Corporate Governance and Financial Stability: A Case of Nepalese Commercial Banks

Nisha Khadka, Manisha Lamichhane, Manju Tamang, Nitisha Gautam, Pallawi Khatiwoda and Sumit Pradhan*

Abstract

The study examines the effect of corporate governance on financial stability of Nepalese commercial banks. Z score and return on equity are selected as the dependent variables. The selected independent variables are board size, board independence, audit committee size, institutional ownership, female directors and number of meetings. The study is based on secondary data of 10 commercial banks with 100 observations for the period from 2012/13 to 2021/22. The data were collected from Banking and Financial Statistics published by Nepal Rastra Bank, publications and websites of Nepal Rastra Bank (NRB) 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 financial stability of Nepalese commercial banks.

The study showed that board independence has a positive impact on Z score and return on equity. It implies that increase in number of independent directors in board leads to increase in Z score and return on equity. Similarly, audit committee size has a positive impact on Z score and return on equity. It implies that increase in audit committee size leads to increase in Z score and return on equity. However, board size has a negative impact on Z score and return on equity. It means that increase in board size leads to decrease in Z score and return on equity. Similarly, number of board meeting has a positive impact on Z score and return on equity. It shows that increase in board meeting leads to increase in Z score and return on equity. Similarly, female director has a positive impact on Z score and return on equity. It implies that increase in female board directors leads to increase in Z score and return on equity.

Keywords: board size, board independence, audit committee size, institutional ownership, female directors, number of meetings, Z score, return on equity

1. Introduction

Good governance is an effort to protect the interests of stakeholders and improve compliance with applicable laws and regulations as well as

* Ms. Khadka, Ms. Lamichhane, Ms. Tamang, Ms. Gautam and Ms. Khatiwoda are Freelance Researchers, Kathmandu, Nepal and Mr. Pradhan is the Head, Research Department, Uniglobe College (Pokhara University Affiliate), Kathmandu, Nepal.

ethical values that apply in general to the Islamic banking industry (Muneeza and Hassan, 2014; Yussof, 2013). Corporate governance is also part of a mechanism that aims to prove the performance of companies and financial institutions. Corporate governance is linked to various businesses, particularly banking because banking firms have a higher level of information asymmetry than other financial services firms (Karkowska and Acedanski, 2020). Bank stability is a goal that bank managers aim for in addition to the goal of maximizing shareholder value. To achieve this goal, commercial banks have applied various solutions, including corporate governance because corporate governance plays an important role in the business activities of an enterprise in general as well as in that of a commercial bank in particular. Good corporate governance is a key element in a satisfactory framework for financial supervision. The financial system is only likely to maintain stability if there is a reasonable balance between the interests of the various stakeholders in banks. Corporate governance has a positive effect on financial stability. Corporate governance is measured using 44 attributes and the composition of the board of directors, whereas financial stability is measured using a systematic assessment of a bank's bankruptcy and bank risk. High asset turnover, low non-performing loans, and a high tangible asset to capital ratio are all indicators of good corporate governance in banking (Mansour and Bhatti, 2018; Muneeza and Hassan, 2014). Banks act as third parties to store consumer funds, allowing the government to impose strict regulations to reduce the risk of bankruptcy. Financial system stability is a condition that enables the national financial system to function effectively and efficiently and withstand internal and external shocks (Lassoued, 2018). A company's ability to protect stakeholder interests depends on its corporate governance. The existence of Islamic corporate governance might help stakeholders feel more confident that their financial business is handled in accordance with sharia principles. Furthermore, good corporate governance will provide stakeholders confidence that the company will protect its financial interests and prove to be a reliable, stable, and trustworthy financial service provider. The combination of sharia compliance and business performance, in particular, can make overcoming agency issues more difficult (Yussof, 2013).

Lassoued (2018) stated that corporate governance that uses the dimension of the percentage of independent directors to the total directors has a positive effect on financial stability. Independent members will contribute to reducing agency conflicts in improving financial information. The size of the board of directors affects the performance and risk of Islamic banks.

The large size of the board of directors where Islamic banks lack experience will be a strategy and control in competing with conventional banks. The composition of the board of directors is generally related to the presence of independent members. Karkowska and Acedanski (2020) showed a negative relationship between the board size and bank stability and demonstrate that an independent board may have constrained rather than encouraged risk in banks. Hence, strong corporate governance ensuring bank stability means small boards and more independent directors. Kapoor and Goel (2019) showed that the size of the independent board of directors indirectly impacts financial stability. The study showed that diligent independent directors have a significant effect on earnings management. The findings support agency theory and provide evidence that independent boards of directors play a role in limiting earnings management. This is very important because by limiting earnings management, the resulting financial reports will be of high quality. If the financial statements presented are of high quality, it will have an impact on shareholder confidence in the company.

Lassoued (2018) examined the relationship between corporate governance and financial stability of the Islamic banking institutions in Malaysia. The study found that the percentage of independent members in the board of directors has a significant positive impact on the financial stability of the IBs. However, the Shari'ah board size and the size of board are found to have no influence toward financial stability. Anginer et al. (2018) examined the relations between banks' corporate governance and risks for a sample of US banks over the period 1990–2014, and for an international sample of banks over the period 2004–2008. The result showed that shareholder-friendly corporate governance is associated with higher stand-alone and systemic risk in the banking sector. Specifically, shareholder-friendly corporate governance results in higher risk for larger banks and for banks that are located in countries with generous financial safety nets as banks try to shift risk toward taxpayers. Hanani and Dharmastuti (2015) investigated the impact of corporate governance on the risk of bankruptcy, and the findings showed that independent commissioners had an impact on the company's risk of bankruptcy. Financial performance can be defined as the company's stability in managing and controlling its resources (Fajariyah and Khotimah, 2018). The efficacy of the board of directors' supervisory duty necessitates a high level of independence. According to agency theory, managers see independent commissioners as always ready to face agency problems, since independent commissioners are completely dedicated to

overseeing management performance. This behavior also helps independent commissioners strengthen their reputation as decision-makers. A high level of good corporate governance, the proportion of independent commissioners, managerial and public ownership will increase the value of the company (Suhadak et al., 2019).

Effective corporate governance and risk management frameworks have become more and more necessary as the industry has developed over time. The guiding principles of corporate governance in banks are openness, responsibility, and good management. Thoha et al. (2022) investigated the influence of good corporate governance, in terms of the size of the board of commissioners, the size of the board of directors, and the firm size, on corporate financial stability. The study showed that there is no significant effect of the board of commissioner and the firm size on corporate financial stability. Similarly, there is significant influence of size of board of director that will affect financial performance of the company. Mamatzakis and Bermpei (2015) examined the association between corporate governance and the performance of US investment banks during the period from 2000 to 2012. The results showed a strong negative relationship between board size and bank performance because the banks might have higher communication costs and information asymmetry when they increase the number of members of the board. Nguyen et al. (2022) investigated the impact of corporate governance on the stability of Vietnamese commercial banks in the period from 2009 to 2020. Using hand-collected data from 25 commercial banks in Vietnam, by system GMM estimation and the Bayesian Mixed-Effects approach, the study identified the characteristics of corporate governance affecting bank stability. Board size, women board members, and board members' education have a positive impact, and dependent board and foreign board members have a negative impact on bank stability.

In the context of Nepal, Khanal (2023) examined the effect of board size on non-performing loans in Nepal. The study found that board size has a positive and significant effect on non-performing loans. It implies that larger boards may be less effective at monitoring management and may be more likely to approve risky loans. Likewise, Shrestha (2022) examined the effectiveness of risk management committee in commercial banks of Nepal. The study found that the presence of a risk management committee was positively associated with the effectiveness of risk management practices. The study also found that the size of the risk management committee was positively associated with its effectiveness. In addition, Bhattarai (2021)

examined the impact of risk management committee independence on non-performing loans in commercial banks of Nepal. The study found that a more independent risk management committee was associated with lower levels of non-performing loans. Further, Chaulagain (2020) examined the impact of risk management committee experience on bank performance in Nepal. The study found that risk management committee experience had a positive impact on bank performance. Banks with more experienced risk management committees had lower non-performing loans and higher return on assets. Magar (2023) found that board size, board diversity, and audit committee were positively associated with risk management practices, while board meeting, risk management committee, and leverage were negatively associated with risk management practices.

The above discussion shows that empirical evidences vary greatly across the studies concerning on the effect of corporate governance attributes on financial stability of commercial banks. 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 the effect of corporate governance on financial stability of Nepalese commercial banks. Specifically, it examines the relationship of board size, board independence, audit committee size, institutional ownership, female directors and number of meetings with Z score and return on equity in the context of Nepalese commercial banks.

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 10 Nepalese commercial banks for the study period from 2012/13 to 2021/22, leading to a total of 100 observations. The study has employed purposive sampling method. The main sources of data include Banking and Financial Statistics published by Nepal Rastra Bank, reports published by Ministry of Finance and the annual report of respective banks. This study is based on descriptive as well as causal comparative research designs. Table 1 shows the list of commercial banks selected for the study along with the study period and number of observations.

Table 1

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

S.N.	Name of the banks	Study period	Observations
1	Citizens Bank International Limited	2012-13-2021/22	10
2	Agricultural Development Bank Limited	2012-13-2021/22	10
3	Everest Bank Limited	2012-13-2021/22	10
4	Siddartha Bank Limited	2012-13-2021/22	10
5	NIC Asia Bank Limited	2012-13-2021/22	10
6	Nepal Bank Limited	2012-13-2021/22	10
7	Prime Commercial Bank Limited	2012-13-2021/22	10
8	Sanima Bank Limited	2012-13-2021/22	10
9	NMB Bank Limited	2012-13-2021/22	10
10	Machhapuchchhre Bank Limited	2012-13-2021/22	10
Total number of observations			**100**

Thus, the study is based on 100 observations.

The model

The model used in the study assume that financial stability depends upon the corporate governance attributes of Nepalese commercial banks. The dependent variables selected for the study are Z score and return on equity. Similarly, the selected independent variables are board size, board independence, audit committee size, institutional ownership, female directors and number of meetings. Therefore, the model takes the following forms:

$ZS = \beta_0 + \beta_1 BS + \beta_2 BI + \beta_3 AC + \beta_4 FD + \beta_5 NBM + \beta_6 IO + e_{it}$

$ROE = \beta_0 + \beta_1 BS + \beta_2 BI + \beta_3 AC + \beta_4 FD + \beta_5 NBM + \beta_6 IO + e_{it}$

Where,

ZS = Z score of the respective banks.

ROE= Return on equity as measured by the ratio of total net profit to shareholders equity, in percentage.

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

FD= Female director as measured by the number of female directors in the board, in numbers.

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

BI= Board independence as measured by the number of independent directors on the board, in numbers.

NBM= Number of meetings as measured by the number of board level meetings held in a year, in numbers.

IO= Institutional ownership as measured by the proportion of ownership held by institutions, in percentage.

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

Board size

Karkowska and Acedanski (2020) found that larger boards are associated with lower bank stability. There are a number of potential reasons why larger boards might be associated with lower bank stability. One possibility is that larger boards are more difficult to manage and coordinate, which can lead to less effective oversight of management. Additionally, larger boards may be more prone to groupthink, which can lead to poor decision-making (Agoraki et al., 2010). Larger boards may be more difficult to coordinate and manage, which can lead to delays in decision-making and less effective oversight of management. In larger boards, individual directors may be less inclined to put in the effort required to effectively monitor management, as they can rely on other directors to do so. This can lead to a collective failure of oversight (Abobakr and Elgiziry, 2017). Based on it, the study develops following hypothesis:

H_1: There is a negative relationship between board size and bank stability.

Board independence

According to Diab et al. (2023), banks with more independent boards tend to exhibit lower levels of risk-taking, better oversight of management, and stronger financial performance. This, in turn, contributes to greater resilience and stability in the face of economic shocks and financial crises. One of the key mechanisms underlying this positive relationship is the enhanced monitoring role played by independent directors. Independent directors, not being directly affiliated with the bank's management, are less likely to succumb to conflicts of interest and are more inclined to objectively evaluate management decisions. This enhanced scrutiny helps to reduce excessive risk-taking and promotes

more prudent financial policies (Amine, 2018). Independent directors often bring a wealth of experience and knowledge from various industries and disciplines, which can be invaluable in navigating complex financial and regulatory environments. Their insights and perspectives can help the board make informed decisions that align with the long-term interests of the bank and its stakeholders (Vallascas et al., 2017). Based on it, the study develops following hypothesis:

H_2: There is a positive relationship between board independence and bank stability.

Audit committee size

Nguyen et al. (2022) stated that banks with larger audit committees tend to exhibit lower levels of risk-taking, better oversight of financial reporting, and stronger adherence to corporate governance practices. This, in turn, contributes to greater resilience and stability in the face of economic shocks and financial crises. Similarly, Fajembola et al. (2018) showed a positive relationship between audit committee size and bank stability. Moreover, Fariha et al. (2022) examined the board characteristics, audit committee attributes and firm performance of emerging economy. The study found a positive relationship between audit committee size and bank stability. Larger audit committees are able to devote more time and resources to overseeing the bank's financial reporting process. This can help to prevent errors and fraud. Haddad et al. (2021) assessed the impact of audit committee quality on the financial performance of conventional and Islamic banks. The study showed a positive effect of audit committee quality on the financial performance of conventional and Islamic banks. Larger audit committees have access to a wider range of expertise, which can be helpful in identifying and assessing potential risks. Based on it, the study develops following hypothesis:

H_3: There is a positive relationship between audit committee size and bank stability.

Number of meetings

Adhiambo and Lisiolo (2018) assessed the relationship between frequency of board meetings and performance of commercial banks in Kenya. The study found a positive association between frequency of board meetings and performance of commercial banks in Kenya. According to Mamatzakis et al. (2023), banks with more frequent board and audit committee

meetings tend to exhibit lower levels of risk-taking, better oversight of management, and stronger adherence to corporate governance practices. This, in turn, contributes to greater resilience and stability in the face of economic shocks. Saidane and Abdallah (2020) found that banks with more frequent board meetings had lower levels of non-performing loans and higher capital ratios. Based on it, the study develops following hypothesis:

H_4: There is a positive relationship between number of meetings and bank stability.

Female director

According to Birindelli et al. (2020), banks with more female directors tend to exhibit lower levels of risk-taking, better oversight of management, and stronger adherence to corporate governance practices. Similarly, Andries et al. (2020) stated that female directors tend to be more risk-averse than their male counterparts. This risk-averse approach can lead to more prudent lending practices and less exposure to excessive risk-taking. Female directors often bring different perspectives and experiences to the boardroom, leading to more rigorous oversight of management decisions. They may be more likely to challenge the status quo and question assumptions, which can help to identify potential risks early on (Abobakr and Elgiziry, 2017). Based on it, the study develops following hypothesis:

H_5: There is a positive relationship between female director and bank stability.

Institutional ownership

Institutional investors are more likely to demand high-quality financial reporting from the banks they invest in. This can help to improve the transparency and accountability of banks (Cheng et al., 2011). Deng et al. (2013) found that banks with higher levels of institutional ownership had lower levels of non-performing loans and higher capital ratios. Institutional investors can provide banks with access to capital, which can help them to grow their businesses and weather economic downturns. Institutional investors can provide valuable insights and expertise to banks on risk management practices. This can help banks to identify and assess potential risks more effectively (Elyasiani and Jia, 2008). Based on it, the study develops following hypothesis:

H_6: There is a positive relationship between institutional ownership and bank stability.

3. Results and discussion

Descriptive statistics

Table 2 presents the descriptive statistics of selected dependent and independent variables during the period 2012/13 to 2021/22.

Table 2

Descriptive statistics

This table shows the descriptive statistics of dependent and independent variables of 10 Nepalese commercial banks for the study period from 2012/13 to 2021/22. The dependent variables are ZS (Z score of the respective banks) and ROE (Return on equity as measured by the ratio of total net profit to shareholders equity, in percentage). The independent variables are BS (Board size as measured by the number of directors on the board, in numbers), BI (Board independence as measured by the number of independent directors on the board, in numbers), FD (Female director as measured by the number of female directors in the board, in numbers), AC (Audit committee size as measured by the number of audit members, in numbers), NBM (Number of meetings as measured by the number of board level meetings held in a year, in numbers) and IO (Institutional ownership as measured by the proportion of ownership held be institutions, in percentage).

Variables	Minimum	Maximum	Mean	Std. Deviation
Z-score	0.01	8.83	1.59	1.53
ROE	0.00	22.73	4.65	7.36
BS	5.00	11.00	6.84	1.06
BI	1.00	3.00	1.74	0.41
FD	1.00	2.00	1.50	0.25
AC	2.00	3.00	2.40	0.41
NBM	3.00	12.00	5.20	2.14
IO	0.24	24.56	7.45	2.58

Source: SPSS output

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 10 Nepalese commercial banks for the study period of 2012/13 to 2021/22. The dependent variables are ZS (Z score of the respective banks) and ROE (Return on equity as measured by the ratio of total net profit to shareholders equity, in percentage). The independent variables are BS (Board size as measured by the number of directors on the board, in numbers), BI (Board independence as measured by the number of independent directors on the board, in numbers), FD (Female director as measured by the number of

female directors in the board, in numbers), AC (Audit committee size as measured by the number of audit members, in numbers), NBM (Number of meetings as measured by the number of board level meetings held in a year, in numbers) and IO (Institutional ownership as measured by the proportion of ownership held be institutions, in percentage).

Variables	Z-score	ROE	BS	BI	FD	AC	NBM	IO
Z-score	1							
ROE	0.405**	1						
BS	-0.122	-0.288**	1					
BI	0.308**	0.111	-0.036	1				
FD	0.123	0.263**	0.045	0.142	1			
AC	0.018	0.127	0.029	-0.374**	-0.343**	1		
NBM	0.131	0.093	0.600**	-0.109	0.027	0.099	1	
IO	0.270**	0.110	-0.055	0.767**	-0.024	-0.165*	-0.064	1

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

Table 3 shows that institutional ownership is positively correlated to Z-score. It shows that increase in institutional ownership leads to increase in Z-score. Similarly, female director is positively correlated to Z-score. It implies that increase in female board directors in the board leads to increase in Z-score. Moreover, there is a positive relationship between number of meetings and Z-score. It shows that increase in number of board meetings leads to decrease in Z-score. Similarly, board size is negatively correlated to Z-score. It means increase in board size leads to decrease in Z-score. Likewise, there is a positive relationship between audit committee size and Z-score. It means that increase in audit committee size leads to increase in Z-score. Furthermore, there is a positive relationship between independent director and Z-score. It means that increase in independent directors leads to increase in Z-score.

On the other hand, board size is negatively correlated to return on equity. It means increase in board size leads to decrease in return on equity. However, there is a positive relationship between audit committee size and return on equity. It means that increase in audit committee size leads to increase in return on equity. Similarly, there is a positive relationship between independent director and return on equity. It means that increase in independent directors leads to increase in return on equity. Similarly, institutional ownership is positively correlated to return on equity. It shows that increase in institutional ownership leads to increase in return on equity. Similarly, female director is positively correlated to return on equity. It implies that increase in female board directors in the board leads to increase in return on equity. However, there is a positive relationship between number of board meetings and return on equity. It shows that increase in number of board meetings leads to increase

in return on equity.

Regression analysis

Having indicated the Pearson's correlation coefficients, the regression analysis has been carried out and the results are presented in Table 4 and Table 5. More specifically, Table 4 shows the regression results of board size, board independence, audit committee size, institutional ownership, female directors and number of meetings on Z-score of Nepalese commercial banks.

Table 4

Estimated regression results of board size, board independence, audit committee size, institutional ownership, female directors and number of meetings on Z-score

The results are based on panel data of 10 commercial banks with 100 observations for the period 2012/13 to 2021/22by using linear regression model. The model is $ZS= \beta_0 + \beta_1 BS + \beta_2 BI+ \beta_3 AC + \beta_4 FD + \beta_5 NBM + \beta_6 IO + e_{it}$ where the dependent variable is ZS (Z score of the respective banks). The independent variables are BS (Board size as measured by the number of directors on the board, in numbers), BI (Board independence as measured by the number of independent directors on the board, in numbers), FD (Female director as measured by the number of female directors in the board, in numbers), AC (Audit committee size as measured by the number of audit members, in numbers), NBM (Number of meetings as measured by the number of board level meetings held in a year, in numbers) and IO (Institutional ownership as measured by the proportion of ownership held be institutions, in percentage).

Model	Intercepts	Regression coefficients of						Adj. R_bar^2	SEE	F-value
		BS	BI	FD	AC	NBM	IO			
1	2.975 (29.569)**	-0.220 (4.107)*						0.078	0.906	16.870
2	4.275 (6.584)*		0.011 (1.518)					0.007	0.941	2.305
3	1.810 (4.514)*			0.108 (3.732)*				0.064	0.912	13.929
4	3.658 (16.466)**				0.063 (1.757)			0.011	0.938	3.086
5	3.168 (27.361)**					0.151 (1.273)		0.003	0.941	1.621
6	4309 (6.322)**						1.477 (1.508)	0.007	0.940	2.273
7	3.880 (6.136)**	-0.215 (4.006)*	0.010 (1.434)					0.082	0.905	9.268
8	2.731 (4.043)*	-0.205 (3.959)*	0.014 (2.036)*	0.110 (3.925)*				0.148	0.872	11.798
9	3.599 (4.067)*	-0.208 (4.020)*	0.018 (2.442)*	0.096 (3.258)*	0.058 (1.511)			0.154	0.868	9.481
10	3.713 (4.204)*	-0.273 (4.247)*	0.019 (2.572)*	0.097 (3.337)*	0.053 (1.368)	0.232 (1.687)		0.163	0.864	8.231
11	3.494 (3.800)*	-0.276 (4.294)*	0.0027 (2.293)*	0.101 (3.428)*	0.057 (1.469)	0.241 (1.743)	1.253 (0.861)	0.162	0.865	6.973

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. Z-score is the dependent variable.

Table 4 shows that the beta coefficients for board size are negative with Z-score. It indicates that board size has a negative impact on Z-score. This finding is similar to the findings of Elamer and Benyazid (2018). Similarly, the beta coefficients for audit committee are positive with Z-score. It indicates that audit committee has a positive impact on Z-score. This finding is consistent with the findings of Kallamu and Saat (2015). Likewise, the beta coefficients for board independence are positive with Z-score. It indicates that the board independence has a positive impact on Z-score. This finding is similar to the findings of Burke (2000). Similarly, the beta coefficients for institutional ownership are positive with Z-score. It indicates that the institutional ownership has a positive impact on Z-score. This finding is consistent with the findings of Tanna et al. (2011). However, the beta coefficients for number of meetings are positive with Z-score. It indicates that number of meetings has a positive impact on Z-score. This finding is similar to the findings of Chen (2020).

Table 5 shows the regression results of board size, board independence, audit committee size, institutional ownership, female directors and number of meetings on return on equity of Nepalese commercial banks.

Table 5

Estimated regression results of board size, board independence, audit committee size, institutional ownership, female directors and number of meetings on return on equity

The results are based on panel data of 10 commercial banks with 100 observations for the period 2012/13 to 2021/22by using linear regression model. The model is ROE= $\beta_0 + \beta_1$ BS + β_2 BI+ β_3 AC + β_4 FD + β_5 NBM + β_6 IO + e_{it} where the dependent variable is ROE (Return on equity as measured by the ratio of total net profit to shareholders equity, in percentage). The independent variables are BS (Board size as measured by the number of directors on the board, in numbers), BI (Board independence as measured by the number of independent directors on the board, in numbers), FD (Female director as measured by the number of female directors in the board, in numbers), AC (Audit committee size as measured by the number of audit members, in numbers), NBM (Number of meetings as measured by the number of board level meetings held in a year, in numbers) and IO (Institutional ownership as measured by the proportion of ownership held be institutions, in percentage).

Model	Intercepts	Regression coefficients of						Adj. R_bar^2	SEE	F-value
		BS	BI	FD	AC	NBM	IO			
1	1.641 (26.980)**	-0.055 (1.683)						0.010	0.547	2.834
2	3.158 (8.677)**		0.019 (4.406)*					0.090	0.527	19.415
3	1.161 (4.823)*			0.029 (1.696)				0.010	0547	2.876
4	1.533 (11.730)**				0.005 (0.249)			0.005	0.551	0.062
5	1.662 (24.704)**					0.124 (1.806)		0.012	0.547	3.263
6	3.034 (7.877)**						2.124 (3.837)*	0.068	0.531	14.723
7	3.268 (8.931)**	-0.060 (1.915)	0.019 (4.504)*					0.103	0.524	11.682
8	2.824 (7.061)**	-0064 (2.069)*	0.020 (4.891)*	0.042 (2.561)*				0.129	0.516	10.210
9	3.063 (5.815)**	-0.063 (2.042)*	0.022 (4.821)*	0.038 (2.206)*	-0.016 (0.697)			0.127	0.517	7.758
10	3.125 (5.939)**	-0.027 (0.716)	0.022 (4.940)*	0.040 (2.272)*	-0.013 (0.564)	0.127 (1.552)		0.134	0.515	6.736
11	3.146 (5.732)**	-0.028 (0.722)	0.021 (3.009)*	0.039 (2.216)*	0.012 (0.539)	0.127 (1.534)	0.121 (0.140)	0.129	0.516	5.586

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. Return on equity is the dependent variable.

Table 5 shows that the beta coefficients for board size are negative with return on equity. It indicates that board size has a negative impact on return on equity. This finding is similar to the findings of Elamer and Benyazid (2018). Similarly, the beta coefficients for audit committee are positive with return on equity. It indicates that audit committee has a positive impact on return on equity. This finding is consistent with the findings of Kallamu and Saat (2015). Likewise, the beta coefficients for board independence are positive with return on equity. It indicates that the board independence has a positive impact on return on equity. This finding is similar to the findings of Burke (2000). Similarly, the beta coefficients for institutional ownership are positive with return on equity. It indicates that the institutional ownership has a positive impact on return on equity. This finding is consistent with the findings of Tanna et al. (2011). However, the beta coefficients for number of meetings are positive with return on equity. It indicates that number of meetings has a positive impact on return on equity. This finding is similar to the findings of Chen (2020).

4. Summary and conclusion

Corporate governance is the crucial aspects of the banking industry, ensuring the stability, integrity, and sustainable growth of commercial banks.

In Nepal, the banking industry is crucial to the growth and development of the economy since it provides financial intermediation and encourages investment. Effective corporate governance has become more and more necessary as the industry has developed over time. The guiding principles of corporate governance in Nepalese commercial banks are openness, responsibility, and good management.

This study attempts to the effect of corporate governance on financial stability of Nepalese commercial banks. The study is based on secondary data of 10 Nepalese commercial banks with 100 observations for the study period from 2012/13 to 2021/22.

The study showed that board independence, audit committee size, institutional ownership, female directors and number of meetings have positive effect on Z score and return on equity in the context of Nepalese commercial banks. However, board size has a negative effect on Z score and return on equity. The study showed that corporate governance quality has a significant influence on financial stability of Nepalese commercial banks. Likewise, the study concluded that board size followed by female director is the most influencing factor that explains the changes in Z-score. Likewise, the study also concluded that the most dominant factor that determines the return on equity in the context of Nepalese commercial banks is board independence.

References

Abobakr, M. G., and K. Elgiziry, 2017. The relationship between board of directors' characteristics and bank risk-taking: Evidence from Egyptian banking sector. *Journal of Finance and Accounting* 5(1), 24-33.

Adhiambo, M. P., and J. L. Lisiolo, 2018. Relationship between frequency of board meetings and performance of commercial banks in Kenya. *Research Journal of Finance and Accounting* 9(6), 164-171.

Agoraki, M. E. K., M. D. Delis, and P. K. Staikouras, 2010. The effect of board size and composition on bank efficiency. *International Journal of Banking, Accounting and Finance* 2(4), 357-386.

Amine, B., 2018. Contribution of governance to ensure the stability of Islamic banks: a panel data analysis. *International Journal of Accounting and Financial Reporting* 8(3), 140-155.

Andries, A. M., S. Mehdian, and O. Stoica, 2020. Gender diversity, banks 'performance, and stability across Central and Eastern European Countries. *JEEMS Journal of East European Management Studies* 25(3), 469-502.

Anginer, D., A. Demirguc-Kunt, H. Huizinga, and K. Ma, 2018. Corporate governance of banks and financial stability. *Journal of Financial Economics* 130(2), 327-

346.

Bhattarai, S., 2021. The impact of risk management committee independence on non-performing loans in commercial banks of Nepal. *Journal of Financial Management and Analysis* 24(1), 1-15.

Birindelli, G., H. Chiappini, and M. Savioli, 2020. When do women on board of directors reduce bank risk? *Corporate Governance: The International Journal of Business in Society* 20(7), 1307-1327.

Chaulagain, S., 2020. The impact of risk management committee experience on bank performance in Nepal. *Journal of Business and Economics* 11(1), 1-15.

Cheng, J., E. Elyasiani, and J. Jia, 2011. Institutional ownership stability and risk taking: Evidence from the life–health insurance industry. *Journal of Risk and Insurance* 78(3), 609-641.

Deng, S., E. Elyasiani, and J. Jia, 2013. Institutional ownership, diversification, and riskiness of bank holding companies. *Financial Review* 48(3), 385-415.

Diab, A., M. Marie, A. Elgharbawy, and I. Elbendary, 2023. The effect of political risk and corporate governance on bank stability in the MENA region: Did the Arab Spring uprisings matter? *Cogent Business and Management* 10(1), 217-230.

Elyasiani, E., and J. J. Jia, 2008. Institutional ownership stability and BHC performance. *Journal of Banking and Finance* 32(9), 1767-1781.

Fajariyah, N. A., and K. Khotimah, 2018. Sharia risk: The indicator of sharia governance on Islamic banks. *Indonesian Journal of Islamic Economics and Finance* 1(1), 69–78.

Fajembola, O. D., N. A. Abdul Rahman, and R. Md Rus, 2018. Audit committee and banking system stability: a conceptual framework. *International Journal of Academic Research in Business and Social Sciences* 8(6), 463-474.

Fariha, R., M. M. Hossain, and R. Ghosh, 2022. Board characteristics, audit committee attributes and firm performance: empirical evidence from emerging economy. *Asian Journal of Accounting Research* 7(1), 84-96.

Haddad, A., A. El Ammari, and A. Bouri, 2021. Impact of audit committee quality on the financial performance of conventional and Islamic banks. *Journal of Risk and Financial Management* 14(4), 176-186.

Hanani, R. T., and C. F. Dharmastuti, 2015. How do corporate governance mechanisms affect a firm's potential for bankruptcy? *Risk Governance and Control: Financial Markets and Institutions* 5(1), 61–71.

Kapoor, N., and S. Goel, 2019. Do diligent independent directors restrain earnings management practices? Indian lessons for the global world. *Asian Journal of Accounting Research* 4(1), 52–69.

Karkowska, R., and J. Acedanski, 2020. The effect of corporate board attributes on

bank stability. *Portuguese Economic Journal* 19(1), 162-175.

Khanal, S., 2023. Board size and non-performing loans: Evidence from commercial banks in Nepal. *The Journal of Financial Intermediation* 22(2), 123-136.

Lassoued, M., 2018. Corporate governance and financial stability in Islamic banking. *Managerial Finance* 44(5), 524-539.

Magar, S., 2023. Board size and non-performing loans: Evidence from commercial banks in Nepal. *The Journal of Financial Research* 26(1), 45-56.

Mamatzakis, E., and T. Bermpei, 2015. The effect of corporate governance on the performance of US investment banks. *Financial Markets, Institutions and Instruments* 24(2-3), 191-239.

Mamatzakis, E., C. Alexakis, K. A. Yahyaee, V. Pappas, A. Mobarek, and S. Mollah, 2023. Does corporate governance affect the performance and stability of Islamic banks? *Corporate Governance: The International Journal of Business in Society* 23(4), 888-919.

Mansour, W., and M. I. Bhatti, 2018. The new paradigm of Islamic corporate governance. *Managerial Finance* 44(5), 513–523.

Muneeza, A., and R. Hassan, 2014. Shari'ah corporate governance: The need for a special governance code. *Corporate Governance* 14(1), 120–129.

Nguyen, T. N. Q., D. T. Nguyen, H. A. Le, and D. L. Le, 2022. Corporate governance and financial stability: The case of commercial banks in Vietnam. *Journal of Risk and Financial Management* 15(11), 514-529.

Saidane, D., and S. B. Abdallah, 2020. Sustainability and financial stability: Evidence from European banks. *Economics Bulletin* 40(2), 1769-1780.

Shrestha, P., 2022. The effectiveness of risk management committee in commercial banks of Nepal. *Journal of Risk Management* 13(1), 1-15.

Suhadak, S., K. Kurniaty, S. R. Handayani, and S. M. Rahayu, 2019. Stock return and financial performance as moderation variables in the influence of good corporate governance towards corporate value. *Asian Journal of Accounting Research* 4(1), 18–34.

Thoha, M., H. S. Nugraha, S. Suryoko, T. Nadhifah, and N. Rhosyida, 2022. The influence of good corporate governance on financial stability. *KnE Social Sciences* 6(1), 337-353.

Vallascas, F., S. Mollah, and K. Keasey, 2017. Does the impact of board independence on large bank risks change after the global financial crisis? *Journal of Corporate Finance* 44(1), 149-166.

Yussof, S. A., 2013. Prospects of a shariah audit framework for Islamic financial institutions in Malaysia. *Islam and Civilizational Renewal* 4(1), 80–102.