

THE ROLE OF CORPORATE GOVERNANCE PRACTICES IN SELECTED INDIAN FINANCIAL INSTITUTIONS

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Abstract

Corporate Governance is a term that refers broadly to the rules processes, or laws by which businesses are operated, regulated and controlled. The Indian banking system is among the healthier performers in the world. In the liberalized economic environment and integration of the country, in to world market the corporate sector in India at present cannot ignore the importance of Corporate Governance. The Corporate Governance philosophy of banks has to be based on pursuit of sound business ethics and strong professionalism that aligns the interest of all stakeholders and the society. Strengthening of public confidence in banks is a vital requirement. Staying focused on fundamentals, adoption utmost professionalism, conformity to prescribed norms of lending & investment, adherence to sound banking principles & ensuring optimum capital efficiency are vital for success & continued survival of banks and Finance Institutions. The present article provides a platform to understand the role of corporate governances in various financial institutions in India.

Key terms: *Financial Institutions, Corporate Governance, Cadbury Committee.*

Introduction

Corporate governance involves regulatory and market mechanisms, and the roles and relationships between a company's management, its board, its shareholders and other stakeholders, and the goals for which the corporation is governed. Lately, corporate governance has been comprehensively defined as "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intension of monitoring the actions of management and directors and thereby mitigating agency risks stemming from the devious deeds of these corporate officers".

World Scenario

Looking beyond India the scenario in general is different. In the country like U.S. and U.K. there is an active market for corporate control to discipline managers, if they fail to maximize shareholders wealth. They largely adopted three main instruments they are – "Proxy contests". Friendly mergers have hardly succeeded to solve the "agency problem". While takeover is not appealing strongly on the ground of heavy cost incurred in it and also for want of political will conducive to the policy. In Germany and Japan the system that prevails in U.K. and U.S. is absent unlike that system there is "Banking Supervisions". The main bank financing the corporate unit acts as an external control mechanism. In such case very least intervention is found and that only when financial problem arises. It is in light of these experiences that innovative approach to the concept is formed. Several credit rating agencies have stepped in the market and they are offering services of the kind, which meets with the quality of Governance in corporate entities.

Principles of Corporate Governance

The Sarbanes-Oxley Act is an attempt by the federal government in the United States to legislate several of the principles recommended in the Cadbury and OECD reports.

1. **Transparency in Dealings and Disclosures:** Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters

concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

2. **Discipline in Operations:** Operational discipline asks for quality approval at every stage of predictor services. It refers to the effective and optimum application of the technology available at times. Integration and co-ordination in the entire system is but the prime requirement for the operational efficiency.
3. **Rights and Equitable Treatment of Shareholders:** Organizations should respect the rights of shareholders and help shareholder to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.
4. **Interests of other Stakeholders:** Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.
5. **Role and Responsibilities of the Board:** The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.

Definition of Financial Institution

An establishment that focuses on dealing with financial transactions, such as investments, loans and deposits. Conventionally, financial institutions are composed of organizations such as banks, trust companies, insurance companies and investment dealers. Almost everyone has deal with a financial institution on a regular basis. Everything from depositing money to taking out loans and exchange currencies must be done through financial institutions.

Any institution that collects money and puts it into assets such as stocks, bonds, bank deposits, or loans is considered a financial institution. There are two types of financial institutions depository institutions and non depository institutions.

Depository institutions, such as banks and credit unions, pay you interest on your deposits and use the deposits to make loans. Non depository institutions, such as insurance companies, brokerage firms, and mutual fund companies, sell financial products

Importance of Corporate Governance in Banking

Banks are a critical component of the economy while providing financing for commercial enterprises, basic financial services to a broad segment of the population and access to payment systems. The importance of banks to national economies is underscored by the fact that banking is, almost universally, a regulated industry and that banks have access to government safety nets. It is of crucial importance therefore that banks have strong corporate governance practices in the assessment of credit risks pertaining to lending process will encourage the corporate sector in turn to improve their internal corporate governance practices. Importance of implementing modern corporate governance standards is conditioned by the global tendency to consolidation in the banking sector and a need in further capitalization.

Good corporate governance is necessary for India as it has to source its scarce capital funds from global investors. India is not the only place for the global investors to put in his money and the country must be able to catch up with aspiration of globalization taking to good corporate governance. In the last few years, the subject of corporate governance has come to the forefront. The governance mechanism in each country and corporate is shaped by various factors like political, economical, social history, legal framework, values and ethics of the practices, managerial practices, business entities banks, corporations, and financial institutions across the world are increasingly relying on corporate governance level of the people. The terms corporate governance is new part of common parlance but its usage has not been very consistent, as the corporate have assimilated the

concept in their own way, base on their value and ethics corporate governance practices in the financial sector also improve the comfort level of the statutory authorities and regulators.

It can also be used as a check to Financial institutions play a determine the relative standing of the institutions, with respect to the bench marks of the best corporate practices in the financial institutions, Significant role sphere of financial system of a country. With professional expertise and these agencies promote the savings and investment habits of the people. They contribute the economic and social well being of the country by accelerating the industrial development of the country financial institutions occupy a prim of place both money market and capital market as well.

Objectives of -the Study

The basic objectives of this study are as follows:

1. To compare the corporate governance practices in various Indian public financial institutions.
2. To know the company's philosophy on corporate governance in various financial institutions.

Scope of the Study

The scope of this study is confined with Governance procedures followed by Indian Public Financial Institutions namely SBI, IDBI, IFCI, NABARD, PNB, UBI, BOB, BOI, KMB, NHB and HDFC. The rationale for selection of these institutions is that being incorporated organizations; they should have same Corporate Governance standards. These twelve institutions have been compared on the basis of company philosophy on corporate governance, requirement and number of Director on Board, various committees formed for effective Corporate Governance.

Corporate Governance Practices in Banking

In India, the public sector banks are functioning with a safe wall around them provided by government ownership. The perception of the government owing the liability of bank failure prevails and attention to know the strength does not receive importance. Government being the controlling shareholder yields special influence on governance of public financial institutions as it selects almost all directors in the case of unlisted public financial institutions, On the contrary, being a government organization, their operations are regulated by rules and procedures prescribed by Ministry of Finance and by RBI, hence board does not have any scope to exercise its powers. Government ownership is one of the primary issues that can have a direct impact on the quality of corporate Governance.

In public sector banks, the rights of the private shareholder share considerably curtailed as their approval is not required or paying dividend or formalizing the annual accounts. Several issues pertaining to the composition of the board has also plagued the Corporate Governance framework. These issues relate to the appointment of directors, fixing of remuneration, professional qualification required and so on.

Corporate Governance Practices in Selected Indian Financial Institutions

Company's Philosophy on Corporate Governance in various Financial Institutions	
SBI	The Bank believes that proper corporate governance facilitates effective management and control of business, which enables the Bank to maintain a high level of business ethics and to optimize the value for all its stakeholders.
NHB	The Board of Directors has been constituted in accordance with the provisions of the National Housing Bank Act, 1987 The composition of eleven Directors includes four Independent Directors, two nominated by Reserve Bank of India, three officials of the Central Government, and two officials of the State Governments. In the Board, there are 2 directors appointed by RBI, 3 central Govt Officials and 2 State Govt Officials.

IDBI	Long term enhancement of all stakeholders value and providing a transparent atmosphere in business dealings. The Bank policies and practices are not only in line with the statutory requirement but also reflect its commitment to operate in the best interest of its stakeholders.
SIDBI	The bank has been following the tenets of business fairness transparency, accountability and responsibility.
IFCI	Corporate Governance is based on the principle of fairness, equity, transparency, accountability and dissemination of information. It believes in maintaining highest standards of Corporate Governance as a part of its legacy and constitution.
HDFC	Best board practices, transparent disclosures and shareholder empowerment are necessary for creating shareholder value. The philosophy on corporate governance is an important tool for shareholder protection and maximization of their long term values.
UBI	UBI Corporate governance stands for responsible and value creating management and control of the bank. It believes in high standard of ethical values, transparency and disciplined approach to achieve in all fields of activities.
NABARD	The Board is governed by NABARD. There is clear bifurcation about mode of Board of Directors appointed, but no mention about the number of dependent and independent directors. There are total 12 Directors in the Board of them are executive directors.

Source: Secondary Data

Related party disclosure (AS 18). Every financial institution under study has also disclosed the total number of Board meeting held during the financial year except SIDBI, NHB and NABARD. SBI and KMB is the leading Bank in holding Board meeting (10 Board meetings). PNB conducted only three (3) Board meeting during the period of study which is against the regulatory norms regarding number of Board meeting Regarding the Multiple Board Seats, HDFC only declares that none of the members on board who are a member of more than ten committees and chairman of more than five committees. However, after due observation from the CG report and Directors report, it is seen that IFCI, BOI and UBI also maintains the due regulatory norms regarding Multiple Board Seats. SIDBI, NHB and NABARD do not disclose any information about multiple Board seats. Thus, it is conclude that HDFC is the only financial institutions under study which disclose other positive aspects of good governance.

Another non mandatory requirement of CG is the Whistleblower Policy which is duly maintained by all most all the financial institutions under study except SIDBI, IFCI, NHB and NABARD. In fine, only IFCI and UBI disclose the information about the names of directors who are seeking appointment/reappointment as directors on the Board, Related Party Disclosures, lending to sensitive sectors, etc. In addition to the statutory disclosures, the Bank discloses voluntarily additional information by way of Directors. Report about the bank overall performance, business strategies, products & Services, Risk Management etc. In fact, PNB gives high priority to good Corporate Governance.

The Bank has complied with the guidelines of Reserve Bank of India and SEBI on the matters relating to Corporate Governance, which has been examined by the Statutory Central Auditors. The Bank is guided (to the extent possible /applicable) by the acclaimed OECD (Organization for Economic Cooperation and Development) principles of corporate governance as far as responsibilities of the Board of Directors, governance infrastructure, rights of shareholders, equitable treatment of shareholders, role of shareholders in governance and disclosures and transparency are concerned. The negative points in respect CG practices by PNB includes non discloser of number of

independent directors on the Board, lack of information about profile of all the existing directors, less number of Board meetings.

Conclusion

The corporate governance practice in the financial sector also improves the comfort level of the statutory authorities and regulators. The companies require proper corporate governance frame work in order to hold them responsible for the issues that are equally important to the society at large. It further requires taking care of each countries unique legal environment and cultural values. Thus, it is observed that both HDFC and PNB are in the keen competition in maintaining best practices with regard to CG practices. The positive aspects of HDFC CG practices includes Board Corporate Governance philosophy, requisite and sufficient number of Board members with large representation of independent directors, and disclosure of information relating to profile of existing directors.

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