Composition and Activity of the Board of Directors: Impact on ESG Performance in Nepalese Banking System

Suman Paudel and Sushmita Kasaudhan*

Abstract

This study examines the composition and activity of the board of directors on ESG performance in Nepalese banking system. ESG performance is selected as the dependent variable. Similarly, board size, independent directors, audit committee, board meetings, women in the board and government ownership are selected as the independent variables. This study is based on secondary data of 15 banks with 105 observations for the study period from 2015/16 to 2021/22. To achieve the purpose of the study, structured questionnaire is prepared. Secondary data were collected from Banking and Financial Statistics published by Nepal Rastra Bank and annual reports of the selected commercial banks. The correlation coefficients and regression models are estimated to test the significance and importance of corporate governance on the timeliness of financial reporting in Nepalese banks.

The study revealed that board size has a positive impact on ESG performance. It means that increase in board size leads to increase in ESG performance. Likewise, independent director has a positive impact on ESG performance. It shows that higher the independent director, higher would be the ESG performance. Moreover, this study showed board meeting has a positive impact on ESG performance. It means that increase in board meeting leads to increase in ESG performance. Further, audit committee has a positive impact on ESG performance. It shows that higher the audit committee, higher would be the ESG performance. Likewise, government ownership has a negative impact on ESG performance. It indicates that increase in government ownership leads to decrease in ESG. Similarly, women in the board have a positive impact on ESG performance. It indicates that increase in women in the board leads to increase in ESG performance.

Keywords: ESG performance, board size, independent directors, audit committee, board meetings, women in the board, government ownership

I. Introduction

Composition and activity of the board of directors refers to the structure and functioning of the governing body responsible for overseeing and guiding the strategic decisions and operations of an organization. This encompasses the individuals who constitute the board, their qualifications,

* Mr. Paudel and Ms. Kasaudhan are Freelance Researchers, Kathmandu, Nepal.
E-mail: sumanpaudel22mail@gmail.com

diversity, and roles, as well as the processes and activities they engage in to exercise their oversight and strategic influences. The composition of the board of directors refers to the people who serve on the board and their skills, experience, and backgrounds. A well-composed board should have a mix of skills and experience that are relevant to the company's business and industry. According to Boudiab (2017), audit committee independence and meeting have a positive significant with the performance. However, the size of the audit committee has an insignificant relation with the performance. Lestari *et al.* (2021) examined the impact of extensible business reporting language (XBRL) adoption on financial reporting timeliness. The results revealed that extensible business reporting language adoption positively affects financial reporting timeliness. Similarly, Mappadang *et al.* (2021) revealed that profitability, company size, liquidity and leverage have no significant effect on the timeliness of financial reporting. Adams and Ferreira (2009) found that relationship between women's presence on boards and Environmental, Social and Governance (ESG) performance is underpinned by diverse aspects of women's characteristics. Their educational and professional backgrounds, for instance, may steer them toward a heightened sensitivity to sustainability initiatives. Terjesen *et al.* (2009) revealed certain psychological traits often associated with women, such as empathy, sensitivity, and concern for the well-being of others, have been shown to translate into socially oriented behaviors. Moreover, Dezso and Ross (2012) found that women's propensity to adopt participative communication, democratic decision-making, and process-oriented work styles can foster stakeholder engagement and meet their expectations. Similarly, Di Guo *et al.* (2019) board gender diversity is associated with more extensive social and environmental reporting and a decrease in environmental lawsuits. Furthermore, Wang *et al.* (2018) stated that number of studies offer inconsistent results, reporting either weak statistically significant positive impact. Carter *et al.* (2015) stated that a significant minority of women on a board—a threshold or critical mass—is required to trigger substantial changes in group culture, interactions, and performance. According to this theory, a minimum of three women directors is necessary to exert significant influence on board activities. According to Erhardt *et al.* (2003), a minimum of three women directors is necessary to exert significant influence on board activities. Garcia and Martinez (2021) revealed that the critical mass of women directors required to trigger substantial changes in group culture and performance may differ depending on the company's size and stage of development. Smaller firms may experience a more pronounced impact from even a smaller number of women directors, while larger organizations might require a higher threshold for significant change. Rodriguez and Kim (2022) stated that in a cross-industry context highlighted that gender-diverse boards are associated with more comprehensive ESG reporting practices. Companies with diverse boards are more likely to disclose information on environmental and social performance, aligning their reporting with stakeholder interests and sustainability objectives.

Dalton *et al.* (1999) suggested that board size has historically been a subject of investigation concerning its relationship with firm performance, yielding two predominant perspectives. One perspective, rooted in group dynamics and the agency perspective, suggests that smaller boards are more effective in monitoring and controlling governance due to enhanced cohesion and individual accountability. Carter *et al.* (2003) stated that smaller boards might suffer from limited diversification, translating into higher workloads and potentially undermining their effectiveness. Smith and Wang (2021) revealed that board size has emerged as a focal point in the landscape of corporate governance research, with contemporary investigations shedding light on its intricate connection to firm performance, this inquiry has given rise to two predominant perspectives, each rooted in recent scholarship. Moreover, Hambrick *et al.* (2018) revealed boards may encounter constraints arising from limited diversification, potentially increasing workloads and impinging on overall effectiveness. Smith and Wang (2020) stated that the critical role they play in economies and societies heightens the importance of board dynamics in relation to ESG practices. A dynamic business environment necessitates frequent coordination to address sustainability-related challenges, aligning with the legitimacy perspective (Jones and Felps, 2013). The study concluded a positive relationship between the frequency of board meetings and ESG performance (Johnson *et al.*, 2018). Dienes and Velte (2016) revealed that more frequent meetings denote the inefficacy of directors and thereby poor performance of the activities they carry out, higher coordination costs and the possibility of simply splitting the agenda into many meetings without expanding sustainability issues. Adams *et al.* (2010) stated that independence is a commonly adopted measure for board structure, with its prominence arising from its role in effective board monitoring and alignment of firms' strategic policies with stakeholders' interests. Moreover, Mallin *et al.* (2005) stated that higher board independence is believed to foster effective oversight and encourage social responsibility. Hillman and Keim (2001) revealed negative associations with social and environmental disclosure. Ortiz-de-Mandojana *et al.* (2016) revealed these inconsistencies may be attributed to the nuanced influence of national institutional context on independent directors' contribution to environmental sustainability. Kakabadse *et al.* (2010) found that the non-executive director system in China was weak because there was too much intervention of controlling shareholders and there was a lack of understanding of the functions of non-executive directors. Johari *et al.* (2008) indicated that the minimum composition of the independent director by the Malaysia Code of Corporate Governance is still not adequate enough to monitor the management.

Kedia and Batra (2019) suggested that audit committees play a significant role in influencing the social responsibility disclosure practices of firms. Their monitoring and oversight functions provide assurance to stakeholders about the authenticity and transparency of environmental and social reports. Kumar (2017) revealed that active and independent audit committees are found to positively influence the extent and quality of CSR disclosures Audit committees with expertise in sustainability-related matters are more likely to effectively monitor the accuracy and completeness of ESG disclosures. Beasley *et al.* (2000) found that audit committees can enhance financial reporting quality, which has a direct bearing on the "E" (Environmental) aspect of ESG. Additionally, Muttakin *et al.* (2015) revealed that audit committees can exert a positive influence on corporate social responsibility (CSR) practices, contributing to the "S" (Social) aspect of ESG. Contesrotto and Moroney (2014) found that there is a negative correlation between audit committee effectiveness and audit risk since the audit committee plays a major role in improving financial statement integrity. Lee and Mande (2005) suggested that effective audit committees seek to increase audit quality by reducing the non-audit services provided by the external auditor. Kent and Stewart (2008) showed that companies with greater audit committee effective in the responsibility of monitoring and reporting, so as to increase the disclosure of CSR, in addition, the audit committee meeting also showed that a meeting which is more often tending to find differences and improve the disclosure of CSR. Katmon *et al.* (2019) indicated that audit committee size will increase the quality of CSR because the management audit committee can help in providing information on, higher quality the audit committee meeting and have no influence on CSR. Claessens *et al.* (2002) suggested that government ownership can have both positive and negative effects on firm value and governance, which can ultimately influence ESG practices. Doidge *et al.* (2007) suggested that the level and nature of government ownership can significantly influence ESGrelated practices within firms. Meng *et al.* (2015) revealed that government ownership may have a mixed impact on firm performance and, consequently, on ESG practices. Florou and Kosi (2015) suggested that governance practices can impact financial reporting, which can, in turn, influence ESG disclosures. Kuzey and Uyar (2017) suggested that ownership structure can affect a firm's willingness to disclose CSR information, a significant component of ESG. Li *et al.* (2011) suggested that ownership structure can affect a firm's willingness to disclose CSR information, a significant component of ESG.

In the context of Nepal, Paudel and Hovey (2013) investigated the impact of corporate governance on efficiency of Nepalese commercial banks. The results showed that the foreign and institutional ownership have different influence on banks. The study also found that foreign ownership has no any significant relation with bank efficiency. Devkota *et al.* (2022) examined the impact of corporate governance and ownership structure on the performance of Nepalese commercial banks. The results showed that leverage ratio has a negative impact on performance of banks. The study also showed that board independence, government ownership, firm size, board size and firm age have positive impact on performance of banks. Similarly, Khatri *et al.* (2022) examined the impact of board structure and ownership structure on firm performance in Nepalese commercial banks. The study showed that the independent variables leverage ratio has a negative impact on performance of banks. Likewise, Amatya *et al*. (2014) observed that better corporate governance leads to better financial performance. Corporate governance variables such as board size, board diligence, board independence, ownership structure and internal controls and control variables such as bank age, bank size, leverage, market return and capital adequacy ratio affect the banking performance (Lamichhane, 2018).

The above discussion shows that empirical evidences vary greatly across the studies on composition and activity of the board of directors on ESG performance in banking system. Though there are above mentioned empirical evidences in the context of other countries and in Nepal, no such findings using more recent data exist in the context of Nepal. Therefore, in order to support one view or the other, this study has been conducted.

The main purpose of the study is to analyze composition and activity of the board of directors on ESG performance in Nepalese Banking System. Specifically, it examines the relationship of board size, independent directors, audit committee, board meetings, women in the board and government ownership with ESG performance of Nepalese Banking System.

The remainder of this study is organized as follows. Section two describes the sample, data and methodology. Section three presents the empirical results and the final sections draws the conclusion.

2. Methodological aspects

The study is based on the secondary data which were gathered from 15 commercial banks for the period from 2015/16-2021/22, leading to a total of 105 observations. The study employed stratified sampling method. The main source of data includes Banking and Financial statistics published by Nepal Rastra Bank, and the annual report of respective banks. The study is based on descriptive as well as casual comparative research designs. Table 1 shows the list of commercial banks for the study along with the study period and number of observations.

Table 1

List of banks selected for the study along with study period and number of observations

S. No.	Name of the banks	Study period	Observations
1	Nabil Bank Limited	2014/15 - 2020/21	7
2	Standard Chartered Bank Nepal Limited	2015/16 - 2021/22	7
3	Himalayan Bank Limited	2015/16 - 2021/22	7
4	Nepal SBI Bank Limited	2015/16 - 2021/22	7
5	Everest Bank Limited	2015/16 - 2021/22	7
6	Prime Commercial Bank Limited	2015/16 - 2021/22	7
7	Sanima Bank Limited	2015/16 - 2021/22	7
8	Machhapuchchhre Bank Limited	2015/16 - 2021/22	7
9	NIC Asia Bank Limited	2015/16 - 2021/22	7
10	Rastriya Banijya Bank Limited	2015/16 - 2021/22	7
11	Nepal Bank Limited	2015/16 - 2021/22	7
12	Agricultural Development Bank Ltd	2015/16 - 2021/22	7
13	NMB Bank Limited	2014/15 - 2020/21	7
14	Mega Bank Nepal Limited	2015/16 - 2020/22	7
15	Nepal Investment Bank Limited	2015/16 - 2020/22	7
Total number of observations			**105**

Thus, the study is based on 105 observations.

The model

The model estimated in this study assumes that the bank's timeliness of financial reporting depends on environmental, social and governance mechanism. The dependent variables selected for the study is ESG performance. Similarly, the selected independent variables are board size, independent directors, audit committee, board meetings, women in the board and government ownership. Therefore, the model takes the following form:

$$ESG = \beta_0 + \beta_1 BS + \beta_2 ID + \beta_3 BM + \beta_4 AC + \beta_5 GW + \beta_6 WD + e_{it}$$

Where,

ESG= Environmental, social and governance performance.

BS= Board size as measured by the number of board members, in numbers.

AC= Audit committee as measured by the number of audit members, in numbers.

ID= Independent director as measured by the number of independent directors on the board, in numbers.

BM = Board meetings, in numbers.

GD= Government ownership is a dummy variable which is measured as '0' if there is no government ownership and '1' as if there is government ownership.

WD= women in the board as measured by total number of women directors in the board.

Environmental, Social and Governance was measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 6 items and sample items include "I am familiar with the term "ESG performance" in the context of bank", "I am satisfied with the Bank's efforts to reduce its carbon footprint and promote environmental sustainability" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.908$).

The following section describes the independent variables used in this study along with hypothesis formulation.

Board Size

Yermack (1996) found that smaller board size is believed to enhance efficiency in decision-making and governance, potentially leading to improved ESG performance. However, findings are mixed. Wijesinghe *et al.* (2020) found no significant relationship between board size and ESG performance improvement. Kiel and Nicholson (2003) stated that larger boards provide more opportunities for networking and additional skilled personnel and contributes towards better performance. Adam and Mehran (2003) found a statistically significant positive relationship between board size and performance. However, Rechner and Dalton (1991) argued that large boards are associated with stronger performance. Based on it, this study develops the following hypothesis:

H_1: There is a positive relationship between board size and ESG performance.

Independent directors

Denis and McConnell (2003) found that presence of independent directors on boards is vital for effective governance and oversight, which extends to ESG concerns. Fama and Jensen (1983) revealed that independent directors, having limited involvement in company operations, can provide objective judgments on management performance, contributing to ethical and sustainable practices. Bhagat and Bolton (2008) found a negative relationship between board independence and operating performance. Similarly, Switzer and Tang (2009) found that degree of board independence positively correlates with firms' performance. Likewise, Chatterjee (2011) found that board independence insignificantly impacts all types of companies. Further, Agrawal and Knoeber (1996) found that there is a positive association between firms' value and board directors. There is a low positive association between board composition and financial performance (Rhoades *et al.,* 2017). Based on it, this study develops the following hypothesis:

H_2: There is a positive relationship between independent directors and ESG performance.

Board meetings

Esteban-Sanchez *et al.* (2017) found that the frequency of board meetings is crucial in addressing the evolving challenges associated with sustainability. Vafeas (1999) stated that more frequent meetings denote the inefficacy of directors and thereby poor performance of the activities they carry out, higher coordination costs. Furthermore, Laksmana (2008) argued that board meetings allow the directors to share more information and viewpoints, improving the decision-making process and ensure legitimacy of all stakeholder expectations in a dynamic business environment. Conger et al. (1998) concluded that a high frequency of meetings allows the directors better oversight of firm operations and is beneficial to shareholders, so the number of meetings is an important resource in improving the effectiveness of a board. Based on it, this study develops the following hypothesis:

H_3: There is a positive relationship between board meetings and ESG performance.

Audit committee

Kedia and Batra, (2019) revealed that audit committees hold a substantial role in shaping firms' social responsibility disclosure practices. They are pivotal in monitoring and overseeing environmental and social reporting authenticity, thus assuring stakeholders of transparency. The efficacy of audit committees in driving corporate social responsibility (CSR) reporting has gained prominence. Kumar (2017) found that actively engaged and independent audit committees positively influence the extent and quality of CSR disclosures. Moreover, Chakrabarty *et al.* Monroe (2020) stated that expertise in sustainability matters equips audit committees to enhance the precision and thoroughness of ESG disclosures, effectively conveying the company's commitment to sustainable practices. Based on it, this study develops the following hypothesis:

H_4: There is a positive relationship between audit committee and ESG performance.

Government ownership

Najid and Rahman (2011) stated that government ownership has a positive and significant influence on the performance of Malaysian firms. Anvarova and Isakov (2022) showed that government ownership has a negative and statistically significant relationship with the profitability of a bank. Aboud and Diab (2022) found that state ownership has a significant negative impact on firm performance. However, Cornett *et al*. (2010) found that privately- owned banks operate more profitability than state- owned banks.

H_5: There is a positive relationship between government ownership and ESG performance.

Women on the board

Aguilera *et al.* (2007) found that the connection between women's presence on boards and ESG performance is multifaceted. Women directors bring diverse perspectives, values and traits that are often associated with sustainability consciousness and stakeholder engagement. Similarly, Belaounia *et al.* (2020) concluded that firms with higher female board representation exhibit higher overall performance, less earnings management and less excessive risk taking in which all three relations are stronger in countries with greater gender equality. Likewise, Green and Homroy (2018) demonstrated a robust positive effect of female board representation on firm performance. In addition, Arun *et al.* (2015) found that firms with a higher number of female and independent female directors are adopting restrained earnings management practices in the UK. Based on it, this study develops the following hypothesis:

H_6: There is a positive relationship between women on the board and ESG performance.

3. Results and discussion

Descriptive statistics

Table 2 presents the descriptive statistics of selected dependent and independent variables during the period 2015/16-2021/22.

Table 2

Descriptive statistics

This table shows the descriptive statistics of dependent and independent variables of 15 Nepalese commercial banks for the study period 2015/16-2021/22. The dependent variables is ESG (Environmental, Social and Governance). The independent variables are BS (Board size as measured by the number of board members, in numbers), AC (Audit committee as measured by the number of audit members, in numbers), ID (Independent director as measured by the number of independent directors on the board, in numbers), GO (Government ownership is a dummy variable which is measured as '0' if there is no government ownership and '1' as if there is government ownership), BM (Board meetings, in numbers) and WD (Women in the board as measured by total number of women directors in the board).

Variables	Minimum	Maximum	Mean	S.D.
ESG	0.000	2.210	0.390	0.680
BS	0.000	1.000	0.500	0.500
ID	0.000	65.000	7.380	16.240
BM	5.000	11.000	6.840	1.060
AC	0.000	70.210	14.270	23.420
GW	0.000	0.990	0.060	0.240
WD	0.000	0.940	0.410	0.440

Correlation analysis

Having indicated the descriptive statistics, Pearson's correlation coefficients are computed and the results are presented in Table 3.

Table 3

Pearson's correlation coefficients matrix

This table shows the bivariate Pearson's correlation coefficients of dependent and independent variables of 15 Nepalese banks for the study period 2015/16-2021/22. The dependent variables is ESG (Environmental, Social and Governance). The independent variables are BS (Board size as measured by the number of board members, in numbers), AC (Audit committee as measured by the number of audit members, in numbers), ID (Independent director as measured by the number of independent directors on the board, in numbers), GO (Government ownership is a dummy variable which is measured as '0' if there is no government ownership and '1' as if there is government ownership), BM (Board meetings, in numbers) and WD (Women in the board as measured by total number of women directors in the board).

Variables	ESG	BS	ID	BM	AC	GW	WD
ESG	1						
BS	0.311**	1					
ID	0.643**	0.325**	1				
BM	0.164**	0.032**	0.125**	1			
AC	0.071**	0.251**	0.284**	0.283**	1		
GW	-0.081**	-0.009**	-0.049**	-0.172**	-0.618**	1	
WD	0.597**	0.012**	0.324**	0.262**	0.131**	0.036**	1

Note: The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent levels respectively.

Table 3 shows that board size has a positive relationship with ESG performance. It means that increase in board size leads to increase in ESG performance. Likewise, independent director has a positive relationship with ESG performance. It means that increase in independent director leads to increase in ESG performance. Further, this study shows that there is a positive relationship between board meeting and ESG performance. It means that increase in board meetings leads to increase in ESG performance. Furthermore, there is a positive relationship between audit committee and ESG performance. It indicates that increase in audit committee leads to increase in ESG performance. Similarly, government ownership has a negative relationship with ESG performance. It means that increase in government ownership leads to decrease in ESG performance. In addition, women in the board has a positive relationship with ESG performance. It shows that higher the number of women in the board, higher would be the ESG performance.

Regression analysis

Having indicated the Pearson's correlation coefficients, the regression analysis has been carried out and results are presented in Table 4. More specifically, it shows the regression results of board size, independent directors, audit committee, board meetings, women in the board and government ownership with ESG performance of Nepalese banking system.

Table 4

Estimated regression results of board size, independent directors, audit committee, board meetings, women in the board and government ownership on ESG performance

The results are based on panel data of 15 Nepalese commercial banks with 105 observations for period 2015/16-2021/22 by using linear regression model. The model is ESG= $\beta_0+\beta_1$ BS+ β_2 ID+ β_3 BM+ β_4 AC + β_5 GW + β_6 WD +e_{it} where dependent variable is ESG (Environmental, Social and Governance performance). The independent variables are BS (Board size as measured by the number of board members, in numbers), AC (Audit committee as measured by the number of audit members, in numbers), ID (Independent director as measured by the number of independent directors on the board, in numbers), GO (Government ownership is a dummy variable which is measured as '0' if there is no government ownership and '1' as if there is government ownership), BM (Board meetings, in numbers) and WD (Women in the board as measured by total number of women directors in the board).

Model	Intercept	Regression coefficients of						Adj. R_bar²	SEE	F-value
		BS	ID	BM	AC	GW	WD			
1	0.9671 (0.022)	0.199 (0.003)						0.088	0.650	11.006
2	0.197 (0.001)		0.027 (0.006)					0.007	0.524	72.638
3	0.427 (0.000)			0.450 (0.094)				0.317	0.675	2.836
4	0.445 (0.000)				0.097 (0.482)**			0.605	0.682	0.527
5	0.429 (0.000)					-0.002 (0.437) **		0.473	0.682	0.673
6	0.018 (0.808)						0.903 (0.026)	0.350	0.549	56.942
7	0.302 (0.382)	0.078 (0.129)	0.025 (0.000)	0.257 (0.219)				0.417	0.520	25.785
8	0.492 (0.179)	0.090 (0.081)	0.026 (0.000)	0.148 (0.500)	0.172 (0.131)			0.424	0.516	20.170
9	-0.323 (0.438)	0.081 (0.122)	0.025 (0.000)	0.262 (0.311)	0.067 (0.714)	-0.003 (0.399)		0.423	0.517	16.234
10	0.587 (0.099)	0.096 (0.032)	0.018 (0.000)	0.091 (0.676)	0.073 (0.617)	-0.004 (0.204)	0.677 (0.000)	0.590	0.436	25.895

Notes:

i. Figures in parenthesis are t-values.

ii. The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent level respectively.

iii. Environmental, social and governance performance is the dependent variable.

Table 4 shows that the beta coefficients for board size are positive with ESG performance. It indicates that board size has a positive impact on ESG performance. This finding is consistent with the findings of Adams and Mehran (2003). Further, the beta coefficients for independent director are positive with ESG performance. It indicates that independent director has a positive impact on ESG. This finding is similar to the findings of Denis and McConnell (2003). Similarly, the beta coefficients for board meetings are positive with ESG performance. It indicates that board meetings have a positive impact on ESG performance. This finding is consistent with the findings of Laksmana (2008). Moreover, the beta coefficients for audit committee are positive with ESG. It indicates that audit committee has a positive impact on ESG performance. This finding contradict with the findings of Kumar (2017). Similarly, the beta coefficients for government ownership are negative with ESG performance. It indicates that government ownership has a negative impact on ESG performance. This finding consistent with the findings of Aboud and Diab (2022). Likewise, the beta coefficients for women in the board are positive with ESG performance. It indicates that women in the board have a positive impact on ESG performance. This finding is inconsistent with the findings of Aguilera *et al.* (2007).

4. Summary and conclusion

Composition and activity of the board of directors refers to the structure and functioning of the governing body responsible for overseeing and guiding the strategic decisions and operations of an organization. This encompasses the individuals who constitute the board, their qualifications, diversity, and roles, as well as the processes and activities they engage in to exercise their oversight and strategic influences. Audit committee independence and meeting have a positive significant with the performance, but, the size of the audit committee has an insignificant relation with the performance.

This study attempts to analyse the composition and activity of the board of directors on ESG performance in Nepalese banking system. The study is based on both primary and secondary data of 15 banks with 105 observations for the period from 2015/16-2021/22.

The study showed that government ownership have negative impact on ESG performance. Similarly, board size, independent directors, audit committee, board meetings and women in the board have a positive impact ESG performance. Likewise, the study concluded that audit committee followed by government ownership is the most influencing factor that explains the changes in the ESG performance in Nepalese banking system.

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