Chapter I

Introduction

1.1 Corporate Governance

“Little neglects add up to mischiefs and mischiefs ultimately lead to bigger frauds and scars and corporate enterprises are no exemption. Little care enables to avoid little neglects; more care helps to avoid mischiefs and greater care adds up to establish fine governance which ultimately leads to excellences.”

Corporate Governance in the context of a present corporation has become synonymous with the practices and processes used to direct and manage the affairs of a corporate body with the objective of balancing the attainment of corporate objectives with the association of corporate behaviour to the expectations of society and accountability to shareholders and other stakeholders.

Corporate governance is based on principles such as conducting the business with integrity and fairness, being transparent in transactions, making necessary disclosures and decisions, complying with the laws, accountability and responsibility towards the stakeholders and commitment to conduct business in an ethical manner. Fundamentally, there is a level of confidence that is associated with a company that is known to have good Corporate Governance. “The existence of a lively group of independent directors on the board contributes a great deal towards ensuring confidence in the market. Corporate Governance is one of the criteria that foreign institutional investors depend on when deciding on which companies to invest in. It is also known to have a positive weight on the share price of the company. Having a spotless
image on the Corporate Governance front also makes it easier for companies to source capital at more rational costs.”2

Unfortunately, Corporate Governance often becomes the centre of discussion only after the exposure of a large scam. Until 1900’s the good Corporate Governance was used to describe how well a business was directed and managed. This has been found suitable in reference to privately owned corporations where managers and shareholders were usually one and there was no conflict between the persons managing or controlling the company and the ultimate beneficiaries. “The situation is not same with publicly owned corporations where the managers and controllers are not the exclusive beneficiaries. Therefore situations arise wherein the objectives of the controllers of the enterprise and the shareholders does not match.”3

This results into tension between the controllers and shareholders, which ultimately affect the company and its internal environment. These tensions are sometimes aggravated through the lack of transparency and communication between parties.

In the current scenario, good Corporate Governance is described as the system of moderating the tensions between the controllers and other stakeholders of a corporation.
Concept of Corporate Governance

“Corporate Governance is an array of relationship between company’s management, its board, its shareholders and other stakeholders. Corporate Governance provides process and structure through which the objective of the company, the means of attaining the objective and systems of monitoring performance is also set.”

Corporate Governance is an approach by which corporate entities are directed and controlled. Corporate Governance is management of companies by the Board of Directors. The concept of Corporate Governance primarily depends on complete transparency, uprightness and accountability of the management. This is essentially the core of good Corporate Governance.

Shleifer and Vishny defined “Corporate Governance as a way in which suppliers of finance to Corporations assure themselves of getting a return on their investment”

Report of SEBI Committee on Corporate Governance “Code of Corporate Governance encapsulates role of management as trustees for shareholders to safeguard the inalienable rights of the shareholders who are the true owners of the corporation.”

The Cadbury Committee Report defines “Corporate Governance as a system by which corporate are directed and controlled.”

“According to the Guidelines for Enhancing Good Economic and Corporate Governance in Africa from the Economic Commission for Africa, “Corporate Governance refers to the mechanisms by which
private, publicly traded and state-owned enterprises are managed and governed, and good Corporate Governance entails the pursuit of objectives by the board and management that represent the interests of a company and its shareholders including effective monitoring and efficient use of resources.”

Confederation of Indian Industry (CII) defines “Corporate Governance as dealing with laws, procedures, practices and implicit rules that determine a company’s ability to take informed managerial decisions.”

“The Canada initiative (Toronto Stock Exchange) defines Corporate Governance as “the process and structure used to direct and manage the business and affairs of the corporation with objective of enhancing shareholder value, which includes ensuring the financial viability of the business.”

A Gandhian Definition says that “Trusteeship obligations inherent in company operations, where resources are united and entrusted to the managers for finest utilization in the stakeholders’ interests.”

“Corporate Governance encapsulates:-

- The management of the associations between a corporate body’s management, its board, its shareholders and other stakeholders.
- The provision of the composition through which the objectives of the company are identified and the monitoring of the means used to accomplish these objectives including the monitoring of performance.
• Bringing more transparency in the decision-making processes of the company.
• The provision of incentives for the board and management to pursue objectives those are in the interests of the corporate body and stakeholders.
• Encouraging the use of resources in a more efficient manner."

Corporate Governance is only part of the larger economic context in which companies operate. It is a key element for improving economic efficiency and is considered as a powerful micro-policy instrument and effective lever for charge in transitional economies. It is a structure of accountability and balances. Good Corporate Governance cannot prevent ill-conceived strategies, product failures or missed opportunities. Instead Corporate Governance can help avoiding corporate shortcomings like defective leadership, poor business performance and lack of trust and confidence among business stakeholders. Corporate Governance is concerned about association among various stakeholders in the governance pattern of the corporations. Business ethics and Social initiatives that the corporation persists towards the communities in which it operates also affect the governance of the corporation.

“Five Golden conventions of best Corporate Governance practices are:

1. **Ethics**: a clearly ethical basis to the business
2. **Align Business Goals**: proper goals, arrived at through the creation of a suitable stakeholder decision making model
3. **Strategic management**: an effective strategy process which incorporates stakeholder value

4. **Organisation**: an organisation suitably structured to effect good Corporate Governance

5. **Reporting**: reporting systems structured to provide transparency and accountability

To demonstrate the totality, and the need for a holistic approach, following figure is presented:

**Pressures on a Company**
1.2 Introduction to Banking Industry in India

Evolution of the Indian Banking Industry

The Indian banking industry has its foundations in the 18th century, and has had a diverse experience since then. The initial banks in India were principally traders’ and were occupied only with financing activities. Banking sector in the pre-independence era developed with the Presidency Banks, which were changed into the Imperial Bank of India and subsequently into the State Bank of India. The initial days of the banking industry saw a widely held private ownership and a highly volatile working environment. Major strides towards public ownership and accountability were made with nationalisation in 1969 and 1980 which transformed the face of banking in India. The industry in recent scenario has recognised the importance of private and foreign players in a competitive scenario and has moved towards greater liberalisation.
The evolution of banking industry can be classified into four distinct phases.

- **Phase I** - Phase of Pre-Nationalisation (prior to 1955)
- **Phase II** - Period of Nationalisation and Consolidation (1955-1990)
• Phase III- Beginning of Indian Banking Sector Reforms and Partial Liberalisation (1990-2004)
• Phase IV- Period of engorged Liberalisation (2004 onwards)

Current Structure

Currently the Indian banking industry has a diverse structure. The present configuration of the Indian banking industry has been analyzed on the basis of its ordered status, business as well as product segmentation.

The present Rs 64 trillion Indian banking industries are governed by the Banking Regulation Act of India, (1949) and are closely overlooked by the Reserve Bank of India (RBI). RBI manages the country's money supply and foreign exchange and also serves as a bank for the Government of India and for the country's commercial banks. Currently, public sector banks account for 70 per cent of the Indian banking assets.

1.3 Corporate Governance in Banking Industry

An institution, including a corporate entity, derives its authenticity from its ability and desire to fulfil social needs. It is therefore, accountable to the society. No financial organization can overlook its responsibility towards the society from which it derives its force and sustenance.

The frequent financial crises and the scams that rocked the nation in the recent past call for a sharper focus on Corporate Governance. The only way to protect the interest of the public at large is to build
"firewalls" by putting in place the practices of good Corporate Governance.

“Basel Committee published a paper on Corporate Governance for banking organizations in September 1999. The Committee emphasised on responsibility of the banking supervisors to ensure that there is effective Corporate Governance in the banking industry. Supervisory experience underscores the need of having appropriate accountability and checks the balances within each bank to ensure sound Corporate Governance, which leads to effective and more meaningful supervision. Sound Corporate Governance also contributes to a collaborative working relationship between bank managements and bank supervisors.”

Basel committee underscores the need for banks to set strategies for their transactions. The Committee also suggests the banks to establish accountability for executing these strategies. Unless there is clearness of information related to decisions it would be difficult for stakeholders to make management accountable.

“From a banking industry perspective, Corporate Governance is the way in which the business of individual organizations is governed by their Boards and senior management, affecting how banks: Set corporate objective; Run the day-to-day operations of the business; and Consider the interests of recognized stakeholders; Align corporate activities and behaviours with the expectation that banks will operate in a safe and sound manner, in compliance with applicable laws and regulations; and Protect the interests of depositors.”
“There are four important forms of oversight that should be included in the organizational structure of any bank in order to ensure the appropriate checks and balances:

(1) Supervision by the Board;

(2) Oversight by individuals not involved in the routine running of the various business areas;

(3) Direct line supervision of different business areas; and

(4) Emphasize on risk management and audit functions.”

1.4 Corporate Governance in ICICI Bank

“Corporate Governance policies of ICICI Bank identify the accountability of the board and the importance of its decisions to all their Stakeholders namely customers, investors, employees and the regulatory authorities. The functions of the board and the executive management are well defined and are distinct from one another. They have taken steps including the setting up of sub committees of the board to overlook the functions of executive management.”

The role, functions, responsibility and accountability of the Board is clearly defined. The primary role of the Board is monitoring of corporate performance, some other functions of the board include

- Approving corporate philosophy and mission
- Participation in the formulation of strategic and business plan
- Approval of financial plans and budgets.
- Overlooking corporate performance against strategic and business plans including overseeing operations
• Ensuring ethical behaviour of the bank and compliance with laws and regulations.

• Keeping shareholders informed regarding plans, strategies and performance

1.5 Corporate Governance in SBI

“For enhancement in management transparency and Corporate Governance, SBI holdings emphasises on most crucial management task i.e. to build and maintain an organisational structure that is capable of responding quickly to the changes in the business environment as well as a fair management system that emphasis interest of the shareholders.”

State Bank of India is committed to the best practises in the area of Corporate Governance. The bank believes that good Corporate Governance is much more than complying with legal and regulatory requirements. Good governance facilitates effective management and control of business, enables the bank to maintain high level of business ethics and to optimise the value for all its stakeholders. The objectives can be summarized as:

• To boost shareholder value

• To safeguard the interest of all the stakeholders including customers, employees and society.

• To ensure transparency and disclosures in required information.

• To check accountability for performance and to achieve excellence at all levels.
1.6 Corporate Governance Initiatives and Enactments

An effective regulatory and legal framework is requisite for the proper and sustained growth of the financial corporations. In the current scenario, it has been essential that corporate entities work in accordance to changed economic trends, code of good Corporate Governance and ensure safety of the interests of the stakeholders. As the forms of corporations and their complications have been continuously increasing, there is requirement of formulating common code of Corporate Governance that can be applied to all kinds of companies. Confederation of Indian Industry (CII) introduced Corporate Governance code in India in 1990s at the time of liberalization as a voluntary measure to be adopted by Indian companies. Ministry of Corporate Affairs also gave a set of guidelines on Corporate Governance. Corporate Governance principles have been framed and accepted all over the world, but continuous initiatives are being made to evolve code which is acceptable in specific environment of India.

Corporate Governance has derived its importance due to frequent scams and scandals in financial industry. Corporate Governance principles are based on parameters like accountability, transparency, trust, disclosures, fairness and integrity of the corporations. A regulatory body like SEBI has given guidelines for effective implementation of Corporate Governance code in the corporations. Applicability of Corporate Governance in banking industry is far more important to upkeep the standards and improve transparency for the stakeholders.
References


5. Murthy N R Narayana, (February 8, 2003), Report of the SEBI Committee on Corporate Governance.


