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Corporate governance practices in Indian banking sector

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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 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 interests of all stakeholders and the society. Strengthening of public confidence in banks is a vital requirement. Staying focused on fundamentals, adoption of 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. The conclusion is that sound Corporate Governance would lead to effective & more meaningful supervision and could contribute to a collaborative working relationship between bank management & bank supervisors. 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, focus on newly-emerging business, 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.

Keywords: corporate, Indian banking, economic

Introduction

Corporate governance has at its backbone a set of transparent relationships between an institution's management, its board, shareholders and other stakeholders. It, therefore, needs to take into account a number of aspects such as, enhancement of shareholder value, protection of shareholder rights, composition and role of board of directors, integrity of accounting practices and disclosure norms and internal control system. In a service industry like banking, corporate governance relates to the manner in which the business and affairs of individual banks are directed and managed by their board of directors and senior management. It also provides the structure through which the objectives of the institutions are set, the strategy for attaining them is determined and the performance of the institution is monitored. Virtually every major industrialized country as well as the Organization for Economic Co-operation and Development and the World Bank has made efforts recent years to refine their views on how large industrial corporations should be organized and governed. Academics in both law and economics have also been intensely focused on corporate governance. Oddly enough, in spite the general focus on this topic, very little attention has been given to the corporate governance of banks.

Objectives

- To understand the role of Corporate Governance in banks in present scenario.
- To know different ways of Corporate Governance to be followed by banks to increase efficiency of banks.

Why Corporate Governance is important in Banks

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. Banks are also important catalysts for economic reforms, including corporate governance practices. Because of the systemic function of banks, the incorporation of 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.

Role of Corporate Governance in Banking Sector

Since the market control is not sufficient to ensure proper governance in banks, the government does see reason in regulating and controlling the nature of activities, the structure of bonds, the ownership pattern, capital adequacy norms, liquidity ratios, etc. In the case of traditional manufacturing corporations, the issue has been that of safeguarding and maximizing the shareholders' value. In the case of banking, the risk involved for depositors and the possibility of contagion assumes greater importance than that of consumers of manufactured products. Further, the involvement of government is discernibly higher in banks due to importance of stability of financial system and the larger interests of the public. The RBI has made it clear that with the abolition of minimum lending rates for co-operative banks, it will be incumbent on these banks to make the interest rates charged by them transparent and known to all customers. Banks have therefore been asked to publish the minimum and maximum interest rates charged by them and display this information in every branch.

Disclosure and transparency are thus key pillars of a corporate governance framework because they provide all the stakeholders with the information necessary to judge whether their interests are being taken care of. Another area which requires focused attention is greater transparency in the balance sheets of co-operative banks. The commercial banks in India are now required to disclose accounting ratios relating to operating profit, return on assets, business per employee, NPAs, etc. as also maturity profile of loans, advances, investments, borrowings and deposits. At the initiative of the RBI, a consultative group, aimed at strengthening corporate governance in banks, headed by Dr. Ashok Ganguli was set up to review the supervisory role of Board of banks. The recommendations include the role and responsibility of independent non-executive directors, qualification and other eligibility criteria for appointment of non-executive directors, training the directors and keeping them current with the latest developments. Some of the important recommendations on the constitution of the Board are to participate in the meetings of the board regularly and ensure that their participation is effective & contributory, they must study the reports submitted to them by the management team and enquire about follow up reports on definite time schedule. They should be actively involved in the matter of formulation of general policies, they should be familiar with the road objectives of the bank, and the policies laid down by the govt. and the changes in the various laws and legislations time to time. They should be loyal to the bank and must remember that they should not reveal any information relating to any constituent of the bank to anyone. In the past, when banks considered the issue of how best to differentiate themselves from their competition, Good Corporate Governance was undoubtedly not applied. Due to the fallout from past corporate failures, more and more banks are looking at good corporate governance from a new perspective. With Indian economic growth increase and major stock Indices reaching record level, the time has come to position corporate governance as a strategic force in Indian banks. Indian banks must drive growth and profitability while continuing to focus on enhancing corporate governance practices. Indian government has mandating corporate governance reforms at banks, can create the necessary infrastructure to ensure the continued flow of investment into the region. Expanding global and regional banks, such as State Bank of India, Bank of Baroda, Bank of India, Punjab National Bank, ICICI Bank, HDFC Bank, Standard Chartered, HSBC, Citibank and others along with major investments by large institutional investor, are enhancing corporate governance practices, increasing competitiveness and permanently changing the competitive landscape of Indian banking environment. Due to rapidly changing banking environment, Indian banks must continue to implement strong corporate governance practices. They must now approach corporate governance as a competitive differentiator in an environment of strong foreign entrants and growing regional competitors.

Conclusion

As far as best corporate governance practices for banks are concerned, they may include realization that the times are changing, establishing an effective, capable and reliable board of directors, establishing a corporate code of ethics by the banks for themselves, considering establishing an office of the chairman of the board, having an effective and operating audit committee, compensation committee and nominating/ corporate governance committee in place, considering effective board compensation, disclosing the information and recognizing their duty to establish corporate governance procedures that will serve to enhance shareholder value.

Important commandments for ensuring corporate governance in banks are

- Banks shall realize that the times are changing the issue of corporate governance has gained attention only in the recent times. Therefore, even the smallest banks need to focus on corporate governance restructuring. This is due to the apparent lack of integrity and values in operation of some large corporations.
- Banks shall establish an Effective, Capable and Reliable Board of Directors Establishing an effective, capable and reliable board of directors requires involving well qualified and successful individuals with integrity. This implies that a majority of banks' board of directors should be truly independent directors. The board must be effective and must meet periodically and it should also have long-term policy, strategy and values.
- Banks shall establish a Corporate Code of Ethics for themselves Corporate ethics and values should be established at the top and should be used to govern the operations of the bank both from long-term and short-term point of view. These codes should be reviewed annually. Unless this exercise is accomplished, executive management cannot anticipate that the rank and file employees will follow such a code on their own.

- Banks shall consider establishing an office of the Chairman of the Board Such an office will be made to report to the board and will act as the board's eyes and ears on a daily basis in connection with the functions of the bank.
- Banks shall have an effective and Operating Audit Committee, Compensation Committee and Nominating/ Corporate Governance Committee The audit committee, compensation committee and nominating committee should be composed of all independent, outside directors of the bank who operate independently. These committees should have access to attorneys and consultants paid for by the bank. This independence of committee will ensure against any bias in the internal audit committee's decisions.
- Banks shall consider Effective Board Compensation Fair compensation should be paid to the directors. Their remuneration should be commensurate to with the risks they take.
- Banks shall disclose the information Bank will find that the disclosure will be quicker and more burdensome than it was in the past. This may be through quarterly letters to the shareholders or other types of communication.
- Banks shall recognize that duty is to establish Corporate Governance Procedures that will serve to enhance shareholder value The primary objective of the board of directors is to maximize the shareholders' wealth. The strategy adopted to achieve this objective should now encompass corporate governance procedures and should be designed with long-term value for shareholders in focus.

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