

A Study of Corporate Governance in Public Sector Banks

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ABSTRACT

Numerous factors influence Corporate Governance. Understanding and defining Corporate Governance is a challenging task. However, conducting research is crucial to grasp the evolving specific requirements of effective Corporate Governance practices and the consequences of such practices.

This research delves into the Corporate Governance of banks in India by utilizing a specially crafted Corporate Governance Index for banks. The index, segmented into six sub-indices, was employed to determine the correlation between CG practices and the bank's profitability, as measured by Return on Assets (ROA) and Net Interest Margin (NIM), as well as firm value metrics such as Price to Book value (PBV) and Tobin's Q. Additionally, a comparison was made between the CG practices of CG-rated public and non-rated private sector banks in India.

For this study, a selective sample of ten banks in India was chosen, comprising an equal number of public and private sector banks, with data collected over an eight-year period from 2009 to 2016. A fixed regression model was utilized to explore the relationship between the sub-indices and the dependent variables. In addition to the CG index, Capital Adequacy Ratio (CAR) and Net NPA ratio were considered as independent variables. The analysis revealed a weak correlation between CG and ROA and NIM, while a significantly strong relationship was established between CG and PBV and Tobin's Q. Furthermore, the governance practices and financial performance of private banks were found to surpass those of public banks.

INTRODUCTION

An equilibrium must be established to ensure that corporate governance does not hinder the growth of the corporate sector. This balance is crucial for the effective management of businesses. The framework of corporate governance is essential for the internal operations of a company. It sets the guidelines for how a business should be managed. Transparency and fairness in operating procedures are key, with both management and shareholders taking responsibility for their actions. Given the separation of ownership and management, corporate governance plays a vital role in ensuring accountability. It influences a company's communication, leadership, strategy, and policies. Directors and senior executives fall under its jurisdiction. The concept of agency relations raises important questions about trust and confidence in a company's operations and management. Corporate scandals like those involving Worldcom, Enron, and Satyam have highlighted the importance of governance mechanisms in firms.

Corporate governance practices are aimed at maximizing shareholder value while also protecting the interests of other stakeholders. According to OECD principles, corporate governance involves relationships between a company's management, board, shareholders, and other stakeholders. This definition emphasizes that corporate governance involves not only directors but also shareholders, management, and all other stakeholders such as lenders, government, and markets. The interaction between shareholders, the board of directors, and management shapes corporate performance. A healthy relationship between shareholders and management is essential, with no conflicts.

Given the broad scope of corporate governance, it is challenging to identify a single defining component. However, the following elements are typically included in corporate governance frameworks:

- Relationship between Shareholders, Directors and Management
- Policies and Practices
- Strategic Decision- making
- Creating a Culture within the organization
- Shareholders and Managers:
- Contribution to Society
- Ensure Compliance
- Define Ethics of an Organization
- Value to Shareholders

STUDY OBJECTIVES

- a. To compare the key corporate governance guidelines proposed by a segment of Public and Private Sector Banks.
- b. To investigate significant CG traits within the Indian banking sector.
- c. To critically analyze the development of CG methodologies in the Indian Banking Industry.
- d. To appraise the decision-making procedures of the banking sector concerning effective CG.

LITERATURE REVIEW

The argument put forth by the writers highlighted the increasing trend of corporate fraud, particularly affecting the board of directors. Their role shifted from being mere spectators to actively managing performance comparisons and monitoring. The recent downfall of major American corporations due to fraudulent activities has subjected board members to rigorous scrutiny from regulatory bodies and the financial sector. The writers delved into corporate governance from both micro and macro perspectives, focusing on the dynamics between shareholders, executives, and corporate governance mechanisms. This also sheds light on how agencies engage with stakeholders and the wider community. The authors analyzed financial and non-financial data disclosures in the annual reports of forty publicly traded companies using a disclosure index comprising 35 items, revealing discrepancies in the quality of disclosures among the sampled firms.

The authors suggested that a significant outcome of recent corporate governance issues is a shift in the perception of governance. They noted that consumer demand highlights substantial variations in the reporting of both statutory and non-statutory data across different enterprises. Only a small number of large corporations included essential documents like balance sheets, directors' reports, auditors' reviews, profit and loss accounts, etc., in their disclosures, while voluntary disclosures were even scarcer. Several studies have explored corporate governance within the Indian market, and the following section provides an overview of some of the most recent and significant research findings.

1. **CG Index:** The complexity of financial markets has led to the discovery of an increasing number of factors that influence corporate governance practices. Initially, only a few key components such as ownership structure, board composition, and corporate issues were considered part of corporate governance. However, market participants are now seeking guidance on governance standards across various interconnected areas like shareholders' rights, disclosures, related party transactions, and more, in response to negative corporate scandal narratives. The CG Index, which encompasses all elements believed to impact governance practices, is utilized to identify such activities. One of the earliest studies, conducted with the help of Gompers et al. (2003), established a 24-provision corporate governance index focusing on shareholders' rights. This study revealed that companies with strong shareholder rights experienced higher profits and better firm valuations, while those with weaker shareholder rights underperformed in the 1990s.
2. **Director's Board:** The Board of Directors holds primary decision-making authority within the corporation, making their role in corporate governance crucial. They are expected to align their work with the company's objectives and have the power to make decisions regarding the enterprise's resources. Various aspects of the board are linked to effective governance practices. Marishetty (2011) identified the four pillars of corporate governance as managers, directors, shareholders, and laws and regulations, providing a comprehensive framework. By incorporating insights from Mr. Narayan Murthy's interview, the author developed a method for observing corporate governance that bridges the gap between theory and practice. The Board of Directors oversees internal governance, while shareholders are involved in external governance. Key areas of focus include impartial directors, board composition, compensation, committees, and the types of unbiased administrators. The examination revealed that a sound corporate governance structure is based on principles, ethics, and a pricing system.
3. **Shareholders:** Shareholders play a crucial role in the company as they provide the majority of capital and are the ones most affected by inadequate corporate governance. Various studies discuss the costs associated with shareholders and the importance of protecting their rights. Chi (2005) suggests that by strengthening shareholder rights, organizational costs can be reduced. To assess corporate governance, Chi developed an index called "G" based on shareholder rights. The author identified a relationship where firm price impacts shareholder rights, and in turn, shareholder rights positively impact firm price.
4. **Ownership:** The ownership structure differs significantly, and being aware of ownership has an influence on the procedures of corporate governance. As per Gopalan(2006), entrepreneurs opt for private ownership due to the stricter, inflexible, and less forgiving nature of corporate governance for publicly owned organization compared to privately owned companies. Even with increased external funding, entrepreneurs have more freedom to make decisions that can enhance the company's value; furthermore, public ownership offers investors liquidity and a lower cost of capital. Yasser(2011) analyzed the impact of corporate governance factors exclusively between 2003 and 2008, as this period reflects the post-implementation effects of the corporate governance code.

RESEARCH METHODOLOGY

The study is focused on eight prominent Indian banks, with four being public(State Bank of India, BoB, PNB and UBI) and

<u>Name of Bank</u>	<u>Year of Establishment</u>	<u>Market Capitalisation (Rs. Crore)</u>
<u>Private Sector Banks</u>		
Dhanlaxmi Bank Ltd.	1927	505.73

The Lakshmi Vilas Bank Ltd.	1926	2651.54
DCB Bank Ltd.	1930	3399.55
ICICI Bank	1994	149536.04
Public Sector Banks		
United Bank of India	1950	2786.05
Punjab National Bank	1894	27791.27
Bank of Baroda	1908	35846.63
State Bank of India	1955	197601.49

Brief Description of Sample Selected under the Study

HYPOTHESIS

H0: Banks in the public and private sectors report corporate governance disclosures in their annual reports in the same ways.

H1: Banks in the public and private sectors report corporate governance disclosures in their annual reports differently.

Data Analysis & Interpretation

We will begin our review with HDFC Bank, proceed to ICICI Bank, SBI, and lastly, PNB. It will restrict the scope of our conversation to these five primary attributes:

- Customer mix
- Product mix
- Infrastructure
- Exposure to rural areas
- Communication and Synergy

Through personal trips to their branches, conversations with their clients, frequent visits to their websites, and—most importantly—an examination of their annual reports, we have obtained information about these banks. We will concentrate on how they performed during the fiscal year 2022–2023 (FY23), which ran from April 1, 2022, to March 31, 2023. To properly comprehend their current situation, we shall, nevertheless, take into account the effects of the recent past events.

Let's get our assessment underway.

A. HDFC Bank

With respect to market capitalization, it is currently the biggest bank in India. Let's assess this bank using the five previously indicated criteria.

Customer Mix: The bank has more than 8.28 lakh customers, with a total of Rs. 1600586 crore in advances and Rs. 1883395 crore in deposits, according to the annual report for 2022–2023. This means that each customer will receive an approximate advance of Rs. 1.92 lakh and a deposit of Rs. 2.19 lakh. They employ 173222 people, or 501 clients for every employee.

Product Mix: HDFC Bank offers a variety of products to cater to both retail and wholesale clients. Under its own brand name, it provides a range of products including deposit, credit, payment, investment, currency, and insurance.

Infrastructure: HDFC Bank boasts a vast branch network and a strong and efficient digital infrastructure. both domestically and internationally. It experienced certain issues with its digital infrastructure in December 2020, and the RBI forbade it from issuing any more credit cards pending further orders. In August 2021, the RBI partially

loosened the limitations. Completely digital services, including easy loan disbursement and account opening, are offered by HDFC Bank. It offers quick customer service and a seamless experience. Additionally, the internal grievance redressal procedure is good.

Rural Exposure: With 2158, 1566, and 2674 branches, respectively, HDFC Bank is mostly found in metro, urban, and semi-urban areas. With only 7821 branches, it has a limited branch network that is not exposed to rural areas. However, it makes up for it with 204 more BCs and 10748 CSC BCs. It features cash deposits and 19727 ATMs. and withdrawal machines in metropolitan, semi-urban, rural, and local areas, respectively.

Synergy and communication: HDFC bank offers a vast range of products and a lot of branches, ATMs, cash deposit and withdrawal machines, and other service locations. It has done a great job of building effective lines of communication and fostering collaboration among all of these service providers.

B. ICICI Bank

Customer Mix: The bank has a total of Rs. 11808.41 billion in deposits and Rs. 10196.38 billion in advances as of the annual report for 2022–2023. Its clientele numbers over 5.5 million. This means that each customer will receive an approximate advance of Rs. 1.91 lakh and a deposit of Rs. 2.36 lakh. There are 425 clients for every 130542 staff.

Product Mix: ICICI Bank offers a variety of products to cater to both retail and wholesale clients. Under its own brand name, it provides a range of products including deposit, credit, payment, investment, currency, and insurance.

Infrastructure: Among all the Indian banks, ICICI bank most likely has the strongest and most capable digital infrastructure. It also boasts a vast branch network both domestically and overseas. Account opening and other fully digital services are offered by ICICI Bank. Loan disbursement is quite simple. It is a trailblazer in this domain. It offers quick customer service and a seamless experience. The procedure for resolving internal grievances is highly effective.

Exposure in Rural Areas: The Bank's presence in these areas is facilitated by a network of branches, ATMs, field employees, and business correspondents (BCs) who offer last-mile connectivity in isolated locations. 649 of the Bank's 6371 branches are located in previously unbanked communities, and 51% of the bank's network is spread throughout rural and semi-urban areas. In order to provide last-mile access to 20540 unbanked sites in distant areas, the Bank employs 13168 Business Correspondents (BCs). As of March 31, 2023, there were more than 17037 ATMs in rural and semi-urban areas.

Interaction and cooperation: ICICI Bank offers an extensive range of products and a sizable quantity of business correspondents (BCs), branches, ATMs, and other service locations. It has done a great job of building effective lines of communication and fostering collaboration among all of these service providers.

C. SBI (STATE BANK OF INDIA)

Customer Mix: The bank has about 46.77 crore customers, with a total of 3269242 crore in advances and 4423778 crore in deposits, according to the annual report for 2022–2023. This means that each customer will receive an approximate advance of Rs. 0.58 lakh and a deposit of Rs. 0.86 lakh. There are 1914 clients for every 235858 employees.

Product Mix: SBI offers a range of products to cater to both retail and wholesale clients. Under its own brand name, it provides a range of products including deposit, credit, payment, investment, currency, and insurance.

Infrastructure: SBI boasts a vast branch network throughout India and overseas, in addition to a strong and capable digital infrastructure. However, compared to the two banks we previously mentioned, it is less efficient. It is primarily due to the enormous quantity of exchanges on each occasion. Digital services including loan disbursement and account opening are offered by SBI. However, a certain amount of paperwork is still required. Despite a low staff-to-customer ratio, SBI's customer service does its best, if not promptly. The method for resolving internal grievances

is adequate. SBI has a total of 22405 branches, 76089 Customer Service Points (CSPs), 65627 Automated Deposit and Withdrawal Machines (ADWMs), and more. This exposes the bank to rural areas. With the majority of its CSPs located in rural areas, it boasts over 8000 branches. **Synergy and communication:** SBI offers a significant number of branches, ATMs, cash deposit and withdrawal devices, and other service points in addition to a wide range of products. It has made some progress toward establishing effective channels of communication and fostering collaboration among every one of these servicing locations. There is still room for development, though.

D. PNB (PUNJAB NATIONAL BANK)

Customer Mix: As to the 2022–2023 annual report, the bank has 1146219 crore in total deposits and 785104 crore in total advances. It serves over 18 crore clients. This means that each customer will receive an approximate advance of Rs. 0.44 lakh and a deposit of Rs. 0.64 lakh. There are 103144 workers there, or 1745 clients for every worker. **Product Mix:** PNB offers a variety of items for both retail and wholesale consumers. Under its own brand name, it provides a range of products including deposit, credit, payment, investment, currency, and insurance. **Infrastructure:** PNB boasts an extensive branch network throughout both India and outside. But in this era of digitalization, its digital infrastructure is inadequate. Its digital customer service system is significantly behind that of banks in the private sector. Furthermore lacking is the internal grievance redressal procedure. In this sense, there's a lot of room for development. **Exposure to Rural Areas:** As of March 31, 2022, the Bank had one of the largest networks of 10098 branches, consisting of 1753 metropolitan, 2035 urban, 2457 semi-urban, and 3853 rural branches. Approximately 63% of the entire branch network is made up of rural and semi-urban branches. **Synergy and communication:** PNB offers a wide range of products and has several branches, ATMs, BC points, and other service locations. In developing effective channels of communication and fostering synergy among all these service sites, it has been moderately successful. There is still room for development, though.

CONCLUSION

In conclusion, the analysis of corporate governance disclosure in Indian private and public sector banks sheds light on the differences between the two. The study utilizes an index based on SEBI clause 49, consisting of eight key factors. While Axis, ICICI, and Bank of Baroda lack information on board experience, other banks disclose details about their directors and directorship in other companies. Although most banks provide data on audit committees, AXIS and HDFC Bank do not specify the committee's role. All banks share information on communication channels, but some do not disclose half-yearly reports. Notably, none of the selected banks mention corporate governance, stakeholder interface, health, safety, and environment committees, or functional committees.

The focus of the current study has been on the composition and independence of the major committees within the board, including the CSR, Audit, Remuneration, Stakeholder Grievance, and Risk Management committees. The findings have been based on the analysis of both public and private sector banks. ICICI, a prominent player in the private sector banking industry, has demonstrated a commendable level of independence compared to other carefully selected private sector banks. On the other hand, DBL has shown a lack of independence among its board committees within the same sector.

In the case of Public Sector Banks, SBI has emerged as the most proactive bank while maintaining a high level of independence. This is evident from the active involvement of Non-Executive Independent Directors in various committees of the Board. However, PNB has been found to have a limited scope for independence due to a significant proportion of Executive Directors in its board committees. Both ICICI and SBI, the two largest banks from different

banking groups, have regular board committee meetings with similar frequency. This suggests that other banks should carefully review their board composition in accordance with the 2013 Companies Act and consider including influential thought leaders as Independent Directors to enhance flexibility.

The growth or decline of each bank, whether in the public or private sector, can be attributed to corporate governance. Therefore, it is crucial to explore strategies to prevent the downfall of public sector banks.

Now, let's discuss the "don'ts."

1. Public sector banks should not simply replicate the actions of private sector banks. Instead, they should devise innovative solutions tailored to their own needs. Imposing higher service fees without offering any additional benefits is unfair to customers who already face difficulties and seek a satisfactory banking experience.
2. Although mis-selling is illegal, cross-selling is considered a convenience. It is not advisable to sell unnecessary products to customers who are misinformed. This unethical behavior was previously limited to private sector banks, but now public sector banks are leading the way in this practice. Here is another example of blindly following the practices of private sector banks.
3. Upgrading software without conducting beta testing and using appropriate troubleshooting techniques is unacceptable. Especially the public sector banks involved in the merger demonstrated a lack of preparedness and indifference towards the issues faced by consumers due to their prolonged software upgrade.
4. Digitalization should not make simple processes more complicated. However, some public sector banks are taking weeks or even months to open new accounts due to digitalization. They are following these steps:
 - i. Verifying the identity of potential clients using the NSDL database and UIDAI through Aadhaar and PAN cards.
 - ii. Collecting physical copies of the required paperwork.
 - iii. Submitting soft copies of these documents to a centralized web gateway.
 - iv. Assigning an employee with access to only soft copies of the documents to verify them. These unnecessary complexities and time-consuming procedures are causing delays.

Now, let's discuss the "dos":

- 1) Strengthening the infrastructure is crucial and there is no alternative. The infrastructure should be capable of handling a large volume of user data while being efficient and user-friendly.
- 2) Prioritizing the creation of products that meet the clients' needs is essential for establishing a positive and long-lasting relationship with them. Banks should promptly address the requests of their clients.
- 3) Careful consideration should be given before deciding to upgrade technology. Employees should receive training on advanced features and troubleshooting techniques. Customers should be provided with alternative options in case things do not go as planned.
- 4) It is preferable to open accounts digitally and have the paperwork physically checked. In these day of fierce competition, it is imperative to make the customer feel at home. A consumer shouldn't be greeted by suffering on your part.

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