



OUR HERITAGE

ISSN: 0474- Vol-68, Special Issue-13

International Conference on

Multidisciplinary Research in Sustainable Development ICMRSD 2019

Organised by: Brihan Maharashtra College of Commerce, (Autonomous), Pune,
Maharashtra

Held on 14, 15, 16 November 2019



A study of influence of corporate governance on financial performance in public sector banking

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Abstract:

Corporate governance is the mechanism which can steer the banks in the turbulent business environment. Indian Public sector bank are facing the challenges in terms of capital erosion, lack of risk assessment and auditing of the transactions, nomination of professionals on the boards of public sector banks. The interest of the shareholders needs to be protected. The future of the business depends on adoption of the relevant business strategy and alignment with customer aspirations of service delivery. The paper investigates the financial performance of State bank of India, Bank of Baroda, Punjab national bank, Bank of India. It also further evaluates whether the respective banks are adhering to the selective corporate governance parameters proposed by the Reserve Bank of India. It further discusses the challenges faced by these banks. Board with the right skills and a clear vision about the future course of the organization and implementation of governance parameters in true sense and not just the window dressing will transform and grow the public sector banking in India.

Key Words: corporate Governance, audit, risk Management, sustainability

Introduction:

Corporate governance concept adopts the comprehensive approach and relies on the knowledge from various fields like accounting, finance, ethics, economic, organizational behavior, law and many more. Banking firms need to adhere to the corporate governance, since banking system is the backbone of our economy and business. Transparency, adherence to best practices, openness and follow code of conduct, role and responsibilities of the various stake holders has become the necessity.

Reserve bank of India regulates the banking industry in India. It is the banker of the banks and design and Implement the monetary policies of the country. Banking is Broadly classified into the public and private sector banking. It pursues different business goals apart from compliance of the rules and regulations mandated for the banking institutions.

Here the concept of corporate governance comes into play. People who are having certain interest in the bank may create a risk to the governance of the banking institution. Coleman and Biekpe (2006) states that the concept of governance has a wider impact which is not just limited to shareholders but affects the society at large. RossLevine (2004) also state that bank's business is affected by lack of transparency. The shareholders and investors have to face the losses due to ambiguity in the conduct of the banking institution. Jensen et al (1976) built a theory of ownership structure of the firm with the cohesion of theory of agency, the rights of proprietary firm and concept of finance. The theory of agency and asymmetry of information are also mentioned in it. Das, A. et al (2004) states that poor corporate



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governance leads to higher attrition of the CEOs as compared to the banks having better practices of corporate governance.

The Indian banking industry structure varies based on the ownership. The major Indian market is covered by 27 public sector banks, 21 private sector and 49 foreign banks respectively (FY17 data). Total deposits of banks grew at a CAGR of 11.66 % and lending at 10.94% respectively. India's retail credit market stood at 4th rank as far as retail credit is concerned. It amounts to US\$ 281 billion (IBEF Report 2019)

The importance corporate governance has increased post Asian currency crisis, subprime lending leading to turmoil in the global markets, vested interest of the bankers led to rise in NPAs. This situation compelled for enhanced policy framework for the efficient corporate governance by the regulators. Hence public sector banking needs to gear up for the transformation. The Top 4 public sector banks in terms of market capitalization are state bank of India, Bank of Baroda, Punjab National Bank, and Bank of India which covers a major market share in Indian context.

Hence the sustainability of the banking business, safeguarding the interest of the shareholders and adherence to the code conduct will ensure the healthy growth of the banking and help the business to flourish.

MATERIAL AND METHODS

Literature Review

Cadbury report by council formed by London stock exchange et al (1991) states that division of power between chairman and chief executive should be there. In order to take fair business decision away from any conflict people with business expertise should be brought on the boards apart the existing stake holders. The remuneration committee should also have berth for non-executive directors.

La Porta et al (2000) states that the various countries follow different practices in terms of ownership control, dividend policies, market depth and access to external sources of finance. It sheds light on the laws prevailing and protection offered to the investors from majority stake shareholders and expropriation by the managers.

RBI bulletin article "Corporate Governance in Banks" - by V. Leeladhar (Dec 2004) elaborates the practices and parameters adopted by the Indian banks like roles and responsibilities of the directors, capital adequacy norms, income recognition, risk management practices, Transparency, Off-site surveillance, Prompt corrective action, non-Performing Assets (NPA) and Return on Assets (ROA). These parameters may trigger the intervention by the central banker.

Economic times report (Mar 02, 2016) explains that two-third of the total banking business lies in the hands of 28 public sector banks. The adherence to of corporate governance may increase the valuation of the company. In order to sustain in the market, Public sector banks need the capital infusion of Rs.25000 crore. Specially the bank of India, central bank of India needs capital for survival.

Pant, A et al (2017) explains that Indian public sector banks are suffering from the poor asset quality and non-performing asset and declining profits. In order to overcome these challenges government has formed a banking board bureau (BBB) to come up with the new governance structure. Author comes up with the issue-based management perspective based on the concept proposed by Jones and Chase.

Objectives of the study

- To understand the concept of corporate governance in banking industry.
- To study the corporate governance framework and specific parameters adopted by Indian public sector banks.
- To study corporate governance in selected public sector banks in India.
- To analyze the influence of corporate governance on financial performance of the selected public sector Banks in India.

Research Methodology

The research will be carried out for the public sector banks in India. There are 20 public sector banks as stated by the Reserve Bank of India as on August -2019. Top 4 public sector banks in terms of market capitalization will be



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considered for the research mentioned below as per the guidelines of the Reserve Bank of India (RBI) and parameters followed at the international level.

Table 1 Market capitalization of banks selected for the study

Sr. No	Bank Name	Market (Rs. Cr.)
1	SBI	269,077.04
2	Bank of Baroda	40,063.67
3	Punjab National Bank	31,284.50
4	Bank of India	22,774.62

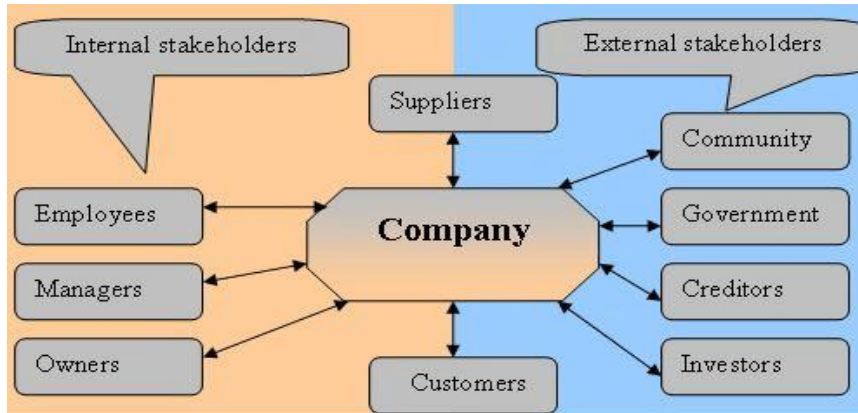
Source: Money control.com dated 10/08/2019

The research will be carried out based on the secondary data from RBI, Research journals, books, newspapers and articles, reports of international institutions.

Data Analysis

Different stake holders a Firm as stated below who are concerned about the growth and sustainability in long run. Each one of them has different view point for the assessment of the firm.

Stake Holders in the Company



Graph 1 Stake holders in the company

Source: Stake Holder Theory Model Achim, M. V., & Borlea, N. S. (2013)

Code of conduct defined with the help of specific parameters help to safeguard the interest of the stakeholders. This corporate governance concept spans across the framework of maintaining transparency in the business model, accounting, finance, interest of the shareholders, board of directors, legal compliances along with obligation on the part of board of directors and avoiding the vested interest of self or relatives.

However, based on holistic approach few common parameters can be considered for evaluation for the corporate governance of Public sector Banks along with the guideline of Reserve bank of India as follows



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Table 2 Parameter guidelines for corporate governance evaluation as per RBI

1	Return on Asset	Return on the all the Assets
2	Return on equity	Return on the Equity
3	Board size	Number of board members
4	Duality	Role Chairman and CEO held by single person
5	Board committees	Various committees constituted to take care of various responsibilities
6	Female Directors	Female directors on the board
7	Average remuneration	The average remuneration
8	Other directorships	Independent and non –executive directors on the board
9	Board meetings	Meeting of board of directors

Source: RBI Reports

Table 3 Financial Performance of the State Bank of India (SBI), Bank of Baroda (BOB), Punjab National Bank (PNB), Bank of India (BOI)

Year/Financial parameters		2017				2018				2019			
Bank Name		SBI	BOB	PNB	BOI	SBI	BOB	PNB	BOI	SBI	BOB	PNB	BOI
ROA	%	0	0.3	.1	0	-0.1	-0.3	-1.6	-0.1	0.1	0.1	-1.3	0.1
ROE	%	1	4.2	2	0.5	-2.0	-4.0	29.7	-2.1	1	2.2	-22.0	2.1
Profit After Tax	Rs. m	2412	18,150	8492	1,667	-45563	-18,871	-126031	-7,873	22996	11,001	-1002643	9065
Earnings Per Share	Rs.	.3	7.8	4.0	1.6	-5.1	-7.1	-45.7	-4.5	2.6		-21.8	3.3
Average dividend Yield	%	1.1	0.7	0	0	0	0	0	0	0	0	0	0
Net NPAs	%	3.7	4.7	7.8	7.2	5.7	5.5	11.2	8.3	3.0	3.3	6.6	5.6

Source: nseindia.com, moneycontrol.com, equitymaster.com

i. Corporate Governance at State Bank of India

The foundation of corporate governance needed to transparency in the functioning. It helps to keep strategic control and most importantly it protects the interest of the stakeholders. The accountability matrixes ensure performance and evaluate it. (Corporate Governance report SBI 2018)

directors appointed by central government and shareholders forms the board. As per the mandate ,the Board meeting should happen at least for 6 times in a year.

Table 4 Corporate Governance Parameters of SBI

Parameters (Below mentioned are stated in terms of numbers)	2017	2018	2019
Composition of board of directors	16	18	15
Audit committee	10	12	10
Stake holder's relationship committee	9	11	9
Risk Management committee	8	12	9
Nomination and remuneration committee	Nomination-3 (formed as and when required) Remuneration committee -4		

Source: SBI Corporate Governance Report 2017, 2018, 2019

As per Q1 FY2019-20 reports for improving corporate governance SBI has created an independent ETHICS business conduct function that looks after the ethical morale of the entire organization. SBI has a Corporate Centre Sustainability Committee (CCSC). It covers all key business heads and responsible for execution sustainability Strategy.

SBI has created a new role of 'Portfolio Management' under the Risk Management Department which focuses on risk identification while performing portfolio management activities

ii. Bank of Baroda



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The net NPA of bank of Baroda for the 2018-19 financial year is 3.33% which has declined over the last couple of year with over exposure to power, roads and EPC, iron and steel & other amounting to Rs. 10410 Crore. It indicates better due diligence for the project finance.

Table 5 Corporate governance parameters of BOB

Parameters (Below mentioned are stated in terms of numbers)	2017	2018	2019
Composition of board of directors	10	15	12
Audit committee	5	6	4
Stake holder's relationship committee	4	6	5
Risk Management committee	5	10	7
Nomination and remuneration committee	4	5	4

Source: BOB Corporate governance report 2017, 2018, 2019

As per econometrics article (14-April-2019), bank planned to conduct board alignment workshop to decide the board vision and align the action plan of the board accordingly. It has also taken up an initiative to hire a consultant to advise the bank on the critical issues of the bank which may affect the business of the bank.

iii. Punjab National Bank-

Table 6 Corporate governance parameters of PNB

Parameters (Below mentioned are stated in terms of numbers)	2017	2018	2019
Composition of board of directors	11	11	10
Audit committee	5	5	5
Stake holder's relationship committee	3	3	5
Risk Management committee	7	7	7
Nomination and remuneration committee	6	6	5

Source: PNB Corporate Governance Report 2017, 2018, 2019

Punjab National Bank has suffered huge losses due to the Nirav Modi scam. Bank had to register the losses to the tune of Rs 13,700 crore. The negative sentiment was build about the asset quality of the bank. This led to fall of the stock price by -53% in last 1 year as per the price on 3-January 2019(ValueSearchonline 4-january2019).

Bloomberg quint article "Fixing governance problem of public sector banks "by N Balasubramanian (5-April-2018) quotes the case hearing of Vijay Mallya extradition in London. While issuing the loan to the kingfisher airlines board has not done the legitimate scrutiny of the proposal, risk analysis not done. Rather it was ignored by the banks, regulators

The author also stated that the position of CEO should be separated from board chair. The government should also refrain from appointing directors more than one. Rest all should be put up for election by the shareholders as per the process.

Net NPA for the financial year 2018-19 is 6.56% which amounts to Rs. 30038 Crores. Bank has taken up "Mission Parivartan" to align people, product and processes. PNB has taken initiative for setting up stressed asset management vertical for effective monitoring and resolution.

iv. Bank of India

Table 7 Corporate governance parameters of BOI

Parameters (Below mentioned are stated in terms of numbers)	2017	2018	2019
Composition of board of directors	11	11	10
Audit committee	5	5	5
Stake holder's relationship committee	3	3	5
Risk Management committee	7	7	7
Nomination and remuneration committee	6	6	5

Source: BOI corporate governance report 2017,2018,2018



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Investor presentation of BOI for Quarter 1 of FY 2019-20 mentioned that Stressed Asset Management Vertical (SAMV) created for faster resolution of Stressed assets.

Bank of India has formed “War Room” and “Watch room” in each Zone for credit monitoring, reduction in the non-performing assets. It has also initiated Proactive Credit Monitoring through “Borrower Health Profile (BHP)”. Bank of India has started Credit Monitoring System with the help of technology for tracking of ‘Early Warning Signals’ under implementation. Bank of India has also for the real time fraud detection started implementation of framework “Enterprise wide Fraud Risk Management”.

RESULT AND DISCUSSION

- **Regulatory Compliance of Corporate Governance Framework-**

State bank of India, Bank of Baroda, PNB and Bank of India have complied with the regulatory compliance for the corporate governance based on the study of corporate governance reports for three financial years. Five important parameters regarding number of board of directors, audit committee, Stake holder’s relationship committee, Risk Management committee and Nomination and remuneration committee are evaluated in the study.

- **Future path for the Indian public sector banking-**

Based on report of the Committee to Review Governance of Boards of Banks in India by P J Nayak (May 2014) worth implementation in true sense.

- **Lack of true sense of purpose-**

Amongst the boards of public sector banks, it is the top most critical challenge. This has aggravated difficulties of specific business strategy, risk management. At times the selection of board members is comprised which leads to inefficient functioning of the bank. The appointment of board members should be much more professionalized. Government intervention along with the RBI leads underperformance of the public sector banks.

- **Stiff erosion in the asset quality of the bank-**

It is reducing the market share of the public sector banks. As per the linear projection (P J Nayak 2014), the market of public sector bank was 73% in 2013 which is likely to go down to 63.20%.

- **Succession planning-**

is much needed for leading the bank on financial performance and corporate governance front. Young talent should be given greater exposure to align it to face the competition and stay relevant.

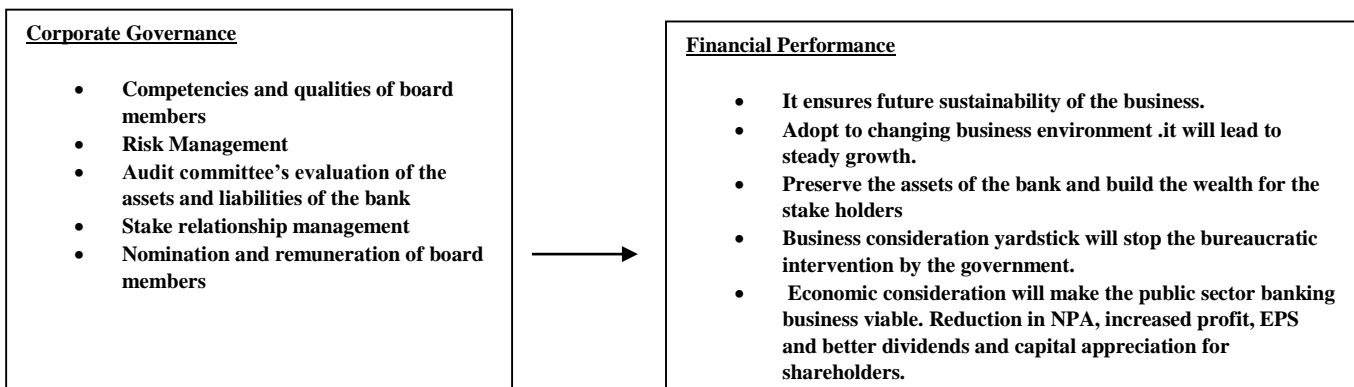
- **Capital infusion-**

The public sector banks need capital to meet the requirements as per changed Basel regulations

- **Delegation of powers and responsibility-**

Public sector bank needs to delegate the powers for efficient functioning and make employees responsible for the implementations.

Table 8 Corporate governance factors affecting the financial performance





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CONCLUSION

The area of focus for the public sector banks need to be the profitability, best possible use of the capital. It need to improvise Hiring, training, retaining the human resource. It should quickly scan the business environment and change accordingly by changing IT strategy, distribution channels, sales professionals, grooming the boards and other employees to face the future volatility.

Future Ahead

The future research can focus on the qualitative and subjective aspects of governance which are not truly reflected through the numbers used to meet the governance compliance like ethics of board members, ability to predict the future business and business dynamics in the turbulent environment.

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