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A Thematic Framework of Governance Practices- Evidence from India

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Abstract:
The paper lays down a background about the Indian banking sector and the approaches of corporate governance followed by them. The elements of banking, their roles and responsibilities, interlinking with each other and the benefits of aligning them under corporate governance are discussed as a part of framing corporate governance framework. The chasms in the current practices of Indian banking sector's corporate governance attempts to loom the implementation challenges. Addressing the areas where corporate governance fails and how banking sector embarks corporate governance are discussed.

Keywords: *Governance, Corporate governance, banking.*

1. Introduction

The industrial revolution and Information technology revolution along with developments in the sector of energy, science, research and production all together gave birth to the era of industrialization and corporations were born out of it. Projecting a corporation or a giant in the business sector brings a structure in focus which is determined to keep its elements such as its tangible & non tangible assets, human resources and policies regulating them in a order which aims at the overall success and growth of the corporate. The practices of corporate governance have emerged as a benchmark to judge the corporate brilliance in national and international business domains (Deb 2013). The study focuses on the corporate governance in the Indian banking sector. Securities Exchange Board of India (SEBI) and Ministry of Corporate Affairs (MCA) collaborated to mandate the practices of corporate governance for the enlisted companies in order to reform them (Afsharipour 2010).The paper lays down a background about the Indian banking sector and the approaches of corporate governance followed by them. The elements of banking, their roles and responsibilities, interlinking with each other and the benefits of aligning them under corporate governance are discussed under the background of the research work. The chasms in the current practices of Indian banking sector's corporate governance attempts to loom the implementation challenges. Addressing the areas where corporate governance fails and how the banking sector embarks corporate governance are also discussed.

2. Characterization of Corporate Governance

The term corporate governance refers to a schematic plan of policies and procedures by which companies are directed and controlled (Deb 2013). It is synonymous with the exercise of authority, direction and control. The existing corporation cultures visualize ownership as a shared collaborative effort engaging the corporate elements. Thus, corporate governance is interpreted as a mix of firms control concentration and structure, financial structure and competitive market environment (Pant & Pattanayak 2010). The effectiveness of corporate governance is determined by the precision in the roles & responsibilities of the key elements within and their effectiveness in performing the assigned task under the controlled structure of governance. The corporate governance looms activities, guidelines, management processes towards ensuring the advantageous utilization of company's resources to achieve the goal (Abdulsaleh 2014). Also, the trust of investors is influenced by the past records of successfully governed companies with decent financial results. Thus, it is clear that effective corporate governance is a strength indicator & perception of poor corporate governance leads to risks (Newby A 2001; Lee 2001). A report by McKinsey & Co. (2002) revealed that an overwhelming majority of firms are willing to pay a premium amount to invest in firms demonstrating the high governance standards.

Importance of corporate governance is palpable from the facts about the major falls globally due to weaknesses analyzed from the corporate governance practices, post the business failures. The obscure aspects of governance (Chakrabarti n.d.) come to limelight only after the analysts try to figure out where the major pitfalls occur due to improper internal control system, financial reporting quality, audit measures, board to management relationship and compensation management practices reward miserably in holistic corporate governance approach (Monem 2011). With the success determinants posing good corporate governance as a healthy measure, some disadvantages of corporate governance in selective areas are also observed.

3. Elements of Corporate Governance

Elements of corporate governance are mostly generalized and categorized upto certain extent as per the domain. Generalized corporate governance elements from Kelley & Drew (Drew et al. 2006) are CLASS, which refers to Culture, Leadership, Alignment, Systems, and Structure. The CLASS model was designed to assess the risk, corresponding to strategic management in a firm.

Engagement of other corporate governance elements as shareholders, board members, committee members and managers is responsible to set up a culture which potentially exploits the individual qualities under the leadership spotlight. (CII 2010; Ranjana 2007; Sangmi & Jan 2014).

Other models attribute the elements of corporate governance as policies pertaining to a combined communication between laws, procedures, practices and implicit rules with prime efficacy. As a result, the environment to make managerial decisions is formed in consent with corporal claimants as shareholders, creditors, customers and employees (CII 2010). An effective corporate governance model defines a set of objectives implying a goal, lists the required components and resources to achieve those objectives, as well as deploying an organizational structure to implement & control the behavior underneath to achieve the goal.

Core corporate governance elements are people, processes and the technology for most of the frameworks (Anon 2012a). The major elements of corporate governance within the banking structures are: shareholders, stakeholders, board members, committee members and management teams (Swarup 2011). The shareholders elect the board members based on their experience, leadership qualities, mutual understanding, foresight on financial knowledge, opinion review & analytics, and negotiation skills. Shareholders further elect members for the committees such as risk management committee, audit committee and compensation committee etc. These committees define the oversight roles for Chief Executive Officers (CEO's) and team auditors. Further classification for the roles is on execution levels, which are chiefly determinant of managers and their capabilities to assess the resources and strategically use them to achieve the targets. To commence with the corporate governance practices, the role of board members is envisaged as a group of leaders, who understand the capabilities of other human resources and use them in the best possible way for strategic planning and implementation. It is also an enabler for the inherent risk assessment and generating operational leadership guidelines to navigate from theories to implementation part (Anon 2012a).

The effective working of corporate governance is a step by step approach, which is similar to a strategy formulation process, followed by its implementation as per the stated procedure. For corporate governance, some principles are formulated by collaborative efforts from strategists, finance auditors and banking domain experts across global banks under the Basel Committee of Bank for International Settlements (BIS), as a working group on Corporate Governance of the Basel Committee on Banking Supervision in Basel, Switzerland. The discussions and findings were published by BIS, as an efficacy determinant for researchers and experts. The procedures to formulate a corporate governance model comprises of some practices which were stated as principles to be followed by the banks to deduce a worthy environment.

These principles (Anon 2014) focus on the overall responsibility of the banks, which include the evaluation of strategic objectives of the bank post implementation, risk assessment and strategy management, and establishing corporate values for all the employees including senior management as well. The core processes consider the financial interests, risk exposure, risk mitigation aspects and compensation management procedures to design a framework for corporate governance

Also, another important principle of corporate governance focuses on corporate ethics and values, which enables a bank to sustain its capabilities and public respect in long term. Eloquently defining the acceptable and non-acceptable behavior, citing the legal consequences of any unethical or illegal activity consenting with national law and jurisdiction, under corporal code of conduct to maintain a fair image of the bank is highly favorable. Due to imbalance of financial inflow and outflow in Indian bank, the practices like bribery, money laundering harm the repute of the organization. As a result the corporal ethical codes of the international norms and standards for banking are need to be protected.

Focusing on training, qualification, incentives driven review and compensation review facets of the board members and human resources within the corporate governance pitch motivates the bank for a responsible corporate culture (Afsharipour 2010; Jongsureyapart 2006; Plastow & Hons 2011). Overall corporate governance promotes integrity for self, senior management and all other human resources within the bank.

4. Limitations of Corporate Governance

The major limitation of corporate governance practices is the absence of identifiers or indicators on the basis of some mathematical metrics or hypothesis, which can project, evaluate & verify the worth of corporate governance code (Turnbull 2011). To understand the cultural outcome of corporate governance practices, inherent measures are the listings of firms or businesses in the stock exchanges or their capital value or financial standing among other competitors. Bodies such as stakeholders or investors consider the share values of the firm into account for investment oriented decision making. The share value metrics is regarded as a proxy (Turnbull 2011), which abandons several economic concerns pertaining to tangible and non-tangible risk management; as well as non-economic issues associated with interests of stakeholders. The ethical codes of the business are not tagged with share value.

Some other disadvantages of corporate governance, underlying within the loopholes are their easily corruptible nature and higher monitoring costs. The corporate governance framework post implementation seeks a calibrated level of government oversight to prevent corruption. If not intervened appropriately and timely, a turbulent financial crisis may occur. An example of such illegal behavior is "creative accounting" fraud incident at Satyam Computers. The ethical codes of corporate governance were neglected which impelled the Indian government to constrict the laws (Bhasin 2013). According to Ibis Associates (2001), in family businesses, where family ties are dominant over the business objectivity; bars the firms to build a worldwide corporation at times.

As cited about the importance and limitations of corporate governance in businesses, next section details empirical about corporate governance practices in banks, leading them as an outstanding firm or ending them in a commotion with public's trust deterioration.

5. Indian Banking Scenario

The expansion of business platforms globally demands Indian banks to maintain the standards and practices in alignment with international banking domains. Thus, they can no longer disregard practicing corporate governance. Need for greater disclosure, transparency in norms and drawing a clear, honest image to retain better shareholder value and business experience, banking businesses strive to acclimatize better ascendancy practices (CII 2010).

From the colonial times to 21st century's digital banking era, it is veridical that Indian banking sector leapt multiple folds to foil in business practices faithfully. Next section discusses the Indian banking sector and involving entities, and a view about nationalization of banks. Also, the role of corporate governance, followed by its limitations is presented.

The scenario of Indian financial sector has a larger network of commercial banks (public and private), financial institutions, stock exchanges (Bombay Stock Exchange – BSE, National Stock Exchange – NSE) and several financial instruments. From the period, 1960 to 1990; when Indian financial system was an instrument of public finance (Agarwal R N 2003). The reserve bank of India (RBI) was the sole monitoring agency for supervision and banking control post-independence till 1968. The later period marked the nationalization of banks, under the leadership of then Prime Minister, Mrs. Indira Gandhi, taking core initiatives of banking reforms by nationalization of the banks (Chaudhary & Sharma 2011; Das 2010; Deb 2013). The sole motif behind was to entail the rural and agriculture income based population of India with the financial facilities to deposit the money and increase savings in a trustworthy manner, moving towards financial empowerment, away from the dictatorial claws of feudal lords and landlords. The nationalized banks were compelled to serve rural Indian under corporate social responsibility initiatives. The two phase initiative started with transforming erstwhile Imperial Bank of India, by British colonials to State Bank of India, during 1959 parliamentary act. Later, seven subsidiaries namely State Banks of Bikaner and Jaipur, Hyderabad, Indore, Mysore, Patiala, Saurashtra & Travancore were nationalized and incubated in State Bank of India one by one. The second phase from year 1969 nationalized 14 other banks, followed by 6 more in the year 1980.

In the present scenario, Indian banking sector, chiefly monitored and controlled by Reserve Bank of India, a nationalized entity is responsible to formulate & design frameworks and guidelines for all the banks in India, including foreign banks. These Domestic Systematically Important Banks (D-SIBs) have faced financial crisis which create harmful effect in economy. So RBI proposed a series of reform measures which can improve banking systems. For example, Basel III reform measures is intended to improve the quality and quantity of regulatory issues of banks, develops risk coverage, introduction of leverage ratio, capital conservation buffer etc (RBI, n.d.). The norms and guidelines rhapsodically involve banks to systematically adapt the corporate governance approaches to maintain the profitability and stability among Indian business domain.

6. Empirical Review of Corporate Governance Practices Within Banks

Chakrabati, Meggison, and Yadav (n.d.) in their study have traced the evolution of the concept of corporate governance system within Indian banks and pointed that within literature framework within the country's legal system ensures that there is investor protection within the country, however in reality, the enforcement of corporate governance is a major problem both interms of internal and external stakeholders.

Gupta and Parua (2006) similarly in their study attempted to determine the degree of compliance of corporate governance within the financial sector. After testing the compliance rate for individual organization, it was revealed that 70% of the companies comply with the corporate governance codes. Further enforcement was analysed by Khanna (2009) who indicated that enforcement has been weak within the banking sector and should be improved for development.

Mehran et al. (2011) in a study which attempts to generalize the analytical observations about internal corporate governance identified important factors of internal corporate governance which can affect the overall performance of the organizations are weak control systems, override of internal control measures, absence of risk management process, abuses of the employees, fraudulent practices within the organization in terms of employment agreement and employee welfare (RANTI, 2011). Better corporate governance is possible by practicing internal corporate governance mechanisms which enhances communication process, accounting standards and auditing standard. Corporate governance activities are highlighted through increasing monitoring, supervising and enforcing internal control variables (Jongsureyapart, 2006).

The World Bank has identified the four key areas of good governance in the bank and they are public sector management, accountability, legal framework for development, transparency and information. For example, Asian Development Bank (ADB) has showed its expertise in transparency and information area. The factor of good governance influences on employees in various perspectives as the roles of employees effects in their performance and achievement. Impact of good governance is also reflected to employee empowerment through which equal distribution of rights, obligations and power can be improved (Mohamad, Daud, & Yahya, 2014). Internal corporate governance is adopted by the banks to resolve the conflict between managers and shareholders, so the value of the bank is maximized. There are two factors in this context to control internal governance mechanism. It is also found that compensation contracts and equity ownership are the key factors of internal governance mechanism to motivate managers as well as directors. Equity compensation, severance pay are embedded in banks' executive compensation. So internal corporate governance is related to stability as well as performance of commercial banks (Cornetta, McNuttb, & Tehranianc, 2010).

Lack of internal corporate governance has been linked with poor performance of fairly managed businesses by several research scholars in the past. It is due to gaps in corporate governance structure which lead to collapse in public repute or ending the attractive

figures on the notes of bankruptcy, which are some of the predicted outcomes. Keen insights revealed these gaps were due of lack of corporate governance ethics and integrity of the organizational elements (Miles & Proctor 2002; Anon 2011; Marcinkowska 2012; Maassen 1999; Monem 2011; Drew et al. 2006).

The concept of internal corporate governance is based on agency theory. Absence of effective monitoring system with an organization, managers' decisions deviate from the shareholders' concern in order to manage earnings of the organization. Internal corporate governance enables to mitigate earning management in financial sector. For example, Turkish banks' operation during the period of 2001 to 2004, duality and board tenure are negatively related to firms' performance. It is found also due to agency theory, CEO manipulates earnings management and it does not effect to the independence of the board chair (ALGHAMDI, 2012).

Another case study, researching on the fall of Lehman Brothers (Latifi 2007; Kumar & Vashist 2009; Mehran et al. 2011), fourth largest bank in United States, often titled as too big to fail, with colossal failure despite the compliances with Institute of Managerial Accountants (IMA) and Generally Accepted Accounting Principles (GAAP) was due to unethical practices within governance resulting in fraud and unpredictable risks. The entire blame was on the board of directors, having nominal experience in the modern securitization era, derivatives trading and financial expertise and then CEO, Richard Fuld's monopoly practices. The risk committee and audit committee were merely acting to sign the orders from top management, barring itself from actual assessment of risk while short term lending, borrow back real estates and collateralized debts. One of the manipulations in the accounts by withdrawal of $50 billion to reduce its debt level and pursue a fair picture globally through its subsidiary, Hudson Castle and following a complex interconnected structure, making it difficult for financial regulator to identify, monitor and control the risk lead a positive rating for Lehman until it collapsed. It was stated in the reports of Anton R. Valukas, one of the examiners for Lehman Brothers post its collapse in year 2010.

The reviews from analysts, audit examiners and other agencies revealed that despite with reliable corporate governance frameworks available indicated that big companies failed due to lack of guidelines and measures towards employing effective internal corporate governance models (Swarup 2011; Monem 2011; Anon 2011)

In terms of employees within small banks, Berger et al. (2012) indicated that focus should be given in internal processes, financial transparency, timely audit and reviews from external agencies, fair reporting to government authority, reducing in terms of providing conflicting and imperfect communication network between managers and founders. Therefore, the measures to align the vision and objectives of board members to enhance internal corporate governance were missing.

7. Conclusion

Economic meltdown started in the Indian banking sector in year 2008 due to reasons like nationalization of banks; superior government control on banks procedures and policies for capital management. However, the current corporate governance practices are analyzed, observed and recommended improvement upon mostly for the developed western economies (Daily et al. 2003). Research has been limited for economies like India and China which offer unique dimension of opportunities due to large population and tremendous growth sectors, attracting foreign investments and economies (Davis 2005). The privatization and globalization of banking practices are embarked by several challenges in corporate governance from India (Rajagopalan & Zhang 2008). The success of financial institutions is not a single step process or a single day activity, but it's a continuously evolving process, insisting the elements within the organization to participate and perform duely and ethically for their duties.

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