Research Paper ICI Value : 61.33| SJIF Impact Factor(2019) : 8.045| ISI Value:1.433
Volume - 7, Issue- 10,October 2019 | e-ISSN : 2347 - 9671| p- ISSN : 2349 - 0187
EPRA International Journal of Economic and Business Review -Peer Reviewed Journal

CORPORATE GOVERNANCE IN INDIAN PRIVATE AND PUBLIC SECTOR BANKS

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ABSTRACT

Banking sector is an important source of finance in any country especially in developing countries like India. Failure of the banking system or any bank adversely affects the whole economy of any country. Since banks are very important for proper functioning for any economy, therefore, their governance should be strong. This paper studied corporate governance in private sector banks and public sector banks in India. In this study, we also discussed how the banking sector is different from the nonfinancial firms and they have different corporate governance need. This study found that the banking sector is quite different from nonfinancial firms. As compare to nonfinancial firms banks are more levered, opaque, complex and heavily regulated. The banking sector also has distinct stakeholder's group, more information asymmetry, and more susceptibility to take the risk. Further ownership structure, board structure, and board functioning are divergent in private sector banks and public sector banks in India.

KEYWORDS: *corporate governance, private sector banks, public sector banks, RBI and government of India.*

INTRODUCTION

Bank's corporate governance captured eminence after the global financial crises. The father of Corporate governance Sir Adrine Cadbury (1992) defined corporate governance as the ways in which activities of a firm directed and controlled. Similarly, the Bank for International Settlements (2006) define corporate governance of banks as the methods used by the board of directors and management to direct and control banking activities. The banking sector is very different from other non-financial sectors in many ways. First, banks are heavily regulated as compared to non-financial firms (Adams & Mehran, 2003). Banks are regulated by many agencies like Indian banking companies regulated by RBI and other prevailing corporate laws. The leverage of banks is high as compare to non-financial firms (Hagendroff, 2014). John, Masi & Paci (2016) concluded that there is 90% leverage in banks and it increases trade-off between robust equity governance and maximizing enterprises value. The author has also provided an optimal design for corporate governance practices. A very large portion of the bank's fund comes from debt. Third, banks are opaque and complex than non-financial firms (Levine, 2004) it is not easy to understand the structure and functioning of banks. Fourth, the stakeholder's group of banks includes depositors, regulators, and bondholders (Adams & Mehran, 2003; Himaj, 2014) is quite different from non-financial firms. Fifth, there is more information asymmetry in the banking sector between insider users and outsider users. The management of the bank has access to all required important information as compare to other stakeholders and they are in the position to use this information for their private benefits. Improvement in technology and revolution in finance make it difficult to follow primitive methods of command and control to reviving an effective and progressive banking system (Klein, Shapiro & Young, 2005). It is difficult for the owner to keep a check on the bank's activities due to the fixedness of its assets (Becht, Bolton & Roell, 2011). All the above characteristics of banks show that banks are very different from non-financial firms, therefore, the corporate governance need of banks is also different.

REVIEW OF LITERATURE

The bank's governance has received little attention in corporate governance literature especially in developing countries like India and other emerging markets. Some major studies focus on the bank's governance are Caprio & Levine, 2002; Arun & Turner, 2004; Das & Ghosh, 2004; Mulbert, 2009; Adams & Mehran, 2003; Beltratti & Stulz, 2009; Peni & Vahama ,2011; Becht et al., 2012; Levine, 2004; Klein, Shapiro & Young, 2005; Deb, 2013; Himaj, 2014; Seerivasan, 2014; Anginer, Demirgue, Kunt, Huizinga & Ma, 2018; Mehran, Morrison & Shapiro, 2011. John et al., (2016) has studied the special nature of banks. The study stated that banks are not like other manufacturing business. The corporate governance of banks evaluated on three aspects (i) maximizing banks equity value, (ii) maximizing total objectives, and (iii) maximizing enterprises value. The study found 90% leverage

in banks and it produces trade-off between maximizing equity value and maximizing enterprises value. This study also gave an optimal design of bank's governance including guidance for the independent directors of the board, the board size, board composition and incentives to top management. Reddy (2002) explored the governance problems in public sector banks and found public sector banks have to follow multiple objectives of government and face a complex principle agent problem in India. The study found that there is a threat of ownership change in public sector banks and this change not only ownership but also the type of ownership. Ownership change also affects the recognition and reputation of banks. Therefore corporate governance in public sector banks is important and complex. Public sector banks cannot follow the same corporate governance practices as private sector banks follow. Arun & Turner (2004) studies corporate governance of banks in developing countries. The author stated that the corporate governance of banks in developing countries significantly affected by political consideration. The study found that managers get independence after the privatization of public sector banks and corporate governance of banks has not been build up by partial disinvestment in public sector banks and more presence of foreign banks leads to appraise corporate governance of banks in developing countries. Sangmi & Jan (2014) empirically tested the difference between corporate governance policies and practices between public sector bank and private sector banks. The study found that there is no significant difference between corporate governance policies and practices in public sector banks and private sector banks but significant difference between corporate governance policies and practices in old private sector banks and new private sector banks in India.

THE OBJECTIVE OF THE STUDY

The objective of this paper is to study the corporate governance regulations and practices in private sector banks and public sector banks.

NEED FOR CORPORATE GOVERNANCE IN BANKS

Banking sector is an important source of finance in any country, especially in developing countries banking sector, provides finance to majorities of economic activities. After the global financial crisis of 2008, corporate governance gained importance also in the banking sector. Failure of the banking system or any bank adversely affects the whole economy of any country. Poor corporate governance practices in banks were one of the reasons for the global financial crisis (Himaj, 2014). Since banks are very important for proper functioning for any economy, therefore, their governance should be strong. The corporate governance for Indian banks gained importance in the 1990s when India has liberalized the banking sector. This liberalization gave more freedom and operational autonomy to banks. After liberalization, the number of private sector banks increased and banks are started raising money from the capital market. The number of foreign banks is also increased which give competition to Indian banks. Therefore the good corporate governance practices are required to match the international standard and for the proper functioning of private and public sector banks. The recent cases of YES Bank, Axis Bank and ICICI Bank in the Indian Banking sector, wherein case of YES Bank and Axis Bank RBI did not allow increasing the tenure of their CEOs. The ICICI Bank had an accusation of doing transactions which were against the interest of its stakeholders. These cases further point up the need for strong corporate governance for banking sector because a mutual cord between these cases is poor governance. Some distinct features of banks like banks are heavily regulated, heavily levered, complex and opaque, more stakeholders and more information, therefore, good corporate governance practices are needed for banks.

CORPORATE GOVERNANCE IN PRIVATE AND PUBLIC SECTOR BANKS

Both public sector banks and private sector banks are regulated by RBI under the Banking Regulation Act 1949. Hence there is a substantial difference between public and private sector banks in terms of composition and operational flexibility of the board. While private sector banks are regulated by RBI only while public sector banks are regulated by RBI and baking division of the ministry of finance the of the government of India under the banking companies act, 1970, the nationalization act, 1980 and the state bank act, 1955 which influence board composition and functioning of public sector banks in many ways. As compare to public sector banks private sector banks are more authorized in appointing their CEOs and appointing their board of directors. Most of the outside directors of public sector banks are appointed by the government of India. Government of India also control the tenure of CEOs and Chairmen and Managing Directors of public sector banks. In contrast, private sector banks have complete freedom to choose the board of directors and CEOs. There is CEO duality in all public sector banks as the position of Chairman and Managing Director is held by the same person. In contrast, the private sector banks can choose the separate person for Chairmen and Managing Directors. Due to the extensive influence of the government of India in composition and functioning public sector banks are less authorized to take a decision as compared to private sector banks. Since the government of India appoints many directors of various categories of public sector banks to have a large board size as compare to private sector banks. As per provision of the banking regulation act fifty percent of the board of directors required to qualify the 'fit and proper' criteria of RBI. RBI also put term limit of not more than eight years for chairmen and managing directors. Under Banking Regulation Act RBI has authority to appoint, reappoint and remove directors in the 'interest of depositors'. Government of India has the power to appoint the Chairmen and Managing Directors of public sector banks and two nominee directors one as representative of the office employee and other as representative of the workmen employed in public sector banks. Government has the authority to nominate one director who is a charted accountant and up to six directors from the general category. RBI's nominee directors on the board enable RBI to exercise direct control on public sector banks and private sector banks.

Conclusion: the study concludes that the banking firm is different firms is different from nonfinancial firms. The board composition and functioning are different in public sector banks and private sector banks. Therefore the same set of corporate governance regulations are not suitable for both banking and nonbanking firms. Further both private sector banks and public sector banks also required different set of corporate governance regulations. In this way corporate scams in both banking and nonbanking firms could be reduced.

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