



# AN IMPACT STUDY ON CORPORATE GOVERNANCE PRACTICES IN BANKING SECTOR IN INDIA

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## ABSTRACT

**T**he Corporate Governance (CG) has emerged as a benchmark for judging corporate excellence in the context of national and international banking practices. The banking industry has been providing more facilities to customers as per the CG regulations also in terms of taking deposits from customers, granting loans and providing corresponding services in banking institutions. The CG philosophy of banks has based on the pursuit of sound banking business ethics and strong professionalism that align the interests of all shareholders and the society. The CG concepts help to attain the goal of each and every business industry by quality services to the society. The main objective of the study is to provide detailed information about CG activities in Indian commercial banks and showing the banking activities towards the CG regulations in selected Indian banking institutions. The researcher made an attempt to show the effectiveness of CG in pre and post-period implementation of CG concept in Indian banks. This study is based on secondary data which were collected from the RBI website and various journals covering the periods from 2001-2013. The selected commercial banks by descriptive analysis, CG score analysis, trend co-efficient and chow test.

**KEYWORDS:** Banking Industry, Corporate Governance, CG Philosophy.

## 1. INTRODUCTION

In the liberalized economy, the Corporate Governance is important to every banking business to achieve probable success. In that way to honor moral values, deal with legal issues and contribute to economic development, while improving the quality of service and their banking activities to the society at large. Although such voluntary social measures have become legal requirements, a number of business leaders in bank have gone further ahead by utilizing their wealth to improve the living conditions of many people in the society. Simultaneously, a change is already occurring from traditional humanity to healthy society development among the more progressive of banking institutions. As a

pillar of the economy, banking sector plays a major role in the economic development of the country. Thus the banking industry has been playing a important role as growth catalyst. In recent year's corporate governance has become important issues at a global level. In this present study, the researchers made an attempt to show the effectiveness of CSR and CG activities in select Indian commercial banks.

## 2. REVIEW OF LITERATURE

**Narayana Gowd and Bhanu et al. (2013)** made an attempt to study the CG practices of SBI and to examine the relationship between market valuation and operating performance with corporate governance score of SBI. An

exploratory research design was employed which depends on RBI report. The secondary data analyzed by multiple regression, correlation analysis and t-test reveals that sales, market value, dividend policy, profits of SBI and its CGS were positively correlated. The CG performance of SBI had been improving year on year during the study period of 2007-08 to 2011-12. It concludes that the impact of CG on market value, profit and dividend policy was not statistically significant.

### 3. OBJECTIVES OF THE STUDY

The main important objectives of the study are:

1. To offer detailed information about CG concepts in Indian commercial banks.
2. To know the banking activities provided by CG concept in selected Indian banks.
3. To prove the effectiveness of Corporate Governance in the selected Indian commercial banks.
4. To distinguish the effectiveness and impact of CG implementation in pre and post-period of banking industry activities in India.

### 4. METHODOLOGY OF THE STUDY

This present study is based on the diagnostic and explanatory in nature and the sample of nine banks belong to the public sector and private sector banks which come under the category of top performing banks. The secondary data was based from the source of various journals and the bank annual reports and RBI reports. This paper is to know the status and the strategies adopted for CG in the banking sector. The study covers the period 2001 to 2013 and the chow test has used to know the effectiveness of commercial banks from pre and post period of CG principles in India.

### 5. ROLE OF CORPORATE GOVERNANCE CONCEPT IN INDIAN BANKS

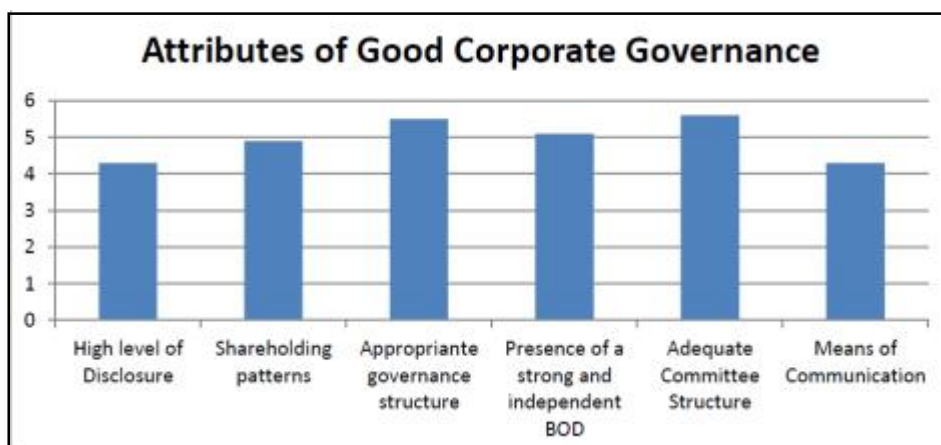
The banks have to provide services in responsible ways so as to retain customers for a long time. The banking and finance organizations should have ethical standards for developing the banking institutions and introducing new products. Specific ethical policies shall be put in place to shape ethical behavior of staff. Besides, the importance

of internal audit has been emphasizing, particularly in banking industries. From the perspective of Indian banking industry, the corporate governance is also includes in its domain the manner in which their board of directors rule the business and affairs of individual institutions and their functional relationship with senior management. In banking industry, corporate governance is used to set corporate objectives include generating economic profits to owners, run the day to day operations of the banking business and consider the interests of recognized stakeholders namely, employees, clients, dealers, supervisors, government and the community, make parallel corporate activities and behaviors with the expectation that banks will operate in a safe and sound manner.

### 6. ANALYSIS OF CORPORATE GOVERNANCE FOLLOWED BY SELECTED COMMERCIAL BANKS IN INDIA

In the banking system, it is believed that proper corporate governance facilitates effective management and control of banking business, which enables the bank to maintain a high level of banking business ethics and to optimize the value for all its stakeholders. The banks should maintain the corporate governance for internal strength and the CSR for customer satisfaction in business. The information about Annual General Meeting (AGM) of Shareholders, market price data, distribution pattern of shareholders, details of dematerialization etc as disclosed in the CG report and the annual report of listed bank in India have been taken for the study. The RBI instructed all the banks and financial institutions to include separate section on CG on their annual report. The selected banks have provided CG practicing details in separate section in annual report. It is observed that the selected banks have disclosed the details about the market price of shares and investors pattern. Based on it the Corporate Governance Score is calculated with the help of Narayan Murthy Committee recommendations. A score of 0.5 was awarded if an item was reported, otherwise a score of zero was awarded. A bank can score a maximum of ten points and a minimum of zero.

### Chart-1 Attributes of Good Corporate Governance in Indian Banking Industry



The below table-1 shows that the corporate governance score of the selected private and public sector banks in India. The corporate governance of the state bank of India was maintained 10 score and it shows this bank maintain as per the norm of RBI committee. Their efficiency was very good in SBI. The Canara Bank and HDFC bank have scored 9.5 points of corporate governance. The Allahabad Bank and Bank of India have maintained 9 score based on CG and CSR activities in banking business. Lastly, the selected banks of Punjab National

Bank, Union Bank of India, Bank of Baroda and other banks were maintained up to 8.50 score based on the CG of RBI norms in India. The CG mean score are based on Dividend payout ratio, Aggregate share value, Return on total assets, Return on Income, and Corporate Governance total score. It shows that the SBI bank contains higher 95 per cent of CG mean score and other banks contain more than 75 per cent of CG mean score in their banks. So, the results show satisfactory level of banking business by the RBI norms.

**Table - 1 Corporate Governance Score of Selected Indian Commercial Banks (Mean Score)  
Corporate Governance Ratings as per the Narayan Murthy Committee Recommendation**

CG Parameters	Allotted Scores	AHB	CB	UBI	SBI	PNB	BOI	BOB	IVB	HDFC
<b>Financial reporting:</b>	3									
a) Balance sheet	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
b) P&L A/C	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
c) Cash Flow Statement	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
d) Segment Report	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
e) Accounting Policies used	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
f) Other Financial Performances (share price & key ratios)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Awards and Recognitions (including ratings).	1(0.5 +0.5)	1	1	0	1	0	1	0	0	1
<b>Corporate Social Responsibility</b>	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Board's Report as per section 217 (a) :	2.5									
Composition of Board	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Board Meetings	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Remuneration	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Dividend	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Appropriation of Reserves	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Investment and Project Details	0.5	0	0.5	0	0.5	0	0	0.5	0	0.5
Recent changes	0.5	0	0.5	0.5	0.5	0.5	0.5	0	0.5	0
Future strategy	0.5	0.5	0	0.5	0.5	0.5	0	0.5	0	0.5
Risk management	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Complaints and non- compliance issues	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
General information about subsidiaries	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
<b>Total Score</b>	<b>10</b>	<b>9</b>	<b>9.5</b>	<b>8.5</b>	<b>10</b>	<b>8.5</b>	<b>9</b>	<b>8.5</b>	<b>8</b>	<b>9.5</b>
<b>Corporate Governance Mean Score (in %)</b>	<b>90</b>	<b>85</b>	<b>87</b>	<b>83</b>	<b>95</b>	<b>86</b>	<b>91</b>	<b>75</b>	<b>70</b>	<b>90</b>

Source: Calculated value as per both primary and secondary data.

## 7. PERFORMANCE OF INDIAN COMMERCIAL BANKS BY EFFECTIVE CG PRINCIPLES

After the banking liberalization period 1998, the banking industry has been changed with more technical aspects of RBI. Since 2007, the RBI has made changes in Indian commercial banks with implementation of

Corporate Governance concepts. It is an amalgamation of policies, program's education and practices which extend throughout a corporation's operation and into the communities. The below Table-2 shows the growth level of total deposits and advances of total commercial banks in RBI during the implementation of CG practices.

**Table 2 – Overall Performance of Indian Commercial Banks after CG Implementation (In Rs.)**

Year	Total Deposits	Advances & loans	Gross NPA	Investments	Total Assets
2000-01	9,891	5,292	637	4,918	12,954
2001-02	11,311	6,090	708	5,872	15,364
2002-03	13,117	7,464	687	6,937	16,991
2003-04	15,422	8,655	648	8,042	19,740
2004-05	17,328	11,243	593	8,697	23,559
2005-06	21,090	15,070	510	8,665	27,858
2006-07	26,119	19,311	504	9,509	34,599
2007-08	31,969	24,769	563	11,773	43,261
2008-09	38,341	30,009	683	14,494	52,413
2009-10	47,525	34,971	847	17,191	60,251
2010-11	56,159	42,975	979	19,236	71,834
2011-12	64,537	50,746	1,423	22,305	82,994
2012-13	75,466	55,454	1,754	24,876	88,778
<b>CAGR %</b>	<b>17.03</b>	<b>20.60</b>	<b>6.53</b>	<b>16.22</b>	<b>18.24</b>

The above table-2 shows that the growth of commercial banks during the initiation of CG principles in India. The aggregate deposits of commercial banks are 17.03 per cent growth during the initiation of CG principle in Indian Commercial banks. The Compound Annual Growth Rate (CAGR) of total deposits and advances from 2001 to 2013 period was 17.03 per cent and 20.60 per cent. The investments and assets of commercial banks always increased by 16.22 per cent and 18.24 per cent. It means that a performance of commercial banks in terms of deposits was much better and the commercial banks have been adopted CG concepts as per the RBI regulations in India.

## 8. STRUCTURAL CHANGES OF SELECT INDIAN COMMERCIAL BANKS IN PRE AND POST CG IMPLEMENTATION PERIOD

The Chow test is a statistical and econometric test of whether the coefficients in two linear regressions on different data sets are equal. The Chow test is most

commonly used in time series analysis to test for the presence of a structural break. It is posed as a partitioning of the data into two parts of size  $n_1$  and  $n_2$ . The Chow test and trend co-efficient analysis is often used to determine whether the independent variables have different impacts on different subgroups of the population and examine the significant level to the study.

$$\text{Chow test, } F = \frac{RSS_c - (RSS_1 + RSS_2) / k}{RSS_1 + RSS_2 / n - 2k}$$

Where, RSSC = Residuals of Combined Period; RSS1& RSS2= Pre and Post period residuals; K = Probabilities; N- No. of observations.

Accordingly, a Chow test was performed on data for each year separately, and values for the parameters are shown in Table-3. The Chow tests were significant at  $p < .001$ . These significant F-tests indicate that not all the independent variables have uniform effects for pre and post reform period, but do not indicate where these

differences lie. Given the effect of huge group sizes, compared to the number of predictor variables used in the present study. Here, the pre-period is 2000-01 to 2006-07 and post period is 2007-08 to 2012-13 in this present study.

**Table 3 - Chow Test and Trends across Pre and Post of CG Implementation Period of CB's**

Period	Deposits in Rs.		Advances & Loans in Rs.		Gross NPA		Investments		Total Assets	
	Average (in Rs.'000)	Trend Co-efficient	Average (in Rs.'000)	Trend Co-efficient	Average (in Rs.'000)	Trend Co-efficient	Average (in Rs.'000)	Trend Co-efficient	Average (in Rs.'000)	Trend Co-efficient
Pre-Period	645	0.019** (-2.65)	675	0.348 (0.97)	185	0.058* (2.06)	597	0.078 (-1.89)	2,836	0.167 (1.46)
Post Period	18,850	0.896 (-0.13)	13,885	0.00* (3.94)	608	0.00** (5.16)	7,416	0.167 (1.46)	23,478	0.272 (-1.15)
Total Period	9,970	0.00* (-7.20)	7,111	0.00* (5.76)	402	0.00** (7.66)	4,089	0.210 (1.28)	13,409	0.819 (-0.23)
<b>Chow test %</b>		<b>27.56</b>		<b>27.96</b>		<b>26.89</b>		<b>24.98</b>		<b>22.09</b>

Note: \* and \*\* indicates 1% and 5% significance level respectively.

The table-3 shows trends in total deposits and advances of select commercial banks in RBI across the pre-reform and post-reform periods. The trend coefficients across the two sub-periods reveals decline in deposits, investments, assets, and gross NPA during pre-reform period and increased in post reform period. The trend coefficients of loans and advances, total assets and investments are positive growth in pre-CG period and post-CG period was negatively sloped in select commercial banks. Whereas, a growth in deposits, advances, and investments emerge positive, but insignificant in both the pre and post-CG periods for commercial banks. The chow-test results for deposits and advances and investments clearly indicate the existence of significant structural difference between the sub-periods. The deposits of commercial banks have structural change of 27.56 per cent, followed by advances and loans are 27.96 per cent, Gross NPA is 26.89 per cent and investments of commercial banks are 24.89 per cent in India. Hence, the structural changes of select commercial banks shows that the stability and growth of the banking activities through CG in India.

## 9. FINDINGS AND SUGGESTIONS

Indian bank sector has been increasing the satisfaction level of customers and stockholders in banking sector through the good Corporate Governance. Based on the CG concept, the select commercial banks have providing more banking products to customer and the corporate governance principles are maintaining higher return and higher satisfaction to stockholders of banking institutions. The Indian banking industry has higher growth rate in deposits, loans, assets and NPA after the implementation of good CG practices. The banking industry has consistency and the chow test is providing the higher structural break between pre and post period

of implementation of CG in commercial banks. The structural changes of select commercial banks shows that the stability and growth of the banking activities through CG in India. The banks perform well through the corporate governance principles but some other banks not following the CG concepts. The researcher suggests that all commercial banks should follow the CG principles under the RBI guidelines.

## 10. CONCLUSION

In Indian banking industry, the CG concept has been adopted as element for success and survival of banks along with fulfilling social objectives and development of economy. The banking institutions under this CG concepts have recognized their responsibility towards the society and are making their contribution in the field of employment generation, education, health care, women welfare and women empowerment. These activities are more developments and higher returns by the deposits and loans of commercial banks.

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