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ADMINISTRATION AND ECONOMIC PERFORMANCE OF COMMERCIAL BANKS IN NEPAL

Rajendra Giri[1], Dr. Gulab Singh Parmar[2]
Department of Management
[1,2]OPJS University, Churu (Rajasthan)

ABSTRACT

The purpose of this study is to investigate the relationship between non-performing loans in Nepalese commercial banks and several components of corporate governance. There are two factors that influence this ratio: the non-performing loan ratio and cost efficiency. Along with board size and independent directors, there are other variables to examine such as the board meetings quantity that have been held,the age of the bank, the female managers' fraction, and an independent managers total quantity. This study findingswere based on secondary sources of data obtained from 18 commercial banks in Nepal between 2010 and 2016. There were a total of 108 observations in this study. All of the information was compiled from annual reports and websites of a few well-known Nepalese financial institutions. Regression models are constructed in order to investigate the significance and influence of corporate governance characteristics on non-performing loans in Nepalese commercial banks.

Keywords: Corporate Administrations, Variables, Audit Committee, Members Board Size, Domestic Ownership (DO),

1. Introduction

Corporate governance has recently gained favour. A lack of corporate governance has been blamed for every major financial disaster since 1997, including the Enron and WorldCom scams in the US. Corporate governance is an important aspect in a company's success. The importance of good corporate governance in banking cannot be overstated. This is due to the banking sector's unique position in the economy, which is to help firms allocate capital and manage risk. As a result, both the bank's and its clients' businesses are largely reliant on bank governance. Good corporate governance is vital for sustaining worldwide corporate integrity, among other things. Accountability and transparency are required. These are vital for long-term growth, expansion, and financial and operational success. Principles of corporate governance of varying quality have an effect on the specific institutions growth as well as a financial system in its entirety.Firm accomplishment has recently gained attention in economic and financial literature due to the role performed by corporate management. Multiple financial scams rattled the US economy in the early and late 2000s, as did the Asian financial crisis in the late 1990s. Corporate governance and firm performance are still debated, notably in the case of commercial banks[1]

The banking system plays an important function as a financial intermediary. The Asian financial crises of 1997–1998 emphasised good corporate governance. For banks, corporate governance is crucial. Inadequate corporate governance can lead to market distrust, economic instability, and systemic danger.[2]Solid corporate governance gives banks more property rights, lowers transaction costs, and strengthens the capital market. Most people assume that corporate governance encompasses all policies and procedures put in place inside an organisation to help economic agents become more involved in the production process.[3]To understand corporate governance theoretically, we must first appreciate agency theory. Theory of agency is the study of conceptual links. Directors or managers are agents chosen by shareholders, the company's owners or principles. An agency issue arises when managers' actions do not always promote investors' interests. Managerial perquisite spending, for example, can be extremely harmful to investors. Employees and supervisors may act in their own best interests in organisations. Shareholders want investigators in action as well as their better interests create choices. Agents, unlike dean, may not always make decisions in their favour. The principal's goals and the agent's goals may not be aligned due to agents' self-interest and opportunism. Agents must follow the principal's rules to maximise shareholder value. Agency theory can help us better comprehend ownership and management.

2. Methodological Aspects

Secondary data was obtained by 18 Nepalese commercial banks over a three-year period for the study. Commercial banks' annual reports and websites offer a plethora of material for the study of these institutions. Table 1 lists the commercial banks that were studied, as well as the duration and number of observations that were made (below).

2.1 The Model

It has been found that a non-performing loan's likelihood is influenced by a number of factors that are related to corporate governance. The aspects of corporate governance include board size, independence, audit committee participation, domestic holding or ownership, female directors, board meetings, bank age, and foreign ownership/CEO duality. Consequently, this is how the equation appears: As a rule of thumb EY equals f (size of the board , independent director quantity on a board, member of the audit committee quality, nation holding, household holding, Duality of the CEO, age of the bank, the board female director quality, board meetings quantity, size of the bank).

S. no.	*Name of commercial banks*	*Study period*	*Observations*
1	Agriculture Development Bank Limited	2010/11–2015/16	6
2	Nabil Bank Limited	2010/11–2015/16	6
3	Nepal Investment Bank Limited	2010/11–2015/16	6
4	Standard Chartered Bank Nepal Limited	2010/11–2015/16	6
5	Himalayan Bank Limited	2010/11–2015/16	6
6	Nepal SBI Bank	2010/11–2015/16	6
7	Everest Bank Limited	2010/11–2015/16	6
8	Kumari Bank Limited	2010/11–2015/16	6
9	Bank of Kathmandu Limited	2010/11–2015/16	6
10	Laxmi Bank Limited	2010/11–2015/16	6
11	Citizens Bank International Limited	2010/11–2015/16	6
12	Prime Commercial Bank Limited	2010/11–2015/16	6
13	Sunrise Bank Limited	2010/11–2015/16	6
14	NMB Bank Nepal Limited	2010/11–2015/16	6
15	NIC Asia Bank Limited	2010/11–2015/16	6
16	Machhapuchchhre Bank Limited	2010/11–2015/16	6
17	Sanima Bank Limited	2010/11–2015/16	6
18	Siddhartha Bank Limited	2010/11–2015/16	6
Total number of observations			108

Table 1: List of sample banks chosen for the study, with study length and number of observations

The supplied model is further subdivided into the following models:

Model 1

$$NPLS = \beta_0 + \beta_1 BS + \beta_2 ID + \beta_3 ACM + \beta_4 FO + \beta_5 DO + \beta_6 CEOD + \beta_7 BA + \beta_8 FD + \beta_9 BM + \beta_{10} BAS + \varepsilon_{it} \ldots \quad (20.i)$$

Model 2

$$CE = \beta_0 + \beta_1 BS + \beta_2 ID + \beta_3 ACM + \beta_4 FO + \beta_5 DO + \beta_6 CEOD + \beta_7 BA + \beta_8 FD + \beta_9 BM + \beta_{10} BAS + \varepsilon_{it} \ldots\ldots \quad (20.ii)$$

Where,

NPLS = The percentage ratio of non-performing loans to total loans is known as efficiency.

CE = The cost-efficiency ratio is the percentage of total operating expenses to net investments.

BS = The quantity of members on the boards is referred to as board size.

ID = The number of independent directors on a board is decided by the number of independent directors.

ACM = The size of the audit committee is determined by the number of members.

FO = The percentage of a company owned by foreigners is known as foreign ownership.

DO = The percentage of domestic ownership in a company is known as domestic ownership.**CEOD =** The term "CEO duality" refers to the summation of board chairperson and CEO responsibilities.

CEO = 0 if the CEO and chairman roles are distinct, 1 otherwise. The term "bank age" refers to the length of time that a bank has been in operation up until the present year.

BM = The board meetings quantity held inside a particular period are known as a board meeting count.

BAS = The total assets of a bank are used to determine its size.

2.2 Board Size

Larger boards have been shown to have a negative impact on loan quality, leading to an increase in non-performing loans. This may be because more interactions and conflicts occur among the board's members when the board is larger. Agency-based thinking underpins this concept. There was a direct correlation between the size of the bank's board and the institution's efficiency. Smaller banks are less profitable and more likely to have non-performing loans, according to research. Some argue that larger boards might push management to reduce debt expenses and improve performance since creditors regard these companies as having better monitors in their financial accounting process.

2.3 Board Independence

When it comes to board independence and bank performance, there are varying outcomes based on actual evidence. According to previous research, the majority of independent directors must participate in order to improve bank governance [5]. According to a recent study, independent boards are more effective. Directors who are unaffiliated with the board are more inclined to stand up for the company's best interests. It has been suggested that the bank's success is inversely related to that of its customers. An independent board of directors has less conflicts of interest when it comes to supervising management, according to the conclusions of the research. Therefore, we feel that increasing the number of independent directors on the board will aid in strengthening management supervision and reducing conflicts of interest for stakeholders. This is why Because it will be unable to coordinate and make decisions with such a huge group of independent directors, we believe that having an excessive number of independent directors will harm the bank's value. An all-independent board is less effective at improving the value of banks than one with an appropriate balance of executive and independent directors..

2.4 Number of Audit Committee Members

Only the bank's success may be significantly influenced by the board of directors. The agency principle protects shareholders due toLeadership (brokers) don't always act on a company's owner (dean) best interests. When it comes to financial reporting, it is the audit committee's principal role to help improve the quality of those reports.[6]It was proposed by the Cadbury Commission that there should be a three-person audit committee. Audit committees with more members are more likely to have more resources than smaller committees. The more people participating in an activity, the better the group performance and the less misbehaviour there will be, according to study.

2.5 Foreign Ownership

The soundness of banks increases when they are owned by non-residents. Non-financial FDI may be stimulated by the presence of foreign banks, according to[7], Even more importantly, foreign ownership boosts human capital, particularly in developing countries where foreign management has more advanced skills and technology. In addition to fostering local competence, a global perspective can aid in the transfer of new knowledge. Foreign holdings have a detrimental impact on non-performing loans, according to an international cross-country study. However, this could assist domestic banks improve their credit quality. Inside a 81 banks survey in 22 emerging markets, foreign involvement in banks reduces bank risk..

2.6 Domestic Ownership

The efficiency of capital allocation is harmed by a growing DO presence. It has been shown that rising DO is associated with more lending in non-foreign financial sectors and industries, meaning that domestic shareholder-controlled banks have misallocated funds. These results are in accordance with the looting approach, which sees bank lending as doomed. According to the research, DO has a substantial effect on a bank's achievement and non-performing loan[8]In spite of the fact that family-run businesses are inefficient, banks controlled by substantial domestic shareholders (such as local enterprises or wealthy individuals) sometimes dedicate a substantial portion of their loan activities to related parties..

2.7 CEO Duality

A increasing DO presence reduces the effectiveness of capital allocation. Rising DO is linked to an increase in lending in non-foreign financial sectors and industries by domestic shareholder-controlled banks. These findings are consistent with the looting view, which perceives bank lending as a failure. The performance of a bank as well as its non-performing debts are significantly affected by DO, according to the study.[9]Banks controlled by large domestic shareholders, such as local firms or affluent individuals, may devote a significant portion of their loan activity to related parties despite the fact that family-run businesses are inefficient[10]

2.8 Bank Size

An organization's size measured in terms of its assets. Large corporations are less likely to go bankrupt because their investment portfolios are more diverse, lowering their overall risk. The efficiency of a bank enhances with the size of the institution.. [11]There was a correlation between the size of the bank and its cost-effectiveness. Due to a low bankruptcy rate, larger companies can borrow more money. Large companies can lessen market knowledge asymmetry by taking edge of market possibilities that boost achievement.Big companies have a better level of financial stability since they can meet their financial obligations and hence have more information exposure.Large banks can better fulfil their clients' financial needs because of their wide branch networks, which has a greater impact on them than on smaller banks that don't have such branches. Since economies of scale vary based on the possible size of a bank's functioning, the efficiency brought about by bank expansion is determined by bank size. Companies with more market experience and well-defined networks have an advantage over start-up banks that are still striving to establish themselves.

3. Results and Discussion

3.1 Descriptive Statistics

From 2010–2011 through 2015–2016, the descriptive statistics for a selection of dependent and independent variables are shown in Table 2. It is possible to have a board with as little as five directors or as many as eleven, with an average board size of 7.907%. From one to four independent directors, the company has an average of 2.343 percent. Audit committees might include as few as two members or as many as five, with 3.546 percent % on average membership. The foreign property percentagespans from 0% to 75%, resulting in an average ownership percentage of 12.939%. The percentage of people who own their own home varies from 25% to 100%, with 86.135 % on average “CEO duality” runs by 0 to 1, with an average of 0.056 percent. In the banking sector, the average age ranges from three to 48 years, with a median of 17.16 percent. The percentage of lady directors spans from 0% to 20%, with an average of 34%. From six meetings a year to 56 meetings a year, board meetings account for an average of 17.64 percent. The size of the banks varies from 2.12 to 129.78, with an average of 49.112 percent.

Variables	*Minimum*	*Maximum*	*Mean*	*S.D.*
CE	0.02	0.65	0.08	0.10
NPL	0.00	8.60	1.81	1.62
BS	5.00	11.00	7.90	1.31
ID	1.00	4.00	2.34	0.84
ACM	2.00	5.00	3.54	0.71
FO	0.00	75.00	12.93	22.59
DO	25.00	100.00	87.06	22.59
CEOD	0.00	1.00	0.05	0.23
BA	3.00	48.00	17.16	10.20
FD	0.00	2.00	0.34	0.61
BM	6.00	56.00	17.64	8.99
BAS	2.10	127.30	48.65	27.47

Table 1: Descriptive statistics

4. Concluding Remarks

In corporate governance, there are connections between the board and management, the board and stakeholders, and the board and other stakeholders. In order to attain their goals, companies and systems form alliances based on ethical principles like corporate culture and corporate value. In terms of the "corporative body," non-performing loans (NPLs) represent the company's effectiveness and efficiency. Investigating the impact of different aspects of corporate governance as of non-performing debt issued by property was our goal. This research used secondary sources from commercial banks which is 18and surveillance which is 108 from 2010–2011 to 2015–2016. Non-performing loans have a positive correlation with the size of the board, the number of independent directors, and the number of audit committee members, as well as the bank's domestic ownership, age and the number of female directors. Consequently, non-performing loans increase as a result of these factors, making the bank less efficient. Non-performing loans have a negative correlation with "foreign ownership" and "CEO duality," indicating that the non-performing loan percentage will fall and thus increase the efficiency of the bank..

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