Corporate Governance Issues & Challenges in Banking Sector in India

D. Babjhan¹, S. Ashok², S. Atiya³

¹Assistant Professor, GATES Institute of Technology, Gooty, Anantapuram District, A.P.(India)
²³ P.G Student, Department of Management Studies, GATES Institute of Technology, Gooty, Anantapuram District, A.P.(India)

ABSTRACT

The corporate Governance is the set of rules, practices, process by which a company is directed. It also provides the frame work for attaining a company’s objectives. It is now recognised as a paradigm for improving competitiveness and enhancing efficiency and thus improving investor’s confidence and accessing capital. The company authority Main Purpose is of financial Reforms Characterized by liberalization & deregulation. Corporate governance has at its backbone a set of visible relationships between an institution’s supervision and its board, shareholders & other stakeholders. In the developmental economic environment & integration of the country at present the banking sector in India cannot ignore the importance of corporate governance. It is the philosophy of banks is the pursuit of sound dealing ethics & strong professionalism that aligns the welfare of all stakeholders & the public. Corporate governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for efficient management and allocation of wealth and discharge of social responsibility for sustainable development of all stakeholders. The objective of the research paper is to study the Impact of corporate governance in banking sector with the help of secondary data. & also study the challenges & issues faced by the banks in India.

Keywords: Corporate governance, Integration, issues and challenges, banking sector, sustainable development.

I. INTRODUCTION

Corporate governance is the association of set of laws, practices, & procedure by which a company is directed. Corporate governance is essentially involves balancing the interest of a company’s many shareholders such as shareholders, management, customers, suppliers, financiers, government & the community. It is also provides the frame work for attaining a company’s objectives. It is an age old concept which provides for a set of transparent relationships between an institution’s management, its board, shareholders & other stakeholders. It is now recognised as a paradigm for improving competitiveness & enhancing efficiency & thus improving investors’ confidence & accessing capital.

Bank & Financial Institutions are the backbone of the economic sector of any country. The healthy economic condition of a nation is depicted through the sound functioning of its banks. Banks form a difficult link of a country’s economic sector hence they are universally regulated industry & their well-being is imperative for the economy. Working of banks is different from other corporate in many important respects, & that makes corporate governance of bank not only different but also critical. Hence corporate governance is conceptually different for banks. If a corporate fails, the fall outs can be restricted to the stakeholders, but if a bank fails, the impact can spread rapidly through other banks with potentially serious consequences for the entire financial system & the macro economy. Thus though various guidelines are provided for working of a bank, corporate governance cannot be overlooked or discarded. Regulations, guidelines & corporate governance are complementary to each other in banking industry.

II. NEED OF CORPORATE GOVERNANCE

Another important factor in banking industry in developing countries is that banks are mostly owned by government. In such situation, banks are mostly guided by government bodies and many laws based on stereotype procedures. The accountability idea is less apparent as the concept of government job discourages the spirit of competition. The need for corporate governance in developing, emerging and transitional economies not only arises from resolving problems of ownership and control, but also from ensuring transparency in achieving the desired goal of corporate governance. In many cases, developing and emerging economies are beset with issues such as the lack of property rights, the abuse of minority shareholders, contract violations, asset stripping and self-dealing. Banks and financial institutions have been making pivotal contributions over the years to nation’s economic growth and development. Public Sector banks have
played a major role in economic development. During the last few years, these institutions are slowly getting corporatized and consequently corporate governance issues in banks assume greater significance in the coming years. Considering the importance of the 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. So the research will identify the attributes of corporate governance and to what extent it is being implemented in India’s banking sector.

2.1 Importance of corporate governance in banking sector:

Every organization has various stakeholders such as directors, employees, shareholders, customers, suppliers, etc. These stakeholders are important for the productivity & efficiency of the organization…but the sharing of information with stake holders is only possible though good corporate governance. : Banks play a pivotal role in the financial & economic system of the nation. The strength of the economy is closely related to the soundness of its banking is now a vital part of our economic system. Modern trade & commerce would almost be impossible without the availability of suitable banking services. Indian banking industry, the backbone of the country’s economy has always played a key role in preventing the economic catastrophe from reaching terrible volume in the country. Hence the failure of banks due to unethical or incompetent policies & management action is detrimental to the shareholders, public depositors & the economy at large. Owing to this fact, a proper corporate governance system is crucial for banks & other financial institutions Banks play a pivotal role in the financial & economic system 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. Modern trade & commerce would almost be impossible without the availability of suitable banking services. Indian banking industry, the backbone of the country’s economy has always played a key role in preventing the economic catastrophe from reaching terrible volume in the country. Hence the failure of banks due to unethical or incompetent policies & management action is detrimental to the shareholders, public depositors & the economy at large. Banking system forms a strategic building block of the economy. The challenge & complexity of implementing corporate governance can be well understood only if we can appreciate the size of the banking system. We need to appreciate that the Indian banking system has made commendable progress in extending its geographical spread & functional reach.

2.2 Issues & challenges of corporate governance in banks:

- Banks are subject to special regulations & supervision by state agencies (monitoring activities of the bank are therefore mirrored);
- Supervision of banks is also exercised by the purchasers of securities issued by banks & depositors.
- Regulations & measures of safety net substantially change the behaviour of owners, managers & customers of the banks.
- Rules can be counterproductive, leading to undesirable behaviour management which expose well-being of stakeholders of the banks.
- Between the bank & its clients there are fiduciary relationships raising additional relationships & agency costs;
- Problem principal-agent is more complex in banks, among others due to the asymmetry of information not only between owners & managers, but also between owners, borrowers, depositors, managers & supervisors;
- The number of parties with a stake in an institution’s activity complicates the Governance of financial institution.

2.3 Research Methodology:
The paper is conceptual in nature. Data collection was achieved by on line websites & the data is filtered to improve the quality of paper. The interpretations are made by the authors with the help of the guide.

2.4 Objectives:
✓ To study the impact of corporate governance practices on banking sector in India
✓ To study the challenges & issues faced by the banks in India
✓ To suggest some measures to the banks in maintaining good corporate governance.

III. IMPACT OF CORPORATE GOVERNANCE PRACTICES ON BANKING SECTOR IN INDIA

Banks engage in the business of accepting deposits & giving loans. They lend money borrowed from depositors to customers who apply for loans. Thus, the collapse of banks will result in monetary loss for the depositors. It is important that the interests of depositors be protected this is also one of the main reasons for corporate governance assuming greater importance. Poor corporate practices can result into banks.

State bank of India is the country’s largest commercial bank in terms of profits, assets, deposits, branches & employees. With over 200 years of existence. State bank group has existence in 33 countries & extensive network of more than 18,000 branches & 26,000 plus ATMs & 100 accounts across the nation. The only Indian bank to feature in the fortune 500 list, SBI has 5 associated banks & 7Subsidiaries arguably the largest in the world. With the millions of customers
across the nation, SBI offers a complete variety of banking products & services with the cutting edge technology & innovative banking model.

State bank of India is committed to the best practices in the area of corporate governance. The sound corporate governance practices State bank of India would lead to effective & more meaningful supervision & could contribute to a collaborative working relationship between bank management & bank supervisors. Based on different elements like boards practices, stake holder’s services & transparent disclosure of information the practice of corporate governance in state bank of India was assessed.

Poor corporate governance can also affect the ability of ban to properly manage its assets & liabilities. This can result into a liquidity crisis. The fact remains that corporate governance approaches will differ among different banking institutions. However, a bank must have a reasonable level of corporate governance taking this different aspects into deliberation such as its size, activities & the nature of its business.

3.1 Challenges & issues faced by the banks in India:

3.1.1 5 key challenges faced by India's banks they are:

Banks are the backbone of every economy. It is very important that banks remains healthy financially. Otherwise, a financial crisis can hit a country leading to recession.

- Asset quality:
The biggest risk to India’s banks is the rise in the bad loans. The slowdown in the economy in the last few years led to a rise in bad loans or non-performing assets (NPAs). These loans are which are not repaid by the borrower. They are, thus a loss for the banks. Net NPAs amount to only 2.36% of the total loans in the banking system. This may not seem like an alarming figure. However, it does not take into restructured assets when a borrower is unable to pay back & the bank makes the loans more flexible to be paid back over a long period of time. Restructured assets are to put pressure on bank’s profitability. Together, such stressed assets account for 10.9% of the total loans in the bank system. & these are just loans which are identified as stressed assets. Yet banks have ability to absorb only 7.9% loss. So, if these debts rotate dreadful too, banks will face major losses.

- Capital adequacy:
One way a bank try to ensure it is protected from bank loans is by setting asset money aside as a ‘provision’. This capital cannot be used for any other purposes including lending. As a result, the banks have a lower capital available to use for its various operations. The capital adequacy ratio measures how much capital a bank has. When this falls, the bank has to borrow money or use depositor’s money to lend. This money, however, is riskier & costlier than bank’s own capital. For example, a depositor can withdraw his/her money any time they want. So, a fall in capital risk asset. In the last few years, CRAR has declined steadily for Indian banks, especially for public sector banks which have higher number of loans. If banks do not shore up their capital soon, some could fail to meet the minimum capital requirement set by the RBI. In such a case, they could face several issues.

- Unhedged forex exposure:
“The wild gyrations in the forex market have the potential to inflict significant stress in the books of Indian companies who have heavily borrowed abroad,” Mundra said in his speech. This stress can affect their ability to pay back debt to Indian banks. As a result, the RBI wants banks to ensure they lend to do not expose themselves to unnecessary debt in dollars.

- Employee & Technology:
Public-sector banks are seeing more employees retire these days. So, younger employees are replacing the elder, more-experienced employees. This, however, happens at junior levels. As a result, there would be a virtual vacuum at the middle & senior level. "The absence of middle management could lead to adverse impact on banks' decision making process as this segment of officers played a critical role in translating the top management's strategy into workable action plans,” the deputy governor said. Moreover, banks - especially government-owned banks - need to embrace technology to offer better products. This will also help make banks more efficient.

- Balance Sheet management:
In the past few years, many banks have tried to delay setting aside money as provisions (for future bad loans). One reason for this is that a bank's chief executives have a short tenure, during which time they want to post higher net
profits & cheer investors. “It must be appreciated that CEOs/ CMDs would come & go but the institutions are perpetual entities. The only thing which can perpetuate their existence is a stronger & healthier balance sheet,” Mudra said. Deferring provisioning is harmful in the long term. It reduces the bank’s ability to withstand financial pressures. This is even more problematic considering the poor capital adequacy in Indian banks. In fact, investors would be happier if the management addresses & sorts out problems rather than posting high net profits that cannot be sustained in the long term, the deputy governor said.

3.2 Measures to the Banks in Maintaining Good Corporate Governance

Most attempts to evaluate the value of good corporate governance focus on conformity-related issues. Numerous rating models also seem to focus on the good corporate governance, such as the composition of boards & the CEO & chairman roles in banking sector

First, what is more significant than which demographic characteristics of a board member process, is what kind of experience he/she has & what types of behavior he/she portrays. Therefore, gender nationality & age diversity are not sufficient to evaluate the effectiveness of a board. One should also evaluate the relevance of the experience of board members to address the main challenge the company is likely to face.

Another important issue is that quality of the information that the board gets is key determinant of its effectiveness. Whether relevant & timely information, existing in context, with the benchmarks & alternatives recognized, assumptions understood & stress tested, or which the potential effects of different alternatives on different stakeholders have been taken into account, would have a significant impact on the quality of the boards decisions.

Third, the impact of panel decisions on production process should be evaluated, not just not inputs such as information quality.

IV. THE SPECIFICITY OF BANKS

- Banks are subject to special regulations and supervision by state agencies (monitoring activities of the bank are therefore mirrored); supervision of banks is also exercised by the purchasers of securities issued by banks and depositors (“market discipline”, “private monitoring”).
- The bankruptcy of a bank raises social costs, which does not happen in the case of other kinds of entities’ collapse; this affects the behaviour of other banks and regulators;
- Regulations and measures of safety net substantially change the behaviour of owners, managers and customers of the banks; rules can be counterproductive, leading to undesirable behaviour management (take increased risk) which expose well-being of stakeholders of the bank (in particular the depositors and owners);
- Between the bank and its clients there are fiduciary relationships raising additional relationships and agency costs;
- Problem principal-agent is more complex in banks, among others due to the asymmetry of information not only between owners and managers, but also between owners, borrowers, depositors, managers and supervisors.

V. GOOD CORPORATE GOVERNANCE STANDARDS

- Establishing standards of conduct and ethical behaviour for directors, senior management and other employees.
- Setting up the responsibilities and also accountability requirements of the board.
- Setting up terms for appointment of qualified and capable individuals to senior management.
- Conducting checks on a single bias to evaluate the effectiveness and senior management in managing the operations of the bank.

VI. SUGGESTIONS

- As far as banks are concerned, corporate objectives should aim at not only securing a high return for shareholders, but also ensuring its contribution towards a sustained growth of the economy
- Every bank has to analyze itself as to what extent it would lend to the priority sector in the absence of Government guidelines.
- The Boards of the banks will have to take the responsibility as to how well they can implement government directive without jeopardizing the long-term interest of the bank in the interest of corporate governance.
- Though the non m& story & other corporate governance requirement disclosures are desirable but for effective & better governance it is necessary that the banks comply the requirements.
Banks should initiate more seminars & workshops in order to highlight the relevance of corporate governance.

Corporate governance should not be practiced just because of regulations but to ensure the betterment & good performance to match to the level of various stakeholders whom they are responsible.

Banks policy makers should be careful in seeing items of corporate governance that are not complied by the banks.

It is necessary that the bank supervisors provide guidance to banks on corporate governance, making it clear that they will not only evaluate the corporate governance policies & procedures, but also evaluate banks’ implementation of these policies & procedures.

It is necessary that the criteria for assessing the corporate governance of banks need to announcedpublicly & also recognize the improvements that have been made.

Stronger enforcement should be top priority for the bank’s policymakers for effective governance

VII. LIMITATIONS OF THE CORPORATE GOVERNANCE IN BANKING SECTOR

7.1 No proper structure:
It is true that the ‘corporate governance’ has no unique structure or design & is largely considered ambiguous. There is still lack of awareness about its various issues, like, quality & frequency of financial & managerial disclosure, compliance with the code of best practice, roles & responsibilities of Board of Directors, shareholders rights, etc.

7.2 No Government Support:
Strong authority principles focusing on fairness, transparency, accountability, responsibility are vital not only for vibrant corporate sector growth, as well as inclusive growth of the economy. Recent corporate also have led to public pressure to reform business practices & increase regulation. The public outcry over the recent also has made it clear that the status quo is no longer acceptable: the public is determineaccountability & responsibility in corporate behavior. It is widely believed that it will take more than just leadership by the corporate sector to restore public confidence in our capital.

7.3 Insider Trading:
Corporate insiders like officers, directors & employees by the virtue of their position have access to confidential information about the corporation & may misappropriate that information to reap profits. In most countries, trading by corporate insiders such as officers, key employees, directors, & large shareholders may be legal, if this trading is done in a way that does not take advantage of non-public information. However, the term is regularly used to refer to a exercise in which an insider or a related party trades based on material non-public information obtained during the performance of the insider’s duties at the corporation, or otherwise in breach of a fiduciary or other relationship of trust & confidence or where the non-public information was misappropriated from the company

VIII. BASIS OF INDIAN MODEL

The vital problem in Indian corporate governance is not a difference between management & owners as in the US & the UK, but a conflict between the foremost shareholders & the alternative shareholders. The problem of the dominant shareholder arises in three large categories of Indian companies. First are the public sector units (PSUs) where the government is the dominant (in fact, majority) shareholder & the general public holds a minority stake. Second are the multinational companies (MNCs) where the foreign parent is the dominant (in most cases, majority) shareholder. Third are the Indian trade groups where the promoters (together with their friends & relatives) are the dominant shareholders with large minority stakes, government owned financial institutions hold a comparable stake, & the balance is held by the general public. It is important to bear in mind that the relation between the company & its shareholders & the relation between the shareholders inter-se is primarily contractual in nature.

IX. CONCLUSION

The corporate governance practice is important for banks in India because number of players in the banking sector have been radically rising. Moreover, the limited support available from the government for further expansion of banks, many banks have been going for public issues, resulting into alteration of ownership. The banks form an integral part of the economy of the country and any failure in a bank might have a direct bearing on the financial health of the country

Banking sector plays a significant role in India to transform economy towards self sufficiency hence the corporate governance of the banking sector is significantly important. There is a need for the development of new policy framework on corporate governance as well as the proper implementation of existing laws, regulations & guidelines
with the equal participation of all relevant stakeholders. Corporate governance has become a topic of increasing interest among the policy makers since it looks at the relationship between the board of directors, shareholders & management.

REFERENCES

5. Corporate governance in banking sector – Indicating transparency &Transolancy By HemaliChukshi, posted on April5, 2015, by journal lawmantra.
7. Corporate governance in banks: problems and remedies-mounikamarcinkowska-university lodz, finance, banking and insurance institute
9. Shodganga.inflibnet.ac./bistream.
11. http://www.slideshare.net/nskbharat/corporate-governance