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Corporate Governance in Indian Banking Sector: A Review of Related Literature

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ABSTRACT

Banking system is the backbone of an economy. It has a significant contribution towards the overall development of an economy. The health of an economy largely depends on the soundness of its banking system. In the liberalised and globalised world, the Indian banking sector cannot ignore the importance of corporate governance as it ensures sound business ethics and safeguards the interests of all stakeholders. Corporate governance is a wider term which defines the rules, structures, methods and processes with which a company is managed and controlled. It increases long-term shareholder value by management accountability and also enhances firm's performance. It eliminates the conflicts arising from the separation of ownership and control. This aim of the present study is to examine the extent of applicability of corporate governance practices in Indian banking sector with the help of previous studies and to suggest some new areas for research.

Keywords: Banking system, Corporate governance, Indian banking sector, Business ethics, Stakeholders, Accountability, Performance

INTRODUCTION

Corporate governance means dealing with problems resulting from the separation of ownership and control. It has been defined as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. The Cadbury Committee of United Kingdom in 2002 defined corporate governance as the system by which companies are directed and controlled. The essence of a company lies in transparency and accountability and in fulfilling the fair expectations of all the stakeholders. The goals of corporate governance are improving shareholders value and supporting a continuing commitment to growth. Corporate governance is a wider term which defines the rules, structures, methods and processes with which a company is managed and controlled. It increases long-term shareholder value by management accountability and also enhances firm's performance. It eliminates the conflicts arising from separation of ownership and control. There must be a balance between ownership and control to achieve good governance.

Banking system is the backbone of an economy. It has a significant contribution towards the overall development of an economy. The health of an economy largely depends on the soundness of its banking system. In the liberalised and globalised world, the Indian banking sector cannot ignore the importance of corporate governance as it ensures sound business ethics and safeguards the interests of all stakeholders. Banks have a special role in the development of an economy and their governance systems are of great importance because they have a very critical position in the overall growth of the economy. History shows that financial institutions have played an effective role in some corporate scandals that shook the Indian economy. As a result, there has been a growing demand for

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transparency and accountability in banking activities. Since competition is getting stronger day by day in the Indian market, banks should no longer use corporate governance as an ethical code of doing business, rather they must utilise it as a technique to lower risk, improve financial performance and enhance long-term shareholder value. In order to be successful, banks must embrace and demonstrate ethical conduct and good governance.

OBJECTIVES OF THE STUDY

The paper has undertaken to address the following objectives:

(a) To study the present status of corporate governance in Indian banking sector.

(b) To review the existing literature of corporate governance in Indian banking sector.

(c) To suggest some less focused areas of corporate governance for further research.

RESEARCH METHODOLOGY

The present study is descriptive in nature which reviews some of the studies made in the context of corporate governance with reference to Indian banking sector. The paper uses secondary sources of data.

Significance of the Study

The following study has undertaken to explore the views of researchers on corporate governance in Indian banking industry. The study will help in finding the aspects and facets of corporate governance on which less or no work has been initiated. It will also provide some new aspects for further research.

Corporate Governance: The Indian Prospective

After liberalisation of Indian economy in 1991, corporate scams had become an annual feature. India had a series of scams that shook investors' confidence and revealed the corporate misgovernance practices of Indian business houses. The major corporate governance failures in India such as Harshad Mehta Scam, Ketan Parekh Scam, the UTI Scam, Vanishing Companies Scam, Bhansali Scam, Satyam, Sahara India Scam, scam of Kingfisher Airlines and so on created an urge to improve corporate governance codes. Lack of transparency and financial disclosures, corruption and mismanagement had been regarded as the way of life for five decades since independence. But, in today's globalised world, corporate governance has taken a significant place.

In India, banks are committed to the best practices in the area of corporate governance, in letter and in spirit. The bank believes that good corporate governance is much more than complying with legal and regulatory requirements. Good governance facilitates effective management and control of business, enables the Bank to maintain a high level of business ethics and to optimise the value for all its stakeholders. So, good corporate governance is fundamental to achieve the objectives of the banks.

Corporate Governance –A Review of Literature

Tabassum (2015) conducted a comparative analysis of corporate governance practices between three types of banks: public, private and foreign banks with a sample of 100 banks in India. Her research aimed to determine the present corporate governance practices in respective banks. She found that the role of 'Board of Directors' was important. Comparative analysis across the banks indicated that there is a difference in corporate governance practices across the three sectors. The primary data collected from bank employees in Delhi with the help of a questionnaire revealed that there is a scope for further improvement in banks' corporate governance practices.

Sangmi and Jan (2014) examined the corporate governance policies of commercial banks in India which are divided into public sector banks and private sector banks. Private sector banks are further classified into old private sector banks and new private sector banks in the study. They used both primary and secondary data. The governance policies have been assessed with the help of five parameters, namely reasons for the written code of corporate governance, availability of corporate governance policies, distribution of related material to concerned parties, issues in code of conduct and other components of corporate governance. Moreover, their study empirically tested the difference in the corporate governance policies between the public sector banks and private sectors banks and also between the old private sector banks and new private sector banks in India. They found that there is no significant difference between the corporate governance policies of public sector banks and private sector banks; in contrary to this, there exists a significant difference between the corporate governance policies of old private sector banks and new private sector banks in India.

Adhikari (2014) examined the legal and regulatory provisions in relation to corporate governance framework in banking institutions with reference to the OECD (Organisation for Economic Co-operation and Development) principles of corporate governance and Basel Committee corporate governance framework in the context of Nepalese commercial banks and their application status. His study revealed that there are several lapses in corporate governance in most of the banks, despite issuing directives to strengthen corporate governance. Further, financial institutions do not have self-managed codes of conduct to disclose board decisions, financial situations and facilities provided to board members and executives.

Jain (2014) studied the theoretical aspects of corporate governance in Indian banking sector. He studied the need, evolution and best practices of corporate governance in India along with the issues relating to corporate governance and also pointed out certain merits of best corporate governance practice. He suggested that there is a need of a more efficient monitoring and transparent internal audit system for effective corporate governance.

Aggarwal (2013) investigated the impact of corporate governance on corporate financial performance in an Indian context using a sample of 20 companies listed on S&P CNX Nifty 50 Index. She used various tests such as regression, correlation, *t*-test and *F*-test using secondary data over a period of 2 years from FY 2010–2011 to FY 2011–2012 to study this linkage. The performance of companies was measured in terms of return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) and profit before tax (PBT). She used governance ratings of companies as proxy for corporate governance performance. She found that governance rating of company has a significant positive impact on its financial performance.

Ajanthan *et al.* (2013) examined the impact of corporate governance on banking performance which was a comparative study between private and state banking sector in Sri Lanka. Their study focused on four aspects of corporate governance, namely board size (BS), board diversity (BD), outside directors percentage (OSDP) and board meeting frequency (BMF). Banking performance has been measured through ROE and ROA. They concluded that corporate governance has a moderate impact on performance of both private and state banks in Sri Lanka.

Deb (2013) examined the practices of corporate governance attributes in Indian banking sector and how they adhere to corporate governance practices. He undertook an empirical study on five banks in India based on interviews and secondary data with the objective to assess the level of compliance of key governance parameter in these banks in tune with statutory and non-mandatory requirements given by SEBI (Securities Exchange Board of India) under Clause 49 of the listing agreement. He found that good corporate governance is a reality and Indian Banking sector has left no stone unturned to achieve this. His primary research reflected sheer sincerity of senior banks' executives to take this mission forward to the zenith of success.

Chilumuri (2013) evaluated the corporate governance practice in Indian banking sector with a case study of the State Bank of India (SBI) based on secondary data. He found that SBI has implemented all the provisions of corporate governance according to the Reserve Bank of India (RBI)/Government of India (GOI) directions and is performing well in every aspect like profits, assets, deposits, branches, employees and services to customers. He also found that the SBI has been conducting different board meetings regularly to provide effective leadership, solving functional matters and monitors bank's performance and the bank has also established clear documentation and transparent management processes for policy development, implementation, decision-making, monitoring, control and reporting.

Katrodia (2012) analysed the corporate governance practices in Indian banking sector. His study was descriptive in nature and showed the corporate governance practices of SBI, Bank of Baroda, Bank of India, Punjab National Bank, ICICI Bank, HDFC Bank, Standard Chartered, HSBC, Citibank and so on. He stressed that Indian banks must continue to implement strong corporate governance practices as it is a competitive differentiator in an environment of strong foreign entrants and growing regional competitors.

Pandya (2011) studied the effect of corporate governance structures, particularly board structure and CEO (chief executive officer) duality, on the performance of selected Indian banks. Using eight public and four private banks operating in India as sample, he examined the relationship between CEO duality and the proportion of independent directors and their effect on firms' performance measured by ROA and ROE. He used various statistical techniques such as multiple regression analysis with Dichotomous variables and Mann–Whitney *U* test in measuring the relationship between the dependent and independent variables. By applying statistical packages such as SPSS and Open Stat, his study concluded that there is no significant relationship between duality and board independence to the performance of banks.

Swarup (2011) studied the nature and purpose of corporate governance with special emphasis on the problems of banks in the field of corporate governance and the conflicts in Indian scenario. He explained the report by the Basel Committee and also how it helped in implementing corporate governance practices in banks. He also illustrated some of the best practices regarding corporate governance in banks. He concluded that bank, being a separate category of financial institutions, requires specialised set of norms for corporate governance.

Sarkar and Sarkar (2000) empirically analysed of the activism of different types of large shareholders in corporate governance in developing and emerging countries like India. They found no evidence of a positive and significant relationship between holdings of institutional investors and company value at any level of equity ownership. Their findings also supported the efficiency of the German/Japanese model of bank-based governance. Their results suggested that the financial institutions start monitoring the company once they have substantial equity stakes in it.

CONCLUSION

Corporate governance starts from the system and ends with honesty. It does not have a single standard and its best practices differ from country to country. The constituent of a best governance practice is still in the process of development. Good corporate governance always shares some common elements which are accountability, fairness, openness and transparency. This paper is a collection of research on corporate governance with reference to the Indian banking sector only. It is evident that corporate governance has great importance for an entity but it is highly significant for the banking sector as banking sector is the backbone of any economy. The success of any economy in the globe depends on the efficiency of its banking sector. Corporate governance can ensure efficiency and effectiveness of any business.

Most of the studies reviewed in this paper are focused on the conceptual framework and also the effect of corporate governance practices on the firms' financial performance. But it has been observed that none of the studies have taken into consideration all the facets of corporate governance to study their impacts on financial performance. So, further research can be done by taking all the aspects of corporate governance in the banking sector and also by taking all the banks operating in India. The research can also be undertaken by using some other measures of financial performance such as ratios, *Z*-score and so on along with corporate governance facets.

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