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CORPORATE GOVERNANCE IN BANKING SECTOR IN INDIA: AN ANALYTICAL STUDY

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ABSTRACT

Corporate governance has at its backbone a set of transparent relationships between an institution's management, its board, shareholders and other stakeholders. In this article, in the first part, the nature and purpose of corporate governance has been discussed with special emphasis on the problems of banks in the field of corporate governance. Also, the conflicts in case of Indian scenario have also been described. In the second part, the report by the Basel Committee has been explained and also how is helps in the corporate governance in banks. And, in the third part, the best practices regarding corporate governance in banks have been illustrated. Finally, the project concludes by saying that banks, being a separate category of financial institutions require specialized set of norms for corporate governance.

KEYWORDS: *Corporate Governance, Public and Private Banks, RBI, SEBI, BESEL, Bank Governance.*

Introduction

Today the concept of Corporate Governance has taken a new dimension due to globalization and liberalization. With the opening up of economy and to be in line with WTO requirements, if the Indian corporate have to survive and succeed amidst increasing competition globally, it can only be through transparency in operations. The excellence in terms of customer satisfaction, return, product and service, return to promoters and social responsibilities towards society and people cannot be achieved without practicing good corporate governance. The fundamental objective of Corporate Governance is to enhance the long-term shareholder value while protecting the interests of other stakeholders, maximizing long-term shareholder value in a legal and ethical manner, ensuring fairness, courtesy and dignity in all transactions within and outside the bank with customers, employees, investors, partners, competitors, the government and the society. The system of corporate governance is important for banks in India because majority of the banks are in public sector, where they are not only competing with one another but with other players in the banking system as well as in financial services system including Financial Institutions, Mutual Funds and other intermediaries Further, with restrictive support available from the Govt. for further capitalization of banks, many banks may have to go for public issues, leading to transformation of ownership. This paper focuses on corporate governance in banking sector and how they adhere to Corporate Governance practices. It further indicates the role and relationship of corporate governance with Indian Banking Sector. Both private and public sector banks are adhering to mandatory requirements of corporate governance attributes as a result it is bringing more transparency and minimizing the chances of fraud and malpractices.

Objectives of Corporate Governance

Good governance is integral to the very existence of a company. As it inspires and strengthensthe investor's confidence by ensuring company's commitment to the higher level of growth and profits. It seeks to achieve following objectives:

- A properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;

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- The Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- The Board effectively and regularly monitors the functioning of the management team; and
- The Board has an effective machinery to serve the concerns of stakeholders;
- The Board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of the interests and well-being of all the stakeholders;
- The Board keeps the shareholders informed of relevant developments impacting the company;
- The Board remains in effective control of the affairs of the company at all times.

Key Components of Good Corporate Governance

Good governance is conclusively the indicator of personal beliefs and valuesthat configure the organizational beliefs, values and actions of its Board. The Board, which is a main functionary, is primary responsible to ensure the value creation for its stakeholders. In the absence of clarity on designated role and powers of the Board, it weakens the accountability mechanism that subsequently, threatens the achievement of organizational goals. Therefore, the key requirement of good governance is theclarity on part of identification of powers, responsibilities, roles and accountability of top position holders, including the Board, the Chairman of the Board and the CEO. In such cases, role of the Board should be clearly documented in a Board Charter, which can be followed throughout.

To elaborate the above discussion, following are the essential elements of good corporate governance:

- A well-structured Audit Committee setup is required to work as liaison with the management, internal and statutory auditors. Importance of such is to review the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues.
- Accountability towards the stakeholders with an objective to serve the stakeholders through strong and sustained communication processesat a regular interval.
- Clear documentation of company's objectives as a part of long-term corporate strategy including an annual business plan together with achievable and measurable performance targets.
- Effective whistle blower policy is another element, whereby the employees may report to the top management about any suspected frauds, unethical behaviour or violation of company's code of conduct. Appropriate mechanism should be in place for adequate safeguard to such employees.
- Emphasis on healthy management environment, which includes appropriate ethicalframework, clear objectives, establishing due processes, clear enunciation of responsibility and accountability, sound business planning, establishing performance evaluation measures.
- Fair and unambiguous legislation and regulations.
- Fairness to all stakeholders.
- Focus on social, regulatory and environmental concerns
- Identification and analyzing risk is an important element of corporate functioning and governance, which should be appropriately taken into consideration as remedial measures. This can be well settled by formulating a mechanism of periodic reviews of internal and external risks.
- To be specific on norms of ethical practices and code of conduct that is required to be communicated to all the stakeholders.
- Transparency and independence in the functioning of the Board, where Board should provide effective leadership for achieving sustained prosperity for all stakeholders, which can be possible by providing independent judgment in achieving the company's objectives.

Why is Corporate Governance Important?

- It enhances higher possibilities in delivering sustainable good business performance.
- It ensures that a well governed company is accountable and transparent towards its shareholders and other stakeholders.
- It ensures that the business environment is fair and transparent enough for companies that one may be held accountable for their actions.
- It has emerged as new way to manage modern joint stock corporations, which are equally significant in cooperatives, state-owned enterprises and family businesses.

Benefits of Corporate Governance

Corporate governance has a unique and important place for the companies and different stakeholders. Following corporate governance codes benefits the owners and managers of companies and increase transparency and disclosure by enhancing access to capital and financial markets. It emphasizes to survive at a crucial period in an increasingly competitive environment through mergers, acquisitions, risk reduction and partnerships through asset diversification. Corporate governance ensures to provide an exit policy with a smooth inter-generational transfer of wealth and divestment of family assets that can reduce the chance for conflicts of interest. It leads to a greater accountability, better system of internal control and better profit margins for the company. It also provides higher potential for future diversification, excessive growth, attracting equity investors (nationally and abroad), and reduction in the cost of credit for corporations.

Corporate governance can provide proper incentives for the board and management that match the objectives, which are in the interest of the company and the shareholders. It ensures greater security to the investment of the shareholders. It creates an environment, where shareholders are sufficiently informed on decisions concerning fundamental. From various empirical researches, it has been found that majority of global institutional investors are willing to pay a premium for the shares of a well-governed company over the other poorly governed companies, which have an impressive and comparable financial record.

Objectives of the Study

- To study the concept of corporate governance in Indian banking sector (Public Banks and Private Banks).
- To identify the role of corporate governance in Indian Banking sector.
- To find out the guidelines issued by SEBI in the context of corporate governance.

Review of Literature

Gupta, P. (2012) has examined that the better corporate administration prompts better execution of the organizations. He additionally found in his examination that corporate administration soundly affects the offer's costs and money related execution of the organizations.

Marshall, D.W. (2014) dissected a revelation score, measure the straightforwardness level and corporate administration exposures made in yearly report of recorded open restricted organizations and distinguished that corporate administration divulgence must be made at least for open constrained organizations in rising economies.

Gayathri, S. (2015) reflected in her investigation that financial division and administrative bodies are submitted towards exposures and force of investor's interest for straightforwardness, it would establish the strong framework for viable Governance.

Som L. (2016) uncovered in her examination that the administration is delegating its very own chiefs for micromanagement has encouraged colleague private enterprise and open division banks experience the ill effects of over the top guideline with too huge an extent of their benefits being utilized to satisfy the administration's deficiency.

Kumar, R. (2016) has depicted in his investigation that Public Sector banks need more noteworthy useful independence in a deregulated domain, notwithstanding, should be joined by more prominent responsibility with respect to their sheets to investors and partners and strategy on corporate administration will be filled in as in compelling way for accomplishing the chose objective.

Kumar, S. S., and Kannappan, M. (2018) has shown that there is a parallel improvement of administration in each open and private division association. In Adoption comparable fundamental shrewd organization administration guidelines, the overall population and private area created as parallel premise on possess particular administration models, practices and components that suit each individual association.

Research Methodology

The study is based on secondary data which is compiled from various secondary sources like RBI, SEBI, journals, banking websites, etc.

Corporate Governance in Banking Sector

It is evident that banking and financial institutions are the strong backbone of any economy. This results in healthy economic condition of a country, which positively correlates with sound functioning of its banking sector. Functioning of banking and financial institutions differs with other corporate entities in many ways that makes corporate governance of banksvery different and critical too. So, if a corporate fails on corporate governance front, the fall outs can be restricted to the stakeholders, but on the other hand, if a banking or financial institution fails, the impact can spread rapidly through other banks and financial institutions, which ultimately have serious implicationon financial system at large. Thus, corporate governance has equal importance in case of banks and financial institutions as well. In Indian market, the concept of corporate governance is emphasized considering the liberalization, privatization and globalization phase, whereby institutionalization of financial markets, foreign institutional investors (FIIs) became dominant players in the stock markets. This phase also left private sector companies with a realization that 'investors keep invested in those corporate, which create values for their investors'. Thus, in this way, corporate essentially requires to adhere with the honest, fair and transparent corporate procedures and practices.

Evolution of Corporate Governance in Indian Banking System

Considering the changing role of corporate governance, various advisory groups and consultative groups were formed to deeply study baking sector in the light of effective corporate governance.

To name a few, an advisory group on corporate governancewas formed under the chairmanship of Dr. R. H. Patil, in March 2001.Subsequently, another consultative group was formed in November 2001 under the Chairmanship of Dr. A.S. Ganguly, with an objective to strengthen theinternal supervisory role of the Boards in banks. In continuation, an advisory group on banking supervision was initiated under the Chairmanship of Shri M.S.Verma. Despite recommendations of these advisory groups and considering the global corporate governance experience, RBI had undertaken several measures to strengthen the corporate governance in the Indian banking sector. Various areas, which were potentially important and needed attention, were emphasized. It included defined role of supervisors, ensuring an environment supportive to the sound corporate governance, effective organizational structure to have responsible board of directors, etc. Considering the fact that Indian banking sector is dominated by the government-managed banks (including public sector banks, nationalized banks and rural banks, etc.), these issues were further examined. In this phenomenon, corporate governance issue was important for public sector banks, especially because they constitute major share of business in the banking sector.

The Reserve Bank of India (RBI) enacted in 1934 and the Securities and Exchange Board of India (SEBI) established in 1992 are two important statutory bodies empowered to regulate and maintain the standard required for the effective corporate governance. Another global initiative in 1999 of the Basel Committee also brought important principles on corporate governance for banks. Additionally, Banking Regulation Act, 1949, Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007, New Companies Act, 2013 andother directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to timehave created a positive environment and future scope for enhancing corporate governance. This evolution phase of corporate governance and banking industry experiencescreated long way of development and setting global standards for corporate governance, which make it more robust and sophisticated in today's time frame.

Need of Effective Governance in Banks

There are various parameters, which refer the crucial need of corporate governance in banking sector. It cannot be denied that banking sector plays important role of managing funds and its circulation. They have access to capital market as well to maintain the statutory requirement of having sound capital adequacy ratio (CAR). This way they also have open-ended investors from the capital market as well as major shareholders. Investors believe that a bank with good governance will provide them a safe place for investment and also give better returns. Therefore, good corporate governance is important factor in retaining existing investors and attracting new investors. Another aspect of greater transparency and fairness motivate its investors, customers, employees and vendors to maintaining long-term relationship with the bank. Important practices in good corporate governance such as assessment of credit risks pertaining to lending process has an encouragement for the corporate sector, as in turn it will improve their internal corporate governance practices and standards, which is conditioned by the global tendency to consolidation in the banking sector.

Another Aspect of Corporate Governance need in the Banking is Influenced

By the fact that boards of directors and senior management govern the business and affairs of individual banks, and at any point of time, any imbalance within the effective corporate governance framework will led to corporate failure. In the light of above, the need of corporate governance in banking sector is essentially required in order:

- To establish a capable, effective and reliable board of directors and their composition,
- To have an effective and operating audit committee, compensation committee and nominating/ corporate governance committee,
- To establish corporate governance procedures in order to enhance shareholder's value,
- To establish a corporate code of ethics.
- To disclose the information in an transparent manner.

RBI's Role in Ensuring Corporate Governance in Banks

RBI, being the central bank and banking sector regulator in India has major role in formulating, implementing and promoting the standards of corporate governance for India's banking sector. Originally, RBI had task to regulate issue of currency, maintaining forex reserve, financing five-year plan, establishing specialized institutions to promote saving and to fulfil needs of priority sector. Afterwards post librelisation phase, it also started focusing on facilitation of efficient functioning of capital and money market, fixing interest rates, providing necessary operational framework to banks for setting various transparency and disclosures norms. It also focuses on safeguarding and maximizing the shareholder's value and stabilizing the financial system. Apart from main functions of RBI, it also has supervisory and regulatory powers for public sector banks, private sector banks, regional rural banks, foreign banks, non-banking financing companies (NBFC), Small Industries Development Bank of India (SIDBI), cooperative banks and various institutions formed under special acts (including SBI Act, IDBI Act, Industrial Finance Corporation, NABARD Act, Deposit Insurance and Credit Guarantee Corporation Act and National Housing Bank Act).RBI also follows the important functions guided by the Board of Financial Supervision (BFS), which inspects and monitor the banks through its CAMELS approach (capital adequacy, asset quality, management, earnings, liquidity, and systems & control). Here primary objective of BFS is to undertake consolidated supervision of the financial sector. It also look after the Department of banking Supervision, Department of Non Banking Supervision and the Financial Institution Division, in terms of issuing necessary directions for important regulatory matters. Within the supervision and regulatory powers, RBI has description over bank licensing, asset liquidity, branch expansion and methods of amalgamation and liquidation, etc., which further empower RBI to play leading role of formulating and implementation of effective corporate governance mechanism for the institutions within banking sector.

RBI follows three important parameters in maintaining and managing effective corporate governance, namely, prompt disclosure and transparency norms, off-site surveillance and timely appropriate corrective action.

- **Important Committees of Board**

Most of the guidelines are based on SEBI guidelines, New Companies Act 2013, Norms set by the RBI or by the Ministry of Corporate Affair. Some of the important guidelines are referred below:

- **Board Composition**

NBFC, listed banks and other financial intermediaries come under the ambit of SEBI. In effective corporate governance, it is encouraged to have higher the number of non-executive director or independent director over the executive director. As per SEBI (LODR) Regulations 2015, an optimum combination of executive and non-executive directors is required with at least one woman director in board and majority of directors need to be from Non-Executive (i.e., 50% or more). In case the Chairman of the board is a Non-executive director then at least 33% of the board of directors shall comprise of Independent Directors. On the other hand when the Chairman is not a regular Non-executive Director, then at least 50% of the board of directors shall comprise of Independent Directors. Although in cases where the regular Non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, then at least 50% of the board of directors of the listed entity shall consist of Independent Directors.

- **An Audit Committee**

As per the Sec. 177 of New Companies Act 2013, every listed company is required to constitute an Audit Committee comprising minimum 3 Directors, with Independent Directors in majority. An audit committee is one of the important board committee to oversee financial reporting process and disclosure. It ensures the correct, sufficient and credible financial statement of the company. Committee needs to meet at least four times in a year.

- **The Remuneration and Nomination Committee**

The Committee should consists more than 2 Non-Executive Directors, and include minimum 50%, as the Independent Directors in the composition. It can have chairperson of the company(whether executive or non-executive) as the member of the Committee, but cannot become the Chairman of such Committee. The Remuneration Committee has prime function to identify persons who are qualified to become directors and can be appointed in senior management in accordance with the pre defined criteria. This committee formulates the criteria for determining qualifications, positive attributes and independence of a director and also empowered to authorize the remuneration, business and other benefits to directors, key managerial personnel and other employees.

- **Risk Management Committee**

It is another important committee, with an objective to assist the Board in fulfilling its corporate governance oversight responsibilities with regard to the identification, evaluation and mitigation of strategic, operational, and external risks.

- **Stakeholders Relationship Committee**

Role of the Stakeholders Relationship Committee (Earlier referred as the Shareholders'/ Investors' Grievance and Administrative Committee) is very important in terms of approving, transferring and transmission of shares, etc. It also reviews the queries/complaints received from the shareholders.

- **Corporate Social Responsibility Committee**

In order to have company's contribution to the social sector development, CSR has been mandatory for companies, which have net worth of Rs. 500 crore or more, or turnover of Rs.1000 crore or more or a net profit of Rs.5 crore or more during any financial year. Such companies need to have CSR Committee of the board, which can articulate the scope of CSR activities, by ensuring compliance with the CSR policy of the banks in accordance to the Companies Act 2013. Key functions of the committee include review of CSR initiatives, formulation of CSR policy, monitoring the CSR activities, implementation of and compliance with the CSR Policy and reviewing and implementing.

Important Guidelines of RBI on Corporate Governance

RBI issues important guidelines from time to time to the banks, NBFC and other financial institutions, which comes under its supervisory control. Some of the key guidelines are discussed below:

- **Guidelines for Licensing of 'Payments Banks'**

The RBI through its recent guideline dated November 27, 2014for Licensing of Payments Banks,emphasized that the Board of the banks should have a majority of independent Directors as well as banks are required to comply with the corporate governance guidelines issued from time to time by the RBI, SEBI, etc.

- **Corporate Governance Directions for Non-Banking Financial Companies (NBFC's)**

RBI vide its Master Circular no. RBI/2015-16/12 DNBR (PD) CC.No.053/03.10.119/2015-16 dated July 1, 2015 directed the NBFCs to frame internal guidelines on corporate governance which is to be approved by its Board of Directors. Through this circular, NFC's are required to have three Board committees on mandatory basis including, Audit Committee, Nomination Committee and Risk Management Committee.

- **Fit & Proper Criteria for Directors**

NBFC's are required to have in place a Board approved policy on 'Fit and Proper Criteria for Directors.Through which, company obtains necessary disclosures from Directors from time to time. The companies are required to ensure in furnishing to the RBI, statement on change of directors and a certificate confirming that fit and proper criteria in selection of the directors has been followed.

Basel Committee on Corporate Governance Principles for Banks

The Basel Committee on banking supervision was setup in 1975 by the Central Bank Governors of the G10 developed countries. It is empowered as the banking supervisory authority. Since its inception, it has introduced the Basel Capital Accord in, the New Basel Capital Accord in 2003.BIS (2015) havecome out with guidelines on corporate governance principles for banks with an objective of promoting the adoption of sound corporate governance practices by banks in worldwide.

Conclusion

The special nature of banking institutions necessitates a broad view of corporate governance where regulation of banking activities is required to protect depositors. In developed economies, protection of depositors in a deregulated environment is typically provided by a system of prudential regulation, but in developing economies such protection is undermined by the lack of well-trained supervisors, inadequate disclosure requirements, the cost of raising bank capital and the presence of distributional cartels. Due to special nature of the activities carried on by the banks, they face a lot of problems as far as the area of corporate governance is concerned. Also, in the Indian scenario, due to the peculiar nature of bank holdings there are a lot of embedded conflicts. There exists a doubt as to what standard should be applied while enforcing corporate governance in banks. Central banks play an important role in this regard. The guidance paper issued by the Basel Committee is of paramount significance in enforcing corporate governance standards in various countries across the world. As far as best corporate governance practices for banks are concerned, they may include realization that the times are changing, establishing an effective, capable and reliable board of directors, establishing a corporate code of ethics by the banks for themselves, considering establishing an office of the chairman of the board, having an effective and operating audit committee, compensation committee and nominating/ corporate governance committee in place, considering effective board compensation, disclosing the information and recognizing their duty to establish corporate governance procedures that will serve to enhance shareholder value.

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