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Corporate Governance and Bank Performance: Evidence from Employee Perspectives in Nepalese Development Banks

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Abstract

Background: Corporate governance ensures accountability, Transparency, and effective management in organizations, playing a crucial role in the stability and performance of banks. In Nepal, weak governance has historically contributed to banking crises, highlighting the need for stronger governance frameworks.

Purpose: This study examines how corporate governance practices influence both financial and non-financial performance in Nepalese development banks, with a focus on employee perspectives. It aims to identify gaps and provide insights to enhance the effectiveness of governance and foster stakeholder trust.

Design/methodology/approach: The study adopts an explanatory research design supported by Structural Equation Modeling (SEM). Primary data were collected from 407 employees across various development banks using a random sampling approach, out of which 384 responses were retained for final analysis. A structured survey instrument based on a five-point Likert scale was administered through the KOBO Toolbox. The data collected were processed using descriptive and inferential statistical techniques in MS Excel and Smart PLS 4.0 to assess trends, relationships, and the strength of governance influences.

Findings: The results indicate that the Board of Directors, Audit Committee, and Transparency and Disclosure exert significant positive effects on non-financial performance, which in turn enhances financial performance. Conversely, CEO Duality shows no significant impact, highlighting that concentrated leadership roles do not necessarily contribute to better organizational outcomes. These findings reinforce the importance of robust governance mechanisms in driving organizational effectiveness.

Conclusion: The study concludes that effective governance, particularly through active boards, strong audit committees, and transparent practice, is vital for enhancing both financial and non-financial performance in Nepalese development banks. The results offer practical implications for policymakers and bank management, emphasizing the need to strengthen oversight, promote ethical leadership, and reinforce Transparency to improve organizational stability and performance.

Keywords: Corporate governance, bank performance, regulatory compliance, personnel management

1. Introduction

Corporate governance is the process of balancing the interests of a company's various stakeholders (Chen, 2021). It provides the framework, governing structure, and measures that help construct governance systems for its stakeholders by providing effective direction and control (E. G. & Weaver, 2014; Thomsen, 2004; Jallali, 2022). This framework plays a pivotal role in the smooth operation and growth of businesses across sectors.

Corporate governance has become a fundamental aspect in the management and growth of organizations, particularly in the finance sector. Good governance helps improve a business, and it is recommended that all organizations take steps to improve the quality of their corporate governance system (Fernandez, 2016). Investors value corporate governance because it demonstrates a company's direction and integrity in its business operations. Corporate governance fosters trust among investors and the broader public. As a result, corporate governance contributes to financial viability by providing market players with a long-term investment opportunity. Corporate governance is primarily concerned with the effectiveness of various governance systems in encouraging long-term investment and commitment from various stakeholders (Alhassan & Boakye, 2020).On the other hand, good governance has numerous advantages, including strong property rights, minimal transaction costs, and capital market development (Claessens & Fan, 2002).

In banking, corporate governance is particularly important due to the sector's centrality in mobilizing resources and maintaining economic stability. Weak governance structures have often been linked to systemic risks, as evidenced in crises within both developed and developing economies (Macey & O'Hara, 2003). The relationship between corporate governance and bank profitability is significant. Banks with sound governance structures tend to exhibit better financial performance due to reduced operational inefficiencies and more effective strategic planning (Agoraki et al., 2010). Consequently, global institutions such as the OECD and the Basel Committee have emphasized board independence, audit oversight, and disclosure mechanisms as benchmarks of effective governance.

In Nepal, the financial sector has undergone significant reform since the 1990s, with the liberalization of the banking industry and the emergence of development banks as key intermediaries. For a developing country like Nepal, Corporate Governance reforms are more significant as they help attract more foreign direct investment and mobilize greater savings through capital markets (Maskey, 2004). Nepal Rastra Bank, the central bank, has introduced multiple regulatory directives to enhance governance, yet challenges remain in terms of Transparency, board accountability, and managerial oversight. While prior research on corporate governance in Nepal has largely examined the relationship between governance practices and financial outcomes from shareholders' or regulatory perspectives, limited attention has been paid to employees, the individuals responsible for operationalizing governance principles in practice.

This study examines the effectiveness of corporate governance in Nepalese development banks, focusing on their adherence to established governance frameworks, the impact of governance practices on their performance, and the challenges faced in their implementation. By analysing the corporate governance structures and practices of these institutions, this study aims to provide insights into how they can enhance their governance frameworks to improve operational efficiency and stakeholder trust. Nepal has a total of eight national-level development banks. The structures, procedures, and practices known as corporate governance (Fiss, 2008). Ensure that a business is run and managed in a manner that best serves the interests of its stakeholders. It includes procedures to protect accountability, integrity, and Transparency inside a company. At development banks, where the stakes are particularly high because of their role in mobilizing money for long-term investment and development projects, effective corporate governance is especially important (Claessens, 2006)

The Corporate Governance scenario gained momentum only after 2002, when the central bank of Nepal, Nepal Rastra Bank (NRB), issued Corporate Governance directives. To date, the regulatory requirements of Nepal Rastra Bank (NRB) have solely served as the Corporate Governance benchmark. The bank runs of Nepal Bangladesh Bank (NB Bank) in November 2006 (Upreti, 2006) and the Vibor Bikas Bank (VBB) crisis in 2011 (Sapkota, 2011), in which the central bank had to rescue VBB, are two remarkable banking crises in Nepal. Vibor Bikas Bank's crisis can be compared to that of Lehman Brothers (Sapkota, 2011). Similarly, the bankruptcy of Nepal Development Bank in 2009 was also a dark phase in the Nepalese banking sector (Sapkota, 2009). However, all three cases were linked to the failures in the implementation of Corporate Governance.

Limited Studies Bheshraj Kushwaha (2025), Pokheral and Pokheral (2022), SEBON Journal (2022), and Global Research on Governance Mechanisms and Financial Performance – have examined the relationship between corporate governance factors and bank performance in the context of Nepalese development banks. Kushwaha (2025) examined the impact of corporate governance variables, including the Board of Directors, Audit Committees, CEO Duality, and Transparency, on the performance of Nepalese development banks. The study highlighted that good governance practices have a positive influence on bank performance, particularly in improving Return on Assets (ROA) and Return on Equity (ROE). Pokheral and Pokheral (2022) conducted a comprehensive study that examined corporate governance structures in Nepalese banks, finding that effective governance frameworks significantly enhance financial stability and performance. The SEBON Journal (2022) emphasized the role of Transparency in governance and its direct impact on investors' trust and bank profitability, further validating the importance of governance standards in enhancing organizational efficiency. Global research has also highlighted that effective governance mechanisms, such as independent boards and well-structured audit committees, can reduce operational inefficiencies and enhance bank profitability by mitigating risks and fostering stakeholder confidence. Studies specifically on Nepalese development banks emphasize the need to strengthen corporate governance in order to overcome the challenges posed by agency issues, enhance financial performance, and ensure the long-term stability of the banking sector.

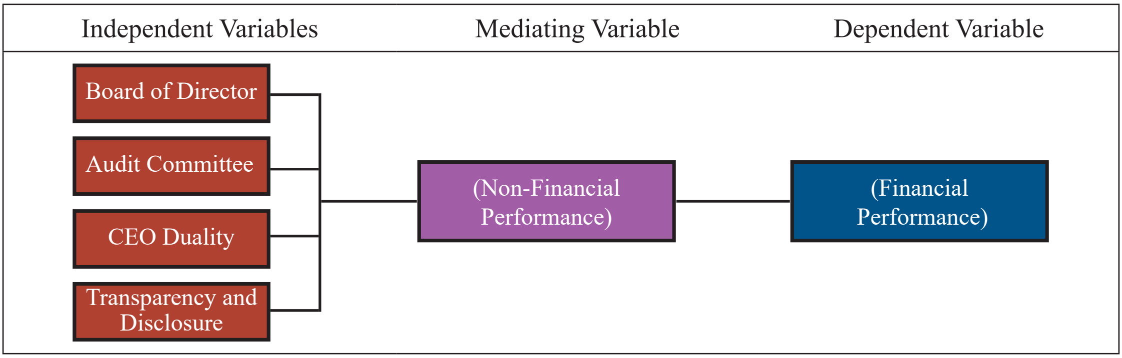
All these studies have examined the relationship between corporate governance mechanisms and bank performance. Kushwaha (2025) emphasized the importance of corporate governance structures, such as the Board of Directors, Audit Committees, CEO Duality, and Transparency and Disclosure, in enhancing the performance of development banks in Nepal. Poudel and Hovey (2013) analyzed corporate governance from the perspective of efficiency but mainly focused on secondary data, leaving gaps in primary data research. Additionally, while many studies focus on corporate governance and financial performance, fewer have explored the impact of non-financial performance as a mediator. The literature reveals that limited research exists on the direct link between corporate governance and non-financial performance in the Nepalese context, with even fewer studies looking at the employee perspective. This study aims to fill these gaps by examining the relationship between corporate governance, non-financial performance, and financial performance in Nepalese development banks, with a focus on employee perspectives.

2. Methods

The research employs an explanatory research design, a common approach in studies that seek to understand cause-and-effect relationships (Basnet et al., 2024). This design was deemed appropriate for the study, as it provides a clear framework for examining how different aspects of corporate governance (independent variables) affect the performance of Nepalese development banks (dependent variable). As discussed by Siaw et al. (2022), the explanatory design allows for the exploration of relationships between independent and dependent variables, making it suitable for testing the hypotheses formulated in this study. Additionally, the design incorporated descriptive attributes to provide a detailed account of the existing conditions within the banks before applying inferential statistics. This was essential for contextualizing the variables and understanding their interaction in real-world banking environments.

Based on Agency Theory, illustrates the governance mechanisms that can influence the performance of development banks. Variables like Board of Directors, Audit Committee, CEO Duality, and Transparency and Disclosure were selected as independent variables due to their significant role in determining the effectiveness of corporate governance. These mechanisms interact with non-financial performance, which in turn influences the financial performance of development banks. Thus, the conceptual model explores the complex relationships between governance structures, non-financial metrics, and financial outcomes.

Figure 1: Conceptual Framework



Source: Adapted from Tyari (2018)

This research includes Agency Theory, Stewardship Theory, and Stakeholder Theory. Agency Theory, which examines the relationship between principals (shareholders) and agents (managers), is central to understanding how governance mechanisms mitigate agency problems in development banks. According to Tyari (2018), the core idea is that agency problems arise when there is a misalignment of interests between owners and managers. Effective governance mechanisms, as explored in this study, can mitigate these issues and enhance overall performance. On the other hand, Stewardship Theory emphasizes that managers act as stewards, prioritizing the long-term interests of the company and its shareholders. In the context of Nepalese development banks, where leadership roles are crucial, this theory emphasizes the importance of a well-functioning Board of Directors and Audit Committees in ensuring that the bank's strategies align with the interests of its stakeholders. Stakeholder Theory further strengthens the research by underscoring the significance of various stakeholders in the governance process. This theory suggests that development banks must address the interests of all stakeholders (e.g., customers, employees, and the government) to ensure long-term sustainability and optimal performance.

Hypothesis Development

The conceptual framework was designed based on the theoretical foundations discussed in Figure 1. It presents the relationships between the governance variables and their impact on the performance of Nepalese development banks. The independent variables Board of Directors (BOD), Audit Committee (AC), CEO Duality (CD), and Transparency and Disclosure (TD) are hypothesized to influence non-financial performance (NFP), which in turn impacts the overall financial performance (FP) of the banks. This research also explores the mediating role of NFP, which was expected to strengthen the relationship between governance variables and financial outcomes.

Table 1: Hypothesis Development

Hypothesis	Proposition
H1	The Board of Directors is positively correlated with non-financial performance.
H2	Audit Committee is positively related to Non-Financial Performance.
H3	CEO Duality is positively related to Non-Financial Performance
H4	Transparency and Disclosure are positively related to Non-Financial Performance.
H5	Non-financial performance is positively related to the Development Bank's Effectiveness (Financial Performance)
H6	Non-Financial performance mediates between the Board of Directors, Audit Committee,

(H1): Board of Directors (BOD) and Non-financial Performance (NFP)

The first hypothesis (H1) posits that the Board of Directors is positively related to non-financial performance. Agency Theory suggests that effective governance structures, such as the Board of Directors, play a crucial role in monitoring management and aligning their actions with the interests of shareholders. When the Board is effective, it should lead to better decision-making, higher employee morale, and more efficient operations, which are key aspects of non-financial performance. Non-financial performance measures, such as employee satisfaction, service quality, and operational efficiency, can ultimately influence a bank's long-term success. By ensuring that the governance structure is strong, the BOD can contribute significantly to improving the internal workings of the organization, which is expected to enhance non-financial outcomes like employee engagement and service delivery.

(H2): Audit Committee (AC) and Non-financial Performance (NFP)

The second hypothesis (H2) suggests that the Audit Committee is positively related to non-financial performance. The Audit Committee plays a pivotal role in overseeing financial reporting and ensuring that internal controls are in place. According to Agency Theory, a strong Audit Committee ensures compliance with legal and regulatory requirements, reducing information asymmetry between the management and stakeholders. This, in turn, boosts trust within the organization, enhances Transparency, and ultimately improves non-financial performance, including efficiency, employee satisfaction, and operational effectiveness. The oversight function provided by the Audit Committee is essential for fostering an organizational culture that values accountability and Transparency, both of which have a positive impact on non-financial outcomes.

(H3): CEO Duality and Non-financial Performance (NFP)

The third hypothesis (H3) examines whether CEO Duality, where the CEO also holds the position of Chairman of the Board, has a positive relationship with non-financial performance. According to Stewardship Theory, CEO duality may improve organizational performance because it allows for unified leadership and decision-making. In this context, a CEO who holds both positions can provide clearer direction, align organizational goals more effectively, and implement strategic decisions quickly. This may lead to improved employee satisfaction, enhanced service quality, and better operational performance. However, it is also essential to note that CEO Duality can be controversial in the context of governance, as it may weaken checks and balances. Despite this, Stewardship Theory suggests that CEO duality, in certain environments, can enhance performance by providing strong leadership and fostering a unified organizational vision.

(H4): Transparency and Disclosure (TD) and Non-financial Performance (NFP)

The fourth hypothesis (H4) posits that Transparency and Disclosure are positively related to non-financial performance. Stakeholder Theory emphasizes the importance of transparent communication with stakeholders to build trust and commitment. In the case of Nepalese development banks, Transparency in decision-making and clear Disclosure of financial and operational performance are essential for improving employee satisfaction and fostering a culture of trust. When employees feel informed and valued, their satisfaction and engagement levels increase, resulting in improved non-financial outcomes, such as enhanced service delivery and operational efficiency. Thus, increasing Transparency and ensuring that stakeholders have access to relevant information about the bank's operations can directly contribute to enhancing non-financial performance.

(H5): Non-financial Performance and Financial Performance

The fifth hypothesis (H5) focuses on the relationship between non-financial performance and financial performance. This hypothesis posits that non-financial performance (such as employee satisfaction, operational efficiency, and service quality) is positively related to financial performance. This idea is rooted in the belief that improving internal organizational outcomes leads to better financial results. For example, satisfied employees are more productive, resulting in enhanced operational efficiency and improved customer service, which ultimately contribute to higher profitability. Research by Griffin & Moorhead (2014) suggests that organizations with strong non-financial performance outcomes tend to perform better financially due to increased productivity and customer loyalty. Therefore, this hypothesis suggests that non-financial factors are crucial drivers of a bank's financial success.

(H6): Non-financial Performance as a Mediator

The sixth hypothesis (H6) posits that non-financial performance mediates the relationship between corporate governance mechanisms (Board of Directors, Audit Committee, Transparency, and CEO Duality) and financial performance. This hypothesis is grounded in the idea that while governance mechanisms directly influence financial outcomes, they also improve internal aspects such as employee morale and service quality. These improvements in non-financial performance serve as a pathway through which governance mechanisms exert their influence on financial performance. Therefore, non-financial performance is expected to mediate the relationship between governance structures and the overall financial performance of Nepalese development banks. This mediation hypothesis reflects the importance of non-financial factors as crucial links in the governance-performance relationship.

Study area and population

The study area for this research is Nepal, specifically focusing on Nepalese development banks. These banks, such as Muktinath Bikash Bank, Garima Bikash Bank, and Shangri-La Development Bank, play a crucial role in the nation's economic development, providing financial services to support infrastructure, agriculture, and small and medium-sized enterprises (SMEs). The study evaluates corporate governance practices within these banks, particularly focusing on the employee perspective. Employees provide valuable insights into the internal workings and governance structures of these institutions, making their experiences essential for the study. The population for this research consists of employees working within these banks, as their perceptions directly impact the effectiveness of governance mechanisms in these institutions. This population is particularly relevant since governance practices are often best understood by those involved in the daily operations and decision-making processes within the banks. (Parajuli, 2019)

Sampling design

The research employs a non-probability sampling technique, specifically convenience sampling, to select participants. This technique is suitable for exploratory studies where the focus is on gathering insights from specific groups, but the researcher does not have access to a complete sampling frame of the population. As Parajuli (2019) notes, convenience sampling is commonly used when time and resource constraints limit the ability to conduct probability sampling. By selecting participants based on their availability and willingness to participate, this method allows for a practical approach to gathering data from employees of Nepalese development banks. Despite its limitations, non-probability sampling is effective in obtaining relevant information from key stakeholders within the organization, particularly when focusing on subjective experiences and perceptions. As mentioned by Griffin & Moorhead (2014), this method is particularly useful for understanding how employees perceive governance structures and their influence on the overall performance of the organization.

The sample size for this study was determined using a formula based on statistical power and the desired level of precision. The formula (Singh & Masuku, 2014) used is as follows:

$$n = \frac{z^2 * p*q}{l^2}$$

Where:

- ► n = required sample size,
- ► z = standard tabulated value for a 5% level of significance (1.96),
- ► p = proportion of the event (0.5),
- ► q = 1 - p (0.5),
- ► l= allowable error (5%).

$$n = \frac{1.96^2 * 0.5 * 0.5}{0.5^2}$$
$$= 384.16$$

Non-response error 5%, 384.16 * 5%=19.21

This formula calculated the sample size as 384.16, but to account for potential non-responses, an additional 5% was added, resulting in a total sample size of 403.36. This was then adjusted to account for non-responses, resulting in a final sample size of 386 respondents. This sample size is considered adequate to ensure that the study has sufficient statistical power to detect significant effects and relationships. The sample size was based on guidelines from Parajuli (2019), This research adopted a quantitative approach utilizing primary data collected through a structured questionnaire survey administered to 386 employees working in various Nepalese development banks.

This large sample size ensures the reliability and generalizability of the findings. The survey was designed to capture employees' perceptions of corporate governance practices within banks, focusing on key aspects such as Transparency, accountability, and leadership effectiveness. The questionnaire was constructed based on established scales from previous studies and modified to suit the context of Nepalese banks.

Data Collection and Analysis Techniques

The study area for this research is Nepal, specifically focusing on Nepalese development banks. These banks, such as Muktinath Bikash Bank, Garima Bikash Bank, and Shangri-La Development Bank, play a crucial role in the nation's economic development, providing financial services to support infrastructure, agriculture, and small- and medium-sized enterprises (SMEs). The study evaluates corporate governance practices within these banks, particularly focusing on the employee perspective. Employees provide valuable insights into the internal workings and governance structures of these institutions, making their experiences essential for the study. The population for this research consists of employees working within these banks, as their perceptions directly impact the effectiveness of governance mechanisms in these institutions. This population is particularly relevant since governance practices are often best understood by those involved in the daily operations and decision-making processes within the banks. (Parajuli, 2019)

Convenience sampling was used for selecting the participants (Maharjan et al., 2022), and the survey was conducted using the Kobo Toolbox to facilitate data collection. The data gathered were then analysed using descriptive and inferential statistics. Descriptive analysis involved summarizing the key demographic characteristics of the respondents, such as gender, age, education, and job position level. This analysis provided valuable insights into the sample's composition and helped contextualize the findings.

Inferential analysis was conducted using Structural Equation Modeling (SEM) with SmartPLS 4.0 software. SEM is particularly useful for studying complex relationships involving multiple variables (Rajbhandari et al., 2022), as it can simultaneously assess direct and indirect effects. In this study, SEM was employed to examine the relationships between governance variables and non-financial performance, as well as the impact of non-financial performance on financial outcomes. Mediation analysis was also performed to determine whether non-financial performance plays a significant role in mediating the relationship between governance mechanisms and financial performance.

3. Results

Socio Demographic Characteristics

The respondent's profile reveals the personal characteristics of respondents combined on the basis of different personal characteristics, such as gender, age, education level, and their position in the organization. Demographic characteristics play a significant role in understanding the behaviour of the respondents. This section, therefore, describes the demographic characteristics of the respondents from various Nepalese development banks. Characteristics. Primary data from 386 participants were collected through a questionnaire survey, which is discussed in this chapter.

Table 2: Socio-Demographic Characteristics

Title	Category	Number	Percentage (%)
Gender	Male	213	55.18
	Female	173	44.82
Age	18-30	105	27.2
	30-40	180	46.63
	40-50	96	24.87
	50 and above	5	1.3
Education Level	Intermediate	13	3.37
	Bachelors	100	25.91
	Masters	257	66.58
	Above Masters	16	4.15
Position Level	Assistant Level	148	12.18
	Operating level	47	33.16
	Officer Level	128	38.34
	Manager or executive level	63	16.32
What do you know about CG (Corporate Governance)?	A set of laws, ordinances, and principles that specify how a business shall be run, governed, and managed.	53	13.73
	Transparency and Disclosure of Information.	18	4.66
	Protecting and promoting the rights of shareholders.	18	4.4
	Operate ethically, with integrity and in compliance with applicable laws and regulations.	26	6.74
	All of the above	312	80.83
Which types of CG (Corporate Governance) activities does your organization use?	Structure of the Board of Directors	36	9.33
	Risk Management	16	4.15
	Regulatory Compliance	21	5.44
	Internal Controls and Audit	25	6.48
	Stakeholder Engagement and Transparency	25	6.48
	All of the above	317	82.12

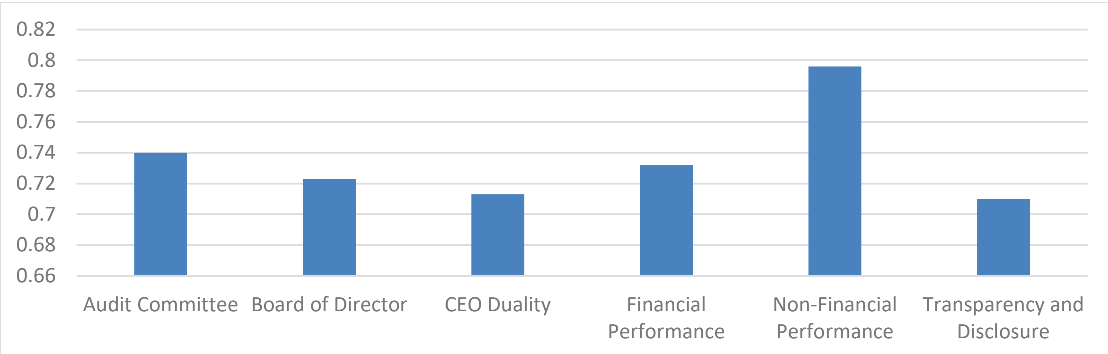
Employees' responses were collected using a five-point Likert scale, which ranged from "strongly disagree" to "strongly agree." The findings were then presented in tables, charts, and graphs to visually depict the data and highlight any significant trends. The descriptive part also includes a breakdown of the socio-demographic characteristics of the respondents. Many respondents were male (55.18%), with a predominant age group of 30-40 years (46.63%) and a high level of education at the Master's degree level (66.58%). The respondents' roles in the bank also varied, with the majority working at the officer level (38.34%). Furthermore, a significant percentage of respondents (80.83%) agreed with the definition of corporate governance that included principles such as Transparency, shareholder protection, and ethical operations.

The inferential analysis in this research employs Structural Equation Modeling (SEM) with SmartPLS 4.0 to test the hypotheses formulated in the study. The main objective of this analysis is to examine the relationships between corporate governance mechanisms, non-financial performance, and financial performance in Nepalese development banks. The analysis includes several stages: common method bias testing, measurement model evaluation, path analysis, and mediation analysis. These methods were employed to assess the strength and significance of the relationships between the variables in the model.

Common Method Bias

To ensure the validity of the results, a Full Collinearity Test was conducted to check for common method bias. This test measures the potential bias introduced when both the independent and dependent variables are measured using the same method, in this case, the questionnaire. According to Kock and Lynn (2012), the value of the Variance Inflation Factor (VIF) should be less than 3.3 or 5 for the data to be considered free from common method bias. In the present study, all VIF values were found to be below 5 (Lawaju et al., 2023), indicating that common method bias did not significantly affect the data, and the data were suitable for further analysis.

Fig 1: Common Method Bias



Measurement Model

Internal Consistency Reliability

Internal consistency reliability was assessed using Cronbach's Alpha (CA) and Composite Reliability (CR). For the model to demonstrate internal consistency, both measures should meet established thresholds. According to Bujang et al. (2018), Cronbach's Alpha should be greater than 0.7, and Composite Reliability values between 0.60 and 0.70 are considered acceptable (Lawaju et al., 2024). In this study, all reliability thresholds were met, indicating that the constructs were reliably measured.

Table 3: Internal Consistency Reliability

Construct	Cronbach's Alpha	Composite Reliability
Audit Committee	0.74	0.77
Board of Director	0.723	0.788
CEO Duality	0.713	0.778
Financial Performance	0.732	0.848
Non-Financial Performance	0.796	0.86
Transparency and Disclosure	0.71	0.821

Convergent Validity

Convergent validity measures the degree to which items within a construct are correlated. This is assessed by checking Average Variance Extracted (AVE). A construct is considered to have good convergent validity if the AVE value is greater than 0.50 (Dhakal et al., 2023), indicating that the indicators explain more than 50% of the variance in the construct. In this study, the AVE values for all constructs exceeded the threshold, indicating strong convergent validity across the measurement model.

Table 4: Convergent Validity

Constructs	Indicator	Outer Loading	Average variance extracted (AVE)
Audit Committee	ac2	0.649	0.528
	ac4	0.755	
	ac5	0.771	
Board of Directors	bd2	0.819	0.65
	bd4	0.794	
CEO Duality	cd2	0.734	0.539
	cd4	0.75	
	cd5	0.718	
Financial Performance	fp1	0.78	0.65
	fp4	0.816	
	fp5	0.822	
Non-Financial Performance	nfp1	0.757	0.552
	nfp2	0.81	
	nfp3	0.719	
	nfp4	0.74	
	nfp5	0.684	
Transparency and Disclosure	td1	0.731	0.535
	td2	0.715	
	td3	0.755	
	td5	0.723	

Discriminant Validity

Discriminant validity ensures that a construct is distinct from other constructs in the model. This is evaluated using the Fornell-Larcker criterion, where the square root of the AVE should be greater than the correlations between the construct and other constructs. Additionally, the Heterotrait-Monotrait ratio (HTMT) is used to check for discriminant validity. The study confirmed that both the Fornell-Larcker criterion and HTMT criteria were met, indicating good discriminant validity.

Table 5: Fornell-Larcker Criteria and HTMT Results

	Fornell-Larcker Criterion						HTMT Results					
	ac	bd	cd	fp	nfp	td	ac	bd	cd	fp	nfp	td
ac	0.73											
bd	0.33	0.806					0.68					
cd	0.45	0.386	0.73				0.81	0.751				
fp	0.52	0.328	0.39	0.81			0.78	0.565	0.603			
nfp	0.57	0.404	0.4	0.76	0.743		0.83	0.668	0.592	0.891		
td	0.55	0.395	0.46	0.65	0.679	0.731	0.86	0.691	0.712	0.895	0.899	

Goodness of Fit

The Goodness of Fit (GoF) index was used to assess the overall fit of the model. GoF combines both the measurement and structural models, providing a single value that reflects how well the model fits the data. In this study, a GoF value of greater than 0.36 was obtained, indicating a satisfactory fit for the model. This confirms that the model adequately explains the data and is suitable for testing the relationships between the constructs.

Structural Model

The study's presented hypotheses were tested by using a structural equation analysis. The primary objective is to specifically assess the model's capacity to explain and forecast changes in endogenous variables induced by exogenous factors. Furthermore, Hair et al. (2011) suggested R2 value of at least 0.20 to ensure a satisfactory model fit(R-Square)

The R-Square value represents the proportion of variance in the dependent variable that is explained by the independent variables. An R-Square value closer to 1 indicates that the model explains a higher proportion of variance in the dependent variable. In this study, the R-Square values for both Non-financial Performance and Financial Performance were found to be high, indicating that the model explains a substantial portion of the variance in these variables.

Table 6: R-Square

Indicators	R-Square	Adjusted R-Square
Fp	0.573	0.576
Nfp	0.528	0.538

The F-Square value is used to assess the effect size of the predictor variables on the dependent variables. An F-Square value greater than 0.35 indicates a large effect size. In this study, the F-Square values indicated that the Board of Directors, Audit Committee, and Transparency and Disclosure had a substantial effect on both Non-financial Performance and Financial Performance.

Table 7: F-square

	f-Square	Effect
ac ≥ nfp	0.085	Substantial effect
bd ≥ nfp	0.025	Negligible effect
cd ≥ nfp	0.001	Negligible effect
nfp ≥ fp	1.342	Substantial effect
td ≥ nfp	0.306	Moderate effect

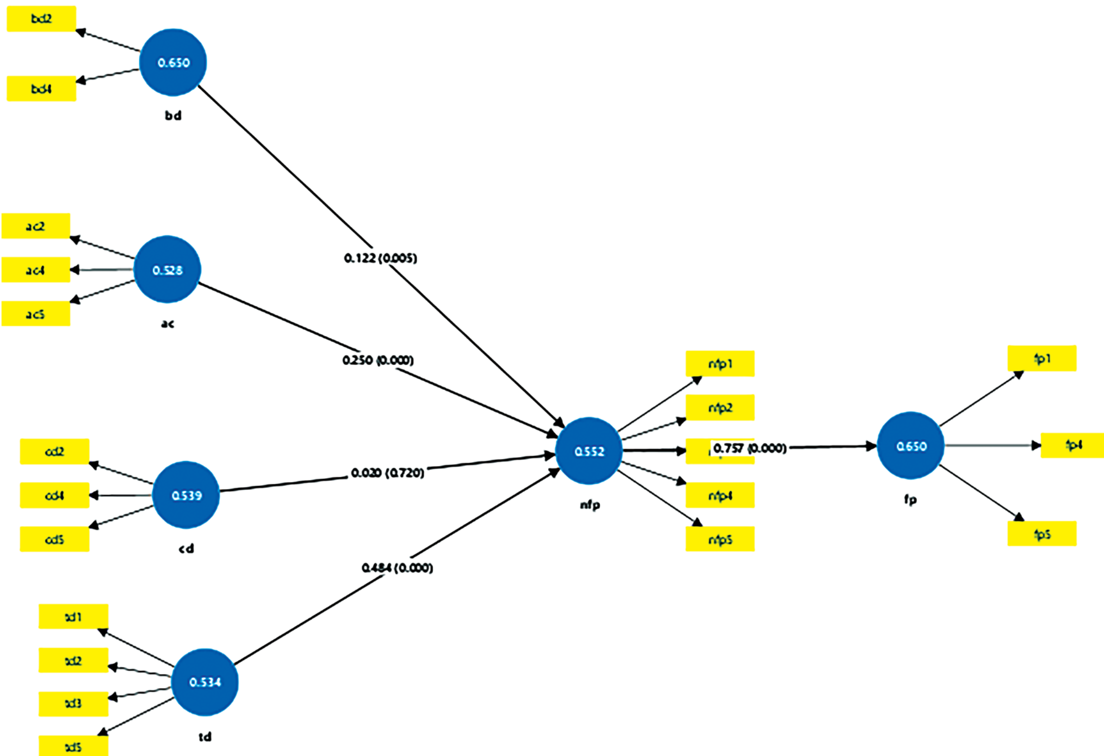
The Q-Squared (Q^2) value measures the predictive relevance of the model. A Q^2 value greater than 0 indicates that the model has predictive relevance. In this study, the Q^2 value was found to be positive, demonstrating that the model has good predictive relevance for both Non-financial Performance and Financial Performance.

Table 8: Predictive Power (Q^2)

	Q^2predict	RMSE	MAE
Fp	0.434	0.757	0.573
Nfp	0.509	0.704	0.551

Path analysis is used to test the direct relationships between the independent variables (governance mechanisms) and the dependent variables (performance). The path coefficients were estimated using Bootstrapping in Smart PLS 4.0, and their significance was tested with a 5,000 bootstrap resample. Path coefficients represent the strength of the relationships between the constructs. As shown in the results, the Board of Directors, Audit Committee, and Transparency and Disclosure all have significant path coefficients, indicating strong relationships with Non-financial Performance. However, CEO Duality was found to have an insignificant effect on Non-financial Performance.

Fig 2: Path Analysis



Hypothesis testing was performed to assess the significance of the relationships between corporate governance mechanisms and performance outcomes. Using bootstrapping in Smart PLS, the p-values for the hypotheses were calculated. The results confirmed that the Board of Directors, Audit Committees, and Transparency significantly influenced non-financial performance, which in turn positively impacted financial performance.

Table 9: Hypothesis Testing

Hypothesis		Beta	SD	t-value	P values	CL		Decision
						LL	UL	
H01	**ac ≥ nfp**	0.25	0.052	4.821	0	0.145	0.348	Supported
H02	**bd ≥ nfp**	0.122	0.044	2.779	0.005	0.039	0.211	Supported
H03	**cd ≥ nfp**	0.02	0.056	0.358	0.72	-0.082	0.137	Not Supported
H04	**nfp ≥ fp**	0.757	0.025	29.915	0	0.706	0.804	Supported
H05	**td ≥ nfp**	0.484	0.047	10.401	0	0.393	0.574	Supported

Mediation Analysis

The mediation analysis assesses the role of Non-financial Performance (NFP) in mediating the relationship between corporate governance mechanisms and financial performance. The analysis shows that NFP acts as a significant mediator, meaning that governance practices, such as the Board of Directors, Audit Committee, and Transparency and Disclosure, influence financial performance indirectly by first improving non-financial performance. This mediation effect reinforces the importance of focusing on internal organizational health, such as employee satisfaction and operational efficiency, to achieve better financial outcomes. This suggests that improving internal outcomes, such as employee satisfaction and operational efficiency, is essential for driving better financial results in Nepalese development banks.

Table 10: Mediation Analysis

	Beat	SD	t-Value	P values	CL		Decision
					LL	UL	
cd ≥ nfp ≥ fp	0.015	0.042	0.358	0.72	-0.07	0.097	Not Supported
td ≥ nfp ≥ fp	0.367	0.04	9.181	0	0.288	0.444	Supported
ac ≥ nfp ≥ fp	0.189	0.041	4.668	0	0.11	0.27	Supported
bd ≥ nfp ≥ fp	0.093	0.033	2.804	0.005	0.029	0.157	Supported

Robustness Check

A series of robustness procedures was undertaken to validate the stability, internal consistency, and reliability of the estimated structural relationships between corporate governance mechanisms and performance outcomes. These procedures encompassed tests for linearity, assessments of unobserved heterogeneity using the FIMIX-PLS approach, and endogeneity diagnostics employing the Gaussian Copula method.

The linearity assessment introduced quadratic terms into the PLS-SEM framework to evaluate whether the effects of Board of Directors, Audit Committee, CEO Duality, and Transparency and Disclosure followed a linear functional form. With the exception of CEO Duality, all quadratic terms were statistically insignificant, indicating that the hypothesized relationships are appropriately modeled using linear specifications. This finding supports the adequacy of the linear structural model for capturing governance performance linkages within the dataset. Unobserved heterogeneity was subsequently examined using the FIMIX-PLS technique, which identifies latent segments exhibiting distinct structural patterns. The analysis revealed two meaningful segments with differing path coefficients, a result further supported by multiple selection criteria (AIC, BIC, CAIC, HQ, EN, and NFI). The presence of such segments suggests that governance mechanisms may exert heterogeneous effects across subgroups, underscoring the need to account for latent class variation in studies involving complex organizational constructs.

Finally, the Gaussian Copula method was employed to detect and correct potential endogeneity, which may arise from omitted variables, measurement errors, or simultaneity. Across all models and governance constructs, the copula-based p-values exceeded the 0.05 threshold, indicating the absence of statistically significant endogeneity. This confirms that the estimated coefficients are not biased by unobserved dependencies between predictors and error terms. Collectively, these robustness checks affirm the empirical soundness of the model and provide strong support for the credibility and stability of the study's findings.

4. Discussion

This study examined how corporate governance mechanisms, including the Board of Directors (BOD), Audit Committee (AC), CEO Duality (CD), and Transparency & Disclosure (TD), shape the effectiveness of Nepalese development banks. We find that BOD, AC, and TD significantly enhance non-financial performance (NFP), and that NFP in turn predicts financial performance (FP), while CEO Duality is not significant. Below, we interpret these patterns, explain the mechanisms that plausibly operate in Nepal's context, and position the evidence relative to earlier work.

The positive BOD NFP/FP relationship is consistent with Agency Theory: active, competent boards reduce information asymmetry and curb managerial discretion through monitoring and strategy setting, which improves internal processes (screening, monitoring, and recovery) and ultimately financial outcomes

(Jensen & Meckling, 1976; Fama & Jensen,1983). In relationship-driven credit markets, such as Nepal, where soft information and collateral constraints are evident, constricted board oversight is likely to be directly reflected in day-to-day operational discipline as perceived by employees. This pattern aligns with broader evidence that stronger boards are associated with better performance and risk outcomes in emerging financial systems (Claessens & Fan, 2002) and resonates with Nepal-focused observations that governance quality matters for bank effectiveness (Sapkota, 2011).

The Audit Committee's significant effect indicates that second-line functions (audit committee, internal audit, and risk committees) reinforce process discipline over credit approval, provisioning, and compliance. In a setting of evolving prudential norms and IFRS-oriented provisioning, empowered Audit Committees can reduce the scope of earnings management and promote timely loss recognition mechanisms, which employees directly experience as improved service quality, process reliability, and learning routines. This is consistent with evidence that capable oversight bodies and internal controls yield more reliable reporting and sounder risk-taking (Klein, 2002; Fama & Jensen, 1983). Framed through Stewardship Theory, disciplined oversight also supports managers to pursue long-term institutional performance rather than short-term outcomes (Donaldson & Davis, 1991).

The positive Transparency and Disclosure related to non-financial performance or financial performance likely operates through two channels. First, better Disclosure lowers funding frictions by increasing the confidence of depositors and counterparties, which can reduce the cost of funds. Second, Transparency enhances internal discipline by exposing processes to external scrutiny, which in turn pressures timely provisioning and effective credit risk controls. These mechanisms align with findings that disclosure quality is associated with improved valuation/operational outcomes in banking and finance (Agoraki et al., 2010) and are consistent with Nepal-context discussions on disclosure and governance reforms (Parajuli, 2019).

The insignificance of CEO Duality contrasts with a strict Agency view yet is compatible with context-contingent interpretations. Two features of Nepal's development banks help explain this: (i) regulatory oversight and committee structures can constrain unilateral CEO influence, diluting any incremental effect of duality; and (ii) relational banking cultures and promoter-public ownership mixes may shift the locus of monitoring toward boards and committees, rendering formal role fusion less salient for NFP. This context dependence echoes comparative governance arguments about how structural features condition the performance effects of organizational design (Fiss, 2008; Maskey, 2004).

That non-financial performance facilitates governance, which in turn supports financial performance through a sequencing mechanism: governance first improves internal capabilities (process quality, service, learning & growth) and risk processes, which then materialize in lagged accounting returns (ROA/ROE). Methodologically, our SEM evidence for mediation is consistent with recommended practices for testing indirect effects and composite models in PLS-SEM (Henseler et al., 2015; Franke & Sarstedt, 2018; Du Prel et al., 2009; Hair et al., 2010). Substantively, this pattern explains why some studies observe stronger short-run links to operational proxies than to bottom-line metrics; internal improvements must accumulate before they are reflected in profitability.

Directionally, our estimates align with mainstream findings that board strength, audit effectiveness, and disclosure support performance. Effect sizes are comparable to, but in some cases smaller than, those reported in multi-country samples, primarily due to bank scale, market depth, and the transitional stage of prudential/disclosure regimes in Nepal (Claessens & Fan, 2002). By using employee-based measures, we triangulate market- and accounting-based studies and surface process-level mechanisms that external metrics may miss, particularly in areas such as credit discipline and customer-facing quality (Cangur & Ercan, 2015; Hair et al., 2010).

Two local dynamics likely amplify these patterns: (i) incremental tightening of prudential directives and disclosure codes has raised the salience of governance roles within development banks, and (ii) competition with commercial banks for deposits and skilled staff increases returns to credible governance signals. Together, these forces make effective boards, empowered audit/risk functions, and transparent reporting more consequential for the operational health that ultimately drives financial performance.

5. Conclusion and Policy Implications

This research underscores the critical role of corporate governance in enhancing the effectiveness of Nepalese development banks. By analyzing various governance mechanisms, such as the Board of Directors (BOD), Audit Committee (AC), CEO Duality (CD), and Transparency and Disclosure (TD), the study examines their influence on both non-financial and financial performance. The findings reveal that most governance mechanisms, particularly the BOD, AC, and TD, have a positive impact on non-financial outcomes like employee satisfaction and operational efficiency, which in turn contribute to improved financial performance. However, CEO Duality was found to be statistically insignificant, suggesting that unified leadership does not necessarily translate to better organizational performance in this context.

Contributing to the body of knowledge on corporate governance, this study addresses a notable gap by focusing on the employee perspective within the Nepalese development banking sector. While prior research has largely concentrated on the perspectives of shareholders or management, this study offers insights from those who directly experience governance practices at the operational level. By emphasizing the importance of strong governance structures, such as Board oversight and Audit Committees, the study provides valuable guidance for both policymakers and bank management to enhance internal governance practices. The research demonstrates that well-functioning governance mechanisms have a positive impact on non-financial performance, ultimately influencing the bank's financial success.

In conclusion, the study emphasizes that corporate governance is crucial in driving long-term performance and stability in Nepalese development banks. The findings advocate for strengthening governance regulations and offering training to board members and audit committees, ensuring they are equipped to improve the internal workings of these institutions. Banks should also focus on adopting employee-cantered strategies, recognizing non-financial performance as a key driver of financial sustainability. Finally, the study recommends that future research examine CEO Duality in different settings and explore how governance practices in other sectors, such as commercial banking and insurance, influence performance outcomes.

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