Corporate Governance in Indian Banking Sector: A Hierarchal Approach

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Abstract

Corporate governance is a broad term in today's business environment. Corporate governance is a multidisciplinary field and borrows concept from various disciplines such as accounting, economics, management, law and consulting. The main function of corporate governance is to make agreements that describe the privileges and tasks of shareholders and the organization. The present paper aims to formulate hierarchical relationships among factors influencing corporate governance mechanism in banking induustry and to examine the present status and scanerios of corporate governance in Indian banking industry. For the accomplishment of the research objectives the various facorts identified and hieririchal relationship developed with the help of interpretive structural modelling techniques. The present status and scanerios has been examining with the help of various commision and committees of Indian banking industry.

Keywords: *Corporate Governance, Hierarchical Relationships, Interpretive Structure Modelling*

1.1 Introduction and Background of the Study

Corporate Governance refers to governing a corporation. It consist of set of policies that are framed and developed for deciding the future course of action which will decide the way forward for the corporation. It encompasses rules and regulations developed by the people who are in-charge of the organisation not only for themselves but also for the people working in the organisation. Corporate governance is a multidisciplinary field and borrows concept from various disciplines such as accounting, economics, management, law and consulting. The main function of corporate governance is to make agreements that describe the privileges and tasks of shareholders and the organization. In case there is any conflict of interest among the stakeholders or between corporation and organisation, then it is the responsibility of the corporate governance strategies to work out the possible solutions for the same. It also involves setting up of standards of governance and administration in the corporations, against which the performance of all the stakeholders involved, is measured. Corporate governance mechanism proves to be fruitful for the corporations.

Corporate governance has been extremely crucial since the post liberalisation era. When India started to ease out restrictions in its market since 1991, from then onwards it has seen an amazing upward trend in the size of its stock market, that is, number of listed firms was increasing proportionately. Studies have highlighted that if a country needs to make it attractive to other country corporations, then it must provide transparency in its operations and the domestic corporations must act in interest of shareholders and aim to increase their value. In India, corporate governance mechanism started to bloom a little late than the rest of the world. It was not until 1991 when liberalization took place and corporate governance established an international context. A major landmark in Indian corporate governance context was the establishment of Securities and Exchange Board of India in 1992, which although was set up to standardise and regulate stock exchange activities. Several committees were set up to lay down and strengthen the corporate governance practices in India. Two such committees were set up under Kumar Mangalam Birla and Narayan Murthy by Securities and Exchange Board of India. The main key takeaway from the recommendations of these committees was the introduction of clause 49. However, increasing corporate governance scams across the globe forced certain alteration and modification in it to stop the happening of these corporate governance frauds in India. Clause 49 of the listing agreement of Indian stock exchange took effect from 2000 to 2003. It contained all the regulations and requirement of minimum number of independent directors, board members, different necessary committees, code of conduct, audit committee rules and limits, etc. Firms that were not following these principles were removed from the listing and were given financial penalties. The corporate governance mechanism in banks is unique in the sense that its level and style of operations is different from other organisations. Since, the bank operate in less transparent way owing to the different and diverse back-end activities, it becomes a tedious task for other stakeholders to keep an eye on the operations of bank. Since, the majority of stake in a government bank is owned by the government itself, therefore, other stakeholders being minority find it extremely difficult to deal with the situation alone. Since banks, particularly public sector banks are operated under pressure to serve general public and work under government pressure, therefore, they indulge in higher operational risk activities at times. This increases the need for corporate governance mechanism in banks.

1.2 Research Objectives

- To formulate hierarchical relationships among factors influencing corporate governance mechanism in banking induustry
- To examine the present status and scanerios of corporate governance in Indian banking industry.

1.3 Factors Impacting Corporate Governance Mechanism

Certain factors influence directly or indirectly the organisations ability to conform to a sound corporate governance mechanism. But, a problem that arises is that these factors do not work in isolation. Also, there exists interdependence among these factors as well. This interdependence makes it essential to understand the relationship between these factors so that an understanding could be developed regarding how or what influences an organisation (particularly bank) while developing a corporate governance plan.

1. **Ownership**- Ownership plays a significant role in corporate governance mechanism of an organisation. It is often found that the philosophy and mind-set of the owners impact the overall corporate governance mechanism being followed in the organisation, whether it is related to making policies or their execution. The ownership can be divided into public sector and private sector ownership. Public ownership means the majority stake in the organisation belongs to the government and general public. Private ownership means the majority stake in the organisation regarding its policies and decision making resides in the hand of few private entities.
2. **Board System**-Board system refers to the arrangement of directors inside the board. There are different type of board systems such as Collective, where every individual has a shared and common purpose and decisions are taken collectively; Governing boards where the board leads the organisation through controlling powers vested to it by the owners of the organisation; Working board where board not only leads the organisation but also works as a staff in the organisation; Advisory board where board serves to provide insight and perspective to any decision maker in the organisation; Fund raising boards where board is developed to draw benefits from connections individuals have with each other. Apart from this, Board structure could be Anglo-Saxon board, which is a one tier board; An Indian board (consisting of women director), German board and a Chinese board. Whatever the composition and system of a board is, it will have consequential impact on board policies and will therefore impact corporate governance mechanism in the organisation.
3. **Independent Directors-** Presence of Independent directors significantly impacts the corporate governance mechanism of the organisation. Since independent directors are truly independent in nature, they do not think about the impact of any significant negative comment on the organisation and hence are crucial in making the organisations adhere to corporate governance principles. More the number of independent directors in the organisation, more are the chances that the organisation will follow policies and guidelines and will not do unethical business practices, which are sure to be disclosed by the independent director.
4. **Committees-** Committees comprises of board of directors and are formed to carry out operations of the organisations systematically. These committees are either temporary (for short term and specific functions) or are permanent. These committees are responsible to carry out operations assigned to them with the overall objective of ensuring strict corporate governance adherence in the organisation. Several committees are framed in the organisation;

few of these are common and are listed as -Audit Committee, Remuneration Committee, Nomination Committee, Shareholder Grievance committee, Risk Management Committee, Corporate Compliance Committee and CSR Committee

5. **Information Disclosure-** Corporate Governance mechanism in an organisation can be measured through the extent to which information is being disclosed to the relevant stakeholders. The information disclosure mechanism should be such that it is relevant to the stakeholders, easily accessible and transparent in nature. All organisations which score high in corporate governance index are the ones with high degree of information disclosure. This information could be related to financial performance of the organisation such as financial statements, or regarding meetings conducted by the board of directors, notice of meeting, information related to Memorandum of Association or Articles or any other information that would assist any of the stakeholder related to organisation in taking suitable decisions that would help them in developing or building relations with the organisation.
6. **Capital of Bank-** Capital of the organisation also influence whether the organisation would follow the corporate governance norms sincerely or not. High capital organisation tends to be more adhering to these norms due to their need for raising funds from outside agencies which affect their goodwill. So, if a bank has sufficient amount of funds available, it might be willing to be more conforming to corporate governance norms than others with limited amount of funds. Capital of the bank would also include the component of capital structure of the bank. If there is more debt and less equity, then the company will have to also ensure that rights of debt holder should be protected as well.
7. **Size of Bank-** Similar to the capital of the bank, size of the organisation also influences their adherence to corporate governance mechanism. It is found that larger banks have high capital, presence in global world and therefore are stricter to adhere to the corporate governance mechanism. It is interesting to note that size also adversely impact the organisations capacity to conform to these practices because of their increased liabilities in terms of number of participants as stakeholders.
8. **Globalization Level-** Level of globalization also has an impact on the willingness or necessity to conform to the corporate governance mechanism. As the world is collapsing and shrinking in terms of reach, organisation have started to mushroom up in places far situated from homeland due to certain advantages. But, these host countries also require that organisations follow sound corporate governance principles which would not make the locals suffer. Similarly, when other countries organisation set up their business in India, government needs to protect the rights of industries within the country as well the organisations set up in the industry. Therefore, government enact laws that need to protect these industries as well.
9. **Political Environment-** Political environment comprises of political stability in the country and the political system being followed in the country. Political stability tends to create an environment based on the ideology of working government which also impacts the laws enacted by them. Also, it is found that organisations during military rule and dictatorship also tend to negate the rules of corporate governance due to their main focus on earning profit motive. Similarly, the intention of the ruling government also influences whether the organisation follows strict corporate governance mechanism or not.
10. **Legal Environment-** Legal environment comprises of the laws which are developed by the country. These laws are related to the functioning which could either impact day to day operations or related to matters which are essential for long term survival of the organisation. In India, laws and provision related to corporate social responsibility, whistle-blower protection in Companies Act or Securities and Exchange Board of India's Listing Obligation and Disclosure Requirements make in mandatory to follow certain provision which have impact on corporate governance mechanism of the organisation.

1.4 Hierarchal Relationships among Factors Influencing Corporate Governance in Banking Sector - Interpretive Structure Modelling (ISM)

In order to develop the hierarchical relationship between the factors involved, Interpretive Structure Modelling technique has been used. The first step involved in preparing ISM digraph is completed with identification of factors related to the system. What follows is preparation of an V-A-X-O matrix that describes the relationship between the factors.

Table 1.1 Self Structuring Interaction Matrix (SSIM)

	01	02	03	04	05	06	07	08	09	10
01	-	V	V	V	V	V	V	A	A	A
02	A	-	V	V	V	O	O	A	A	A
03	A	A	-	O	V	O	O	O	A	A
04	A	A	O	-	V	O	A	O	A	A

05	A	A	A	A	-	O	O	O	A	A
06	A	O	O	O	O	-	V	O	O	O
07	A	O	O	V	O	A	-	A	A	A
08	V	V	O	O	O	O	V	-	A	A
09	V	V	V	V	V	O	V	V	-	V
10	V	V	V	V	V	O	V	V	A	-

Source: Author's work

The relationship identified and coded is converted into form of zeroes and ones in the subsequent table. This gives us driving power and dependence level of factors and their driving power.

Table 1.2 Initial Reachability Matrix (Pre-Iteration)

	01	02	03	04	05	06	07	08	09	10
01	1	1	1	1	1	1	1	0	0	0
02	0	1	1	1	1	0	0	0	0	0
03	0	0	1	0	1	0	0	0	0	0
04	0	0	0	1	1	0	0	0	0	0
05	0	0	0	0	1	0	0	0	0	0
06	0	0	0	0	0	1	1	0	0	0
07	0	0	0	1	0	0	1	0	0	0
08	1	1	0	0	0	0	1	1	0	0
09	1	1	1	1	1	0	1	1	1	1
10	1	1	1	1	1	0	1	1	0	1

Source: Author's work

After incorporating transitivity in the above table, a final table is derived which gives the final driving and dependence level of each factor involved in the system.

Table 1.3 Final Reachability Matrix (Post Iteration)

	01	02	03	04	05	06	07	08	09	10	Driving
01	1	1	1	1	1	1	1	0	0	0	7
02	0	1	1	1	1	0	0	0	0	0	4
03	0	0	1	0	1	0	0	0	0	0	2
04	0	0	0	1	1	0	0	0	0	0	2
05	0	0	0	0	1	0	0	0	0	0	1
06	0	0	0	0	0	1	1	0	0	0	2
07	0	0	0	1	0	0	1	0	0	0	2
08	1	1	1*	1*	1*	1*	1	1	0	0	8
09	1	1	1	1	1	1*	1	1	1	1	10
10	1	1	1	1	1	1*	1	1	0	1	9
Depen-dence	4	5	6	7	8	5	6	3	1	2	

Source: Authors' work

The driving power and dependence level of each factor together is charted to form a chart for better presentation. This analysis is also known as MICMAC and gives great implications which are necessary for deep understanding of the topic. The following figure graphically represents the driving power and dependence level of each factor and on the basis of which, factors are categorised into 4 types.

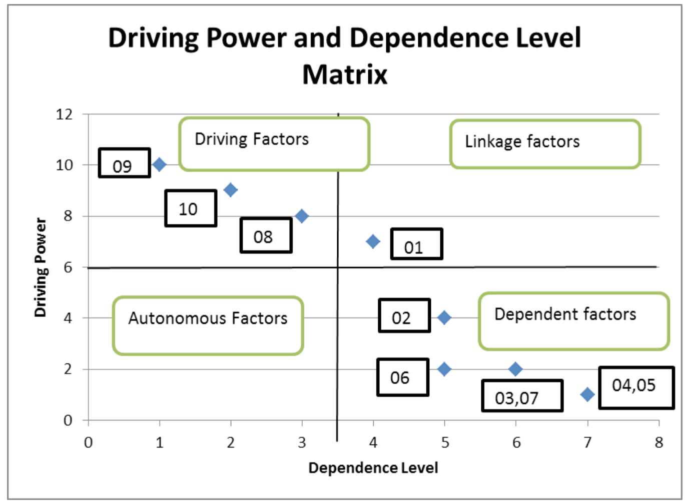

Figure 1.1 Driving and Dependency Matrix

Source: Authors' work

Interpretation from Driving and Dependence matrix-

- Driving factors: These factors are those which have high degree of driving power and low degree of dependence level. These factors are responsible for bringing change in the system. In our study, it was observed that factor 08, 09 and 10 i.e. Level of globalization, Political environment and Legal environment are driving factors and they channelize and ensure sound corporate governance mechanism in industry.
- Linkage factors: These factors are those with high degree of driving power and dependence level; which act as connector between driving factors and dependent forces. These factors pass on the impact of driving factors on to the dependent factors. In our study, factor 01 i.e. Ownership was identified to be a linkage factor.
- Autonomous factors: These are those factors which have low degree of driving power and dependence level. These factors do not cause much impact to the system. Their impact may be on fewer factors but can have significant factors on few. In our case, no such factor was identified.
- Dependent factors: These factors are those with low degree of driving power and high degree of

dependence level. These factors are the one's which feel the overall impact triggered by driving and autonomous or linage factors. In our study, 02, 03, 04, 05, 06, and 07 i.e. Board system, Independent directors, Committees, information disclosure, capital of bank and size of the bank are found to be the dependent factors.

After the MICMAC analysis has been conducted, the next step is to determine the partition level of each factor. Partition level here means the placement of each factor in the hierarchy. The following table helps in determining the partition level.

Partition Level Tables

Iteration Level 1

Factor No	Driving Power	Dependence Level	Intersection Set	Leve L
1	1,2,3,4,5,6,7	1,8,9,10	1	
2	2,3,4,5	1,2,8,9,10	2	
3	3,5	1,2,3,8,9,10	3	
4	4,5	1,2,4,7,8,9,10	4	
5	5	1,2,3,5,8,9,10	5	Level I
6	6,7	1,6,8,9,10	6	
7	4,7	1,6,7,8,9,10	7	
8	1,2,3,4,5,6,7,8	8,9,10	8	
9	1,2,3,4,5,6,7,8,9,10	9	9	
10	1,2,3,4,5,6,7,8,10	9,10	10	

Iteration Level 2

Factor No	Driving Power	Dependence Level	Intersection Set	Leve L
1	1,2,3,4,6,7	1,8,9,10	1	
2	2,3,4	1,2,8,9,10	2	
3	3	1,2,3,8,9,10	3	
4	4	1,2,4,7,8,9,10	4	
6	6,7	1,6,8,9,10	6	Level II
7	4,7	1,6,7,8,9,10	7	
8	1,2,3,4,6,7,8	8,9,10	8	
9	1,2,3,4,6,7,8,9,10	9	9	
10	1,2,3,4,6,7,8,10	9,10	10	

Iteration Level 3

Factor No	Driving Power	Dependence Level	Intersection Set	Level
1	1,2,6,7	1,8,9,10	1	
2	2,	1,2,8,9,10	2	
6	6,7	1,6,8,9,10	6	
7	7	1,6,7,8,9,10	7	Level III
8	1,2,6,7,8	8,9,10	8	
9	1,2,6,7,8,9,10	9	9	
10	1,2,6,7,8,10	9,10	10	

Iteration Level 4

Factor No	Driving Power	Dependence Level	Intersection Set	Level
1	1,6	1,8,9,10	1	
6	6	1,6,8,9,10	6	
8	1,6,8	8,9,10	8	Level IV
9	1,6,8,9,10	9	9	
10	1,6,8,10	9,10	10	

Iteration Level 5

Factor No	Driving Power	Dependence Level	Intersection Set	Level
1	1	1,8,9,10	1	
8	1,8	8,9,10	8	Level V
9	1,8,9,10	9	9	
10	1,8,10	9,10	10	

Iteration Level 6

Factor No	Driving Power	Dependence Level	Intersection Set	Level
8	8	8,9,10	8	
9	8,9,10	9	9	Level VI
10	8,10	9,10	10	

Iteration Level 7

Factor No	Driving Power	Dependence Level	Intersection Set	Level
9	9,10	9	9	Level VII
10	10	9,10	10	

Iteration Level 8

Factor No	Driving Power	Dependence Level	Intersection Set	Level
9	9	9	9	Level VIII

Once the partition level has been determined each factor is placed at its position in hierarchy and the model is developed incorporating all the links, i.e. including the transitive links as well. In the next and last step, the transitive links are removed and a clear hierarchy is derived. What is interesting to observe that ISM digraph an MICMAC analysis both share the common implications. In our MICMAC analysis all those factors which were found to be driving forces are placed at the bottom of the ISM digraph. Similarly the factors that were found to be dependent in MICMAC analysis are found to be placed at top of the ISM digraph. And the linkage factor, i.e. Ownership is observed to be linking the driving factors with the dependent factors in the system. This ISM digraph authenticates and proves our analysis.

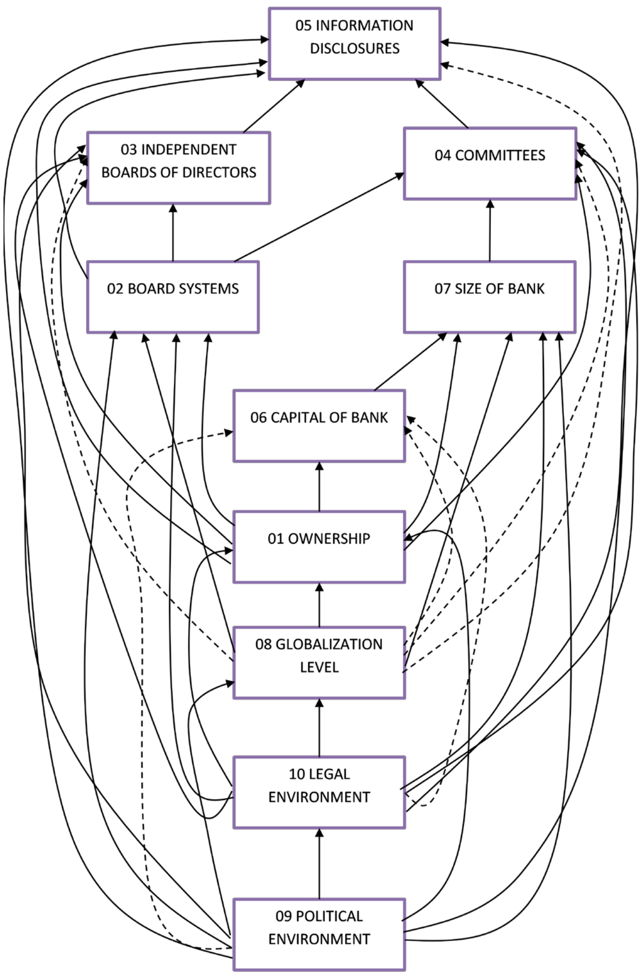

Figure 1.2 Hierarchical relationship among factors influencing corporate governance

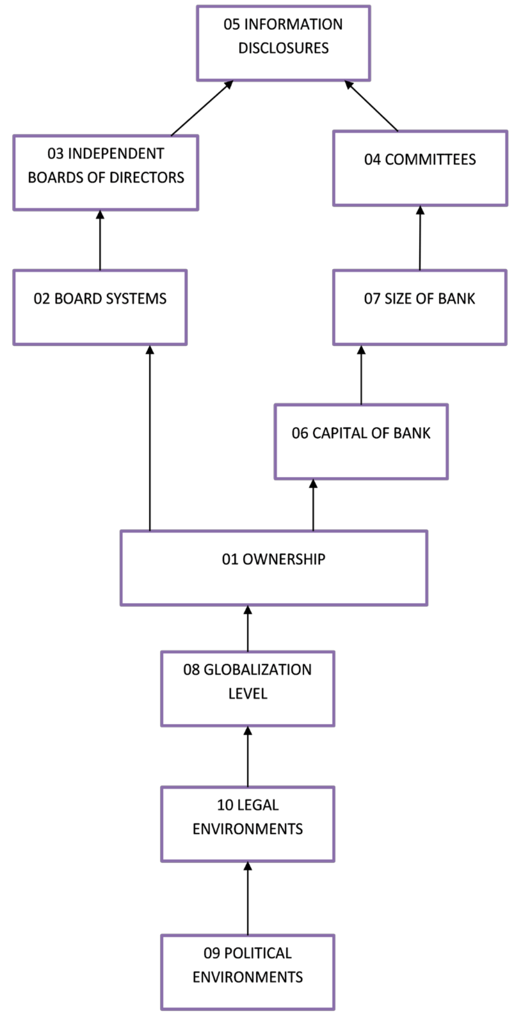

Figure 1.3 Final ISM di-graph depicting hierarchical relationship

1.5 Conclusion and Implications for the Study

Following conclusions can be drawn from the study and on the basis of it, implications could be drawn which would have significant impact on development of corporate governance mechanism-

- Political environment: Several banking scams have recently rocked the Indian economy recently. These scams are result of nexus between political lobby and businessman. Only a strong political system backed by strong will to end this lobby could prove consequential for end of negative and unethical practices. Also, major political parties can also incorporate their vision for corporate governance in their election manifesto so that the general public which is suffering from it could have a sigh of relief from the same.

- Legal environment: Legal environment is found to be pushing organisations towards building up a sound corporate governance mechanism. Therefore it is a requirement that several laws should be enacted and passed. These laws should make provision for stringent corporate governance mechanism in the country. Agencies should be framed for ensuring that organisations work towards their corporate governance mechanism sincerely.
- Globalization level: Since globalization has proven to be fruitful for corporate governance, therefore the government should ensure that no regulatory measures are passed regarding the same. Also, rules regarding Foreign Direct Investment and Foreign Portfolio Investment should be framed such that it allows for inflow of international funds and therefore will be better for corporate governance mechanism.
- Ownership: Private sector undertakings are found to be more efficient in developing a sound corporate governance mechanism owing to factors such as more professionally followed code of ethics and conduct, more educated employees with professional degree and others. If public sector undertakings are not working soundly in terms of corporate governance, there should be some laws and punishment regarding the same. Focus should be more on PSU's so that they also follow sound corporate governance mechanism because they work more with money of general public.

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