Journal of Corporate Finance Management and Banking System
ISSN: 2799-1059
Vol : 03 , No. 02 , Feb-Mar 2023
http://journal.hmjournals.com/index.php/JCFMBS
DOI: https://doi.org/10.55529/jcfmbs.32.1.8

Impact of Corporate Board Size on Firm Performance: Evidence from the Nepalese Banks

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Received: 20 October 2022 **Accepted:** 04 January 2023 **Published:** 02 February 2023

Abstract: The purpose of this study is to determine the impact of corporate board size on the firm performance of Nepalese commercial banks. This study examines the banks that have directors less than seven on the board and directors equal to or more than 7 on the board, based on 8 years of data taken from the year 2013 to 2020. The study includes 27 banks as sample banks. The firm performance is measured by the Return on equity (ROE) and Return on assets (ROA). Corporate board size and firm performance are measured by using the Independent Sample t-test. The finding of the study shows that banks have less than seven directors on the board and banks have equal to or more than seven directors on the board have not found a significant impact on the firm performance of the commercial banks in Nepal.

Keywords: Board Size, Firm Performance, Return on Equity, Return on Assets.

1. INTRODUCTION

Corporate Governance is the set of rules, practices, as well as processes that are managed and controlled by a company (Wilathgamuwa, 2018). It is also the major area of academic research in industrialized and developing countries around the world (Nazar, 2012). Thus, today's business environment, there is more competition. It is now more important than ever to ensure that corporate governance succaessfully safeguards the interests of shareholders. The concept of corporate governance is how suppliers supply the money to the company and ensure that they will receive a return on investment. The word "corporate governance" mainly refers to protections that help small investors avoid being usurped by managers and powerful stockholders. (Shleifer and Vishny, 1996; La Porta et al, 1999). A substantial quantity of corporate governance literature covers the effectiveness of boards of directors.
The size of the board is an important aspect of corporate governance. According to the agency theory, lower board sizes may be associated with better corporate financial performance. A smaller board size is less difficult for coordination and communication issues. Additionally, due to the issue of the span of control, smaller boards are likely more successful at monitoring

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management's activities than larger boards because they are harder for the CEO to influence. As a result, smaller boards may result in greater financial performance for the company. (Lipton and Lorsch, 1992; Jensen, 1993). While the resource dependence approach is in favor of large boards, the agency theory places a major emphasis on the value of smaller boards. On the other side, the resource dependence theory proposed that larger boards with more directors are good in minimizing reliance on external resources because they may offer more opportunity for environmental links than smaller boards. (Pfeffer and Salancik, 1978)
Corporate board members play a vital role in the firm's corporate governance, and understanding this relationship is crucial to our understanding of corporate governance. (Guest, 2009). Advising and monitoring are the two main roles of directors (Raheja, 2005). The advising role entails giving the CEO knowledgeable advice. (Fama and Jensen, 1983). The board of directors' second role is to appoint the CEO. (Chief Executive Officer) and other top executives, assess their performance and make sure that management adhere to for shareholders' interests (Hermalin and Weisbach, 1998). If an executive's performance is below standard, they are replaced.
The performance demonstrates how well an organization uses its resources to achieve its goals. (Daft, 1997), it is also an important part of evaluating the overall success of the company (Parker, 2000). Most firms' performance indicators start with financial performance measures. (Bloxham, 2002). ROA and ROE are better indicators of corporate financial performance.(Stern et al, 2004). The banking sector of Nepal has very special and plays an essential role in the achievement of the continuous economic growth of the nation. It comprises Licensed Commercial Banks, which dominate the financial system and account for the highest capital utilization in the financial system. Banks are offering payment services, making it easier for all companies to conduct their financial transactions. (Wilathgamuwa, 2018). This study aims to determine the relationship between the corporate board size and the performance of the banks. This article follows the following sections: section 2 explains the review of the literature on board size and company performance. Section 3 includes the formation of the hypothesis. Section 4 describes the methodology used to evaluate the major hypothesis supported by the model and data. Section 5 explains the results and findings. Section 6 concludes the study.

Literature Reviews

Agency Theory

In order to manage the company, shareholders appoint directors, who are also required to operate in their best interests. During the period, managers acted in accordance with their own interests because there was no affiliation between the company's shareholders and managers, and this created conflicts of interest. Given that circumstance, independent board members can lower this risk by overseeing and managing the managers' section. (Alqatan, Chbib, and Hussainey, 2019). Arosa, Iturralde, and Maseda, (2013) show that an adequate monitoring system is required to protect shareholders from the self-interest of the managers. So a high proportion of outside directors favorable to the organizations to monitor the actions of managers. Other than that, agency relation is defined as a contract between owners and managers. According to these contracts, owners delegate their decision-making power to the managers of the firm. As a result, the division between ownership and management is created,

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and it leads to a conflict of interest and agency problems. Both parties try to maximize their own benefits. The researcher suggested that the behavior of the directors is the best way to reduce the agency problem within the company.

Resource Dependency Theory

Suganya and Kengatharan (2017) emphasized that a board of directors is more than just its members; they are also a company's capital. Directors provide organizations with resources such as information, skills, and knowledge as well as access to crucial organizational components. It aids in maximizing the firm's worth. So, the firms should attract external directors with knowledge in different areas. According to this resource dependency theory, Anis et al., (2017) explained how the board is a crucial link between the company and outside resources that is necessary to improve the organization's performance and presentation. The role of the resource dependency theory is to provide valuable external resources to enterprises. So the large and well-diversified leads to giving valuable links to external resources the organizations (Erik Meyer, 2013). Resource dependency theory describes how external resources affect organizational behavior. Organization and Resources are linked by the Board of directors. Different types of directors provide different benefits to the firms and more diverse board provides more valuable resources to the organization (Abeysirigunawardana, 2018)

Board Size and Firm Performance

Jensen (1993) argues that "Keeping boards small can improve their performance. When boards get beyond seven or eight people they are less likely to function effectively and easier for CEO to control." Similarly, Lipton and Lorsch (1992) state "when a board has more than ten members it becomes more difficult for them all to express their ideas and opinions." and add that the overcrowding on American corporate boards results in financial losses for shareholders, job losses for staff, and a decline in the corporation's ability to compete on the global stage. According to Lipton and Lorsch (1992), boards should only include seven or eight members. They also support the idea of smaller boards. The argument used against large boards is that it is more difficult and expensive for a large number of individuals to communicate, coordinate, and make decisions than it is for a smaller group. Somathilake, (2005) & Hewathenna, Haleem, and Jamaldeen, (2015) found that there is a direct and negative correlation between board size and firm performance.
According to Gafoor, Mariappan, and Thyagarajan (2018), boards of Indian banks with a size between 6 and 9 have a significantly positive link with company performance. The size of the board is a factor in how much it monitors and advises management on various matters, and it also contributes to the bank's decision-making competency. However, boards larger than 9 become inconsequential in terms of a company's success.
Majeed et al., (2020) investigated the board size and directors' composition related to the financial performance of Pakistani and Chinese commercial banks, covering the period of 2009 to 2018. Based on the results of a panel regression model, there is no significant association between the size of Pakistani commercial banks' boards of directors and their financial performance. However, a significant and positive correlation was found to exist between the number of directors on a board and the financial performance of Chinese commercial banks.

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Kaymak and Bektas (2008) and Bektas and Kaymak (2009) found that the relationship between board size and the performance of the bank is non-significant, by working under the BIST data set 12 banks are used, The findings suggest a negative correlation between board size and bank profitability. Dogan and Yildiz (2013) uncover the impact size of the board on a firm's financial performance by selecting data from 2005 to 2010 and 2006 to 2008 respectively.

Hypothesis

H_1: There is a significant difference in firms' performance with directors less than seven on the board and directors equal to or more than seven on the board.

2. METHODOLOGY

Altogether, there are 27 commercial banks are operating in Nepal, and all the banks were taken as sample banks for the study which has been listed on the Nepal Stock Exchange from the year 2013 to 2020 period. An independent sample t-test was conducted to determine the impact of corporate board size and bank performance. The study focused on the directors less than seven on the board and equal to or more than seven on the board of the commercial banks. Bank performance such as ROE and ROA two financial measures were used for this study. An Independent sample t-test was used to determine the impact of the no. of directors on the board and bank performance of Nepalese commercial banks.

3. RESULTS AND FINDINGS

Table1.1 Descriptive statistics of ROE and ROA by grouping variables (No. of directors on the board)

Descriptive Statistics						
No. of directors participated in a board		N	Mean	Std. Deviation	Std. Error Mean
ROE	Directors less than seven in a board	8	13.9550	3.23503	1.14376
	Directors equal to or more than seven in a board	19	15.4663	5.48072	1.25736
ROA	Directors less than seven in a board	8	1.5913	0.85119	0.30094
	Directors equal to or more than seven in a board	19	1.5937	0.34761	0.07975

Table 1.2 Independent Samples t-test results

Independent Samples Test								
	Levene's Test for Equality of Variances		t-test for Equality of Means					
	F	Sig.	t	df	Sig. (2-		Std. Error	95% Confidence

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						tailed)	Mean Difference	Difference	Interval of the Difference	
									Lower	Upper
ROE	Equal variances assumed	0.494	0.488	-0.724	25	0.476	-1.51132	2.08860	-5.81287	2.79024
	Equal variances not assumed			-0.889	21.775	0.384	-1.51132	1.69975	-5.03849	2.01586
ROA	Equal variances assumed	3.621	0.069	-0.011	25	0.992	-0.00243	0.22691	-0.46977	0.46490
	Equal variances not assumed			-0.008	8.002	0.994	-0.00243	0.31133	-0.72032	0.71546

Table 1.1 shows the descriptive measures of ROE and ROA by a grouping variable (No. of directors participated in a board). Altogether, there are 27 commercial banks operating in a country Out of 27 banks, 8 banks have less than 7 directors on the board and 19 banks have equal to or more than 7 directors on the board. The mean ROE of the banks that have less than 7 directors participating on the board is 13.9550 (SD 3.23503) and banks that have equal to or more than 7 directors participating on the board is 15.4663 (SD 5.48072). Likewise, the mean ROA of the that have less than 7 directors participating on the board is 1.5913 (SD 0.85119) and banks that have equal or more than 7 directors participating on the board is 1.5937 (SD 1.5937)

Table 1.2 shows the independent sample t-test result. The first portion of the table indicates Levene's test results. This test is done to understand if the variances of ROE and ROA in the two categories of no. of directors participated on the board (directors less than 7 on the board and directors equal to or more than 7 on the boards) are homogeneous (equal) or not. Here, the p-value (Sig.) of Levene's test, is 0.488. Since the p-value is > 0.05, it indicates the variances of ROE of banks that have directors less than 7 on the board and directors equal or more than 7 on the board are equal. Therefore, Levene's test p-value is >0.05, so the study considered the t-test results of "Equal Variances assumed". An independent-samples t-test was conducted to compare the bank performance (ROE) of banks that have directors less than 7 on the board and directors equal to or more than 7 on the board. Based on the results, there were no significant

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differences (t (25) = -0.724, p = 0.476) in scores for banks that have less than 7 participated on the board (M = 13.9550, SD = 3.23503) and a banks that have equal to or more than 7 directors participated on the board (M = 15.4663, SD = 5.48072). The magnitude of the differences in the means (mean difference = -1.51132, 95% CI: - 5.81287 to 2.79024) was very small. Hence, the alternative hypothesis is rejected and the null hypothesis is accepted. Therefore, the mean ROE of directors less than 7 on the board and directors equal to or more than 7 on the boards is not different (p = 0.476)

Similarly, the p-value (Sig.) of Levene's test, is 0.069. Since the p-value is > 0.05, it indicates the variances of ROA of banks that have directors less than 7 on the board and directors equal or more than 7 on the boards are equal. Therefore, Levene's test p-value is >0.05, so the study considered the t-test results of "Equal Variances assumed". An independent-samples t-test was conducted to compare the bank performance (ROA) for banks that have directors less than 7 on the board and directors equal to or more than 7 on the boards are equal. There were no significant differences (t (25) = - 0.011, p = 0.992) in scores for banks that have directors less than 7 on the board (M = 1.5913, SD = 0.85119) and banks that have equal to or more than 7 directors on the board (M = 1.5937, SD = 0.34761). The magnitude of the differences in the means (mean difference = -0.00243, 95% CI: - 0.46977 to 0.46490) was very small. Hence, the alternative hypothesis is rejected and the null hypothesis is accepted. Therefore, the mean ROA of directors less than 7 on the board and directors equal to or more than 7 on the boards is not different (p = 0.992)

4. CONCLUSIONS

This study offers new insights into the relationship between no. of directors on the board (directors less than seven on the board and directors equal to or more than seven on the board) and firm performance. Altogether, 27 commercial banks are operating in the nation, and all the banks were taken as sample banks for the study. The 8 years of data were taken from the year 2013 to 2020. This study concludes that banks have directors less than seven on the board and directors equal to or more than seven on the board did not play a significant role in the firm performance. This result is similar to Majeed et al.,(2020), reported no significant association was found between board size and the financial performance of Pakistani commercial banks. Therefore, the policy of adding more no. of directors to the board did not enhance the significant financial performance of the banks. Thus, this study recommended not adding more directors to the board which increases the cost to the bank.

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