Corporate Governance and Performance
in Commercial Banks in Nepal

SUDEEP LAMICCHHANE

Thesis Submitted in Partial Fulfillment of the Requirements for
the Degree of Master of Business Administration
in International Business

University of the Thai Chamber of Commerce

2015
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ABSTRACT

This Thesis examines the Corporate Governance and Performance of Nepalese Commercial Banks and also studies the impact of Corporate Governance on banking performance. This research covers a total of 27 commercial banks in Nepal from 2010 to 2014. The study focuses on 5 aspects of Corporate Governance namely, Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Control as well as four control variables, Bank Age, Bank Size, Leverage and Capital Adequacy Ratio. Banking performance is measured through Efficiency (Non-performing Loans/ Total Loans), Stock Returns, Return on Assets (ROA) and Return on Equity (ROE). The Multiple regression analysis is used to study which Corporate Governance and Control variables affect the banking performances in terms of Efficiency, Stock Returns, ROA and ROE. The Corporate Governance variables used are Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Controls. The Control variables used are Bank Age, Bank Size, Leverage, Market Return and Capital Adequacy Ratio (CAR). The regression results indicate that Board Diligence and Ownership Structure are significant variables affecting Efficiency. Stock Returns is affected by Bank Size and Leverage. The factors affecting ROA are Board Size, Board Independence, Bank Size, Internal Controls and CAR while ROE is affected by Bank Size, CAR and Bank Age.

Keywords: Corporate Governance, Banking performance, Efficiency, Stock Returns, Return on Assets (ROA), Return on Equity (ROE), Commercial Banks in Nepal.
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CHAPTER 1
INTRODUCTION

Banks are an integral part of an economy. The Asian financial crisis of 1997/98 as well as the global financial crisis of 2007/08 highlighted the need for corporate governance in banking sector even more. As banks have a multiplier effect on the economy, regulating it as well as applying Corporate Governance is very crucial. As Banks have a large number of stakeholders such as shareholders, creditors, customers as well as employees, all of whose economic wellbeing depends upon the health of the banking system of those countries. The lack of Corporate Governance in Banks can make the market to lose confidence in its ability and leads to economic crisis (Garcia-Marco & Robles- Fernandez, 2008). On the other hand, good governance has lots of advantages like strong property rights, minimum transaction cost and capital market development (Claessens & Fan, 2002). For a developing country like Nepal, Corporate Governance reforms are more significant as it helps to attract more foreign direct investment and mobilizes greater savings through capital markets (Maskey, 2004). In 2005 the central bank of Nepal, Nepal Rastra Bank issued directives to strengthen Corporate Governance, but it however reported several lapses in several banks. Hence, this research paper aims to find out the discrepancies and offer recommendations to it.

1.1 Background of Banking in Nepal

The first commercial bank in Nepal was established in 1937 A. D. with the name Nepal Bank Limited (NBL), a government owned bank. However it took nearly two decades for the country’s central bank, Nepal Rastra Bank to be established in
1956 and after a decade in 1966 Rastriya Banijya Bank (RBB) was established, again a government owned bank. In 1968, the Government of Nepal again established Agriculture Development Bank, then a development Bank to facilitate loans to farmers and promote agriculture. With the wave of privatization and liberal policies in mid 1980s (Acharya et al, 2003) the government relaxed the entry barriers for domestic and foreign banks, and also withdrew the control of central bank over portfolio management. After 1984 a series of private and joint venture banks came into being with Nepal Arab Bank, 1984 (now NABIL Bank), Nepal Indoseuz Bank, 1986 (now Nepal Investment Bank) and Nepal Grindlays Bank, 1987 (now Standard Chartered Bank Nepal). The 3 joint venture bank dominated the banking scenario till 1993. Then post 1993 private as well as joint venture banks started to appear in the Nepalese financial sector, in fact 12 joint venture and private banks were established in 12 years, counting the number to 30 till 2015. However there have been some mergers between commercial banks. Hence the number of banks is somewhat stable since the last 5 years as older banks merge and new banks initiate, making the total number virtually unchanged.

The central bank (Nepal Rastra Banks) categorizes banks and financial institutions in 4 categories, viz. Class A, Class B, Class C and Class D. The Difference between the classes of banks is Class A is a full-fledged bank which has the authority to foreign currency exchange, Credit Card issuance and Letter of Credit Issuance authority along with regular banking functions like deposits and loans whereas Class B and Class C are restricted of foreign exchange as well as credit card and LC issuance. Class D are the micro credit development banks. According to Nepal Rastra bank (2014), by the end of mid – July 2014, altogether 204 banks and non- bank financial institutions licensed by NRB are in operation. Out
of them, 30 are “A” class commercial banks, 84 “B” class development banks, 53 “C”
class finance companies, 37 “D” class micro-credit development banks, 16 saving and
credit co-operatives and 30 NGOs.

![Graph showing the number of commercial banks from 2005-2015](image)

**Figure 1.1** No. of Commercial banks from 2005-2015

The Corporate Governance scenario gathered momentum only after 2002 when the central bank of Nepal, Nepal Rasta bank (NRB) issued Corporate Governance directives. Till today, the regulatory requirements of Nepal Rastra Bank (NRB) solely act as the Corporate Governance benchmark. The Bank run of Nepal Bangladesh bank (NB Bank) in November of 2006 (Upreti, 2006) and the Vibor Bikas bank(VBB) crisis in 2011 (Sapkota, 2011), in which the central bank had to rescue VBB, are the two remarkable banking crisis in Nepal. Vibor Bikas Bank’s crisis can be compared to Lehman Brothers (Sapkota, 2011). Similarly, the bankruptcy of Nepal Development Bank in 2009, was also one of the dark phases of Nepalese banking sector (Sapkota, 2009). However, all three cases were linked to the failures in the implementation of Corporate Governance.

The Table 1.1 reflects the number of commercial banks in Nepal along with the establishment date.
<table>
<thead>
<tr>
<th>S.N.</th>
<th>Name of Commercial Bank</th>
<th>Year of Est. A.D.</th>
<th>Head office</th>
<th>Website of Related bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>Nabil Bank Limited</td>
<td>1984</td>
<td>Kathmandu</td>
<td><a href="http://www.nabilbank.com">www.nabilbank.com</a></td>
</tr>
<tr>
<td>7</td>
<td>Himalayan Bank Limited</td>
<td>1993</td>
<td>Kathmandu</td>
<td><a href="http://www.himalayanbank.com">www.himalayanbank.com</a></td>
</tr>
<tr>
<td>15</td>
<td>Machhapuchre Bank Limited</td>
<td>2000</td>
<td>Pokhara</td>
<td><a href="http://www.machbank.com">www.machbank.com</a></td>
</tr>
<tr>
<td>16</td>
<td>Kumari Bank Limited</td>
<td>2001</td>
<td>Kathmandu</td>
<td><a href="http://www.kumaribank.com">www.kumaribank.com</a></td>
</tr>
<tr>
<td>17</td>
<td>Laxmi Bank Limited</td>
<td>2002</td>
<td>Birgunj</td>
<td><a href="http://www.laxmibank.com">www.laxmibank.com</a></td>
</tr>
<tr>
<td>18</td>
<td>Siddhartha Bank Limited</td>
<td>2002</td>
<td>Kathmandu</td>
<td><a href="http://www.siddharthabank.com">www.siddharthabank.com</a></td>
</tr>
<tr>
<td>19</td>
<td>Sanima Bank Ltd</td>
<td>2004</td>
<td>Kathmandu</td>
<td><a href="http://www.sanima.com">www.sanima.com</a></td>
</tr>
<tr>
<td>20</td>
<td>Global IME Bank Limited</td>
<td>2007</td>
<td>Birgunj</td>
<td><a href="http://www.globalimebank.com">www.globalimebank.com</a></td>
</tr>
<tr>
<td>21</td>
<td>Citizens Bank International Limited</td>
<td>2007</td>
<td>Kathmandu</td>
<td><a href="http://www.ctznbank.com">www.ctznbank.com</a></td>
</tr>
<tr>
<td>22</td>
<td>Prime Commercial Bank Limited</td>
<td>2007</td>
<td>Kathmandu</td>
<td><a href="http://www.primebank.com">www.primebank.com</a></td>
</tr>
<tr>
<td>25</td>
<td>Kist Bank Limited(Now Prabhu Bank Ltd)</td>
<td>2009</td>
<td>Kathmandu</td>
<td>Kistbank.com</td>
</tr>
<tr>
<td>26</td>
<td>Mega Bank Limited</td>
<td>2009</td>
<td>Kathmandu</td>
<td><a href="http://www.megabanknepal.com">www.megabanknepal.com</a></td>
</tr>
<tr>
<td>28</td>
<td>Janata Bank limited</td>
<td>2009</td>
<td>Kathmandu</td>
<td><a href="http://www.janatabank.com.np">www.janatabank.com.np</a></td>
</tr>
<tr>
<td>29</td>
<td>Civil Bank limited</td>
<td>2010</td>
<td>Kathmandu</td>
<td><a href="http://www.civilbank.com.np">www.civilbank.com.np</a></td>
</tr>
<tr>
<td>30</td>
<td>Century commercial bank limited</td>
<td>2011</td>
<td>Kathmandu</td>
<td>Centurybank.com.np</td>
</tr>
</tbody>
</table>

Source: IM Nepal, 2014

**Capital Markets in Nepal**

The history of capital market in Nepal is very short. The securities marketing centre was established in 1976 by the Government of Nepal to facilitate the trading of government securities. In 1984 the securities marketing centre was converted into the Securities Exchange Centre (SEC) (Gurung, 2004). After the economic liberalization
policies were implemented, the country became more competitive and in 1993, the SEC was divided into two different entities i.e. Securities Exchange Board of Nepal (SEBON) and Nepal Stock Exchange Limited (NEPSE). NEPSE opened its trading floor on 13 January 1994. The trading floor is restricted to listed corporate securities and government bonds with the market intermediaries in buying and selling of such securities. As of 2014, NEPSE has 270 listed companies (Nepalstock, 2015).

Source: Himalayan Times, 2015

**Figure 1.2**: Yearly peaks of NEPSE index 2008-2015

1.2 **Statement of the Problem**

The 21\textsuperscript{st} Century has seen a lot of changes and volatility than any other era in terms of global economy. As the competition is getting intense day by day, slowly the work practices and principles are also changing as well as they are also following unethical practices to beat the competition. The banking sector of the financial sector
has changed a lot (from barter system to current e-banking/mobile banking). As organizations become more globalized, the need for generating more profit became paramount. Along with it came major drawbacks like banking failures, unethical practices, lack of efficiency in organization as well as principal agent problem to name a few. Corporate Governance is a field that has emerged as a solution to a lot of redundancies in the financial institutions.

A lot of studies have been done by prominent professional experts (e.g., Martin, 1977; Pettway & Sinkey, 1980; Lane, Looney, & Wansley, 1986; Espahbodi, 1991; Cole & Gunther, 1995, 1998; Helwege, 1996; Schaeck, 2008; Cole & White, 2012) have their main focus on the problems arising from accounting variables like non-performing loan ratios, capital ratios and earnings.

Moreover, only a few have tried to empirically analyse the influence Corporate Governance characteristics, such as ownership structure or management structure, Bank Size or Bank Age have on a bank’s performance.

In the context of Nepal, a minimal number of researches have been done in the field of Corporate Governance of banks. Only Poudel and Hovey (2013) have measured Corporate Governance and performance in terms of Efficiency. Apart from those, no significant research has been done. Hence, the situation of Corporate Governance and its effect on the performance in Nepalese Commercial Banks’ sector is ambiguous. The present study aims at identifying the situation of Corporate Governance for Commercial Banks in Nepal, and tries to assess the relationship between Corporate Governance and performance in Nepalese commercial banks.
1.3 Significance of Study

Till date, this research paper is the first to analyze the performance variables like Stock Returns, Return on Assets (ROA) and Return on Equity (ROE) in Nepalese Commercial banking sector. This study can be used as a reference for Corporate Governance variables’ effectiveness on the performance by the 27 commercial banks in comparison with other financial institutions and banks as well as policy makers in Nepal. It will provide helpful reference to fellow academicians for further research in the field of Corporate Governance in Nepalese banks. Moreover, this paper will try to fill the gaps Nepalese commercial banks have on performance by analysing the Corporate Governance factors that affect the performance.

1.4 Research Objective

The present study has following objectives

- To study the effect of Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Control) on the performance variables Efficiency, Stock Return, Return on Assets (ROA) and Return on Equity(ROE) of Nepalese Commercial Banks.
- To study the effect of control factors (Bank Age and Bank Size) on the performance variables Efficiency, Stock Returns, Return on Assets (ROA) and Returns on Equity (ROE) of Nepalese Commercial Banks.

1.5 Research Questions

The topic strives to give answers to following questions:
-What effect do Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Control) have on performance variables Efficiency, Stock Returns, Return on Assets (ROA) and Return on Equity (ROE) of Nepalese Commercial Banks?

-What effect do control factors (Bank Size and Bank Age) has on performance variables Efficiency, Stock Returns, Return on Assets (ROA) and Return on Equity (ROE) of Nepalese Commercial Banks?

1.6 Expected Benefits

The research paper is expected to benefit the following:

-Commercial Banks in Nepal: As this research paper aims to find the impact of Corporate Governance and control variables on the performance of Commercial banks, hence, the commercial banks can benefit from the results which will guide them to give emphasis to the more important Corporate Governance variables. Similarly, it will be beneficial to Development banks (Class B) as well as Finance (Class C) as a reference, as all these institutions are financial intuitions.

- Regulators and Financial Policy Makers in Nepal: As the Central Bank Nepal (Rastra Bank) is the sole body responsible for making and amending rules and regulations regarding Corporate Governance, the research paper will benefit the policy makes in Central Bank. The rules and regulation has been published in 2006, but the implementation and the effectiveness of the Corporate Governance directive is however unknown in terms of banking performance. Hence, this research paper will
be useful as a reference as it analyses the effect of Corporate Governance on performance.

- **Fellow Academicians:** Till date, this research paper is the first to analyze the performance variables like Stock Returns, Return on Assets (ROA) and Return on Equity (ROE) in Nepalese commercial banks, it will be helpful to future researchers who want to do research on the Corporate Governance and performance on the banking sector of Nepal.

1.7 Operational Definitions

**Corporate Governance:** Corporate Governance refers to the structures and processes for the direction and control of companies. Corporate Governance concerns the relationship among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good Corporate Governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

**Board Size:** Board Size is the number of personnel in a board of directors of a bank who can make a bank’s policy.

**Board Independence:** Board Independence refers to the diversity on the board in terms of shareholding, with the presence of independent and outside directors.

**Board Diligence:** Like Board Size, Board Diligence is characterized by the frequency with which the board of directors meet formally to implement or change policies.

**Board Committees:** Board Committees are an independent professional body like the audit committee which oversee corporate activities.
Ownership Structure: It is the percentage of ownership held by foreign or institutional owners, other than the general public.

Bank Size: The size of the bank measured in terms of total assets.

Bank Age: The measurement of the number of years the bank is in operation since its establishment.

Leverage: The ratio of the bank’s loan capital (Liabilities) to the value of its equity.

Capital Adequacy Ratio: the ratio of a bank’s capital to its risk.

Efficiency: The ratio of Non-performing loan to Total Loan. The lower NPL ratio signifies the higher efficiency of the banks.

Stock Return: The appreciation or depreciation in the price of stock as compared to the year before.

Return on Assets (ROA): Return on assets (ROA) is an accounting-based performance measure widely used in the corporate governance literature. It is a measure which assesses the efficiency of assets employed by the firm and shows the earnings the firm has generated from its investment in capital assets. ROA is calculated as net income divided by total assets.

Return on Equity (ROE): Return on equity (ROE) is another accounting-based performance measure widely used in corporate governance research. It is a measure that shows the profit generated from the money invested by the shareholders. ROE is calculated by dividing net income by common equity.
2.1. Literature Review

Previous studies on Corporate Governance put forward many dimensions and behaviour of companies with different affecting variables. Though Martin and Cullen (2006) argued that none of the theoretical perspective can fully summarize the complicities of an organization, Corporate Governance mechanisms like Board characteristics, Audit committee characteristics, Ownership structures, are considered the measure for Corporate Governance variables (Poudel & Hovey). This section summarizes the studies that have been done in terms of Corporate Governance as well as Corporate Governance variables like Board size, Board Diligence, Board Independence, Internal controls and Ownership Structure, Control variables like Bank Age, Bank Size, Leverage and Capital Adequacy Ratio and their impact on Efficiency, Stock Return, Return on Assets and Return on Equity.

2.1.1 Corporate Governance and the Role of Banks

According to King and Levine (1993a,b); Levine (1997) banks are relatively more important stimulants of economic growth as they are always dominant in an economy for developing financial systems. Likewise, in the case of developing economies, banks are the major sources of finance, as the financial market are not fully developed. Thirdly, banks of the developing economies act as the main depository institution of the economy’s saving because of the accepted means of payment they have.
Corporate Governance has been the most used term among press, practitioners as well as practitioners in the business world (Dennis, 2001). According to Cadbury report (1992), Corporate Governance can be compared to a system which directs and controls organizations. According to John and Senbet (1998) Corporate Governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected. And this consists of stakeholders, contrary to the belief that they should be shareholders only. Even non-financial stakeholders such as customers, employees and suppliers consist of this group along with debt-holders.

Corporate Government initiates at the root level of organization, on the base, then, inside the boardroom, and among the directors (Kocourek, Burger & Birchard, 2003). It is an indispensible part of why, how and when the board of directors gather, work and interact with each other as well as the management. Nevertheless, until and unless the directors apply the theory measurement, performance criteria and process for qualitative reforms in the way they act, it is meaningless. Tricker (1994) implies Corporate Governance as an umbrella term which consists of matters that come forward with the interactions in between the BOD, senior management, stakeholders and shareholders. It can also be described as the system, much more formal, regarding accountability towards the shareholders from the senior management. However in a broad sense Corporate Governance will consist of the interdependence of formal and informal interactions with the corporate sector as well as the results it gives with the society in general.

According to Furfine (2001) the Corporate Governance in banks needs separate analysis than other firms, as they got two related characteristics. First, it is
affected by the opaqueness banks have than other financial institutions and secondly, how better the growth and development is supported by Corporate Governance.

According to Bushman and Smith (2003), there are three channels related with financial accounting information which can have a direct effect on value added, investments and productivity of firms. The first channel help identify the investment opportunities which are promising by the managers and investors by using financial accounting information. The second channel discusses about corporate control that urges managers to select good projects and reject those which are considered bad by the use of financial accounting information. The third channel emphasizes reduction of information asymmetries among investors with the help of financial accounting information.

Anwar (2009) suggest that Corporate Governance is more important for financial institution as there is an ever present risk of moral hazard. The establishment of the Corporate Governance codes was to eliminate any scope of discrepancies from regulatory standards by financial intuitions, either voluntarily or involuntarily.

According to Prowse (2003); Morgan (2002); Macey and O’Hara (2003), the Corporate Governance practice is different in bank and non-banking firms. According to Cadbury (1999), Corporate Governance holds the equilibrium between social goals and communal and individual goals. According to OECD (2006), the structure of Corporate Governance clarifies how the rights and responsibilities should be distributed in the corporation among different groups such as shareholders, managers, board as well as stakeholders and direct how to make decisions on corporate affairs with its own set of rules and procedures.
World Bank views Corporate Governance as a bundle of standards, organizational concepts and rules in economics that regulate the day to day activity of managers, companies as well as directors. According to Shleifer and Vishny (1997) Corporate Governance can be defined as the ways which gives assurance to suppliers of finance to corporation for getting the return on investment. Agency theory states that if managers are allowed to operate independently, they might end up making detrimental decisions to shareholders regarding payout, financing and investment.

According to Thapa R. B (2008), Corporate Governance’s significance runs to all the corporate institutions not just banks. But for banks it is more crucial and essential because they depend on Other People’s Money (OPM). He further argues that the chance of moral hazard problems and vested interest arises due to the lack of adequate control mechanism and the lack of transparency. The higher degree of transparency gives rise to ensuring the fairness and maximizing the shareholders’ value.

Moreover, Corporate Governance is essential as bank relies on Other People’s money (OPM) (Abbasi, Kalantari & Abbasi, 2012). Corporate Governance helps stakeholders exercise control over corporate insiders and managers for the protection of the interests of stake holders (John & Senbet, 1998). An attractive investment climate with competitive companies and efficient financial system is widely attributed to good Corporate Governance. Hence, not only the operations are disrupted but also it will have an overall impact in economy if Corporate Governance is absent. In the views of Anwar (2009) the US financial crisis was a result of regulatory governance failures, he further argues that the failure to comply with Corporate Governance codes makes a company non-compliant and creates opacity. Jensen and Meckling (1976);
Williamson (1985); Hovey, Li and Naughton, (2003) focused on the impact of Corporate Governance on the performance and efficiency, relating to agency theory.

According to Reaz and Arun (2005) the CG for banking companies are unique as there is a big difference with other type of firms in terms of claims on the banks assets and funds. Macey and O’Hara (2003) suggested that for banking institutions, a broader view of Corporate Governance have to be adopted as the Corporate Governance mechanism comprises of both depositors and shareholders for banks. There should also be government control or regulatory control to control the behavior of bank management (Arun & Turner, 2003).

Berle and Means (1991) gave emphasis on agency theory and corporate governance to separate the ownership of corporate body and the management. A Corporate Governance framework should protect several rights of shareholder’s like voting right, board election right as well as right to information and equitable treatment (Tricker, 1984). Adhikari (2008) argues that Corporate Governance is associated with leadership and control of a company as well as its sustainability. The strategic objectives and the means to attain and monitor those can only be ensured by establishment of good Corporate Governance (Sapkota, 2008). According to Islam et al.,(2009), Corporate Governance in banking industry is more important than other industries, particularly in less-developed countries because economic development and growth is dependent to a large extent on well-functioning, stable and soundly managed banking system. Banking business is a high regulation business and is always overseen by regulating agencies and government. Banks are the principle element of financial reforms and economic development of a country (Gorkhali, 2010). Alexander (2004) argues that to get easy access to capital markets and decrease the cost of capital, good corporate governance practices are necessary, moreover, it
helps protect the rights of minority shareholders and foreign shareholders. According to Kharouf, (2000) the governance of a firm is affected by the participants in the entity. The corporate behaviour can be influenced by controlling shareholders, but, all shareholders should get equal voice for the violation of their rights and to prohibit insider trading.

The view about good and bad corporate governance is given by two journals, Garcia-Marco and Robles-Fernandez, (2008) suggest bad Corporate Governance of banks can invite systematic risk and lose confidence in the ability of bank which in turn leads to economic crisis in the country where as Claessens and Fan, (2002) argue that good Corporate Governance minimizes transaction cost, strengthens property rights, leads to capital market development and reduces the cost of capital. Ubha (2007) claims that the chances of corruption, misconduct of management, financial frauds and malpractices are reduced by corporate governance.

2.1.2 Corporate Governance practices in Nepal

From review of literature and Corporate Governance principles from the banking perspectives it is clear that Corporate Governance ensures transparency, accountability and professionalism in the financial system that enhances the credibility and acceptability to the shareholders, employees, present and potential investors, customers, lenders, governments and general public. Since Banks deal in public money and public confidence is of outmost importance (Gorkhali, 2010).

Corporate Governance should be strengthen through setting the clear strategies, well-defined organizational structure to implement the strategic, transparent reporting system in an ethical manner and controlled environment (Kharouf, 2000). According to Poudel and Hovey (2011), Corporate Governance is
equally significance to all types of corporate entities. The 1997-1998 economic crises in the Asian countries highlighted the importance of corporate governance. In developing countries such as Nepal, a good governance of Banks is crucial for the survival of its economy.

In Nepalese context, more of the Corporate Governance practices are expected to evolve under the regulatory requirements of the Nepal Rastra Bank rather than other laws and rules. Therefore, in this section, history and general environment of banking institutions in Nepal and applications of corporate governance with reference to OECD Principles of Corporate Governance and Basel Committee on Banking Supervision framework are discussed.

For a developing country like Nepal, Corporate Governance plays a significant role to attract Foreign Direct Investment and Foreign Portfolio Management and to mobilize capital market saving (Sapkota, 2008). Similarly Basel committee, (2006) advises that to implement the Corporate Governance principles, a bank should be proportionate with the group to which it belongs in terms of structure, risk profile, size, complexity and economic significance.

The central bank of Nepal, Nepal Rastra Bank (NRB), has also issued corporate governance directive to banks and its directors on section 79 of the Nepal Rastra Bank Act, 2002. Following is the summary of the NRB directives, the full version is presented on the appendix section.

- Observance of minimum acceptable standard of code of conduct
- Non-involvement in activities against the interest of the Bank
- Prohibition of part time working, becoming director and holding trusteeship in other institutions
- Complete and Accurate maintenance of records and reports
- Maintenance of confidentiality and fair and equal treatment

Similarly, the NRB directive also provides duties and responsibilities of Board of directors which includes acting like custodian of public deposits, establishing an audit committee headed by non-executive director, conducting regular internal audits, regular meeting of Board of Directors, etc. Even section 100 of Nepal Rastra bank Act 2002, also imposes fines on directors if found to be acting against the interest of depositors or withholding the bank documents.

2.1.3 Firm Performance

A lot of research has been focused on Corporate Governance and performance. One of the reasons is the growth prospects of the economy as good Corporate Governance attracts capital investment, reduces investors’ risk and improves the company’s performance (Spanos, 2005). Bank performance is the bank profitability and productivity in banking (Jeon & Miller, 2006). In addition, performance may also refer to the development of the share price, profitability or the present valuation of a company (Melvin & Hirt, 2005). A wide variety of definitions of firm performance have been proposed in the literature (Barney, 2002). According to Reazee (2009), corporate accountability is ensured by Corporate Governance, as well as it enhances the reliability and quality of the financial information which in turn enhances the capital market leading to improved investor confidence. Various studies identified the determinants of profitability (Velnampy, 2005 & 2006, 2013, Velnampy & Pratheepkanth, 2012, and Niresh & Velnampy, 2012) The existing literature on Corporate Governance practices has used accounting-based performance measures, such as Return on Equity (ROE) and Return on Assets (ROA), and market-based
measures, such as Tobin’s Q, as proxies for firm performance (Abdullah 2004; Bhagat & Black 2002; Daily & Dalton 1993).

2.1.4 Board Size

Yoshikawa and Phan (2003), in their research about foreign shareholdings and boardroom reforms in Japan, recommended smaller board to minimize agency cost and have effective control over the management, and they are not in favour of larger boards as this will escalate comparatively large numbers of potential interactions and conflicts among group members. There is another school of thought in favour of larger board which believes that firms with larger board size have the ability to push the managers to track lower costs of debt because creditors view these firms as having more effective monitors of their financial accounting process and increase performance (Anderson et al., 2004). Conversely Jensen and Ruback (1983), in their research about the market of corporate control, argue that the size of the board should be limited to seven or eight members. Based on the Codes of Corporate Governance in Nepal, the board of directors consists of five to nine members. Some studies have suggested smaller boards are better for improving firm performance (Lipton & Lorsch, 1992; Barnhart & Rosenstein, 1998) while some other studies provide positive relationship between board size and firm performance (Zahra & Pearce, 1989; Mak & Li, 2001). However, Ghabayen (2012) in his research about board characteristic and firm performance in Saudi Arabia found no any relationship between Board Size and a firm’s performance. Poudel and Hovey (2013) found Board Size to be statistically significant to performance in the research about Efficiency of Nepalese Commercial Banks from 2005-2011. Akpan and Riman (2012) in the research about Nigerian Banks, found Board Size to be statistically significant.
Tai (2015) found significance of Board Size in ROA, but the contribution of Board Size on Efficiency and ROE is insignificant in the study of Gulf Banks.

Similarly, Praptiningish (2009) in the study about Corporate Governance and performance in Southeast Asian Banks found no any significant relation between Board Size and performance. El-Chaarani (2014) in the study about Lebanese Banks, found the Contribution of Board Size on performance to be not significant. However, Aebi et al. (2012) found significant contribution of Board Size on Stock Return and ROE in the study about Corporate Governance and banking performance during crisis 2007-2008. In the study about Corporate Governance in Pakistani banks Mangla (2012) found Board Size to be statistically positive significance on accounting performance like ROA and ROE. Rambo (2013), in the research of Commercial Banks in Kenya, found significant negative impact of Board Size on financial performance suggesting larger Board Size would result in proportionate decrease in net returns of commercial banks. However, Essen et al., (2013) in the study on European Financial Crisis found significant positive contribution of Board Size on Stock Returns.

### 2.1.5 Board Independence

According to Choe and Lee (2003) the agency problem can be reduced by higher proportion of independent not-executive director as per their research on South Korean bank governance reform after the financial crisis of 1997-1998. Similarly Zahra and Pearce (1989), in their research paper about board of directors and corporate financial performance, also emphasize that for a board to be effective, it should constitute greater proportion of outside directors. Allen and Gale (2000) implied that the main Corporate Governance problem arises if some managers have the opportunity to boost their payoffs by abusing the authority. Moreover, when the bank acts as an external monitor for loan against third parties, the principal-agent
problem will manifest (Alexander, 2004). The Nepal Rastra Bank, the central Bank of Nepal also emphasizes on independent director on the board, with having at least one independent director on the board. Although the executive directors have specialized skills, expertise and valuable knowledge of the firms’ operating policies and day-to-day activities, there is a need for the independent directors in the board to add the fresh ideas, independence, objectivity and expertise gained from their own fields (Choe & Lee, 2003). Some researchers like Baysinger and Butler (1985) and Ezzamel and Watson (1993) found outside directors are positively related with a firm’s performance whereas Wen et al. (2002) and Brick and Chidambaran (2008) observed the negative result between outside directors and a firm’s performance.

In different direction, Kajola (2008) found no any significant relationship between board composition and firm performance in the Nigerian listed firms. Considering the importance of independent director on board, Nepalese bank should appoint one independent director from the professional bodies prescribed by central bank of Nepal. However, Poudel and Hovey (2013) found no significance effect of board size on Nepalese Commercial Banks. Tai (2015) also in the research of Gulf Banks, was unable to find significant contribution of outside directors in the performance of Banks. Similarly, Praptiningish (2009) found no contribution of Independent board on performance in Southeast Asian Banks. On the contrary, El-Chaarani (2014) found Board Independence to be extremely significant on the performance variables like ROA and ROE in the study about Lebanese banks. However, in the time of crisis, Aebi et al. (2012) found no significance of Board Independence on performances like Stock Return and ROE. Conversely, Erkens et al. (2012) found significant negative relationship between Board Independence and Stock Return.
2.1.6 Board Diligence

According to Vafeas (1999) one of the important determinants is the Board Diligence and is related to factors such as the board member’s qualification as well as number of board meeting per year. He shared the view that board meetings are beneficial to shareholders. Based on code of corporate governance in Nepal, board have to sit at least twelve times per year. A more diligent board concerned with devoting more time for supervision of manager’s activity to achieve the shareholders’ expectations. Moreover, when boards hold regular meetings, they are more likely to remain informed and knowledgeable about relevant performance of the company leading them to take or influence and direct the appropriate action to address the issue (Abbott et al., 2003). Likewise, Hermanson et al., (2002) put forward the number of board meetings as a factor related to Board Diligence, referring Board Diligence to be the proxy of the frequency of board meetings. Lipton and Lorsch (1992) stated Board Diligence as an important resource to improve the board effectiveness, and the bonds between directors can be strengthened by frequent meetings. The intensity of board’s activities and its efficiency is measured by the board meetings (Finegold et al. 1998).

Vafeas (1999) in his research about board meeting frequency and firm performance among Forbes 350 largest firms between 1990-1994, found negative relationships between Board Diligence and a firm’s performance whereas a study conducted by Ponnu and Karthigeyan (2010) in the Malaysian firms concluded no significant relationship between frequency of board meeting and a firm’s performance. Poudel and Hovey (2013) in the context of Nepalese Banks, found Board Diligence to be statistically significant. On the contrary, Tai (2015) was unable to establish relation of Board Diligence on performance on Gulf Banks.
2.1.7 Ownership Structure

Relevant literature on Corporate Governance provides much attention to the issue of shareholder identity (Shleifer & Vishny, 1997). There are numbers of research into the relationship between ownership and bank profitability. It is accepted that foreign ownership plays crucial role in a firm’s performance, particularly in developing and transitional economies (Görg & Greenaway, 2004). Most of these studies carried out in Industrial (De Young & Nolle, 1996; Genay et al., 2000) and developing countries (Bonin et al., 2005). Clarke et al. (1999) have argued that foreign banks are more profitable than domestic once in developing countries and less profitable in industrial countries in their research about foreign entry in banking sector in Argentina.

The traditional view that the Ownership Structure of firm has no influence on the value of the firm has been challenged by Berle and Means (1991). Accordingly, higher percentage of institutional ownership could contribute to lower the risk of the firms because stock ownership should be a better incentive mechanism when a firm’s risk is high (Sanders, 1999). In addition, Bhojraj and Sengupta (2003) regarding the role of institutional investors observed that a firms’ risk, institutional ownership enjoys lower bond yields and higher bond rating due to monitoring power of the institutional owners. Pound (1988) opined that institutional investors can work out the operation of firm at a lower cost because they have more experience. Chaganti and Damanpour (1991) and Han and Suk (1998) noted positive link between institutional ownership and a firm’s performance but, in contrast, Craswell et al. (1997), in their research about Australian banks’ ownership structure and corporate performance found negative relationship.
Poudel and Hovey (2013) found Institutional Ownership to be significant in Nepalese Banks but failed to find significance in foreigner ownership. However, Aebi et al. (2012) found significant negative impact of institutional ownership in the time of crisis. Similarly, Erkens et al. (2012) also found significant negative impact of institutional ownership on stock returns in the time of crisis of 2007-2008. Ramiz and Inayat (2012) found no any significant impact of ownership structure on performance, namely ROA and ROE in different types of banks in Pakistan.

2.1.8 Internal Control

The significant components of control (Internal) are the procedures relating to control and environment, and accounting system (Harvey & Brown, 1998). Smircich (1983) subscribes to the same sentiments by highlighting that the tone at the top has implications on the direction taken by employees. Furthermore, Jansen (1998) pointed out that historically internal controls, has focused conforming employees’ actions to the desires of management.

Control environment reflects the overall attitude, awareness and actions of the board of directors, management and stockholders. The accounting system consists of the methods, records and report on entity’s transactions to provide complete, accurate and timely financial information. Finally the control procedures are essentially specific procedures put in place by management to provide assurance that the company’s objectives will be met. They usually come in the form of authorizations, segregation of duties, design and use of adequate documentation and records, adequate safeguards or access to assets and independent checks on performance.

The control environment reflects the overall attitude, awareness and actions of the BOD, management and stockholders. Borerwe (2004) consented to Deal and
Kennedy (1982)’s views and defined corporate governance from the banking industry as a manner in which boards of directors govern the business affairs of individual institutions and senior management, affecting how the banks:

- run the day to day operations of the business;
- align corporate activities and behaviours with the expectation that banks will operate in safe and sound manner, compliance with laws and regulations; and
- set corporate objectives including generating economic returns to shareholders and protect the depositor’s interests.

Robbins (1992) defines internal control systems as the whole system of controls, financial and otherwise, established by management in order to carry out the business of the enterprise in an orderly and efficient manner, ensure adherence to management, safeguard the assets and secure as far as possible the completeness and accuracy of the records.

According to Grieves (1998) internal control consist of recognition of risk and its assessment, the culture of control and management oversight, information and communication, monitoring of activities and correcting deficiencies, control of activities and segregation. Internal controls are there to protect a financial institution from loss or misuse of its assets (khan, 1994). Poudel and Hovey (2013) found audit committee size to be statistically significant. Ramiz and Inayat (2012) also found audit committee size to be negatively significant on performance variables, ROA and ROE in Pakistani Banks.

2.1.9 Bank Size

There are several literatures about the size of bank and the performance. Some researchers indicate that a medium sized bank is more efficient than large and small banks (Berger et al, 1987; Noulas et al, 1990; Mester, 1992; Clark, 1996). However

Velnampy and Nimalathasan (2008) examined about firm size on profitability between Bank of Ceylon and Commercial Bank of Ceylon in Sri Lanka during ten years period from 1997 to 2006 and found that there is a positive relationship between Firm size and Profitability in Commercial Bank of Ceylon Ltd, but there is no relationship between firm size and profitability in Bank of Ceylon. Akpan and Riman (2012) in the research about Nigerian banks did not found any significance between the Performance and Bank Size. Similarly, Tai (2015) in the study of Gulf Banks did not find significant contribution of Bank Size on Efficiency, ROA and ROE. In the research about Southeast Asian banks 2003-2007, bank size was not found to be significant (Praptiningish, 2009).

On the other hand, El-Chaarani (2014) found Bank Size to be statistically significant in the study about corporate governance and performance in Lebanese Banks. Similarly, Aebi et al. (2012) found significant positive relation between Bank size and ROE in the time of crisis of 2007-2008. This result is also validated by Erkens et al. (2012) with significant negative relation between bigger size of bank and stock returns during the financial crisis of 2007-2008. However, Essen et al. (2013) found positive impact of Firm size on the study about the European financial Crisis.
2.1.10 Bank Age

DeYoung and Hasan (1998) find that bank performances are positively affected by bank age. DeYoung et al. (1999) assert that the bank begins its operations as a financial intermediary firm entering the market and competition on a certain scale. A newly established bank has certain characteristics and its own-way of managing the operation compared to an older bank. As it is reaching its maturity stage, a bank has more experience in managing and deciding appropriate policies to cope with the rapid changes in the industry. The age of a bank positively affects the bank performance due to age having a positive correlation with experience (i.e. learning curve) which finally leads to higher performance (DeYoung & Hasan, 1998; DeYoung et al., 1999). However, El-Chaarani (2014) found no any significance between the age of bank and performance in the study about Lebanese banks from 2006-2010. Essen et al. (2013) found significant negative impact of firm age on stock returns in the study about the financial crisis in Europe.

2.1.11 Capital Adequacy Ratio

Previous studies on bank performance show that Capital Adequacy Ratio (CAR) also affects the performance of the banks (DeYoung & Hasan, 1998). A Capital Adequacy Ratio is set by the regulators to meet minimum capital requirements so bank’s management will manage their assets properly and will have an increase in performance (Unite & Sullivan 2003; Naceur & Kandil 2009). The operational functions and security functions can be increased by the compliance with a Capital Adequacy Ratio (Siamat, 2004). The performance of the bank can be improved by an adequate level of Capital Adequacy Ratio accompanied by effective and efficient bank management and lending activities (Utama & Musa, 2011).
According to Naccur and Kandil (2009) the role of regulators in setting the minimum level of Capital Adequacy Ratio will increase bank performance. Supriyatna et al. (2007) argue that Capital Adequacy Ratio can be used to classify the bank performance as good or bad. Capital Adequacy Ratio also reflects the compliance level of a bank with the regulation and represents their protection of public interest.

According to Brigham and Erhardt (2005) the review from Basel Committee implies that the regulatory monitoring which is issued by the central bank or government also affect the banking performance particularly in profitability, through the Capital Adequacy Ratio. Capital Adequacy Ratio determines how well financial institutions can cope with the shocks to their balance sheets. In commercial banks, capital adequacy is the relative risk weights assigned to the different category of assets held both on and off balance sheet items (Fourier, 2006: Matama, 2008).

2.1.12 Leverage

Leverage can be described as the extent to which a business is using the borrowed money. Business companies with high Leverage are considered to be at risk of bankruptcy if, in case, they are not able to repay the debts. However, it can lead to an increased shareholders’ return on investment. According to Kalemli-Ozcan et al. (2012) banks in emerging market grow Leverage less aggressively and are able to maintain their Leverage ratios during financial crisis. Beltratti and Stulz (2011) found that banks from countries with tighter regulation were able to perform better as they had better Leverage ratio. Rajan and Zingales (1995) show that, the factors that are most important for Leverage are size, profitability and tangibility. Lemmon et al (2008) found leverage to be stable for listed non-financial firms than the financial
firms. Krishnamurthy (2010) emphasized that during the financial crisis of 2007-2008 investment banks decreased the leverage by selling assets and commercial banks and governments increased it by acquiring these assets.

2.1.13 Efficiency

In all organizations, efficiency is one of the most valuable destinations and one of the most important objectives for the senior management (Hosenininassab, Yavari et al 2012). According to Kang (2013) efficiency is important for commercial banks as it reflects the resource allocation performance as well as the evaluation of all input and output. Similarly, Lakstutine (2008) opined that a bank’s efficiency shows the income generated by bank from their activities. According to Capiro (2003) corporate governance mechanism promotes efficiency in banks as well as reduces the expropriation of bank resources. Firm’s efficiency can also be measured by profitability (Khan & Jain, 1998). Similarly Manlagnit (2011) opined that bank performance can be gathered by cost efficiency and profitability. Kwan and Eisenbach (1997) view a link between efficiency, risk and capital. Moreover Fiordelisi et al. (2011) described efficiency as ratio of nonperforming loans to total bank loans. Girarardone et al. (2009) emphasized on a variety corporate governance structures including bank type in describing efficiency. Efficiency also depends upon the type of regulatory reforms on corporate governance (Fare et al., 2004) and bank performance can also be improved by private monitoring (Barth et al., 2004). Driffield et al. (2007) suggested that corporate governance impacts on banking efficiency.
2.1.14 Stock Returns

According to Cole et al. (2008), the future economic growth of a bank is indicated by Stock Returns, and the share of returns of banking industry shows the performances of a country’s banking sector. Ball and Brown (1968) found that the information in stock price can be reflected on earnings. Most of the studies about Stock Returns are mainly focused on earnings (Chen & Zhang, 2007). Similarly Shleifer and Vishny (1997) viewed stock return as an assurance from the corporation to suppliers of finance by applying corporate governance. They pointed out that as corporate governance solves the principal-agent problem, hence it will give the investors or the supplier of finance more confidence with high returns on their investment.

2.1.15 Return on Assets (ROA)

ROA reflects the deployment of bank assets to yield its income (Adams & Mehran, 2003; Siamat, 2004; Andres & Vallelado, 2008; Christopher, 2009). ROA equals after tax net income (profits) divided by average total assets of bank (Saunders & Cornett, 2005, Christopher, 2009, Lin & Zhang, 2009). This aims to examine the amount of after tax net income that can be earned for every dollar of assets in the bank. It reflects whether the bank uses assets effectively in order to produce its income, so it is an important profitability indicator. However caution needs to be exercised in situations where high ROAs reflect big cost cuts such as those on IT development, skilled, labor force, advertising, that may impact adversely on the long term competitiveness of the institution. Similarly, Christopher (2009), in the study about the performance of Hong Kong Banks found that larger banks have
higher ROA, meaning they utilize the assets more effectively than medium sized and small banks. Lin and Zhang (2009) also use Return on Assets (ROA) as measurement of bank performance (i.e. profitability). However, in their research in Chinese banks, they found the new banks to be more efficient in terms of utilizing the assets, hence having higher ROA. But according to Rhoades (1998) in Lin and Zhang (2009), ROA is biased upward for banks that earn significant profits from off-balance sheet operations such as derivative securities, as these activities generate revenue and expenses but not recorded as assets.

2.1.16 Return on Equity (ROE)

ROE is a net income available to common stockholders divided by common equity (Brigham & Ehrhardt 2005). This aims to examine the amount of after tax net income that can be earned for every dollar of equity. It indicates the amount of income that shareholders will earn in a bank. But, Christopher (2009) concludes that banks may employ high leverage to increase their ROE, but also point outs that increasing leverage should also be a concern for the bank’s management. Use of higher leverage may increase the risk of bankruptcy. In his research about the top 5 banks in Hong Kong, he found that the large banks are more concerned about the shareholders and have comparatively high ROE. ROE is a popular proxy of bank performance relevant to shareholder’s investment (Siamat, 2004; Berger et al., 2005; Kim & Rasiah, 2010).
2.2 Conceptual framework

The conceptual framework has been derived from the literatures on variables of Corporate Governance and the determinants of performances such as Efficiency, Stock Returns and ROA and ROE. The variables of Corporate Governance such as Board Size, Board Diligence, Board Independence, Ownership Structure, Internal Controls, Bank Size and Bank Age are the independent variables whereas Efficiency, Stock Returns, ROA and ROE are the dependent variables. Ajanthanet al. (2013) linked Corporate Governance variables with banking performance. Corporate governance variables were divided into Board Size, Board Independence, Board Diligence and Board Diversity whereas the performance measures were ROA and ROE. Similarly, Poudel and Hovey (2013) showed relationship between Corporate Governance variables such as Board Size, Board Diligence, Board Independence, Ownership Structure with Efficiency of the bank performance. The efficiency was measure by the ratio of non-performing loans to total loan. Utama and Musa (2011) gave emphasis on Capital Adequacy Ratio, Bank Size as well as Ownership as the variables of Corporate Governance to calculate performance such as ROA and ROE. On the other hand, Erkens et al (2012) linked Corporate Governance factors like Board Independence, Ownership Structure, and Size with performance variable of Stock Returns. Willesson (2014) has put forward Efficiency, ROA, ROE and Stock Returns as a measure for Corporate Governance. Adams and Mehran (2003) also emphasized on ROA, ROE and Stock Return as a measure of performance with Corporate Governance variables like Board Size, Board Independence, Ownership Structure, and Board Diligence.
Corporate Governance factors:
- Board Size
  (Mangla, 2012)
- Board Diligence
  (Poudel & Hovey, 2013)
- Board Independence
  (El-Chaarani, 2014)
- Ownership Structure
  (Praptiningish, 2009)
- Internal Controls
  (Poudel & Hovey, 2013)

Control Variables:
- Bank size
  (Fanta et al., 2013)
- Bank Age
  (Essen et al., 2013)
- Leverage
  (Erkens et al., 2012)
- Capital Adequacy Ratio
  (Tai, 2015)

Figure 2.1 Conceptual Framework

Note:
1. Leverage is used on Stock Returns only.
2. Capital Adequacy Ratio is used in ROA and ROE only.
2.3. Hypothesis

H1: Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Controls) have effect on Efficiency of Commercial Banks in Nepal.

H2: Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Controls) have effect on Stock Returns of Commercial Banks in Nepal.

H3: Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Controls) have effect on ROA of Commercial Banks in Nepal.

H4: Corporate Governance factors (Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Controls) have effect on ROE of Commercial Banks in Nepal.

H5: Control factors (Bank Size and Bank Age) have effect on Efficiency of Commercial Banks in Nepal.

H6: Control factors (Bank Size, Bank Age, and Leverage) have effect on Stock Returns of Commercial Banks in Nepal.

H7: Control factors (Bank Size, Bank Age and CAR) have effect on ROA of Commercial Banks in Nepal.

H8: Control factors (Bank Size, Bank Age and CAR) have effect on ROE of Commercial Banks in Nepal.
Chapter 3
METHODOLOGY

A quantitative method of data analysis which involves a descriptive analysis and multiple regression analysis is employed to analyse the normal distribution and the deviation of regression variables. Multiple regressions is conducted to achieve the purpose of the study: corporate governance and performance in Commercial Banks in Nepal.

3.1 Research Design

Under taken research study is aimed to identify the relation between Corporate Governance and Performance in Commercial Banks in Nepal. Study is aimed to ascertain the effect of Board Size, Board Diligence, Board Independence, Ownership Structure, Internal Control, Bank Size and Bank Age on the Efficiency, Stock Returns and the Return on Assets and Return on Equity. Hence, a total of four accounting-based indicators as dependent variables are used. The first indicator of performance of bank is measured by Efficiency (Non-performing Loan/ Total Loan). The second indicator is Stock Returns (buy and hold stock returns during 2010-2014). The third and fourth indicators are the ROA and ROE. The objective of these indicators is to examine the impact of Corporate Governance on overall bank performance. The main independent variables are the Board Size, Board Diligence, Board Independence, Ownership Structure, Internal Controls, Bank Size and Bank Age.
3.2 Data Collection

3.2.1 Population and sample of the study:

In this study the population consists of the commercial banks of Nepal with are total 30 in numbers as per their listing on Nepal Stock Exchange (NEPSE) index. The research only takes into account Class A banks as defined by the central bank of Nepal, hence the development banks and financial institutions on Class B and Class C are not included. As the population of Class A bank is 30, but 3 banks are excluded, hence the sample size will is 27 banks. Nepal Rastra Bank is excluded from the research due to unavailability of data, Civil Bank Ltd and Century Commercial Bank Ltd are excluded as they were established in 2011, whereas the data has been collected from 2010-2014 .

The plan that is used for the research is the secondary data from annual reports, financial statement, the website of the respective banks as well as the website of Central bank and yearly report of Nepal Rastra Bank (central bank). The performance of Banks from their annual reports is the elements of population of research and the data from 2010-2014 is taken as 7 banks were established in between 2008/2009 fiscal year. Hence for 1 bank the data for 5 years is used and for 27 banks the number sums up to 135 observations.

3.2.2 Reliability and Validity of Data

Secondary data for the study is drawn from audited accounts [i.e., income statements (statement of comprehensive income) and balance sheets (statement of financial position)] of the concerned banks as fairly accurate and reliable. Therefore, these data may be considered reliable for the study. Necessary checking and cross
checking are done while scanning information and data from the secondary sources. All these made in order to generate validity data for the present study. Hence, researcher satisfied content validity.

3.3 Data Analysis

The tools that are used for the analysis of data are descriptive statistics, Correlation and multiple regression analysis. For Efficiency, multiple regression is the method of analysis in the study. Stock Return is examined by estimating models regressing stock returns on Corporate Governance variables. For ROA and ROE the data is analysed by using multiple regression methods.

3.3.1 Descriptive Statistics

Descriptive statistics are calculated for Corporate Governance variables and Control variables against firm performance variables of Efficiency, Stock Return, ROA and ROE in this study. In this section mean, maximum, minimum, standard deviation and number of observations of each variable is analysed and result is reported in tabular form. Descriptive statistics describe the characteristics of Board Structure, Ownership Structure, Bank Size and Age among Commercial Banks in Nepal and the variables used to measure the performance of these Commercial Banks. Similarly the descriptive statistics also describe the measurement variables of different size and different age with the performance.
3.3.2 Referential Statistics

Before running a regression, a correlation test is done among the explanatory variables to identify the multicollinearity problem. The correlation coefficient examines the relation between the financial variables. A correlation coefficient has a range from +1 to -1, where +1 is the maximum value and -1 is the minimum value. Hence, a correlation coefficient greater than 0 indicates a positive linear association between two variables whereas, a value less than 0 indicate a negative linear association. When one value increases (decreases), and other also tends to increase (decrease), it is called positive linear association and when one value increases (decreases) then the other value tends to decrease (increase), it is called negative linear association. A correlation coefficient of 0 indicates no linear relationship between two variables. The closer the coefficient is to either -1 or +1, the stronger the correlation between two variables.

3.3.2.1 Multicollinearity

According to Tabachnick and Fidell (2007), the correlation exceeding ±0.9 is supposed to have multicollinearity problem. The table 4.2 shows there is multicollinearity problem between two independent variables Board Size and Board Independence. Hence, two separate regression is conducted one excluding Board Size and another excluding Board Diligence.

3.3.2.2 Serial Correlation

Durbin- Watson Statistic: the Durbin–Watson statistic is a test statistic used to detect the presence of autocorrelation (a relationship between values separated from each other by a given time lag) in the residuals (prediction errors) from a
regression analysis. The value of $d$ always lies between 0 and 4. If the Durbin–Watson statistic is 2, this means no autocorrelation, substantially less than 2; there is evidence of positive serial correlation. As a rough rule of thumb, if Durbin–Watson is less than 1.0, there may be cause for alarm. Small values of $d$ indicate successive error terms are, on average, close in value to one another, or positively correlated. If $d > 2$, successive error terms are, on average, much different in value from one another, i.e., negatively correlated (Durbin & Watson, 1971).

Next step, the multiple regression method is used to find the effect of independent variable on dependent variables such as Efficiency, Stock Returns, ROA and ROE.

Models
The performance of the bank is measured by Efficiency, Stock Return, ROA and ROE. Hence, four measures of regression models are used to find the Bank performance.

1) Efficiency
Following Poudeland Hovey (2013) and Ajanthan et al. (2013) the first measure of bank performance is Efficiency. The Efficiency of bank is the dependent variable and other seven are independent corporate governance variables in the study. For efficiency, descriptive and multiple regressions are the methods of analysis in the study. The model is as follows:

$$\text{Efficiency} = \beta_0 + \beta_{1BS} + \beta_{2BD} + \beta_{3BI} + \beta_{4OS} + \beta_{5IC} + \beta_{6BkS} + \beta_{7BA} + e$$
2) Stock Returns

Following Erkens et al. (2012), and Adams and Mehran (2003) the second measure of bank performance is Stock Returns. The relation between firm performance and Corporate Governance is examined by estimating models regressing stock returns on corporate governance variables. The model is as follows:

\[
\text{Stock Returns} = \beta_0 + \beta_1 \text{BS} + \beta_2 \text{BD} + \beta_3 \text{BI} + \beta_4 \text{OS} + \beta_5 \text{IC} + \beta_6 \text{Lvg} + \beta_7 \text{BkS} + \beta_8 \text{BA} + e
\]

3) ROA

Following Tai (2015), Fanta and Kemal (2013), Mangla (2012) and Chaarani (2014), the third measure of bank performance is ROA. The data is analysed by using multiple regression methods. The models are as follows:

\[
\text{ROA} = \beta_0 + \beta_1 \text{BS} + \beta_2 \text{BD} + \beta_3 \text{BI} + \beta_4 \text{OS} + \beta_5 \text{IC} + \beta_6 \text{CAR} + \beta_7 \text{BkS} + \beta_8 \text{BA} + e
\]

4) ROE

Following Tai (2015), Fanta and Kemal (2013), Mangla (2012), Akpan and Riman (2012), Utama and Musa (2011) and Ajanthan et al. (2013) the fourth measure of bank performance is ROA. The data is analysed by using multiple regression methods. The models are as follows:

\[
\text{ROE} = \beta_0 + \beta_1 \text{BS} + \beta_2 \text{BD} + \beta_3 \text{BI} + \beta_4 \text{OS} + \beta_5 \text{IC} + \beta_6 \text{CAR} + \beta_7 \text{BkS} + \beta_8 \text{BA} + e
\]

Where,
### Table 3.1: Description of variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Independent variables</strong></td>
<td>BS</td>
<td>Board Size</td>
</tr>
<tr>
<td></td>
<td>BD</td>
<td>Board Diligence</td>
</tr>
<tr>
<td></td>
<td>BI</td>
<td>Board Independence</td>
</tr>
<tr>
<td></td>
<td>OS</td>
<td>Ownership Structure</td>
</tr>
<tr>
<td></td>
<td>IC</td>
<td>Internal Controls</td>
</tr>
<tr>
<td></td>
<td>BKs</td>
<td>Bank Size</td>
</tr>
<tr>
<td></td>
<td>BA</td>
<td>Bank Age</td>
</tr>
<tr>
<td></td>
<td>Lvg</td>
<td>Leverage</td>
</tr>
<tr>
<td></td>
<td>CAR</td>
<td>Capital Adequacy Ratio</td>
</tr>
<tr>
<td><strong>Dependent variables</strong></td>
<td>EFF</td>
<td>Efficiency</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>Stock Return</td>
</tr>
<tr>
<td></td>
<td>ROA</td>
<td>Return on Assets</td>
</tr>
<tr>
<td></td>
<td>ROE</td>
<td>Return on Equity</td>
</tr>
</tbody>
</table>

### 3.4. Expected Result

The expected outcome for this research is that the Corporate Governance variables have effect on the performance of the banks. The performance of the bank is measured by Efficiency (non-performing loan to total loan), Stock Return (price appreciation or depreciation on the value of stock), ROA (net income to total assets) and ROE (net income to total common equity).

**Board size.** Board size is a corporate governance variable that can affect firm efficiency and financial performance. Since a larger board may lead to better firm effectiveness, it is expected that board size effects bank performance (Mak & Li, 2001).
**Board Independence.** As outside directors are regarded as more independent than inside directors, they can monitor managerial performance and efficiency more effectively. Therefore, it is expected that the proportion of non-executive directors in the board effects bank performance (Choe & Lee, 2003).

**Board Diligence.** Like board size, more frequent board meetings may lead to better firm effectiveness. It is expected that the number of board meetings effects bank performance (Abbot et al., 2003).

**Internal controls** provide independent professional oversight of corporate activities. It is expected that the number of board committees effect bank performance (Robbins, 1992).

**Ownership Structure** focuses on institutional ownership and large shareholders. It is expected that the high ownership structure effect bank performance (Pound, 1988).

**Bank Age** shows the number of years since the bank was first established. It is expected that the higher age of banks effect performance as they have more experience in a country’s economic scenario (DeYoung & Hasan, 1998).

**Bank Size** refers to the total assets of the bank. It is expected that bigger sized banks are able to utilise funds more efficiently, resulting an effect in performance (Hasan & Marton, 2003).

**Leverage** refers to the ratio of total liabilities by total assets. It is expected lower leverage ratio stimulates better performance (Beltratti & Stulz, 2011).

**Capital Adequacy Ratio** refers to the ratio of capital that should be reserved, usually minimum 10%, regulatory monitoring issued by central Bank or the government. It is expected Capital Adequacy Ratio improves operational functions and security functions (Siamat, 2004).
Chapter 4
RESULTS AND FINDINGS

4.1 Descriptive Statistics

The descriptive statistics is presented on the table 4.1 for the Corporate Governance and Control Variables along with the dependent variables Efficiency, Stock return, ROA and ROE.

Table 4.1: Descriptive Statistics of Corporate Governance and Control Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>EFF(%)</td>
<td>135</td>
<td>.000</td>
<td>24.200</td>
<td>2.31413</td>
<td>3.306132</td>
</tr>
<tr>
<td>BS (No.)</td>
<td>135</td>
<td>4</td>
<td>10</td>
<td>7.50</td>
<td>1.251</td>
</tr>
<tr>
<td>BD (No. of Times)</td>
<td>135</td>
<td>12</td>
<td>67</td>
<td>15.21</td>
<td>8.670</td>
</tr>
<tr>
<td>BI (%)</td>
<td>135</td>
<td>10.00</td>
<td>25.00</td>
<td>13.7646</td>
<td>2.64491</td>
</tr>
<tr>
<td>OS (%)</td>
<td>135</td>
<td>.12</td>
<td>100.00</td>
<td>50.2739</td>
<td>26.61187</td>
</tr>
<tr>
<td>IC (No.)</td>
<td>135</td>
<td>2</td>
<td>5</td>
<td>3.68</td>
<td>.769</td>
</tr>
<tr>
<td>BKS (ln)</td>
<td>134</td>
<td>21.57062</td>
<td>25.20640</td>
<td>24.0477176</td>
<td>.64970326</td>
</tr>
<tr>
<td>BA(Years)</td>
<td>27</td>
<td>5</td>
<td>77</td>
<td>17.78</td>
<td>15.240</td>
</tr>
<tr>
<td>SR (ln)</td>
<td>129</td>
<td>-.941609</td>
<td>1.599388</td>
<td>.06399578</td>
<td>.556153457</td>
</tr>
<tr>
<td>Lvg (%)</td>
<td>133</td>
<td>-21.90</td>
<td>47.41</td>
<td>19.9526</td>
<td>9.95482</td>
</tr>
<tr>
<td>ROA (%)</td>
<td>135</td>
<td>-4.96</td>
<td>8.15</td>
<td>1.4922</td>
<td>1.28565</td>
</tr>
<tr>
<td>ROE (%)</td>
<td>135</td>
<td>-278.73</td>
<td>65.56</td>
<td>14.4207</td>
<td>27.85831</td>
</tr>
<tr>
<td>CAR (%)</td>
<td>135</td>
<td>-11.13</td>
<td>70.00</td>
<td>13.2282</td>
<td>7.41620</td>
</tr>
</tbody>
</table>

The independent variable Board Size shows the mean is 7.5, which is according to range of 7 or 8 people set by Jensen and Ruback (1983) to be effective. Similarly Board Diligence is 15.21 times, which is higher than the number (12 times) set by Central Bank. Board Independence is at 13.76%, as almost all the banks have just 1 outside director on their board of directors just enough to satisfy the central bank directive of having minimum 1 outside director. Another independent variable Ownership Structure shows 50.27% of ownership held by institutions other than general public which shows institutions have significant ownership in Nepalese
banks. The standard deviation of Ownership Structure is also high at 26.61% as the minimum is 0.12% and the maximum is at 100%. The mean for Internal Control is 3.68 but the minimum is 2 persons and the maximum is just 5 people. Hence the standard deviation of .769 is less compared to other variables. As the Bank Size is taken as the ln of the total assets, the value 24.047 is the mean which shows that most of the banks are around the same size. The average age for banks is 17.78 years as of 2014, with Nepal Bank being the oldest at 77 years as of 2014. The Leverage ratio is at 19.95% and the Capital Adequacy Ratio is 13.22%, which is higher than 10% set by the Basel II committee and Central Bank.

The dependent variables are also depicted in the descriptive statistics. As we can see the mean of Efficiency is at 2.31% which is lower compared to the time of 2005-2011 where it was 3.9% (Poudel & Hovey, 2013). Similarly the log of Stock Return mean is at 0.0639 with standard deviation of 0.5561. The mean of ROA is at 1.49%, and the mean of ROE is at 14.42%, however, the standard deviation of ROE is the highest at 27.85%, as the lowest ROE is at -278%, which was held by Grand Bank in 2014.

4.2 Correlation

Similarly, the dependent variable Stock Return is negatively correlated with Board Diligence, Board Independence, Leverage and Internal Control, where Bank Size and Leverage are statistically significant. However, the independent variables like Board Size, Ownership Structure and Bank Age are positively correlated with Stock Return. However, none of these independent variables have statistically significant correlation with Stock Return. The dependent variable Stock Return has
### Table 4.2: Correlation of independent and dependent variables

<table>
<thead>
<tr>
<th></th>
<th>EFF</th>
<th>BS</th>
<th>BD</th>
<th>BI</th>
<th>OS</th>
<th>IC</th>
<th>BKS</th>
<th>BA</th>
<th>SR</th>
<th>Lvg</th>
<th>ROA</th>
<th>ROE</th>
<th>CAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>EFF</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BS</td>
<td>-108</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BD</td>
<td>.245**</td>
<td>.116</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI</td>
<td>.096</td>
<td>-973**</td>
<td>-083</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OS</td>
<td>-191*</td>
<td>-040</td>
<td>.000</td>
<td>.065</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IC</td>
<td>-.052</td>
<td>.134</td>
<td>.189*</td>
<td>-.147</td>
<td>.128</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BKS</td>
<td>.071</td>
<td>-.171*</td>
<td>.213*</td>
<td>.195*</td>
<td>.087</td>
<td>.298**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Age</td>
<td>.193</td>
<td>-.503**</td>
<td>-.183</td>
<td>.524**</td>
<td>-.610**</td>
<td>-.369</td>
<td>-.089</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SR</td>
<td>.072</td>
<td>.030</td>
<td>-.035</td>
<td>-.024</td>
<td>.017</td>
<td>-.130</td>
<td>-.337**</td>
<td>.326</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lvg</td>
<td>.037</td>
<td>-.329**</td>
<td>-.434**</td>
<td>.347**</td>
<td>-.099</td>
<td>-.204*</td>
<td>.183*</td>
<td>.537**</td>
<td>-.184*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>-.346**</td>
<td>-.158</td>
<td>.201*</td>
<td>.204*</td>
<td>.172*</td>
<td>.208*</td>
<td>.143</td>
<td>-.283</td>
<td>-.020</td>
<td>-.208*</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE</td>
<td>-.468**</td>
<td>-.081</td>
<td>.031</td>
<td>.105</td>
<td>.130</td>
<td>.068</td>
<td>.222**</td>
<td>.734**</td>
<td>-.013</td>
<td>-.026</td>
<td>.628**</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>CAR</td>
<td>-.184*</td>
<td>.247**</td>
<td>.091</td>
<td>-.286**</td>
<td>.095</td>
<td>.013</td>
<td>-.534**</td>
<td>-.675**</td>
<td>-.195*</td>
<td>-.359**</td>
<td>.169</td>
<td>-.036</td>
<td>1</td>
</tr>
</tbody>
</table>

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

*. Correlation is significant at the 0.05 level (2-tailed).
negative correlation with other dependent variable ROA and ROE as well as positive correlation with Efficiency.

Moreover, the dependent variable ROA has negative correlation with Board Size and Bank Age among the independent variables and has positive correlation with Board Diligence, Board Independence, Ownership Structure, Internal Control, Bank Size, and CAR. Board Diligence, Board Independence, Ownership Structure, Internal Control and Leverage have statistically significant positive correlation with ROA. Among the dependent variables, ROA has negative relation with Stock Returns and statistically significant negative relation with Efficiency, and ROA has statistically significant positive relationship with ROE also.

Likewise, another dependent variable ROE is negatively correlated with Board size. Other independent variables like Board Diligence, Board Independence, Ownership Structure, Internal Control, Bank Size, Capital Adequacy Ratio and Bank Age. The independent variables Bank Size and Bank Age are also statistically significant with ROE. ROE also has statistically significant dependence with Efficiency and ROA, whereas Efficiency is negatively correlated and ROA is positively correlated. Another dependent variable Stock Returns is negatively correlated with ROE but it is not significant.

4.3 Regression

The regression of Corporate Governance and Control variables on Dependent variable Efficiency, Stock Returns, ROA and ROE is done as follows:
4.3.1 Regression of Dependent variable Efficiency with Corporate Governance and control variables

The table 4.3 shows the specification of 6 variables Bank Age, Ownership Structure, Internal Controls, Board Diligence, Board Size and Bank Size reveal the ability to predict Efficiency. The Durbin Watson score is 1.72 with is around 2, hence no serious autocorrelation is present.

The model summary examination with ANOVA (F-value) indicates the model explains the most possible combination of predictor variables that could contribute to Efficiency. For the model the F-value is 2.954 and respective P value is .010, which is statistically significant.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>t</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>2.319</td>
<td>11.324</td>
<td>.205</td>
<td>.838</td>
</tr>
<tr>
<td>BS</td>
<td>-.358</td>
<td>.236</td>
<td>-1.514</td>
<td>.132</td>
</tr>
<tr>
<td>BD</td>
<td>.102***</td>
<td>.033</td>
<td>3.090</td>
<td>.002</td>
</tr>
<tr>
<td>OS</td>
<td>-.024**</td>
<td>.010</td>
<td>-2.258</td>
<td>.026</td>
</tr>
<tr>
<td>IC</td>
<td>-.302</td>
<td>.387</td>
<td>-.780</td>
<td>.437</td>
</tr>
<tr>
<td>BKS</td>
<td>.146</td>
<td>.464</td>
<td>.315</td>
<td>.753</td>
</tr>
<tr>
<td>Bank Age</td>
<td>-.005</td>
<td>.043</td>
<td>-.113</td>
<td>.910</td>
</tr>
</tbody>
</table>

R² = 0.122  Durbin-Watson = 1.720  F-value= 2.954 (0.010)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The regression of Efficiency and Corporate Governance is shown in the given table 4.3. Efficiency is measured by the ratio of Non-Performing loan, the lower the NPL the higher the efficiency of banks. We can see negative coefficients between Efficiency and Board Size, Ownership Structure, Internal Control and Bank Age. The independent variable Ownership Structure has significant negative relationship with
Efficiency, it implies that higher number of institutional ownership has significant effect on bank’s efficiency. Similarly, Board Diligence has significant positive relation with Efficiency which implies less numbers of board meetings has better effect on Efficiency.

Similarly, the table 4.4 shows the specification of 6 variables Bank Age, Ownership Structure, Internal Controls, Board Diligence, Board Independence and Bank Size that reveal the ability to predict Efficiency. The Durbin Watson score is 1.738 with is around 2 meaning the autocorrelation is not significant.

The table 4.4 illustrates the model summary of F-value, it explains the contributor to the Efficiency with the most possible combination. For the model the F value is 2.832 and respective P value is .013, which is statistically significant.

**Table 4.4: Regression Result of Corporate Governance Variables without Board Size on Efficiency**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-2.564</td>
<td>10.567</td>
<td>-.243</td>
<td>.809</td>
<td></td>
</tr>
<tr>
<td>BD</td>
<td>.099***</td>
<td>.033</td>
<td>.261</td>
<td>3.021</td>
<td>.003</td>
</tr>
<tr>
<td>BI</td>
<td>.146</td>
<td>.114</td>
<td>.116</td>
<td>1.279</td>
<td>.203</td>
</tr>
<tr>
<td>OS</td>
<td>-.024**</td>
<td>.011</td>
<td>-.193</td>
<td>-2.271</td>
<td>.025</td>
</tr>
<tr>
<td>IC</td>
<td>-.302</td>
<td>.389</td>
<td>-.070</td>
<td>-.775</td>
<td>.440</td>
</tr>
<tr>
<td>BKS</td>
<td>.156</td>
<td>.468</td>
<td>.031</td>
<td>.334</td>
<td>.739</td>
</tr>
<tr>
<td>Bank Age</td>
<td>-.004</td>
<td>.043</td>
<td>-.009</td>
<td>-.102</td>
<td>.919</td>
</tr>
</tbody>
</table>

R² = 0.117\[\text{Durbin-Watson}\] = 1.738\[\text{F-value}\] = 2.832 (0.013)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The regression of Efficiency and Corporate governance is shown in the given table 4.4. The results are consistent with table 4.3 where the regression was run with Board Size. Similar to table 4.3 Board Diligence has significant positive effect on
Efficiency and Ownership Structure has significant negative contribution on Efficiency. Hence, lower frequency of board meeting and higher percentage of institutional ownership is desired.

The Hypothesis H1 and H5 are tested on the basis of the results from the multiple regressions on Efficiency. The study has hypothesized that Corporate Governance factors have effect on Efficiency of Nepalese Commercial Banks. From the regression results Board Diligence and Ownership Structure are found to have significant effect on Efficiency. Hence Hypotheses H1 is supported and H5 is not supported as the control variables Bank Age and Bank Size do not have significant effect on Efficiency.

4.3.2 Regression of Dependent variable Stock Return with Corporate Governance and Control variables

In the model for Stock Returns the predictors used are Leverage, Ownership structure, Internal controls, Bank Age, Board Size, Board Diligence and Bank Size. The R² is 0.153, which implies that only 15.3% of the variations in Stock Returns can be explained by the difference in the variability of predictors. This shows, there are other external variable than corporate governance that affect the Stock returns in the commercial Banks in Nepal. The Durbin-Watson statistics is 1.956 which is nearly 2, meaning it has very less auto correlation.

The ANOVA summary depicts the F- value that can indicate the possible combination of predictor variables with Stock Returns. The model has F- value of 3.279 with corresponding significance of 0.0023 which is statistically significant.
Table 4.5: Regression result of Corporate Governance variables without Board Independence on Stock Returns

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>t</td>
</tr>
<tr>
<td>(Constant)</td>
<td></td>
<td>5.744</td>
<td>1.874</td>
<td>3.066</td>
</tr>
<tr>
<td>BD</td>
<td></td>
<td>-.002</td>
<td>.006</td>
<td>-.408</td>
</tr>
<tr>
<td>OS</td>
<td></td>
<td>.001</td>
<td>.002</td>
<td>.552</td>
</tr>
<tr>
<td>IC</td>
<td></td>
<td>-.042</td>
<td>.064</td>
<td>-.660</td>
</tr>
<tr>
<td>BKS</td>
<td></td>
<td>-.227***</td>
<td>.080</td>
<td>-2.848</td>
</tr>
<tr>
<td>Bank Age</td>
<td></td>
<td>.012*</td>
<td>.007</td>
<td>1.778</td>
</tr>
<tr>
<td>BS</td>
<td></td>
<td>-.012</td>
<td>.039</td>
<td>-.305</td>
</tr>
<tr>
<td>Lvg</td>
<td></td>
<td>-.011*</td>
<td>.006</td>
<td>-1.944</td>
</tr>
</tbody>
</table>

R² = 0.153  Durbin-Watson = 1.956  F-value = 3.279 (0.003)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The table shows the regression result for Stock Return and Corporate Governance and control variables. For Stock Returns, Bank Size and Leverage have significant negative result and Bank Age has significant positive result. The significant negative relationship between Stock Return and Bank size shows that larger size of bank will not improve the returns from the stock market for Nepalese Banks. Similarly, higher percentage of Leverage also has negative contribution on Stock Returns of Nepalese Commercial Banks, whereas older banks performed better on the stock market. Other positive coefficient of independent variable Ownership Structure does not have significant relationship with Stock Returns. Similarly the Board Size, Board Diligence and Internal Control also have minimal significance on Stock Return.

Similarly, the table 4.6 shows the predictors used for dependent variable Stock Return are Board Independence, Market Return, Ownership Structure, Board Diligence, Internal Control, Bank Size, Bank Age and Leverage ratio. The Durbin-Watson significance of 1.956 is nearly equal to 2, which signifies no autocorrelation.
The ANOVA summary depicts the F-value that can indicate the possible combination of predictor variables with Stock Return. The model has F-value of 3.298 with corresponding significance of 0.003 which is statistically significant.

**Table 4.6: Regression result of Corporate Governance variables without Board Size on Stock Return**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>(Constant)</td>
<td>5.602</td>
<td>1.772</td>
<td>3.161</td>
<td>.002</td>
</tr>
<tr>
<td>BD</td>
<td>-.003</td>
<td>.006</td>
<td>-.428</td>
<td>.670</td>
</tr>
<tr>
<td>OS</td>
<td>.001</td>
<td>.002</td>
<td>.518</td>
<td>.605</td>
</tr>
<tr>
<td>IC</td>
<td>-.040</td>
<td>.064</td>
<td>-.632</td>
<td>.529</td>
</tr>
<tr>
<td>BKS</td>
<td>-.229***</td>
<td>.080</td>
<td>-2.872</td>
<td>.005</td>
</tr>
<tr>
<td>Bank Age</td>
<td>.012*</td>
<td>.007</td>
<td>1.719</td>
<td>.088</td>
</tr>
<tr>
<td>Lvg</td>
<td>-.011**</td>
<td>.006</td>
<td>-1.976</td>
<td>.050</td>
</tr>
<tr>
<td>BI</td>
<td>.009</td>
<td>.019</td>
<td>.456</td>
<td>.649</td>
</tr>
</tbody>
</table>

R² = 0.154 Durbin-Watson= 1.956 F-value= 3.298 (0.003)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The table 4.6 shows the regression results of Corporate Governance and control factors on the dependent variable Stock Return. This result of the table is also similar with the table4.5 where Bank Size, Leverage and Bank Age have significant negative contribution to Stock Return. Other independent variables like Board Diligence, Ownership Structure, Internal Control, and Board Independence have no significant contribution on Stock Returns.

The Hypothesis H2 and Hypothesis H6 are tested on the basis of the results from the multiple regressions on Stock Return. The study has hypothesized that Corporate Governance and control factors have effect on Stock Returns of Nepalese Commercial Banks. From the regression results only Control factors Bank Size, Bank
Age and Leverage are found to have significant effect on Stock Returns. Hence, only Hypothesis H6 is supported, and Hypothesis H2 is not supported.

4.3.3 Regression of Dependent variable ROA with Corporate Governance and control variables

The model summary for the Dependent Variable ROA is illustrated on the table 4.7. Here the predictors are Capital Adequacy Ratio, Internal Controls, Ownership Structure, Board Diligence, Board Size, Bank Age and Bank Size. The Durbin-Watson score is 1.575, which means these is minimal autocorrelation which is not serious.

The ANOVA (F- value) model summary is depicted in the table. Here, the F-value of 4.2 and corresponding P value of 0.0 is statistically significant which means the model can explain the contribution of the independent variables (predictors) relationship with ROA.

Table 4.7: Regression result of Corporate Governance variables without Board Independence on ROA

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-7.464</td>
<td>5.335</td>
<td>-1.399</td>
<td>.164</td>
</tr>
<tr>
<td>BD</td>
<td>.020</td>
<td>.013</td>
<td>1.578</td>
<td>.117</td>
</tr>
<tr>
<td>OS</td>
<td>.005</td>
<td>.004</td>
<td>1.198</td>
<td>.233</td>
</tr>
<tr>
<td>IC</td>
<td>.237</td>
<td>.146</td>
<td>1.618</td>
<td>.108</td>
</tr>
<tr>
<td>BKS</td>
<td>.362*</td>
<td>.216</td>
<td>1.678</td>
<td>.096</td>
</tr>
<tr>
<td>Bank Age</td>
<td>-.003</td>
<td>.017</td>
<td>-.156</td>
<td>.877</td>
</tr>
<tr>
<td>CAR</td>
<td>-.241***</td>
<td>.018</td>
<td>2.797</td>
<td>.006</td>
</tr>
<tr>
<td>BS</td>
<td>-.241***</td>
<td>.089</td>
<td>-2.714</td>
<td>.008</td>
</tr>
</tbody>
</table>

R²= 0.188  Durbin-Watson= 1.575  F-value= 4.20 (0.000)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level
The given table 4.7 gives the result of the regression of dependent variable ROA with Corporate Governance and control variables. The Corporate Governance variables like Board Size, Bank Size and Capital Adequacy Ratio have significant effect on ROA. The negative relationship between Board Size shows that decreasing the board size will yield better ROA. Similarly, increasing the size of total assets also significantly increases the ROA. Capital Adequacy Ratio is found to be significant in case of ROA, maintaining the adequate level of capital can give higher Return on Assets (ROA). Whereas Bank age, Board Diligence, Internal Control and Ownership structure has no significant relationship.

Similarly, the table 4.8 shows the predictors Bank Independence, Ownership Structure, Board Diligence, Internal Control, Capital Adequacy Ratio, Bank Age, Leverage and Bank Size on dependent variable ROA. The Durbin-Watson score of 1.515 means there is no significant autocorrelation.

The ANOVA summary of Dependent variable ROA and the predictors explains the relationship on the contribution of independent variables on ROA. The F-value of 4.947 with corresponding P-value of 0.0 shows the value to be highly significant.

The table 4.8 shows the regression result of Corporate Governance and control variables on ROA. The result is similar with the table 4.7, and shows Internal Control and Capital Adequacy Ratio has significant contribution on ROA. Board Independence also has significant positive correlation on ROA, hence increasing the percentage of Independent directors will yield better returns from the assets. Other variables like Board Diligence, Ownership Structure, Bank Size and Bank Age do not have significant contribution on ROA.
Table 4.8: Regression result of Corporate Governance variables without Board Size on ROA

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-10.766</td>
<td>5.061</td>
</tr>
<tr>
<td>BD</td>
<td>.019</td>
<td>.012</td>
</tr>
<tr>
<td>OS</td>
<td>.004</td>
<td>.004</td>
</tr>
<tr>
<td>IC</td>
<td>.262*</td>
<td>.144</td>
</tr>
<tr>
<td>BKS</td>
<td>.341</td>
<td>.212</td>
</tr>
<tr>
<td>Bank Age</td>
<td>-.006</td>
<td>.017</td>
</tr>
<tr>
<td>BI</td>
<td>.145***</td>
<td>.042</td>
</tr>
<tr>
<td>CAR</td>
<td>.055***</td>
<td>.018</td>
</tr>
</tbody>
</table>

R² = 0.214 Durbin-Watson = 1.515 F-value = 4.947 (0.00)

Note:
***- Significant at 0.01 level
** - Significant at 0.05 level
*- significant at 0.1 level

The Hypothesis H3 and Hypothesis H7 are tested on the basis of the results from the multiple regressions on ROA. The study has hypothesized that Corporate Governance and Control factors have effect on ROA of Nepalese Commercial Banks. From the regression results Board Size, Board Independence and Internal control are found to have significant effect on ROA. Similarly, Control variables Bank Size and CAR also have significant effect on ROA. Hence, Hypotheses H3 and H7 both are supported.

4.3.4 Regression of Dependent variable ROE with Corporate Governance and control variables

The 8 constant independent variables of ROE are shown in the above model summary. The predictors Capital Adequacy Ratio, Internal Controls, Ownership Structure, Board Diligence, Board Size, Bank Age and Bank Size. As ROE is an accounting variable, the higher proportion of the variability cannot be explained by
the predictors of Corporate Governance. The Durbin Watson value at 1.897 is nearly equal to 2, hence no serious autocorrelation is present.

The model summary shows the F-value ANOVA for the dependent variable ROE, with the predictors Capital Adequacy Ratio, Internal Controls, Ownership Structure, Board Diligence, Board Size, Bank Age, Bank Size and Bank Independence. The F-value of 1.898 with the significance P value of .059 implies that it is significant.

**Table 4.9: Regression Result of Corporate Governance Variables without Board Independence on ROE**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td></td>
<td>Tolerance</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-341.605</td>
<td>121.733</td>
<td>-2.806</td>
<td>.006</td>
</tr>
<tr>
<td>BD</td>
<td>-.128</td>
<td>.289</td>
<td>-.442</td>
<td>.659</td>
</tr>
<tr>
<td>OS</td>
<td>.113</td>
<td>.091</td>
<td>1.245</td>
<td>.215</td>
</tr>
<tr>
<td>IC</td>
<td>-.265</td>
<td>3.338</td>
<td>-.080</td>
<td>.937</td>
</tr>
<tr>
<td>BKS</td>
<td>13.869***</td>
<td>4.927</td>
<td>2.815</td>
<td>.006</td>
</tr>
<tr>
<td>Bank Age</td>
<td>.744*</td>
<td>.384</td>
<td>1.937</td>
<td>.055</td>
</tr>
<tr>
<td>CAR</td>
<td>.693</td>
<td>.420</td>
<td>1.652</td>
<td>.101</td>
</tr>
<tr>
<td>BS</td>
<td>-.353</td>
<td>2.027</td>
<td>-.174</td>
<td>.862</td>
</tr>
</tbody>
</table>

R² = 0.10 Durbin Watson = 1.897 F-value 2.005 (0.059)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The table shows the result of the regression between dependent variable ROE and independent variables. Here we can see the minimal significance between ROE and Corporate Governance variables. However, ROE is significantly affected by control variables Bank Size and Bank Age. The positive relationship shows that increasing the total assets will improve ROE ratio in Nepalese commercial banks. Similarly, the newly established banks are found to be low in ROE. The independent
variables like Board Size, Board Diligence, Ownership Structure and Internal Control have minimal significance with ROE.

The Table 4.10 shows the model summary of predictors Board Independence, Ownership Structure, Board Diligence, Internal Control, Capital Adequacy Ratio, Bank Age and Bank Size on ROE. The Durbin Watson value of 1.901 is nearly equal to 2, signifying no autocorrelation.

The Table 4.10 shows the ANOVA summary of predictors’ ability to define the relationship on ROE. The F-value of 2.024 with the P value of 0.057 is significant.

**Table 4.10**: Regression Result of Corporate Governance variables without Board Size on ROE

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>-345.806</td>
<td>117.335</td>
<td>-2.947</td>
<td>.004</td>
</tr>
<tr>
<td>BD</td>
<td>-.126</td>
<td>.288</td>
<td>-0.437</td>
<td>.663</td>
</tr>
<tr>
<td>OS</td>
<td>.110</td>
<td>.091</td>
<td>1.209</td>
<td>.229</td>
</tr>
<tr>
<td>IC</td>
<td>-.133</td>
<td>3.349</td>
<td>-0.040</td>
<td>.968</td>
</tr>
<tr>
<td>BKS</td>
<td>13.711***</td>
<td>4.924</td>
<td>2.784</td>
<td>.006</td>
</tr>
<tr>
<td>Bank Age</td>
<td>.722*</td>
<td>.386</td>
<td>1.872</td>
<td>.064</td>
</tr>
<tr>
<td>CAR</td>
<td>.705*</td>
<td>.421</td>
<td>1.675</td>
<td>.096</td>
</tr>
<tr>
<td>BI</td>
<td>.379</td>
<td>.977</td>
<td>.388</td>
<td>.699</td>
</tr>
</tbody>
</table>

R² = 0.100  Durbin-Watson=1.897  F-value= 2.005 (0.059)

Note:
***- Significant at 0.01 level
**- Significant at 0.05 level
*- significant at 0.1 level

The regression result of Corporate Governance and control variables on Efficiency is shown in the Table 4.10. Similar to Table 4.9, ROE has minimal significance with Corporate Governance variables but have statistically significant positive relation with Control variables Bank Age, CAR and Bank Size.
The Hypothesis H4 and Hypothesis H8 are tested on the basis of the results from the multiple regressions on ROA. The study has hypothesized that Corporate Governance factors have effect on ROE of Nepalese Commercial Banks. From the regression results of table 4.9 and 4.10, Hypothesis H8 is supported. Similarly, Hypothesis H4 is not supported.
5.1 Conclusion

The study examined the relationship between Corporate Governance and Commercial Bank Performance in Nepal between 2010 and 2014. The independent variables that were hypothesized were Corporate Governance and Control factors. The Corporate Governance factors are Board Size, Board Diligence, Board Independence, Ownership Structure and Internal Control. The Control variables are Bank size and Bank Age, along with that two proxy variables, Leverage and Capital Adequacy Ratio, are also used. The study covers 27 out of 30 Commercial Banks in Nepal. The study uses Descriptive Analysis, Parson’s Correlation Coefficient (r) in bivariate analysis and multiple regression analysis to determine the effect of Corporate Governance and Control factors on the performance of Commercial Banks in Nepal.

The consolidated regression results of the models Efficiency, Stock Returns, ROA and ROE is presented on the following table. The models present the coefficients and signify the effects and strength of each independent variable. The sign before the coefficient indicate the direction of influence. A negative(-) regression coefficient shows a negative effect (reduction) on financial performance, whereas a positive regression (+) coefficient shows an incremental effect on the performance.
Table 5.1 Summary of 4 Models

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Model 1 Efficiency</th>
<th>Model 2 Efficiency</th>
<th>Model 2 Stock Returns</th>
<th>Model 3 Stock Returns</th>
<th>Model 3 ROA</th>
<th>Model 4 ROA</th>
<th>Model 3 ROE</th>
<th>Model 4 ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>BS</td>
<td>-.358</td>
<td>-.012</td>
<td>-.241***</td>
<td>-.353</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BD</td>
<td>.102***</td>
<td>.099***</td>
<td>.003</td>
<td>.020</td>
<td>.019</td>
<td>-.128</td>
<td>-.126</td>
<td></td>
</tr>
<tr>
<td>BI</td>
<td>.146</td>
<td>.009</td>
<td>.145***</td>
<td>.379</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OS</td>
<td>-.024**</td>
<td>-.024**</td>
<td>.001</td>
<td>.005</td>
<td>.004</td>
<td>.113</td>
<td>.091</td>
<td></td>
</tr>
<tr>
<td>IC</td>
<td>-.302</td>
<td>-.302</td>
<td>-.042</td>
<td>.237</td>
<td>.262*</td>
<td>-.265</td>
<td>-.133</td>
<td></td>
</tr>
<tr>
<td>BKs</td>
<td>.146</td>
<td>.156</td>
<td>-.227***</td>
<td>-.229***</td>
<td>.362*</td>
<td>.341</td>
<td>13.869***</td>
<td>13.711***</td>
</tr>
<tr>
<td>BA</td>
<td>-.005</td>
<td>-.004</td>
<td>.012</td>
<td>-.003</td>
<td>-.006</td>
<td>.744*</td>
<td>.722*</td>
<td></td>
</tr>
<tr>
<td>LVG</td>
<td>-.011</td>
<td>-.011*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.051***</td>
<td>.145***</td>
<td>.693</td>
<td>.705*</td>
</tr>
<tr>
<td>R square</td>
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<td>.117</td>
<td>.153</td>
<td>.175</td>
<td>.188</td>
<td>.214</td>
<td>.100</td>
<td>.100</td>
</tr>
<tr>
<td>Durbin-Watson</td>
<td>1.720</td>
<td>1.738</td>
<td>1.956</td>
<td>1.945</td>
<td>1.575</td>
<td>1.515</td>
<td>1.897</td>
<td>1.901</td>
</tr>
<tr>
<td>F Statistics</td>
<td>2.954</td>
<td>2.832</td>
<td>3.279</td>
<td>3.340</td>
<td>4.200</td>
<td>4.947</td>
<td>2.005</td>
<td>2.204</td>
</tr>
<tr>
<td>Observations</td>
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<td>135</td>
<td>135</td>
<td>135</td>
<td>135</td>
<td>135</td>
<td>135</td>
<td>135</td>
</tr>
</tbody>
</table>

Note: ***- Significant at 0.01 level  
**- Significant at 0.05 level  
*- Significant at 0.1 level.
The study found that Board Diligence and Ownership Structure have significant effect on Efficiency of Commercial Banks in Nepal. Board Diligence has positive relation with Non-performing Loan to Total Loan ratio, hence decreasing the frequency of board meetings will have positive impact on Efficiency of banks. Similarly Ownership Structure has negative relation with Non-performing Loan to Total Loan ratio, hence increasing the percentage of institutional and foreign ownership will have positive effect on Efficiency of Commercial Banks in Nepal.

The regression results of Stock Return found Bank Size and Leverage have significant negative impact on Stock return. The bigger sized banks’ stock prices were more volatile during recession and also increased at slower pace during recovery also. Similarly, Leverage has negative correlation with Stock Returns, decreasing the leverage percentage will have higher returns from stock.

ROA is another dependent variable which is significantly affected by Board Size, Board Independence, Bank Size, Internal Controls and Capital Adequacy Ratio. Board Size has negative impact on ROA, proposing smaller board size is good for ROA. Similarly, Board Independence has positive contribution to ROA. Increasing the percentage of outside directors can increase the ROA. Bigger banks are found to be more efficient in terms of ROA. The Audit Committee should also be bigger for better ROA, which is shown by significant positive contribution by Internal Controls. Similarly Capital Adequacy Ratio has positive impact, hence increasing the CAR will have positive impact on ROA.

The analysis of ROE shows that ROE is positively affected by control variables Bank Age, CAR and Bank Size. The older banks are found to be better performing on giving returns to its shareholders, similarly the larger sized banks are
more efficient on giving higher return on equity. The adequate level of Capital Adequacy Ratio is also necessary for ROE to have better ratio.

5.2 Discussion

The discussion and analysis of the independent variables are given on this section.

Board Size:

This research found that large Board Size positively impacts the performance of commercial banks in Nepal. In case of Efficiency, the Board Size is negative, meaning large membered Board Size is responsible for lower Non performing loans (NPL). This is consistent with the findings of Zhara and Pearce (1989) and Mak and Li (2001) which suggest positive relationship between Board Size and Performance. However Stock Returns and ROE have negative but insignificant relation with Board Size, which is in line with Ghabayen (2012) where no relationship with board Size and performance is established. ROA has a very significant negative relation with Board Size. Tai (2015) also found statistically significant positive contribution of Board Size in ROA. The result of this study does not support the findings of Haniffa and Hudaib (2006) that proposed a statistically significant relationship and positive relationship with board size and ROA. Mangla (2012) also found significant relation between Board Size and ROA and ROE in the research about banks in Pakistan. However Willesson (2014) failed to find any significant relation between ROA and Board Size in the study about Corporate Governance in European Banks. Similarly, Akpan and Riman (2012) in the research about Corporate Governance and profitability in Nigeria found insignificant relation between Board Size and performance (ROA & ROE), and In ROE, the relation was not significant. Ajanthan et
al. (2013) also failed to find significant relation between Board size and ROA and ROE in the study about corporate governance and banking performance in Sri Lanka.

**Board Diligence**

The study found significant positive relation between the ratio of NPL (Efficiency) and Board Diligence, meaning higher number of board meeting will have negative impact of performance. This is in consistent with the research of Vaefas (1999) and Poudel and Hovey (2013) that concluded negative relation between Board Diligence and performance. On the other hand, Stock Returns has negative relation with Board Diligence. This is inconsistent with Abbot et al (2003) that emphasized better performance of a firm. However this result is consistent with Hermanson et al. (2002) and Fich and Shivdasani (2006), where a negative relationship was established between number of board meetings and market return. Similarly, both ROA and ROE have no significant relationship with Board Diligence, which is consistent with Velnampy (2013), Klien (1998), Tai (2015), Brick and Chidambaran (2010), Bhagat and Black (2000) that failed to find any significant relationship between board monitoring and accounting returns.

**Board Independence**

The result of this study showed not any significant effect of Board independence and performance measures of Efficiency, Stock Returns and ROE, and a significant positive effect on ROA. This supports Klien (1998) that independent directors may not be effective. Similarly, the result also support Bhagat and Black (2001), Kajola (2008) and DeZoysa et al. (2010) that failed to find relationship between performance and Independent Director. The significant positive relation between Board independence and ROA is consistent with Zhara and Pearce (1989)
and Chole and Lee (2003), which emphasized higher proportion of independent directors for better performance. Tai (2015) in the study about Gulf Banks found the contribution of Board independence and ROA and ROE not statistically significant.

Ownership Structure

The study found significant negative relation between Non-performing loan and Ownership structure, which means Institutional Ownership has positive relation with efficiency. This is consistent with the findings of Poudel and Hovey (2013), Baysinger and Hoskission (1990) and Han and Suk (1998) that emphasized that higher institutional ownership is positively related to performance as the top management is monitored more actively. However other 3 models, Stock Returns and Accounting measures (ROE and ROA) have no significant relationship with Ownership Structure. The findings are consistent with Agrawal and Knoeber (1996) and Li and Qian et al (2006) who found no significant relationship between firm performance and Institutional ownership. Mangla (2012) in the research about banks in Pakistan also fail to find any significant relation between Ownership Concentration on both ROA and ROE.

Internal Control

This study is able to find significant positive contribution of internal controls on ROA, other than those other Models of bank performance do not have significant contribution. This finding is consistent with Klien (2002), Poudel and Hovey (2013) Coleman-Kyereboah (2007) and AlBeera (2009) which found significant positive relationship. The findings of this studies disagrees with Sarea et al (2013) in Jordan, Rouf (2011) in Bangladesh and Ghabayen (2012) in Saudi Arabia, which also found no significant effect of audit committee size on performance. This is inconsistent with
the findings of Mangla (2012) that also found minimal significant relationship between ROA and audit committee. However, the same research found some significance between audit committee and ROE in private banks.

**Bank Size**

The study found significant relationship with Bank Size and Bank performance in Nepal. The relationship with Stock Return, ROA, and ROE is found to be statistically significant. Bank Size has negative significant effect on Stock Returns which is consistent with Essen et al (2013), in the research about European firms during July 2005-december 2006. Utma and Musa (2011) found the bank size to be positively significant on both ROA and ROE in the study about Corporate Governance and performance in Indonesia. Love and Rachinsky (2007) also found Bank Size to be positively significant with ROE in Russia and positively significant with both ROA and ROE in Ukraine. This relationship is also emphasized by Drake and Hall (2003) and Miller and Noulas (1996). Similarly, Hasan and Marton (2003) also found size positively related with efficiency in Banks in Hungary. Sathye (2001) also found a positive relation between performance and size in Australian Banks.

**Bank Age**

The control variable Bank Age has been found to have positive significant effect on Stock Return and ROE. Other dependent variables Efficiency and ROA do not have significant impact on Bank Age. El-Chaarani (2014) in the research about Lebanese banks found Bank Age to be without any significance on ROA and ROE. Essen et al (2013) also found no significance between firm size and Stock Returns.
Leverage

The study included Leverage for Stock Returns and found out negative significant relation between leverage and Stock Returns. This finding is consistent with Essen et al. (2013) that also found negative significant impact of Leverage on Stock Returns during the European financial crisis during July 2007-December 2008. Similarly Erkens et al. (2012) also found negative but no significant relationship between Stock Returns and Leverage in the study about global financial crisis of 2007-2008. This is consistent with the findings of Gupta et al. (2013) which found significant negative relation between Stock Returns and Leverage.

Capital Adequacy Ratio

This study used capital adequacy ratio for accounting performance only, hence only ROA and ROE was used to find the contribution of Capital Adequacy Ratio in Nepalese Commercial Banks. The study found CAR statistically significant positive relationship with ROA and positive relationship with ROE. The significant relationship between ROA and CAR is recognized by Pratiningish (2009) in the study about Corporate Governance and Bank Performance in Indonesia, Philippines, Malaysia and Thailand. Similarly the positive but insignificant relation is consistent with Aebi et al. (2012) in the research about corporate governance and bank performance in financial crisis. Fanta et al.(2013) also found significant positive impact of CAR on ROA.
5.3 Implication of the study

The results have several implications for Commercial Banks in Nepal. It will help Nepalese Commercial Banks to understand which Corporate Governance and Control factors are critical to improve the Efficiency, Stock Return, ROA and ROE. This study provides a guideline for banks in Nepal to formulate strategies and policies.

1. In terms of Efficiency, there should be lower number of board meetings as high frequency of Board meetings negatively affects the efficiency while the banks with higher institutional ownership perform better.

2. For Stock Return, banks with high level of total assets are found to have lower returns from market. Similarly, high level of leverage is also counter-productive, hence it should be kept below 20%. Unexpected increase in the Stock Exchange also has negative effects on the Stock Price of banks. The NEPSE (Nepal Stock Exchange) has 250 listed companies, in which the commercial banks are only 30 in number. The result implies that banks stocks tend to perform better when the market is in downturn.

3. To increase the ROA, the Board Size should be smaller, Independent director percentage in the board should be high and the total assets should be greater in proportion to other banks. Similarly, the leverage should be below 20% and there should be more than 10% of capital reserved for CAR.

4. ROE is mostly affected by the control factors, Bank Size and Bank Age. The results indicate that Bigger and older banks are more efficient in terms of ROE. They are able to mobilize funds better than new and smaller banks.
5.4 Research Recommendation

- For Banks

The study recommends that the Board Size in Nepalese Commercial banks should not be large. The percent of independent directors (Board Independence) should also be high, as all banks have only 1 independent director, therefore the bigger Board Size make the percentage of independent director low. Similarly, the Leverage ratio should be low for the banks to improve their financial performance. The bigger sized banks (Bank Size) are performing better, so it is necessary to maintain sufficient capital to attain better performance. The research also found that the older banks (Bank Age) are more efficient than the new banks. Hence, the new banks should follow the strategy of old banks to be more successful.

- For Policy makers and Regulators

The result obtained from this research has several recommendations for policy makers and Regulators. The Central Bank of Nepal, Nepal Rastra Bank (NRB) is the sole body to implement the corporate governance as well as other banking policies and regulating them. The findings stress the importance of central bank in monitoring and guiding the commercial banks for better performance. The results, shows the Board Size was exceeded to 10 persons in 1 bank, hence effective monitoring is necessary. Regarding Board Diligence, most of the banks are having board meetings 12 times a year, just to maintain the central bank guideline, but there is no maximum limit and board meetings have been held 67 times also. There should be a policy for maximum number of board meetings also as higher numbers of board meeting are negatively contributes to the performance of commercial banks. The results also show the some of the banks are still no maintaining the Capital Adequacy Ratio of 10% as proposed by Basel Committee, hence effective regulations are also necessary.
5.5 Limitations and Further Research

The limitation of the study and the suggestions for further research is presented in this section. As with any other research, this study is also subjected to several limitations.

5.5.1 Limitations

1. The sample of this study has excluded 3 banks, Rastriya Banijya Bank is excluded because of unavailability of data. Similarly, Civil Bank and Century Commercial Bank are excluded as they were established on 2011, whereas the data is collected from 2010 to 2014. Hence, the outcome of this study misses the data of these 3 banks.

2. The study considers the data of 5 years from 2010 to 2014. For better understanding of the situation, multiple numbers of years has to be considered, as 5 years is a short time.

3. The data used in this study are collected from the annual reports and financial statement of commercial banks, annual reports of the central bank and the respective banks websites. The data in the reports are subjected to manipulation, the assets maybe undervalued, the different method of depreciation used by banks may produce alterations, different ways of treatment of certain expenditure and revenue items (Adusei, 2011).

4. The study explored only 7 Corporate Governance and Control factors, however in general there are a lot of factors like GDP growth rate, inflation, foreign exchange rate, market interest rates (Poudel and Hovey, 2013) that affect the performance of banks.
The researcher believes that these limitations do not compromise on the validity or conclusions drawn based on the results.

5.5.2 Further Research

For future research, it is suggested that the use of larger data set, including the cross-sections and time series data, in order to get more accurate and reliable data analysis. The sample size should be increased along with the number of years considered for data collection, similarly, instead of yearly data, quarterly data set can be used in order to be able to assess the effectiveness and implication of policies related to the corporate Governance and Control mechanisms. Future research should also consider adding more Corporate Governance and Control factors like the number of board members attending the board meeting, number of audit committee meeting, the qualification of board members, the average tenure of the board members, market returns as well as macroeconomic factors than the existing 7 in this study. The ownership structure can also be divided into domestic institutional ownership and foreign institutional ownership to test the Corporate Governance and performance in further studies.
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APPENDIX
Corporate Governance Directive by Nepal’s Central Bank, Nepal Rastra Bank 2002

The following Directives have been issued with regard to the provisions to be complied with by licensed institution concerning good corporate governance having exercised the powers conferred by Section 79 of the Nepal Rastra Bank Act, 2002.

1. Provisions Relating to Code of Conduct to be observed by Directors

(1) Directors of the Licensed Institution to Observe Minimum Acceptable Standard of Code of Conduct

(a) Directors of a bank shall sign a declaration as to observance of the regulations relating to the Code of Conduct issued by this Bank.

(b) Every person, upon appointment as a Director and prior to taking over the charge, shall provide information in writing to the Board of Directors as to whether or not he/she has any financial interest with the institution.

(c) A Director of a bank or financial institution shall not interfere in the daily activities of the management.

(d) A Director himself/herself shall be liable for any *ultra vires* act committed exceeding his/her authority. In such cases, the Institution shall not be liable.

(2) Not to be involved in Activities against the Interest of the Licensed Institution

(a) Directors of the licensed institution shall not engage directly or indirectly in any activity which is against the interest of the institution.

(b) Directors shall not engage directly or indirectly in any transactions of the customers in which they have financial interest. Where the Director has financial interest in any customers through ownership, partnership, or borrowing or giving loan by providing guarantee, he/she shall not be deemed eligible to continue to be in the post of the Director.
(c) The above restriction shall not apply in cases of transactions of publicly issued shares/securities, unless the Board of Directors certifies the existence of financial interest of such Director.

(d) Where the Chief Executive is, in addition to engagement in the operation of the licensed institution, engaged in the operations of business related to the business of any other institution licensed by this Bank, such an activity shall also be regarded against the interest of the institution.

(e) Directors or members of their undivided family shall not engage in securities transactions by holding more than 10 percent shares of the organized securities trading firms (broker, market maker etc.).

(f) No transaction exceeding an annual amount of one hundred twenty thousand rupees or transaction of house rent shall be allowed to be concluded with a Director or a shareholder holding more than one percent of shares or with a firm/company in the ownership of his/her family or with which he/she has financial interest.

(3) **Prohibition for part-time working**

The Chief Executive of a licensed institution shall not engage in part time employment in any other institutions licensed by this Bank other than working for the institution in which he/she is engaged.

Provided that this clause does not prohibit for engagement in other business activities which is not against the interest of the licensed institution and is done with the prior approval of the Board of Directors. The licensed institution may give such approval only where the interest of the institution shall not be prejudiced.

(4) **Prohibition to become Director of more than one licensed institution**
The person who is a Director of a financial institution shall not be allowed to be a Director of any other licensed institution or a credit and saving cooperative institution being operated under the Cooperatives Act, 1991.

(5) Prohibition to hold Trusteeships
Directors of a licensed institution shall not engage as trustee or administrator of customers' land or assets. Where a Director is engaged as such and holds the signing authority for the customers' bank account, approval of the Board of Directors shall be obtained. Provided that, Directors of the licensed institutions shall not be prohibited from acting only as the Guardian or Advisor of the "D" class licensed institution.

(6) Prohibition to misuse the position
Directors shall not engage in any activities resulting in personal benefit by misusing the name and the office assumed. Directors and their relatives shall not use their family connection in dealing with the licensed institution. Where the "family" proposes to borrow from the licensed institution disclosing the family relationship, the Director is prohibited to participate in the decision-making process relating to such proposal. Further, the use of position to obtain preferential treatment such as in purchasing goods, shares and other securities is prohibited. Furthermore, Directors shall not use the influence of their position for exchanging in gold, silver, foreign exchange or foreign securities.

(7) Records and Reports to be maintained Complete and Accurate
Accounting records and reports of the licensed institution shall be maintained complete and accurate. Directors shall not personally alter the authoritative records and documents relating to accounts.

(8) Maintenance of Confidentiality
(a) Directors of the licensed institution shall maintain confidentiality of customer information and transactions. Directors, even after vacating the office, shall not (unless written permission is obtained from the licensed institution) divulge or make use of any secrets, copyright material, or other correspondence, accounts and dealings of the licensed institution and its customers for personal financial interest.

(b) Business and financial information of any customer may be made available to any other third person or organization only with the written consent of the customer. Provided that, providing any information relating to financial transactions to the third party as required by law shall not be construed as breach of confidentiality.

(9) Fair and Equal Treatment

Directors shall conduct business transactions fairly and equitably without being influenced by the friendships and associations with the customers.

(10) Written Information to be provided

Licensed institutions are required to inform, in writing, the Bank and Financial institutions, Regulation Department and concerned Supervision Department of this Bank as to the adoption of above Code of Conduct as well as additional in-house code of conduct included by the licensed institution for its internal operational purpose, where necessary.

(11) Report to be submitted

Report as to the compliance of Code of conduct prescribed under these Directives by the Directors shall be submitted within 15 days from the closure of the fiscal year to Bank and Financial Institutions Regulation Department and concerned Supervision Department of this Bank. Where a Director has not complied with the Code of Conduct, particulars as to the same along with the actions initiated against such Director shall be reported immediately to the above departments of this Bank.
2. Duties and Responsibilities of Board of Directors

Directors of a licensed institution who are involved in the important functions like collection and acting as custodian of the public deposits shall be active in the operation of the licensed institutions to protect the interests not only of its shareholders but also of its depositors. Since good conduct and activities of Directors would bring positive impact to the licensed institution as well as to the country's overall financial system, therefore, the following arrangements have been made in respect of appointment of Directors, their duties and responsibilities:-

(a) With a view to administer the licensed institution more efficiently, rationally and professionally, it shall select and appoint qualified and able executives by adopting appropriate Personnel Administration Byelaws.

(b) The licensed institution shall establish an Audit Committee to be headed by a nonexecutive Director. Detail working manual in respect of internal auditing shall be prepared and audit shall be conducted accordingly.

(c) Regular internal audit shall be conducted through qualified internal auditors. Provision shall be made to submit the internal auditors report directly to the Audit Committee. Provided that a person or firm entrusted with the function of internal audit of the institution and the partner or employee of that firm shall not be allowed to be involved in the Statutory Audit of the institution. Similarly, the Board of Directors shall make an arrangement where a person or firm entrusted with the Statutory Audit work of the institution and partner or employee of that firm shall not be allowed to be involved as Internal Auditor of the institution.

(d) The licensed institution being an organization engaged in mobilization of public funds, its Directors shall supervise and monitor the activities with a higher degree of prudence and competence.
(e) Although Directors may delegate authorities to employees, the ultimate responsibilities of the work of such employees lie on the Directors. Thus, a record of any supervision and actions taken against the employees shall be placed in the meeting of the Board of Directors.

(f) The licensed institution shall adopt written policies in respect of investment, credit, management of assets and liabilities, budgeting, profit planning and other written policies and ensure implementation of the same by the employees.

(g) Directors shall keep themselves informed of the condition of the business, its activities as well as the policies pursued by the management and initiate remedial measures as may be necessary.

(h) The meeting of Board of Directors shall be convened as are provided under the existing law.

(i) Directors may be dismissed from their position for non-compliance of the existing laws and policy, Directives and regulations issued by this Bank. Therefore, they shall have to be familiar themselves with relevant laws, related regulations and guidelines and shall have to regularly monitor that these are not violated.

(j) Fines imposed under Section 100 of Nepal Rastra Bank Act, 2002 on the Directors and officials who have acted against the interest of depositors or withheld the documents requested by this Bank shall be the personal liability. The concerned licensed institution shall not reimburse such fines paid on individual basis by charging in its accounts.

(k) Professional Director of an institution shall not have subscribed the promoter share ownership of that institution.

(l) The chairperson of the Board of Directors shall not be allowed to represent in any other internal committee or sub-committee other than the Board of Directors.
(m) Except in cases prescribed by the law in force for the time being, non-executive Director and other Directors shall not be allowed to make correspondence having used the seal of that institution and name of the office (logo).

(n) Licensed financial institution shall not be allowed to invite members other than Directors in its Board of Directors meeting and provide meeting allowances and other facilities as same as the Directors.

Provided that this clause shall not be deemed to have hindered to invite an expert having no financial interest for opinion/consultation on particular subject and to seek his/her opinion/consultation and to provide remuneration to him/her, in case the Board of Directors of a banks and financial institution deems it necessary.

(o) Every Director who has been elected/nominated to Bank/financial institution shall have to take an oath of office and secrecy within thirty five days from the date of his/her election/nomination.