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OWNERSHIP PATTERN AND CORPORATE GOVERNANCE ON BANKING PERFORMANCE: AN EMPIRICAL EVIDENCE FROM NEPALESE COMMERCIAL BANKS

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Abstract

The main purpose of the study is to assess the impact of ownership pattern and corporate governance on performance of commercial banks in Nepal. In this regard the dates were gather from 22 banks out of 28 commercial bank in Nepal. Further, the pooled cross- sectional date analysis has been undertaken in the study. The results of this study depict that concentrate ownership pattern has positive association with a bank profitability. This study concluded that ownership structure and corporate governance variables could influences the decision making practice in Banking sector of Nepal. However larger board size could one of the major reason in delay in financial decision making. Finally, banking institutions may use the result and findings of the study in providing a basis for reassessing their future concerned strategy.

Key Words: *Ownership, corporate governance, Performance, Practice, Nepal*.

1. Introduction

It is known that corporate governance is based upon the establishment of a mechanism that ensures transparency, accountability as well as the maintenance of an effective information disclosure channel that will eventually lead to a proper culture regarding the corporate sector (Owiredu and Kwakye, 2020). Theorists Shleifer and Vishny (1997) claim that it is a process in which those who supply finance to corporations makes certain that they get their investment back in terms of profit or the principle to the least. Likewise, there is also an argument that a good corporate governance need a mechanism which is sound both internally and externally: one that respond effectively and adequately to the interests of internal as well as external stakeholders, in order to obtain advantages in the corporate market (Tura, 2012; Kyere and Ausloos, 2020). It is evident that the importance of corporate governance is increasing these days in modern organizations as it has been proven to strengthen business performances in the long run, regardless of the types, nature and the size of such organizations (Al-Azzam, Al-Qura'an and Al-Mohameed, 2015. It has also been recognized as a

practice that reduces the firms' agency costs (Abdullah et al., 2019). If the performance of the firm is to be increased, then a well-designed ownership structure becomes vital. But sometimes such structures might increase the agency costs, which might eventually reduce the firm's value (Balsmeier & Czarnitzki 2015).

Corporate governance has always been a subject of persisting debate. Berle and Means (1993) concluded that the growing diffusion of holdings could give rise to separation of ownership and control. This results in a struggle of concern between its holdings and performance and adversely affects its mechanism, as reported by Jensen and Meckling (1976). Corporate governance structures are required as an outcome. 'Ownership structure' is one of such possible mechanism that can mitigate problems of agency. As far as the argument goes, a bank's management is controlled by ownership concentration and managerial ownership and it could also influence the maximization of shareholders and their wealth. Khan (2011) believes that due to the weakness of capital markets, regulation and weak supervision, instances of imperfect corporate governance or concentrated ownership structure in banks can be seen in both developed and developing countries. Hence, policymakers and regulators in the financial circumference can be benefitted by a detailed research of ownership structure, eventually safeguarding the particular economic system. An agency problem between managers and shareholders might arise if there is the presence of concentrated ownership problem in banks. The existence of such concentrated holdings mechanism is a major problem that results in multiple insecurities when it comes to the protection of the rights of the minority shareholders, as argued by Alimehmeti & Paletta (2010). Agency theory also states that such ownership structures are harmful to a bank's functioning. Hence, there is an ever-increasing need for the study of the issue in order to mitigate such problems.

In developing countries, many studies are made regarding the ownership structure of banks. Conclusions of such research vary as they either claim the domination of foreign banks in the host country or that of domestic, private or state owned ones. Different results in such are also reflected in terms of ownership structure and profitability. Contrasts can be seen in the researches of McConnell and Servaes (1990) and that of Antoniadis et. al. (2010), as the former mention a country where a positive effect on profitability is seen by ownership structure of banks whereas the latter talks about nonlinear negative or positive relations between an ownership structure in relation to the bank's profitability. The soundness of corporate practices are measured by ownership structures. According to Morck (1998), managers are monitored well in an ownership concentration (either institutional or block holdings), which, in turn, strengthens corporate practices and its functioning. But mixed results have also been evident when it came to empirical studies of ownership structure and corporate government practices. The diffuseness of shareholdings and bank performance is based on an inverse relation, as stated by Berle & Means (1993). But later on, Demsetz and Lehn (1985) as well as Holderness and Sheehan (1988) denied and challenged this ideal. Their studies concluded the non-association of concentrated ownership with higher bank valuation or better operating performance. This left doubts regarding the validity and applicability of results on effect of ownership structure studies in terms of concentrated shareholdings on corporate governance and its impact on performance, including its institutional ownership.

It has been proven by Pradhan & Adhikari (2009) that a better bank efficiency can be achieved by a more concentrated ownership. Banks with local majority holdings are also seen to be performing less profitably than those with foreign majority ownership. Hence those wil foreign majority outsmart their local counterparts, making it easier to predict so, since they receive technical, managerial and financial support. Besides other things being equal, this is a factor that help to uplift their performance (Adusel, 2011).

A negative statistical significant co-relation between Tobin's Q with board size was found by Kutubi in 2011. But between the board size and the performance measure of ROA and ROE, the result doesn't show any significant co-relation. If one is to observe the major constraints in exercising good corporate governance in Nepal, then it is evident that the cause is the dominant family business groups in corporate affairs: ones that have formed high concentration of corporate ownership structure in the markets. A joint effort of the investors (promoters) is required to ensure good corporate governance in Nepal. This group must actively take part in

their corporate activities to ensure that there are no fraudulent or insider activities. They will also require the regulatory authority's assistance, whose job will be to protect the rights of all the stakeholders by enforcing rules and regulations. This will ultimately help to enhance a proper corporate governance culture with a favorable environment (Pokhrel, 2007). Views on different components of corporate governance differ according to different authors. According to Barako & Tower (2007), foreign ownership has a significant positive impact on a bank's performance whereas institutional shareholders have no significant influence as such. Another negative impact on a bank's performance is due to communication problems, caused by a larger board size. According to Eisenberg, Sundgren & Wells (1998), this is the major cause of a slower and less efficient decision-making process in banks. An increasing function of dispersed ownership is the positive relationship between corporate governance and firm performance, as explained by Abhallah and Ismail (2017). They also claim that at high levels of ownership concentration, the value addition of good corporate governance is not necessarily maintained. A positive correlation between board independence and firms' performance' of tourism industry was also obtained by Al-Najjar (2014). Likewise, Lepore et al. (2017) found that in countries with weak investor protection, higher ownership concentration with an effective judicial system improves a firm's performance. It was also discovered by Bian and Deng (2017) in a study of Chinese banks that higher ownership dispersion enhanced return on assets (ROA), return on equity (ROE) and decreases the ratio of non-performing loans. A negative impact on a bank's performance is caused by the increase in the number of the members in the board of directors. A close relationship among corporate governance, ownership structure and organizational performance was also seen in such cases. These results had also been the outcomes of the majority of studies done regarding the issue. This study attempts to examine the relationship between ownership structure, corporate governance and bank performance. Specifically, it tries to explore the effect of ownership structure and corporate governance on performance of Nepalese commercial banks.

2. Methodological aspects

This study is based on both primary and secondary data which were gathered from 22 banks in Nepal. The main source of data is questionnaire based on 5-point Likert scale, banking and financial statistics published by Nepal Rastra Bank, annual reports of different sample banks and Supervision report of Nepal Rastra Bank. In addition to these, different published articles, reports, books, journal and graduate research projects are also analyzed. The data were collected on return on assets, return on equity, institutional ownership, concentrated ownership, government ownership, other ownership, board size, bank's age, transparency & disclosure and independency of board. The pooled cross-sectional data analysis has been undertaken in the study. The research design adopted in this study is causal comparative type as it deals with the relationship of ownership structure and corporate governance with bank performance. More specifically, the study examines the effect of institutional ownership, concentrated ownership, government ownership, other ownership, board size, bank's age, transparency & disclosure and independency of board on a typical bank's performance. The data were collected for the period of 2009/10-2019/20.

The Model

As a first approximation, the model estimated in this study assumes that the bank performance depends on several ownership structure and corporate governance variables. The ownership structure variables are of institutional ownership, concentrated ownership, government ownership and other ownership. The corporate governance variables include board size, bank's age, transparency & disclosure and independency of the board. Therefore, the model takes the following form:

Bank Performance = f (Ownership structure variables, Corporate Governance variables)

Where, the bank performance is used as a dependent variable and is measured in terms of the following:
ROA = Return on Assets
ROE = Return on Equity

There are various measures of bank performance. According to Jeon & Miller (2006) bank performance is measured as the bank profitability and productivity in banking. In this study, bank performance has been measured as bank profitability in terms of return on assets and return on equity.

The independent variables consist of ownership structure and corporate governance variables as under:

Ownership structure variables
IO = Institutional ownership
CO = Concentrated ownership
GO = Government ownership
OO = Other ownership
Corporate governance variables
BS = Board size
BA= Bank's age
T&D= Transparency & disclosure
IB= Independency of board

Institutional ownership

Percentage sum of the shares held by other institutions or corporate entities helps to measure institutional ownership. To monitor managers and members of the board to guarantee sufficient benefits, institutional shareholders have greater incentive, as reported by Singh & Davidson (2003). Similar to other (large) shareholders, these stakeholders have the capacity and the means required to keep the managers in an order, devoid of opportunistic behaviors. A positive relationship between institutional ownership and bank performance is a state that is advocated by Smith (1996).

Concentrated ownership

Stocks owned by large block shareholders (investors that hold at least 5 percent of equity ownership within the firm) and individual investors are referred to as those with ownership concentration. Each party attempting to maximize their own wealth is the assumption of this theory. This means that concentrated shareholders are measured by a total percentage of the largest five shareholders who owns more than 0.5 percent or more of the total shares, which stands out for the particular bank. Concentrated level of ownership is a significant factor attracting shareholders to control managers and to perform corporate governance mechanism, as suggested by Shleifer and Vishny (1997) and Kaoru, Hideaki & Ikuko (2009).

Government ownership

Ownership of the government is measured as a percentage of shares led by itself. Likewise, a significant negative relationship with bank performance was found between government ownership and concentration, as discovered by Ongore (2011). Similarly, it was observed by Lin & Zhang (2006) that there were negative effects on the performance of banks under state ownership. Conclusions of Li Yue and Zhao (2009) showed that firms have easy access to long-term debt if they are state owned. They also explained about such firms' negative association with bank performance but their positive association with long-term investment.

Other ownership

According to Hommel (2011), low performance of banks is caused by its authorities' inability to monitor its activities, due to its major portion of shares being held by the general public, other entities and large number of promoters.

Corporate governance variables

Board Size

Board size has played a crucial role in the ability of a board of directors to execute their main responsibility of monitoring and controlling firm operations, thereby maximizing the firm's value and protecting the interests of shareholders. Fixing the optimal number of board of directors is a dilemma. Lower level of a firm's performance is associated with larger boards, as reported by Cheng (2008). Negative relation to return on equity of the board size was also another important observation done by Turki (2012).

Bank Age

Bank age can be defined in terms of years of formation, incorporation or listing. It is measured as the number of years since the establishment of the bank. In 1999, Sanders reported that the performance of the bank is positive if it is aged. It was seen that the public and the stakeholders tended to trust those banks that had existed for longer periods of time with its goodwill in the market. Therefore, they perform better and have higher ROA, ROE.

Transparency & Disclosure

When it come to convenient and reliable information in the performance and decision of organization, transparency and disclosure is the state of access to the public (Armstrong, 2005). Another study on impacts of transparency and disclosure conducted by Burak, Erdil and Altindag (2017) also showed its positive impacts on a business performance.

Independence of Board

Since they are not dependent on the management, the independent board of directors can monitor a firm's activities effectively, since they are not associated with the top executives of the company (Fama & Jensen, 1983; Beasley, 1996; Christensen et al., 2010). Likewise, Kyere and Ausloos, also noted the presence of a statistical significance of an independent board on a ROA, in 2020.

Since the last four decades, researchers believe that there is a connection between ownership structure and bank performance. There are many studies published to examine this relationship. The relationship between ownership structure and performance are studied extensively in several studies. In regards to the relationship between ownership structure and profitability, different results were found. The results in the prior studies on the effect of ownership structure and corporate governance on such a bank's performance are mixed and unclear. Hence, this study has been conducted to get a clear idea of the effect of ownership structure on performance of Nepalese commercial banks.

3. Presentation and Analysis of data

This study is aimed to see the contribution of ownership structure and corporate governance on the performance of Nepalese commercial banks, for this data is analyzed with descriptive statistics, correlation analysis and regression analysis as follows.

Table 2: Descriptive Statistics

Variables	N	Min.	Max.	Mean	Std. Deviation
IO	240	0	80	25.54	23.41
CO	240	0	100	45.67	21.83
GO	240	0	100	7.89	18.08
OO	240	0	100	48.33	30.49
BS	240	7	15	10.73	1.52
BA	240	10	84	21.79	15.93
T&D	240	1	5	3.85	.4253
IB	240	1	5	3.94	.6625
ROA	240	11.38	36.78	19.76	8.72
ROE	240	67.65	218.07	87.38	48.55

Source: Survey, 2020

Table 2 shows that institutional ownership ranges from zero percent to 80% whereas concentrated ownership, government ownership and other ownership ranges from zero percent to 100%. Similarly, board size ranges from 7 to 15 persons. The, average institutional ownership is 25.54% while average concentrated ownership is 45.67%. Average government and other ownership are 7.89% and 48.33% respectively. In addition, the board of directors is composed of 10.73 members on an average. Likewise, the mean years of bank operation is 21.79. The average responses on state of transparency & disclosure and independency of board of directors in the Nepalese commercial banks are 3.85 and 3.94 (out of 5 Likert scale), indicating that Nepalese banks are transparent to their operations and timely displays their financial information to all of their stakeholders and also shows that majority of banks' board of directors are independent to make impactful decisions. Likewise, return on assets ranges from minus 11.38% to 36.78%, leading the average return on assets to 19.76% while the return on equity ranges from minus 67.65% to 218.07%, leading to the average return on equity of 87.38%.

Correlation analysis

This analysis is used to measure the strength and relationship between independent variable ownership structure (mean aggregate scores on Institutional ownership, concentrated ownership, government ownership and other ownership), corporate governance (board size, bank's age, transparency & disclosure and independency of board) with dependent variables banking performance (ROA and ROE).

Table 3: Correlation among variables of ownership structure and corporate governance with ROA and ROE

Variables	ROA	ROE	IO	CO	GO	OO	BS	BA	T&D	IB
ROA	1									
ROE	0.11	1								
IO	0.24**	0.29**	1							
CO	0.11**	0.16**	0.32	1						
GO	-0.04**	-0.08**	-0.23	0.22	1					
OO	-0.02**	-0.04**	-0.48	-0.63	-0.25	1				
BS	-0.09**	-0.11**	0.18	0.05	-0.12	0.14	1			

BA	0.25**	0.28**	-0.09	0.22	0.55	-0.2	-0.32	1		
T&D	0.54**	0.57**	-0.10	-0.03	0.22	-0.19	-0.12	0.43	1	
IB	0.43**	0.37**	-0.04	-0.05	-0.01	0.07	0.04	-0.02	-0.04	1

Source: Survey, 2020
Note:
**. Correlation is significant at the 0.01 level (2-tailed).

Table 3 shows Pearson's correlation coefficients which indicate that there exist both positive as well as negative relationship between dependent and independent variables. The highest positive correlation can be seen between transparency & disclosure with return on equity and return on assets (r= 0.57 and r=0.54). Similarly, a positive association is also seen (r= 0.43 and r= 0.37) between return on assets and return on equity with independency of board members. The return on assets and return on equity are negatively related to government ownership, other ownership and board size (r= -0.04 & r= -0.08, r= -0.02 & r= -0.04 and r= -0.09 & r= -0.1). However, ROA, and ROE has positive relation with Institutional ownership, Concentrated ownership and bank's age (r= 0.24 & r= 0.29, r= 0.11 & r= 0.16 and r= 0.25 & r= 0.28). This result indicates higher transparency & disclosure, independency of the board's directors, institutional ownership and shows that concentrated ownership leads to higher return. It also shows that the banks having government ownership and other ownership are not able to show effectiveness in their operation which could cause in downfall in their profitability. The table also express that institutional ownership facilitates large numbers of shareholders having different specialty to provide constructive feedbacks to the management of organizations, which could increase organizational profitability. Similarly, the table also point out that the higher aged banks are more trusted in their service as the general public leads to higher profitability of banks operated in Nepal.

Regression of Ownership Structure and Corporate Governance on return on assets

The regression analysis is conducted to find, how ownership structure and corporate governance affected performance of Nepalese commercial banks. The overall mean score on ownership structure and corporate governance is considered as independent variables. Similarly, return on assets is considered as a dependent variable. Thus, mean aggregate scores of ownership structure and corporate governance regressed on return on assets. The beta coefficients provide the relative importance of independent variable over dependent variable. The highest beta coefficient value of independent variable is expected to have highest influence on return on assets, while the lower beta coefficient stands second in terms of relative significance and so on. The Regression results are shown in tables below.

Table 4: Summary of Regression model 1

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	
		0.848[a]	.730	0.714	1.21414	
		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	205.757	1	205.757	164.14	0.000
	Residual	54.647	44	1.422		
	Total	260.404	45			

a. Dependent variable: Return on Assets
b. Predictors: Constant, Ownership structure and Corporate Governance.

The study used F-statistics to establish the appropriateness of the regression model to give reliable results. An F- significance value of p=0.000 was established. This shows that the regression model has a less than 0.001 likelihood (probability) of giving a wrong prediction. The table shows that the value of co-efficient of determination (adjusted R square) is 0.714 for all the variables studied (ownership structure and corporate

governance). This implies that there was a variation of 71.4% between the independent variable (ownership structure and corporate governance) and dependent variable (return on assets). Thus, it means that ownership structure and corporate governance explained 71.4% of the return on assets in Nepalese commercial banks.

Table 5: Regression Coefficients of model 1

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	10.872	1.563		7.217	0.000
	Ownership Structure	0.372	0.33	.568	12.532	0.020
	Corporate Governance	0.404	0.25	.034	0.115	0.063

a. Dependent Variable: Return on Assets.

The study results show that there is a positive relationship between ownership structure and corporate governance with return on assets of Nepalese commercial banks. The un-standardized regression coefficients show for how every metric unit change in the independent variable, the dependent variable changes by x units. This implies that a unit increase in ownership structure would lead to a unit increase in return on assets in Nepalese commercial banks at a factor of 0.372. A unit increase in corporate governance would influence return on assets of Nepalese commercial banks by a unit of 0.404. The results further show that there is a significant relationship between ROA and the two variables (ownership structure and corporate governance), as shown by the p value; *(p=0.000<0.05).*

The equation 1, Y = 10.872 + 0.372X1 + 0.404X2.

Regression of ownership structure and corporate governance on return on equity

This regression analysis is conducted to find, how ownership structure and corporate governance affected return on equity of Nepalese banks. The overall mean score on ownership structure and corporate governance is considered as independent variables. Similarly, return on equity is considered as dependent variable. The Regression results are shown in tables below.

Table 6: Summary of Regression model 2

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	
		0.788[a]	.748	0.722	1.32135	
		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	200.438	1	200.438	152.28	0.000
	Residual	57.970	47	1.443		
	Total	258.408	48			

a. Dependent variable: Return on Equity
b. Predictors: Constant, Ownership structure and Corporate Governance.

The study used F-statistics to establish the appropriateness of the regression model to give reliable results. An F- significance value of p=0.000 was established. This shows that the regression model has a less than 0.001 likelihood (probability) of giving a wrong prediction.

The table shows that the value of co-efficient of determination (adjusted R square) is 0.722 for all the variables studied (ownership structure and corporate governance). This implies that there was a variation of 72.2% between the independent variable (ownership structure and corporate governance) and dependent variable

(return on equity). Thus, it means that ownership structure and corporate governance explained 72.2% of the return on equity in Nepalese commercial banks.

Table 7: Regression Coefficients of model 2

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	10.885	1.583		5.165	0.000
	Ownership Structure	0.393	0.32	.553	10.487	.010
	Corporate Governance	0.436	0.30	.039	0.128	0.042

a. Dependent Variable: Return on Equity.

The study results show that there is a positive relationship between ownership structure and corporate governance with return on equity of Nepalese commercial banks. The un-standardized regression coefficients show for how every metric unit change in the independent variable, the dependent variable changes by x units. This implies that a unit increase in ownership structure would lead to a unit increase in return on equity in Nepalese commercial banks at a factor of 0.393. A unit increase in corporate governance would influence return on equity of Nepalese commercial banks by a unit of 0.436. The results further show that there is a significant relationship between ROE and the two variables (ownership structure and corporate governance), as shown by the p value; *($p=0.000<0.05$).* The equation 2, Y = 10.885 + 0.393X1 + 0.436X2.

4. Discussion and Conclusion

There is no any doubt on the importance of corporate governance for smooth functioning of any organization. It can be said that corporate governance could help to bring the organizational operation on the track to achieve organizational goals and objectives. Ownership structure is also one of the components that may have direct or indirect influence on organizational functioning and decision making. This study also tries to explore the impact of ownership structure and corporate governance on the banking performance of Nepalese commercial banks. This study observed that the board size of the Nepalese banks has the negative association with the profitability of banks, which explain that larger board size could cause in delay in financial decision-making and may cause to miss the different profitable financial opportunities. Likewise, it is also found that the age of banks has the positive relation with their performance, indicating that banks' customers have more trust on aged bank due to their experienced service quality. This study found that institutional ownership has a positive association with a bank's profitability, which indicated that the expertise of these institutional shareholders and their inputs to the management is beneficial for decisions and strategies making; which leads to higher financial performance. The conclusion show similarities with the study of Marsy in 2016, as it showed that a positive and significant relation with firm performance of institutional ownership verifies the assumption that in such a setup, monitoring and controlling the activities of a firm reduces agency costs and enhances corporate performances. Despite the fact that Abdullah (2019) concluded in his study about the nature of concentrated ownership to be influencing a firm's performance either positively or negatively, the study shows that concentrated ownership has positive association with a bank's profitability, whereas governement association has a negative association for the same. This is similar to Dwaikat and Queiri's theory (2014) on the negative effect of ownership on a firm's performance. This study also displays that the transparency & disclosure and independency of board of directors has strong positive association with profitability of banks, which denoted that timely, updated and fairness in displaying the financial information amongst all the stakeholders increases trust worthiness of Nepalese commercial banks. It also expresses that independency of board of directors could support their management with their expertise and give advice on effective decision-making. It was the conclusion of Kipruto and Minja (2020) that when it comes to the process of decision-making, board independence plays a very objective and inspirational role, and the eventual financial performance of the organization is dependent upon this. This study also detected that both ownership structure and corporate governance has the significant impact on banking performance (ROA and ROE) in Nepalese commercial

banks. It noted that, corporate governance has slightly stronger effect on both ROA and ROE as compared with ownership structure in Nepalese commercial banks. Staying consistent with the research of Mirchandani and Gupta (2018), the research shows that though ownership structures do not have a strong impact on the profitability of the banks, there is a significant relationship between corporate government practices and a bank's performance. Thus, this study concludes that ownership structure and corporate governance variables could influences the decision-makings, smooth functioning and performance of Nepalese commercial banks. Hence, the knowledge generated through this study can be useful for future academicians, researchers and concerned authorities for their future concerned strategies. This study will be significant to financial institutions, researchers and academicians nonetheless. Banking institutions may use the findings of the study in providing a basis for re-assessing their state of corporate governance as well as ownership structure as per the changing situation. Similarly, academicians will also find the study useful in adding to the existing literature on corporate governance, ownership structure and banking performance. Finally, the study concludes that there is still a considerable area for further research and further improvements since, only few variables of ownership structure, corporate governance and banking performance has been used in this study. In addition, this study has been trying to assess and analyze the ownership structure, corporate governance and banking performance of Nepalese commercial banks.

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