Corporate Governance and Banking Financial Performance: An Empirical Study of Domestic Systematically Important Banks of India.

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Abstract

In the era globalization of business, the principle of good corporate governance is necessary. The present study examines the corporate governance mechanisms on bank's financial performance in the Domestic Systematically Important Banks (D-SIB's) of India. There has been always difference in the working culture, style, attitude, perception between every Public and Private sector Banking Industry. The objective of the study was to know about the corporate governance practices of Domestic Systematically Important Bank of India which includes State Bank of India, Housing Development and Finance Corporation and Industrial Credit and Investment Corporation of India. The required secondary data was collected from corporate governance reports and audited annual reports of selected banks for the time period of ten years ranging of 2008-09 to 2018-19. Panel data regression and Pearson correlation tools are used with help of SPSS. The study found that corporate governance has positive significance impact on the financial performance (ROA and ROE) of the public sector banks (SBI), in contrast the corporate governance doesn't record any significant positive relationship with financial performance of private sector banking Industry (HDFC and ICICI) of India. it is concluded that banks operating in the region whose board meetings are more frequent have higher financial performances than the other banks with lower board meetings. Future researches in this direction could provide additional views about the relationship between the internal and external corporate governance and the financial performance of banking industry.

Keywords**:** Corporate Governance, ROA, ROE, GOV, D-SIB's.

I. INTRODUCTION

In 2009 an international body i.e. Financial stability Board (FSB) affiliated with G20 was set up after the international crisis of 2008. FSB was setup to monitor the global financial system. The board of FCB observed that every country has certain big banks with huge client base and turnover of billions of dollars. The market force and government rescued these banks to ensure the national economy doesn't collapse, so that an ordinary citizen/client doesn't suffer. These banks were identified as Domestic Systematically Important Banks (D-SIB's). In India the reserve Bank of India (RBI) has classified three Domestic Systematically Important Banks at national level. These include State Bank of India (SBI), Housing Development and Finance Corporation (HDFC) and Industrial Credit and Investment Corporation of India (ICICI) banks. These banks play a key role at the times when the economy of the country is under threat. The corporate governance and financial performance of these banks is an important area of interest.

The developments of new technologies, globalization, deregulation and major industry consolidation have placed the banking industry at a strategic crossroads. Under this era the banking industry plays an important role in the development of the country. Moreover, banking system of any country are extremely important engines of its growth, as they are most important source of finance for the majority of firms, in addition to playing a major role in the debit and credit system. Corporate governance of banking industry in emerging economies like India is of crucial importance as banks hold an overwhelmingly dominant position in the financial systems. Nowadays corporate governance of any organization or company has become one of the most topical issues in the modern business world today. Corporate governance is a mechanism which is used to direct and control different organizations. It includes relationships between, and accountability of, the organization's stakeholders, as well as the laws, policies, procedures, standards, practices and principles which may affect the organization's direction and control (Cadbury, 1992). It also includes reviewing the organization's practices and policies in regard to the ethical standards and principles, as well as the organization's compliance with its own code of conduct.

The governments of most developed and developing countries have taken intensive steps to make a strong financial sector based on well-established financial organizations, in order to bring their countries on the platform with international developments. This will enable the vision of these countries with solid economy that will be recognized at international level. The corporate governance mechanism in the developing countries is much behind than the corporate governance mechanism of the developed countries. Thus, the developing countries are said to provide adequate coverage of the corporate governance mechanism of different organizations. The policy makers in the developing countries need to ensure that the companies implement effective corporate governance mechanisms. The implementation of international corporate governance standards will be fruitful for the business environment of the developing countries. In India the banking sector is significantly correlated with the economic growth. Therefore, bank governance is of crucial importance as the reduced role of economic regulation has resulted in the managers of banks having greater freedom on how they run their banks. Moreover, the study of the corporate governance and financial performances of the banking industries should be time to time unravelled, so that the gap for the development of this sector can be made in a sustainable way. Keeping in view the scope of the corporate governance in the financial performance, the present study was conducted.

Objective of the study:

1. To compute the corporate governance rating and analyse its financial impact in terms of ROA and ROE over the Domestic Systematically Important Banks of India.
2. To know about the corporate governance practices in Domestic Systematically Important Banks of India.
3. To understand the categorization of all three banks under Domestic Systematically Important Banks of India.
4. To understand the composition of board of directors and working of audit committee of banks under Domestic Systematically Important Banks of India.

Hypothesis:

H01: There is no significant difference of composition of board of directors and audit committee among selected Domestic Systematically Important Bank of India (D-SIB's).

H02: Corporate governance have significant positive financial impact over the selected Domestic Systematically Important Bank of India (D-SIB's).

II. LITERATURE REVIEW

The banking industry of India as corporate are needed to be governed under corporate governance norms of New Companies Act 2013 and Revised Clause 49 of SEBI regulations as other companies. Additionally, they are also covered under the internationally followed Basel Committee norms (1999). Moreover, every year new policies are laid down to enhance the financial performance of the banking sector. The quality of governance is directly linked to the policy framework. In 21st century, stability and prosperity will depend on the strengthening of capital markets and the creation of strong corporate governance systems. A number of works has been done to investigate the relationship between corporate governance and financial performance of banking sector. Andres et al. (2005)

researched that there is a negative relationship between board size and banks' performance. Kesner (1987) explored the relationship between the proportion of executive directors and market returns and result found that there is a positive and significant relationship between these two factors. Wolfgang (2003) stated that good corporate governance lead to higher profit, higher sales growth, increased valuation and lower capital expenditure. Zahra and Pearce (1989) found that an effective board having greater proportion of non-executive directors is significant to banking companies' performance. Ezzamel and Watson (1993) also found that non-executive directors were positively associated with profitability of UK financial institutions. Banks are prudentially regulated and highly levered compared to other companies and hence bank governance deserves special attention (Adams and Mehran, 2003). Cadbury (1992) called for greater transparency and accountability in areas such as board structure and operation, directors' contracts and the establishment of board monitoring committees. Bank regulators and analysts long believe that ROA and ROE act as appropriate proxies for profitability (Mostafa et al. 2007). Macus et al (2008) investigated that the board of meetings are helpful in enhancing the performance of the banking industry.

III. RESEARCH METHODOLOGY

Top public sector bank i.e. SBI, and top two private sector banks i.e. HDFC Bank, ICICI Bank as per market capitalization were selected from the listed banks on BSE. These banks are also called domestic systematically important bank of India(D-SIB's). This study is purely based on secondary data. The required secondary data of corporate governance is collected from corporate governance reports of selected banks whereas performance variable data is collected from audited annual reports of respective banks for the time period of ten years i.e. ranging of 2008-09 to 2017-18 which provides the snapshot of the corporate governance practices adopted by the banking institutions. The selected corporate governance variables are Board size, ratio of outside directors and number of meetings held in a year. The bank performance was measured by ROE, ROA, and GOV. In addition to the Bank scope database, the respective banks' websites and other related websites were used to extract the needed financial and non-financial information about each bank from its published audited financial statements, annual reports, and other relevant information. In order to test the hypotheses, quantitative method was used to investigate the effects of corporate governance mechanisms on bank performance. The data were tabulated and statistically analysed by the analyses of variance (ANOVA) at ($P \leq 0.05$) level of significance. Multiple regression analysis will be done to evaluate the parametric relationships between different corporate governance and financial performance of banking industry using SPSS software.

IV. RESULTS AND DISCUSSION

As the Table-1 illustrates, Corporate Governance Score of different Banking sectors of India aren't significantly different. This implies that most of the banks in India have similar levels of profitability and ownership structure. However, the deviation seems to be almost similar for number of board meetings and the size of the board. These might be the contributing factor in the differences in performances among banking sector of India, something the study looks to explore. It seems that the frequency of board meetings for banks operating in India doesn't vary significantly. The increase in the number of board meetings of the selected banking units of India per year means an increase in monitoring, supervision, direction, and attentiveness by the board of directors which leads to facilitating the bank's operations and assisting management in achieving the objectives of bank's through making the right decision on the right time, taking advantage of the available opportunities and avoiding the potential threats. The frequency of board meetings in a region helps the board members to understand the bank's operations in order to perform the board tasks appropriately. Therefore, it is concluded that banks operating in the region whose board meetings are more frequent have higher financial performances than the other banks with lower board meetings. This result is consistent with the result of the studies conducted by (Davidson et al., 1998; Godard and Shatt, (2004) reported that the frequent board of meetings of the banking industry has a significant influence on its financial performance. It was investigated by Bouaziz and Triki, (2012) that the board of meetings of a specific bank helps the board members to understand the bank's operations in order to perform the board tasks appropriately.

Table-1: Corporate Governance Score of different Banking sectors of India:

Company	N	Mean	SD	SE	95% confidence interval for mean		Minimum	Maximum
					Lower Bound	Upper Bound		
SBI	10	11.50	1.433	.453	10.47	12.52	10	13
HDFC	10	12.00	.942	.298	11.32	12.67	11	13
ICICI	10	11.30	.1.418	.448	10.28	12.31	10	13
TOTAL	30	11.60	1.275	.232	11.12	12.07	10	13

Table-2: ANOVA Table for Corporate Governance Score of Indian Banking Industry:

Source of Variation	SS	df	MS	F	Sig.
Between Group	2.6	2	1.3	.787	.465
Within Group	44.60	27	1.652		
Total	47.20	29			

The mean difference is significant at the 0.05 level.

Table-2 gives the result for the analysis of one-way ANOVA, the results are given in the three rows. The F-value is .787 which is less than F-critical and the P value is .465 which is more than 0.05. Therefore, the null hypothesis $H_{0:}$ There is no significant difference between compositions of board of director of domestic systematically important bank of India is accepted. It means that there is no significant difference between any two or more than two company's compositions of board of director of the selected units of banking sector in India. Ahmed et al (2016) also found that there is no significant difference between any two or more than two company's compositions of board of director of the Islamic Bank Performance of Bangladesh.

Table-3: Descriptive Statistics of corporate governance values (ROA, ROE and GOV) of the selected banks of India:

Company	Particulars	ROA (%)	ROE (%)	GOV (%)
SBI	**Mean**	0.54	9.90	82.13
	Median	0.66	10.83	82.14
	Std. Dev.	0.38	4.76	10.24
	Observations	10.0	10.0	10
HDFC	**Mean**	18.33	18.50	85.71
	Median	18.13	18.50	85.71
	Std. Dev.	1.64	1.43	6.73
	Observations	10.0	10.0	10.0
ICICI	**Mean**	1.38	10.55	81.42
	Median	1.39	10.71	78.56
	Std. Dev.	0.32	2.63	10.75
	Observations	10.0	10.0	10.0

Table-3 shows the descriptive values of mean corporate governance values (ROA, ROE and GOV) of the selected banks of India. It's observed that the highest ROA mean value (18.33) in HDFC bank and lowest ROA value (0.54) in SBI, however the ROA values of ICICI bank was 1.38 respectively. Similar trend was observed for the other descriptive values of ROA and ROE across all the three banks. The mean of corporate governance (GOV) in HDFC bank is highest with 85.71%, whereas SBI has 82.13% and ICICI has 81.42% which is significantly a good score. This highlights that all three banks have high governance administration and there is still scope for improvement in couple of areas, so as to achieve even higher governance ratings. The impact of corporate governance score on financial performance of firm has been summarized using of regression analysis.

Table-4: Summary of Regression Analysis of corporate governance values (ROA, ROE and GOV) of the selected banks of India:

Company	Particulars	R	R^2	Adjusted R^2	F	Significance of F	Beta Coefficient for GOV (b_1)
SBI	**ROA**	.834	.696	.658	18.29	.003*	.834
	ROE	.896	.803	.778	32.51	.004*	.896
HDFC	**ROA**	.485	.236	.140	2.467	.155	.485
	ROE	.082	.007	-.117	.054	.821	.082
ICICI	**ROA**	.184	.034	-.087	.281	.611	.184
	ROE	.209	.044	-.076	.366	.562	.209

***represent statistically significant at 0.005 level respectively.**

As the R^2 and adjusted R^2 values suggest, the model was strong enough to explain the movements of the financial performance of the public and private sector banks of India. Model 1 investigates the relationships between bank financial performance measure (ROE & ROA) and the corporate governance variables. Its seen from the Table-4 that the R^2 values are sufficiently high (ROA=69.6%, ROE=80.3%) in case of ROA and ROE of public sector Banks (SBI). Thus, the model appears highly significant for ROA (F-value = 18.29, p-value = 0.003) and ROE (F-value =32.51, p-value = 0.004) with reference to the corporate governance. In simple words we can say that the corporate governance has a significant positive influence on the financial performance of the public sector banks (SBI) of India. Thus, the hypothesis i.e. Corporate governance rating has a significant financial impact over the public sector banking industry i.e. SBI is accepted. This result was in consistent with those of Adams and Mehran (2003), who identified a positive correlation between corporate governance and bank performance. Good corporate governance lead to higher profit, higher sales growth, increased valuation and lower capital expenditure of the banking industry (Wolfgang 2003**).** Table shows the ROA and ROE values of the private sector banks and its significance. It's seen from the table that the R^2 values for ROA and ROE of private sector banks (HDFC and ICICI) were very low, and the model couldn't explain the financial performance exactly. The p- values of ROA and ROE of both private sector banks (HDFC and ICICI) were higher than 0.05. Thus, the model for the private sector banking industry of India couldn't significantly predict the relationship between the corporate governance and financial performance of private sector banks of India. So, we accept the null hypothesis i.e., Corporate governance rating have no significant positive financial impact over the private banking industry of India. The Model 1 investigates the relationships between bank financial performance measure (ROE & ROA) and the corporate governance variables. It's seen from the Table-4 that the R^2 values are negative in case of ROA and ROE of private sector Banks (HDFC & ICICI). Andres et al. (2005) researched that there is a negative relationship between corporate governance and bank performance. Wilson (2006) found that poor corporate governance can lead market to lose confidence in the inability of a bank to manage properly its assets and liability which could in turn trigger a bank liquidity crisis. Thus, a proper attention is required by the policy makers of the private sector banks regarding the corporate governance.

V.SUMMARY AND CONCLUSION

The present paper investigates the effect of corporate governance mechanisms on bank financial performance in the banking industry of India. This paper highlights the corporate governance practices in domestic systematically important bank operating in India and the effect of such practices on ROE, ROA and GOV. The banking governance is of crucial importance as the reduced role of economic regulation has resulted in the managers of banks having greater freedom on how they run their banks. Nowadays the government of India has taken the necessary actions to have a strong financial sector based on well-established banking industry, in order to keep pace with international developments and enable the vision of a sustainable economy that will be recognized internationally. The policy makers of India and other countries need to ensure the implementation of effective corporate governance mechanisms. This implementation should be appropriate for the business environment while embracing international corporate governance standards. The results of the present study reveal that the corporate governance score of different banking sectors of India aren't significantly different. This implies that most of the banks in India have similar levels of profitability and ownership structure. It was also observed that banks operating in the region whose board meetings are more frequent have higher financial performances than the other banks with lower board meetings. The study further found that corporate governance has positive significance impact on the financial performance (ROA and ROE) of the public sector banks (SBI), in contrast the corporate governance doesn't record any significant positive relationship with financial performance of private sector banking Industry (HDFC and ICICI) of India.

VI. SUGGESTIONS AND FURTHER SCOPE OF STUDY

- All the Domestic Systematically Important Bank of India should focus on periodically review compliance report under all applicable laws to the company.
- Disclosure of definition of financial expertise was missing in the annual reports of all the selected units of banking industry. This is very important to briefly describe that that is financial expertise and thus it clears the knowledge needed for being a financial expert.
- The increased number of corporate governance aspects specially in banking industry is very crucial as it is purely a sector which primarily deals with financial aspects in way of accepting deposits or advancing loans.
- Further study can be done by having comparison between the two or more public sector banks. This will help in understanding the difference in corporate governance between them and to analyse their financial performance on its basis as well.
- Study can also be done on the comparison of financial performance of as per this work and can analyse Earning per Share (EPS), Net profits, Loan Disbursement etc.

CONFLICT OF INTEREST

The authors declare that they do not have any conflict of interest with the submission of this manuscript.

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