Corporate Governance Practices in Public and Private Sector Banks

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Abstract: Corporate Governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. Corporate governance has at its backbone a set of transparent relationships between an institution’s management, its board, shareholders and other stakeholders. The system of corporate governance is important for banks in India because, majority of the banks are in public sector, where they are not only competing with one another but with other players in the banking system as well as in financial services system including Financial Institutions, Mutual Funds and other intermediaries. 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 Indian banking system is among the healthier performers in the world. While deregulation has opened up new vistas for banks to augment revenues, it has entailed greater competition and consequently greater risks. Today‘s corporate governance means to do everything better and provides for risk assessment, risk cover, early warning systems against failure as well as prompt corrective action. This paper examines the practices of corporate governance attributes in banking sector and how they adhere to corporate governance practices.

Key Words: Corporate Governance, Banks, Indian Banking Sector, Best Practices.

INTRODUCTION:

Corporate Governance is about promoting corporate fairness, transparency and accountability. Corporate governance is "the system by which companies are directed and controlled". It 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. In contemporary business corporations, the main external stakeholder groups are shareholders, debt-holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees. Corporate Governance in the present day context encompasses the interests of not only the shareholders but also many stakeholders, which includes employees, customers, suppliers and the community and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs. **Due to the unique role of banks in national and local economies and financial system systems, supervisors and Governments are also stakeholders’ .A good corporate governance mechanism improves the health of the corporate sector, thus enhancing national competitiveness.**

OBJECTIVES OF THE STUDY:

The present paper focus on the following aspects:

1. To understand the need of corporate governance practices in banks.
2. To highlight the present situation of corporate governance practices in Public and Private sector banks in India.
3. To highlight the steps taken by banks for the implementation of effective corporate governance mechanism.

NEED OF CORPORATE GOVERNANCE IN BANKS:

Corporate Governance has become very important for banks to perform and remain in competition in this era of liberalization and globalization. Banks in a broad sense are institutions whose business is handling other people's money. A Joint stock bank also known as Commercial Bank which is nothing but a company whose business is banking. Protecting the interest of depositors becomes a matter of paramount interest to banks. In banking parlance, the Corporate Governance refers to conducting the affairs of a banking organization in such a manner that gives a fair deal to all the stake holders i.e. shareholders, bank customers, regulatory authority, society at large, employees etc. The significance of corporate governance in banking sector weighs very much due to very nature of banking transactions. Banking is the crucial factor effecting economic development of an economy. It is the life-blood of a country. It is responsible for the flow of credit and for maintaining the financial balances of the economy. In India, since the nationalization process banks emerged as a tool of economic development along with social justice.

As per Basel committee Report 1999, Banks have to display the exemplary of corporate governance practices in their financial performance, transparency in the balance sheets and compliance with other norms laid down by section 49 of corporate governance rules. Most importantly, their annual report should disclose accounting ratios, relating to operating profit, return on assets, business per employee, NPAs, maturity profile of loans, advances, investments, borrowings and deposits.

Similarly the audit reports of bank should highlight those disclosures which are in line with corporate governance rules. Hence, auditors should have the complete know how about all the features of the latest guidelines given by Reserve Bank of India (RBI) and ensure that the financial statements are made in a fraud free manner and should mirror the implementation of corporate governance. Apart from auditor's seriousness to bring those requirements appropriately in audit report, there should be adequate internal control systems in the operational activities of banks. It is very much essential for banks to devote adequate attention on internal control system so as to maximize their returns on each unit of capital inducted through an effective funds management strategy and mechanism. (Basel Committee Report, 1999).

Banks should concentrate more on to set corporate objectives to run the day-to-day operations of the business and consider the interests of recognized stakeholders i.e., employees, customers, suppliers, supervisors, governments and the community and line up corporate activities and behaviours with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and of course protect the interests of depositors, which is supreme.

Banks in India are facing increasing competition, within and outside India, both in terms of markets for its products and for sources of fund. It has, therefore become necessary for banks to constantly reengineer, to provide the products and services to suit the ever-changing requirements, to accelerate the speed with which the transactions are completed and to constantly evaluate and provide training to the workforce update the knowledge and impress upon them the necessity to have a professional and competitive approach. In order to meet the statutory need of having a sound Capital Adequacy requirements, banks are accessing the Capital Market at regular intervals. Hence the Banks need to stimulate the interest of investors at all times. Investors believe that a bank with good governance will provide them a safe place for investment and also give better returns. Good Corporate Governance is, therefore, an important factor in a competitive environment.

CORPORATE GOVERNANCE GUIDELINES FOR BANKS:

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of banks are governed by their boards of directors and senior management, which affects how they function:

Set corporate objectives;

- Operate the bank's business on a day-to-day basis;
- Meet the obligation of accountability to their shareholders and take into account the interests of other recognized stakeholders;

- Align corporate activities and behavior with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and
- Protect the interests of depositors.

Supervisors have a keen interest in sound corporate governance as it is an essential element in the safe and sound functioning of a bank and may affect the bank's risk profile if not implemented effectively. As the functions of the board of directors and senior management with regard to setting policies, implementing policies and monitoring compliance are key elements in the control functions of a bank, effective oversight of the business and affairs of a bank by its board and senior management contributes to the maintenance of an efficient and cost-effective supervisory system. Corporate governance is a key element in improving the economic efficiency of a bank. Good corporate governance also helps ensure that corporations take into account the interests of a wide range of constituencies, as well as of the communities within which they operate**.** Further, it ensures that their Boards are accountable to the shareholders. This, in turn, helps assure that corporations operate for the benefit of society as a whole. While large profits can be made taking advantage of the asymmetry between stakeholders in the short run, balancing the interests of all stakeholders alone will ensure survival and growth in the long run. This includes, for instance, taking into account societal concerns about their welfare and the environment as a part of corporate social responsibility.

SEBI GUIDELINES ON CORPORATE GOVERNANCE IN BANKS:

SEBI has now suggested to RBI to consider issuing appropriate guidelines to banks and financial institutions so as to ensure that all listed companies would have uniform standards of corporate governance. As requested by SEBI, it has now been proposed that the SEBI Committee's guidelines may be taken up for adoption by those commercial banks listed in stock exchanges so that they can harmonize their existing corporate governance requirements with the requirements of SEBI, wherever considered appropriate.

With a view to further improving the Corporate Governance standards in banks, the following measures are now recommended for implementation.

(a) In the interest of the shareholders, the private sector banks and public sector banks which have issued shares to the public may form committees on the same lines as listed companies under the Chairmanship of a non-executive director to look into redressal of shareholders' complaints.

(b) All listed banks may provide un-audited financial results on half yearly basis to their shareholders with summary of significant developments.

CORPORATE GOVERNANCE IN PUBLIC SECTOR BANKS:

The major shareholding of the public banks with the Government the reasons for such ownership may include solving the severe informational problems inherent in developing financial systems, aiding the development process or supporting the vested interests. Government-owned (Public Sector) banks have played a major role in economic development. During the last few years, these institutions are slowly getting "corporative" and consequently corporate governance issues in banks assumes greater significance in the coming years. Considering the importance of banking sector the practice of corporate governance and how it helps banking industry in India in terms of bringing more transparency and overall growth of banking sector.

Basel Committee has underscored the need for the banks to establish the strategies and to become accountable for executing as well as implementing them. The existing legal institutional framework of public sector banks is not aligned with principles of good corporate governance. The bureaucratic hassles, red tapes and de motivated work culture add further fuel to the fire. So far banks have been burdened with "social responsibility " and compelled to tow the line of thinking dictated by the political party in power, healthy banking policies will not be able to become the top priority. Monopoly of PSB in banking business had protected them from competition and bank Managements have thereby became complacent.

The issue of corporate governance in PSBs is important and also complex. From the banking industry perspective, the attributes of corporate governance provide guidelines to the directors and the top level managers to govern the business of banks. These guidelines relate to how banks establish corporate aims, carry out their daily activities, and take into account the interest of stakeholders and making sure that the corporate activities are in tune with the public expectations that banks will function in an ethical and legal manner thereby protecting the interest of its depositors (Basel Committee, 1999).

Banks should continue its pursuit of achieving these objectives through the adoption and monitoring of corporate strategies, prudent business plans, monitoring of major risks of the banks business and pursuing the policies and procedures to satisfy its legal and ethical responsibilities. Hence, banks should aim at enhancing the long term shareholder value while protecting the 'interest of shareholders, customers and other in line with international best practices.

CORPORATE GOVERNANCE IN PRIVATE SECTOR BANKS:

Private Sector Banks have also been more tech savvy, growth oriented and have less of NPAs. Private sector banks have to conform with standard of good banking practices such as:

- Ensuring a fair and transparent relationship between the customer and bank
- Instituting comprehensive risk management system and its adequate disclosure
- Proactively handling the customer complaints and evolving scheme of redressal for grievances.
- Building systems and processes to ensure compliance with the statutes concerning banking.

RECENT STEPS TAKEN BY BANKS IN INDIA FOR CORPORATE GOVERNANCE:

(a) Induction of non executive members on the Boards

(b) Constitution of various Committees like Management Committee, Audit Committee, Investor's Grievances Committee, ALM Committee etc.

(c) Gradual implementation of prudential norms as prescribed by RBI,

(d) Introduction of Citizens Charter in Banks

(e) Implementation of "Know Your Customer" concept,

The primary responsibility for good governance lies with the Board of Directors and the senior management of the Bank

CONCLUSION:

Globalization and liberalization is sweeping across the sectors of economy and banking industry is not an exception. The implementation of corporate governance norms in Indian banks have been phenomenal after the bank reforms were put in place. With the initial framework of Ganguly committee, there has been a consistent focus on 'fit and proper' standards. The PSBs have even began to rate their corporate governance standards from rating agencies. Banks have been working on sustainability of corporate governance standards and have begun to realize the importance of corporate social responsibility which is an integral part of it. The multiplicity of regulators, issues in the appointment of rightly qualified Board members and conflict of interest between long term and short term objectives always pose bigger challenges. In this era of revolutionary changes, banks shall confront various risks and managing these risks shall be the future challenges of banks. In competitive business environment, organizations that adopt good corporate governance and best practices will be able to survive and attain sustainable growth levels. Public Sector Banks need greater functional autonomy in a deregulated environment. Such autonomy, however, needs to be accompanied by greater accountability on the part of their boards to the stakeholders. A Corporate Governance Policy shall serve as an effective instrument for achieving this goal. The success of corporate governance rests on the awareness on the part of the banks of their own responsibilities. While law can control and regularize certain practices, the ultimate responsibility of being ethical and moral remains with the banks. It is this enlightenment that would bring banks closure to their goals. The following aspects require special mention while judging the standard of corporate governance in a banking institution:

- Constitution of the Board of directors:
- Transparency
- Policy formulation
- Internal controls
- Committees of the Board

Now the banks, more particularly the public sector ones, feel the real heat of the competition. The interest rate cuts, dwindling margins and more number of players to serve a reduced number of bankable clients have all added to the worries of the banks. The customer has finally come to hold the centre stage and all banking products are tailor-made to suit his tastes and preferences. This sudden change in the banking environment has bereaved the banks of all their comforts and many of them are finding it extremely difficult to cope with the change.

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