CORPORATE GOVERNANCE IN NEPALESE FINANCIAL SECTOR: DOES POLICY MATTER?

Submitted To

Research Committee
Research and Consulting Service Department
Nepal Administrative Staff College

Submitted By
Basanta Raj Sigdel
Santosh Koirala

June, 2015

Recommended Citation

Sigdel, B.R. & Koirala, S. (2015). Corporate governance in Nepalese financial sector: Does policy matter? Lalitpur, Nepal: Nepal Administrative Staff College.

ACKNOWLEDGEMENT

This research paper has been materialized in this form with the help of many individuals and institutions. First, the team extends profound gratitude to the respected respondents of banks and finance companies for their valuable and generous support without which the project would not have been successful. Similarly, we are thankful to the Research Committee of NASC and Research and Consulting Services Department for their continuous guidance, facilitation and support in this endeavor.

ABSTRACT

The study examines insiders' perspectives on the determinants of corporate governance in the Nepalese financial sector. For this, we use a 5-point Likert scale questionnaire developed by CLSA, modified and contextualized to Nepalese setting. The study reveals that whereas accountability, discipline, and transparency significantly and positively promote corporate governance, factors like fairness, responsibility, independence and social awareness have been unable to explain corporate governance. The study also evidences positive and significant role of classification policy of the central bank in promoting better governance. We suggest that policy makers need to revise regulation for promoting social awareness through more mandated public disclosures of information, and top-management of the companies develop more responsive work-conditions and provisions to promote fairness in the organization.

TABLE OF CONTENTS

Contents **Page No.**

LIST OF FIGURES AND TABLES

Contents **Page No.**

1. Introduction

Governance simply refers to the process or act of governing. When it comes to an organized corporate sector, it is the way by which an organization is directed or controlled. The relative effectiveness of corporate governance has a profound effect on how well a business performs. General observation shows that businesses have prospered and remained prosperous are those that have found ways to govern their affairs effectively. Similarly, with the companies that have performed poorly, it is common to track the problems to the boards that have not effectively addressed the issues confronting their business. Colley et al. (2005) suggests that corporate governance is systems to ensure that organization's obligations to its major stakeholders-customers, employees, creditors, suppliers and distributors, the community, and owners- are met with integrity and in compliance with applicable laws and regulations.

Organization for Economic Cooperation and Development (OECD) principles of corporate governance are categorized into six parts: 1) ensuring the basis for an effective corporate governance framework; 2) the rights of shareholders and key ownership functions; 3) the equitable treatment of shareholders; 4) the role of stakeholders in corporate governance; 5) disclosure and transparency; and, 6) the responsibilities of the board (OECD, 2004).

The board of directors is an intermediate layer of governance between the shareholders and management. As Salmon (1993) suggests "…in the ongoing debate over America's competitive position, winning is everything but, without an effective board you are not even in the game." This supports the idea that Role of the Boards is primarily important for good governance. It is inevitable that debates on corporate governance center on the board composition, perks of directors and ensuring their accountability to shareholders (Gouri, 1998). Similarly, culture is also an important factor that affects governance. Shrestha (1995) states that along with the establishment of all types of companies, corporate and professional culture is supposed to be more important for strengthening their positioning in national economy.

Corporate governance at least covers three types of issues: ethical, efficiency and accountability (Jhaveri, 1998). We can look to the investment community's rapidly disintegrating confidence in parts of Asia (Lewis, 1998) to realize that maintaining the integrity of business institutions is critical for continued economic success. In the early 2000s, the massive bankruptcies and criminal malfeasance of the corporations including Enron, WorldCom, as well as lesser corporate debacles, such Adelphia Communications, America Online (AOL), Arthur Anderson, Global Crossing, and Tyco led to increased shareholder and governmental interest in corporate governance. In the later 1990s, the Asian Financial Crisis attracted a lot of attention fell upon the corporate governance systems of the developing world, which tend to be heavily into cronyism and nepotism. One of the largest corporate scam in India, Satyam Computers (Vasishth & Rajput, 2010) in India and similar failure of financial institutions show the importance of governance and ethics in managing corporations.

Corporate governance in financial system aims at promoting healthy market practice and reducing financial anomalies resulting from agency problem. Among various other functions, banking system fundamentally performs an intermediary role in capital formation accepting deposits from customers, raise capital from investors or lenders (supply-side of credit) and then use lend this money to the business ventures and other economic activities (demand side of , buy securities and provide other financial services to customers. Financial system is therefore, believed to financial market that accelerates the performance of engine of growth of an economy. Good corporate governance is a need in financial system in that it controls market distortion from the various stakeholders in the system.

The implication of financial sector governance in developing economies is even far-reaching for following stylized facts. First, banks have an overwhelmingly dominant position in developing economy financial systems, and are dominant engines of economic growth (Levine, 2004). Second, as financial markets are usually under developed, they are typically the most important source of finance for a majority of firms. Third, they are usually the main depository for the economy's savings. Fourth, many developing economies have recently liberalized their banking systems reducing the role of economic regulation. Consequently, managers of financial institutions have obtained a greater degree of freedom in running their organization.

Stake of the financial sector in Nepalese economy is significant. Economic growth in recent years has been facilitated by the growth of financial sector. From the Association of South East Asian Nations (ASEAN) crisis to recent scandals in Nepalese financial sector, good corporate governance has been felt essential for sustainable growth of corporate financial sector. Rawal

(2003) identified protection of shareholders' rights, clarity in duties and responsibilities of all stakeholders involved, disclosure and transparency, legal frameworks that sufficiently address good governance mechanism are all important to ensure a healthy growth of financial sector. In recent years, some financial institutions in the country have been failure in safeguarding fiduciary responsibilities of the public and maintain accountability to the stakeholders. Some of them include - Nepal Development Bank, Gorkha Development Bank, Capital Merchant Banking and Finance Limited, Samjhana Finance, United Finance Company, Oriental Group, Nepal Share Market Finance. The problem has now spread to the cooperatives as well which are making headlines in these days.

In such a scenario, this research aims to analyze the factors affecting corporate governance in Nepalese financial sector considering categories of banks and financial institutions as policy moderation variables.

2. Statement of the problem

The subject of corporate governance in developing economies has recently received a lot of attention in the literature: credit accrue to the growth prospective of these economies. In addition, noise trading as opposed to fundamentals has been documented to affect markets of these economies (Claessens & Yurtoglu, 2012). These markets are, in general, less efficient and therefore, demands corporate governance at higher intensity.

For development-oriented economies like Nepal, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks, on the other hand, reduce investor confidence, and can discourage outside investment.

In Nepalese context, governance has been the topic of much recent academic work and policy discussion (Khatiwada (2002), Rawal (2003), Kafle (2004), Thapa (2008), McGee (2010), Poudel and Hovey (2013) among others). Poudel and Hovey (2013) investigated the impact of corporate governance on efficiency of Nepalese commercial banks covering 29 commercial banks out of 31 banks from the 2005-2011 time spans and documented that bigger board and audit committee size and lower frequency of board meeting and lower proportion of institutional ownership lead to better efficiency in the commercial banks.

With plethora of empirical studies at global level and reasonably adequate studies in national context, we have found, to the best of our knowledge, dearth of studies incorporating insiders' perspective of corporate governance, particularly in Nepalese context. Perspectives from insider stakeholders provide emic version to the existing understanding and absence of which makes our understanding incomplete and partial. It is, therefore, a big area to be left unexplored. The study aims to fill this gap.

2.1 Research Question

The study explores the realm of corporate governance from the eyes of insider practitioners. We have attempted to find out the insiders perspectives on factors contributing good corporate governance in financial sector of Nepal. In the pursuit, we also examine the impact of the central bank's classification (policy) of financial institutions in constituting better governance.

2.2 Research Design

This study is deductive in nature and employs structured survey questionnaire of CLSA[1].Annex A.2 provides details of questions incorporated. The questionnaire was pretested with 25 experts. Revised and contextualized questionnaires were sent to 150 respondent officers from three categories of banks as classified by Nepal Rastra Bank[2](Commercial Banks, Development Banks and Finance Companies respectively) who fulfilled the established criteria[3]. One hundred questionnaires were returned out of which 96 were usable. The analysis consists of hierarchical regression.

---

[1] The questionnaire has been adopted form Credit Lyonnais Securities Asia (CLSA) to measure the corporate governance contextualized to Nepalese setting through expert's opinion, and pretesting of questionnaires through scale reliability test and Principal Component Analysis. This study is therefore, using exact but in amended form of CLSA questionnaire.

[2] Bank and Financial Institution Act (2006) has classified banks of Nepal into 4 categories based on capital requirements and scope of operations. Classes A, B and C refer to Commercial Banks, Development Banks and Finance Companies respectively. We exclude "D" class financial institution as this category deals with micro-credits and demands focused study.

[3] The criteria for selecting respondents include: should be associated with A, B or C class financial institutions licensed by Nepal Rastra Bank with at-least four years of work experience in banking sector and at-least two years of work experience in compliance department.

2.3 Limitation of Research

The study has purposefully excluded class D financial institution because of its specialized micro-financial banking unlike the other three categories. This perception based survey does not take/ not enquire the ethnographic lens to supplement and triangulate the finding. This is beyond the scope of the present project and may constitute a potential project of future. Similarly, respondents were limited to Kathmandu Valley which limits the generalizability of the findings. However, the researchers have attempted to maintain the objectivity of the study with tested methods and robustness checks.

3. Literature Review

There has been renewed interest in the corporate governance practices of modern corporations since 2001, particularly due to the high-profile collapses of a number of large corporations, most of which involved accounting fraud. The recent collapse of these high profile institutions around the world have shown that no company can be too big to fail. A common trend that ran through these monumental failures was poor corporate governance culture, exemplified in poor management, fraud and insider abuses by both management and board members, poor asset and liability management, poor regulations and supervision among others .Thus, the celebrated Enron case in the United States of America, Baring Bank in the United Kingdom, Parmalat in Italy, and One Tel in Australia, the financial crisis in the South East Asian countries and a host of others attest to the significance of good governance in the public and the private sectors of the economy (Sanusi 2004).

Corporate governance serves and guides to secure the dedication of stakeholders with objective to functionalize their skills, knowledge and experience to avail the full benefits. To avail the maximum organizational benefits corporate governance sets legal terms and condition for the allotment of property rights among stakeholders, organizing their associations and manipulating their incentives for achieving their eager to work together. Further, corporate governance is vital because of the delegation of responsibility for production, process improvement and innovation (Suzanne et al. 2006). Studies have also shown that good corporate governance practices have led to significant increases in economic value added of firms, higher productivity, and lower risk of systemic financial failures for countries (World Bank, 2005).

Miles (2010) indicates that Anglo American model is based on normative free market principles, relies on various pre-requisites for its successful operation, guides about corporate governance that it has focus on the association between company directors and shareholders. To alleviate corporate governance problems different system has been adopted under the Anglo American governance model to stream line the benefits of directors concerned to shareholders. The Model focuses first on director's independency as it is integral part of corporate governance control because these are the eyes and ears of shareholders and it can invite a constituent of objectivity for internal communication of company. Secondly, it emphasis on independency not only because, it can help in internal discussion but also due to commandment usually consider board of directors liable for different integral duties of company (Deakin et.al. 2005).

Another contrasting view on role of independency in good corporate governance has been described by OECD. It indicates that efficient corporate governance mostly relies upon the severances of power connecting a company's managers, directors and majority and minority shareholders. This study holds accountable to manger under the self-governing oversight by the board of directors and an external auditor. Good economic and political governance can result of good economic outputs, and for the business prosperity, good corporate governance is significant which can be assured by accountability.

Corporate governance is the system of accountability among share holders, the boards of directors and the management of corporate entity (Lusaka, 2005). For achieving strategic corporate objective decision making process must be held accountable. Furthermore, he also encompassed the essentials of good corporate governance like; fairness, transparency, accountability and responsibility are least standards which can offer maximum protection from financial crisis and can intensify the access to capital. One more developing inspection reports that transparency, independence, accountability, discipline, fairness and social responsibility are major principles in good corporate governance.

Corporate governance is an important issue given the essential role banks plays in the financial systems of developing economies and the widespread banking reforms that these economies have implemented (Arun & Turner, 2002). This is even more crucial in financial sector because of unique nature and functioning of financial institutions. It becomes paramount significant to financial institutions to imbibe sound corporate governance policies and minimize carelessness while handling depositors' funds (Khurana, 2012). When, banks and financial institutions evolve through errors, mistakes or manipulations and misconducts, the stakeholders and more importantly the depositors will suffer. So, study of failures and drawing lessons is important for necessary correction, precautions, and regulations.

Mwanakatwe (2005) also noted that corporate governance is more crucial in banking industry because of its role being the custodian of public funds due to high leverage of responsibility banks are more accountable. Furthermore he mentioned that banks are organism of financial intermediaries and have a position of trust in economic system. Because of theses intensive obligations banks are very sensitive to ineffective corporate governance. To support his arguments he presented a view that good corporate governance in banking sector can yield investor's confidence and can attract more investments.

Musasike (2005) highlighted some key issues in banking sector regarding corporate governance like internal controlling process, risk management, auditor's independence, material disclosures and internal audit competence. He found that the Development Bank of South Africa witnessed good business outcomes by inculcating fairness, transparency and reduction of corruption via implementing good corporate governance. However, it is observed that there is no single corporate governance model to implement; there is room for improvement, proper monitoring and system for early caution signs in risky projects.

A major corporate governance challenge for banks involves the principal-agent problem and how it can undermine financial stability when the incentives of bank management and directors are not aligned with those of the owners of the firm (Kern, 2004). This may result in different risk preferences for management as compared to the firm's owners, as well as other stakeholders, including creditors, employees, and the public. Because of high transaction costs and institutional barriers, aligning the interests of these groups may be difficult, if not impossible, without regulatory intervention. At the same time, banks are both opaque and complex. As Levine (2004) notes, "Banks can alter the risk composition of their assets more quickly than most nonfinancial industries, and banks can readily hide problems by extending loans to clients that cannot service previous debt obligations."

Central Bank of Nigeria (2006) identified the weaknesses in the corporate governance for banks in Nigeria among others include:

- Disagreement between board and management giving rise to board squabbles
- Ineffective board oversight functions
- Fraudulent and self-serving practices among members of the board, management and staff
- Overbearing influence of Chairman or MD/CEO, especially in family-controlled banks
- Weak internal controls
- Non-compliance with laid-down internal control and operation procedures
- Poor risk management practices resulting in large quantum of non-performing credits including insider-related credits.
- Abuses in lending, including lending in excess of single obligor limit
- Technical incompetence, poor leadership and administrative inability

Babalola et.al. (2013) investigated whether or not the Nigerian banking sector is yet to learn any lesson from the incidence of poor corporate governance which has been the bane of the sector since the early 90s till date. In the course of this study, corporate governance issues such as insider abuses, inadequate disclosure, lack of transparency, weak internal controls, ineffective board, fusion of the post of the Chairman and that of the Managing Director and non-separation of ownership from management were identified.

Anderson and Campbell (2004) stated that corporate governance alone is not the cause of the current financial crisis. However, Corporate Governance could have prevented some of the worst aspects of the crisis had effective governance operated throughout the period of time during which the problems were developing and before they crystallized. Furthermore, effective Corporate Governance could have helped to reduce the catastrophic impacts that the global and national economies are now suffering.

Recent academic work and policy analyses give insight into the governance problems exposed by the financial crisis and suggest possible solutions. Drawing on the governance of financial and non financial institutions, Mehran et.al. (2011) identified four major dimensions of governance-executive compensation, boards, risk management, and market discipline- which have significant impact in the financial crisis.

Emerging market countries like Nepal improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks, on the other hand, reduce investor confidence, and can discourage outside investment. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research (World Bank, 2005). Similarly, impact of improvements in corporate governance quality on traditional measures of real economic activity—GDP growth, productivity growth, and the ratio of investment to GDP—is positive, significant, and quantitatively relevant, and the growth effect is particularly pronounced for industries that are most dependent on external finance (IMF, 2006).

World Bank observance standards and codes (2005) elucidates that awareness of the importance of corporate governance is growing in Nepal. The central bank has introduced higher corporate governance standards for banks and other financial companies as part of a wider program of financial sector reform. Accounting and auditing standards are being developed. Also a number of draft laws have been prepared that, if passed and implemented, should deepen and accelerate the reform process. However, the legal framework contains large and significant gaps. Critical institutions, including the securities board and company registrar, have few resources and little authority. Most importantly, political uncertainty and the current security situation have weakened the economy and delayed the passage of draft legislation.

Poudel and Hovey (2013) investigated the impact of corporate governance on efficiency of Nepalese commercial banks covering 29 commercial banks out of 31 banks from the 2005-2011 time spans. Corporate governance variables are represented by board size, independence and diligence, Audit Committee size, independence and diligence and ownership structure. The non-performing loan variable is used for bank's efficiency. The regression analysis is used to examine the relationship between corporate governance and efficiency of bank. The findings show that bigger board and audit committee size and lower frequency of board meeting and lower proportion of institutional ownership lead to better efficiency in the commercial banks.

In this connection, Nepalese financial sector is in the course of consolidation in respect with the organized sector of the economy. Corporate governance matters even more in this phase of development. Although the subject of corporate governance in developing economies has recently received a lot of attention in the literature (Oman, 2001; Goswami, 2001; Lin, 2001; Malherbe & Segal, 2001), it has been almost ignored by researchers (Caprio & Levine, 2002). In Nepalese context also, in terms of numbers and scope of studies, research in the area of corporate governance needs to be emphasized.

Bank governance has been the topic of much recent academic work and policy discussion (Senior Supervisors Group, 2008, 2009; Walker Report, 2009; Committee of European Banking Supervisors, 2010). Because of their contemporaneous nature, there has been little connection between the academic approach and policy analysis. The purpose of this study is to make such connections in the context of Nepalese financial sector and ground the policy debate on scientific evidence.

4. Conceptual Schema

Cadbury commission (1992) defines corporate governance as: "…the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the directors include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The Board's actions are subject to laws, regulations and the shareholders in general meeting."

Though the term corporate governance came into vogue in 1980s its interest in policy and academia heightened after 2001 following big corporate scandals and window dressing frauds. Global Financial Crisis 2008 opened another episode of regulatory limitations and which shattered the previous strong belief of too big to fall.

Corporate governance can be analyzed through seven characters including corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility King Report (2002). These factors are built on the OECD principles that guide financial institutions and are derived from the Basel Guidelines. These principles include responsibilities of the Board, Directors, Chairmen, CEOs, senior management, Board appointed committees, auditors, shareholders and regulators. Accountability, internal controls, related party transactions, conflicts of interest, information disclosures have also been extensively dealt with and targeted in the formulation of these principles.

Figure 3.1 shows the theoretical schema of this study depicting the different factors responsible for corporate governance. This framework indicates corporate governance as dependent variable and contributing factors - Transparency, Independency, Accountability, Fairness, Social Awareness, Discipline and Responsibility are dimensions to measure the corporate governance as independent and construct variable. Bank categories- A, B, and C as per Bank and Financial Institutions Act, 2006 is considered as moderating variables, so as to analyze the effect of policy moderation in overall corporate governance of those banks and financial institutions. Below figure is the schematic representation of factors that guide our research question.

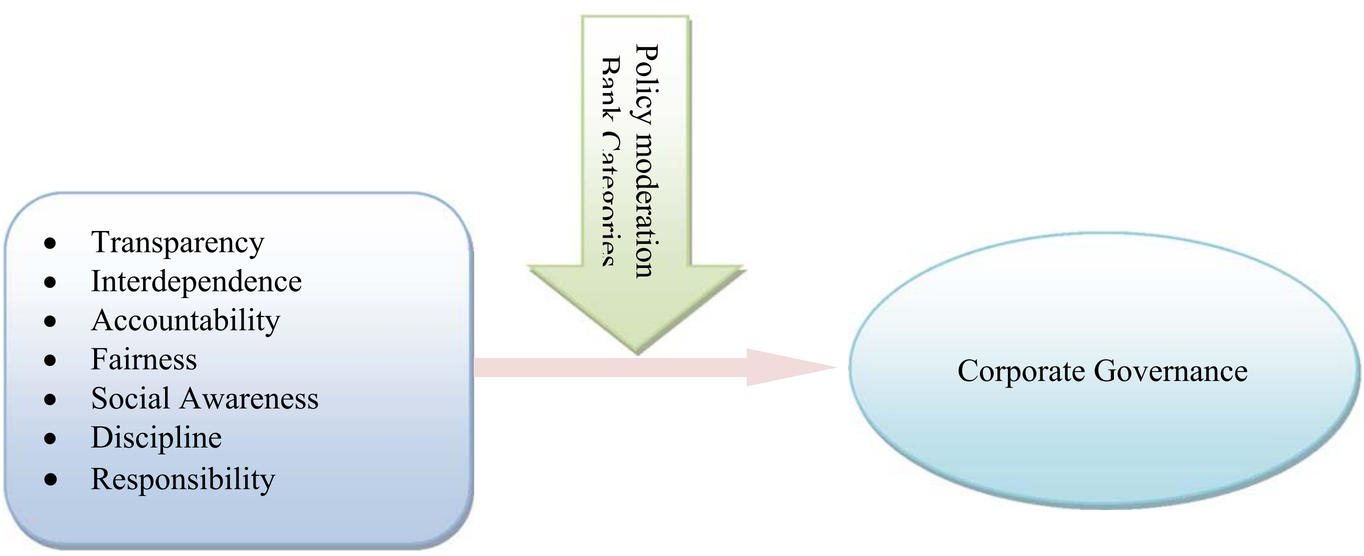

Figure 3.1: Factors affecting Corporate Governance

5. Data Presentation and Analysis

We have applied hierarchical regression model to study the effect of these seven dimensions on the overall corporate governance at firm level. Besides, the study has attempted to assess the impact of classification policy of Nepal Rastra Bank on the corporate governance of financial institutions.

5.1 Correlation among Predictive Factors

Following table presents the correlation among predictive factors of corporate governance.

Table 4.1

Correlation among the factors of Corporate Governance

	INTD	RESP	DISC	FAIR	TRANSP	SAWARE	ACCOUNT
INTD	1.000	$-.286^{**}$	-.066	$.437^{**}$	-.085	.137	.122
p-value		.005	.522	.000	.411	.183	.238
N		96	96	96	96	96	96
RESP		1.000	$.355^{**}$	-.064	-.163	.103	-.069
p-value			.000	.538	.112	.319	.505
N			96	96	96	96	96
DISC			1.000	.011	-.051	.199	-.020
p-value				.918	.622	.053	.850
N				96	96	96	96
FAIR				1.000	.039	$.295^{**}$	-.009
p-value					.707	.004	.932
N					96	96	96
TRANSP					1.000	$.219^{*}$	-.070
p-value						.032	.499
N						96	96
SAWARE						1.000	.138
p-value							.181
N							96
ACCOUNT							1.000

Even though correlation between some of the predictive variables are significant, their value is less than 0.5 suggesting that they are reasonably independent to each other in explaining governance. This encouraged us to use all of the factors prescribed by CLSA.

5.2 Robustness Check

Collinearity Test:

Variance Inflation factor (VIF) and Tolerance: This test checks the collinearity of the predictive variables, which if detected would violate the basic assumption of Gaussian Regression and the estimated parameter would be misleading.

$$VIF = \frac{1}{(1 - R_j^2)}$$

Where R_j^2 is the coefficient of determination of Regression of X_i on the remaining k-2 regressors.

$$Tolerance = \frac{1}{VIF} = 1 - R_j^2$$

For perfect collinearity TOL=0 and VIF=Infinity

Table 4.2

Collinearity Diagnostics

	Collinearity Statistics	
Variables	Tolerance	VIF
INTD	.649	1.540
RESP	.736	1.359
DISC	.747	1.339
FAIR	.723	1.383
TRANSP	.800	1.250
SAWARE	.789	1.267
ACCOUNT	.930	1.076

5.3 Hierarchical Regression Analysis

Table 4.3 presents the hierarchical regression analysis of the data where dependent variable is Corporate Governance (CG). BDB and BDC refer to classification dummies of B and C class financial institutions (policy variables) respectively. Explanatory variable include Independence (INTD), Responsibility (RESP), Discipline (DIS), Fairness (FAIR), Transparency (TRAN), Social Awareness (SAWAR) and Accountability (ACC). Model 1 includes effect of policy variables only whereas Model 2 incorporates other explanatory variables of corporate governance.

Table 4.3

Hierarchical Regression Analysis

Model		**Coefficients**	**Standard Error**	**t-stat**	**p-value**
1	(Constant)	4.156	.119	34.959	.000
	BDB	-.709	.161	-4.393	.000**
	BDC	-.756	.180	-4.213	.000
2	(Constant)	.648	1.138	.570	.570
	BDB	-.553	.184	-3.002	.004**
	BDC	-.580	.167	-3.476	.001**
	INTD	.084	.133	.627	.532
	RESP	.112	.122	.922	.359
	DIS	.270	.139	1.950	.055*
	FAIR	-.052	.127	-.409	.683
	TRAN	.370	.141	2.628	.010**
	SAWAR	-.174	.106	-1.650	.103
	ACC	.275	.108	2.543	.013
Model		R-Squared	Adjusted R-squared	p-value of F-Statistic	
1-Moderating Effect Only		0.213	0.196	000**	
2-Full Model		0.433	0.373	000**	

** indicates significant at 10%, and **signifies significant at 5%.*

Table 4.3 shows the summary of our regression model. Overall 37.3 percentage of the variation in corporate governance score has been explained by our model (2). Transparency, accountability and discipline have significant positive effect in the perception of good governance.

5.4 Findings and Discussions

Transparency, accountability and discipline have significant positive effect in the perception of good governance.

5.4.1 Transparency

Transparency of a business firms has been a matter of primary concern for promoting corporate governance. Regular disclosure of periodic financial performance report by management, prompt public announcement of pertinent information by the company's board, the clarity and completeness of publicly relayed information and easy access of senior management to analyst are the factors that promote transparency in the banking system. There exists strong positive and statistically significant relationship (p-value=1%) between corporate governance and transparency. In the five point Likert, one unit increase (decrease) in the transparency level would cause 0.37 unit increase (decrease) in perceived corporate governance. The finding reveals that transparency is the major explanatory factor in promoting corporate governance of banking sector.

5.4.2 Accountability

Accountability refers to the answerability of the financial institution to their stakeholders. The primary attention of accountability in this study concern with the independence and segregation of board of directors and executive committee, commencement of regular and periodic board meetings, the impartial appointment of external auditors and objective and proper review of the work of external auditors. The study has identified this factor to be the second best explanatory factor for promoting corporate governance in the banking sector. The study revealed that one unit increase in accountability measure in 5 point Likert would result in 0.257 unit increase in the good governance score of the sample firms. The result is significant at p-value 1.3% and therefore considered highly statistically significant.

5.4.3 Discipline

Discipline in the paper takes into account the focus of firms on their core business. It is represented by the following: a) existence or non-existence of explicitly expressed mission statement with focus on corporate governance; b) the clear focus and stand of top management on the core business of the firm; c) the internal mechanism to address disciplinary action and its explicit reports; and d) provision of the company to include separate section for assessment of company's performance in implementing corporate governance principles in its annual report. The study revealed that discipline exerts reasonably strong positive influence on promoting corporate governance. However, the result is reasonably significant (p-value=5.05% as against benchmark alpha=5%).

5.4.4 Influence of Other Explanatory Factors

Explanatory factors like fairness, responsibility, independence and social awareness have non-significant effect on the corporate governance in the study. Fairness factors take into account the employee dimension of organization where employees consider their organization fair and equitable in work related issues. Responsibility factor takes into account the openness of top management and board to protect and address the primary benefit of the shareholders. It differs with accountability in that it considers the responsiveness of top management and board to reflect from past mistakes and address shareholders concern, not only in rigid financial terms. The study has revealed non-significant relation between employee perceived fairness and corporate governance that may suggest the business environment where employees are not considered strategic to reflect employee concern translated into the image of the companies.

5.4.5 Influence of Classification Policy

Hierarchical regression output presented in Table 4.3 shows the influence of classification policy variables on perceived score of corporate governance. BDB (BDC) refers to policy dummy that take value 1 if the respondent is from Development Banks (finance companies) category and 0 otherwise. Table 4.3 shows that on an average, perceived corporate governance scores of respondents from Development Banks and Finance Companies are 0.553 and 0.580 units less (in the scale of 5) than their counterparts from Commercial Banks, and the differences are highly significant. This implies that the perception of good governance is closely associated with differences in regulation. The classification policy seems to be successful in communicating the intended differences in regulation.

6. Conclusion and way forward

The study has focused on analyzing insiders' perspectives on the components and factors that promote corporate governance in Nepalese Banking Sector. For this, we have used CLSA questionnaire and administered that to 96 respondents. The respondents are officer level in class A, B and C type of financial institutions classified by the central bank of Nepal. Hierarchical regression model is employed to assess the relative contribution of explanatory factors in explaining corporate governance. The study has following findings:

- Transparency and Accountability are major explanatory factors in promoting corporate governance in the banking sector of Nepal.
- Discipline exerts reasonably strong positive influence in promoting corporate governance in the sample institutions.
- Other explanatory factors like fairness, responsibility, independence and social awareness have non-significant effect on the corporate governance.
- The classification policy has contributed positively in promoting good governance.

The insignificant factor scores of responsibility, fairness, independence and social awareness shows that the assessment of corporate governance in banking sector may be reactive and compliance based. This would catch the attention the analysts, policy makers and practitioners to be forward looking and not get caught in the myopic trap resulting in the assessment of corporate governance only from financial measures and short-term benefit (losses). This may have resulted because of growing sector in which the prime concern of corporate governance revolves around financial governances of firms.

REFERENCES

Anderson, C. & Campbell T. (2004). Corporate Governance of Japanese Banks. *Journal of Corporate Finance.* 10: 327-354.

Arun T.G., & Turner J.D.(2002). *Corporate Governance of Banks in Developing Economies: Concept and Issues.* Institute for Development Policy and Management, University of Manchester.

Babalola A. & Ajewole, O. (2013). Corporate Governance: Has the Nigerian Banking Sector Learnt Any Lesson? International Journal of Business and Social Research, (3) 2.

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

Caprio, G. & Levine, R. (2002). Corporate governance in finance: Concepts and international observations. World Bank, IMF, and Brookings Institution Conference 2002.

Central Bank of Nigeria. (2006, March). Code of corporate governance for banks in Nigeria. *Post Consolidation Report.*

Claessens S., & Yurtoglu, B. (2012). Corporate governance in emerging markets: A survey. *Emerging Markets Review*, 15: 1-33

Colley, J.L. et al. (2005). *What is Corporate Governance?* New Delhi: Tata McGraw Hill.

Committee of European Banking Supervisors. (2010). *High Level Principles for Risk Management. London:* European Banking Authority.

Deakin, H.R. et al. (2005). *Anglo American CG and the employment relations hip*. CBR: ITEC.

Walker, S. D., et al. (2009). A Review of Corporate Governance in UK Banks and other Financial Industry Entities. London: HM Treasury, http:// www.hm-treasury.gov.uk/d/ walker_review_consultation_160709.pdf .

Goswami, O. (2001). The Tide Rises, Gradually: Corporate Governance in India. OECD Development Center, Paris (www.oecd.org/dev/).

Gouri, G. (1998). Public Enterprise Disinvestment and Corporate Governance: A conceptual framework. *ASCI Journal of Management,* 27 (1&2): 71-89

Jhaveri, N.J. (1998). Corporate Governance: The concept and Implications in the Indian Context. *ASCI Journal of Management*, 27 (1&2): 62-70

Kafle, D.R. (2004). Towards Corporate Governance. SEBO Journal, 2(I), Securities Borad of Nepal.

Kern, A. et.al. (2004). Corporate Governance and Banking Regulation. *Cambridge Endowment for Research in Finance Working Paper 17,* University of Cambridge.

Khatiwada Y.R. (2002, February). Financial sector reforms and corporate governance in Nepal. *Byavasthapan Souvnir,* 21. Management Association of Nepal.

Khurana S. (2012). *Corporate Governance.* New Delhi: Dreamtech Press.

King Report (2002). King Committee on Corporate Governance, Institute of Directors, South Africa, pp.10-11.

Levine, R. (2004) The Corporate Governance of Banks: A Concise Discussion of Concepts and Evidence. *Policy Research Working Paper 3404*, Washington, DC: World Bank.

Lewis, M. (1998).The World's Biggest Going-out-of- business Sale. *The New York Times Magazine*, pp.34-69.

Lin, C. (2001). Private Vices in Public Places: Challenges in Corporate Governance Development in China. OECD Development Centre, Paris (cf. www.oecd.org/dev/).

Lusaka, Z. (2005). *Economic and Corporate Governance and Accountability in Southern Africa.* Economic Commission for Africa.

Malherbe, S. & Segal, N. (2001). Corporate Governance in South Africa. OECD Development Center, Paris (www.oecd.org/dev/).

McGee, R.W. (2010). Corporate governance in transition and developing economies: A case study of Nepal. *Working Paper* .Florida International University.

Mehran H., Morrison, A., & Shapiro, J. (2011). Corporate Governance and Banks: What Have We Learned from the Financial Crisis?. *Federal Reserve Bank of New York Staff Reports*, 502

Miles, L. (2010). *Transplanting the Anglo American CG model into Asian countries: prospects and practicality*. Middle Sex University.

Musasike, L. (2005). *Economic and Corporate Governance and Accountability in South Africa. Economic Commission for Africa.*

Mwanakatwe, C. (2005). *Economic and Corporate Governance and Accountability in South Africa*. Economic Commission for Africa.

Nicolo G.D, Laeven L., & Ueda K. (2006). Corporate Governance Quality: Trends and Real Effects. *International Monetary Fund (IMF) Working Paper 06/293.*

Oman, C.P. (2001). Corporate Governance and National Development. *Working Paper 180.* OECD Development Center.

Rawal, T. (2003). *Corporate Governance and Financial Sector Reform in Nepal.* Society for International Development, Nepal Chapter.

Salmon, W. J. (1993, January-February).Crisis Prevention: How to Gear up Your Board?. *Harvard Business Review*.

Sanusi, J. (2004). Corporate governance: A keynote address delivered at Abuja between February, 17-20.

Senior Supervisors Group. (2008). *Observation on Risk Management Practices during the Recent Market Turbulence.* March 6. http://www.newyorkfed.org/newsevents/news/banking/2008/SSG_Risk_Mgt_doc_final.pdf.

Senior Supervisors Group. (2009). *Risk Management Lessons from the Global Banking Crisis of 2008.* October 21.http://www.newyorkfed.org/newsevents/news/banking/2009/SSG_report.pdf.

Sharma, R. P., & Martin H. (2013, May). Corporate Governance and Efficiency in Nepalese Commercial Banks. *International Review of Business Research Papers, 9(4): 53 – 64.*

Shrestha M.K. (1993). A Focus on Growing Financial Intermediary in Nepalese Capital Market. *The Nepalese Management Review*, IX (1):15.

Suzanne, C.N. et. al. (2006). Corporate Governance and Human Resource Management. *British Journal of Industrial Relations,* 44 (3): 541–567.

Thapa, R.B. (2008, December). Corporate Governance: Need & Significance in Nepalese Banking System, Paper on International Conference on ‘Challenges of Governance in South Asia’ in Kathmandu, Nepal.

Vasishth, N. & Rajput, N. (2010). Corporate governance values and ethics with case studies. New Delhi: Taxmann Publications.

World Bank. (2005). Report on the Observance of Standards and Codes. Corporate Governance Country Assessment Nepal.

ANNEX
Questionnaire Used in Survey
Likert's Scale of 1-5, "1" Representing the Strongly Disagree and "5" Strongly Agree

Variable	Items	Scale
Discipline	Company has issued a 'mission statement' that explicitly places a priority on good corporate governance.	
	Management sticks to clearly defined core businesses. (any diversification into an unrelated area in last 3 years would count as NO)	
	Over the past 5 years, it is true that the company has not declared any warrants against trespassers.	
	Over the past 5 years, it is true that the company has not built up disciplinary action report.	
	Company's annual report includes a section devoted to the company's performance in implementing corporate governance principles.	
Transparency	Management has disclosed three or five year performance report.	
	Public announcement of results have been made within 2 working days of board meeting.	
	The reports are clear and informative. (based on perception of analyst)	
	Company consistently discloses major and market sensitive information punctually.	
	Analysts have good access to senior management. Good access implies accessibility soon after results are announced and timely meeting where analyst are given all relevant information and are not misled.	
	Company has an English/ official language website where results and other announcements are updated promptly. (no later than one business day)	
Independence	The chairman is an independent, non executive director.	
	Company has an executive or management committee which is substantially different from members of the board and not believed to be dominated by referrals.	
	Company has an audit committee. it is chaired by a perceived genuine independent director.	
	Company has a remuneration committee. It is chaired by a perceived genuine independent director.	
	External auditors of the company are in other respects seen to be completely unrelated to the company.	
	The board includes no direct representatives of banks and other large creditors of the Company. (Having any representatives is a negative.)	
Accountability	The board members and members of the executive/management committee substantially different. (i.e. no more than half of one committee sits on the other.)	
	There are any foreign nationals on the board.	
	Full board meetings are held at least once a quarter.	
	Audit committee nominates and conducts a proper review the work of external auditors.	
	The audit committee supervises internal audit and accounting procedures.	

Responsibility	The board/senior management have made decisions in the recent years seen to benefit them at the expense of management, has the company been seen as acting effectively against individuals responsible and corrected such behavior promptly, i.e. within 6 months.	
	Over the past five years, there were open business failures or misbehavior; responsible persons were appropriately and voluntarily punished.	
	There is any controversy or questions over whether the board and/or senior management take measures to safeguard the interests of all and not just the dominate employees.	
	There are mechanisms to allow punishment of the executive/ management committee in the event of mismanagement.	
Fairness	It is true that there have not been any controversy or questions raised over any decisions by senior management in the past 5 years where upper management are believed to have gained at the expense of middle or lower management.	
	All the employees have access to their appraisal record.	
	Criticism/suggestions methods are easily available.	
	All necessary information for appraisal criteria are made available prior to evaluation.	
	It is true that there have been no questions or perceived controversy over whether the Company has issued transparency report or not.	
	The head of department report to either the CEO or the board member concerned to employee's equality.	
	Over the past five years, it is true that total director's remuneration has not increased faster than employees.	
Social Awareness	Company has an explicit (clearly worded) public policy statement that emphasizes strict ethical behavior: i.e. one that looks at the spirit and not just the letter of the law.	
	Company has a policy/culture that prohibits the employment of the under-aged.	
	Company has an explicit equal employment policy.	
	Company is explicitly environmentally conscious	