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Corporate governance in the Indian banking sector: A survey of literature

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Abstract
A system of transparent interactions between an institution's management, board, shareholders, and other stakeholders is at the heart of corporate governance. The nature and goal of corporate governance have been examined in the first half of this survey of, with a focus on the difficulties that banks face in the area of good corporate governance. In the particular circumstance of an India, the conflicts have also been detailed. In the second part, the Basel Committee's report is described, as well as how it aids in overall bank corporate governance. Finally, in the third section, the best practises in bank corporate governance are shown. Finally, the research finds that banks, as a distinct type of financial firms, need a set of good governance standards which is specific and unique to them.

Keywords: corporate governance, good governance, Indian banking sector, banks, best practices

Introduction

The banking sector is crucial to the country's economic well-being. Owing to economic growth, our banking system has become increasingly important, and the health of the economy is dependent on banks' ability to maintain financial stability and liquidity. Without the supply of suitable banking services, modern trade and business would be nearly impossible. The Indian banking industry being at the core of the country's economy, has always played a significant role in keeping economic calamities away from reaching the masses in the country. The banking system of India is amongst the healthiest performers worldwide. Staying focused on fundamentals, adoption of the highest degree of professionalism, conformance to established rules of lending and investment, commitment to sound banking principles and achieving optimal capital efficiency are crucial for success and continuous existence of banks. In the liberalised economic climate and integration of the country in to the global market, the business sector in India at present may not disregard the necessity of Corporate Governance. Corporate Governance is currently a problem as well as the key component that may be utilised as instrument to maximise the wealth of shareholders of a firm.

Corporate governance is founded on a system of transparent connections between the management of an organisation, its board of directors, shareholders, and other stakeholders. It must therefore consider a variety of factors, including the augmentation of shareholder value, the preservation of shareholder rights, the structure and role of the board of directors, the integrity of accounting practises and disclosure standards, and the effectiveness of the internal control system. Corporate governance, in a service sector such as banking, refers to the way in which individual banks' operations and affairs are governed by their board of directors and senior management. Additionally, it offers the framework within which organizations establish their goals, develop their strategies for achieving them, and measure their success.

Almost every significant industrialised nation, as well as the Organization for Economic Co-operation and Development and the World Bank, have made recent moves to revise their perspectives on the organisation and governance of huge industrial firms. Intellectuals in law and economics have also devoted considerable attention to corporate governance. Surprisingly, despite the widespread emphasis paid to this subject, relatively little consideration has been devoted to bank corporate governance.

The first section of this literature survey explored the nature and purpose of corporate governance, with a particular focus on the issues confronting banks in this area. Conflicts in the Indian perspective are also discussed. The second half discusses the Basel Committee's report and how it aids in bank corporate governance.

Additionally, the final section illustrates optimal practises in corporate governance for banks. Lastly, the review closes by stating that banks, as a distinct class of financial companies, need a unique set of corporate governance standards.

Nature and purpose of corporate governance

Modern day corporations should be considered as nothing beyond a series of contractual agreements among the myriad claimants to the goods produced and revenues earned by them. The group of claimants comprises not only shareholders, but also creditors, suppliers, employees, the local economy in which the business works, and of course, the consumers. In the case of banks, these claimants also include the regulatory agencies in performing their function as underwriters of deposits and lenders of last resort and in their role as representatives of other claimants (Jensen & Meckling, 1976) [38].

To the extent fiduciary responsibilities reduce the agency costs by restricting the flexibility of management to act in its own unrestrained self-interest, such restrictions will be especially effective devices in the banking environment due to various inherent difficulties in supervising the banks (Shleifer & Vishny, 1997) [59]. So too are the bank balance sheets which are extremely complex, but as Furfine (2001) [29] had pointed out, rapid advancements in technology and the ever-expanding financial intelligence have challenged the ability of traditional regulation and supervision to establish a safe and secure banking system. The duty of care dictates that directors employ due care, judgment and diligence in the management of company. Directors' liability for a breach of the obligation may come in two separate instances. First, liability may result from poorly advised or irresponsible decision making. Second, liability may occur as a result of the inability of the board to monitor the situations in which appropriate attention would, presumably, have prevented the damage (Jordan, 1996) [39].

The traditional legal and economic perspective of fiduciary obli gations is that firms and their directors must assume fiduciary d uties towards shareholders and the shareholders only. There has been substantial controversy over the subject as to whether or no t the shareholders ought to be the only benefactors of directors' fiduciary obligations (Benston, 1999) [16].

The primary challenge of corporate governance is based on the Berle-Means model of the segregation of shareholders' ownership and management's control in the contemporary firm. Agency problems develop when the primary lacks the requisite authority or knowledge to oversee and supervise the agent and when the remuneration of the principal and agent is not balanced. Several variables help to lower these principal agency conflicts (Berle & Means, 1932) [32]. Banks are structured in a number of ways, from freestanding corporate entities and individual bank holding companies through several bank holding companies and post the Gramm Leach Bliley Act, banks are also seen as diverse banking holding companies (Andrade *et al*., 2001) [6]. To the degree that few of the major American banks, like Citibank and Bank of America, are fully owned subsidiaries of holding corporations, these banks will not mimic the stereotypical American company wherein ownership is detached from control (Allen & Gale, 2000) [5].

Special problems of banks

Banking i s crucial sector of the economy while supplying finance to commercial firms, fundamental financial services to a large proportion of the population and access to payment services (Barua & Barua, 2020). The significance of banks to country's economy is highlighted by the fact that they are, almost worldwide, a highly regulated business and that they have access to the government safety net. It is of essential significance consequently that banks have good governance standards (Eissa A *et al*., 2021) [27]. Banks are also significant drivers for economic changes, particularly corporate governance policies and procedures. Due to the inevitable role of banks, the integration of corporate governance standards in the evaluation of credit risks relevant to the loan process would motivate the corporate sector in response to strengthen their internal corporate governance procedures (Arun & Turner, 2004) [8]. Significance of applying current corporate governance standards is characterized by the worldwide trend toof consolidation in the banking industry and a necessity of greater capitalization (Paulet, 2011) [49]. The question that has to be addressed here, is how essential is the subject of corporate governance in banks and other financial organisations. Banks, much like any other organisation are established organisations. As a consequence of this, the essential standards of corporate governance extend to them as any other established organisation. Coupled with this, some elements that are highly peculiar to banks, further add to the relevance of Corporate Governance concerns in banks.

Among other characteristics, the most essential one is the premise that banks represent an essential component of the economy of the nation, and any collapse in a bank may have a substantial influence on the financial health of the nation. Banks, aid in directing and facilitating the savings of the population (Stiglitz, 1999) [60].

In two aspects, the capital structure of a bank is distinctive. To begin with, banks have a low level of equity in comparison to other businesses. Second, banks' obligations are primarily in the form of deposits, which are readily accessible to creditors/depositors, but their assets are mostly in the form of longer-term loans. As a result, the primary feature that distinguishes banks as financial intermediaries is their ability to provide liquidity. Banks provide liquidity for the business ecosystem by preserving illiquid assets and releasing liquid liabilities (Diamond & Dybvig, 1983; Peia & Vranceanu, 2019) [25, 50]. Since banks only retain a percentage of deposits on reserve at any given point, the liquidity creation function may pose a collective-action dilemma among the account holders (Abowd & Kaplan, 1999) [2]. Account holders will not be able to get immediate reimbursement of their deposits since the bank will not have enough money on hand to do so. In the unusual situation of a bank run, this imbalance between deposits and obligations creates a hazard. (Maher & Andersson, 2000; Anginer & Demirgüç-Kunt, 2018) [46, 7].

The financing patterns of a bank is the second essential determinant of strong corporate governance. Banks are, by design, highly leveraged financial enterprises, with the equity capital of the owners limited to a small fraction of debt capital in the form of borrowed money and savings from the account holders. As a consequence, bank stakeholders, particularly depositors and lenders, have a legitimate claim towards commitment from banks and their boards of directors. (Caprio & Levine, 2002; Handa, 2018) [21, 33].

The control function is the third crucial component of the Corporate Governance system in banks. It is critical to describe the subject briefly. Internal and external irregularities are dealt with by banks' control functions (Claessens & Jansen, 2000; Lin, 2017) [22, 44]. Internal irregularities refer to instances in which a bank's own employees engage in immoral or unethical behaviour external irregularity is concerned with circumstances in which bank customers attempt to find evidence of wrongdoing. The consequences of external malpractices are so severe that particular intervention is necessitated for both their avoidance and post-occurance assessment (Gorton, 1994) [31]. In this regard, it is worth recalling the COSO framework, which was created with this objective in mind. (Gorton *et al*., 2016; Thabit *et al*., 2017; Udeh, 2019; Park *et al*., 2021) [62, 63, 48].

Lastly, failure to follow established guidelines might be one of the most difficult aspects of the Corporate Governance regime. With the central bank and other regulatory agencies keeping a

close eye on banks, it is a frequent remark that the majority of bank collapses have transpired as a result of compliance problems (Jensen, 1976) [38]. Failure to comply with regulatory requirements has never been done away with, despite the introduction of several assessments and regulations, one of which being the Basel II guidelines. At this point, it is critical to evaluate the influence that governments exert on the governance of banks, as well as the relevance of government intervention in banks. (La Porta *et al*., 1999) [43].

The involvement of a public money also gives rise to the risk of malpractice and self-dealing in the banking sector when the provisions for monitoring are relaxed. In the 1980s, it was believed that one-third of banking crises occurred fraudulent activities and self-dealing operations (Clarke, 1988) [23]. According to a comparable estimate, insider lending was responsible for a majority of bank runs between early 1990s (Jackson & Symons, 1999) [37], as well as non-performing loans (Tacneng, 2015; Prasanth *et al*., 2020) [61, 52]. Obviously, unethical conduct is possible in any huge company, since it is inconvenient for the ownership to watch all personnel at the very same time. Nevertheless, sinceowing to the fact that a major share of banking institutions' assets are stored in relatively liquid state, these issues are especially severe (Maher & Andersson, 2000) [46].

Corporate governance in the Indian banks and the associated conflicts

Public sector banks dominate a majority of the banking activity in India. This challenges corporate governance since effective management is vested in the government, while senior management and the board of directors of banks are just bureaucrats (Reddy, 1998; Gayathri, 2015) [55, 30]. It is indeed high time that the country considerd whether corporate governance is consistent with the current structure of Government control since it holds the organisation's leadership responsible to the political establishment (Sarkar & Sarkar, 2000; Bakare, 2021) [10]. Given this contradiction, even diminution of public ownership under 51 percent would not ensure strong corporate governance standards until the government redefines its position from the ground up. The Joint Parliamentary Committee on Stock Market Scam said that banks must adhere to such methods and practises that are fundamental to all aspects of corporate governance (Verghese, 2002) [66].

In banking, the responsibility of care has a longstanding and contentious past. Briggs v Spaulding was the first instance to explain the contemporary tort-based duty of care for bank directors (Macey & O'hara, 2003) [45]. In Briggs, the president of the First National Bank of Buffalo made unlawful and improper loans to himself, members of his household, and other individuals with almost no financial soundness, causing the bank to go bankrupt. The bank's directors gave no consideration whatsoever to the proper management of the bank's affairs, but were rather reliant on the president to oversee and monitor the matters of the bank. The bank's receiver eventually prosecuted some of the bank's officers and directors, saying that the bank had sustained damages as a consequence of their misconduct and failing to carry out their responsibilities properly and promptly. The court found that directors must display reasonable care, skill and diligence in the management of a bank's business, which entails more than serving as figureheads, when evaluating the level of care expected of bank's directors. Briggs created a legislation against negligence of directors of state chartered and insured banking institutions by mandating that the directors of such institutions much exhibit ordinary care in administering the operations of a bank.

The Briggs Court, in establishing this standard of care, acknowledged that establishing high fiduciary norms involves high costs: "One must be very careful... not to press so hard on honest directors as to make them liable for these constructive defaults, the only effect of which would be to deter all men of any property, and perhaps all men who have any character to lose, from becoming directors of companies at all" (Sandall, 2018) [57].

Ensuring high standards of corporate governance

The Basel Committee on Banking Supervision was created in the year 1975 by the Central Bank Governors of the G10 industrialised nations as a committee of banking supervisory agencies. The Committee established the concept of Capital Adequacy framework, referred to as the Basel Capital Accord, in 1988, with a capital adequacy requirement of 8%. (Bank for International Settlements, 2006). In April 2003, the committee also released a consultation paper named "The New Basel Capital Accord" to supersede the 1988 Accord, which reaffirms the necessity for capital adequacy standards within the existing treaties. Basel II was the generic term for this agreement, which was then being finalised to comprise three important pillars namely: (1) Minimum Capital Requirements, (2) Supervisory Review Process, and (3) Market Discipline.

In August 1999, the Basel Committee released a guideline document titled "Enhancing Corporate Governance for Banking Organizations" to supervisory authorities throughout the globe to help them in encouraging banks in their countries to implement solid corporate governance procedures (Usui, 2003) [64].

From a banking industry point of view, corporate governance entails the fashion in which their boards of directors and senior management oversee the affairs of the individual banks, impacting how banks placed their corporate objectives, perform day-to-day activities, take into account the interests of various stakeholders, coincide corporate activities with the presumption that banks will function in a safe and orderly fashion and in conformance with applicable legal and regulatory requirements and safeguard the welfare of account holders (Becker & Stigler, 1974) [15]. (Becker & Stigler, 1974) [15].

Establishing organizational plans and a set of corporate values that are transmitted all through the organisation, robust risk management capabilities, distinctive controlling of threats, establishing and imposing clear lines of accountability, and so on are a few of the ideal corporate governance practises for banks, according to the paper. (Hay & Shleifer, 1998) [34].

Role of central banks in ensuring corporate governance

The relevance of corporate governance and its execution in the banking industry has grown as the rivalry and dependency of banks and financial institutions in domestic and international markets has expanded. Banks may accomplish good governance by following a set of legal, accounting, financial, and economic norms and regulations. The necessity for integrity and accountability of overnat of overnancee in the private and public sectors is underlined to ensure that competence and integrity in the banking industry be maintained. The central bank's regulatory framework may have an impact on the banking sector's overall

health (Ramana, 2012; Imeokparia, 2013; Misra, 2020; Dikau & Volz, 2021) [53, 36, 47, 26].

The best practices of corporate governance in banks

The board of directors' and management's business practises may be used to foster effective governance. Many bank collapses in the history have been blamed on incompetent leadership and poor management, which allowed banks to acquire poor quality assets and take on extra exposures exceeding their capability (Kohli, 2003; Deb, 2013; Gupta & Shallu, 2014) [41, 24, 32]. At this part, we could go over some of the most important rules for promoting good governance in banks.

Corporate governance is a relatively new topic that has received a considerable interest lately. As a result, even the smallest of banks must prioritise corporate governance reforms. This is due to certain huge organisations' perceived lack of integrity and values in their operations (Rashid *et al*., 2020; Hopt, 2021) [54, 35]. Establishing an efficient, competent, and dependable board of directors requires the involvement of well-qualified, accomplished, and trustworthy personnel. This indicates that the majority of directors on the boards of directors of banks should be really independent and autonomous. The board must be functional, meet on a regular basis, and have long-term vision, direction, and principles (King & Levine, 1993; Endraswati & Suhardjanto, 2014; Bukair & Rahman, 2015) [40, 28, 20].

Corporate principles and codes of conduct should be developed at the top level and utilised to guide the bank's activities both long-term and short-term (Baklouti *et al*., 2016) [11]. These principles and codes should be checked at least once a year. Executive management cannot expect rank-and-file personnel to embrace such principles and codes suo moto till this process is completed (Boubakri *et al*., 2004) [19]. Such a setup will be required to report to the board of directors and will serve as the board's eyes and ears on a continuous basis in relation to the bank's operations (Adams & Mehran, 2003) [3].

The audit committee, compensation committee, and nomination committee should be made up of all of the bank's independent external directors who work independently and autonomously. These committees should have access to bank-paid lawyers and advisors. This committee's independence will guarantee that the internal audit committee's judgments are free of prejudice (van & Wesson, 2021) [65]. The directors should be compensated fairly. Their pay should be proportionate to the risks they assume (Abang'a *et al*., 2021) [1]. Following the financial crisis, the Financial Stability Forum (later the Financial Stability Board, or FSB) released a series of Precepts (FSF Principles for Sound Compensation Practices, dated April 02, 2009) and Deployment Guidelines (FSB Principles for Sound Compensation Practices-Implementation Standards, dated September 25, 2009) on reasonable compensation and reward systems in order to identify and overcome the challenges in a cohesive manner across jurisdictions. Competitive remuneration structure, compensation congruence with sensible risk taking, appropriate supervisory monitoring, and participation are all included in the Guidelines (Reserve Bank of India, 2019) [56]. In the present context, the reporting and disclosure process for banks is found to be both expeditious and more rigorous than it was before. These communications may take the form of quarterly communication to shareholders or other forms of communication (Bhattacharya *et al*., 1998) [18]. According to Ayorinde *et al*. (2012), corporate governance is all about building confidence, assuring transparency and accountability, and making sure that a reliable medium of information sharing and disclosure that will promote efficiency and good corporate performance. When it comes to the board of directors, the main goal is to enhance shareholder value. The approach for achieving this goal should now include corporate governance processes and be created with protracted shareholder value in mind. In addition, the board of directors should consider all stakeholders. They must not behave in an unfair or immoral manner, since doing so would not only erode the moral foundation of governance, but will also convert the organisation into a major failure (Kouki & Guizani, 2015; Ahmadjian, 2016) [42, 4].

Conclusion

Because of the unique nature of banking organisations, a wide understanding of corporate governance is essential while banking operations must still be regulated to safeguard depositors. In a deregulated ecosystem, depositors' safety and security is normally delivered by prudential regulatory oversight in advanced economies however, in emerging economies, such safeguards are undermined by a relative paucity of well-trained managers, insufficient reporting and disclosure norms, the expense of raising bank capital, and the existence of redistributive cartels. Because of the unique nature of the operations carried out by banks, they are confronted with several challenges in the field of corporate governance. There are also a number of underlying conflicts in the Indian environment owing to the unusual structure of bank ownership. When it comes to implementing corporate governance in banks, there is some debate over which benchmark should be used. In this sense, central banks play a crucial role. The Basel Committee's guideline document is very important in implementing corporate governance requirements in several countries throughout the globe. As far as effective corporate governance methods for banks are concerned, they certainly involve the realisation that the times are changing, trying to establish an efficient, competent and dependable board of directors, having established corporate ethical standards by the banks for their own selves, take into account setting-up an office of the board Chairman, maintaining an efficient and working audit committee, remuneration committee and nomination and corporate governance committee in place, take into account optimal board compensation, revealing the material information and recognising their obligation to instal corporate governance policies and procedures that will help in promoting shareholder value.

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