on the performance. Ashenafi Beyene Fanta et al. (2013) in their work entitled "Corporate Governance and Impact on bank performance" found that a good corporate governance always leads to the better financial performance of banks. The study found that the board size has negative impact on financial performance of banks.

Research Objectives

Looking into the statement of problems, it is important to review whether variables of corporate-governance have or have not impact on the financial performance of Nepalese commercial banks. It is also important to give an authentic recommendation to stakeholders about the influence of corporate governance practices in the improvement of the financial performance of commercial banks in Nepal. The step of the Central bank has further strengthened the financial capability and also requirement of a good governance system to strengthen the performance and to safeguard the interest of shareholders. Corporate-governance is very important for an emerging economy in a Least Income Countries (LIC) like Nepal. Objectives are outlined as follows.

- To examine the impact of board size, board independence, board diligence, female directors, audit committee size, audit committee independence on NPL of commercial banks in Nepal.
- To examine the relationship between board size, board independence, board diligence, female directors, audit committee size, audit committee independence on NPL of commercial banks in Nepal.

Figure 2 Conceptual Model



This study has been done on the basis of Dynamic Panel Data taken from the year 2017-018 to 2021-22 for 5 years. Data have been taken from Annual reports of all the 11 Class “A” commercial Banks of Nepal that are published on Web sites of the concerned commercial banks. Corporate-governance variables are used as independent variables. NPL has been taken as Dependent variables. Statistical Software Application SPSS has been used to find out correlations among the variables and finding the impact of independent variables upon the dependent’s variable. Fig. 1

Hypothesis formulation

Based on research objectives, following research hypothesis have been formulated.

H1: There is statistically significant impact of board size on NPL of commercial banks of Nepal.
H2: There is statistically significant impact of female director on NPL of commercial banks in Nepal.
H3: There is statistically significant impact of audit committee size on NPL of commercial banks in Nepal
H4: There is statistically significant effect of board independence on NPL of commercial banks of Nepal.
H5: There is statistically significant effect of audit committee independence on NPL of commercial banks of Nepal.
H6: There is statistically significant influence of board diligence on NPL of commercial banks of Nepal.

Research Methodology

Research design

Descriptive and causal comparative research design has been used for the research work. *Population and Sample size* Eleven commercial banks were taken (out of 21 commercial banks) as a sample for the study. Data for independent variables and dependent variables were taken from the websites of the concerned commercial banks of Nepal. *Data Collection Tools and Process* Secondary data were collected from the annual report of websites of concerned commercial banks. The data were taken for 5 years from the fiscal year 2017-018 to 2021-022. The total number of observations was 55 (11 commercial banks for 5 years observations for each). Various statistical tools like Descriptive Statistics, Correlation Analysis, Regression analysis, t-test, were applied using software application SPSS.

Regression model

$NPL^{it} = \alpha_o + \beta 1\ BS^{it} + \beta 2\ FD^{it} + \beta 3\ AC^{it} + \beta 4\ BI^{it} + \beta 5\ ACI^{it} + \beta 6\ BD^{it} + €^{it}$
Whereas,
α_o = constant
β1, β2, β3 ……. β6 = slope of independent variables
€ = error term
BS = Board Size
FD = Female director
AC = Audit Committee Size
BI = Board Independence
ACI = Audit Committee Independence
BD = Board Diligence
NPL = Non-Performing Loan

Data Analysis and Empirical results

Descriptive statistics

The descriptive statistics for dependent variable, NPL and independent variables BS, FD, AC, BI, ACI and BD are described in Table no 1. Mean, standard deviations are used as he descriptive statistics. N represents the no of observation.

Table 1 Descriptive statistics and correlation

	Mean	SD	NPL	BS	FD	AC	BI	ACI	BD
NPL	1.3638	1.2227	1						
BS	6.9455	0.93131	.262	1					
FD	0.1781	0.30042	.231	-.002	1				
AC	3.2364	0.66566	-.217	.051	-.213	1			
BI	8.8983	8.12032	-.564**	-.227	-.324*	.378**	1		
ACI	2.1925	7.4702	.511**	-.072	.124	-.080	-.262	1	
BD	32.5455	32.40246	.763**	.053	.414**	-.319*	-.571**	.316*	1

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

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

Table 1 shows the relationship between corporate governance and performance of commercial banks in Nepal. The average value of NPL is 1.3638 with standard deviation 1.2227. The average value of BS is 6.9455 with standard deviation of 0.93131. The average value of FD is 0.1781 with standard deviation of 0.30042. The average value of AC is 3.2364 with standard deviation of 0.66566. The average value of BI is 8.8983 with standard deviation of 8.12032. The average value of ACI is 2.1925 with standard deviation of 7.4702. The average value of BD is 32.5455 with standard deviation of 32.40246

Regression Analysis

A multiple regression technique which was used by many researchers was applied to examine the relationship between the corporate governance and firm performance (Al-Matari et al.,2012; Al-Sahafi et al.,2015; Farhan et al.,2017; Naushad & Malik,2015). It has also been stated by Hutcheson and Sofroniou (1999), that when the regression model comprises both continuous and dummy variables, OLS is a suitable statistical technique. Hence, the OLS regression has been used to test the relationship between corporate governance variables and financial performance of commercial banks in Nepal.

Table 2 Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.860[a]	.739	.707	.66226

a. Predictors: (Constant), BD, BS, AC, ACI, FD, BI

Table 2 Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	-1.481	.858		-1.726	.091
	BS	.295	.102	.225	2.897	.006
	FD	-.418	.333	-.103	-1.256	.215
1	AC	.034	.150	.019	.230	.819
	BI	-.016	.015	-.105	-1.075	.288
	ACI	.051	.013	.312	3.951	.000
	BD	.024	.004	.641	6.631	.000

a. Dependent Variable: NPL

Table 2 shows the results on financial performance of commercial banks in Nepal using NPL as the dependent variable. The table shows that audit committee independence (ACI) and Board diligence (BD) were statistically positively significant with NPL at 1% level." The result indicates that the increase in the number of meetings of board (BD) and audit committee independence could promote more diversified ideas on a regular basis which in turn decrease in NPL as a result of better decisions.

Conclusion

The purpose of this study was to investigate the link between the financial performance of commercial banks in Nepal and the corporate governance variables of board size, female director, audit committee size, board independence, audit committee independence, and board diligence by examining the interaction between these factors. The fact that there have been so few studies conducting research in the topic of corporate governance, particularly in the banking business, is what prompted the decision to conduct this study. This study makes a contribution to the existing body of literature about the significance of corporate governance in the banking business in Nepal. All of the hypotheses that were offered are not supported by the findings of the study. There is a possibility that the government, the body in charge of the capital market, commercial banks, and other financial institutions might benefit from this study. Another potential benefit of this study is that it might serve as a source of inspiration for other financial industries, such as insurance and financial services, amongst others. As the dependent variable, non-performing loans (NPL) were used to analyse the findings about the financial performance of commercial banks in Nepal. Both board diligence (BD) and audit committee independence (ACI) were shown to have a statistically significant positive relationship with non-performing loans (NPL) at the 1% level, as shown in the table. According to the findings, an increase in the number of board meetings (BD) might potentially encourage the development of a wider variety of ideas on a consistent basis, which would then lead to a reduction in non-performing loans (NPL) as a consequence of having better decisions.

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