REVIEW OF LITERATURE

“Corporate Governance is about promoting corporate fairness, transparency and accountability “

J. Wolfenson

2.1 INTRODUCTION:

Review of literature is a crucial chapter which helps a researcher to evaluate various work of researcher and find the research gap in relation to their study.

In the present study extensive literatures are reviewed and the summary of the same is presented below. The review of literature is divided into the following sections:

- Corporate governance and firm performance
- Corporate governance in banks
- Corporate governance and disclosure
- Corporate governance and board composition
- Corporate governance from shareholder’s perspectives

2.2 CORPORATE GOVERNANCE AND FIRM PERFORMANCE:

Corporate governance provides structure for the benefit of concerned stakeholders by ensuring that firms adhere to ethical standards and best practices. There are large number of studies which investigates the relation between corporate governance and the firm performance. Different scholars have different views on the relationship between the corporate governance and the firm performance. There are research which shows positive relationship between the corporate governance and the firm performance, few researches shows the negative relationship between the two variables and there is some research which shows mixed impact of the corporate governance with that of firm performance. Literatures which were reviewed are highlighted as below.

Dharmapala and Khanna (2008) report that small Indian firms which are subject to Clause 49 react positively to announced plans by the Indian securities regulator to enforce the Clause, relative to similar firms not subject to clause 49.
Love and Rachinsky (2008) in their paper investigate the connection between ownership, corporate governance and operating performance in the banking sector for the period 2003 – 2006. Their sample consists of 107 Russian banks and 50 Ukrainian banks. Regression results showed some significant but economically unimportant relationship between corporate governance and operating performance.

Aggarwal et al. (2007) asserts that good governance helps firms to have favorable access to capital markets although this benefit holds little value to firms in under-developed capital markets or for firms with limited growth opportunities. Better governance restricts controlling shareholders’ expropriation of minority and this loss of private benefits is even more in countries with low investor protection. Hence, countries that have weak protection for investors are expected to have worse corporate governance and hence enhanced firm level governance can lead to a marked improvement in firm value.

Block, Jang and Kim (2006) and Claessen (2006) studied that the concern over corporate governance stems from the fact that sound governance practices by organizations, banks inclusive results in higher firm’s market value, lower cost of funds and higher profitability. Balasubramanian and Vikramaditya Khanna (2006) studied 370 public Ltd companies in India. They have identified areas in which Indian corporate governance is relatively strong and those in which it is weak. On the whole the study has concluded that Indian corporate governance rules are more appropriate for larger companies but the regulation regarding related party transactions needs to be strengthened. The study has also examined the relationship between measures of governance and indicators of the firm’s financial performance. It has found evidence of a positive relationship for an overall governance index and separately for indices covering shareholder rights and disclosure. But this is evident only for large sized firms in the BSE 200 index and insignificant for smaller sized firms.

Bhattacharyya and Rao (2005) examine whether adoption of Clause 49 (an important set of governance reforms in India) predicts lower volatility and returns for large Indian firms.

Klein, Peter & Shapiro, Daniel & Young, Jeffrey (2005) study on Corporate Governance, investigates the relationship between firm value as measured by Tobin’s Q, and newly released indices of effective corporate governance for a sample of 263 Canadian firms. The index has a maximum value of 100 and was obtained by summing four sub indices; a) board
composition. b) Shareholding policies. c) Shareholder rights policies. d) Disclosure policies. The results indicated that corporate governance does matter in Canada, and that size was consistently negatively related to performance where growth and performance were positively related. However, they found no evidence that a total governance index affected firm’s performance, because they found no evidence that board independence had any positive effects on performance, and it was negatively related for family owned firms.

Chiang (2005) study on An Empirical Study of Corporate Governance and Corporate Performance explores the relationship among indicators of corporate governance, including transparency and operating performance measures, and whether or not the indicators could be predictors of operating performance. According the study corporate transparency had a significant positive relationship with operating performance and it was one of the most important indicators for evaluating corporate performance. This study concluded that companies with good corporate governance also had a significant positive relationship with operating performance.

Bocean and Barbu (2005) study on Corporate Governance and Firm Performance was to develop the understanding of corporate governance and its effects on corporate performance and economic performance. It examined some of the economic implications associated with various corporate governance systems. According to the study the corporate governance matters for economic performance.

Connelly and Limpaphayom (2004) state that one of the causes of the 1997 Asian financial crisis was poor corporate governance practice.

L. Brown & M. Caylor(2004) ‘Corporate Governance & Firm Performance’, has shown that well governed companies outperformed poorly governed ones by 18.7 percent in terms of ROI and 23.8 percent for ROE.

Barth Capiro Jr, and Nolle (2004) compared the corporate governance of banks across countries and studied that the transparency was measured by the bank’s disclosure of accounting practice. They found a positive relationship between good corporate governance and country’s income level.
Klapper and Love (2003) used firm-level data from 14 emerging stock markets and document that corporate governance provisions matter more in countries with weak legal environments. They also found that better corporate governance is highly correlated with better operating performance and higher market valuation.

McKinsey Survey in (2002) found that in all countries including Eastern Europe, Africa, and Asia, Company Valuations were higher and investors were willing to pay higher share premiums ranging up to 30-40 percent for better governed companies. Spremann (2002) also mentions that the corporate governance practices in East Asia made the firms more vulnerable to the crisis.

La Porta et al. (2002) studied firm’s performance from 27 developed countries. They found evidence that there is higher valuation of firms in countries with better protection of minority shareholders.

Butler, Kraft, and Weiss (2002) argued that firms with a higher percentage of tangible assets have lower agency costs because it is more difficult for managers to misappropriate well defined assets-in-place than to extract value from uncertain growth opportunities. Therefore, since those firms with higher than average assets-in-place may tend to have lower levels of agency costs, they can reduce their reliance on disclosures in line with lower levels of agency costs. It may also be argued that firms with relatively high levels of debt financing have higher agency costs, and therefore, exhibit a greater demand for monitoring by creditors and others.

Morck, Shleifer and Vishny (1988) analyzed firm performance measured by Tobin's Q ratio and found that the Tobin's Q increases in the early stage indicating a positive association between the share structure and the firm value; and decreases in the later stage, indicating a negative relation between the share structure and firm value. In other words, the relationship between share structure and Tobin's Q is non-linear.

Leftwich, Watts and Zimmerman (1981) found that the debt ratios of companies which were semi-annual reporters in the US were significantly higher than the corresponding ratios for the other reporting frequencies; and assets-in-place, used in this context as a proxy for
information asymmetry, of semi-annual reporting firms was lower than that for other reporters.

Watts and Zimmerman (1986) argued that companies with larger profits are more vulnerable to regulatory intervention and hence they could be more interested in disclosing detailed information in their annual reports in order to justify their financial performance and to reduce political costs.

Shleifer and Vishny, (1997) studied that due to broader view of corporate governance, which views the subject as the methods by which suppliers of finance control managers in order to ensure that their capital cannot be expropriated and that they earn a return on their investment can be extended to this sector.

2.3 CORPORATE GOVERNANCE IN BANKS:

The failures of banks during the global financial crisis were due to poor ethical standards and lack of transparency and disclosure. According to the OCED (1999) the basic pillars of corporate governance are - Fairness, Transparency, Accountability and Responsibility. The main purpose of corporate governance is to strengthen Corporation’s competitiveness, ensure transparency and prevent scandals. With greater transparency and disclosure banks can have good flow of information towards various stakeholders such as depositors, shareholders and employees. Bank’s can be termed as trustees of depositors since they have prime responsibility to safeguard their funds. It is prime responsibility of banks to protect the interest of investors.

Love Inessa and Rachinsky Andrei (2007), report on Corporate Governance, Ownership and Bank Performance in Emerging Markets: Evidence from Russia and Ukraine have studied the relationship between ownership, corporate governance and operating performance in banks using a sample of 107 banks in Russia and 50 banks in Ukraine surveyed by International Financial Corporation in 2003-2006. They found some significant, but economically unimportant relationship between governance and contemporaneous operating performance and an even weaker link with the subsequent performance.
Peong Kwee Kim and Devinaga Rasia (2010) studied the relationship between Corporate Governance and Bank Performance in Malaysia during the Pre and Post Asian Financial Crisis. The Study indicated a positive relationship between corporate governance practices and bank performance. Eleven banks for the period 1995-2005 were studied.

Maria Praptiningsih (2009) in the study Corporate Governance and Performance of Banking Firms: Evidence from Indonesia, Thailand, Philippines, And Malaysia found the similarities between bank and non-bank in terms of corporate governance monitoring mechanisms. The basic arguments is that a good corporate governance monitoring mechanisms are still matters in order to achieve the shareholders objectives as well as the stakeholders and the firms goals.

Elyasiani and Jai (2008) studied that the performance of the Bank Holding Companies are related positively to institutional ownerships and the dependence of the bank holding companies on returns is weaker than the dependence in the firms.

Tandelilin, Kaaro, Mahadwartha, Putu and Supriyatna et al. (2007) in their study Corporate Governance, Risk management and Bank performance examined the correlation among corporate governance, risk management and bank performance using a sample of 51 Indonesian banks for the period 1999 – 2004. They have used a Triangle Gap Model with primary and secondary data analysis. The model used in this study found that there is no linear effect of corporate governance on bank performance.

Inam (2006) conducted study and concluded that poor corporate governance can lead markets to lose confidence in the ability of a bank to properly manage its assets and liabilities including deposits, which could in turn trigger a bank run or lead to liquidity crisis.

Wilson (2006) studied that poor corporate governance can lead market to lose confidence in the inability of a bank to properly manage its assets and liability, including deposits which could in turn trigger a bank liquidity crisis.

Oluyemi (2005) analyzed that corporate governance to be of special importance in ensuring stability of the economy and successful realization of bank strategies. In achieving this, strict compliance to standards of lending high risky loan should be adequately secured.

Stanwick and Stanwick (2005) argued that members on the board of directors of banks are important for the bank's long term performance. Board of directors is a collective of People who are nominated by the shareholders of a company, and responsible for making decisions
and supervising the daily operations of the firm. The existence of board of directors is very essential and necessary.

Gavin & Geoffrey (2004) studied that corporate governance enhances financial performance. According to them through board roles and board effectiveness, corporate governance also leads to improved financial performance, while unforeseen event moderates the link between board roles and board effectiveness.

Macey and O’Hara (2003) argue that because of the peculiar contractual form of banking, a broader view of corporate governance should be adopted and the corporate governance mechanisms for banks should encapsulate depositors as well as shareholders. They identify important elements that distinguish banks from other firms. The liquidity production role of banks is explained through their capital structure, which is unique in two aspects: i) banks usually have very little equity compared to other firms, and ii) a bank’s liabilities are in form of deposits, which are available to their creditors and depositors on demand; in contrast a bank’s assets are loans that on average have longer maturities than the liabilities. The mismatch between liabilities and assets can become a problem with corporate governance implications in the unusual situation of a bank run.

Adams and Mehran (2003) studied the differences between the corporate governance for Banks and manufacturing firms by comparing a set of corporate governance variables. They found that board size, the number of outside directors in the board, the number of committees and the frequency of reunion of the board are all of them larger for Bank Holding Companies than for firms in the manufacturing sector. Conversely, the proportion of CEO stock pay to salary plus bonuses, the percentage and market values of direct CEO equity holdings and block ownership appear to be smaller for BHCs relative to manufacturing firms.

Lowengrub, et al, (2003) evaluated the case study of banks in Germany and highlighted that the need to assume much larger role of corporate governance held by small shareholders, which is means that the good corporate governance can solve the agency problem in particular banking firms.

Caprio and Levine (2002) mention in their study the opaqueness of banks makes it costly for depositors to constrain managerial discretion through debt covenants and for the diffuse equity holders to write and enforce effective incentive contracts or to use their voting rights as a vehicle for influencing firm decisions.
U Griffith et al. (2002) using data from the largest U.S. BHCs for the years 1995-1999, investigated that performance of commercial banks is related to CEO ownership, but again, the relationship is not always positive. Bank performance increases until CEO ownership reaches the 12 percent level and decreases until 67 percent is achieved.

Barth, Capiro and Levine (2000) and World Bank (2002) justifies the views about the shareholding pattern of public sector bank that they are under government patronage. According to the study the possibilities of misgovernance cannot be ruled out in public sector banks compared to private sector banks.

Reddy Y.V (2002) highlights the role public sector banks in India and the governance challenges towards the public sector banks which is of major concern.

Bell et al (2000), has studied that in last 20 years there were several bank failures witnessed throughout the world. Financial distresses in most of these countries were attributed to a high incidence of non-performing loans, weak management and poor credit policy.

Carse (2000) argued that a strong corporate governance standard is particularly important for banks. This is because most of funds that banks use for business belong to their creditors and depositors. The failure of a bank will affect not only its own shareholders, but have a universal affect on other banks. Therefore, it is important to ensure that banks are operating properly.

Agreeing on the same line, World Bank (2002) also voiced the same concern on state ownership and political interference. In its report it observed that:

i) State ownership of banks inversely related to bank competence, borrowing, saving, productivity and growth

ii) There isn’t any proof which suggests state ownership reduces banking crisis.

iii) The evidence undoubtedly states that state bankers are subject to political clash that usually leads to weak performance; and

iv) Privatization is perhaps the only way to guarantee that freedom from political decision making can enhance governance in banks.
2.4 CORPORATE GOVERNANCE AND DISCLOSURE:

“Not everything that counts can be counted, and not everything that can be counted, counts.”

“If people are good only because they fear punishment, and hope for reward, then we are a sorry lot indeed.”

- Albert Einstein

Financial disclosure enables various stakeholders of banks to monitor the bank’s performance. Whittington (1993) emphasized that the primary use of annual reports is to disseminate quantitative and qualitative information about the company to all the stakeholders, including existing and potential shareholders. It necessitates the adoption of good corporate governance practices in banks in order to ensure transparency and liquidity.

There are differences in the key parameter of corporate governance in relation to disclosure and transparency from country to country. According to OECD guidelines accurate and timely disclosure on company objective major share ownership and voting rights, directors and the executives and their remuneration, significant foreseeable risk factors, governance structures and practices: material issues regarding employees and other stakeholders are the important parameters for disclosure and transparency. However according to Asia Pacific Economic Co-operation principles timely and accurate disclosure of financial and non-financial information with regard to company performance is required. International Corporate Governance Network (ICGN) global governance principles emphasizes on timely and full disclosure of information such as disclosure of share holding and the status of voting rights, disclosure of directors compensation policies, annual audits by external statutory auditors etc., The SEBI also bought a sea change in the listing requirements in terms of disclosure and transparency.

There are few study related to the area of corporate governance disclosure which is highlighted below.

Mamta Brahmbhatt, Rashesh Patel And Swati Patel (2012) found the existence of difference between adherence to corporate governance rate of private and public sectors banks based Corporate Governance Score card prepared for comparison purpose. Different parameters are been given importance by different private and public sector banks and also within the same sectors, the difference exists. There exists ambiguity in correlation between
compliance of corporate governance parameters and net profit. Clause 49 as per SEBI rule is not been able to provide numerical value of importance to each parameter as it is debatable issue over years. Primary research reveals the importance of different parameters set from the perspective of investors and financial advisors. The research was based on four banks for 3 years, i.e., 2008-09 to 2010-11.

Prashant Kumarand Tara Prasad Upadhyaya (2011), In their study a Corporate governance Index was constructed with 110 questions distributed as among thirty three questions to Board Responsibility, sixteen questions to Board Structure, fourteen questions to shareholders rights, thirty three questions to Transparency and disclosures and rest fourteen questions to Audit Committee. The questionnaires had yes/no pattern with value ascertaining 1 to yes and 0 to No. The study highlighted that the corporate governance index shall help the organization to assess and value them as they stand in Corporate Governance environment and also help the common shareholders, promoters, bond holders, depositors, employees and all the stake holders to know the governance status of the organization where they are going to associate. They have mentioned that the good governance status with high rank leads the better performance of the organization.

Beltratti & Stulz (2009) found no evidence that banks with better governance (when governance is measured with data used in the well known Corporate Governance Quotient score) performed better during the crisis but found strong evidence that banks with more shareholder-friendly boards performed worse in terms of stock return performance during the crisis and better during 2006. They demonstrated that banks that relied on short term funding did suffer considerably more than those that relied on longer-term funding, such as deposits. Al-Habaybah (2009), study on factors influencing the extent of mandatory compliance with IAS disclosure requirements by manufacturing companies listed at Amman Stock exchange in 2006, also explains the relationship between some of corporate specific characteristics (size, age, leverage and profitability) and some of corporate governance attributes like audit committee independence, type of audit firm and ownership structure/concentration on the level of the compliance. They used the index of compliance which was devised to quantify the level of the compliance which was applied to financial statement of 50 manufacturing companies listed at Amman Stock Exchange for the year 2006. The study revealed a significant positive relationship between (size, leverage, profitability, ownership structure, Type of audit firm) and the level of mandatory compliance with IASs. The results didn't
support any relationship between the age of the company and the independent of audit committee with extent of the compliance.

Michael Maingot, Daniel Zeghal (2008) analysed eight Canadian banks for one year i.e., 2003 with 54 disclosure items and identified that larger banks have more disclosure. The results reveal that the size of the bank measured by total assets seems to be a determinant factor affecting the volume of disclosure of information related to corporate governance.

Gill et al. (2009) studied that the primary way by which companies can become transparent to stakeholders is through corporate information disclosure that is through corporate performance disclosure and financial accounting disclosure.

Hossain’s (2008) study revealed the level and extent of the corporate governance disclosure of the banking sector in India. After collecting the annual reports of 38 Indian banks for the year 2002-2003, he adopted a regression model to investigate the relationship between corporate governance disclosure and various corporate attributes such as size, profitability, ownership, listing, status, age etc. The study revealed that out of 101 mandatory disclosure items score of Canara bank is 80, Corporation bank is 98, Punjab National bank is 91, Vijaya Bank is 81, and Syndicate bank is 88.

Rogers (2006) in the study "Corporate governance and financial performance of selected commercial bank in Uganda" highlights the relationship between the core principles of corporate governance and financial performance in commercial banks of Uganda. Four commercial banks that deal with both retail and corporate customers were selected. Data was collected from both corporate and retail customers of commercial banks. According to the study Corporate Governance predicts 34.5 % of the variance in the general financial Performance of Commercial banks in Uganda. However the significant contributors to financial performance include openness and reliability. On the other hand credit risk as a measure of disclosure has a negative relationship with financial performance.

Young (2004) examined the relationship between corporate governance and firm value by using the Corporate Governance Index (CGI) and Tobin's Q, which measures the firm's value. The results conclude that corporate governance does matter in firm value.

Hossain and Mitra (2004) found assets-in-place to systematically influence the level of voluntary disclosure of US multinational companies.
Lamoureux (2004) highlighted the disclosure practices at some companies are improving due to higher regulatory standards and growing acceptance of good governance.

Lawrence D Brown and Marcus L. Caylor of Georgia (2003) relate corporate governance to firm valuation using 1868 firms based on 51 internal and external corporate governance provisions. The 51 factors are coded either 0 or 1, depending on whether the firm’s corporate governance standards are minimally accepted or not. They document that Gov-Score is significantly and positively associated with Tobin’s Q and they examine the link between firm valuation and corporate governance measures.

Leung and Cooper (2003) in their study have identified some of the factors which affect good governance being creative accounting, inappropriate management compensation, inadequate regulation and lack of independence in audit function.

Klapper and Love (2002) developed a Corporate Governance Index using the questionnaire data as well as Worldscope data and used six components of the index: management discipline, transparency, independence, accountability, responsibility, fairness. The components are not studied as sub indices since they each have overlapping parts. This index has a maximum value of 100 and a minimum value of zero. Their empirical tests show that better corporate governance is highly correlated with better operating performance and market valuation.

Haniffa and Cooke (2002) suggested that structural complexity may be significant in explaining variability in the extent of disclosure.

Cooke (1989) studied that the information released by firms is primarily targeted towards creditors financial analysts, and investors for their decision-making regarding investments.

Venkatram and Ramanujam (1986) classified the different approaches to the measurement of business performance, which they consider to be a subset of the broader domain of organizational effectiveness. They highlighted that business performance would consist of financial plus operational performance. Financial performance uses financial indicators growth sales, profitability (ROA, ROS, and ROE) earnings per share and market measurements (market-to-book value, stock returns and Tobin’s Q). On the other hand, operational performance broadens the concept of business performance by including the key
operational success factors that might lead to financial performance, such as, market share, product quality, marketing effectiveness, new product introduction and manufacturing value-added.

Courtis (1978) argued that structural complexity requires a firm to have an effective management information system for monitoring purposes, and that the availability of such a system helps to reduce the cost of information production per unit, and thus higher disclosure. Agency theory (Jensen and Meckling, 1976) suggests that strong corporate governance leads to better performance and accounting outcomes.

2.5 CORPORATE GOVERNANCE AND BOARD COMPOSITION:

According to OECD key responsibilities of the board is overseeing the process of disclosure and communication, monitoring the effectiveness of governance practices and change them. Both the OECD Principles and the Basel Committee's guidance on corporate governance suggest that boards should be able to exercise objective, independent judgement on corporate affairs. Although the Principles do not take a stand on what proportion of the board should be capable of such judgement, they do suggest that a sufficient number of nonexecutive board members be appointed on the board.

If the board is to fulfill its functions properly, it needs to ensure that it receives sufficient flows of information, internal and external, as well as adequate administrative support. In this regard, the OECD Principles suggest that board members should have access to accurate, relevant and timely information in order to fulfill their responsibilities. Board members, especially non-executive directors, should have access to bank staff and other technical expertise, including opportunities to obtain views from internal and external auditors.

According to the Agency theory Board composition is vital for the performance of the Bank - Jensen and Meckling,

International Corporate Governance Network (ICGN) global governance principles states the responsibilities of the board of directors is judgment of directors independent of management operation, establishment and nomination of committees for audit compensation and outside director.
In the present study corporate governance of banks is evaluated in terms of composition of the board, number of board committees, number of board meeting. Following literature was analyzed for the present study.

Cristina Alexandrina Stefanescu (2012) studied the relationship between board committees features and the level of disclosure in case of banking institutions listed on London Stock Exchange. Data collection was based on information provided by banks’ websites. The study revealed that the presence and the quality of board committees proved to be able to explain positive influences over all types of disclosures analyzed, but with different levels of significance.

Jamie Allen, Secretary General, Asian Corporate Governance Association (2009) highlighted the major progress in Asia in relation to corporate governance. They highlighted the improvements in these areas such as financial reporting, Board composition, Shareholder’s rights, Accounting/Auditing, and Regulatory Enforcement. In relation of financial reporting they have highlighted more detailed disclosure rules, faster reporting, quarterly reporting, and disclosure of “material” events, director pay, and director dealings.

In relation to Board composition and function the introduction of independent directors, board committees, director training, higher expectations placed on directors, higher fees paid to directors is suggested and towards shareholder rights they highlighted the formal rights to be strengthened, retail activist groups to be formed and institutional investors voting to the shares held by them. Where in relation to Accounting/Auditing, they have suggested local accounting standards brought more into line with international standards, independent regulation of audit profession in some, with respect to regulatory enforcement financial regulators still under-equipped, but they highlighted that there has been more focus on enforcing listing rules and key securities laws (e.g. insider trading).

Gavin and Geoffrey (2004) states that committee is a group of members to whom some specific role has been delegated by a full board. Committees can be used to gather, review and summarize information and report back to the full board for decision or can be delegated specific decision making powers.

Uzun, Szewcyz and Varma (2004) investigated that board composition and structure of oversight committees are significantly related to the incidence of corporate fraud using
regression analysis. They have used 266 companies where 133 chosen from accused firms and 133 no fraud firms. The period of the study was 1978 to 2001. They examined that high proportion of independent directors indicates less fraud.

Weir and Laing (2001) state that “if non-executive directors resulted in effective monitoring, their effectiveness would increase in line with their board representation.

Dalton et al. (1999) performed a meta-analysis of 131 observations on the relationship between the board size and financial performance. Both accounting-based indicators of financial performance (such as return on assets, return on equity) and indicators based on market returns (such as Jensen’s alpha, the Treynor measure, the Sharpe measure) were used to measure financial performance. Their analysis found that there is a strongly positive relationship between the two variables, suggesting that corporate governance, in the form of a larger board, is associated with better firm performance.

Jensen (1993) studied that the board of directors is known as one of the most important instruments to solve the corporate governance problem, since it is the organ primarily used by other stakeholders to monitor management.

Cadbury (1992) has highlighted the importance of board committees and proposed to set up sub-committees of the board to focus on specific aspects of governance that are considered problematic. Where APEC states that formation of board of directors and deciding their remuneration is the key responsibilities of the boards of directors.

Zahra and Pearce (1989) study reveals that the diverse background of the directors enhance the quality of their advice.

Fama (1980) states that Non-executive directors may act as “professional referees” to ensure that competition among executive directors stimulates actions consistent with shareholder value maximization.

The Basel Committee's guidance on Enhancing Corporate Governance for Banking Organizations notes that bank boards have found it beneficial to establish certain specialized committees The OECD Principles further recommend that when committees of the board are
established, their mandate, composition and working procedures should be well defined and disclosed by the board.

Board can be classified into unitary board and a two tier board. Unitary board consists of executive and non executive directors which takes decision as a unified group. India has the unitary board system.

According to the advisory group of corporate governance in India Bank board’s should play an active role in providing oversight of the way in which senior management approaches different kinds of risks which banks face, such as, credit risk, market risk, liquidity and operational risk. Board of nationalised banks need to be strengthened to pursue policies, which are in the best interests of the banks themselves. There is a need that bank board ensures that senior management implement policies that prohibits activities and relationships that diminish the quality of corporate governance, such as, conflicts of interest, self dealing and preferential treatment to related parties. Bank’s board need to take corrective steps through appropriate restructuring of the boards.

2.6 CORPORATE GOVERNANCE FROM SHAREHOLDER’S PERSPECTIVES:

The important stakeholders of banks are shareholders, depositors, employees, suppliers, and government. The shareholders are one of the major stakeholder’s since they supply finance for the banks and thus a need arises to look into corporate governance from the shareholder’s perspective. The composition of the board, board committees, and board meetings, enhancement of the shareholders’ value and protection of shareholder’s interest are the important aspect in the study of the corporate governance.

Shareholders have suffered due to the dilution of their rights and negligence of the management and lack of good performance by the organization. There are certain issues related to that of shareholder’s in terms of not receiving the information in time, lack of information, grievance not properly redressed, and the issues related to return on their investment. It becomes prime duty of the banks to redress these issues of the shareholder’s as part of the good governance.

There is a conflict of interest between the minority shareholders and the promoters of the bank which has become one of the concerned issues of corporate governance. Evaluating corporate governance in banks with shareholder’s perspectives is an important aspect.
Monika Marcinkowska (2012) paper presents key aspects requiring reforms: the role, constitution and accountability of board, risk management, management remuneration, transparency. New regulations and guidance are presented, creating the foundations for a new order of the financial market. The paper also points out the banks’ stakeholders’ accountability. It analyses the bank’s transparency and bank’s shareholders as part of the study.

Fahlenbrach and Stulz (2010) studied that bank with CEOs whose incentives were more closely aligned with the interests of shareholders performed worse. Banks with higher-option compensation and a larger fraction of compensation in bonuses for their CEOs did not perform worse during the crisis.

Elena F Pérez Carrillo (2007) has argued that shareholders and stakeholders interests are compatible and both contribute to corporate long term efficiency and progress. It is further argued that it is essential to achieve a wide consensus on how to control management actions in support of stakeholder’s interests.


IIF Task Force Report (February 2006) highlights about the corporate governance framework in India according to the latest reforms as prescribed by Clause 49 which has weak enforceable penalties for noncompliance. It has suggested severe penalty for non-compliance with Clause 49 as of the de-listing of a security, however under current practices, companies are seldom de-listed. It also highlights the SEBI’s Clause 49 to be similar to the IIF code and the shareholder activism in India is practically non-existent. It shows that to help expedite minority shareholders’ grievances, SEBI’s Clause 49 stipulated that there must be a board-level shareholder grievance committee to address such disputes and that a non-executive director must chair this committee. The introduction of grievance committees is one mechanism whereby shareholders can obtain redress outside of India’s inefficient and corrupt court system. It has also shown that the corporate governance related requirements in India are largely based on the recommendations of the Cadbury and Higgs Reports and the
Sarbanes-Oxley Act. SEBI has been proactive in keeping India’s corporate governance rules and regulations in line with best practices in the world.

Oluyemi (2005) study is related to shareholder presenting a major role in the provision of corporate governance. Moreover, the author asserted that small or diffused shareholders exert corporate governance by directly voting on critical issues such as mergers, liquidation and some fundamental changes in the business strategy. They also indirectly elect the boards of directors to represent their interests and oversee the myriad of managerial decisions.

La Porta, Silanes and Shliefer (2000, 2002) view corporate governance as a set of mechanisms through which outside investors (shareholders) protect themselves from inside investors (managers).

Arun and Turner (2002) suggested that there exist a narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interest.

The report of the Advisory Group of Corporate Governance (AGCG, 2001) recommended that depositors being the major stakeholders in banks, whose interests may not always be recognized, sound corporate governance should consider their interests and ensure that individual banks are conducting their business in such a way as not to harm interests of depositors. The most fundamental theoretical basis of corporate governance is agency costs. Shareholders are the owners of joint-stock, limited liability Company, and are its principals. By virtue of their ownership, the principals define the objectives of the company. The management, directly or indirectly selected by shareholders to pursue such objectives, is the agents. While the principals might assume that the agent will invariably do their bidding, it is often not so. In many instances, the objectives of managers are quite different from those of the shareholders. This divergence in objectives between ownership and management leads to agency costs, which in turn leads to the need for corporate governance.

According to OECD (1999) shareholders have rights to attend and participate in AGMs, to elect Board members, to receive dividends, and to avail relevant timely and regular and accurate information, Right to transfer shares, to know capital structures and arrangements that confer on some members and disproportionate controlling rights. With respect to the equitable treatment of shareholders it has given guidelines that a) All shareholders including minority and foreign shareholders receive equitable treatment b) Effective redressal for rights
violations c) Change in voting rights subject to their vote. D) Prohibition of insider trading and self dealing and d) Directors to avoid decisions concerning their own interests.

International Corporate Governance Network (ICGN), global governance principles states that the equitable treatment of shareholders is possible through one share, one vote and protection of the rights of minority and foreign shareholders. The present study helps to identify the various attributes of corporate governance and try to analyze to what extent it is been implemented in the bank.

Nationalised banks Sec 32E of Banking companies acquisition and transfer of undertaking act 1970/80 states that no shareholders other than the central government shall be entitled to exercise voting rights in respect of any shares held by him or her in excess of one percent of the total voting rights of all the shareholders of the nationalised banks. The government is the dominant owner of the Indian banking sector. The imposition of decisions by the dominant owner influences the shareholder value. The shareholder’s rights of nationalised banks stand considerably abridged since their approval is not required for paying dividend or approving accounts at the annual general meeting. With banking amendment bill the voting rights of a shareholder in nationalised banks do not exceed ten percent irrespective of the size of the holdings which is twenty percent in case of the private banks. For infusing increased corporate governance in banks, shareholders should have the right to discuss, vote on, and approve the profit and loss account and the balance sheet, at the annual general meeting of the banks.

According to Kumarmanglam report on corporate governance there are many organizations which is not giving due attention to the basic procedures for shareholders services such as adequate attention to redress investors grievances such as a delay in transfer of shares, delay in dispatch of share certificates , timely dissemination of information of investors, quality of information etc.,

SEBI has been regularly receiving large number of investor complaints on these matters. While enough laws exist to take care of many of these investor grievances, the implementation and inadequacy of penal provisions have left a lot to be desired. Corporate governance is considered an important instrument of investor protection, and it is therefore a priority on SEBI’s agenda. To further improve the level of corporate governance, need was felt for a comprehensive approach at this stage of development of the
capital market, to accelerate the adoption of globally acceptable practices of corporate governance. This would ensure that the Indian investors are in no way less informed and protected as compared to their counterparts in the best-developed capital markets and economies of the world.

According to Anand Sinha, Deputy Governor, Reserve Bank of India, The whole gamut of corporate governance could be considered as a blend of various segments namely, regulatory governance, market governance, stake holder governance and internal governance. In the present chapter literature related to the study is reviewed. Banks disclosure standard can be improvised further by disclosing information relating to the true state of the banks affairs, their vision statements and future business strategies.

Some of the gaps identified in the study are:

- Most of the studies are based on firms.
- Many studies are undertaken for one year which makes the study static in nature.
- Only limited study is there on shareholder’s perspective.
- Lots of studies are based on conceptual aspects of the only.
- Limited study is been made on public sector banks.
- There are very few studies in relation to corporate governance from shareholder’s perspectives.