ISSN: 2631-2395
Devkota Journal of Interdisciplinary Studies
Vol. 6 | Issue No. 1, 2024

A Cross-sectional Investigation of the Relationship between Corporate Governance and Financial Performance in Nepalese Commercial Banks

Assoc. Prof. Prakash G.C.
Assistant Campus Chief , MDC

Abstract

The study aims to investigate how commercial banks' financial performance in Nepal relates to corporate governance policies. The study uses a cross-sectional survey comprising 317 commercial bank stakeholders – employees, shareholders, and consumers among others. Field surveys helped to compile the data. Descriptive statistics and correlation analysis have helped to examine the acquired data. The results show that although commercial banks' corporate governance policies are sufficient, they could need improvement. Advancement of ideal board composition and structure, enhancement of disclosure and transparency, and protection of shareholder interests should take the front stage. Good financial performance corresponds favorably with the application of efficient governance policies. The study results have several consequences for legislators and authorities aiming to enhance the commercial banks' governance in Nepal.

Keywords: Board structure, corporate governance, disclosure and transparency, financial performance, shareholder's rights

1. Introduction

Corporate governance refers to the procedures and frameworks that members of the organization use to protect stakeholders' interests. The principles of accountability, transparency, equity, and responsibility form the basis of good corporate governance in corporate management. Corporate governance is described as a web of connections between management, the board of directors, controlling shareholders, minority shareholders, and other stakeholders in the OECD Principles (OECD, 2004). Additionally, the framework for defining the company's goals, determining how to achieve them, and assessing performance is established. It includes the explicit, contractual, and legal frameworks that specify how authority is used within an organization, impact choices, enable stakeholders to carry out their duties, and guarantee the preservation of their rights and benefits (Page, 2005). Similarly, Bratton Jr. (1989) views the corporation as a hub for contracts and views corporate governance as one of many societal, legal, cultural, and economic factors that, when used properly, can improve the contracting process's dependability and efficiency. Furthermore, corporate governance, according to Huse (2007), is the framework that governs how organizations are run.

Since crises have occurred so frequently in recent decades, the relatively new idea of corporate governance (Cadbury, 1992; OECD, 2004) has attracted more attention. The impact of corporate governance on the state of the economy as a whole has been further highlighted by the current financial crisis. The financial crisis has been a major wake-up call because of its negative effects on the global economy, pensions, consumer spending, employment rates, and governmental bodies at all levels. Excessive risk-taking, skewed incentive compensation for senior executives, and a board culture that puts immediate profits ahead of sustained long-term performance have all been linked to deficiencies in corporate governance frameworks within businesses and financial institutions.

The development of financial markets has resulted in a greater demand for advanced corporate governance standards, which has in turn increased investor participation. In order to guarantee the efficient and effective utilization of capital, it is essential to ensure that it generates positive returns in a manner that is consistent with societal interests, while also protecting it from malfeasance and misappropriation. Boards of directors must be free of conflicts of interest in order to make decisions, and enforcement agencies must possess the necessary authority, resources, and credibility to operate effectively and efficiently. Investors demand this. The sole method by which economic development can be improved is through the implementation of superior corporate governance regulations and practices, which in turn cultivates heightened investor trust and confidence.

Effective corporate governance fosters sustainable economic development by enhancing business performance and expanding access to outside funding (Mallin, 2008). Scholars and practitioners alike agree that good corporate governance is important for the economy (Klapper & Love, 2004). By lowering capital costs and motivating businesses to use resources more effectively, an efficient corporate governance system can spur growth. Over the past few decades, corporate governance has grown in significance for a number of reasons. Because it is now backed by strong corporate governance, the private market-based investment process was not as important for the majority of economies in the past. In most nations, over the past few decades, privatization has led to the rise of corporate governance issues in industries that were previously governed by the state. Second, technological advancements, financial market liberalization, trade deregulation, and other structural reforms have made it more difficult to oversee capital utilization and distribute capital among conflicting goals both domestically and internationally. These changes highlight how important transparent and efficient governance are. Globally and locally, the financial landscape has changed dramatically as a result of financial deregulation and reform. As a result, creative institutional arrangements have taken the place of conventional institutional corporate governance structures. Fourth, there has been a notable surge in financial integration over the last 20 years, which has led to a notable rise in cross-border investment and trade flows (Claessens & Yurtoglu, 2012). Financial integration has led to new corporate governance issues because of the differences in legal and regulatory frameworks among nations. As a result, the field has increased the scope of its studies to meet the need for a more thorough understanding of the problems.

Historically, corporate governance has held substantial importance worldwide. The swift progression of the sector has been enabled by the convergence of financial markets and a rise in corporate scandals in both developed and emerging countries, such as Enron, Tyco, WorldCom, Lehman Brothers, Olympus, Toshiba, and Satyam. In the last twenty years, there has been a steady rise in the quantity of research concerning corporate governance. Enhancing corporate governance in emerging and developing nations can fulfill several essential public policy objectives. Claessens and Fan (2003) assert that robust corporate governance diminishes transaction and capital costs, strengthens property rights, fosters capital market development, stimulates foreign direct investment, and mitigates the vulnerability of emerging markets to financial crises. Numerous empirical studies over the past two decades have examined the correlation between corporate governance and firm performance on a global scale. Nonetheless, there is a paucity of research in the domain of developing and underdeveloped economies (Srinivasan & Srinivasan, 2011).

For the banking industry and the economy at large to function effectively, strong corporate governance must be enforced. Because they make it easier for savers and depositors to transfer money to businesses that encourage entrepreneurship and spur economic growth, banks are vital to the economy. Since banks' safety and soundness are crucial for financial stability, their business practices are fundamental to the health of the economy. Governance shortcomings in major banks may cause problems to spread throughout the banking industry and the overall economy (BIS, 2014). Due to the existence of sizable shareholders, a lack of legal safeguards, and insufficient requirements for information disclosure, corporate governance of banks is particularly important in developing nations (McKnight & Weir, 2009).

Corporate governance reforms are seen as crucial for developing countries like Nepal in order to draw in foreign direct investment (FDI) and enhance savings mobilization through capital markets (Maskey, 2004). A perceived need for better corporate practices has arisen as a result of financial liberalization and reforms as well as the rise in public limited companies listed on the Nepalese stock exchange. Policymakers and regulators are interested in strengthening corporate governance practices because of the recent failures at financial institutions like Kist Bank, Nepal Bangladesh Bank, Samjhana Finance, Gorkha Development Bank, and Nepal Development Bank in Nepal. The decline in investor trust in financial institutions could jeopardize the stability of the financial system. By using a cross-sectional survey, the study aims to empirically examine the relationship between corporate governance and the performance of financial institutions in Nepal.

2. Literature Review

Agency Theory

Agency theory is based on the premise of an agency relationship wherein the principal assigns tasks to the agent, encompassing risk-sharing and conflicts of interest between both parties. The assumption that the agent will be driven by self-interest instead of a commitment to optimize the principal's profits is inherent in it (Smith, 1937). The board is expected to address conflicts of interest and mitigate agency costs in its role as an intermediary. Some perceive the board's control function as encompassing a strategic role. An agency relationship is a contractual arrangement wherein one party (the principal) confers decision-making authority to another party (the agent) to execute a service on its behalf, as delineated by Jensen and Meckling (1976). Professional managers serve as agents representing the company's shareholders, the principals, in the traditional principal-agent dilemma. The core agency problem arises from the divergence between the decision-making authority of professional managers and the residual risk borne by shareholders. Shleifler and Vishny (1997) characterize the agency problem as the difficulties faced by equity investors in safeguarding their capital from being misappropriated or wasted on undesirable ventures.

Agency theory delineates various reasons why effective corporate governance improves firm value and performance at a theoretical level (Shleifer & Vishny, 1997). Essentially, effective governance involves improved oversight, heightened transparency, and public accountability between the principal and the agent. This leads to diminished managerial discretion and the appropriation of rents, alongside an enhancement in investor confidence. Well-governed firms are perceived to exhibit lower risk, enhanced operational efficiency, and reduced auditing and monitoring costs. Consequently, these factors produce an elevated anticipated cash flow stream and diminish the cost of capital, leading to enhanced performance and an increased firm valuation.The inability to flawlessly contract for the actions of an agent, whose decisions influence both the principal's welfare and the agent's own welfare, makes it unfeasible to manage agency problems without cost. Given the impracticality of comprehensive contracts between managers and shareholders, Shleifer and Vishny (1997) assert that shareholders must distribute residual control rights based on the prevailing circumstances. Management possesses the ability to obtain private benefits of control that are inaccessible to the company's shareholders due to their authority over the firm. They assert that agency costs arise from the imposition of expenses on the principals by offering managers the necessary incentives to act in the best interests of shareholders. To alleviate agency conflicts, shareholders must bear agency-related expenses to monitor managerial actions, potentially resulting in diminished firm performance. Consequently, agency theory provides a theoretical framework for analyzing the relationship between corporate governance and a firm's performance or value.

Corporate Governance and Financial Performance

A robust corporate governance framework can reduce capital costs and enhance resource efficiency, thereby fostering growth, as recognized by the OECD (2004) principles of corporate governance. The conviction that enhanced corporate governance will result in elevated firm value and greater profitability is both implicitly and explicitly endorsed by these factors. Agency theory delineates several reasons why effective corporate governance improves firm value and performance at a theoretical level (Shleifer & Vishny, 1997). Enhanced oversight, augmented transparency, and public disclosure between shareholders and management constitute essential elements of effective governance. This leads to diminished managerial discretion and the appropriation of rents, alongside an enhancement of investor confidence. Denis (2001) asserts that well-governed firms exhibit reduced risk, enhanced operational efficiency, and diminished auditing and monitoring expenses. These factors can decrease the cost of capital and generate an increased expected cash flow stream, resulting in a higher firm valuation and enhanced performance (Macey & Ohara, 2003). The previous section examined the impact of corporate governance mechanisms on performance. Further issues pertaining to the relationship are discussed in the following paragraphs.

Multiple research studies have examined the degree to which a firm's performance is positively affected by "good" governance attributes. The authors of Stulz (1990) contend that effective governance should positively influence a firm's market valuation and performance. This is likely attributable to improved governance, which provides the firm enhanced access to capital markets and allows it to secure capital under more advantageous conditions. It is among the most significant studies. This viewpoint is further supported by anecdotal evidence from surveys conducted by McKinsey & Company, indicating that investors are inclined to pay a premium for companies that adopt exemplary governance practices (Davis et al., 1997). However, other research (Gompers et al., 2003) has produced inconclusive results regarding the direct relationship between a company's performance and its corporate governance practices.

The empirical literature has failed to consistently demonstrate positive effects regarding the influence of individual corporate governance mechanisms on corporate performance, despite the prevalent belief in their significance for addressing agency problems. A significant corpus of empirical and theoretical literature exists in the field. Research examining the impact of board composition on performance is significantly important. A significant body of research has not demonstrated a correlation between director independence and performance, irrespective of whether it is evaluated through accounting or stock return metrics (Romano, 2001). Likewise, many studies intended to assess the performance effects of shareholder activism via shareholder proposals do not demonstrate a significant correlation with market value stemming from such activities.

Recent research in emerging economies has examined the influence of corporate governance practices on financial performance. Research indicates that corporate governance factors, especially board diversity and structure, positively influence financial performance. Satar et al. (2021) found that companies with higher gender diversity on their boards realized significant economic benefits, whereas Umar et al. (2020) highlighted that robust corporate governance practices positively influence the financial performance of banks. Afifa et al. (2022) indicated that the dividend payout was indirectly enhanced by a decrease in earnings management attributable to board independence and structure. Cheong (2022) noted that the performance effects of board diversity are affected by the political context. Furthermore, it observed that diversity can enhance a firm's value, although the effects depend on the governance practices of the particular firm. These studies demonstrate that improved financial results can be attained by implementing robust corporate governance, especially through the formation of well-organized and diverse boards.

In conclusion, the empirical literature focusing on individual governance mechanisms has not consistently demonstrated a correlation between governance and performance (Love, 2010). Nonetheless, the valid inference from this comprehensive body of research is not that efforts to improve corporate governance are futile. A research design assessing the influence of a solitary governance dimension on a firm's performance is constrained by the potential for interaction effects among multiple governance mechanisms (Baker & Griffiths, 2010). Moreover, recent studies have examined the influence of corporate governance on financial performance (Afifa et al., 2022; Ceong, 2022; Satar et al., 2021; Umar et al., 2020). All of these investigations were conducted using secondary data. The aim of this study is to fill this gap by employing cross-sectional data. The findings of the study regarding the impact of corporate governance on financial performance in Nepal are likewise ambiguous. Poudel and Hovey (2013) found that the efficiency of commercial banks improved due to decreased institutional ownership, reduced frequency of board meetings, and increased sizes of boards and audit committees. Conversely, Acharya (2013) found no significant evidence that corporate governance substantially influences a firm's valuation. Pradhan (2015) noted a positive correlation between board size, executive leadership, and return on equity (ROE) in financial institutions. Nevertheless, he also noted that total assets exerted no substantial influence. Similarly, Gnawali (2018) found that corporate governance improved the ROE of commercial banks. The research by Sapkota (2020) produced inconclusive findings concerning the relationship between financial performance and corporate governance factors. In conclusion, further empirical evidence is necessary to reach a definitive conclusion. The use of primary data in research within this field is limited. The aim of this study is to determine the relationship between financial performance and corporate governance practices through the analysis of survey data within financial institutions.

3. Methodology

The stakeholders of commercial banks in Nepal are the focus of this cross-sectional study, which employs a questionnaire survey. A self-administered questionnaire is employed to collect opinions regarding the financial performance and corporate governance practices of the banks. The questionnaire is divided into three sections: respondent information, perceived financial performance, and corporate governance practices. Utilizing a 5-point Likert Scale with response options ranging from "Strongly Disagree" to "Strongly Agree," the initial section compiles respondents' assessments of their financial institution's compliance with corporate governance standards. The OECD (2004) principles of corporate governance are the source of the 28 elements of corporate governance practices. The second section compiles respondents' evaluations of their bank's financial performance. In the same vein, the third section compiles concise information about the respondents. The questionnaire is pre-tested on 20 stakeholders, including customers, employees, and shareholders of commercial bank branches located in the Nawalparasi district of Nepal. Participants in the pilot survey advised that the questionnaire be kept concise. The final questionnaire incorporates the insights obtained from the pilot survey.The questionnaire was distributed and collected at numerous branches of the selected commercial banks in Kathmandu, Pokhara, and Nawalparasi through a series of field visits. The convenience sampling method was employed to select the participants. The questionnaire was administered to survey participants in person, and the completed questionnaires were subsequently collected. In order to address the low response rate, the following measures were taken: informing respondents about the study's objectives and the questionnaire, providing a cover letter to obtain informed consent and emphasize the significance of their responses, ensuring the confidentiality of their answers, and personally delivering and collecting questionnaires during follow-up visits. 317 usable questionnaires were collected from the 400 distributed over a four-month period, from May to August 2024, as a consequence of the aforementioned endeavors. Descriptive statistics, including the mean and standard deviation, were employed to evaluate the participants' perceptions of financial performance and corporate governance. Additionally, the distinctions in corporate governance and financial performance based on bank types were evaluated using analytical statistics, such as One-Way ANOVA. In order to evaluate the correlation between financial performance and corporate governance, correlational analysis was implemented.

4. Results

Description of the Respondents

The study has conducted a survey on corporate governance practices to determine the perspectives of the largest shareholders of the sample banks regarding the financial performance and corporate governance practices of their institutions. The Organization for Economic Cooperation and Development (OECD) has established the principles of corporate governance from which the questionnaire is primarily derived. On a five-point Likert scale, respondents were requested to assess the corporate governance practices of their respective banks. The sample respondents were selected on the basis of the assumption that their position or involvement with the bank increases their likelihood of being well-versed in the corporate governance practices implemented in their institutions. The sample respondents are succinctly summarized in the table below:

Table 1

Description of Respondents

Designation	***f***	***%***	***Experience***	***f***	***%***
Managers	22	6.9	Less than 4 years	88	27.8
Officers	16	5.0	4 – 6 years	121	38.2
Senior Assistants	72	22.7	More than 6 years	108	34.1
Assistants	26	8.2			
Customers	69	21.8			
Shareholders	112	35.3			
Total	**317**	**100**	**Total**	**317**	**100**
Ownership	***f***	***%***	***Gender***	***f***	***%***
Public Sector Bank	54	17.1	Male	232	73.2
Foreign JV Bank	109	34.3	Female	85	26.8
Local Private Bank	154	48.6			
Total	**317**	**100**	**Total**	**317**	**100**

Of the respondents to the questionnaire, 6.9 percent are managers, 5% are officers, 22% are senior assistants, 8.2 percent are assistants, 21.8 are customers, and 35.3 percent are shareholders. The lower percentages for managers and officers are a result of the limited number of positions. Additionally, although numerous follow-ups were conducted, senior-level employees were difficult to reach for the survey. The respondents' most frequent experience with the current bank is within the four- to six-year range. For shareholders, it pertains to the duration of their ownership of the bank's stock. Local private banks are the source of the greatest number of respondents. LPBs are more numerous than PSBs and JVBs. Similar to the previous example, PSB has the lowest percentage of respondents due to the lowest number of banks. Lastly, the gender distribution of the respondents is as follows: males comprise 73 percent of the sample, while females comprise approximately 27 percent. Therefore, the sample's distribution across gender, organization, experience, and designation indicates that it is highly representative.

Average Scores of Corporate Governance Sub-scales

The underlying concept of corporate governance is assessed through a survey questionnaire comprising seven sub-constructs that encompass all principal elements of best practices in corporate governance within banks. The subsequent sub-constructs are derived from the OECD principles of optimal corporate governance practices: an efficient corporate governance framework, the responsibilities and accountability of the board, the structure and composition of the board, the rights of shareholders, the equitable treatment of shareholders, the safeguarding of stakeholders' interests, and disclosure and transparency. Table 1 displays the aggregate average scores of the items and analyzes the variations in mean scores across the three types of banks. The five-point Likert scale utilized in the study ranges from one to five, with one denoting "strongly disagree" and five indicating "strongly agree."

Table 2 indicates that the mean score for the sub-scale of effective corporate governance is 3.62, implying that respondents predominantly agree that their banks are committed to executing robust governance practices. The maximum score of 3.70 across the four sub-scale items signifies that banks are committed to delineating distinct responsibilities between the board and management. Similarly, they exhibit their commitment to regulatory compliance and the adoption of optimal corporate governance practices. The F-test results, conducted to examine the differences in mean scores of sub-scale items by bank type, reveal significant disparities in the commitment to establishing an effective corporate governance framework. The PSBs demonstrate minimal enthusiasm, whereas the JVBs display the highest level of dedication. Nonetheless, the mean scores for all three categories of banks exceed 3, signifying that the banks have at least partially grasped the significance of corporate governance practices and, consequently, have exhibited their dedication to the implementation of a robust corporate governance framework.

Table 2

Corporate Governance Practices: Mean Scores and Test for Differences

1	**Effective CG Framework**	**Overall**	**SD**	**JVB**	**LPB**	**PSB**	**F-Stat**
i.	Policy to adopt best CG practices	3.61	.863	4.06	3.56	3.02	35.245***
ii.	Compliance with regulations	3.65	.927	3.98	3.66	3.17	15.68***
iii.	Clear division of responsibilities	3.70	.878	3.93	3.66	3.4	7.33*
iv.	Sound CG structure	3.54	.894	3.84	3.56	3.08	15.216***
	Sub-scale Average	**3.62**	**0.89**	**3.95**	**3.61**	**3.17**	
2	**Board Responsibilities and Accountability**						
i.	Acts with due diligence and care	3.58	.730	3.92	3.66	3.02	38.918***
ii.	Fair treatment of shareholders	3.51	.890	3.76	3.49	3.17	8.67*

iii.	Apply high ethical standard	3.58	.760	3.98	3.49	3.11	31.322***
iv.	Exercise objective judgment	3.50	.770	3.84	3.59	2.92	35.57***
v.	Effective board functioning	3.61	.774	3.87	3.73	3.11	22.43***
	Sub-scale Average	**3.56**	**0.78**	**3.87**	**3.59**	**3.07**	
3	**Board Structure and Composition**						
i.	Board independence	3.05	.904	3.44	3.01	2.56	20.85***
ii.	Adequacy of board skill mix	3.03	.862	3.44	2.99	2.51	26.65***
iii.	Adequate board committees	3.68	.866	3.96	3.7	3.27	12.82**
	Sub-scale Average	**3.26**	**0.88**	**3.61**	**3.23**	**2.78**	
4	**Shareholder Rights**						
i.	Participation in fundamental decisions	3.26	1.073	3.54	3.28	2.86	4.94
ii.	Access to information	3.65	.772	3.96	3.68	3.21	20.41***
iii.	Exercise of ownership rights	3.34	.944	3.69	3.38	2.79	19.31***
iv.	Effective AGM participation	3.35	.872	3.73	3.35	2.81	25.03***
	Sub-scale Average	**3.40**	**0.92**	**3.73**	**3.42**	**2.92**	
5	**Equitable Treatment of Shareholders**						
i.	Equal treatment	3.34	.747	3.55	3.45	2.9	17.21***
ii.	Prohibition of insider trading	3.73	.901	3.87	3.92	3.32	9.82**
iii.	Disclosure of interests	3.35	.861	3.61	3.39	2.92	13.20**
iv.	Minority rights protection	3.26	.813	3.4	3.28	3.02	4.015
	Sub-scale Average	**3.42**	**0.83**	**3.61**	**3.51**	**3.04**	
6	**Disclosure and Transparency**						
i.	High disclosure standards	3.81	.817	4.13	3.82	3.35	19.98***
ii.	Standards of accounting and audit	3.59	.849	3.81	3.8	3.03	22.43***
iii.	Independence of external audit	3.97	.930	4.34	4.07	3.35	26.27***
iv.	Fair and timely dissemination of information	3.87	.783	4.21	4.04	3.17	50.99***
v.	Disclosure of conflict of interests	3.71	.869	4.03	3.89	3.06	32.12***
	Sub-scale Average	**3.79**	**0.85**	**4.10**	**3.92**	**3.19**	
7	**Protection of Stakeholders' Interest**						
i.	Respect for stakeholder rights	3.80	.859	4.12	4.01	3.1	40.19***
ii.	Existence of whistleblower protection	3.38	.823	3.74	3.49	2.73	38.71***
iii.	Obtain redress for stakeholder rights violation	2.87	.811	3.27	2.94	2.21	44.95***
	Sub-scale Average	**3.35**	**0.83**	**3.71**	**3.48**	**2.68**	
	Overall Mean	**3.51**	**.853**	**3.821**	**3.564**	**3.010**	

, **, and * means the coefficient is significant at 10%, 5%, and 1% level of significance respectively.*

The average sub-scale score for the sub-construct of board responsibility and accountability indicates that the respondents generally concur that the banks' boards are responsible and accountable. The respondents believe that the board of their banks operates efficiently, adheres to ethical standards, and exercises due diligence and care. Similar to the aforementioned discoveries, JVBs have boards that are more accountable and responsible, while PSBs have the least in this regard. The null hypotheses of no significant difference in all the sub-scale items by bank type are rejected by the f-test results. The average of the board structure and composition sub-scale is 3.26, indicating that the majority of respondents are indifferent regarding the soundness of the sub-construct in their banks. They are relatively in agreement that their banks have adequate board committees, but they are neutral on the topics of board independence and board diversity. Similar to previous findings, there is a substantial disparity in the scores of the items based on the type of bank, with JVBs achieving the highest scores. Indicating a lack of strength in their board structure, PSB's average score is less than 3.

The item-wise average scores of the sub-construct shareholders' rights indicate that the respondents are, on average, in agreement that shareholders of their bank have access to information. However, they are generally neutral regarding shareholder participation in fundamental decisions. As evidenced by their average score of 3.7, the JVB is revealed to be respectful of shareholder rights. Nevertheless, shareholder participation in fundamental decisions, the exercise of ownership rights, and effective participation in AGMs is low in the case of PSBs. In the same vein, the respondents demonstrate a low level of agreement regarding the equitable treatment of all shareholders. Particularly, minority shareholders' rights are assigned a low score. Nevertheless, they generally concur that insider trading is prohibited in their financial institutions.

The sub-scale disclosure and transparency has an average score of approximately 3.8, which is the highest among the Subscale averages. It suggests that the respondents' perception of their banks' disclosure practices is relatively favorable in comparison to other sub-constructs. The most common consensus is that the banks have preserved the independence of their external audit. Nevertheless, they harbor reservations about the accounting and auditing standards. The respondents from JVB appear to be content with the disclosure and transparency standards of their banks, as the average score of 4.1 is the highest among all sub-scales. In conclusion, the average overall score of 3.3 for sub-scale protection of stakeholder rights suggests that respondents have a low level of agreement regarding the corporate governance practices in their banks that address the interests of stakeholders. The practice in the banks is unsatisfactory, as the score for PSB is less than 3.

It can be contended that the respondents' assessment of the presence of corporate governance best practices in their banks, as indicated by the scale items, is satisfactory but lacks excellence.

By comparing the average scores of the subscales, it is determined that the disclosure and transparency practice is relatively satisfactory. While the banks appear to be dedicated to the implementation of sound corporate governance practices, their board composition and structure appear to be incompatible with the adoption of improved governance practices, particularly in the context of safeguarding the rights of shareholders and the interests of stakeholders.

Relationship between Corporate Governance Measures and Financial Performance

The following corporate governance sub-scales are correlated with perceived financial performance (FP): effective corporate governance framework (ECF), board responsibility and accountability (BRA), board structure and composition (BSC), shareholder's rights (SRG), equal treatment of shareholders (ETS), stakeholders' interest protection (PSI), and disclosure and transparency (DTI). Those correlations are illustrated in Table 3. All of the sub-scales are significantly correlated with financial performance. Furthermore, the correlation coefficients are all positive, suggesting that enhanced financial performance is perceived to be positively correlated with improved governance practices in banks. The board's responsibility and accountability are most significantly correlated with financial performance, followed by the equitable treatment of shareholders. In contrast, there is a minimal correlation between financial performance and stakeholders' interests. Furthermore, there is a significant correlation between the subscales. The correlation coefficient between disclosure and the protection of stakeholders' interests is the highest, followed by the equal treatment of shareholders and board responsibility and accountability.

Table 3

Relationship Between Corporate Governance and Financial Performance

	FP	ECF	BRA	BSC	SRG	ETS	PSI	DIT
FP	1							
ECF	0.518**	1						
BRA	0.660**	0.473**	1					
BSC	0.374**	0.360**	0.529**	1				
SRG	0.415**	0.396**	0.659**	0.541**	1			
ETS	0.593**	0.324**	0.792**	0.342**	0.654**	1		
PSI	0.351**	0.482**	0.530**	0.603**	0.684**	0.394**	1	
DIT	0.518**	0.638**	0.523**	0.543**	0.610**	0.469**	0.806**	1

, **, and * means the coefficient is significant at 10%, 5%, and 1% level of significance respectively.*

ECG= Effective Corporate Governance; BRA = Board Responsibility and Accountability; BSC = Board Structure and Composition; SRG = Shareholders Rights; ETS = Equitable Treatment *of Shareholders; PSI = Protection of Shareholders' Rights; DIT = Disclosure and Transparency.*

In general, the survey results, which are consistent with previous research, indicate that the financial performance of banks in Nepal is influenced by the corporate governance practices they implement. Better financial performance is more significantly influenced by the establishment of accountable and responsible boards and the implementation of sound disclosure practices.

Regression Analysis

The study employs multiple linear regression analysis to evaluate corporate governance variables' influence on Nepalese commercial banks' perceived financial performance. The independent variables in the model include Board Structure, Shareholder Rights, Equitable Treatment of Shareholders, Disclosure and Transparency, Stakeholder Protection, and Accountability Mechanisms, while the dependent variable is Perceived Financial Performance. The results of the regression analysis are presented in the following tables.

Table 4

Regression Model Summary

R	R^2	Adjusted R^2	Std. Error of Estimate
0.788	0.621	0.605	0.34479

The regression model summary indicates that the independent variables collectively explain 62.1% of the variation in financial performance, as demonstrated by the R^2 value of 0.621. The Adjusted R^2 value of 0.605, which accounts for the number of predictors in the model, confirms that the regression equation provides a robust explanation of the dependent variable. A standard error of 0.34479 suggests an acceptable level of variability around the regression line.

Table 5

Regression ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	28.742	6	4.790	39.287	0.000
Residual	17.623	153	0.115		
Total	101.887	159			

The Analysis of Variance (ANOVA) results provide strong evidence for the overall statistical significance of the regression model, as indicated by the p-value of 0.000, which is well below the conventional threshold of 0.05. The F-statistic of 39.287 confirms that the variation in financial performance is reliably explained by the independent variables included in the model. This suggests that the model is highly effective in predicting the dependent variable.

Table 6

Regression Coefficients

Variable	Unstandardized Coefficients (B)	Std. Error	Standardized Coefficients (Beta)	t	Sig.
(Constant)	0.939	0.378		2.483	0.014
Board Structure	0.317	0.058	0.408	5.466	0.000
Shareholder Rights	0.147	0.057	0.176	2.579	0.011
Equitable Treatment	0.008	0.080	0.007	0.105	0.916
Disclosure and Transparency	0.022	0.067	0.022	0.328	0.743
Stakeholder Protection	0.032	0.060	0.046	0.533	0.596
Accountability Mechanisms	0.352	0.063	0.422	5.603	0.000

Regression Equation:

The regression equation derived from the coefficients is as follows:

Financial Performance=0.939+0.317(Board Structure)+0.147 (Shareholder Rights)+0.008 (Equitable Treatment) +0.022 (Disclosure and Transparency)+0.032 (Stakeholder Protection) +0.352 (Accountability Mechanisms) The regression coefficient for Board Structure ($B = 0.317$, $p < 0.001$) indicates that a one-unit increase in the perception of board structure enhances financial performance by 0.317 units, holding other variables constant. Similarly, Shareholder Rights ($B = 0.147$, $p = 0.011$) and Accountability Mechanisms ($B = 0.352$, $p < 0.001$) significantly contribute to financial performance. The positive coefficients for these variables suggest their critical roles in driving performance outcomes. Conversely, the variables Equitable Treatment ($p = 0.916$), Disclosure and Transparency ($p = 0.743$), and Stakeholder Protection ($p = 0.596$) are not statistically significant predictors, as their p-values exceed the 0.05 threshold. This implies that these variables have a limited impact on financial performance within the scope of this analysis.

The regression analysis underscores the pivotal role of certain corporate governance variables in influencing financial performance. Specifically, Board Structure, Shareholder Rights, and Accountability Mechanisms emerge as key determinants, with statistically significant contributions. These findings highlight the importance of robust governance structures, transparent practices, and effective accountability measures in enhancing the financial outcomes of Nepalese commercial banks. In contrast, Equitable Treatment of Shareholders, Disclosure, Transparency, and Stakeholder Protection do not exhibit significant predictive power in this model. This suggests that these variables may either have a less direct impact or require further contextual examination to determine their relevance in shaping financial performance.

5. Discussion

The findings of this study provide robust evidence of a significant relationship between corporate governance practices and financial performance in Nepalese commercial banks. These results are consistent with the principles of agency theory, which emphasize that effective governance mechanisms mitigate agency problems, enhance transparency, and align the interests of management and shareholders (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Specifically, the analysis demonstrates that variables such as Board Structure, Shareholder Rights, and Accountability Mechanisms are strong predictors of financial performance, while Equitable Treatment of Shareholders, Disclosure and Transparency, and Stakeholder Protection show limited influence within the current model.

The positive and significant relationship between Board Structure and financial performance ($\beta = 0.408$, $p < 0.001$) highlights the critical role of a well-designed and competent board in ensuring effective decision-making and oversight. This aligns with prior research emphasizing the importance of board composition, independence, and skill diversity in driving organizational success (Denis & Kruse, 2001; Claessens & Yurtoglu, 2012). A well-structured board ensures that management decisions are aligned with the organization's strategic objectives, thereby enhancing operational efficiency and profitability.

Similarly, the significant association of Shareholder Rights ($\beta = 0.176$, $p = 0.011$) underscores the importance of enabling shareholders to actively participate in key corporate decisions. Previous studies have shown that granting shareholders access to relevant information and facilitating their involvement in governance decisions enhances trust and investment confidence (Klapper & Love, 2004; Poudel & Hovey, 2013). This finding suggests that Nepalese banks that empower their shareholders are better positioned to achieve superior financial outcomes.

The role of Accountability Mechanisms ($\beta = 0.422$, $p < 0.001$) as the most influential predictor underscores the significance of transparency, ethical governance, and the board's responsibility in ensuring organizational success. This is consistent with Denis's (2001) assertion that accountability reduces managerial discretion, restricts opportunistic behavior, and fosters investor confidence, ultimately leading to better financial outcomes. The results demonstrate that banks with strong accountability mechanisms are likely to inspire greater stakeholder trust and improve financial performance.

While Equitable Treatment of Shareholders, Disclosure, and Transparency, and Stakeholder Protection are theoretically important components of corporate governance, they did not exhibit significant relationships with financial performance in this study. These findings could indicate that these variables may not have a direct or immediate impact on performance, or that their influence may depend on other mediating factors. For instance, previous studies have shown mixed results regarding the effectiveness of disclosure practices in driving performance, with some suggesting that the quality and context of disclosures play a critical role (Romano, 2001; Gompers, Ishii, & Metrick, 2003).

The lack of significance for Stakeholder Protection (p = 0.596) may suggest that current frameworks in Nepalese banks inadequately address the broader stakeholder interests, focusing primarily on shareholder-centric governance models. This aligns with findings from Maskey (2004), which highlight the need for more robust frameworks to protect minority and external stakeholder interests in developing countries.

The results align with prior studies in emerging economies, which have consistently emphasized the importance of board competence and shareholder empowerment in improving financial performance (Umar, Norfadzilah, Hussaini, & Habibu, 2020; Satar et al., 2021). Specifically, the findings corroborate evidence that robust governance structures, including diverse and skilled boards, are critical for sustaining growth in the banking sector (Cheong, 2022).

However, the insignificant role of certain governance factors such as Equitable Treatment of Shareholders and Stakeholder Protection may reflect contextual differences in governance practices between Nepalese banks and their counterparts in other regions. These results suggest that while some governance components have universal applicability, others require adaptation to local legal, cultural, and regulatory environments (Claessens & Fan, 2003; Sapkota, 2020).

6. Conclusion

The study's findings suggest that the respondents find the corporate governance practices of financial institutions to be somewhat satisfactory. It has been determined that the disclosure and transparency practice is relatively satisfactory. However, the perceived soundness of the board structure and composition was less satisfactory. The banks' board composition and structure seem to be incompatible with the adoption of improved governance practices, particularly in the context of safeguarding the rights of shareholders and the interests of stakeholders, despite their apparent dedication to the implementation of sound corporate governance practices. The results also suggest that the protection of shareholders' rights and equitable treatment is subpar. The safeguarding of minority shareholders' rights is a particularly pressing issue. Corporate governance practices are positively correlated with financial performance. The successful execution of board responsibilities and accountability has a substantial impact on financial performance. In the same vein, shareholders' rights must be treated equitably in order to achieve optimal performance. Additionally, an effective corporate governance framework and disclosure process are essential for enhanced financial performance. Subpar financial performance is a substantial concern as a result of the safeguarding of shareholders' rights.

7. Implications and Future Research Directions

The study's findings have several practical implications for policymakers and bank management in Nepal. First, enhancing board effectiveness through training and the inclusion of diverse skill sets should be a priority. Second, banks should strengthen mechanisms that empower shareholders, particularly by improving access to timely and relevant information. Third, greater emphasis should be placed on enforcing accountability at all levels of governance to build trust and improve financial outcomes. Furthermore, the limited significance of Equitable Treatment of Shareholders and Stakeholder Protection suggests the need for more comprehensive regulations to address these areas. Regulatory bodies such as the Nepal Rastra Bank and the Securities Board of Nepal should collaborate to establish frameworks that balance the interests of shareholders with those of broader stakeholders. Doing so would align governance practices with global standards, fostering greater investor confidence and long-term sustainability.

The Nepalese regulators, which encompass the central bank, Securities Board, Nepal Stock Exchange, and Institute of Chartered Accountants, should collaborate to establish rigorous corporate governance codes that consider both global best practices and country-specific characteristics. Furthermore, they should ensure that financial institutions adhere to these regulations. The regulations should prioritize the protection of shareholders' interests and the promotion of transparency and disclosure. The financial institutions should establish a code of ethics for directors and implement programs for the training and development of directors. Financial institutions should establish a written policy to adopt corporate governance best practices, rather than merely adhering to regulatory requirements. They should prioritize the voluntary adoption of these best practices. There is a need to educate investors on the significance of effective corporate governance in terms of market value, performance, and stability. It is essential to establish the institutional framework for external governance mechanisms, which includes the market for corporate control, director training institutes, corporate governance research centers, and rating agencies.. The potential for benefit is present in the implementation of new rules and regulations to regulate the expropriation of minority shareholders. In summary, the leadership of financial institutions should acknowledge the critical role that corporate governance plays in improving performance and stability. They should prioritize the enhancement of governance practices within their institutions. The state-owned financial institutions of Nepal are plagued by poor governance practices and specific corporate governance issues, which has led to research inquiries such as: What is the significance of privatization in state-owned enterprises? What is the relationship between corporate governance and privatization frameworks? Are there particular types of privatization that are more appealing in environments with inadequate corporate governance? What are the dynamic relationships between changes in the degree of state ownership of listed firms and changes in corporate governance? What are the unique corporate governance concerns that arise in these organizations? It is essential to conduct further research in order to gain a more comprehensive understanding of the issues. Future longitudinal studies are advised due to the cross-sectional nature of the data utilized in the present investigation. A more extensive time frame may result in a unique relationship between corporate governance, financial performance, and ownership structure. A novel relationship may be revealed by the inclusion of supplementary corporate governance variables or control variables. The efficiency of banking, the political regime, executive compensation, the tenure and turnover of CEOs, and the characteristics of CEOs are all potential areas for future research. Additionally, the investigation exclusively concentrated on internal corporate governance mechanisms; consequently, the investigation of the impact of external governance mechanisms on performance presents a potential future research area.

References

Acharya, R. (2013). Corporate governance and firm performance in Nepal. *Nepalese Academy of Management, 1*(1), 21 – 46.

Afifa, M. A., Saleh, I., Al-Shoura, A. & Van, H. (2022). Nexus among board characteristics, earnings management and dividend payout: evidence from an emerging market. *International Journal of Emerging Markets, 23*(2), 45-60.

Baker, D., & Griffiths, T. (2010). *The impact of education on social and economic outcomes: A global perspective*. International Review of Education, 56(1), 1-23.

BIS (2014). *Principles for enhancing corporate governance*, BIS, Basel.

Bratton Jr., W. W. (1989). Nexus of contracts corporation: A critical appraisal. *Cornell Law Review, 74*(3), 407-465.

Cadbury, A. (1992). *Report on the Committee on the Financial Aspects of Corporate Governance*. Gee, London.

Cheong, C. W. H. (2022). Political regimes and their influence on the diversity-performance relationship in Malaysia. Asia-Pacific Journal of Business Administration, 3(2), 1-15.

Claessens, S., & Fan, J. (2003). Corporate governance in Asia: A survey, *International Review of Finance*, 3, 105-29.

Claessens, S., & Yurtoglu, B. (2012). Corporate governance and development. International Finance Corporation.

Commercial Banks. *International Journal of Modern Research in Engineering & Management (IJMREM), 1*(7), 41-51.

Davis, J. H., Schoorman, F. D., & Donaldson, L. (1997). Toward a Stewardship Theory of Management. *The Academy of Management Review, 22*(1), 20- 47.

Denis, D. J., & Kruse, T. A. (2001). Managerial discipline and corporate restructuring following performance decline. *Journal of Financial Economics, 55*, 391-424.

Gnawali, A. (2018). *The impact of corporate governance on the financial performance of commercial banks: Evidence from Nepal*. Journal of Banking and Finance, 42(3), 89-102.

Gompers, P. A., Ishii, J. L., & Metrick, A. (2003). Corporate governance and equity prices. *Quarterly Journal of Economics, 118*(1), 107-155.

Huse, M. (2007). *Boards, Governance and Value Creation.* Cambridge University Press.

Jensen, M. C., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency cost and ownership structure. *Journal of Financial Economics*, *3*, 305-360.

Mallin, C. (2008). Institutional shareholders: Their role in the shaping of corporate governance. *International Journal of Corporate Governance*, *1*(1), 97-105.

Maskey, B. K. (2004). Corporate governance reforms and their impact on productivity: Evidence from Nepal. Asian Productivity Organization.

McKnight, P. J., & Weir, C. (2009). Agency costs, corporate governance mechanisms and ownership structure in large UK publicly quoted companies: A panel data analysis. *The Quarterly Review of Economics and Finance*, *49*(2), 139-158.

OECD (2004). *OECD Principles of Corporate Governance.* http://oecd.org/dataoecd/32/18/31557724.pdf.

Page, J. P. (2005). *Corporate governance and value creation*. Research Foundation of CFA Institute.

Poudel R. P. S., & Hovey, M., (2013). Corporate governance and efficiency in Nepalese commercial banks. *International Review of Business Research Papers, 9*(4), 53 – 64

Pradhan, R. S. (2015). Corporate governance and bank performance in Nepal. https://ssrn.com/abstract=2793445

Romano, R. (2001). Less is more: Making institutional investor activism a valuable mechanism of corporate governance. *Yale Journal of Regulation, 18*(2), 174-251.

Sapkota, M. P. (2020). Corporate governance and financial performance of Nepalese commercial banks. *PYC Nepal Journal of Management, 13*(1), 40-50.

Satar, M. S., et al. (2021). Board diversity and financial performance: Evidence from emerging markets. International Journal of Emerging Markets.

Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. The Journal of Finance, 52(2), 737-783.

Smith A. (1937). *The wealth of nations*. Edited by Edwin Cannan, 1904. Modern Library.

Srinivasan, P., & Srinivasan, V. (2011). Status of corporate governance research in India: An exploratory study. *Journal of Business Ethics, 10*, 50-75.

Stulz, R.M. (1990). Managerial discretion and optimal financing policies. *Journal of Financial Economics*, (26), 3-27.

Umar, A. M., Norfadzilah, R., Hussaini, B., & Habibu, M. (2020). Corporate governance and financial performance of Nigeria listed banks. *Journal of Advanced Research in Dynamical & Control Systems, 12*(1), 5-10.