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Corporate Governance Practices of Indian Public Sector and Private Sector Banks

A Comparative Study

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Abstract

Banks play a major role in providing credit to the productive sectors of the economy as well as act as facilitators of financial inclusion and foremost source of employment. Whereas, the Banking Sector Acts as catalysts in promoting the growth of economy, these also possess the capability to cause calamity to an economy. Well governed banks have the ability to cope up with risk associated with them and benefit to the economy. The present study is an attempt to investigate the Corporate Governance practices being adopted by the Indian Public Sector Banks and Private Sector Banks. For this purpose, two Public Sector Banks and Private Sector Banks have been selected taking into account the top banks in the BSE 100 index ranked on the basis of market capitalization. In order to study the quality of Corporate Governance practices of the banks, an assessment tool – Corporate Governance Disclosure Index (CGDI) has been developed. The data has been collected from the annual reports of the banks from the financial year 2002 to 2014. Further, to investigate the difference in both the sector banks, student's t-test has been applied. The findings of the study reveal that both the sector banks have significant difference

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with respect to Board related parameters, Remuneration Committee sub-index and Non-Mandatory sub-index.

Keywords: Corporate Governance, Corporate Governance Disclosure Index

INTRODUCTION

A strengthened Corporate Governance system of the financial sector of any nation is of significant importance for the growth and development of its economy. For Indian economy as well, the prominence of banks could be assessed from the fact that banking is a regulated industry almost across the whole globe. These financial institutions also have access to the government safety nets (Mishra and Rao, 2013). However, the complexity of standard governance problems among financial institutions results with higher emphasis towards financial sector. These problems include lack of transparency, agency conflicts and higher regulations, particularly in case of banks. Due to the importance of the stability of banks and involved larger interests of the public, the government plays an evidently significant role in these institutions.

Corporate Governance has been imposed in one form or the other in both Public Sector and Private Sector Banks time and again. These practices are enforced by making varied committees of the board. Moreover, professionals are also inducted on these boards. They take informal decisions by an unrestricted dialogue till an accord emerges at the board and its sub-committees. But, such prescriptions actually don't work in real practices as are expected. As far as prudential aspects are concerned, uniform treatment of Public Sector and Private Sector Banks have been ensured by the Reserve bank in terms of current regulatory frameworks (Reddy, 2005). Although the principles for both the sectors are alike, some of the governance aspects of Public Sector Banks are exempt from the applicability of the related provisions of the Banking Regulation Act. This is so because these banks are governed by the respective legislations under which they were established. Therefore, despite of the identical approach of central bank toward both the sector banks, distinct treatment is necessary in coping with governance problems between public sector and private sectors (IDRBT, 2004).

BACKGROUND OF THE RESEARCH

The financial crisis became the reason for the increased attention towards Corporate Governance. Further, corporate scandals happened internationally in the late 1990s and early 2000s has brought the attention towards the concern for improved Corporate Governance. The consequences of these scandals have to be faced by various stakeholders other than the actual participants.

The Indian Financial sector had also marked the traces on the economy with the number of events. No doubt financial liberalization has led to substantive benefits in terms of increased transparency; it has also supplemented the incidences of corporate mis-governance. Trends in Indian Financial system since 1990 expose the flaws on the part of Corporate Governance. These apparent mis-happenings have shown the ineffective Corporate Governance that has allowed the opportunistic individuals and institutions to manipulate the market to their advantage. These scandals destroyed the confidence of investors in financial concerns. The investors admitted to investing in stock markets as an additional risk. As a result of financial scandals, banks lost their money. The concerned stakeholders along with the depositors became the main victims in case of failure of financial institutions. The main setback was faced by the customers of the banks who made up for those losses. The dimensions and consequences of these scams are of greatest importance to the governance system of financial institutions in particular and to the nation in general. The essence of the argument is that despite of existence of operational, regulatory authorities empowered with legal endorsements the occurrence and recurrence of these financial and security scams can be credited to the failure of Corporate Governance.

Considering the prominence of the banking industry the present study is an attempt to study the Corporate Governance practices of banks. Corporate Governance practices adopted by banks could lead the banks towards bringing more transparency, making them more accountable and increased contribution towards the growth of the banking industry. So, the objective framed for the study is to examine the extent of Corporate Governance practices adopted by banks and to identify the difference in Corporate Governance practices of Public Sector Banks and Private Sector Banks. In the next section of the research paper, review of various related studies have been briefed followed by research methodology adopted, results and analysis and concluding remarks.

LITERATURE REVIEW

The issue of Corporate Governance has become the major area of research since last few years. The literature on this subject in its broader subtext covers a variety of facets, such as ownership concerns, protection of shareholder's interest, improving shareholder value, board related concerns, etc. However, the studies related to Corporate Governance in Indian banking sector are very few. Brahmbhatt, Patel and Patel (2012) compared the Corporate Governance practices of public and private banks with main emphasis on investors and financial advisors perspective and also analysed the correlation between the practices adopted and their growth. Score card method containing the parameters of Clause 49 have been adopted for comparison. As per the findings difference was reflected in the practices adopted. Moreover, the mandatory norms were found to be met while the non mandatory clauses were not included in their corporate system. Katrodia (2012) considering the importance of banking sector focused on the corporate governance practices of the banking sector. The study concludes that in order to achieve the transparency, excellence and increased shareholder's wealth, banks need to ensure good corporate governance practices. Further, better adopted practices would result in more effective and meaningful supervision. These practices would also contribute to a collaborative work relationship between bank management and their supervision. Chilumuri (2013) analysed the different aspects of corporate governance practices followed by State Bank of India. The study concluded that in order to achieve better transparency, excellence and maximization of shareholder's value and wealth, the bank need to make improvements in investment policies, customer services, internal control systems and credit risk management. Deb (2013) examined the corporate governance practices in the Indian Banking sector by assessing the quality of reporting in their annual reports. According to the finding of the study, even though the Indian banking sector has been opened up for private sector a major part is still under the control of the public sector.

These banks because of the government ownership need not to adopt all the corporate governance practices recommended. Tyagi, Atif and Naseem (2013) in their study of banking industry made a comparison among the corporate governance practices of public sector (SBI and BoI) and private sector banks (HDFC and ICICI). The study reported the difference among the practices of both the sector banks and found the practices of private sector banks better than public sector banks. Kaur, Pareek and Upadhaya (2014) examined the disclosure practices adopted by the Indian Banking sector. In order to examine these practices, a composite checklist was developed that was based on Clause 49. *The findings of the study reveal that along with the mandatory guidelines banks are also on the path to follow the voluntary recommendations. Kumar and Singh (2015) examined and compared the corporate governance practices of SBI and HDFC bank for the years 2012-13 and 2013-14. By using corporate governance score card method the study found a gap between the required and implemented norms. Further, it was found that the practices of SBI were better than the corporate governance practices determined by HDFC bank.*

With the purpose to quantify the Corporate Governance, different authors has adopted different approaches and developed Corporate Governance index for the purpose. Brown and Caylor (2006) provided with an alternative measure of governance to G-Index with the advantages of broader scope, more coverage and more dynamic nature. They created a summary of governance measure, Gov-Score which is based on 51 firm- specific provisions. The Gov-Score measure represents both internal and external governance and seven provisions that derived the relation between Gov-Score and firm value. Ananchotikul, (2008) constructed a firm-specific index of quality of Corporate Governance. In this study only publicly available information on each company was used to construct the Index. Chenug, Jiang and Tan (2010) constructed a comprehensive scorecard based on the OECD principles of Corporate Governance to address the question whether transparency matters among Chinese listed companies. Sarkar, Sarkar and Sen (2012) constructed a Corporate Governance Index (CGI) for 500 large listed Indian firms for the period from 2003 to 2008 in their study. The index construction uses information on four important Corporate Governance mechanisms: the Board of Directors, the Ownership Structure, the Audit Committee, and the External Auditor.

RESEARCH METHODOLOGY

To examine the Corporate Governance practices of banks, Corporate Governance Disclosure Index (CGDI) has been developed. The CGDI framed for the purpose has been based on SEBI's Clause 49 of Listing Agreement, review of literature on indexes developed by earlier researchers, recommendations of other regulatory authorities and in-depth going-over of annual reports. To develop the index a comprehensive approach has been used that captures all the major facets of Corporate Governance. A total of 117 attributes has been included in the CGDI. These attributes have been grouped into two broad categories of the index, i.e. Mandatory and Non-Mandatory. Board Structure, Board Procedure, Audit Committee, Remuneration Committee, Shareholders' Grievance Committee, Transparency & Disclosure, and Shareholders' Right have been considered the broad parameters under Mandatory Recommendations. The items included in the parameters under the Mandatory Recommendations are such that are legitimately required to be disclosed, but the items that are voluntary to be disclosed have also been included in the Index.

In order to make comparison between Public Sector Banks and Private Sector Banks, four banks have been chosen with the highest number of bank branches. Hence, State Bank of India, Punjab National Bank, ICICI bank Ltd., and HDFC bank Ltd. formed the sample for the study. Annual reports of these banks for thirteen years i.e. from the year 2001-02 to 2013-14 have been used. The latest thirteen years have been considered as the time period of the study based on the availability of annual reports. Content analysis of these annual reports has been performed to measure the quality of Corporate Governance of the banks. Further, independent sample student's t-test has been applied to analyze the collected data and test for the hypothesis that there is insignificant difference between Public Sector Banks and Private Sector Banks with regard to different Corporate Governance parameters. Cohen's d has also been calculated to estimate for the effect size of independent variables.

RESULTS AND ANALYSIS

The results of the t-test to compare between both the sector banks (Table 1) reports that Public Sector Banks have followed Board Structure related recommendations to a smaller extent M = 49.28 (SD = 10.80) as compared to Private Sector Banks. As per Levene's test for Equality of Variance for Board Structure, F = 1.09, p = 0.301 (which is > 0.05), therefore variances have been

Table 1: Independent Sample T-Test for Corporate Governance Parameters of Private Sector and Public Sector Banks

Parameters	*Sector*	*N*	*Levene's Test (sig value)*	*t-stat*	*Sig.*	*Mean*
Board Structure sub-index	Private Sector	26	.301	5.149	.000	64.664
	Public Sector	26				49.279
Board Procedures sub-index	Private Sector	26	.112	1.995	.051	54.769
	Public Sector	26				49.077
Audit Committee sub-index	Private Sector	26	.398	.393	.696	66.064
	Public Sector	26				64.706
Remuneration Committee sub-index	Private Sector	26	.000	7.695	.000	56.509
	Public Sector	26				22.188
Shareholders' Grievance Committee sub-index	Private Sector	26	.011	2.345	0.24	60.842
	Public Sector	26				50.000
Transparency and Disclosure sub-index	Private Sector	26	.522	-1.088	.282	67.308
	Public Sector	26				60.627
Shareholders' Right sub-index	Private Sector	26	.468	-.534	.595	88.972
	Public Sector	26				90.256
Non-mandatory Recommendations sub-index	Private Sector	26	.677	3.893	.000	43.376
	Public Sector	26				23.505

Source: SPSS Output based on secondary data assumed to be equal. For this, $t = 5.149$, $p < .05$ (significant at 1 percent level of significance). The estimated Cohen's d (1.4) for Board Structure sub-index indicates larger effect size for explanatory variables. In case of Board Procedure sub-index, Private Sector Banks have higher mean score than Public Sector Banks in following recommendations related to Board Procedures. The assumption of homogeneity of variance has been tested by Levene's Test for Equality of Variances. As per Levene's Test for Board Procedures $F = 2.612$, $p = 0.112$ which is greater than 0.05, providing evidence for the assumption that the variance between Private Sector Banks and Public Sector Banks has been equal. The results of t-test reveals that $t = 1.995$ and $p = .051$ which is insignificant. Moreover, for Board Committees, the difference in scores of both the sector banks was found to be statistically significant in case of Remuneration Committee sub-index with $t = 7.695$ and $p = .000$. The effect size for this analysis ($d = 0.729$) has been found to exceed the convention for larger effect size. For Shareholders' Grievance Committee sub-index as well, the results report a statistically significant difference at 5% level of significance with $t = 2.345$ and p value = .024. Cohen's d for the effect size of independent variables has been estimated at 0.64, indicating medium effect size.

Further, to examine the differences in transparency and disclosures made by Private Sector Banks and Public Sector Banks the results of independent sample t- test indicates that the difference was found to be statistically non-significant, $t = 1.088$, $p = .282$ (> .05). The results of t-test carried out to study the difference for Shareholders' Right sub-index report $t = -.534$ and $p = .595$ (>.005) which have not reached statistical significance. Regarding Non-Mandatory sub-index, the results of the test, $t = 3.893$ and $p = .000$ has lead to the rejection of null hypothesis. It indicates that there is a significant difference between Public Sector Banks and Private Sector Banks in following the recommendations of Clause 49 related to Non Mandatory recommendations. The effect size estimated with Cohen's d for Non-Mandatory Recommendation sub-index is 1.07 that exceeds the convention for larger effect size.

CONCLUDING REMARKS

The present study attempts to explore the difference in Corporate Governance practices of Indian Public Sector Banks and Private Sector Banks. A comprehensive CGDI has been framed inclusive of guidelines of Clause 49 of Listing Agreement to explore the quality of Corporate Governance practices being followed by both the sector banks. The outcome of content analysis has established that Indian banking sector has been following the Corporate Governance practices without leaving any stone unturned. The study finds that among the Mandatory recommendations of the CGDI, there exist significant differences in the Board Structure, Remuneration Committee, and Shareholders' Grievance Committee related practices of these banks. While, for Board Procedure sub-index the difference was found to be moderately significant. Moreover, it was found that with respect to Non-Mandatory Recommendations the difference in the practices of Public Sector Banks and Private Sector Banks was statistically significant. As per the results, Private Sector Banks considered in the study were found more compliant with the Clause 49 and most of the Corporate Governance parameters which includes Non-Mandatory Recommendations as well.

Currently, about four – fifth of the banking business is under the control of Public sector banks inclusive of nationalised banks and State Bank of India and its subsidiaries. The weak spot in the Corporate Governance practices impinges from the multiple role played by the government in the functioning of PSBs. The effective management of these banks is entrusted upon the function of government as owner, manager and regulator. In addition, Corporate Governance regime for both the sector banks should be identical and henceforth, it is desirable to bring all the banks under a single act inspite of multiple acts.

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