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## **Study about Corporate Governance**

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### **Abstract**

*Nepal Rastra Bank is the highest regulatory body in all financial-related activities in Nepal. Nepal has not a long history of Corporate Governance practices. Effective corporate governance reduces ownership and control problems and draws a clear line between the shareholder and the manager. One of its major objectives is to improve the overall corporate governance system of the financial institutions including commercial banks and create financial stability in the country. Especially for the Nepalese banking sector, corporate governance practices in the commercial bank of Nepal, relationships between board size and commercial bank effects in their performance, and the relationships between audit committee size and commercial bank performance in Nepal are the objectives of the article.*

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**Keywords:** *Corporate governance, Nepal Rastra Bank, Performance, Banks, Financial activities*

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### **Introduction**

Nepal Rastra Bank is the highest regulatory body in all financial-related activities in Nepal. Nepal has not a long history of Corporate Governance practices. License from NRB is the most crucial aspect to operate intermediaries' transactions, after having the registration in Company Register Office (COR). Financial institutions are regulated through the Nepal Rastra Bank Act 2002, Bank and Financial Institutions Act 2017, and Company Act 2006 respectively. Other than these Acts listed companies need to abide by the Securities Act 2006 and the directives issued by the Securities Board of Nepal and Nepal Stock Exchange Limited. Several players have participated in the financial market. The market of financial institutions including commercial banks increased after the announcement of liberal policy by the government in the 1980s to operate it. All banking institutions from A to D level are the main players in the financial market. Apart from these, other institutions like the Employees Provident Fund (EPF), Citizen Investment Trust (CIT), and Deposit Insurance and Credit Guarantee Corporation (DICGC) are also playing an important role in the financial market in Nepal.

Effective corporate governance restricts ownership and conducts challenges and acquires a pure demarcation between the stakeholder and the manager (Khan, 2011). For this

monetary policy is the important mechanism to maintain corporate governance. The monetary policy has likewise epicenters on enriching acclaim circulates to the cornucopian sectors for verifiable economic and financial sector progress, and widening financial martial and financial inclusion (Nepal Rastra Bank, 2014). There is only one stock exchange as a securities market i.e. NEPSE regulated by Securities Act 2006. Comparatively Nepalese stock market is very small, having less number of securities in terms of number, variety, and facility (Dhungel, 2002). Financial institutions including commercial banks, however, are regulated by Nepal Rastra Bank, the central bank of Nepal. Overall responsibility of controlling and directing commercial banks is given to NRB and NRB act is assumed as autonomous act to monitor, supervise and facilitate the financial institutions. For this, as of 2014, NRB has issued 22 directives towards the financial institutions including 'A' class licenses commercial banks. Among the other directives directive No-6: 'The Corporate Good Governance' is only one directive that alarmed to follow the good corporate governance norms for the chairman. Board members, CEOs, and employees of commercial banks including other financial institutions (Nepal Rastra Bank, 2014). The role, regulations, responsibility, and accountability of every party are defined clearly in the relevant Acts and directives issued by NRB.

Nepal is running via an archconservative stage of reform in organizations. The apex absorption of corporate property-ship construction and eminence of kinship commerce groups in commercial matters has become the main bridles in operating productive marketable governance. Notwithstanding, enumerate of governance regenerates are underway, and favorable manifestations have been perceived in the banking institutions (Pokhrel, 2008).

The banking sector is taken as the major factor in the economic growth of the country. Asian Development Bank outlook, (2006) update, expressed that a cogent financial section is significant as long as both abolishing banking clutch, which can threaten macroeconomic stability, and for providing the private sector with ready access to finance, which is essential for it to play its role as the driver of growth.

### **Methodology**

Ontology is ultimately based on our belief system (Ricucci, 2008). We believe that NRB's obligations have given a very strong legal standpoint to commercial banks to follow corporate governance principles. The ontology of study about corporate governance is to study the concept and administrative approach to initiate primary get ways and viewpoints for managing commerce with good and moral interest (Udayakumar & Ratanam, 2021).

Corporate governance and the performance of commercial bank-related literature were borrowed as secondary data for the research study. Mainly Nepal Ratra Bank-related published and unpublished journals, books, reports, and archives are known as secondary sources of data. The previous literature was the key material for the study. Secondary data was very useful for the research. The secondary data sources involved an array of materials. As extensive desk studies were conducted for the collection of relevant secondary information.

### **Connotations of corporate governance**

The term “governance” is derived from the Latin word “gubernare” which means to “steer” usually applied to the steering of a ship which eludes that corporate governance bosom the duty of administration rather than manipulation. The definitions, components, scope, and area of corporate governance may differ from person to person, organization to organization, and industry to industry. Corporate governance has currently known to be the cutting edge of debates at the policy level around the world. Fundamentally, which connects to the mechanisms and reference for decision-making at the corporate level, but it may also cage a broad area of other conditions, majorly implicated with the boosts that drive business behavior.

Emerging markets are characterized by less information efficiency and higher volatility, and they are smaller in size, these confine the application of the empirical models proposed for the development (Khaleel, et al, 2020). In addition to achieving the organization's goals, it manages the relationships among its stakeholders, including its board of directors and shareholders. However, despite that, the principal-agent problem and service-related problems in the organization are also dealt with through this system (which also deals with accountability within the organization) (Khan, 2011). This is because emerging market varies from their developed counterparts in several characteristics including their political system, corporate capital structure, corporate governance, ownership structure, taxation system, liquidation law, and financial system (Khaleel, et al, 2020).

According to this school of thought, it is a policy prescription governed by ethical principles, based on board-driven policy decisions, that is globally practiced to guide companies on a sustainable growth trajectory that will allow them to contribute substantially to society in the long run. Several such successful companies can be found in a country, which contributes to the creation of a productive environment that can be beneficial to the country's economic development. Hence, the establishment of a high standard of corporate governance is necessary for consistency in economic development. But many times certain companies are unable to effectively disseminate the principles of corporate governance to the top management stream leading to their failure. Such failed institutions are detrimental to the stakeholders and the welfare of society (The Institute of Company Secretaries of India, 2014).

The world council for corporate governance that the foundation of any structure of corporate governance is disclosure. Closeness is the bottom of collaborative assurance in the corporate process and finance will pour into the cores of financial function that bear up a trust (Cadbury, 2005). The framework of corporate governance should be based on four pillars such as responsibility, accountability, fairness, and transparency (World Bank, 2003). But it must be kept in our mind that the fundamental concern of corporate governance is to ensure the conditions whereby a firm’s directors and managers are held accountable and ensure better and effective protection for all stakeholders. Hart (1995) clues that corporate governance aftereffects climb in a commercial house whenever two affections are bestowed. Fundamentally, there is a problem in the agency, or conflict of business, connecting members of the commercial houses; these might be holders,

chairpersons, job holders, or buyers and sellers. They include stakeholders not just shareholders, but also debt holders and even non-financial stakeholders such as employees, suppliers, customers, and other interested parties.

Great corporate administration is exceedingly related to superior working execution and showcase valuation of companies. FRC (2008) highlighted that Great corporate administration contributes for the way better company execution by making a different board to release its obligations within the best interface of shareholders; in case it is disregarded, the results may be defensibility or destitute execution. Great administration ought to encourage proficient, viable, and entrepreneurial administration that can provide shareholder esteem over the longer term. The governance process is there to energize the proficient utilization of assets and similarly to require responsibility for the stewardship of those assets. The OECD (1999) defined it as “a set of connections between a company’s administration, its board, its shareholders, and other partners. Corporate administration moreover gives the structure through which the destinations of the company are set and implies accomplishing those goals and checking execution.” DCCI (2006-07) illustrated that corporate governance companies the legal infrastructures organizing (corporate law, security law, accounting rules), business ethics, and the overall business environment.

The point is to adjust as about as conceivable the interface of people, enterprises, and society. Kumar (2010) highlighted that corporate administration bargains with laws, strategies; hones, and certain rules that decide a company’s capacity to require administrative choices, its claimants, in specific shareholders, leasers, clients, the state, and workers. There’s a worldwide agreement around the objectives of great administration of great corporate administration to maximize the long-term shareholders’ esteem. The theories under laying the revolution of corporate governance are Agency, Stewardship, Stakeholder, and Resource Dependency Theories.

### **AGENCY THEORY**

Agency theory has its root in economic theory. However, it was further developed by Jensen and Meckling (1976). The asset reliance hypothesis concentrates on the part played by the board of chiefs in giving get assets required by the firm.

Okeahalam and Akinboade (2003) stated that the organization’s framework practices and rules of overseeing teaching are concerned closely with the corporate administration so there ought to discover those connections that control, make, or decide the nature of the relationship through those connections. Corporate administration infers that companies ought to adjust the interface of shareholders with shareholders at all levels of the organization.

### **STEWARDSHIP THEORIES**

They observed that where managers have served a corporation for several years, there is a “merging of individual ego and the corporation. This would suggest that extrinsic incentive contracts are less important where managers gain intrinsic satisfaction from performing their duties. This theory also links the success of firms with that of the managers. It tends to argue against the agency theory which posits that managerial opportunism is not relevant.

## **RESOURCE DEPENDENCY THEORIES**

Okeahalam and Akinboade (2003) surveyed by examining a commitment to corporate administration in Africa and said that the present-day concepts of division of administration from proprietorship make corporate administration and vital issue for inquiring about.

The interfaces of individuals who control the organizations are varying from those who contribute within the company through outside funds. Too, the principle-agent issue and the intrigue of shareholders can as it were diminish through successful corporate administration.

## **CORPORATE GOVERNANCE AND BANK PERFORMANCE**

There are mixed results regarding the relationship between the size of the bank's board and its performance in terms of profitability. Yermack's (1996) empirical study was the very first, which was about the effects of board size on performance from a panel of 452 mega US firms between 1984- 1991. Several studies on large publicly traded US firms have confirmed the negative impact of board size on performance.

Board size is believed to be the basic aspect of effective decision-making. Vefas (2005) suggested that the board size and its performance had a non-linear relationship. Both too small and too large of a board size are likely to make it ineffective. Lipton and Lorsch (1992) recommended that the ideal board size should not exceed eight or nine directors. Jensen (1993) claimed that there is a strong correlation between the effectiveness of the board if the number of members exceeds seven or eight. This is due to the coordination issues and process problems that occur, which add to a lack of effective oversight. While it is generally accepted that boards have been small in size in past years, it has been shown that small boards are more effective because their directors can communicate with each other better, as well as manage these factors in a more resourceful manner to encourage more productive discussions. For example, studies of board size and corporate performance have indicated that small boards are linked with higher market values. Yermack (1996) documented the negative connections between board size and firm value. Drawing from Yermack's study, Eisenberg et al. (1998) provided a similar conclusion on the board size and the firm value in a sample of small and mid-size Finnish firms.

Vefas (2000) uncovered that market participants perceive the content quality of earning information is higher in firms with a small board (with a minimum of five members). This is possible because of the commitment of every member and the probability of them accepting their responsibility as a personal obligation. Members of a small board are responsible for monitoring less, compared to those on a large board (Vafeas, 2000). Abbott et al. (2004) suggested that firms with small board sizes experience a lower incidence of restatements because small boards contribute to effective communication and there are fewer possibilities of breakdown communication. This suggested that, as the board members communicate effectively, they reduce misunderstanding incidence and consequent errors, and that they are more sensitive to the issues that may influence their shareholders' or investors' confidence, particularly concerning the issues of financial reporting.

Non-executive directors are associated with the responsibility to monitor managers and thus reduce the agency costs that occur from the ownership and control separation in day-to-day company management (Brennan & McDermott, 2004; Fama, 1980; Fama & Jensen, 1983). Therefore, a higher proportion of independent non-executive directors on boards is expected to induce a more effective monitoring function which then leads to more reliable financial statements.

It is clarified that the audit committee is the main body and then process that is established by the board of directors and whose major responsibility has to do with financial reporting. A significant characteristic that contributes to the effectiveness of audit committees appears to be their size. Consequently, a small committee cannot perform its duties efficiently because it is unable to fulfill its duties efficiently as the given assignments cannot fulfill their duties efficiently.

The effectiveness of management monitoring in companies with large audit committees has previously been demonstrated. An audit committee with a large number of members monitors financial reporting more effectively.

Heracleous (2001) researched the theme and concluded, "Researchers have failed to find any convincing connection between the practices in corporate governance and organizational performance". Companies can fail even when they are large, as illustrated by the recent collapses of these high-profile institutions around the world.

### **VINDICATIONS OF CORPORATE GOVERNANCE**

This research aims to advance the corporate governance research agenda by describing the governance practice and examining the corporate governance principles, mechanisms, and firm performance and any relationship between them, in the context of Nepal.

Few studies have investigated corporate practices and bank performance in Nepal, a developing country. Consequently, this study will add to the literature on corporate governance practices and bank performance from the perspective of an emerging economy, and it will also contribute to the development of corporate governance in Nepal, with policy implications for the code of best practices in corporate governance and the new model, particularly concerning considering stakeholders' interests. It is hoped that future researchers will be able to further explore the issues highlighted by this study, implement the developing model of corporate governance and extend the avenues that this study has opened up. The above discussion on the limitations of this study and the possibilities for future research conclude this research.

Positive impact on performance was recorded with larger board size by Mak and Li (2001) and Adams and Mehran (2005); however, in examining 147 Singaporean firms from 1995 data, Mak and Li (2001) support the argument that board structure is endogenously determined when the results of their OLS indicate that board size, leadership structure, and firm size have a positive impact on firm performance but their 2SLS regressions do not support this result. On the other hand, Adam and Mehran (2005) found a positive relationship between board size and performance (measured by Tobin's Q) in the US banking industry, which is contrary to the findings of Yermack (1996), and Eisenberg, Sundgren, and Wells (1998) in US non-financial firms.

Larcker, Richardson, and Tuna (2007) for example, determine that the relationship between corporate and the performance of firms fails to produce a consistent set of results. Fallatah and Dickins (2012), concluded that corporate governance and firm performance (measured as return on assets) are unrelated, but corporate governance and the value of the firm (as measured by Tobin's Q and market value of equity) are positively related.

Naushad & Malik (2014) examined that GCC banks' performance is significantly influenced by corporate variables. The banking sector comprises the conventional and Islamic banks in the GCC sector and is important due to their ability to bring stability to this region, reviewed and analyzing the different empirical and theoretical contributions in establishing the relationship between corporate governance and firm performance also created a focus for future research of measuring the impact of the corporate.

Usually, independent directors also serve as experienced professionals in other firms or large organizations and therefore, care about their reputation (Nguyen and Nielsen, 2010). The committee should contain an independent board of directors along with other members. Islam (2009) posited that an independent audit committee is one of the important mechanisms in this respect. P.J. (2003) reports that audit committees comprising members with some corporate or investment banking background are negatively associated with earning management.

## **CONCLUSION**

It commends a summary that how corporate governance appellative the deflection between the administrator's and stakeholders' interests (Khan, 2011). The government of Nepal is implementing the FSRP to improve the corporate governance position of financial institutions, especially commercial banks. One of its major objectives is to improve the overall corporate governance system of the financial institutions including commercial banks and create financial stability in the country. In this background, we can conclude that the Nepalese financial system has still characterized by various institutional and structural deficiencies that had weakened the system's capabilities to meet the needs of the established organizations (Nepal Ratra Bank, Policy Paper, 2003). Some of the institutions are doing good business and ensuring their customers and stakeholders but some other financial institutions are showing a lack of corporate governance practices concerning their authority, responsibility, and accountability.

The former research in Nepal didn't show or highlighted the significant relationship between corporate governance and bank performance or firm performance. So this study aims to feel the gap between corporate governance practices and their relationship with the performance of the commercial bank of Nepal. There was not found any other research on the same topic in Nepal. So it is the first research conducted on the topic of corporate governance and bank performance in Nepal in the commercial banking sector, thus this also helps to fill the gap between different research conducted by the research. This study is to fill the gap in the literature on corporate governance by answering the research question on corporate governance and Nepalese bank performance.

The system of impressive corporate governance will benefit to ascertain the variance between proprietorship and administration by commanding the audit of content from

diverse points and attempts to break the machinery challenges of the organizations (Khan, 2011). As mentioned in the statement of the problem, some of the commercial banks are underperforming and need to reform them. It also ensures to keep the overall system in sound condition. Reform is required in every aspect of commercial banks to create competencies in the overall system.

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