Impact of Corporate Governance Onfirm Performance in Context of Nepalese Commercial Banks

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Abstract: ***This research entitled Impact of corporate governance on firm performance in context of Nepalese commercial banks focus on relationship between corporate governance and firm performance in context of Nepalese listed commercial banks. Nine listed commercial banks over the time period from 2011 to 2016 were taken for analysis. To measure firm performance as a dependent variable ROE, ROA and Non-performing loan is used. Board size, numbers of female director, Board meeting, firm age, CEO duality, Audit committee, Total debt were used to measure corporate governance variable as independent variable.The data are collected from the Banking and Financial Statistics published by NRB, NRB directives, Company Act and Financial Institution Act,2063; supervision report of Nepal Rastra Bank and annual report of every listed commercial banks. In addition to these, different published articles, report, books and magazines are also analyzed. The multiple regression models are applied to test the significance and importance of corporate governance in the Nepalese Commercial Banks. The result shows that there is a significant impact of corporate governance on ROA as well as ROE in the financial institution mainly Commercial Banks.Board meeting, board size, female director and CEO duality have negative and significant effect on firm performance however age of the firm, firm size and total debt have positive effect on firm performance based on return on assets. While regressing firm performance based on return on equity firm age is the major factor in determining the firm performance.***

Keywords: Corporate governance, ROE, ROA, Firm size, Board size, Board meeting, number of female directors, Total debt and CEO duality

1. Introduction

Banking sector plays crucial role for development of the economy. Bank assess as a financial intermediaries between demand sector and supply sector of the economy. Economic Crises in the Asian country(1997-1998) has highlighted the importance of corporate governance. While financial crisis at culmination, regulators, government and academicians tend to focus on the corporate governance more enthusiastically in order to enhance investors' confidence that would attract more employment of fund in business. (Silwal, 2016).

Corporate governance has been a much-discussed topic in economics, management, business ethics, company law and many other disciplines. Corporate Governance is a mechanism by which business corporations are directed and controlled. The Corporate Governance composition specifies the distribution of rights and responsibilities among different participants in the corporations, such as, the board, managers, shareholders, auditors, accountants and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the constitution through which the company's objectives are set, and the means of attaining those objectives and monitoring performances.

Corporate governance is a set of rules and regulation which guide and direct the management to achieve the objective. To increase the value of the firm and shareholder wealth good corporate governance is essential. In case of developing country like Nepal good corporate governance helps to attract foreign direct investment, increase foreign portfolio and increase saving through capital market. Nepal Rasta bank (2010), Central bank of Nepal also set policies regarding corporate governance for every financial institution so that loyalty of customer can increase. Banking act 2014 has a strong legal basis for superintending banking institution. NRB has purposed action for banks like licensing function has been stopped, merger and acquisition has emerged, commercial banks need minimum paid-up-capital requirement of RS 8billionand financial institution have to disclose their statement in each quarter for public. This will definitely help in instilling reprisal and good corporate governance.

Executive compensation offers opportunities to analyze many concepts central to labor economics, including incentives, marginal productivity, contracts, promotions, separations and careers (Murphy, 1999). A long-term incentive plan is important for motivating top management to reach the goals of the company. These programs provide executives with the incentive to meet certain corporate goals for an extended period of time as well as preventing top executives from going to work for other firms. (Sigler, 2011)

The main purpose of the study is to determine relationship between corporate governance variables and the firm performance by taking appropriate variables to represent both of the variables. Specifically, the study examines the impact of CEO duality, board size, Number of female directors, firm age, firm size, Board meeting and Total debt on firm performance.

The structure of this paper includes five sections. Following this section, section 2 is committed for a literature review discussion the theories explaining the mechanism of impact of corporate governance on firm performance, as well as the relationship between them. The next section focuses on explanation of data collection, measurements of model variables and regressions. Section 4 discusses empirical results on the effects of corporate governance on firm performance in Nepalese commercial bank from 2011 to 2016. The final section summarizes main findings, provides suggestion for firms in Nepalese on corporate governance and firm performance.

2. Literature Review

The World Bank, in 1999, states that corporate governance incorporates two techniques, internal and external corporate governance. Internal corporate governance gives priority to shareholders' interest, operates on the board of directors to monitor top management. On the other hand, external corporate governance monitors and controls managers' behaviors by means of external regulations and force, in which many parties involved, such as suppliers, debtors (public director),management team, lawyers, providers of credit ratings and investment bank (professional institutions).

The literature on agency theory and firm performance has argued no statistical significance in the case of CEO duality and board independence on firm performance but negatively significant relationship between board size and firm performance (Nguyen, 2017).

(Wereko, Corporate Governance and Firm Performance: Evidance from Insurance sector of Ghana, 2012) findings shows that large board size, board skill, management skill, longer serving CEOs, size of audit committee, audit committee independence, foreign ownership, institutional ownership, dividend policy and annual general meeting are positively associated with the financial performance of insurance companies in Ghana.

(Otman, 2014)Their study supports the argument that when firms implement good corporate governance, the result is improved firm performance (financial performance and market value). They also support for the agency theory perspective that corporate governance mechanisms may mitigate agency problems, leading to an improvement in the performance of the company. They conclude good corporate governance can facilitate a good relationship between management and stakeholders, thereby enhancing the firm's performance.(Chen Luxi, 2013)present that size, leverage and industry all affect the financial performance of firm. Their study also shows that in companies with larger sizes, the impact of corporate governance is larger. (Mohammad Yameen, 2019)Findings show that board directors' size and audit committee's size negatively impact the performance of Indian firm, while board directors' composition and diligence, the audit committee's composition and diligence, and foreign ownership positively affect the performance of Indian firms measured by accounting and marketing proxies.

3. Methodological Aspect

The research study follows Descriptive and casual comparative research design to conduct the study.The study is based on secondary data, which are gathered from 9 listed commercial banks in Nepal from 2011/12 to 2016/17 leading to a total 54 observations. The data are collected from annual report of listed commercial banks.

Table 1 shows the number of listed commercial banks selected for the study along with the study period and number of observations.

Table 1: List of banks along with study period and number of observation

S.N	Name of bank	Study period	Observation
1	Everest Bank Limited	2011/12-2016/17	6 years
2	Himalayan Bank Limited	2011/12-2016/17	6 years
3	Nabil Bank Limited	2011/12-2016/17	6 years
4	Nepal SBI Bank Limited	2011/12-2016/17	6 years
5	Agriculture Development Bank Limited	2011/12-2016/17	6 years
6	Laxmi Bank Limited	2011/12-2016/17	6 years
7	Sunrise Bank Limited	2011/12-2016/17	6 years
8	Prime Commercial Bank Limited	2011/12-2016/17	6 years
9	Nepal Investment Bank Limited	2011/12-2016/17	6 years
	Total		54

Table 2: A summary all variables used in this study: definition and measurement

Variable	Definition	Measurement
ROA	Return on Assets	Net Income to Total Assets
ROE	Return on Equity	Earning after tax to total equity.
NPL	Non-performing loan	Quality of outstanding loan
CD	CEO Duality	Coded '1'if CEO is the chairman and '0' if not the same person.
FS	Firm Size	Natural logarithm of total assets.
BS	Board Size	Number of director in board committee.
FA	Firm Age	Establishment of bank to till date.
BM	Board Meeting	Number of board meeting conducted in one fiscal year.
NFD	Number of Female Director.	Position of female in board member. if yes the number is mention and if not codded by '0'.
TD	Total Debt	Total loan amount of bank.

Source: (Nguyen D. H., 2014) and selfelobrotated

Model

The model estimated in this study assumes that the bank performance depends on several corporate governance variables. The corporate governance variables considered as are firm size, CEO Duality, Board size, Firm age, Board meeting, Audit committee, Number of female director and total debt. The firm performances variables consider are ROA, ROE and Non-performing loan.

Bank Performance = $\beta 0 + \beta 1$ FS $+\beta 2$ CEO + $\beta 3$ BM + $\beta 4$ FA + $\beta 5$ BMTN + $\beta 6$ FD + $\beta 7$ DEBT +e

NPL = $\beta 0 + \beta 1$ FS $+\beta 2$ CEO + $\beta 3$ BM + $\beta 4$ FA + $\beta 5$ BMIT + $\beta 6$ FD + $\beta 7$ DEBT +e

ROA = $\beta 0 + \beta 1$ FS $+\beta 2$ CEO + $\beta 3$ BM + $\beta 4$ FA + $\beta 5$ BMIT+ $\beta 6$ FD + $\beta 8$ DEBT +e

ROE = $\beta 0 + \beta 1$ FS $+\beta 2$ CEO + $\beta 3$ BM + $\beta 4$ FA + $\beta 5$ BMIT + $\beta 6$ FD + $\beta 7$ DEBT +e

Where,
FS = Firm size
CEO = CEO Duality

BM = Board member Size
FA = Firm Age
BMIT = Board Meeting
FD = Number of Female Director
TD = Total Debt
e = Error term
Where, the bank performance is used as a dependent variable and is measured in terms of the following:
ROA = Return on Assets
ROE = Return on Equity
NPL = Non-performing loan

4. Variables and Hypothesis

Corporate governance variable
The study of corporate governance does influence firm performance is widely spread in developed countries, however the outcomes are contrary.

Firm size (FS)
Asset has been used as the measure of the firm's size. As expected that larger banks will perform best because they have well management power, better technology, huge manpower and have more diversified investment opportunities than that of small banks.(Chen Luxi, 2013)Pinpointsthat firm size intensifies the positive impact of corporate governance on firm performance, and the coefficient in the model is significant. Base on it, this study develops the following hypothesis:
H1: There is positive relationship between firm size and firm performance.

CEO Duality (CD)
CEO duality is a binary variable which has a value of one if one individual has the joint title of chairman and CEO and one individual has the executive position and there is no separate CEO in the bank. If the posts are separate, it is zero. The CEO duality sometimes considered good and bad. (Nguyen D. H., 2014) CEO as chairperson helps the CEO understand better on an entire business of company and makes more informed decisions. CEO duality has positive correlation with firm performance measured by ROA but with ROE it shows insignificant relation but CEO duality have negative relation with firm performance. Base on it, this study develops following hypothesis:
H2: There is negative association between CEO Duality and firm performance.

Board size (BS)
Board size refers to the total number of directors on the board which includes both executive and nonexecutive directors.The Board of Directors can be described in terms of size, structure, tenure, and voting mechanisms. We intuitively understand that the size of group matters for decision making.**(**Silwal**,** 2016**)**found that board size of the firm have significant effect on firm performance. Larger the board size performance of the firm would be high. (Wereko, Corporate Governance and Firm Performance: Evidance from Insurance sector of Ghana, 2012)results indicate a statistically significant positive relationship between board size and return on assets mean firm performance.Based on it, this study develops following hypothesis:
H3: There is positive association between board size and firm performance.

Firm Age (FA)
As the firm matures, their performance deteriorates. With increase in age, ROA increase, costs goes up, and market size increases too. The age has been determines by investigating number of years since its establishment and operation. A newly established firm has a higher performance as it has to prove itself in the market, hence its performance declines as it establishes itself in the market. But older the company can also indicate the company occupying larger markets and customer which has helped for its establishment.
H4: There is positive relation between firm age and firm performance.

Board Meeting (BM)
(F. Todd DeZoort, 2002) Found that Greater meeting frequency is associated with a reduced incidence of financial reporting problems and with greater external audit quality. Several factors, including board independence and company size, are associated with meeting frequency. (Nepal Rastra Bank, 2006) The Governor shall preside over the meeting of the Board. The meeting of the Board shall be held as per the requirement of the Bank at least once in a month. The Governor shall call the meeting of the Board but in case of a written request from three Directors of the Board to call the meeting of the Board, the Governor shall call the meeting of the Board. Base on the above discussion, the study develops the following hypothesis:
H5: There is positive relationship between board meeting and firm performance.

Number of female director (FD)
Number of female director is the women who are the member of board and the companies with at least one women on their board.Researcher found that the gender gap in executive pay is smaller when a greater number of women sit on the compensation committee of the board, which is the group responsible for setting executive compensation. Base on the study following hypothesis is developed:
H6: There is negative relationship between number of female director and firm performance.

Total Debt (TD)
Debt is an amount of money borrowed by one party from another. A debt arrangement gives the borrowing party permission to borrow money under the condition that is to be paid back at certain period later date with interest. Base on the study following hypothesis can developed:
H7: There is positive relationship between total debt and firm performance.

5. Presentation and data analysis

Descriptive statistics
Table 3 summarizes the descriptive statistics of variables and used in this study during the period 2011 to 2016 for 6 year with 54 observations. Clearly, return on equity ranges from 5.17 percent to 54.38 percent, leading the average return on equity to 18.56 percent while the return on assets

ranges from 0.09 percent to 3.57 percent, leading to the average return on assets of1.76 percent.

Table 3: Descriptive Statistics

	ROE	ROA	LTA	LNPL	LDEBT	FD	FA	CEO	BMTN	BM
Mean	18.56981	1.761481	24.92698	20.43718	24.47986	0.370370	21.83333	0.129630	17.88889	7.648148
Median	16.91500	1.705000	24.98388	20.36482	24.54565	0.000000	21.00000	0.000000	15.50000	8.000000
Maximum	54.38000	3.570000	25.75290	25.69202	25.39314	2.000000	49.00000	1.000000	45.00000	10.00000
Minimum	5.170000	0.090000	23.78099	17.97744	23.26685	0.000000	5.000000	0.000000	6.000000	4.000000
Std. Dev.	7.461296	0.627975	0.485756	1.426695	0.499028	0.652898	11.91598	0.339050	9.778040	1.333988
Skewness	2.086165	0.284477	-0.526828	1.460092	-0.513979	1.515978	0.624767	2.205271	1.531366	-0.538277
Kurtosis	11.00474	3.848230	2.567750	7.271151	2.616069	3.974577	2.811604	5.863222	4.334672	3.033422
Jarque-Bera	183.3396	2.347208	2.918314	60.23296	2.709228	22.82074	3.592864	62.21459	25.11378	2.610195
Probability	0.000000	0.309250	0.232432	0.000000	0.258047	0.000011	0.165890	0.000000	0.000004	0.271146
Sum	1002.770	95.12000	1346.057	1103.608	1321.913	20.00000	1179.000	7.000000	966.0000	413.0000
Sum Sq. Dev.	2950.560	20.90068	12.50581	107.8793	13.19854	22.59259	7525.500	6.092593	5067.333	94.31481
Observations	54	54	54	54	54	54	54	54	54	54

The ratio of non-performing loan to total loans varies from 17.997 to 25.69 percent, leading to the average of 20.24 percent. Likewise, the board size ranges from 4 to 10 persons, the average board size has been observed to 7.64 persons. Number of female director range from 0 to 2 number with an average 0.37 member and with standard deviation 0.65.similarly the board meeting of the bank range from 6 to 45 meeting with an average 17.889 meeting and standard deviation 9.77. likewise firm age range from 5 to 49 years of its operation with average of 21.833 and standard deviation of 11.91. And firm total debt range from 23.266 percent to 25.39 with average of 24.47 percent and standard deviation of 0.499.

Correlation analysis

Having indicated the descriptive statistics, the Pearson Correlation Coefficient have been computed and result are presented in the Table 4:

Table 4: Pearson Correlation Matrix

	ROE	ROA	LTA	LNPL	LDEBT	FD	FA	CEO	BMTN	BM
ROE	1.000000	0.525011	0.366503	-0.004526	0.387863	-0.232297	0.213594	0.034020	-0.271709	-0.154256
ROA	0.525011	1.000000	0.542310	0.121145	0.524486	0.004159	0.672860	-0.163089	0.210789	-0.020313
LTA	0.366503	0.542310	1.000000	0.180972	0.842138	-0.075177	0.731849	0.000290	0.028518	-0.284336
LNPL	-0.004526	0.121145	0.180972	1.000000	0.003493	0.276954	0.382419	0.001201	0.205067	0.190892
LDEBT	0.387863	0.524486	0.842138	0.003493	1.000000	-0.152970	0.521841	-0.083987	-0.039012	-0.301933
FD	-0.232297	0.004159	-0.075177	0.276954	-0.152970	1.000000	0.316086	0.119960	0.293249	0.087456
FA	0.213594	0.672860	0.731849	0.382419	0.521841	0.316086	1.000000	-0.027243	0.420223	-0.013255
CEO	0.034020	-0.163089	0.000290	0.001201	-0.083987	0.119960	-0.027243	1.000000	-0.217533	-0.314420
BMTN	-0.271709	0.210789	0.028518	0.205067	-0.039012	0.293249	0.420223	-0.217533	1.000000	0.351340
BM	-0.154256	-0.020313	-0.284336	0.190892	-0.301933	0.087456	-0.013255	-0.314420	0.351340	1.000000

Note: The asterisk signs shows(**) Correlation is significant at the 0.01 level (2-tailed),( )Correlation is significant at the 0.05 level (2-tailed).*

Table 4 shows that firm size, total debt and firm age is positively related with ROE and ROA. This indicate if firm asset is increase then firm ROE and ROA also increases likewise if firm grow older its ROE and ROA will be high. Likewise board meeting, number of board member and number of femal director is negatively related to firm ROE and ROA which mean larger the board member and larger the board meeting lower would be ROE and ROA. But number of femal director, CEO Duality is positively related with ROA. This indicates that larger the female in board and dual chairman in the board high will be ROA. Non-performing loan is negatively correlated with ROE only but positive with all other variables. This indicates that higher the non- performing loan lower will be ROE.

Regression analysis

The regression of corporate governance variables on bank performance has been analyzed by defining bank performance in terms of return on equity, return on assets and non-performing loans to total loans. The regression of corporate governance variables on ROA, ROE and non-performing loan produced the results as indicated in Table 5.

Having indicated the pearson correlation coefficient, the regression analysis has been performed and the result are presented in Table 5, which shows the regression result of board meeting, board size, firm size, number of female director,CEO Duality and firm age on firm performance.

The table indicates that beta coefficients are negative for board size, total debt, number of board member and number of female director indicating that smaller the board size, low debt and low member on board higher would the ratio return on equity. However, the beta coefficient is significant at 5 percent level of significance with board meeting and 10 percent with firm age. As the firm increase board meeting high will be ROE.

Table 5: Estimated relationship between ROE and independent variables

Dependent Variable: ROE				
Method: Least Squares				
Date: 07/17/19 Time: 16:00				
Sample: 1 54				
Included observations: 54				
Variable	Coefficient	Std. Error	t-Statistic	Prob.

LTA	-2.785550	5.151296	-0.540747	0.5913
LDEBT	4.154226	3.650915	1.137859	0.2611
FD	-2.721706	1.732492	-1.570978	0.1230
FA	0.274095	0.165629	1.654870	0.1048
CEO	0.665597	3.033289	0.219431	0.8273
BMTN	-0.289959	0.123286	-2.351932	0.0230
BM	0.266897	0.829924	0.321592	0.7492
C	-15.60660	92.08480	-0.169481	0.8662
R-squared	0.287039	Mean dependent var		18.56981
Adjusted R-squared	0.178545	S.D. dependent var		7.461296
S.E. of regression	6.762483	Akaike info criterion		6.796611
Sum squared resid	2103.634	Schwarz criterion		7.091275
Log likelihood	-175.5085	Hannan-Quinn criter.		6.910251
F-statistic	2.645665	Durbin-Watson stat		1.837599
Prob(F-statistic)	0.021926			

Table 6: Estimated relationship between ROA and independent variables

Dependent Variable: ROA				
Method: Least Squares				
Date: 07/17/19 Time: 16:01				
Sample: 1 54				
Included observations: 54				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
LTA	-0.674759	0.337007	-2.002211	0.0512
LDEBT	0.527296	0.238849	2.207650	0.0323
FD	-0.218252	0.113343	-1.925596	0.0603
FA	0.050204	0.010836	4.633178	0.0000
CEO	-0.184414	0.198443	-0.929305	0.3576
BMTN	-0.007253	0.008066	-0.899286	0.3732
BM	-0.000639	0.054295	-0.011769	0.9907
C	4.816310	6.024349	0.799474	0.4281
R-squared	0.569221	Mean dependent var		1.761481
Adjusted R-squared	0.503668	S.D. dependent var		0.627975
S.E. of regression	0.442413	Akaike info criterion		1.342810
Sum squared resid	9.003566	Schwarz criterion		1.637474
Log likelihood	-28.25587	Hannan-Quinn criter.		1.456451
F-statistic	8.683342	Durbin-Watson stat		1.987173
Prob(F-statistic)	0.000001			

The regression of corporate governance variables on return on assets shows that beta coefficients for the board size, board meeting, CEO duality and number of female director are not significant in as indicated in Table 6. However, coefficients are significant for firm size total loan and firm age. Thus the result indicates larger the firm size large would be return on asset. Likewise as firm increase its total debt and as firm age grow older ROA increases.

Table 7: Estimated relationship between NPL and independent variables

Dependent Variable: LNPL				
Method: Least Squares				
Date: 07/17/19 Time: 16:02				
Sample: 1 54				
Included observations: 54				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
LDEBT	-0.943262	0.720923	-1.308408	0.1972
LTA	0.831815	1.017194	0.817755	0.4177
FD	0.313072	0.342104	0.915137	0.3649
FA	0.039538	0.032706	1.208895	0.2329
CEO	0.047654	0.598964	0.079560	0.9369
BMTN	-0.008814	0.024344	-0.362035	0.7190
BM	0.201528	0.163880	1.229729	0.2251
C	20.42443	18.18340	1.123246	0.2672
R-squared	0.239663	Mean dependent var		20.43718
Adjusted R-squared	0.123959	S.D. dependent var		1.426695
S.E. of regression	1.335344	Akaike info criterion		3.552209
Sum squared resid	82.02467	Schwarz criterion		3.846874
Log likelihood	-87.90965	Hannan-Quinn criter.		3.665850
F-statistic	2.071353	Durbin-Watson stat		1.046379
Prob(F-statistic)	0.065966			

The next aspect of the study is concerned with the regression of corporate governance variables on the Non -performing loan. The regression of corporate governance variable on non-performing loan produced the results as indicated in Table 7. The table indicates that beta coefficients are negative for board size and female director indicating that smaller the board size and female director, higher would the ratio of non-performing loan to total loans. However, the beta coefficient is not significant at 5 percent level of significance. The results also indicate that larger the Board Meeting lower would be the non-performing loan to total loans where beta coefficient is also insignificant. Likewise, the results also indicate that larger the firm age and total debt, lower would be the non-performing loan to total loans where beta coefficient is insignificant.

6. Summary and Conclusion

Many companies have failed because of corporate governance problems and unethical practices. The objective behind corporate governance is to safeguard the interests of shareholders.In general, Corporate Governance system is system that regulates the operation and activities of a company especially in management. Weak corporate governance can lead to a serious financial crisis and affect other countries, and then the financial crisis was attributed to a downturn of the economy as well as the company (Jakpar, 2019).

This study examines the relationship of board size, board meetings, firm size, firm age, total debt, CEO Duality and female directors with firm performance measured by ROA, ROE and Non-performing loan in Nepalese commercial banks. A sample size of 9 commercials bank is used. Data are collected form annual report and NRB Directive for the period of 2011 to 2016.

The result reveals that firm size, total debt and age of the firm have significant impact on return on assets. Board meeting and CEO duality have negative impact whereas age of the firm, number of female director, firm size and total debt has positive impact. While going through the variables, age of the firm, total debt and firm size has been found to be more informative than board size and board meeting, female director and CEO duality of the firm.

Return on equity is positively influenced by size, age, total debt and CEO Duality and negatively influenced by board size, board meeting and female director. Board meeting have been found to be statistically strong in determining firm performance (ROE).

All the variables are positively correlated with firm non-performing loan but there is negative relation with ROE and non-performing loan. ROA and non-performing loan are positively related. The result also indicates that return on assets is positively related to return on equity

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