A Comparative Review of Corporate Governance Practices within Banking Sector (Private, Public and Foreign Banks): An empirical review

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ABSTRACT: Banking sector contributes substantially towards the overall growth and development to economy within emerging countries like India, and therefore there is a need for healthy investment environment. Mismanagement within banks due to frauds have been reported in the part, therefore corporate governance has emerged as an important ideal and there is need to evaluate the level of enforcement of Corporate Governance practices. The study has therefore been undertaken to conduct comparative analysis of corporate governance practices between three types of banks; public, private and foreign banks (N=100) in India. This research aimed to determine the present corporate governance practices in respective banks. The findings of the study indicate that the role of ‘Board of Directors’ was important. Comparative analysis across the banks indicated that there is difference in corporate governance banks practices across the three sectors. The respondents across all the banks indicated that there was scope of further improvement.

Keywords: Corporate governance, financial disclosure, Non-financial disclosure, Issues of code of conducts, Board of Directors.

1. Introduction

The need for corporate governance in India was felt after the government adopted the policy of liberalization, privatization, and globalization in early 1990s. The corporate culture of India is connected to the dominance of State Owned Enterprises (SOEs) before liberalization and privatization in 1990s. Fernando (2009) explains that the industrial and business organizations in India were quite unethical towards their employees, shareholders and customers. Furthermore, he points out, that at the SOEs the employees at all the levels indulged in mis-governance, and at the private enterprises, only employees at the top level of the management indulged in mis-governance.

A major security market scam, back then, by Harshad Mehta, in 1992, which, also, involved a large number of banks was a result of corporate mis-governance. Similarly, in 1995-98, mutual funds scam, witnessed public sector banks raised Rs. 15,000 crores, and could not fulfill its commitments (Fernando, 2009). No major scam involving banks has happened in India. But, the Asian financial crisis of 1997-98, and other financial emergencies in the western economies signals the requirement of a strong financial architecture in an increasingly globalized world (Deb, 2013).

Globally, in 1988, the Basel Committee on Banking Supervision introduced Basel norms I to cover credit risk of the banks. In India, in 1994, a Board of Financial Supervision (BFS) was formed involving Central Board of Directors of Reserve Bank of India (RBI). Under the BFS, the RBI regulates the corporate governance of the banks. It monitors bank’s corporate governance using the CAMELS approach, which means, capital adequacy, asset quality, management, earnings, liquidity, and systems and controls. This study is an attempt to perform an empirical review on corporate governance practices adopted by public and private sector banks in India.

1.2 Aims and Objectives

The aim of this study is to conduct a comparative analysis of corporate governance practices in the public, private and foreign banks in India.

The objective is:
1. To determine the current state of corporate governance within the banking industry.
2. To determine the different corporate governance practices within the banks.

1.3 Literature Review

1.3.1 Defining Corporate Governance

Corporate governance has been defined by many international organizations, government institutions, and scholars in the last five decades. Nobel Laureate and economist Milton Friedman (1970) defined it narrowly in terms of principal-agent problem, wherein the interests of the business clash with the shareholder’s desires (Fernando,
2009, p.14). Standard & Poor (S&P) (n.d.) also defined corporate governance narrowly to fair sharing of profits between the shareholders and the management.

Over the years, the definition of Corporate Governance by the OECD (1999), as cited in Brahmbhatt, Patel, & Patel (2012) specifies that the rights and responsibilities, duties, rules and regulations of all the human resources in the corporation, and indirectly helps in framing the objectives, and aims of the organization. Furthermore, it develops the means of monitoring those objectives.

The most appropriate definition for this study is from Securities and the Exchange Board of India (SEBI) can be applied to this research. According to SEBI, corporate governance is about following the best practices ethically, and the maintenance of distinct corporate and personal funds of the management.

1.3.2 Need for Corporate Governance within Banking Sector

Banking sector is the most important sector within an economy, as it works as an engine towards the regulation of the monetary policies within country. Scholars have pointed several reasons towards the adoption of corporate governance within the banking sector (Chakrabarti, 2005; Katrodia, 2014). Firstly, it functions in a less transparent manner as compared to other businesses, which means the information is hidden from the large number of creditors. The nature of the banking business can prompt the management to alter the risk profile of the banks and siphon off the funds (Chakrabarti, 2005).

Secondly, a majority of business is done by public sector banks in India, so, it can be termed as and unregulated industry. Various studies suggest that principal-agent problem, i.e. differences in opinions and interests when a principal hires an agent to act/ make decisions on his behalf, crops up in public enterprises (Fratianni, Hagen, & Waller, 1997; Schmielewski & Wein, 2012). This fact itself entails requirement of strict corporate governance practices (Katrodia, 2014).

Thirdly, being the most important sector, which is tied up with the State policies, the corporate governance practices at the banks would serve as the model, that should be followed by others business organizations in the financial industry.

Fourthly, the banks differ from other business corporations with regard to the complexity and the kinds of business risks these are vulnerable to. Besides that, the consequences of these risks if poorly managed can affect the economy at a macro level (Pati, 2006).

1.3.3 Corporate Governance Practices within Banking Sector: Empirical Review

To understand the corporate governance practices within the banking sector in India, several studies have been conducted by scholars. A few of these are discussed as below:

A study was conducted by Brahmbhatt et al. (2012) in order to compare corporate governance practices in public and the private sector banks. The findings of the study reveal the possibility of improvement of corporate governance laws for the betterment of all stakeholders across both the banks. The author collected data from selected Public and Private sector banks (SBI, Bank of India, ICICI, Axis, etc.) through a survey questionnaire. Parameters based scorecard method was used to conduct the comparative analysis, on the basis of Clause 49. The main findings of the study brought up the score cards and ranking of banks taken in sample. It ranked Bank of India 1, State Bank of India 2, ICICI bank 3, and Axis Bank Ltd 4 and so on for observance of corporate governance within the firm through stringent regulations.

Deb (2013) conducted a study among senior managers of public and private sector banks (N=5) to determine the corporate governance practices. Researcher analyzed that banks need to ensure transparency in financial statements, in order to protect their shareholders. Comparative study across the banks revealed that public banks were more transparent in comparison to private banks.

Another study published by Sharma & Gupta (2013) aimed to find out the comparative transparency of operations and performance in public (N=18) and private sector banks (N= 16) between 2008 and 2012 through the development of a corporate disclosure index based on 49 parameters. The results of this study indicate that there is not much difference in the disclosure norms followed by the public sector banks and the private sector banks in the year 2011-12.

A recent study conducted by Sangmi & Jan (2014) in 2013, aimed to find out the difference between the corporate governance of public sector banks and private sector banks on the basis of clause 49 of SEBI through a survey of managers in 96 Commercial Banks (27 Public Sector, 31 Private Sector and 38 Foreign Banks). The main finding of this study is that there is no significant difference between the corporate governance policies of public sector banks and private sector banks. But, according to this study, there exists a significant difference between the old private sector banks and new private sector banks’ corporate governance.

From the above information, it is clear that none of these have discussed the significance of foreign banks in the context of corporate governance. The present study aims to find out the corporate governance differences in the foreign, public and private banks.
1.4 Research Methodology

1.4.1 Sources of Information

The paper uses descriptive methods to determine the corporate governance practices of banks which include public banks, private banks and foreign banks (N=100). Primary data was collected from bank employees in Delhi. Questionnaire was developed (See Appendix 1) and responses were gathered to highlight the comparative review of corporate governance practices across sample banks. Aim and objectives of the study were explained to the respondents. Additionally, the researcher also collected secondary data from different sources, for example, journals, newspapers, thesis, report etc.

1. Sampling Plan

In this study, the sample size was 100 and simple random sampling was implied to gather the data of 100 respondents as the respondents. 3 Banks were selected, 1 each from public bank (N=30), private bank (N=30) and foreign bank (N=40). Self-administered questionnaire was developed and distributed and responses were gathered for further analysis.

1. Tools and Techniques

Quantitative analysis was adopted in this research wherein SPSS 19.0 was used for analysis. The researcher transferred the responses to an excel sheet by coding them and then imported the data to SPSS 19.0. The frequency analysis was conducted to determine demographic profile of the respondents and likert scale was applied to understand the corporate governance practices of the banks.

1.4.2 Research Hypothesis

Hypothesis 1: There is no significant difference between the Corporate Governance Practices across Public Sector, Private Sector and Foreign Banks in India.

2. Analysis and Interpretation

2.1 Demographic Analysis of the respondents

The demographic analysis revealed that more males (65%) participated in the survey in comparison to females, 60% of the respondents were well educated with post-graduation degree. 38% of the respondents indicated that they were working with the organization for more than 15 years, so their long association with the organization has proved they have knowledge about the corporate governance practices of their bank. Further, regarding the board size of the bank, 57% of the bank employees responded that they have 10 to 15 board members in their bank and more than half of the sample population indicated about the crucial role of ‘Board of Directors’ and that regular reports are generated by the internal auditor. Lastly, according to 73% of the respondents the chief internal auditor has unrestricted communications with external auditors. The respondents (66%) added also that there is scope of improved corporate governance practices in their bank.

1. Hypothesis Testing

Null Hypothesis (H1): There is no significant difference between the Corporate Governance Practices across Public Sector, Private Sector and Foreign Banks in India.

Alternative Hypothesis (H1A): There is significant difference between the Corporate Governance Practices across Public Sector, Private Sector and Foreign Banks in India.

The above hypothesis has been estimated through each bank’s quantification of mean and the table has been presented on the basis of factor and these four factors are financial disclosure, non-financial disclosure, internal communication and code of conduct. The results of corporate governance practices w.r.t. financial disclosure are presented below. The results indicate that nearly all the banks had sound corporate governance practices in terms of segment reporting, critical accounting policies, financial and operating results and information regarding future plans were disclosed regularly to stakeholders.

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Public Bank (N=30)</th>
<th>Private bank (N=30)</th>
<th>Foreign bank (N=40)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do Financial Disclosure influences on corporate governance practices?</td>
<td>1.95</td>
<td>1.80</td>
<td>1.95</td>
</tr>
<tr>
<td>Financial and Operating Results.</td>
<td>2.03</td>
<td>2.03</td>
<td>2.00</td>
</tr>
<tr>
<td>Critical Accounting Policies.</td>
<td>2.03</td>
<td>1.73</td>
<td>1.98</td>
</tr>
<tr>
<td>Segment reporting.</td>
<td>1.93</td>
<td>1.93</td>
<td>1.88</td>
</tr>
<tr>
<td>Information regarding future plan.</td>
<td>2.05</td>
<td>1.87</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Table 1: Mean of Financial Disclosure

The mean of Non-financial disclosures of each bank has been presented below. The table indicated that the Public and Foreign banks had better non-financial disclosure enforcement in comparison to private banks as the
responses from private banks employees were skewed more towards neutral stand. Foreign banks indicated to have better risk management disclosure policies in comparison to other banks.

<table>
<thead>
<tr>
<th></th>
<th>Public Bank (N=30)</th>
<th>Private bank (N=30)</th>
<th>Foreign bank (N=40)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do non-financial disclosure influences on corporate governance practices?</td>
<td>2.07</td>
<td>2.55</td>
<td>1.95</td>
</tr>
<tr>
<td>Ownership and shareholders’ rights.</td>
<td>2.17</td>
<td>2.55</td>
<td>2.03</td>
</tr>
<tr>
<td>Governance structure and policies.</td>
<td>2.15</td>
<td>2.68</td>
<td>2.03</td>
</tr>
<tr>
<td>Risk management.</td>
<td>2.11</td>
<td>2.55</td>
<td>1.93</td>
</tr>
<tr>
<td>Independence of auditors.</td>
<td>2.20</td>
<td>2.74</td>
<td>2.05</td>
</tr>
</tbody>
</table>

Table 2: Mean of Non-financial disclosure

In terms of Issues of code of conduct the results of three banks have been presented below. According to the table, public banks (1.80) had better corporate governance practices in comparison to private and foreign banks. Foreign banks indicated to have better compliance and enforcement in terms of information privacy of outsider information and compliance of laws and regulations which could be because they were more serious in operation in foreign land.

<table>
<thead>
<tr>
<th></th>
<th>Public Bank (N=30)</th>
<th>Private bank (N=30)</th>
<th>Foreign bank (N=40)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do issues of code of conduct influences corporate governance practices?</td>
<td>1.80</td>
<td>2.50</td>
<td>1.95</td>
</tr>
<tr>
<td>Ethical standards in dealing with customers, vendors and other relevant parties.</td>
<td>2.03</td>
<td>2.43</td>
<td>2.08</td>
</tr>
<tr>
<td>Company expectations of management and employees.</td>
<td>1.83</td>
<td>2.63</td>
<td>2.10</td>
</tr>
<tr>
<td>The privacy of information about outsider companies.</td>
<td>2.00</td>
<td>2.47</td>
<td>1.93</td>
</tr>
<tr>
<td>The privacy of information about employees.</td>
<td>1.90</td>
<td>2.70</td>
<td>2.00</td>
</tr>
<tr>
<td>The importance of Compliance with laws and regulations.</td>
<td>1.90</td>
<td>2.67</td>
<td>1.93</td>
</tr>
</tbody>
</table>

Table 3: Mean of Issues of code of conduct

3. Conclusion and Discussion

This study has tried to determine the corporate governance practices of public, private and foreign banks. The findings of the study has showed that there is significant difference in mean score across the bank, with some areas of more significant importance for private banks in comparison to other two banks. Nevertheless, better compliance and enforcement of corporate governance practices was mostly indicated by public and foreign banks. Therefore null hypothesis is rejected and alternative hypothesis is accepted in this study.

References:


