

Review Article

Impact of Corporate Governance on Financial Performance of Nepalese Insurance Company

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Abstract - This study examines the impact of corporate governance on the performance of Nepalese insurance companies. Return on assets and return on equity are the dependent variables. The independent variable is board size, independent directors, female directors, board meetings, and higher shareholders percentage. This study is based on secondary data collected from 20 insurance companies operated in Nepal from 2012/13 to 2016/17 lending to 105 observations. The data were collected from annual reports of selected insurance companies. The regression models are estimated to test the significance and impact of corporate governance and firm performance on other insurance-specific variables on Nepalese insurance companies' performance.

The study reveals that board size is positively related to return on assets. It shows that the larger the board size, the higher would be the return on assets. Similarly, the number of the board meeting is positively correlated to return on assets. The result shows that return on assets is positively correlated to the number of female directors in the board, which indicates that the number of female directors on the board leads to an increase in return on assets. Likewise, there is a negative relationship between the percentage of higher shareholders and return on assets, which indicates that the increase in the percentage of higher shareholders leads to a decrease in assets return.

Similarly, the study shows that board size is positively related to return on equity. It shows that the larger the board size higher would be the return on equity. Similarly, the number of board meetings is positively correlated to numbers to return on equity. It indicates that an increase in the number of board meetings leads to an increase in equity return. The result shows that return on equity is positively correlated to the number of female directors on the board, which indicates that an increase in the number of female directors on the board leads to an increase in equity. Likewise, the percentage of higher shareholders is positively correlated to return on equity, which indicates that the increase in the percentage of higher shareholders leads to an increase in equity return. The regression results show that the beta coefficients for board size and leverage are positive with return on assets. However, the beta coefficients for the number of board meetings are positive with return on assets. The result also shows that

the beta coefficients for board size and the number of independent directors are negative with return on Equity in Nepalese insurance companies.

Keywords - Return on Assets, Return on Equity, Board size, female directors, independent directors, percentage of higher shareholders, leverage.

I. INTRODUCTION

Corporate governance is the mechanisms, processes, and relations by which corporations are controlled and directed. Governance structures and principles identify the distribution of rights and responsibilities among different corporation participants (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and include the rules and procedures for making decisions in corporate affairs. Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory, and market environment. Governance mechanisms include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders.

II. REVIEW OF LITERATURE

Corporate governance is essential in every corporate body to ensure smooth operations of the firms. It ensures transparency of the firms' day-to-day activities to build up the firm's stakeholders' confidence. The study found that the insurance firms use a similar corporate governance structure in their firms, which is normally a top-bottom approach headed by the board of directors, followed by the chief executive officer, the managing director, and other senior executives such as deputy directors for the various operations of the firms (Yensu et al., 2017)

According to Najjar (2012), the corporate governance mechanisms intend to induce managers to act according to the best interest of the shareholders, which is by maximizing the good and bad corporate governance that, is a crucial step in building the market's confidence and attracting positive investment flows to the institution and the economy board size, firm size, number of blockholders found to have a statistically significant impact on firm's performance in the insurance industry expressed by the dependent variable - return on equity.



Kingsley and Theophilus (2012) argued that corporate governance has a positive impact on firm performance. The factors of board size, board and management skill, CEO tenure, size and independence of audit committee, foreign and institutional ownership, dividend policy, and annual general meeting all have a positive correlation with the insurance companies' performance. The findings showed that the insurance companies must have the right board size, which is highly independent of the Company's Management and with the appropriate skills. This would ensure that the board is well-diversified and can give the company's strategic direction. Demeke (2016) found that board characteristics and board size is also identified to have a significant negative correlation with firm performance. This study showed that outside directors and board size support stewardship theory, which argued that managers are stewards and being monitored by outsiders and large group is unnecessary. However, more frequent board meetings lead to higher firm performance for better communication between Management and directors, enhancing firm performance.

Tornyeva and Wereko (2012) explained that adopting good corporate governance enhances the transparency of the company's operations, ensures accountability, and improves the firm's performance. The study also helps protect the shareholders' interests by aligning their interests with that of the managers. Hence, the relationship between corporate governance and the performance of insurance companies. The results showed that, generally, corporate governance has a positive impact on firm performance. The factors of board size, board and management skill, CEO tenure, size and independence of audit committee, foreign and institutional ownership, dividend policy, and annual general meeting all have a positive correlation with the insurance companies' performance. Buallay et al. (2017) showed no significant impact on corporate governance adoption on the firm's operational performance in the listed companies in the Saudi stock exchange. After testing the effect of control variables on the firm's operational performance we found that negative and insignificant relationship between the firm size and board size. The ROE model results showed no significant impact on corporate governance adoption on the firm's financial performance in the listed companies in the Saudi stock exchange. After testing the effect of control variables on a firm's financial performance, the study found a positive and insignificant relationship with the firm size, negative and insignificant relationship with the firm size board size.

III. RESEARCH METHODOLOGY

The study is based on secondary data, which were gathered from 20 Nepalese insurance companies with 103 observations for 2012/13 to 2016/17. The main sources of data are collected from the annual report published in an insurance company.

Table 1. List of Insurance Companies selected for the study along with study period and number of observations

S.N.	Name of the Insurance Company	Study Period	Observation
1	Prime life Insurance Limited	2012/13-2016/17	5
2	Nepal life Insurance Limited	2012/13-2016/17	5
3	National life Limited	2012/13-2016/17	5
4	Life Insurance Cooperation Limited	2012/13-2016/17	5
5	Surya Life insurance Limited	2012/13-2016/17	5
6	Asian Life Insurance Limited	2012/13-2016/17	5
7	Met life insurance Limited	2012/13-2016/17	5
8	Gurans Life Insurance Limited	2012/13-2016/17	5
9	Everest General Insurance Limited	2012/13-2016/17	5
10	Siddhartha General Insurance Limited	2012/13-2016/17	5
11	Himalayan General Insurance Limited	2012/13-2016/17	5
12	IME General Insurance Limited	2009/10-2016/17	8
13	Sagarmatha General Insurance Limited	2012/13-2016/17	5
14	United General Insurance Limited	2012/13-2016/17	5
15	Nepal Insurance Company Limited	2012/13-2015/16	4
16	NLG Insurance Company Limited	2011/12-2016/17	6
17	Lumbani General Insurance Limited	2012/13-2016/17	5
18	NecoInsurance Limited	2012/13-2016/17	5
19	Premier Insurance Company Limited	2012/13-2016/17	5
20	ShikharInsurance Limited	2012/13-2016/17	5
Total number of observations			103

The model

The model estimate in the study assumes that the impact of corporate governance on firm performance. Governance indices have been constructed for Europe and the United Kingdom, Germany, Russia, Korea, the United States, and several emerging markets. They are used to illustrate the relation between corporate governance and performance. (Black et al., 2006). Mostly, these researches are significantly positive in this study, a research framework is presented in the regression model

$$ROA = \alpha + \beta_1 BS + \beta_2 ID + \beta_3 FD + \beta_4 BM + \beta_5 HS + \beta_6 L + \beta_7 FS + e$$

$$ROE = \alpha + \beta_1 BS + \beta_2 ID + \beta_3 FD + \beta_4 BM + \beta_5 HS + \beta_6 L + \beta_7 FS + e$$

Where,

BS = The total number of directors on the board.

ID = The total number of directors on the board.

FD=The number of female directors on board.

BM= Annually board meeting in a year.

HS= Higher percentage of share held by an individual.

ROA= Return on Assets means net income divided by total assets and multiple by percentage.

ROE= Return on Equity net income divided by total equity and multiple by percentage.

FS = Total premium collected in the year.

L= Total current debt divided by total equity and multiple by percentage.

The following section describes the independent variables used in this study.

Board Size (BS)

This board size determines the number of directors aboard. The study found that to restore investor confidence in any firm, and the board should increase its independence and competence. Demeke (2016) revealed a negative association between board size and firm performance. Larger companies require a greater number of directors to monitor and control a firm's activities (Yermack, 1996). Similarly, Wu (2003) suggested board size is positively associated with firm performance, and larger boards provide a host of advantages. Likewise, Make and Kusandi, (2005) suggest a negative relationship between firm size and performance. Singh and Davison (2003) argued that smaller board members are better able to make timely decisions than large boards. Based on this statement mention above, the study purpose the following hypotheses.

H₁: There is a negative relationship between board size and performance.

Independent Director (ID)

An independent director is a non-executive director of a company and helps the company improve corporate credibility and governance standards. Mohamma and Fadzil (2018) suggest a positive relationship between the board's independence and firm financial performance. Zeng (2018) found a positive impact between independent directors and the performance of china Companies. Similarly, the study showed a negative relationship between the degree of board independence and better financial performance (Najjar, 2012). Similarly, Fuzi et al. (2012), the study on companies listed on the New Zealand

Stock Exchange from 2007-2011, showed a significant negative association between the number of non-executive directors and firm performance. Likewise, Shekh et al. (2013). . based on this statement mention above, the study purpose the following hypotheses.

H₂: There is a negative relationship between independent directors and performance.

Female Director (FD)

The presence of women on board's size. Board gender diversity is a significant aspect of corporate governance. Cater et al. (2003) found that women directors consider a spectrum of stakeholders before deciding. Garcia et al. (2015) revealed that women's presence on the boards of banks improves their governance, which causes the bank to be more profitable. (Gulamhussen & Santa, 2015) , have proven that a female director is positively significant to a firm's performance. (Zhang, 2013), concluded that the female board of directors positively affects corporate performance by data from 973 listed companies. (Lückerath, 2013) There is no statistically significant, positive relationship between top female managers and company performance (Lückerath, 2013). Based on this statement mention above, the study purpose the following hypotheses.

H₃: There is a positive relationship between female directors and performance.

Board Meeting (BM)

Board Meeting refers to the meeting of directors of the company. Researchers found that the frequency of board meeting is related to better firm performance with inconsistent results finding a positive relationship between the frequency of board meetings and corporate performance Demeke, (2016). Higher frequency of board meetings can result in a higher quality of managerial monitoring and positively impact corporate financial performance (Ntim, 2009). Similarly, frequent meetings intermingled with informal sideline interactions can create and strengthen cohesive bonds among directors (Lipton & Lorsch, 1992), and there was a positive impact on corporate performance. Mohamman and Fadzil (2018) found a positive relationship between the frequency of board meetings and firm financial performance. Based on this statement mention above, the study purpose the following hypotheses.

H₄: There is a positive relationship between board meetings and performance.

Percentage of Higher Shareholders (HS)

Higher Share Concentration is measured as a percentage of shares owned by the largest investor. As that anticipates it, ownership will be less concentrated in free economies because these economies create conditions that are more likely to encourage participation in firm ownership. Javid and Iqbal (2008) focus on ownership positively affecting firms' profitability and performance measures. Similarly, Alba et al. (1998) study showed that

ownership concentration is positive and significant to profitability. Likewise, XU and Wong (1993) found a significant positive correlation between ownership concentration and firm performance. Based on this statement mention above, the study purpose the following hypotheses.

H₅: There is a positive relationship between % of higher shareholder and profitability.

Table 2. Descriptive statistics

	Minimum	Maximum	Mean	Std. Deviation
BS	4	12	7.39	1.78
ID	0	2	0.79	0.51
FD	0	3	0.29	0.61
BM	7	38	18.71	6.69
HS	4.51	55	22.38	15.39
ROA	0.01	17.32	3.02	3.38
ROE	0.01	35.15	7.19	8.35
L	0.07	93.79	28.89	22.04
FS	38	7090	1304	1282

This table shows the descriptive statistics of dependent and independent variables of Insurance Company for the study period of 2012/13 to 2016/17. The dependent variables are ROA (Return on assets is the ratio of net income divided by total assets, in percentage) and ROE (Return on Equity is the net income ratio divided by total net worth Equity, in percentage). The independent variables are BS (Board size defined as the number of director in the board ratio), ID (Independent director is the

number of non-executive director of a company and helps the company in improving corporate credibility), FD (Female Director is the number of female director inboard), BM (Board meeting is defined as the total number of the meeting conducted in a year). HS (Higher percentage of share held by an individual).

Correlation analysis

It shows the correlation coefficients of dependent and independent variables for selected Nepalese Insurance companies.

Table 3. Pearson's correlation coefficients matrix

Variable	ROA	ROE	BS	ID	FD	BM	HS	L	FS
ROA	1								
ROE	0.855**	1							
BS	0.80	0.101	1						
ID	0.232*	0.155	0.160	1					
FD	-0.072	-0.075	0.040	0.164	1				
BM	-0.107	-0.093	-0.073	-0.159	-0.091	1			
HS	0.167	0.198*	0.048	-0.093	-0.107	0.057	1		
L	0.177	0.307**	-0.121	-0.249*	-0.177	0.001	-0.089	1	
FS	0.297**	-0.323**	0.097	0.023	0.262**	-0.045	0.135	-0.447**	1

Notes: The asterisk signs (**) and (*) indicate that the results are significant at 1 percent and 5 percent level, respectively

This table shows the bivariate Pearson's correlation coefficients between the selected insurance company variables for the study period of 2012/13 to 2016/17. The dependent variables are ROA (Return on assets ratio of net income divided by total assets, in percentage) and ROE (Return on Equity is the net income ratio divided by total equity, in percentage). The independent variables are BS (Board size defined as the number of director in the board ratio), ID (Independent director is the number of non-executive director of a company and helps the company in improving corporate credibility), FD (Female Director is the number of female director in the board), BM(Board

meeting is defined as the total number of the meeting conducted in a year)HS (Higher percentage of share held by an individual).

The result shows that board size has a positive relationship with the return on assets and equity return. The result shows that independent directors positively correlate with the return on assets and return on equity. However, the female director has a negative relationship with return on assets and return on equity. The result also shows that the boarding meeting has a negative relationship with return on assets and equity return.

Similarly, leverage has a positive relationship between return on assets and return on equity.

The result also reveals that board size, independent director, a higher percentage of share, and leverage have a positive relationship between return on equity and return on assets. The female directors and board meetings have a negative relationship between return on equity and return on assets. The firm size positive relationship with return and assets and a negative relationship with return on equity. Similarly, the board size, independent director, higher percentage of share, and leverage have led to an increase in productivity. However, female directors and board meetings have decreased the productivity of the insurance company.

Regression Analysis

Having indicated the Pearson correlation coefficients, the regression analysis has been carried out, and the results are presented. More specifically, the table shows the regression results of Board size, Independent director, Female director, Board meeting, Percentage of highest shareholder, Leverage, and Firm size on return on assets for Nepalese Insurance Company.

Table 4. Estimated regression results of Board size, Independent director, Female director, Board meeting, Percentage of highest shareholder, Leverage, and Firm size on ROA.

Model	Intercept	Regression coefficient of							Adj. R_bar ²	SEE	F-value
		BS	ID	FD	BM	HS	L	FS			
1	1.86 -1.25	0.16 (0.08)							0.006	3.4	0.65
2	1.81 (2.99)**		1.53 (2.39)**						0.04	3.3	5.71
3	3.14 (8.41)**			-0.4 -0.7					0.005	3.4	0.52
4	4.04 (4.04)**				-0.05 (1.08)				0.002	3.4	1.16
5	2.21 (3.75)**					0.04 (1.69)			0.018	3.4	2.85
6	2.27 -1.26						0.026 (1.80)		0.022	3.4	3.24
7	23.73 (3.75)**							-1.008 (3.28)**	0.088	3.2	10.74
8	19.93 (2.88)**		1.934 (3.11)**				0.019 -1.27	-0.92 (2.88)**	0.155	3.1	7.19
9	24.85 (3.73)**	0.32 -1.66		0.27 -0.5				-1.18 (3.52)**	0.096	3.2	4.91
10	-0.93 -0.96		2.12 (3.34)**			0.049 (2.36)*	0.04 (2.88)**		0.135	3.2	6.26
11	-0.52 -0.32	0.13 -0.68	1.88 (2.89)**				0.04 (2.61)**		0.09	3.2	4.33
12	1.07 -0.83		1.87 (2.86)**		-0.04 -0.65		0.04 (2.53)*		0.09	3.2	4.32
13	25.41 (3.76)**			0.17 -0.3	-0.05 -1.11			-1.04 (3.17)**	0.082	3.3	4.02

The results are based on panel data of 20 Insurance companies with 105 observations for the period of 2066 to 2074 by using the linear regression model. The model is $ROA = \beta_0 + \beta_1 BS + \beta_2 ID + \beta_3 FD + \beta_4 BM + \beta_5 HS + \beta_6 L + \beta_7 FS + e$, where the dependent variable is ROA (Return on assets is the ratio of net income divided by total assets, in percentage). The independent variables are BS (Board size defined as the number of director in the board ratio), ID (Independent director is the number of non-executive director of a company and helps the company in improving corporate credibility), FD (Female Director is the number of female director inboard), BM (Board meeting is defined as the total number of the meeting conducted in a year) HS (Higher percentage of share held by an individual).

Notes:

- Figures in parentheses are t-values.
- The asterisk signs (**) and (*) indicate that the results are significant at 1 percent and 5 percent, respectively.
- The dependent variable is the return on assets.

The result shows that the beta coefficients for board size are positive with return on assets. It indicates that board size has a positive impact on return on assets. These findings are similar to the findings of Wu (2003).

However, the independent director's beta coefficients positively correlate with return on assets (Mohamma & Fadzil, 2018) . It indicates a female director harms return on assets (Lückerath, 2013). Likewise, the beta coefficients for board meetings are negative with return on assets. It indicates that frequency in board meetings harms return on assets. This finding is inconsistent with the findings of (Demeke 2016). Likewise, the percentage of higher shareholders' beta coefficients have a positive relationship with return on assets. This finding is consistent with the findings of. (JAVID & IQBAL,

2008).Likewise, the beta coefficient of leverage has a positive relationship with return on assets. This finding is consistent with the findings of (Vithessonthi & Tangurai, 2015).similarly the beta coefficient of firm size has a negative relationship with return on assets .this finding is inconsistent with the findings of (Kipsha, 2013) The results also show that the beta coefficients for Board size, independent director, female director, Board meeting and percentage of higher shareholders are significant at 1 and 5 percent level of significance.

Table 5. Estimated regression results of Board size, Independent director, Female director, Board meeting, Percentage of highest shareholder, Leverage, and Firm size on return on equity.

Model	Intercept	Regression coefficient of							Adj. R _{bar} ²	SEE	F-value
		BS	ID	FD	BM	HS	L	FS			
1	3.58 (0.98)	0.49 (1.01)							0.00	8.34	1.02
2	5.18 (3.42)**		2.52 (1.57)						0.014	8.28	2.47
3	7.49 (8.13)**			-1.03 (0.75)					0.006	8.36	0.56
4	9.37 (3.80)**				-0.12 (0.94)				0.009	8.35	0.88
5	4.79 (3.32)**					0.12 (2.02)*			0.029	8.22	4.06
6	3.97 (3.13)**						0.11 (3.22)**		0.085	7.98	10.38
7	57.17 (3.66)**							-2.43	0.084	7.99	10.27
8	36.01 (2.13)*		3.99 (2.62)**				0.10 (2.71)**	-1.70 (2.12)*	0.16	7.63	7.61
9	59.73 (3.65)**	0.88 (1.87)		0.59 (0.43)				-2.88 (3.49)**	0.09	7.92	4.68
10	-3.73 (1.62)		4.53 (3.01)**			0.14 (2.87)	0.14 (4.29)**		0.19	7.49	9.06
11	3.43 (1.26)				-1.34 (1.15)	0.13 (2.5)*	0.12 (0.33)		0.13	7.78	6.06
12	-3.68 (0.97)	0.53 (1.16)		3.77 (2.41)*			0.14 (3.94)**		0.14	7.75	6.36
13	41.07 (2.44)**				-0.05 (1.11)	0.13 (2.69)**		-1.91 (2.39)*	0.17	7.61	7.77

The results are based on 20 insurance company panel data with 105 observations for 2011/12 to 2016/17 using the linear regression model. The model is $ROE = \alpha + \beta_1 BS + \beta_2 ID + \beta_3 FD + \beta_4 BM + \beta_5 HS + \beta_6 L + \beta_7 FS + e$, where the dependent variable is ROE (ROE is defined as net income divided by total equity and multiple by percentage). The

independent variables are BS (Board size defined as the number of director in the board ratio), ID (Independent director is the number of non-executive director of a company and helps the company in improving corporate credibility), FD (Female Director is the number of female director inboard), BM (Board meeting is defined as the total number of the meeting conducted in a year). HS (Higher percentage of share held by an individual).

Notes:

- i. Figures in parentheses are t- values.
- ii. The asterisk signs (**) and (*) indicate that the results are significant at 1 percent and 5 percent, respectively.
- iii. The dependent variable is the return on assets.

The result shows that the beta coefficients for board size with return on equity. It indicates that board size has a positive impact on return on assets. These findings are similar to the findings of (Yermack, 1996) However, the beta coefficients for the independent director have a positive relationship with return on Equity Sheikh et al., (2013). It indicates female director harms the return on assets; this finding is inconsistent with the finding of (Zhang, 2013). Likewise, the beta coefficients for board meetings are negative with return on assets. It indicates that frequency in board meetings harms return on assets. This finding is inconsistent with the findings of (Demeke 2016). Likewise, the percentage of higher shareholders' beta coefficients have a positive relationship with return on assets. This finding is consistent with the findings of. (JAVID & IQBAL, 2008). Likewise, the beta coefficient of leverage has a positive relationship with return on assets. This finding is consistent with the findings of (Vithessonthi & Tangurai, 2015). Similarly the beta coefficient of firm size has a negative relationship with return on assets. This finding is inconsistent with the findings of (Kipsha, 2013) The results also show that the beta coefficients for Board size, independent director, female director, Board meeting and percentage of higher shareholders are significant at 1 and 5 percent level of significance.

Table 5 shows the regression results of Board size, independent director, female director, Board meeting, and percentage of higher shareholders on Nepalese insurance companies' productivity.

IV. CONCLUSION

Return on Assets and Return on Equity of the firm in the market is not static; rather, it changes frequently. The study of the ROA and ROE has been a subject of great interest these days. Moreover, it is a subject of immense curiosity, especially in the insurance sector, to identify the factors that influence ROA and ROE. Many studies have been undertaken to study factors affecting the ROA and ROE in developed countries.

This study attempt to examine the impact of corporate governance and firm performance on the Nepalese insurance company. Return on Assets and Return on Equity are the dependent variables. The independent variable is Board size, independent directors, Female

directors, Board meetings, and % of higher shareholders. This study is based on secondary data collected from 20 insurance companies operated in Nepal from 2012/13 to 2016/17, lending to 105 observations.

This study shows that the board size, independent directors, percentage of higher shareholders, leverage, and firm size positively impact ROA. However, the result shows that there is a negative impact on female directors and board meetings. The study also shows that board size, independent directors, percentage of higher shareholders, and leverage positively impact the ROE. However, female directors, board meetings, and firm size hurt ROE. The study also concludes that the most influencing factor for ROA of Nepalese insurance companies is board size, firm size, independent directors, percentage of higher shareholders, and leverage. Likewise, the most influencing factor for ROE of Nepalese Insurance companies is the number of independent directors followed by board size, percentage of higher shareholders, and leverage.

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