AN EMPIRICAL STUDY ON COMPONENTS OF CORPORATE GOVERNANCE AND ITS IMPACT ON BANKS PERFORMANCE

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ABSTRACT

The globalization of banking markets has raised important issues regarding corporate governance regulation for banking institutions. Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy." From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they function and has some of its objectives as meet the obligation of accountability to their shareholders and take into account the interests of other recognized stakeholders; align corporate activities and behavior with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations.

This research paper addresses some of the major issues of corporate governance as it relates to banking regulation with objectives to study the corporate governance of the selected bank. Also to measure the impact of component of corporate governance on its performance. An attempt is made to find out the relationship of banks profitability with the help of ROA (Return On Assets), ROE (Return On Equity), NPM (Net Profit Margin), and TOBIN Q. For the same, five components viz, Shareholders and general shareholders meeting, Board of Directors, Supervisory board, Disclosure and transparency, auditing and Violation are used. The study conclude that in private banks supervisory board is not good because it CGI (Corporate Governance Index) point lies below the MIN point and there is need to improvement in his operation policy and paid based on their performance.

Key Points: Corporate Governance, Banking Regulation, CGI Scoring

I. OVERVIEW OF INDIAN BANKING SYSTEM

The Indian banking system consist of 26 public sector banks, 20 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. Public- sector banks control nearly 80 percent of the market, thereby leaving comparatively much smaller shares for its private peers. In 2012 banks were impacted by the strong economic headwinds, heighten regulatory pressure, persistently high cost structures, and low customer trust. Market volatility and Euro zone debt concerns continued to weigh down the underperforming European banking sector index.

As of August 5, 2015, 175 million accounts had been opened under Pradhanmantri Jan Dhan Yojna (PMJDY) and 154 million Repay debit cards were issued. These new accounts have mustered deposits worth Rs 22,033 cr (US$ 3.31 billion). Standard & Poor estimates that credit growth in India's banking sector would improve to 12-13 per cent in FY16 from less than 10 per cent in the second half of CY14.

II. CORPORATE GOVERNANCE AND ITS SIGNIFICANCE

Corporate Governance is a mechanism to structure, operate and control a company with the objective to achieve long-term strategic goals of safeguarding the interests of shareholders and different stakeholders. It is concerned with the proper implementation of policies and procedures by a company to satisfy its related parties including shareholders, employees, customers, suppliers, regulatory authorities and the community at large. SEBI came up the regulations for listing companies in 1999, which included mandatory and non-mandatory recommendations. These guidelines played a prominent role in the Indian corporations. Followed by CII and SEBI (Security Exchange Board of India) other regulatory authorities also actively participated in strengthening the corporate governance system of India. Besides these, to improve the effectiveness and supervision of banking industry Reserve Bank of India has also adopted various corrective actions. The issue of Corporate Governance is of much concern for the banking sector as these financial institutions are the machines for economic growth both in developing as well as developed nations. In addition the banking institutions are the repositories of households' savings and the consequences of the poor governance of these institutions leads to the involvement of large amount of systematic as well as social cost. Governance of banking institutions is more important than the non-financial firms because of lack of transparency, higher regulations and these also have a critical position in development of economies.

A Component of Corporate Governance:

A. ***Board of Director:*** A board of director is a group of individuals that are elected as, or elected to act as, representatives of the stockholders to establish corporate management related policies and to make decisions on major company issues.

B. ***Supervisory Board:*** A supervisory board or supervisory committee, often called board of director, is a group of individuals chosen by the stockholders of a company to promote their interests through the governance of the company and to hire and supervise the executive directors and CEO.

C. ***Executive Director & Non-Executive Director:*** An executive director is a chief executive officer (CEO) or managing director of an organization, company, or corporation. The title is widely used in North American non-profit organizations, though many United States nonprofits have adopted the title president or CEO.

   A non-executive director is a member of a company's board of directors who is not part of the executive team. A non-executive director typically does not enage in the day-to-day management of the organization, but is involved In policy making and planning exercises.

D. ***Independent Director:*** An independent director (also sometime known as an outside director) is a director (member) of a board of directors who does not have a material or pecuniary relationship with company or related persons expect sitting fees. Independent Directors do not own shares in the company.

E. ***Audit Committee:*** An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management. Most audit committees are made up of three to five or sometimes as many as seven directors who are not a part of company management.

III. LITERATURE REVIEW

Anshuman Kumar, Yatin Nihalani (2014) studies shows that an unbalanced panel of 40 Indian banks both from the public and the private sector tried to predict the impact of the composition of the board of directors, via ordinary linear regression applied to key performance indicators like ROA, ROE, and Return on Long Term Funds, P/BV ratio and EPS (Earning Per Share). The study implies positive correlation between the numbers of people present in the board of a bank. It also indicates negative correlation between the number of board meetings held by a company and its financial performance. The presence of directors holding chairs in boards of other firms has a detrimental impact on indicators like Returns on Long Term Funds. CMA Dr.Meenu maheshwari, Sapna meena (2014) observed that research alternative hypothesis has been proved that SBI is showing maximum compliance toward corporate governance norms. The positive aspects of SBI corporate governance practices include board corporate governance philosophy, requisite and sufficient number of board member with large representative of non-executive directors. Some negative aspect like not disclosing information on dematerialization of share, whist blower policy, review of chairman of various committee an director seeking appointment or re-appointment information are not given in the annual report. Jatinder Kaur(2014) Corporate Governance has insignificant effect on the performance of Indian banks. Corporate governance is most likely to impact the performance of banks from different dimensions. In addition to accounting measures, operating measures, market valuation or efficiency of banks all are subject to have positive influence of better corporate governance which can be addressed in further research. Robin Thomas, Shailesh Singh Thakur(2014) The findings showed a smaller board size, higher proportion of independent directors and a higher percentage of public ownership lead to better performance of Indian banks. Tran Thi Thanh Tu1, Nguyen Hong Son1 & Pham Bao Khanh(2014) The ROE and ROA is used to measure the bank performance. There is a statistically significant difference in corporate governance of listed banks and non- listed banks in Vietnam. They also found the positive correlation of disclosure, the role of board of directors, shareholders and shareholder meetings with bank performance.

IV. RESEARCH METHODOLOGY

A) Objectives of The Study

1. To assess the corporate governance of the selected bank.
2. To measure the impact of component of corporate governance on bank performance.

B) Hypothesis

Ho: The components of CG have no significant relationship with banks profitability measured by ROA, ROE, NPM, and TOBIN Q.

Ha: The components of CG have a significant relationship with banks profitability measured by ROA, ROE, NPM, and TOBIN Q.

Ho: There is no significant difference in the corporate governance index scoring between private and public banks.

Ha: There is a significant difference in the corporate governance index scoring between private and public banks.

V. DATA ANALYSIS AND INTERPRETATIONS

The CGS table no.1.2 shows that private and public sector banks adhere to the required norms for corporate governance .out of the the five years of study period on an average ICICI has scored highest among four public players in meeting and overall scoring highest in all five components of corporate governance taken in consideration. Among public players SBI has scored maximum points followed by BOB in the scoring among five components .none of the banks have violated the disclosure norms of CG (Corporate Governance).

Ho: There is no significant difference in the corporate governance index scoring between private and public banks.

Ha: There is a significant difference in the corporate governance index scoring between private and public banks.

The Mann-Whitney U test has been used to compare the CG scoreing of the banks and test whether there is any significant difference in the scoreing of the components. Table no.1.3 states that there is a significant difference in the scoreing of CG2 (composition of the board of directors) and CG4 (disclosure and transparency) among public and private banks at 1% level of significance. The same is evident from table 1.3. There is a difference in the median score of the CG2 and CG4 components for public and private banks. And private banks have performed superior as compared to public banks. According to Icra, public sector banks cannot achieve the highest possible corporate governance rating. This is due to the composition of boards and committees, as well as limited scope of such banks to adopt emerging best practices in succession planning, executive compensation, not to mention limited managerial autonomy wherein shareholder rights are weaker compared to companies in other sectors.

Ho: The components of CG have no significant relationship with banks profitability measured by ROA, ROE, NPM, and TOBIN Q.

Ha: The components of CG have a significant relationship with banks profitability measured by ROA, ROE, NPM, and TOBIN Q.

As the data was not normally distributed spearman's rho correlation has been used (non-parametric correlation test). Table 1.4 shows that CG2 (composition of the board of directors) has a significant relationship with ROE, ROA and NPM of the banks , CG3 (supervisory board) has a signification relationship with ROE(return on equity) and NPM and CG1 (shareholders and general meeting) has a significant relationship at ROA of the bank.

VI. FINDINGS AND CONCLUSIONS

This study was conducted to test whether component of corporate governance has an significant effect on bank performance. The above finding suggest that in private banks supervisory board is not good because it CGI point lies below the MIN point and compare to all bank HDFC bank violation point is -1, which is not good for bank, remaining all component of CG are strong and in public bank union bank violation point is also -1 which is not good for bank. Above finding also suggest that CG1 and CG3, CG5 mean difference are insignificant and CG2 and CG4 are significant and it also depict the large gap in CG2 and CG4 compare to CG1 and CG3.

Private bank among all 4 dependent variable ROE, ROA, NPM, TQ. TQ is not normally distributed and CG3 and CG5 are also not normally distributed. Finding also suggest that ROA has a perfect strong relation with CG1 there is large variability compare to another variable there is a 0.833 variability in ROA due to CG1.In public bank among all 4 dependent variable like ROE, ROA, NPM, TQ. ROE, ROA are normally distributed and CG1, CG2 are also normally distributed. ROE have a strong relationship with CG2 and CG3, ROA with CG2 and NPM with CG2, CG3.

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FIGURES AND TABLES

Table: 1 Showing the corporate governance Index value for the five components

Components	Expected Max Value	Expected Min Value	Median
Shareholders and general shareholders meeting	37	18	28
Board of director	34	18	26
Supervisory board	8	8	8
Disclosure and transparency, auditing	21	12	17
Violation	0	-1	-0.5

Table: 2 Showing CGI Scoring for Private & Public Banks

Name of the bank	Scoring of five components					
	ders and general shareholders	Board of director	Supervisory board	e and transparency,	Violation	Total out of 100
Hdfc	25	33	6	18	0	82
Axis	32	29	5	16	0	82
Icici	33	32	6	17	0	88
Yes bank	25	33	6	18	0	83
Median score	**28.5**	**32.5**	**6**	**17.5**	**0**	
Union bank	26	29	7	13	0	74
State bank of india	33	30	7	15	0	85
Punjab national bank	28	27	6	14	0	75
Median score	**28.5**	**28**	**6.5**	**14**	**0**	**0**

Table: 3: Showing Mann Whitney U Test (non-parametric test)

	CG1PP	CG2PP	CG3PP	CG4PP	CG5PP
	184	102	165.5	81.5	200
Z	-0.437	-2.669	-0.989	-3.252	0
Asymp. Sig. (2-tailed)	0.662	0.008	0.323	0.001	1

Table: 4 Showing Spearman's rho

			CG1	CG2	CG3	CG4	CG5
Spear man's rho	ROE	Correlation Coefficient	0.365	.672**	.595**	0.287	0.02
		Sig. (2-tailed)	0.114	0.001	0.006	0.22	0.934
	ROA	Correlation Coefficient	.499*	.573**	0.404	0.201	0.378
		Sig. (2-tailed)	0.025	0.008	0.077	0.396	0.1
	NPM	Correlation Coefficient	0.392	.516*	.541*	0.173	0.06
		Sig. (2-tailed)	0.087	0.02	0.014	0.466	0.803
	TQ	Correlation Coefficient	0.064	0.134	0.317	0.261	0.06
		Sig. (2-tailed)	0.788	0.572	0.173	0.266	0.803

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

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