Role of Board Size in the Non-performing Loans of Cambodian Banking Industry

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Author’s contribution

The sole author designed, analysed, interpreted and prepared the manuscript.

ABSTRACT

This study is an effort to examine the role of board size on the non performing loans of Cambodian banking sector. Undoubtedly non-performing loans are the biggest problem for the developing countries and Cambodia has no exception. However, we also include the role of the profits in the non-performing loans of the Cambodian banks. We have collected the whole banking non-performing loans from the central bank of Cambodia over the period of 10 years. We collected the data of Board size and performance has been collected from the annual published statements by the banks. After applying the regression analysis, we have found that board size has positive response to the non-performing loans of the Cambodian banks, this relationship explains the agency effect. More interestingly we also found that higher the profits the banks are more likely to generate more non-performing loans.

Keywords: Non-performing loans; Cambodian banking industry; developing countries; board size; profit after tax.

1. INTRODUCTION

The majority of the national asset is with the Cambodian banking sector. The assets of the banking system augmented by 12% last year to attain about 28,89 thousand million dollars HAD, that is 131,43% GDPS. Credit was concentrated in key economic sectors such as the wholesalers and the retailers (30 p. 100), agriculture (10,40 p. 100), the building (9,50 p. 100), the residential property loans (9,30 p. 100) and other sectors (40,80 p. 100). At the same time, the store of banks augmented 25,11 for one hundred, that is an increase of 3,29 points of percentage in comparison with 2016, what makes that the sum of stores came to 17,42 thousand million dollars HAD.

The ratio of the unproductive loans resided in 2,40% in 2017 in comparison with 2016. The output of the assets of banking sector (ROA) and the output of equity capitals (ROE) were 1,54% and 8,40%, respectively.

Cambodian banking sector develops fast. At the end of 2017, the sector counts 39 commercial
banks, 15 specialized banks, 69 institutions of microfinance, seven institutions of store of microfinance, 313 rural credit institutions, six offices of representation, 11 institutions of financial credit, six thirds the transformers of parties, nine service suppliers of payment, a society of agency of valuation of credit and 2 478 money changers of money. Besides, the total number of credit cards and of debit passed to 74 130 and 1 813 435 cards respectively [1].

2. LITERATURE REVIEW

The 1990’s to 2000’s era was the era of corporate governance reforms for many developing countries. This provided laboratory environment to examine the relationship between banks ownership structure and performance. After decade of these reforms, recently domestic private banks, foreign banks have been allowed to complete with state owned banks freely La Porta et al. [2].

Strand of literature states that state owned banks in developing countries are inefficient than domestic and foreign private banks [1,2,3,4,5,6,7,8]. These conclusions make sense why many governments have privatized state-owned banks. Those who favor board size does matter for non-performing loans argue that there is positive relationship between board size and non-performing loans, as board size increases, it facilitates the long debate and there is always problems of communication and coordination. They argued that cost overwhelming the advantage of more people [9]. Jensen states “Keeping boards small can help improve their performance”.

Number of studies used board size to measure the effect of corporate governance as enterprises [9,10,11]. There is still debate among researchers on the board size, because of its importance on one side and cost on the other side. This is why; still there is no conclusive remark on the board size. The ones who favors large board size claimed that larger board size facilitate managers from their diverse thinking and experience. This is acceptable and seems true, but other group made criticism on this argument by pointing out the issues of flexibility, coordination and time etc.). They claimed that when the size gets larger, there are issues of flexibility and coordination between all members that leads to inefficient decisions.

One side of the literature reported the positive relationship between the board size and firms performance as Pfeffer [12] Pfeffer and Salancik, [13] especially in the banking industry. They claimed that as banks are unique industry and due to its complex operations and different nature, larger board size facilitates managers to do the complex decisions.

On the basis of literature, we argued that Higher Board size have positive influence on non-performing loans of Pakistan.

2.1 Data and Methodology

We have collected the data of Cambodia banks for the last 10 years from 2008 to 2018. We collected the data from the central bank of Combodia and we develop the following regression Model. We have collected the data for the corporate governance from the annual reports of the banks

\[ NPL = \alpha + \beta_1 BS + \beta_2 PT + \epsilon \]

Where

\( BS = \) Board Size
\( PT = \) Profit after Tax

3. RESULTS AND DISCUSSION

This is the description of the variables and its sources.

3.1 Descriptive Analysis

We have applied the descriptive analysis to take an overview of the banking sector of the Cambodia and also know the average profit and Non-Operating loans ratio in the Cambodia banking sector.

<table>
<thead>
<tr>
<th>Description of variables</th>
<th>Sources of information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size (BS)</td>
<td>Annual Reports</td>
</tr>
<tr>
<td>Profit After Tax (PAT)</td>
<td>Annual Reports</td>
</tr>
<tr>
<td>Non-performing Loans</td>
<td>Central Bank</td>
</tr>
</tbody>
</table>
From the above posed table it is very clear that the average board size is 10 which seems a larger as many scholars suggested that the board size should be in between 5-10. The larger the board size the larger the agency issue in the banks. This is the reason that profit of the banks is not so high as compared to the non-preforming loans of the industry.

3.2 Correlation Analysis

This table demonstrates the correlation among the suggested variables. We found that non-performing loans are positively correlated with Profit after tax. The values shows that if a banks earn good profits it is most likely that they are generating more non-performing loans.

**Table 3. Correlation matrix**

<table>
<thead>
<tr>
<th></th>
<th>InNPL</th>
<th>InPAT</th>
<th>BS</th>
</tr>
</thead>
<tbody>
<tr>
<td>InNPL</td>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>InPAT</td>
<td>0.18</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>BS</td>
<td>0.30*</td>
<td>-0.12</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Similarly as per the expectation we find that there is negative correlation between the board size and the profit after tax for the Cambodian banks. We also find that there is positive association between the board size and the non-performing loans that support the agency theory.

3.3 Regression Analysis

To measure the influence of Board size and non performing loans we test the regression model and found the following results.

Overall model is best fit as evident by the P-value that is 0.00 and we have good R-saquare that is 77.73 percent which is good enough for the social sciences. We also test the D-w stat that is in good range. We found very clearly that Board size have positive influence on the non-performing loans that means that if the size of the board is larger and larger there are more and more non performing loans for the banks. The same is true for the Profit after tax if a bank earns good profit it is more likely they are generating more non performing loans.

**Table 4. Board size and Non-performing regression**

<table>
<thead>
<tr>
<th></th>
<th>Coef.</th>
<th>Std. Err</th>
<th>P&gt;│t│</th>
</tr>
</thead>
<tbody>
<tr>
<td>BS</td>
<td>0.11</td>
<td>0.03</td>
<td>0.00***</td>
</tr>
<tr>
<td>lnPBT</td>
<td>0.10</td>
<td>0.017</td>
<td>0.00***</td>
</tr>
</tbody>
</table>

*** Significant at alpha 1%, 5% & 10%; ** Significant at alpha 5% & 10%; *Significant at alpha 10% only

4. CONCLUSION

This study is an important study for the development of the Cambodian banking industry. As the importance of the banking sector in the development of any country is not negligible. This study confirms that the banking health can be achieved only by prating well governance practices. The board size is an important variable of the governance. A lot of research has been done to identify the role of the board size. i.e [14,15,16]. But the results are inclusive yet. So, this study is an effort to contribute in the exiting literature for the developing countries perspective.

The practical importance of this study is that the government and securities and exchange commission of Cambodian think about the governance position of the country and implement the laws as per the given results. As many scholars () suggest that the average board size should be in-between on 5 to 8 where as in Cambodian it is high that is 10 that’s why it has larger non- performing loans that is not harm the financial health of the Cambodian banks but also the financial health of the whole country.

COMPETING INTERESTS

Author has declared that no competing interests exist.

REFERENCES


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