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Role of Corporate Governance in Indian Banking Sector

KEYWORDS: Corporate Governance, Banking sector, Stakeholders

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ABSTRACT *Banking system plays a very important role in the economic life of the nation. The health of the economy is closely related to the soundness of its banking is now an essential part of our economic system. The Corporate Governance philosophy of banks has to be based on pursuit of sound business ethics and strong professionalism that aligns the interests of all stakeholders and the society. India at present cannot ignore the importance of Corporate Governance. This paper discusses the corporate governance as an internal mechanism in banks, its necessity in the banking sector, the history of corporate governance in the world as well as India, best practices of corporate banking incorporated in India and measures taken by various banks such as SBI, ICICI, HDFC and many other banks to implement them and the recent developments in this area in the banking sector.*

INTRODUCTION

The Indian financial system will grow not only in size but also in complexity as the forces of competition gain further momentum and financial markets acquire greater depth. There is an assurance that the policy environment will remain encouraging of healthy growth and development with accent on more operational flexibility as well as greater prudential regulation and supervision. It has been realized that Corporate Governance is vital for better management of any organization. Financial Institutions are no exceptions and there has been increasing demand for transparency in functioning of these Institutions in view of several scams. As the competition strengthen in the Indian banking market, banks can no longer look at corporate governance simply as a code of doing business but must utilize it as a tool lower risk and enhance shareholder value.

MEANING OF CORPORATE GOVERNANCE

In the first half of the 1990's the issues of corporate governance received considerable Press attention due to the wave of CEO dismissals their boards. "Corporate Governance in simple words is a set of system which ensures business movements and modules it in regulated & Leger format." Corporate governance is a term that refers to the rules, processes, or laws by which businesses are operated, regulated, and controlled. The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and government regulations.

HISTORY OF CORPORATE GOVERNANCE

The subject of corporate governance gained limelight after a string of collapses of high profile companies like Enron, the Houston, Texas based energy giant, and WorldCom, the telecom behemoth which shocked the business world with both the scale and age of their unethical and illegal operations. Some corporate governance norms and standards present around the globe.

- The Sarbanes-Oxley legislation in the USA.
- The Cadbury Committee recommendations for European companies. The Cadbury Report states "Corporate governance is the system by which companies are directed and controlled".
- Unlike South-East and East Asia, the corporate governance initiative in India was not triggered by any serious nationwide financial, banking and economic collapse.
- Also, unlike most OECD countries, the initiative in India was initially driven by an industry association, the Confederation of Indian Industry,
- Following CII and SEBI, the Department of Company Affairs modified the Companies Act, 1956 to incorporate specific corporate governance provisions regarding independent directors and audit committees.
- In 2001-02, certain accounting standards were modified to further improve financial disclosures. These were:
  - ✓ Disclosure of related party transactions
  - ✓ Disclosure of segment income: revenues, profits and capital employed
  - ✓ Deferred tax liabilities or assets
  - ✓ Consolidation of accounts

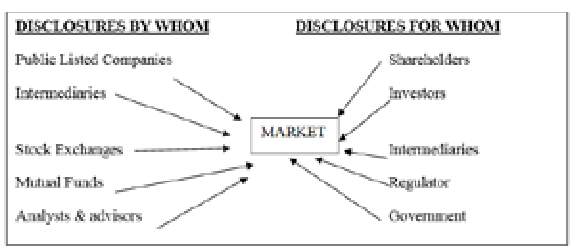

Figure 1- Disclosure based Regulation – Components & types of Disclosure

CORPROATE GOVERNANCE ON INDIAN PERSPECTIVES

Corporate governance in India is evident from the various legal and regulatory frameworks and Committees set relating to corporate functioning comprising of the following:

- Companies Act, 1956,
- Monopolies and Restrictive Trade Practices Act, 1969,
- Foreign Exchange Management Act, 2000,
- Securities and Exchange Board of India Act, 1992,
- CII Code of desirable corporate governance (1998),
- UTI code of governance (1999),
- Naresh Chandra Committee (2002),
- N.R. Narayanamurthy Committee (SEBI2003).

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OVERVIEW OF INDIAN BANKING SECTOR
The banking industry is one of the most regulated industries in India. Since the opening up of the economy in 1991 the banking industry has experienced a gradual phased deregulation. A number of reforms have been initiated in this sector ranging from interest rate liberalization to restructuring of the public sector banks to increased competition and hence efficiency. Today, the public sector banks which earlier provided plain services are competing with a large number of private banks and foreign banks which utilize different innovative approaches and services.

CORPORATE GOVERNANCE IN THE INDIAN BANKING SECTOR
Almost eighty percent of the total banking operation in India is under the control of the public sector banks consisting of the nationalized banks, the State Bank of India and its subsidiaries. The issues pertaining to Corporate Governance becomes more critical in case of these banks as the controlling power of these banks link with the Government. Government ownership is one of the primary issues that can have a direct impact on the quality of corporate governance. The importance of Corporate Governance issues in public sector banks is important, due to two principal reasons.

First, they constitute a huge share of business in the banking industry in India, and second, it is highly unlikely that they are going to be phased out in due course. Disclosure and transparency are thus key pillars of a corporate governance framework in banks because they provide all the stakeholders with the information necessary to judge whether their interests are being taken care of. Due to rapidly changing banking environment, Indian banks must continue to implement strong corporate governance practices.

CORPORATE GOVERNANCE PRACTICES ADOPTED BY INDIAN BANKS
In this paper a modest effort is made to discuss the reporting pattern of India's popular banks namely HDFC, SBI, ICICI and many others. The rationale for selection of these banks is that being incorporated organizations; they should have same Corporate Governance standards. In view of transparency in functioning, the role of different Committees has a vital role to play. Six parameters have been chosen for comparison of various corporate governance practices namely, Company's philosophy on Corporate Governance, Formation of Board of Directors, Composition of Board of Directors, Particulars of Director's, Organizational Committees, and Additional Information supplied in CG report or in the Annual report.

HDFC Bank - Corporate Governance Practices
The bank believes in adopting and adhering to the best recognized corporate governance practices and continuously benchmarking itself against each such practice. HDFC Bank recognizes the importance of good corporate governance, which is generally accepted as a key factor in attaining fairness for all stakeholders and achieving organizational efficiency. The bank was amongst the first four companies, which subjected itself to a Corporate Governance and Value Creation rating by the rating agency. Under the terms of Bank's organizational documents, HDFC Limited has a right to nominate two directors who are not required to retire by rotation, so long as HDFC Limited, its subsidiaries or any other company promoted by HDFC Limited either singly or in the aggregate holds not less than 20% of paid up equity share capital of the Bank. At present, the two directors so nominated by HDFC Limited are the Chairman and the Managing Director of the Bank.

SBI - Corporate Governance Practices
To enhance management transparency and corporate governance, SBI Holdings recognizes that one of its most crucial Initiatives for Strengthening Corporate Governance management tasks is to build and maintain an organizational structure capable of responding quickly to changes in the business environment. SBI Holdings' Board of Directors consists of 13 directors (as of June 27, 2008), and the Company has adopted the Executive Officer System to clarify the functions and responsibilities of directors and the Board of Directors. Currently, 11 executive officers manage the execution of business affairs. These officers include the CEO and COO/CFO as well as nine executive officers who manage each business division.

With four corporate auditors, the company strives to further reinforce the effectiveness of its corporate governance through systematically combining various types of audits by the accounting auditors, corporate auditors and the Internal Audit Department. SBI Holdings recognizes the importance of conducting business activities in conjunction with a sound internal control system.

ICICI Bank - Corporate Governance Practices
The ICICI Bank corporate governance policies recognize the accountability of the Board and the importance of its decisions to all constituents, including customers, investors, employees and the regulatory authorities, and to demonstrate that the shareholders are the cause of and ultimate beneficiaries of our economic activities. The Board consists of eight members, and is responsible for the management of whole business. The Board's role, functions, responsibility and accountability are clearly defined.

The Audit and Risk Committee consists of five directors, all of which are independent directors. It provides direction to and oversees the audit and risk management function, reviews the financial accounts, interacts with statutory auditors and reviews matters of special interest.

BANK OF BARODA - Corporate Governance Practices
The Bank continues its Endeavour to enhance its shareholders' value by protecting their interest by ensuring performance at all levels and maximizing returns with optimal use of resources.

The Bank complies with not only the statutory requirements, but also voluntarily formulates and adheres to a set of strong Corporate Governance practices. The Bank has high standards of ethical values, transparency and a disciplined approach to achieve excellence in all its sphere of activities. The Bank is striving hard to best serve the interests of its stakeholders comprising shareholders, customers, Government and society at large.

The Bank is a listed entity; it's not a company but a body corporate under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and is regulated by Reserve Bank of India. The composition of Board of Directors of the Bank is governed by the provisions of the Banking Regulation Act, 1949, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, as amended and the Nationalized Banks.

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CONCLUSION

In the outcome of the global financial crisis, it is particularly important that along with a common understanding on accounting principles and standards, there should also be strong and effective corporate governance. Indian Banks can start by focusing on the corporate governance themes, government can also learn how to effectively utilize and enforce corporate governance laws. Banks need to ensure good Corporate Governance in order to achieve excellence, transparency & for maximization shareholders value & wealth. With elements of good corporate governance, sound investment policy, appropriate internal control systems, better credit risk management, commitment to better customer service, adequate automation and proactive policies, banks will definitely be able to grapple with these challenges and convert them into opportunities.

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