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Impact of Corporate Governance on Profitability of Joint Venture Commercial Banks in Nepal: From Investor's Perspective

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Abstract

Good corporate governance has a crucial role in strengthening shareholder trust, promoting competitiveness, and ultimately driving economic growth. The study's major goal was to investigate the impact of corporate governance on the profitability of joint venture banks in Nepal. The information used in this study was gathered from primary sources using a descriptive research design. 400 individual investors were taken from the broker no. 36 and 32 situated in Putalisadak area, Kathmandu who generally hold the joint venture commercial banks' share; participated in the survey through questionnaire Google form and physically distributed while collecting responses from October 5 to 25, 2024 with purposive judgmental sampling. The majority of respondents think that non-performing loan and Board size destructively linked with profitability. On the other hand, board independence and the number of board meetings are positively correlated. To sum up, dependent variable Profitability (ROE and ROA) are significant at 1% and 5% significance level with independent variables. BOD should treat minority shareholders in equitable basis.

Keywords: Corporate social responsibility (CSR), Corporate governance, Profitability, Return on Assets, Return on equity

Introduction

Good corporate governance systems depend on incentives and specialization as the firm grows. Internal control effective mechanisms brought about by sound governance practices increase accountability and profitability. Effective corporate governance is helped to banks in order to achieve the efficient corporate social responsibility (Poudel, 2015). The rules and practices

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used by businesses to achieve specific goals. Further, investors, employees, customers, suppliers, and the general public are referred to as corporate governance. To optimize shareholder wealth is the function of governance.

Research Issue

Business governance is characterized by a weak level and regulatory framework. Similarly, it consists of accounting and auditing standards and inefficient control by the board of directors. Likewise, there might chance of disregard for the rights of minority shareholders by BOD (Chomlou 2000, Goet, 2022, Poudel 2015). This research mainly concerned with the important components of corporate governance, relationship between the variables and impact of variables on profitability of sample banks.

Objective of the study

- To assess the corporate governance most important components issues in Nepalese banking sectors.
- To analyze the relationship between corporate governance variables and its impact on profitability.

Literature Review

Good corporate governance refers to the practice of professionalism in controlling and overseeing a corporation. Wheelen and Hunger (2006) defined that corporate governance as the relationship among shareholders, top level management and board of directors. Likewise, it determines the path and performance of the corporation. Poudel (2012) used descriptive research design with regression analysis for the corporate governance issue in Nepalese banking sector. The study found that larger board and audit committee sizes, less frequent board meetings, and a lower proportion of institutional ownership resulted in greater efficiency in commercial banks.

Farouk and Hassan (2014) performed a thematic analysis and depicted company's financial success was depends upon the auditor size and board independence. Zabri, Ahmad, & Lean (2015) also used thematic analysis and coded that internal corporate governance processes are board independence, and the number of board of directors. Poudel (2015) conducted content analysis on ten commercial banks. The result shows that corporate governance procedures have a positive significant correlation with the amount of CSR efforts. Rao and Desta (2016) used unweighted checklist, content analysis for profitability analysis. The researcher found that ROE and ROA is two parameters for the financial strength. According to Alam and Akther (2017), capital structure and assets size had a significant impact on both ROE and return on assets.

Dangol (2021) depicted that there is negative relationship between board gender diversity on ROE and ROA. The research further revealed that the relationship of board gender with ROA has weak negative correlation. Goet (2022) asserted that there is relationship between board size, company size and credit/ deposit ratio. Further, researcher found that the stated variables effect on the financial performance (return on equity) of Nepalese commercial banks. Thapa (2023) used descriptive and inferential research to show that independent parameters including the number of board meetings, foreign ownership, and bank performance had a positive

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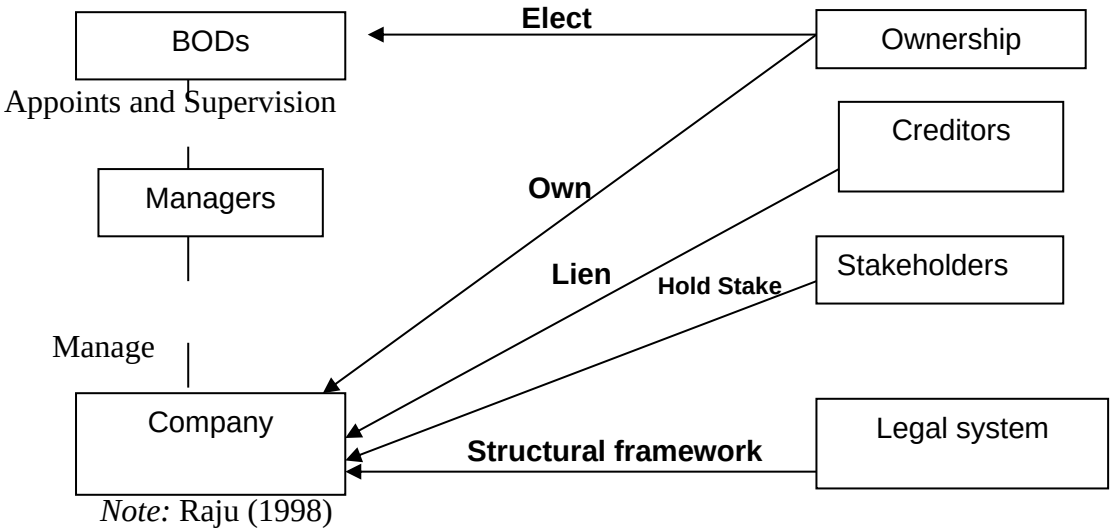
relationship. However, the negative association between board size and capital adequacy ratio was found. The result shows that larger board sizes resulted in lower bank performance. Furthermore, Nepal's financial sector's corporate governance policies are still in their early stages, yet joint venture bank procedures are more consistent than those of the government and other banks. Kharga (2024) used descriptive research design and had taken the panel data of 26 commercial banks and 8 development banks of ten years. By using Random Effect Model to explain business performance as measured by ROA, all corporate governance indicators—including board size, board independence, frequency of board meetings, audit committee size, and female directors—are negligible. While leverage and macroeconomic factors such as GDP and inflation have no noticeable effect on ROA, the control variable, firm size, shows a strong positive relationship with ROA. Overall, corporate governance has a minor impact on business success, according to both Fixed and Random Effect Models. The BOD is responsible for formulating business objectives and developing policies. Similarly, other responsible is appointing top-level professionals in order to perform the function. The board also evaluates management performance to ensure the stakeholder's interest and return.

The board performs three functions: representation, direction, and oversight. The BODs are accountable to their appointers. Similarly, board's business market mapping for the both company and stakeholders; which is stated as given below.

Figure 1

System of Corporate Governance and the Board of the Directors



Note: Raju (1998)

Research Framework

Under this study, the dependent variables are profitability (ROA, ROE). Similarly, independent variables BOD size, board independence and number of board meeting and non-performing loan as stated.

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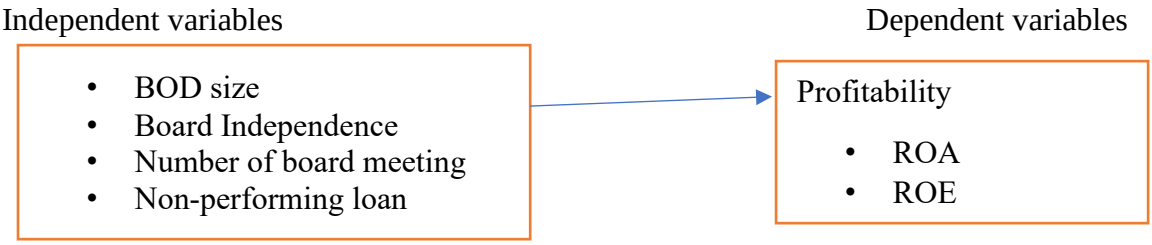

Note: Researcher sketch from reviewing various articles

Research Methodology

Research design

The information used in this study came from primary sources with descriptive research design and somehow explanatory since the participants also explore the facts about the corporate governance system of banks where they have been made investment.

Population and sample

Since the all the individual Investors who have made the investment in the sample banks are the individual investors in selected area henceforth it is infinite and also company follow the privacy policy of the investors. Hence, regarding the infinite population, researcher follow the Cochran (1997) if the population is unknown, a minimum of 384 responses are sufficient

SS = (Z-score) ^{2} * p*(1-p) / (margin of error) ^{2}

SS = (1.96) ^{2} * 0.5*(1-0.5) / (0.05) ^{2}

SS = 3.8416 * 0.25 / 0.0025

SS = 384.16

(Z-score is 1.96 for 95% confidence level)

However, researcher was taken 400 individual investors from the broker no. 36 (Secured securities Co. Ltd.) and 32 (Premier Securities Co. Ltd.), situated in Putalisadak area, Kathmandu (among 75 brokers) who generally hold the joint venture commercial banks' share; participated in the survey through questionnaire Google form and physically distributed for collecting respond October 5 to 25, 2024 with purposive judgmental sampling technique. For the result analysis**,** 390 respondents are valid and 4 of them did not fill the all questions and rest of them did not submit the respond in the given time and altogether non-response rate was 2.5%. Similarly, Jamovi software has been used for the result or output of the variables.

Regression Model

$Y = b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + \ldots + er$

Where, Y= Dependent variable; ROA, ROE

Independent variables: X_1 = BOD size and b_1 is its beta coefficient

X_2 = Board independence and b_2 is its beta coefficient

X_3 = Number of board meeting and b_3 is its beta coefficient

X_4 = non-performing loan and b_4 is its beta coefficient

er = error term

Then, ROA/ROE = b_1BOD size + b_2Board independence + b_3 Number of board meeting + b_4 non-performing loan + er

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Table 1

Reliability test

	Mean	SD	Item-rest correlation	If item dropped Cronbach's α
BOD size	3.33	1.04	0.938	0.894
Board independence	3.37	1.05	0.928	0.824
Number of board meetings	3.32	1.03	0.771	0.801
Non-performing loan	3.1	1.02	0.74	0.858

Note: Field survey, 2024

For this research, Cronbach Alpha value of BOD size, board independence, number of board meetings and non-performing loan is 0.894, 0.824, 0.801 and 0.858 respectively. It indicates the high level among the stated detected items variables. All of Cronbach Alpha is greater than 0.70 i.e., acceptable for the validity. However, George and Mallery (2009) demonstrated that Cronbach Alpha values are more than 0.60; it means sufficient for the questionnaire's reliability.

Result and analysis

Table 2

Descriptive statistics

Particulars	**Mean**	Std. Deviation	Minimum	Maximum	Total
AGM held in time	3.25	1.251	1	5	390
Minority of shareholder issue	3.53	1.024	1	5	390
Poor transparency disclosure	3.61	1.135	1	5	390
Lack of professional management	3.87	1.36	1	5	390
following rules and regulations including NRB	3.47	1.207	1	5	390
Protection of shareholders right	3.15	1.017	1	5	390

Note: Field survey, 2024

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The mean value of lack of professional management, poor transparency disclosure, minority of the shareholder's issue, following rule and regulation including NRB protection of shareholder's right is 3.87, 3.61, 3.53, 3.47 and 3.15 respectively. Similarly, the mean value regarding AGM held in time is 3.25. The result shows that there is major issue regarding lack of professional management, poor transparency and minority of shareholder issue indicated the lack of corporate governance issue which also affects the profitability of banks by analyzing respondent's view.

Table 3

Descriptive statistics of variables

	Mean	Std. Deviation	Minimum	Maximum	Total
BOD size	3.2	1.551	1	5	390
Board Independence	3.53	1.054	1	5	390
No. of BOD meeting	3.31	1.145	1	5	390
Non-Performing Loan	3.19	1.36	1	5	390
ROA	3.57	1.117	1	5	390
ROE	3.37	1.128	1	5	390

Note: Field survey, 2024

The mean value of board size, board independence, ROA, ROE and number of BOD meeting is 3.53, 3.57, 3.37 and 3.31 respectively. Similarly, size of BOD and NPL similarly, size of BOD and NPL (non-performing loan) also affects the corporate governance statistically with mean value 3.2 and 3.19 respectively. To sum up the respondent's view, board independence, ROA, ROE and number of meetings influences the corporate governance.

Table 4

Exploratory Factor analysis

Factor Loadings

	Component	
	1	Uniqueness
ROA	0.897	0.0434
ROE	0.882	0.0314
BOD size	0.805	0.301
Board independence	0.867	0.2318
Number of board meetings	0.812	0.2297
Non-performing loan	0.821	0.2531

Note. 'varimax' rotation was used

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Table 5

Principal Component Analysis

Component Loadings

	1	Uniqueness
ROA	0.937	0.0454
BOD size	0.825	0.301
Board independence	0.877	0.2318
Number of board meetings	0.852	0.2297
Non-performing loan	0.801	0.2531

Note. 'varimax' rotation was used

Tables 4 and 5 show that exploratory factor analysis and principal component analysis reveal that all loading variables have values larger than 0.60, indicating reliability.

Table 6

Homogeneity of Variances Test (Levene's)

F	df1	df2	P
0.608	2	388	0.73

The p-value is 0.730, which is more than 0.05, indicating that there is no link between the independent variables and ROA using the homogeneity of variances test.

Table 7

Normality Test (Shapiro-Wilk)

	W	P
BOD size	0.611	< .070
Board independence	0.75	< .062
Number of board meetings	0.776	< .061
Non-performing loan	0.658	< .055

The normality test (Shapiro-Wilk) further demonstrates that all of the variables of BOD size, board independence, number of board meetings, and non-performing loans are normal, showing p values greater than 0.05 at the 5% level of significance.

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Table 8

Correlational matrix

		BOD size	Board Independence	No. of BOD meeting	Non-performing loan	ROE	ROA
BOD size	Pearson Correlation	1					
	Sig. (2-tailed)						
	N	390					
Board Independence	Pearson Correlation	.901**	1				
	Sig. (2-tailed)	0.00					
	N	390	390				
No. of BOD meeting	Pearson Correlation	.959**	.932**	1	1		
	Sig. (2-tailed)	0.00	0.00				
	N	390	390	390	390		
Non-performing loan	Pearson Correlation	.769**	-0.732	1	1		
	Sig. (2-tailed)	0.00	0.00				
	N	390	390	390	390		
ROE	Pearson Correlation	.898**	.941**	.924**	-0.902	1	
	Sig. (2-tailed)	0.00	0.00	0.00	0.00		
	N	390	390	390	390	390	
ROA	Pearson Correlation	.945**	.901**	.959**	-0.914	.939**	1
	Sig. (2-tailed)	0.00	0.00	0.00	0.00	0.00	
	N	390	390		390	390	390

The dependent variable Profitability (ROE and ROA) both are correlated (significant) with stated independent variables (p< .01, .05) at 1% and 5% significance level. For ROE, board

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independence is highest and the least size of BOD i.e., explained by 88.55% and 80.64% respectively and remaining by other variables/factors (unexplained factors). Similarly, the portion of number of BOD meeting is highest and lowest is BOD independence i.e., explained by 89.3% and 81.18% respectively and remaining by other variables/factors (unexplained factors) for ROA. Thus, the result reveals that the independent stated variables with profitability of corporate governance variables are correlated.

Table 9

Model Fit Measures of ROA

Model	R	R^2	Adjusted R^2	AIC	BIC	RMSE	F	df1	df2	P
1	0.9	0.83	0.832	-94.3	-39	0.211	681	13	377	< .001

The adjusted r square 0.832 indicates that 83.2% ROA is determined by the stated four independent variables. AIC (Akaike information criterion), estimates the model quality which is -94.3. Lesser AIC score indicates a better-quality model.

Bayesian Information Criterion (BIC) is statistical model fits which is -39. Root mean square error (RMSE) is the standard deviation of the residuals. It indicates the distance between the regression line and the data points which is 0.211.

Overall model test is fit since p-value 0.001 is less than 0.05 at 5% level of significance.

Table 10

Model Fit Measures of ROE

Model	R	R^2	Adjusted R^2	AIC	BIC	RMSE	F	df1	df2	P
1	0.9	0.8	0.802	-92.3	-37.8	0.191	671	13	377	< .001

For ROE, adjusted r square indicates 80.2% is determined by the four independent variables. AIC (Akaike information criterion), estimates the model quality which is -92.3. Lesser AIC score indicates a better-quality model. The Bayesian Information Criterion (BIC) measures statistical model fit and is -37.8. The root mean square error (RMSE) represents the residuals' standard deviation. It represents the distance between the regression line and the data points, which is 0.191.

Regression Analysis

The regression analysis shows that respondent ROA and ROE i.e., overall, with BOD size, board independence, number of board meetings and non-performing loan is significant ($p < .05$) at 5% significance level which is shown in the following table.

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Table 11

Regression result

Predictor	Estimate	SE	Lower	Upper	T	P	Std. E
Intercept	0.913	0.041	0.815	1.039	17.207	<.001	
BOD size	1.098	0.073	0.924	1.222	14.079	<.001	1.015
Board independence	3.207	0.145	3.69	3.943	31.701	<.001	3.752
Number of board meetings	-1.782	0.118	-2.124	-1.791	-14.853	<.001	-1.79
Non-performing loan	-0.161	0.051	-0.226	-0.096	-4.315	<.001	-0.154

Note: Field survey, 2024

Findings and Discussion:

Respondents agree on the independent variables. However, the higher mean suggests board independence, as reported by respondents (3.53). In terms of the most important issues of corporate governance, the mean 3.87 respondents said professional management, the mean 3.15 said shareholder rights protection, the mean 3.61 said poor transparency, and the mean 3.47 said following rules and regulations, including the NRB. In terms of profitability, ROE is somewhat greater than ROA when considering the respondent's point of view, with 3.56 agreed upon. Farouk and Hassan (2014) reported a similar conclusion in which BOD independence improved the firm's financial performance. Similarly, respondents think that a lesser non-performing loan indicates a stronger return, or profitability, for banks. Cronbach's α value for all variables exceeds 0.80, indicating dependability. The normality test (Shapiro-Wilk) also reveals that all of the variables, including BOD size, board independence, number of board meetings, and non-performing loans, are normal, with p values less than 0.05 at the 5% level of significance.

According to the correlation matrix, the dependent variable Profitability (ROE and ROA) is correlated (significant) with all independent variables at both 1% and 5% significance level. Ahmad and Lean (2015) found that BOD size and independence influence company governance and profitability. For ROE, the highest portion is board independence whereas the smallest is BOD size. Similarly, for ROA, the percentage of BOD meetings is the largest, while BOD independence is the lowest. For both ROA and ROE, RMSE indicates that the data is close to the line of best fit.

The overall model test is fit since the p-value 0.001 is less than 0.05 at the 5% threshold of significance. The regression analysis reveals that the dependent variables ROA and ROE are significantly related to BOD size, board independence, number of board meetings, and non-performing loans at the 5% level of significance, as shown by a p value less than 0.05.

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According to Goet (2022), BOD size, business size, and foreign ownership all have an impact on financial performance, particularly in terms of return on equity. Thapa (2023) showed a similar favorable association between BOD size, board independence, and bank performance. Similarly, Khagra (2024) found that important measures of corporate governance effects include board size, board independence, and the number of meetings held, which all have an impact on the bank's profitability.

Conclusion

The results show that the bank's profitability has strong association with board size board independence, the number of BOD meetings. t-paired test is used to correlate the corporate governance variables. Finally, the majority of professional management prioritizes corporate governance. The majority of respondents think that board size and non-performing loans are negatively connected with bank profitability. However, bank's profitability is correlated with board independence and the number of board meetings. To sum up, the dependent variable Profitability (ROE and ROA) is significant in all independent variables.

Implications

According to the findings, Nepalese banks have poor professional management therefore, banks should improve the professionalism and transparency disclosures. To increase profitability, banks should improve their timely reports, build professional management systems. Similarly, banks should perform timely audits, and implement a control the financial system. The greatest difficulty of corporate governance in Nepalese banking industry, according to respondents, is minority shareholders, who are not treated fairly and do not have access to suitable norms and regulations. Furthermore, researchers can use secondary data and add sample size and covariates to obtain the results.

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