Chapter IV
Relevance of CSR and Corporate Governance in Banking Sector

The Fourth chapter highlights on Relevance of CSR and Corporate Governance in Banking Sector it also gives the details of Recent Findings about Corporate Governance in India, Indian Banking System: An Overview, Reserve Bank of India and Banking and Financial Institutions, Private Banks in India, Co-operative Banks in India, Most Comprehensive Listing of Banks in India, Bank wise offices of Indian SCBs outside India - 2015, Current Scenario of Indian Banking Sector, Domestic Credit Portfolio Compositions of SCBs, Corporate Governance and Banks, Why Corporate Governance in Banks, Corporate Governance and the World Bank, Basel Committee on Corporate Governance, Sound Corporate Governance Practices for Banks, Corporate Governance and Indian Banks, Indian Banking Sector’s Unique Nature and its Implications, Government Control and Withdrawal Effects and International Financial Institutions and Promotion of Social Responsibility.

Introduction
The Indian financial sector comprises a large network of commercial banks, financial institutions, stock exchanges and a wide range of financial instruments. It has undergone a significant structural transformation since the initiation of financial liberalization in 1990s. Before financial liberalization, since mid 1960’s till the early 1990’, the Indian financial system was considered as an instrument of public finance. The evolution of Indian financial sector in the post independent period can be divided in to three distinct periods. During the first period (1947-68), the Reserve Bank of India (RBI) consolidated its role as the
agency in charge of supervision and banking control. Till 1960’s the neo-Keynesian perspective dominated, argued interest rates should be kept low in order to promote capital accumulation. During this period Indian financial sector was characterized by nationalization of banks, directed credit and administered interest rates. The second period (1969 - mid 1980’s), known as the period of financial repression. The financial repression started with the nationalization of 14 commercial banks in 1969. As a result interest rate controls, directed credit programmes, etc. increased in magnitude during this period. The third period, mid 1980’s onwards, is characterized by consolidation, diversification and liberalization. However a more comprehensive liberalization programme was initiated by the government of India during early 1990’s. The impetus to financial sector reforms came with the submission of three influential reports by the Chakravarty Committee in 1985, the Vaghul in 1987 and the Narasimham Committee in 1991. But the recommendations of the Narasimham Committee provided the blueprint of the reforms, especially with regard to banks and other financial institutions. In 1991, the government of India initiated a comprehensive financial sector liberalization programme. The liberalization programme includes de-controlled interest rates, reduced reserve ratios and slowly reduced government control of banking operations while establishing a market regulatory framework. The major objectives of the financial liberalization were to improve the overall performance of the Indian financial sector, to make the financial institutions more competent and more efficient. As mentioned earlier, the financial sector comprises commercial banks, stock exchanges and other financial institutions. However, Indian financial system continues to be a bank based financial system and the banking sector plays an important role as a resource mobiliser. It remains the principal source of resources for many
households, small and medium enterprises and also caters the large industries. And also provides many other financial services. Underlining the importance of the banking sector, several banking sector specific reforms as a part of financial reforms were introduced to improve the performance of the Indian banking sector and to make the Indian banks more competent and efficient. Against this backdrop, the present paper intends to study the corporate governance of the Indian banking sector. The most recent and acute evidence of effects of globalization can be exemplified by the issue of Global Financial Crisis and its spill over effect on the economy of almost all countries. Globalised or connected economies left no country untouched from the consequences of the crisis. The sources of the crisis may be limited to some developed economies, but developing economies are not also free from having potential risks in this regard, though in slightly different form and of a varied degree. The crisis is indeed to a great extent attributed to the failures in ensuring good corporate governance practices. Various research and policy papers has identified absence of a strong risk management framework in the financial institutions, lack of sufficient disclosures of both financial and nonfinancial information, inefficient accounting standards and regulatory requirement, and remuneration system of the executives etc as some of the CG failures that resulted in the worst financial crisis the world have seen since great depression of 1930. The current crisis has also questioned the government and regulatory bodies, the board, and the credit rating agencies for their inefficient role in ensuring good corporate governance. According to Federal Deposit Insurance Corporation (FDIC), 702 banks were considered as troubled banks and problem assets totalled $402.8bn at the end of 2009. The FDIC took over 140 banks in 2009 and FDIC also expected total bank failure to cost $100 from 2008 to 2013. Banks,
being the most important vertebrae of a country's economic backbone, requires sound CG practice and proper monitoring of their compliance. Steps to do this will vary from country to country but there must be a standard regulation and practice. In addition to the role played by the government and regulatory bodies and respective industries in different jurisdictions, a number of multilateral organizations have long been advocating to promote best CG practices across the world. Organization for Economic Cooperation and Development’s (OECDs) principles on CG has been using as a benchmark for almost all the countries in the World. In addition, Basel committee’s guideline on enhancing CG for banking organization is also a reference point for improving the CG practices in the banking sector. In India, the role of banking sector is worth mentioning. Being the largest source of finance, banking sector is also one of the major sources for employment. In addition, Indian banks, the dominant financial intermediaries in India, have made good progress over the last five years, as is evident from several parameters, including annual credit growth, profitability, and trend in gross non-performing assets (NPAs). While the annual rate of credit growth clocked 23% during the last five years, profitability (average Return on Net Worth) was maintained at around 15% during the same period, and gross NPAs fell from 3.3% as on March 31, 2006 to 2.3% as on March 31, 2011. Though India have not seen any major collapse in the banking sector due to current global financial crisis, however, currently, Indian banks face several challenges, such as increase in interest rates on saving deposits, possible deregulation of interest rates on saving deposits, a tighter monetary policy, a large government deficit, increased stress in some sectors (such as, state utilities, airlines, and microfinance), restructured loan accounts, unamortised pension/gratuity liabilities,
increasing infrastructure loans, and implementation of Basel III. Therefore, a study on CG practices in the banking sector of India will be helpful for knowing the current status of the CG in the banking sector and also be helpful to identify the areas where actions are necessary to improve the governance in the banking sector. This research work tried to capture the latent demand of various stakeholders in India by conducting a comprehensive study to determine the corporate governance practices in the banking sector of India.

Recent Findings about Corporate Governance in India

Of late, a burgeoning empirical literature has begun to document important features of corporate governance in India. Researcher has summarized some of the major findings in this section, beginning with research examining corporate board composition. Jayati Sarkar and Subrata Sarkar show that corporate boards of large companies in India in 2003 were slightly smaller than those in the United States (in 1991), with 9.46 members on average in India compared to 11.45 in America. While the percentage of inside directors was roughly comparable (25.38% compared to 26% in the U.S.), Indian boards had relatively fewer independent directors, (just over 54% compared to 60% in the U.S.) and relatively more affiliated outside directors (over 20% versus 14% in the U.S.). 41% of Indian companies had a promoter on the board, and in over 30% of cases a promoter served as an Executive Director. There is evidence that larger boards lead to poorer performance (market-based as well as in accounting terms), both in India and in the United States. The median director in large Indian companies held 4.28 directorships in 2003, and this number is considerably (and statistically significantly) higher for directors in group-affiliated companies (4.85 versus 3.09 for non-affiliated companies). The figures
were similar for inside directors, being 4.34, 4.95 and 3.06 for large companies, group affiliates, and non-affiliated companies, respectively. As for independent directors, however, the median number of positions held was 4.59, with no major differences between group and stand-alone companies. Interestingly, independent directors with multiple directorships are associated with higher firm value in India while busier inside directors are correlated negatively with firm performance. Busier independent directors are also more conscientious in terms of attending board meetings than their counterparts with fewer positions. As for inside directors, it seems that the pressure of serving on multiple boards (due largely to the prevalence of family owned business groups) does take a toll on the directors’ performance. However, busy independent directors also appear to be correlated with a greater degree of earnings management as measured by discretionary accruals. Multiple positions and non-attendance of board meetings by independent directors seem to be associated with higher discretionary accruals in firms. After controlling for these characteristics of independent directors, board independence (measured by the proportion of independent directors) does not seem to affect the degree of earnings management. However, CEO-duality, where the top executive also chairs the board, and the presence of controlling shareholders as inside directors are related, perhaps unsurprisingly, to greater earnings management. Shareholding patterns in India reveal a marked level of concentration in the hands of the promoters. In 2002-03, for instance, Jayati Sarkar and Subrata Sankar find that promoters held 47.74% of the shares in a sample of almost 2500 listed manufacturing companies, and held 50.78% of the shares of group companies and 45.94% of stand-alone firms. In comparison, the Indian public’s share amounted to 34.60%, 28% and 38.51%, respectively. As for the impact of concentrated shareholding on
firm performance, an earlier study by these same authors finds that in the mid-90’s (1995-96) holdings above 25% by directors and their relatives was associated with higher valuation of companies while there was no clear effect below that threshold. More recently, based on 2001 data that distinguishes between “controlling” insiders and non-controlling groups, Ekta Selarka reports a U-shaped relationship between insider ownership (with insiders being defined as promoters and “persons acting in concert with promoters”) and firm value, with the point of inflection lying at a much higher level, between 45% and 63%. Institutional investors--comprising government sponsored mutual funds and insurance companies, banks and development financial institutions (DFIs) that are also long-term creditors, and foreign institutional investors--hold over 22% shares of the average large company in India, of which the share of mutual funds, banks and DFIs, insurance companies, and foreign institutional investors are about 5%, 1.5%, 3% and 11%, respectively. Analyzing cross-sectional data from the mid-1990’s, Jayati Sarkar and Subrata Sarkar find that company value actually declines with a rise in the holding of mutual funds and insurance companies in the range 0-25% holding, after which there is no clear effect. On the other hand, for DFIs’ holdings, there is no clear effect on valuation below 25%, but a significant positive effect above 25%, suggesting better monitoring when stakes are higher. Executive compensation in India, which was freed from the strict regulation by the Companies Act in 1994, is another area of corporate governance that has received attention among researchers. Managerial compensation in India often has two components--salary and performance-based commission as well as retirement and other benefits and perquisites. Based on an analysis of unbalanced panel data for roughly 300 firms each year, Sonja Fagernäs reports that the average total compensation (salary plus
commission) of Indian CEOs has risen almost three-fold between 1998 and 2004 (from Rs. 2.1 million (approximately USD 48,500) to Rs. 6.4 million (approximately USD 143,000) in real terms. During this period, the proportion of profit-based commission has risen steadily, from 13.4% to 25.6%, and the proportion of CEOs with commission as part of their pay package has risen from 0.34 to 0.51. CEO pay has thus clearly become more performance based over the past decade. There is also some evidence that this increasing performance-pay linkage is associated with the introduction of the corporate governance code or Clause 49. Meanwhile, executive compensation as a fraction of profits has also almost doubled from 0.55% to 1.06%. Fagernäs also finds that CEOs related to the founding family or directors are paid more than other CEOs. In a firm fixed effects model, she finds being related to the founding family can raise CEO pay by as much as 30% while being related to a director can cause an increase of about 10%. There is some evidence that the presence of directors from lending institutions lowers pay while the share of non-executive directors on the board connects pay more closely to performance. A recent study finds that, during 1997-2002, the average (of a sample of 462 manufacturing firms) board compensation in India has been around Rs. 5.3 million (approximately USD 120,000), with wide variation across firm size. The average board compensation is Rs. 7.6 million (USD 171,000) for large firms and Rs. 2.5 million (USD 56,000) for small firms. The board compensation also appears to be higher, on average, at Rs. 6.9 million (USD 155,500) if the CEO is related to the founding family. Both board and CEO compensation depend on current performance, and CEO pay depends on past-year performance as well. Diversified companies also pay their boards more. Given that almost two-thirds of the top 500 Indian companies are group affiliated, issues relating to corporate governance
in business groups are naturally very important. Tunneling, or “the transfer of assets and profits out of firms for the benefit of those who control them” is a major concern in business groups with pyramidal ownership structure and inter-firm cash flows. Marianne Bertrand and her co-authors estimate that an industry shock leads to a 30% lower earnings increase for business group firms compared to stand-alone firms in the same industry. They find that firms farther down the pyramidal structure are less affected by industry specific shocks than those nearer the top, suggesting that positive shocks in the former are siphoned off to the latter, benefiting the controlling shareholders but hurting the minority shareholders. However, Bernard Black and Vikramaditya Khanna question how this logic would make them less sensitive to negative shocks. There is also some evidence that firms associated with business groups have superior performance than stand-alone firms. More recently Raja Kali and Jayati Sarkar argue that diversified business groups help increase the opacity of within-group fund flows driving a wider wedge between control and cash flow rights. A greater degree of diversification also aids tunnelling. Using data for Indian firms in 385 business groups in 2002-03 and 384 groups in 2003-04, Kali and Sarkar find that firms with greater ownership opacity and a lower wedge between cash flow rights and control than those in a group’s core activity are likely to be located farther away from the core activity. This incentive for tunnelling explains, according to them, the persistence of value destroying groups in India and occasional heavy investment by Indian groups in businesses with low contribution to group profitability. Using a sample of over 600 of the 1000 largest (by revenues) Indian firms in 2004, Jayashree Saha finds that, after controlling for other corporate governance characteristics, firm performance is negatively associated with the extent of related party
transactions for group firms but positively so for stand-alone companies. This further strengthens the circumstantial evidence of tunneling and its adverse effects. The same study also reveals that, using a sample of over 5000 firms for the period 2003-2005, most related party transactions in India occur between the firm and “parties with control,” as opposed to management personnel as in the United States. Also, group companies consistently report higher levels of related party transactions than stand-alone companies. Transparency and corporate governance levels are very closely related. Cross country studies have repeatedly put India among the worst nations in terms of earnings opacity and management. Indian accounting standards provide considerable flexibility to firms in their financial reporting and differ from the International Accounting Standards (IAS) in several ways that often make interpreting Indian financial statements a challenging task. These deviations, however, need to be viewed in the right perspective. India still falls short of the median number of deviations from IAS in the 49 country sample of Kee-Hong Bae and co-authors. The nature of corporate governance can affect the capital structure of a company. In the presence of well functioning financial institutions, debt can be a disciplining mechanism in the hands of shareholders or an expropriating mechanism in the hands of controlling insiders. Studying the relationship between leverage and Tobin’s Q in 1996, 2000, and 2003, Jayati Sarkar and Subrata Sarkar conclude that the disciplinary effect has been more marked in recent years as institutions have adopted greater market orientations. They also find limited evidence of the use of debt as an expropriating mechanism in group companies. The market for corporate control was relatively limited in India until the mid-1990’s, when the average number of mergers per year leapt from 30 between 1973-74 and 1987-88, and 63 between 1987-88 and 1994-95, to 171 between 1994-95 and 2002-03.
Merger activity appears to occur in waves and is split roughly evenly between inter-industry and intra-industry mergers. The share of group-affiliated mergers has increased significantly in the post 1994-95 period. With regard to public sector governance, Nandini Gupta finds that even when control stays in government hands, partial privatization has a positive impact on profitability, productivity, and investment of the PSEs concerned. She argues that the monitoring role of the markets has been responsible for this. Another study argues that the effect of partial privatization may have been confounded with the application of MoUs to these cases before the partial privatizations, finding that the application of MoUs or performance contracts has had a positive impact on profitability as well as operational performance of PSE. If we discuss the progress of corporate governance practices in Asia, there are measurably changes nowadays we can find. Like in many of the Asian countries, corporate governance reform in South Asian nations is also seen in larger extent than before. For example, the rate of development of CG code or guideline, implementation of the capital adequacy framework (Basel II), compliance with International Financial Reporting Standards (IFRS), level of disclosure of financial and non-financial information, regulatory development of protection of the shareholders rights including the minority shareholders has been remarkable.

Indian Banking System: An Overview
The banking system in India is significantly different from that of other Asian nations because of the country’s unique geographic, social, and economic characteristics. India has a large population and land size, a diverse culture, and extreme disparities in income, which are marked among its regions. There are high levels of illiteracy among a large percentage of its population but, at the same time, the country has a
large reservoir of managerial and technologically advanced talents. Between about 30 and 35 percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centres. The country’s economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the “exported growth” of other Asian economies, with emphasis on self-reliance through import substitution.

A Brief History of Indian Banking Sector:
The word ‘Bank’ has said to be derived from the French word “Bancus” or “Banque”, i.e. bench. It is believed that the early bankers, the Jews of Lombardy, transacted their business on benches in the marketplace. Other believes it is derived from the German word “Back” meaning a joint stock fund. The modern banking system began with the opening of Bank of England in 1694. Bank of Hindustan was the first bank to be established in India, in 1770. The earliest institutions that undertook banking business under the British Regime were agency houses which carried on banking business in addition to their trading activities. Most of these agency houses were closed during 1929-32. Three Presidency banks known as Bank of Bengal, Bank of Bombay and Bank of Madras were open in 1809, 1840 and 1843 respectively at Calcutta, Bombay and Madras. There were later merged into the Imperial Bank of India in 1919 following a bank crisis. The first bank of limited liability managed by Indians was the Oudh Commercial Bank started in 1881. Earlier between 1865 and 1870, only one bank, the Allahbad Bank Ltd., was established. Subsequently the Punjab National Bank began in 1894 with its office at Anarkali Market in Lahore (now in Pakistan). The Swadeshi movement, which began in 1906, prompted formation of a number of
commercial banks such as the Peoples Bank of India Ltd., the Central Bank of India, the Indian Bank Ltd. and the Bank of Baroda Ltd. A series of banking crises between 1913-1917 witnessed the failure of 588 banks. The banking companies (Inspection Ordinance) came in January, 1946 and the Banking Companies (Restriction of Branches) Act was passed in February, 1946. The Banking Companies Act was passed in February 1946, which was later amended to be known as the Banking Regulation Act, 1949. Meanwhile the RBI Act 1934 was passed and the Reserve Bank of India became the first central bank of the country w.e.f. April 1, 1935, it took over the central banking activities from the Imperial Bank of India. The RBI was nationalized on January 1, 1949. The Imperial Bank of India was partially nationalized to form a State Bank of India in 1955. In 1959, subsidiaries of SBI namely, State Bank of Bikaner & Jaipur, State Bank of Hyderabad, State Bank of Indore, State Bank of Mysore, State Bank of Patiala, State Bank of Saurashtra and State Bank of Travancore were established. The nationalization of 14 privately owned banks in India took place on 19th of July 1969 by Mrs. Indira Gandhi, the then Prime Minister, with another installment of nationalization of 6 banks on 15th April, 1980. The major objective of nationalization was to ensure mass banking as against class banking with banking infrastructure aimed at hilly tracts and terrains of the country. Prior to 1969, State Bank of India(SBI) was the only public sector bank in India. SBI was nationalized in 1955 under the SBI Act of 1955. In 1993, one of the nationalized bank namely, New Bank of India, was merged with another nationalized bank i.e. Punjab National Bank.

**Indian Banking Structure:**

Various features of Indian Banking Sector are reflected through structure, size and diversity of the country’s banking and financial
sector. The banking system has had to serve the goals of economic policies enunciated in successive five year development plans, particularly concerning equitable income distribution, balanced regional economic growth, and the reduction and elimination of private sector monopolies in trade and industry. In order for the banking industry to serve as an instrument of state policy, it was subjected to various nationalization schemes in different phases (1955, 1969, and 1980).

**State Co-Operative Agriculture & Rural Development Banks**

**Primary Co-Operative Agriculture & Rural Development Banks**

As a result, banking remained internationally isolated (few Indian banks had presence abroad in international financial centers) because of preoccupations with domestic priorities, especially massive branch expansion and attracting more people to the system. Moreover, the sector has been assigned the role of providing support to other economic sectors such as agriculture, small-scale industries, exports, and banking activities in the developed commercial centers (i.e., metro, urban, and a
limited number of semi-urban centers). On these bases we can explain the Indian financial structure and Indian Banking Structure separately. This is explained in Figures 1.1. Indian banking structure in mainly divided as Scheduled Banks and Unscheduled Banks. Scheduled Banks expressed as Scheduled Commercial Banks (SCBs) which can be further grouped as State Banks Group and other Nationalized Banks, Foreign Banks, Regional Rural Banks and other Scheduled Commercial Banks. SBI Group consists of the State Bank of India (SBI) and Associate Banks of SBI. The Reserve Bank of India (RBI) owns the majority share of SBI and some Associate Banks of SBI.1 SBI has 13 head offices governed each by a board of directors under the supervision of a central board. The boards of directors and their board meets every week. In 1969, the Government arranged the nationalization of 14 scheduled commercial banks in order to expand the branch network, followed by six more in 1980. A merger reduced the number from 20 to 19. Nationalized banks are wholly owned by the Government, although some of them have made public issues. In contrast to the state bank group, nationalized banks are centrally governed, i.e., by their respective head offices. Thus, there is only one board for each nationalized bank and meetings are less frequent (generally, once a month). The state bank group and nationalized banks are together referred to as the public sector banks (PSBs). In 1975, the state bank group and nationalized banks were required to sponsor and set up RRBs in partnership with individual states to provide low-cost financing and credit facilities to the rural masses.

**Reserve Bank of India and Banking and Financial Institutions:**

RBI is the banker to banks—whether commercial, cooperative, or rural. The relationship is established once the name of a bank is included in
the Second Schedule to the Reserve Bank of India Act, 1934. Such bank, called a scheduled bank, is entitled to facilities of refinance from RBI, subject to fulfilment of the following conditions laid down in Section 42 (6) of the Act, as follows:

• it must have paid-up capital and reserves of an aggregate value of not less than an amount specified from time to time; and
• it must satisfy RBI that its affairs are not being conducted in a manner detrimental to the interests of its depositors.

The classification of commercial banks into scheduled and non-scheduled categories that was introduced at the time of establishment of RBI in 1935 has been extended during the last two or three decades to include state cooperative banks, primary urban cooperative banks, and RRBs. RBI is authorized to exclude the name of any bank from the Second Schedule if the bank, having been given suitable opportunity to increase the value of paid-up capital and improve deficiencies, goes into liquidation or ceases to carry on banking activities. Specialized development financial institutions (DFIs) were established to resolve market failures in developing economies and shortage of long-term investments. The first DFI to be established was the Industrial Finance Corporation of India (IFCI) in 1948, and was followed by SFCs at state level set up under a special statute. In 1955, Industrial Credit and Investment Corporation of India (ICICI) was set up in the private sector with foreign equity participation. This was followed in 1964 by Industrial Development Bank of India (IDBI) set up as a subsidiary of RBI. The same year saw the founding of the first mutual fund in the country, the Unit Trust of India (UTI). A wide variety of financial institutions (FIs) has been established. Examples include the National Bank for Agriculture and Rural Development (NABARD), Export Import Bank of India (Exim Bank), National Housing Bank (NHB), and
Small Industries Development Bank of India (SIDBI), which serve as apex banks in their specified areas of responsibility and concern. The three institutions that dominate the term-lending market in providing financial assistance to the corporate sector are IDBI, IFCI, and ICICI. The Government owns insurance companies, including Life Insurance Corporation of India (LIC) and General Insurance Corporation (GIC). Subsidiaries of GIC also provide substantial equity and loan assistance to the industrial sector, while UTI, though a mutual fund, conducts similar operations. RBI also set up in April 1988 the Discount and Finance House of India Ltd. (DFHI) in partnership with SBI and other banks to deal with money market instruments and to provide liquidity to money markets by creating a secondary market for each instrument. Major shares of DFHI are held by SBI. Liberalization of economic policy since 1991 has highlighted the urgent need to improve infrastructure in order to provide services of international standards. Infrastructure is woefully inadequate for the efficient handling of the foreign trade sector, power generation, communication, etc. For meeting specialized financing needs, the Infrastructure Development Finance Company Ltd. (IDFC) was set up in 1997. To nurture growth of private capital flows, IDFC will seek to unbundle and mitigate the risks that investors face in infrastructure and to create an efficient financial structure at institutional and project levels. IDFC will work on commercial orientation, innovations in financial products, rationalizing the legal and regular framework, creation of a long-term debt market, and best global practices on governance and risk management in infrastructure projects.
**Private Banks in India:**

Prior to nationalization, Banks in India with the sole exception of SBI were in private hands with community and trade orientation. Nationalization of 14 banks in the year 1969 and another set of 6 banks in the year 1980 reduced the importance of private sector banks and public sector banks started playing a major role in extending the horizon of banking services to the nook and corner of the country. With history repeating itself, private sector banking got a fillip with the Government of India relaxing the conditions for opening of private sector banks in the year 1994, as a part of their liberalization program. Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an ‘in principle’ approval from the RBI to set up a bank in the private sector. As on 31st March, 2005, there are 30 private banks operating in the country. Private Banks have been playing a crucial role in enhancing customer oriented products with no choice left with the public sector banks except to innovate and compete in the process. Reserve Bank of India has come out on clear cut terms their guidelines on ownership and governance in private sector banks.

On the issue of aggregate foreign investment in private banks from all sources (FDI, FII, NRI), the guideline stipulate that it cannot exceed 74% of the paid up capital of a bank. If FDI (other than by foreign banks or foreign bank groups) in private banks exceeds 5%, the entity acquiring such stake would have to meet the “fit and proper” criteria indicated in the share transfer guidelines and get the RBI’s acknowledgement for transfer of the shares. The aggregate limit for all FII investments is restricted to 24% of which can be raised to 49% with the approval of the board/ shareholders. The current aggregate limit for all NRI investment is 24%, with the individual NRI limit being five percent, subject to the approval of the board/ shareholders.
Co-operative Banks in India

The Co-operative banks have a history of almost 100 years. The Co-operative banks are an important constituent of the Indian Financial System, judging by the role assigned to them, the expectations they are supposed to fulfill, their number, and the number of offices they operate. The co-operative movement originated in the West, but the importance that such banks have assumed in India is rarely paralleled anywhere else in the world. Their role in rural financing continues to be important even today, and their business in the urban areas also has increased phenomenally in recent years mainly due to the sharp increase in the number of primary co-operative banks. While the co-operative banks in rural areas mainly finance agricultural based activities including farming, cattle, milk, hatchery, personal finance etc. along with some small scale industries and self-employment driven activities, the co-operative banks in urban areas mainly finance various categories of people for self-employment, industries, small scale units, home finance, consumer finance, personal finance, etc. Some of the co-operative banks are quite forward looking and have developed sufficient core competencies to challenge state and private sector banks. According to NAFCUB (National Federation of Urban Cooperative Banks & Credit Societies Ltd.) the total deposits & landings of Co-operative Banks is much more than Old Private Sector Banks & also the New Private Sector Banks. This exponential growth of Co-operative Banks is attributed mainly to their much better local reach, personal interaction with customers, and their ability to catch the nerve of the local clientele. Though registered under the Co-operative Societies Act of the Respective States (where formed originally) the banking related activities of the co-operative banks are also regulated by the Reserve
Bank of India. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

**Most Comprehensive Listing of Banks in India**

The commercial banking structure in India consists of: Scheduled Commercial Banks and Unscheduled Banks. Scheduled commercial Banks constitute those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42 (6) (a) of the Act. For the purpose of assessment of performance of banks, the Reserve Bank of India categories them as public sector banks, old private sector banks, new private sector banks and foreign banks. IDBI and IDBI Bank Ltd. have been merged to form Industrial Development Bank of India (IDBI) Ltd. IDBI is notified as a scheduled bank by the Reserve Bank of India (RBI) under the Reserve Bank of India Act, 1934. RBI has categorized IDBI under a new sub group "other public sector bank".

**Indian Bank’s Operations Abroad:**

As on March 31, 2011, fifteen Indian Banks – thirteen from the public sector and three from the private sector had operations overseas spread across 30 countries with a network of 155 branches. The Bank of Baroda has the highest overseas presence, followed by the State Bank of India and Bank of India. Details are given in the following table.
Table No:-4.1

Bank wise offices of Indian SCBs outside India - 2015

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<th>Sr. No.</th>
<th>Bank Name</th>
<th>Overseas Branches (Total)</th>
<th>Sr. No.</th>
<th>Bank Name</th>
<th>Overseas Branches (Total)</th>
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<td>Bank of Baroda</td>
<td>47</td>
<td>9</td>
<td>UQO Bank</td>
<td>04’</td>
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<tr>
<td>2</td>
<td>State Bank India</td>
<td>45</td>
<td>10</td>
<td>Axis Bank</td>
<td>03</td>
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<td>Bank of India</td>
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<td>HDFQ Bank</td>
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<td>Indian Overseas Bank</td>
<td>06</td>
<td>13</td>
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<td>Total Overseas Branches</td>
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*Source: Annual Reports, Results of Banks, ICRA Research.*

**Current Scenario of Indian Banking Sector:**

Good internal capital generation, reasonably active capital markets, and governmental support ensured good capitalisation for most banks during the period under study, with overall capital adequacy touching 14% as on March 31, 2015. At the same time, high levels of public deposit ensured most banks had a comfortable liquidity profile. While banks have benefited from an overall good economic growth over the last decade, implementation of SARFAESI [The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002], setting up of credit information bureaus, internal
improvements such as upgrade of technology infrastructure, tightening of the appraisal and monitoring processes, and strengthening of the risk management platform have also contributed to the improvement. Significantly, the improvement in performance has been achieved despite several hurdles appearing on the way, such as temporary slowdown in economic activity (in the second half of 2008-09), a tightening liquidity situation, increases in wages following revision, and changes in regulations by the RBI, some of which prescribed higher credit provisions or higher capital allocations. Currently, Indian banks face several challenges, such as increase in interest rates on saving deposits, possible deregulation of interest rates on saving deposits, a tighter monetary policy, a large government deficit, increased stress in some sectors (such as, State utilities, airlines, and microfinance), restructured loan accounts, unamortised pension/gratuity liabilities, increasing infrastructure loans, and implementation of Basel III. The Indian financial sector (including banks, nonbanking financial companies, or NBFCs, and housing finance companies, or HFCs) reported a compounded annual growth rate (CAGR) of 19% over the last three years and their credit portfolio stood at close to Rs. 49 trillion (around 62% of 2010-11 GDP) as on March 31, 2015. Banks accounted for nearly 86% of the total credit, NBFCs for around 10%, and HFCs for around 4%. Within banks, public sector banks (PSBs), on the strength of their country-wide presence, continued to be the leader, accounting for around 76% of the total credit portfolio, while within the NBFC sector, large infrastructure financing institutions accounted for more than half the total NBFC credit portfolio; NBFCs that are into retail financing took up the rest. While the Indian banking sector features a large number of players competing against each other, the top 10 banks
accounted for a significant 57% share of the total credit as on March 31, 2015.

**Table No:-4.2**

**Key Players in Indian Banking Sector**

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<tbody>
<tr>
<td>7.567</td>
<td>18%</td>
<td>2.9%</td>
<td>07.8%</td>
<td>13%</td>
<td>3.3%</td>
</tr>
<tr>
<td>2,421</td>
<td>06%</td>
<td>3.5%</td>
<td>08.4%</td>
<td>24%</td>
<td>1.8%</td>
</tr>
<tr>
<td>2,287</td>
<td>05%</td>
<td>28%</td>
<td>10.0%</td>
<td>24%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2,164</td>
<td>05%</td>
<td>2.3%</td>
<td>13.2%</td>
<td>10%</td>
<td>4.5%</td>
</tr>
<tr>
<td>2,131</td>
<td>05%</td>
<td>2.5%</td>
<td>08.3%</td>
<td>17%</td>
<td>2.2%</td>
</tr>
<tr>
<td>2,125</td>
<td>05%</td>
<td>2.6%</td>
<td>10.9%</td>
<td>26%</td>
<td>1.5%</td>
</tr>
<tr>
<td>1,600</td>
<td>04%</td>
<td>42%</td>
<td>12.2%</td>
<td>17%</td>
<td>1.1%</td>
</tr>
<tr>
<td>1,571</td>
<td>04%</td>
<td>1.8%</td>
<td>08.1%</td>
<td>16%</td>
<td>1.8%</td>
</tr>
<tr>
<td>1,424</td>
<td>03%</td>
<td>3.1%</td>
<td>09.4%</td>
<td>19%</td>
<td>1.1%</td>
</tr>
<tr>
<td>1,297</td>
<td>03%</td>
<td>23%</td>
<td>06.4%</td>
<td>18%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Sector 42.874</td>
<td>100%</td>
<td>2.9%</td>
<td>09.7%</td>
<td>17%</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

*Source: Annual Reports, Results of Banks, ICRA Research.*

Total banking credit stood at close to Rs. 39 trillion as on March 25, 2015 and reported a strong 21.4% growth in 2010-11, led by credit to the infrastructure sector and to NBFCs. In 2011-12, although the pace of credit growth has been subdued in the first two months (up just 0.2% from March 2011 levels), it is in line with the pattern noticed in the previous years (0.1% in 2010-11 and 0.4% in 2009-10). According to
ICRA’s estimates, private banks reported a higher overall credit growth of around 26% in 2010-11 (10% in previous year) as compared with PSBs, which achieved around 22% (20% in previous year). Historically, the banking sector’s credit portfolio has been growing at over 20% per annum over the last several years (except in 2009-10, when the growth rate moderated to 17% mainly because of the decline in ICICI Bank’s credit portfolio). Over the years, credit growth has outpaced deposits growth; the credit portfolio reported a CAGR of 24% over the last eight years, while deposits achieved a CAGR of 19% and the investment portfolio of 14% over the same period. The higher growth in credit could be achieved because of the slower growth in investments and the increase in capital. In 2010-11, while deposits growth for SCBs slowed down to 17%, credit growth was maintained at 21% with the growth in investments being just 13%. The higher credit growth vs. deposits growth led to an increase in the credit deposits ratio (CD ratio) from 72.2% as in March 2010 to 75.7% as in March 2011, although the CD ratio moderated to 74.2% as on May 27, 2011, largely because of the slow credit growth in comparison with deposits during the first two months of 2011-12.
Table No:-4.3

Domestic Credit Portfolio Compositions of SCBs

<table>
<thead>
<tr>
<th>Credit Portfolio Composition</th>
<th>March 25.2010</th>
<th>March 25.2015</th>
<th>As % of Total Credit as in March 2011</th>
<th>Growth (Year on Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Allied Activities Loans</td>
<td>4.161</td>
<td>4.603</td>
<td>13%</td>
<td>11%</td>
</tr>
<tr>
<td>Non-Agri Corporate Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial Real Estate Loans</td>
<td>921</td>
<td>1.118</td>
<td>03%</td>
<td>21%</td>
</tr>
<tr>
<td>Loans to NBFCs</td>
<td>1.134</td>
<td>1.756</td>
<td>05%</td>
<td>55%</td>
</tr>
<tr>
<td>Power Sector Loans</td>
<td>1.878</td>
<td>2.692</td>
<td>07%</td>
<td>43%</td>
</tr>
<tr>
<td>Other Infrastructure Loans</td>
<td>1.920</td>
<td>2.575</td>
<td>07%</td>
<td>34%</td>
</tr>
<tr>
<td>Other Corporate Loans</td>
<td>14.528</td>
<td>17.076</td>
<td>47%</td>
<td>18%</td>
</tr>
<tr>
<td>Retail Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Housing Loans</td>
<td>3.009</td>
<td>3.461</td>
<td>09%</td>
<td>15%</td>
</tr>
<tr>
<td>Credit Card Outstanding</td>
<td>201</td>
<td>181</td>
<td>00%</td>
<td>-10%</td>
</tr>
<tr>
<td>Vehicle Loans</td>
<td>638</td>
<td>793</td>
<td>02%</td>
<td>24%</td>
</tr>
<tr>
<td>Other Retail Loans</td>
<td>2.008</td>
<td>2.419</td>
<td>07%</td>
<td>20%</td>
</tr>
<tr>
<td>Total Non Food</td>
<td>30.400</td>
<td>36.674</td>
<td>100%</td>
<td>21%</td>
</tr>
</tbody>
</table>
During 2010-11, the infrastructure sector, particularly power, and NBFCs were the key drivers of the credit growth achieved by the banking sector. Credit to the power sector reported a growth of 43%, while other infrastructure credit grew by 34% during 2010-11, against an overall credit growth of 21%. As in March 2011, the infrastructure sector (including power) accounted for 14% of the total credit portfolio of banks. Within the power sector, historically banks have been taking exposure to State power utilities as well as independent power producers (IPPs). Going forward, with many banks approaching the exposure cap on lending to the power sector and given the concerns hovering over the prospects of the sector itself, the pace of growth of credit to this segment could slow down. However, in the short to medium term, the undisbursed sanctions to power projects are likely to provide for a moderate growth. As for bank credit to NBFCs, the same increased by 55% in 2010-11 and accounted for around 5% of the banks’ total credit portfolio as in March 2011. Moreover, around half of this went to infrastructure related entities, and the rest mainly to NBFCs engaged in retail financing. Most of the NBFCs are focused on secured assets classes, have reported low NPA percentages, and are well-capitalised. As for banks’ retail lending, this continued to lag overall credit growth during 2010-11. Retail credit grew by 17% in 2010-11 against the overall credit growth of 21%, although the 17% figure marked a significant increase over the 4.1% reported in 2009-10. Credit to commercial real estate also increased in 2010-11, reporting a 21% growth that year as against nil in 2009-10. The Gross NPA percentage of SCBs did not increase by the extent that the stress in the Indian market during 2008-09 would warrant because of large loan
Restructuring over last 2-3 years (4-5% of total advances); Gross NPAs declined marginally from 2.4% as in March 2010 to 2.3% as in March 2011. However, higher provisioning led to a reduction in Net NPAs from 1.1% as in March 2010 to 0.9% as in March 2011. Over the last two years, PSBs’ Gross NPAs rose from 2% to 2.3%, while private banks’ NPAs declined from 2.9% to 2.3%. The Gross NPA percentage of the PSBs got impacted by slippages from restructured accounts, “agri debt relief”, and slippages because of automation of asset classification. Better provisioning coverage and a stronger capitalisation profile allowed private banks report better solvency (Net NPA/Net Worth) than PSBs during last few years.

**Corporate Governance and Banks**

Banks are central to market development and socio-economic growth, regulatory and economic reforms including corporate governance practices. Like in many other parts of the world, bank also playing a critical role in the socio-economic development process in Asia. For example, banks are the dominant industry, important drivers for economic growth, most important sources of finance, and main depository for the economy’s savings. Corporate governance principles and practices are most significant in the banking industries compared to the other industries and arguably one of the most important discussions in this current financial crisis. Banks accept money largely in the form of deposits from the general public (i.e. depositors). Banks lend money that is in effect “borrowed: from these depositors, and the failure of banks could result in a monetary loss for the depositors with significant consequences for the economy. Corporate governance principles and practices are particularly significant in the banking sector. Banks have an especially important role in any economy. First and foremost, they
accept deposits from and are liable to the general public. These deposits constitute a significant portion of a nation’s wealth, and must therefore be managed appropriately. Should this wealth be managed inadequately, people’s money and livelihood could be at stake. Another issue that makes bank governance difference is the fact that banks provide loans. Banks are the sole source of finance for the great majority of the enterprises, in particular in emerging markets. The assessment and selection of customers and the ensuing decisions to extend or refuse credit are important processes that fundamentally influence the growth of the economy. Finally, some banks are expected to make credit and liquidity available in difficult market conditions. The importance of banks to national economies is underscored by the fact that banking is, almost universally, a regulated industry. It is thus of great importance that banks have strong corporate governance practices.

It is important to take a wider corporate governance view since banks are not fundamentally different from other companies with respect to corporate governance, even though there are important differences of degree and failures will have economy – wide ramifications. For example, operational and reputational risks might be more dynamic and valuable in banking than in other companies but the need to effectively manage risk is the same. What differentiates banking in terms of corporate governance is the more important role of stakeholders (i.e. depositors) and implicit or explicit guarantees with respect to classes of liabilities which changes the incentives facing boards, shareholders and managers. Failure of a bank could also have systematic consequences which is not the case with non banks. 

Corporate Governance and the Financial Crisis: Key Findings and Main Messages, June 2009, OECD.
Why Corporate Governance in Banks?

If we examine the need of improving corporate governance in banks, two reasons stand out:

(i) Banks exist because they are willing to take on and manage the risks. Besides with the rapid pace of financial innovations and globalization, the face of banking business is undergoing a sea change. Banking business is becoming more complex and diversified. Risk taking and management in a less regulated competitive market will have to be done in such a way that investors’ confidence is not eroded.

(ii) Even in a regulated set up some big banks in the public as well as in the private sector had incurred substantial losses. This along with the massive failure of NBFCs, had adversely impacted investors’ Another important paramount matter for banks is protecting the interest of depositors. Banks deal in peoples’ funds and should, therefore, act as trustees of the depositors. But there are evidence across the world that vulnerability of depositors to the whims of managerial misadventures in banks and that why banks should be regulated tightly than other corporate. So we can say that the main objective of corporate governance in banks is to protect the depositors’ interest and then be to ‘optimise’ the shareholders’ interests. All other consideration would fall in place once these two are archived. And for achieving all these, sound corporate governance is very much essential. Sound corporate governance makes the work of supervisors infinitely easier and also contributes to a collaborative working relationship between bank management and bank supervisors. In addition, transparency of information related to existing conditions, decisions and action is integrally related to accountability in that it gives market participants sufficient information with which to judge the management of a bank.
Corporate Governance and the World Bank:
The World Bank report in corporate governance is a landmark in the evolution of the theory and application of this concept of best corporate behaviour. The World Bank report on corporate governance recognizes the complexities of the very concepts of corporate governance and therefore focuses on the principles on which it is based. These principles such as transparency, accountability, fairness and responsibility are universal in their application. The way they are put into practice has to be determined by those with the responsibility for implementing them. The stronger the partnership between the public and private sectors, the more soundly base will be their governance structures. Equally as the report emphasises, governance initiatives wins more support when driven from the bottom up rather than from the top down. Corporate governance is concerned with holding the balance between economic and social goals and between individuals and community goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. The World Banks report points the way to the establishment of trust and the encouragement of enterprise. It marks an important milestone in the development of corporate governance.

Basel Committee on Corporate Governance:
In 1988, the Bank for International Settlement (BIS) – based Basel Committee on Banking Supervision came out with regulations regarding the capital requirements for banks. Although these were essentially intended for internationally operating banks, in due course, almost all countries adopted these regulations for their banks. The crux of the
Basel-I requirements is the assignment of risk weights for different assets in a bank’s book and aggregating the risk weighted assets of which 8 percent was recommended as the capital of the bank. The committee’s recommendations were not mandatory but the world’s central banks speeded up the process of compliance, particularly following the East Asian crisis and the collapse of certain hedge funds in New Your which threatened to bring down banking systems of the US and the developed world. India adopted Basel – I norms in 1992 closely following the inception of economic reforms. Basel committee published a paper on corporate governance for banking organizations in September 1999. The committee felt that it was the responsibility of banking supervisors to ensure that there was effective corporate governance in the banking industry. Basel Committee underscored the need for banks to set strategies for their operations. The committee also insisted banks to establish accountability for executive these strategies. The Basel Committee has also issued several papers on specific topics, where the importance of corporate governance has been emphasized. These includes Principles for the Management of Interest Rate Risk (September 1997), Framework for Internal Control Systems in Banking Organizations (September 1998), Enhancing bank Transparency (September 1998) and Principles for Management of Credit Risk (issued as a consultative document in July 1999). These papers have highlighted the fact that strategies and techniques that are basic to sound corporate governance include the following:

- The corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure compliance with them.
☐ A well articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured.
☐ The clear assignment of responsibilities and decision making authorities, incorporating a hierarchy of required approvals from individuals to the board of directors.
☐ Establishment of mechanism for the interaction and cooperation among the board of directors, senior management and the auditors.
☐ Strong internal control systems, including internal and external audit functions, risk management functions, independent of business lines and other checks and balances.
☐ Special monitoring of risk exposures where conflict of interest are likely to be particularly great, including business relationship with borrowers affiliated with the banks, large shareholders, senior management or key decision makers within the firm.
☐ The financial and managerial incentives to act in an appropriate manner offered to senior management, business line management and employees in the form of compensation, promotion and other recognition.
☐ Appropriate information flows internally and to the public.

**Sound Corporate Governance Practices for Banks:**
Supervisors have a keen interest in determining that banks have sound corporate governance. For that purpose, supervisors are required to critically evaluate the corporate governance structure on the basis of following elements:
**Ensuring the Critical Elements of Corporate Governance Process:**

a) Establishing strategic objectives and a set of corporate values that are communicated throughout the banking organizations.

b) Setting and enforcing clear lines of responsibility and accountability throughout the organization.

c) Ensuring that board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not subject to undue influence from management or outside concerns.

d) Ensuring that there is appropriate oversight by senior management.

e) Effectively utilizing the work conducted by internal and external auditors, in recognition of important control function they provide.

f) Ensuring that compensation approaches are consistent with the bank’s ethical values, objectives, strategy and control environment.

g) Conducting corporate governance in transparent manner.

**Ensuring Sound Corporate Governance Environment:**

The Basel Committee recognizes that primary responsibility for good corporate governance rests with the board of directors and senior management of banks; however, there are many other ways that corporate governance can be promoted, which includes the following:

a) Government – through laws

b) Securities’ regulations, stock exchanges – through disclosure and listing requirements

c) Auditors – through audit standards on communications to board of directors, senior management and supervisors

d) Banking industry associations – through initiatives related to voluntary industry principles and agreement on and publication of sound practices.
Ensuring the Role of Supervisors:
Supervisors should be aware of the importance of corporate governance and its impact on corporate performance. They should expect banks to implement organizational structures that include appropriate checks and balances. Regulatory safeguards must emphasis accountability and transparency. Supervisors should determine that the boards and senior management of individual institutions have in place processes that ensure they are fulfilling all of their duties and responsibilities. Sound corporate governance considers the interest of all stakeholders, including depositors, whose interest may not always be recognized. Therefore it is necessary for supervisors to determine that individual banks are conducting their business in such a way as not to harm depositors.

Ensuring the New Basel Capital Accord (Basel II), its Implementation and its Impact:
On 26th June, 2004, the committee came out with new Basel norms that are expected to change the complexion of banking throughout the world. The final version of the revised accord, titled “The International Convergence of Capital Measurement and Capital Standards: A Revised Framework” is known in short as the New Basel Capital Accord or simply Basel II. Basel II aims at correcting most of the deficiencies that Basel I suffered from. Basel II rests on three pillars as given below:

- Pillar I of the new capital framework revised the 1988 Accord’s guidelines by aligning the minimum capital requirements more closely to each bank’s actual risk of economic loss.
- Pillar II of the new capital framework recognizes the necessity of exercising effective supervisory review of banks’ internal assessment of
their overall risks to ensure that bank management is exercising sound judgement and has set aside adequate capital for these risks.

- Pillar III leverages the ability of market discipline to motivate prudent management by enhancing the degree of transparency in banks’ public reporting. It sets out the public disclosures that banks must make that lend greater insight into the adequacy of their capitalization.

The implementation of Basel II is imperative in the context of emerging market economies that “may face unique problems in the absence of well developed credit rating systems, robust data collection mechanisms and other infrastructure”. So non implementation without justifiable reasons will finally get reflected in adverse credit ratings, higher borrowing costs and the consequent effects on the real economy. This is one reason no country can afford to delay implementation of Basel II indefinitely.

**Corporate Governance and Indian Banks:**

The subject of corporate governance has received a lot of attention in recent times in India, corporate governance issues and practices by Indian banks have received only a scanty notice. The question of corporate governance in banks is important for several reasons in India, because India has recently liberalized its banking system through privatization, disinvestments and has reduced the role of economic regulation and consequently managers of banks have obtain greater autonomy and freedom with regard to running of banks. This would necessitates their observing best corporate practices to regain the investors’ confidence now that the government authority does not protect them anymore. Corporate governance in banks has assumed importance in India post 1991 reforms because competition compelled banks to improve their performance. Even the majority of banks and
financial institutions, owned, managed and influence by the government with neither high quality management nor any exemplary record of practising corporate governance have realised the importance of adopting better practices to protect their depositors and the banking public.

**Indian Banking Sector’s Unique Nature and its Implications:**

The unique nature of banking firm is in the developed or developing world, requires a broad view of corporate governance to be adopted by banks which encapsulates both shareholders and depositors. In particular, the nature of the banking sector is such that regulations are necessary to protect depositors as well as the overall financial system. The narrow approach to corporate governance views the subject as the mechanism through which the shareholders are assured that managers will act to promote their interests. The special nature of banking will call for the adoption of the broader view of corporate governance for banks. Besides, the special nature of banking requires government intervention in order to restrain the behaviour of bank management. A further issue is that interest of bank shareholders may oppose those of governmental regulators, who have their own agendas, which may not necessarily coincide with maximizing bank value. Shareholders may want managers to take more risk than a socially optimal, whereas regulators have a preference for managers to take substantially less risk due to their concerns about system-wide financial stability. Shareholders could motivate such risk taking using incentive compatible compensation schemes. However, from the regulators point of view, managers’ compensation schemes should be structured so as to discourage banks from becoming
Government Control and Withdrawal Effects:
In India, the issue of corporate governance in banks is complicated by extensive political intervention in the operation of the banking system. Government ownership of banks is a common feature in India. The reason for such ownership may include solving the severe informational problems inherent in developing financial systems, aiding the development process or supporting vested interests and distribution cartels. With a government owned bank, the severity of the conflict between depositors and managers very much depends upon the credibility of the government. Given a credible government and political stability, there will be little conflict as the government ultimately granted deposits. The inefficiencies associated with government owned banks especially those emanating from a lack of adequate managerial incentive have led governments under some pressure from international agencies to begin divesting their ownership stakes. In the case of India too, there are subtle pressure on the government from international organizations that provide development funds such as the World Bank and International Monetary Fund to withdraw their stakes in commercial banks. The divestment of government owned banks raises several corporate governance issues. If banks are completely privatised, then there must be adequate deposit insurance schemes and supervisory arrangements established in order to protect depositors and prevent a financial crash. To sum up, effective governance of banks must have the following minimum criteria:
1. The basic objective of governance should be safeguarding depositors’ money and optimising shareholders’ interests.
2. The directors should be competent and persons of integrity.
3. The chairman of the board should preferably be unconnected with the management of the bank.
4. Board can function through committees and Risk Management Committee assumes special importance in the context of rapid changes taking place in the financial markets. In measuring and monitoring risks, the board should enlist the assistance of experts.

5. The board should forbid banks from pursuing business which might be proper in form but highly improper in substance.

6. As a general rule, the board should ask the management to spell out as to when a transaction, especially in derivative products, could result in losses and take a view on the probability of incurring the losses. On the basis of the overall risks appetite of banks, the transaction may be approved or rejected.

7. Suitable risks and rewards system should be put in place for the directors of banks.

International Financial Institutions and Promotion of Social Responsibility

One of the well known international financial institutions is the World Bank, which aims not only at financing investment projects, but also at the introduction of principles relating to the protection of the environment or of the population’s health and safety. Therefore, in 2007, the World Bank has implemented Environmental, Health, and Safety Guidelines – EHS Guidelines. These guidelines provide the measures achievable with existing technologies and levels of performance. Areas subject to these guidelines are: the environment, health and safety, the health and safety of communities, building and laying up. Besides these, there are sectoral guidelines applicable for the following sectors: agriculture, forestry, industry, chemical industry, oil and gas, infrastructure, processing industry, energy and mining. Of the international financial institutions, an important activity in this field is
compiled by the International Finance Corporation (IFC). This does not involve only the financing of economic entities from developing countries, but also the implementation of policies aimed to protect the environment and respect human rights. IFC’S involvement started in 1989 with the development of the procedure concerning the evaluation of projects in terms of environmental impact, named Safety Policy, based on the World Bank’s policy. The year 2006 was marked by a new step in the field of sustainable development through the adoption of IFC’s Sustainability Framework. IFC’s Sustainability Framework is made up of eight performance standards that IFC clients must fulfil. By implementing these standards, the IFC’s clients will minimize, and even eliminate, some negative effects on the environment, labour or local communities. Also the fulfilment of these standards of performance ensures to those companies competitive advantages and the discovery of new opportunities for development. These standards were developed taking into account the commitments of the IFC:

- IFC’s mission is the fight against poverty, this can be achieved through the promotion of sustainable growth and sustainable investments;
- IFC is considering avoiding disproportionate distribution of the economic development costs, environmental destruction and unsustainable use of natural resources; this can be achieved through a strong commitment of companies towards stakeholders, so as to avoid or mitigate negative effects on people and the environment;
- climate change is a global challenge, and reducing emissions of greenhouse gases is a priority for IFC, which cooperates in this respect, with the private sector and offers innovative investment tools and consulting services to ensure friendly solutions;
o IFC supports low-carbon economic development, supporting access to clean energy services; in the future, IFC will also require its customers information on emission of greenhouse gases, which will allow the quantification of the carbon footprint of the IFC’s investment portfolio;

o IFC recognizes the responsibility of economic operators on the observance and protection of human rights;

o IFC believes that women have an important role in the process of economic growth and poverty reduction. In this sense, IFC plans to create opportunities for women and eliminate gender discrimination through investments and advisory activities.

o In order to help the partners and to unite the public perception about the way of assessment of investment projects, the following performance standards have been developed:

1. Assessment and management of environmental and social risks and impacts;
2. Labour and working conditions;
3. Resource efficiency and pollution prevention;
4. Community health, safety, and security;
5. Land acquisition and involuntary resettlement;
6. Biodiversity management and sustainable management of living natural resources;
7. Indigenous peoples;
8. Cultural heritage.

Depending on the obtained score, the investment’s projects are classified into three categories, reflecting the impact of the project on the environment and the community, namely: A (high impact), B (medium impact), C (low impact). The performance standards have been continually upgraded, so as to satisfy the requirements of a wide range of stakeholders. On 8 September 2009 it began the first update and
reassessment process of the performance standards that lasted 18 months and focused on the process of consulting as many stakeholders from a wide range of areas as possible, so that the standards to be suitable for a large number of industries. The consultation was attended by a large number of stakeholders from diverse fields such as: companies, financial institutions, business associations, trade unions, civil society organizations, community representatives, multilateral and bilateral financial institutions, United Nations agencies and governments. During these discussions, there have been highlighted two contradictory trends of opinion, namely: one of the ideas said that the principles need to be more stringent and was supported mainly by non-governmental organizations and developed countries, and the second idea warned that if the principles will be more severe, compliance will prove too costly or too difficult to accomplish, especially for small and medium sized enterprises. The second idea was supported by many companies and several government representatives. From 1 January 2012 the new performance standards came into force. IFC has launched the concept of sustainable finance for a responsible financing of investment projects. IFC say that all financial institutions are subject to certain social and environmental risks from its own customers. Neglect of the consequences of these risks may bring serious damage to reputation and financial performance of banks. From the social and environmental risks that may negatively influence the activity of a customer, the most frequent are environmental pollution, health, safety and security in the workplace, community impacts and threats to biodiversity and cultural heritage. That’s why the World Bank Group Environmental, Health, and Safety Guidelines were issued and are focused on: Environment, Occupational Health and Safety, Community Health and Safety, Construction and Decommissioning. The banks’ clients come from
various sectors of activity, which is why banks are designed to highlight the areas in which environmental, social and ethical risks have a high probability of manifestation. Because of this Industry Sector Guidelines have been developed for the following industry: forestry, agribusiness/food production, chemicals, oil and gas, infrastructure, general manufacturing, mining and power. In addition to evaluating the financial performance, the banks assess the social, environmental and ethical risks for companies in these sectors. Assessment involves the analysis of the following items: the system of corporate governance; the system of risk management; corporate social responsibility policy; method of stakeholder-consultation; history of environmental problems or social company faced.

The international financial crisis was a signal of alarm which resulted in a change of the vision of the social responsibility linked to the granting of credit to individuals. Due to the crisis forms of manifestation it led to the emergence of the concept of responsible lending. Not understanding the financial mechanisms of crediting by the population, together with the lack of accountability on the part of banks led to the emergence of a crisis generated by the loans obtained without a careful evaluation of the possibility of redemption, as was the case with the credits obtained with the ID card. As a result of these realities, most banks that have launched social responsibility programs, have at least a financial education program, which aims to disseminate among the population, especially young people, the advantages of using banking products. An interesting category of CSR programs is represented by the activities involving employees of the companies, as the ones from the banking sector, which involves employees as volunteers in various programs supported by banks.
Non Financial Disclosures:

Company Objectives

- The objectives of the enterprise should be disclosed.

There are two general categories of company objectives: the first is commercial objectives, such as increasing productivity or identifying a sector focus; the second is much more fundamental and relates to governance objectives: it seeks to answer the basic question, "why does the company exist?" This section refers to these governance objectives. The objectives of enterprises may vary according to the values of society. In many countries, but by no means all, the primary corporate objective is to maximize the long-term return to shareholders (shareholder value). This objective appears in many codes throughout the world.

Ownership and Shareholders Rights

- The beneficiary ownership structure should be fully disclosed to all interested parties. Changes in the shareholdings of substantial investors should be disclosed to the market as soon as a company becomes aware of them. The beneficiary ownership structure of an enterprise is of great importance in an investment decision, especially with regard to the equitable treatment of shareholders. In order to make an informed decision about the company, investors need access to information regarding its ownership structure.

Changes in Control and Transactions Involving Significant Assets

- Rules and procedures governing the acquisition of corporate control in the capital markets and extraordinary transactions such as mergers and sales of substantial portions of corporate assets should be disclosed. Best practice suggests a substantial amount of pre control transaction disclosure, including the disclosure of the intention to acquire control,
and to take the company private, and of associated squeeze-out/sell-out rights relevant for minority shareholders. Other typical disclosures include the identity of the bidder, past contacts, transactions and agreements between the merging entities (or acquirer and target, as the case may be), and a discussion of the consequences of the control transaction for the shareholders of the companies involved, as well as disclosure of the financial situation of the bidder and its source of funds for the control transaction.

**Governance Structures and Policies:**

- **The structure, role and functions of the board**

  The term "board" has different meanings in unitary and two-tier systems. A unitary board is composed of executive and non-executive directors. In a two-tier system the term “board” is distinguished between the management board, whose members have executive responsibilities, and the supervisory board, responsible for the monitoring and supervision of the company’s management. Variations exist among the two-tier systems, and the responsibilities of the supervisory board could in some countries include responsibilities for the strategic direction of the company. While the two-tier system is not as widely utilized as the one-tier system, it is nevertheless prevalent in several large economies such as Austria, Germany and the Netherlands. In this document, the term "board" is used to refer to the highest governing and monitoring body or bodies of an enterprise on which executive and non-executive or supervisory board members sit. The recommendations contained herein typically apply to both one-tier and two-tier systems.
Ethics policy and support structure

☐ The existence of an enterprise code of ethics and any governance structure put in place to support that code of ethics should be disclosed. Any waivers to the code of ethics or the rules governing ethics procedures should also be disclosed. Member of the Board and Key Executives

☐ Duties and Qualifications

The number, type and duties of board positions held by an individual director should be disclosed. An enterprise should also disclose the actual board positions held, and whether or not the enterprise has a policy limiting the number of board positions any one director can hold. Shareholders need to be aware of the number, type and duties of outside board and management positions that any individual director holds. Information on outside board and management positions should be disclosed for key executives as well. The purpose of this information is to make a judgement on the ability of directors and key executives to meet all of their commitments; thus the number as well as the type and duties of the position (which gives some indication of the commitment involved) should be disclosed.

Evaluation Mechanism

The board should disclose whether it has a performance evaluation process in place, either for the board as a whole or for individual members. Disclosure should be made of how the board has evaluated its performance and how the results of the appraisal are being used. Along with the duties and responsibilities of directors, shareholders will need to know how directors were evaluated, what criteria were used and how they were applied in practice, particularly with reference to remuneration. CACG Guidelines stress that evaluations should be based
on objective criteria. The IAIM Guidelines (Ireland) and Preda Code (Italy) leave to the remuneration committee the selection of appropriate criteria and the establishment of whether these criteria have been met.

**Director’s Remuneration**

Directors should disclose the mechanism for setting directors’ remuneration and its structure. A clear distinction should be made between remuneration mechanisms for executive directors and non-executive directors. Disclosure should be comprehensive to demonstrate to shareholders and other stakeholders whether remuneration is tied to the company’s long-term performance as measured by recognized criteria. Information regarding compensation packages should include salary, bonuses, pensions, share payments and all other benefits, financial or otherwise, as well as reimbursed expenses. Where share options for directors are used as incentives but are not disclosed as disaggregated expenses in the accounts, their cost should be fully disclosed using a widely accepted pricing model.

**Material Issued Regarding Stakeholders and Environmental and Social Stewardship**

The board should disclose whether there is a mechanism protecting the rights of other stakeholders in a business. OECD Principle IV concerns itself with ensuring that the rights of stakeholders protected by law are respected. Even where no legislation exists, it is considered good practice to make additional commitments, as corporate reputation and performance may require recognition of broader interests. For example, the CACG Guidelines require that a board identify the corporation’s internal and external stakeholders and agree on a policy for how the corporation should relate to them.
Material Foreseeable Risk Factors

☐ The board should give appropriate disclosures and assurance regarding its risk management objectives, systems and activities. The board should disclose existing provisions for identifying and managing the effects of risk bearing activities. The board should report on internal control systems designed to mitigate risks. Such reporting should include risk identification mechanisms.

General Meetings

☐ Disclosure should be made of the process for holding and voting at annual general meetings and extraordinary general meetings, as well as all other information necessary for shareholders to participate effectively in such meetings. Notification of the agenda and proposed resolutions should be made in a timely fashion, and be made available in the national language (or one of the official languages) of the enterprise as well as, if appropriate, an internationally used business language. The results of a general meeting should be communicated to all shareholders as soon as possible.

GOOD PRACTICES FOR COMPLIANCE

☐ Where there is a local code on corporate governance, enterprises should follow a “comply or explain” rule whereby they disclose the extent to which they followed the local code’s recommendations and explain any deviations. Where there is no local code on corporate governance, companies should follow recognized international good practices.
Concluding Remark:-

Although it is a very old concept, early writings about social responsibility dating from the 1950s, it began to develop in years 90’. With the growing interest in corporate social responsibility, international financial institutions have taken the initiative and have assumed the role of developers. IFC’s involvement in the process has resulted in the publication of IFC’s Sustainability Framework, which introduced a set of principles of good practice that must comply in order to be able to get financing. The main positive aspect of this publication was the standardization of requirements relating to social responsibility. However, the principles may not apply in all branches of industry, which is why sectoral guidelines have been designed for each industry sector in part. The Equator principles are a result of the major banking institutions in the field of CSR. They have issued a set of principles, according to which we can classify investment projects depending on their impact on the environment, social impact and business ethics. Global Reporting Initiative has created a unified system of reporting companies’ achievements in the field of CSR. Year after year, more and more companies are sending reports of activities in the field CSR, in some cases, like the United Kingdom, the percentage of companies reporting being 100%. According to the latest study by KPMG 95% of the largest 250 companies in the world reported programs in social responsibility field. Banks from Romania have developed many CSR programs, most of them being education, volunteering, social. Most of the programs of responsibility are made by RCB, RBD and UniCredit-Tiriac. RCB is Romania’s first bank which reported to the Global Reporting Initiative. After the international financial crisis banks business philosophy has changed, many of them including literacy programs for financial education. The purpose of these programs is to
disseminate information about financial products and their correct use by the general public, and in particular by young people.

References:


