CONCEPTUAL FRAMEWORK

"Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

OECD

3.1 INTRODUCTION:

The development of corporate governance depends on the different theories which explain the nature of corporate governance mechanisms and the differences of practice regarding the legal, cultural, ownership and political systems which differ between countries. In this chapter the important theories related to corporate governance, models of corporate governance, nationalization of Indian bank, shareholding pattern of banks, governance status of Indian banks and the summarized committee reports and acts analyzed are highlighted.

3.2 THEORIES ON CORPORATE GOVERNANCE

Five important theories which elucidate and explain corporate governance are:

1. Agency theory
2. Transaction cost theory
3. Stewardship theory
4. Stakeholder theory
5. Sociological theory

1. **Agency Theory:** In this theory owners are the principals and managers are the agents and agency loss is present where this is the extent to which return to the owners falls. Agency theory specifies the mechanisms that reduce agency loss. According to this theory there are two broad mechanisms that help reduce agency costs and hence improve corporate performance through better governance. The two mechanisms are a) A fair and accurate financial disclosures and b) efficient and independent board of directors. Jensen and Meckling (1976) define agency relationship as a contract under which principal engages the agent to perform on behalf of the principal. The agents exert immense control over the running of the company, the allocation of resources on behalf of shareholders as well as
controlling the information to be disclosed to capital providers. Anglo Saxon model uses this theory in its framework.

2. **Transaction cost theory**: This theory can be viewed as closely related to agency theory. This theory views the company as a governance structure, whereas agency theory views the company as a nexus of contracts. Solomon and Solomon (2004) argued that transaction cost theory is based on the fact that companies have become so large and complex that price movements outside companies’ direct production and the markets coordinate transaction. In other words, the way in which companies are organized determines their control over transactions.

3. **The stewardship theory** assumes that managers are basically trustworthy and attach significant value to their own personal reputations. It defines situations in which managers are stewards whose motives are aligned with the objectives of their principles.

4. **The stakeholder theory** is based on the assumption that the essence of corporate activity is not only for the benefit of the shareholders, but also for all relevant stakeholders (Freeman 1984).

5. **Sociological theory** focuses on board composition and wealth distribution. Under this theory, board composition, financial reporting, and disclosure and auditing are of utmost importance to realise the socio-economic objective of Corporations. Solomon and Solomon (2004) argue that the acceptance of these theories views on what is wrong in the practice depends on the characteristics of the country where some theories may be more appropriate and relevant in some countries.

The definition of the term corporate governance differs depending on which theory or model is applied. In the shareholders’ model (agency theory), corporate governance is defined as a relationship between agents (managers) and principals (owners or shareholders).

### 3.3 CORPORATE GOVERNANCE MODELS AROUND THE WORLD

Corporate Governance systems vary around the world. The following are the important models developed by the scholars;

1. The Anglo-American Model
2. The German model
3. The Japanese model
4. The Indian Model

In the Anglo-American Model
In the Anglo-American model, all directors participate in a single board comprising both executive and non-executive directors in varying proportions. This model is the basis of corporate governance in Canada, America, Britain, and Australia.

Fig 3.1 The Anglo-American

1. German Model: This is also known as two-tier board model. In this model corporate governance is exercised through two boards, in which the upper board supervises the executive board on behalf of stakeholders and is typically societal-oriented. In this model although shareholders own the company, they do not entirely dictate the governance mechanism. They elect 50 per cent of members of supervisory board and the other half is appointed by labour unions, ensuring that employees and labourers also enjoy a share in the governance. The supervisory board appoints and monitors the management board.

(Source: Fernando A. C (2011) Corporate Governance)
2. The Japanese model: The Japanese system of corporate governance is many-sided, centring around a main bank and a financial/industrial network or keiretsu. In the Japanese model, the four key players are: main bank (a major inside shareholder), affiliated company or keiretsu (a major inside shareholder), management and the government.

The distinctive features of Japanese model are:

a. The president who consults both the supervisory board and the executive management is included.

b. Importance of the lending bank is highlighted.
4. Indian Model of Corporate Governance:

Indian corporate governance model is more or less based on UK model. India has adopted key tenets of the Anglo-American external and internal control mechanism after economic liberalization.

Significantly, most of the recommendations of the three committee-SEBI appointed Kumar Mangalam Birla Committee(2000), the government appointed Naresh Chandra Committee(2003) and the SEBI’s Narayan Murthy committee are remarkably similar to those of England’s Cadbury committee and America’s Sarbanes-Oxley Act in terms of their approaches and recommendations.
Indian model of corporate governance

**External Environment**

- Government Regulations, Policies, Guidelines etc.
- Corporate Culture, Structure, Characteristics, Influences

**Internal Environment**

- Company Vision, Mission, Policies, Norms
- Internal Stakeholders
- Auditors
- Board of directors
- Company Act, SEBI, Stock Exchanges
- Depositors, Borrowers, Customers, And Other

**Corporate Governance System**

- Proper Governance
- Shareholder Value

**Corporate Governance Outcomes/Benefits To Society**

- Transparency
- Investor Protection
- Concern for customer
- Healthy corporate sector development

*Fig 3.4 (Source: Fernando A. C (2011) Corporate Governance)*
<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Feature</th>
<th>Anglo-American corporate governance</th>
<th>German corporate governance</th>
<th>Japanese corporate governance</th>
<th>Indian corporate governance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Shareholder value</td>
<td>Long term corporate value</td>
<td>Long term corporate value</td>
<td>Shareholder value</td>
</tr>
<tr>
<td>1</td>
<td>Corporate objective</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Shareholding</td>
<td>Diffused institutional investors, significant block holders</td>
<td>Banks, promoter families other corporate</td>
<td>Financial non-financial corporate</td>
<td>Directors and relatives, other corporate, foreign investors, govt-term lending institution, foreign investors.</td>
</tr>
<tr>
<td>3</td>
<td>Governance focus</td>
<td>Capital market</td>
<td>Corporate body</td>
<td>Keiretsu or business network</td>
<td>Maximize surplus</td>
</tr>
<tr>
<td>4</td>
<td>Measure of success</td>
<td>Return on financial capital</td>
<td>Return on human capital</td>
<td>Return on social capital</td>
<td>Return on financial capital</td>
</tr>
<tr>
<td>5</td>
<td>Decision-making</td>
<td>Checks and balances between voice and exit options. Outside stake holders excluded</td>
<td>Within the network of stake holders including employees local community</td>
<td>Within the network includes business associate and bank as stakeholders</td>
<td>Management, outside stake holders excluded</td>
</tr>
<tr>
<td>6</td>
<td>Control of corporates</td>
<td>Separated from ownership</td>
<td>Linked with ownership</td>
<td>Linked with ownership</td>
<td>Linked with ownership</td>
</tr>
<tr>
<td>7</td>
<td>Orientation</td>
<td>Short-term, driven by stock market prices</td>
<td>Long-term</td>
<td>Long-term</td>
<td>Short-term gains</td>
</tr>
<tr>
<td>8</td>
<td>Long-term investment</td>
<td>Physical capital, R&amp;D, human capital</td>
<td>Plant and equipment employee training</td>
<td>R&amp;D, employee training</td>
<td>Physical capital</td>
</tr>
<tr>
<td></td>
<td>(Primary)</td>
<td>Liquid</td>
<td>Less importune, due to close ties with banks</td>
<td>Less important, because of close ties with banks</td>
<td>Less important due to institutional funding</td>
</tr>
<tr>
<td>9</td>
<td>Capital market:</td>
<td>Liquid</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Capital market: (Secondary)</td>
<td>Investor commitment</td>
<td>Major Investors</td>
<td>Board composition</td>
<td>Goal of the board</td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------</td>
<td>---------------------</td>
<td>-----------------</td>
<td>-------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>10</td>
<td>Important, frequent hostile takeovers possible.</td>
<td>Not important, hostile takeovers rare.</td>
<td>Not important, hostile takeovers rare.</td>
<td>Not important, hostile takeovers rare.</td>
<td>Low</td>
</tr>
<tr>
<td>11</td>
<td>Low</td>
<td>High, important in difficult times</td>
<td>BAsks business network employees government and institutional shareholders</td>
<td>Business network main bank government institutional shareholders individual shareholders and employees</td>
<td>Directors and relatives other corporates Foreign investors: government, term lending institutions: public shareholding and institutional investors (UT)</td>
</tr>
<tr>
<td>12</td>
<td>Institutional shareholders: individual shareholders: business network employees government and banks</td>
<td>Two tier boards upper tier supervisory board lower tier management board</td>
<td>Executive and non-executive director (representing outside finance institutions)</td>
<td>Executive and non-executive directors</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Executive and non-executive directors</td>
<td>To promote shareholder wealth</td>
<td>To promote long-term organizational health</td>
<td>To promote long-term organizational health’s</td>
<td>Short term gains</td>
</tr>
<tr>
<td>14</td>
<td>Little</td>
<td>High</td>
<td>Little formally more informally</td>
<td>Little</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
<td>Low, subject to government approval</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
<td>Low uncertain</td>
<td></td>
</tr>
<tr>
<td>----</td>
<td>----------</td>
<td>---------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>19</td>
<td>Weakness</td>
<td>Instability: short termism</td>
<td>Internationalization difficult: vulnerable to global capital market</td>
<td>Secretive, corrupt practices growth in institutional activism and financial speculation in recent times</td>
<td>Lack of proper disclosures secretive corrupt practices instabilities.</td>
</tr>
</tbody>
</table>

(Source: Fernando A. C from a) Corporate governance, The Indian scenario by Vasudha Joshi, foundation books b) Large shareholder activism in corporate governance in developing countries: Evidence from India by Jayati and Subrata Sarkar, International review of finance, September 2000, Vol. 1 Issue 3.)
3.4 NATIONALISATION OF INDIAN BANKS

Post independence the major historical event in banking sector was the nationalization of 14 major banks on 19th July 1969. The nationalization was deemed as a major step in achieving the socialistic pattern of society. In 1980 six more banks were nationalised taking the total nationalised banks to twenty.

The nationalization was deemed as a major step in achieving the socialistic pattern of society.

The Government of India issued an ordinance Banking Companies Acquisition and Transfer of Undertakings Ordinance, 1969 and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. These banks contained 85 percent of bank deposits in the country. Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies Acquisition and Transfer of Undertaking Bill, and it received the presidential approval on 9 August 1969.

Further six more commercial banks were nationalised in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With this second dose of nationalization, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank and was the only merger between nationalised banks which resulted in the reduction of the number of nationalised banks from 20 to 19. After this, until 1990s, the nationalised banks grew at a pace of around 4% closer to the average growth rate of the Indian economy and IDBI though considered as other public sector bank became part of the nationalised bank list thus increasing the number to 20.

The Nationalised banks are owned by the government. The governmental holding is composed of holdings by the central government, RBI and President of India. Additional holding by FIs is a quasi-governmental holding and thus leaves the non-government shareholders in a weak position. The RBI holds the promoter stake in SBI and thereby holds the stake in the associate banks too thus putting RBI in the role of the majority stakeholder as well as the regulator making it more liable to form policies that would help the banks in which it holds the stake.
The nationalization of the banks took place in India with the following reasons.

- To check the monopolies by large private business houses and spread the banking across the country.
- In order to direct the funds to needy sectors such as villages, small industries, agriculture etc and for the economic development.
- To cater to the needs of desirable section of the society and reduce the regional imbalance.

Post nationalization there has been a fundamental change in the lending policies of the nationalised bank. It had led to a banking revolution in the country with a great change in the thinking and outlook of commercial banks. There has been a fundamental change in the lending policies of the nationalised banks. Indian banking has become development-oriented. It has changed from class banking to mass-banking or social banking. This system has improved and progressed appreciably.

- Development oriented Banking-The banks were concentrated in the big commercial centres. They mostly granted short-term commercial loans. They were unwilling to venture into new fields of financing. But after nationalisation of banks, the concept of banking has widened from acceptance of deposits and mere lending to development oriented banking.
- The Lead Bank Scheme of nationalised bank has played an important role in the bank expansion programme
- Since nationalisation of banks, there has been a substantial growth in the deposits of commercial banks. The expansion of bank credit has also been more spectacular in the post-bank nationalisation period.
- Nationalised banks have been participating in the Social Banking Poverty Alleviation Programmes.

3.5 PRESENT SCENARIO OF BANKS IN INDIA

As on March 2013 reports shows that Public sector banks had a major market share of around 80% and that of private sector banks with 20%. Within the public sector banks, State bank of India and its associates had a share of 19.1% and Nationalised banks with 60.6%. Thus Nationalised banks form an important category in the banking spaces as they account for almost half of the total assets of the banking system.
Table 3.1

Bank Group Wise Pattern of Ownership of Deposits – As on March 31, 2012

(Amounts in Rs. Billion; Share in Per cent)

<table>
<thead>
<tr>
<th>Sector/Bank Group</th>
<th>SBI &amp; Its Associates</th>
<th>Nationalised Banks</th>
<th>RRBs</th>
<th>Private Sector Banks</th>
<th>Foreign Banks</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Government Sector</td>
<td>2,499</td>
<td>6,141</td>
<td>136</td>
<td>436</td>
<td>149</td>
<td>9,361</td>
</tr>
<tr>
<td></td>
<td>(18.4)</td>
<td>(17.9)</td>
<td>(7.4)</td>
<td>(3.7)</td>
<td>(5.3)</td>
<td>(14.6)</td>
</tr>
<tr>
<td>II. Private Corporate Sector (Non-Financial)</td>
<td>1,490</td>
<td>3,345</td>
<td>10</td>
<td>3,309</td>
<td>1,230</td>
<td>9,384</td>
</tr>
<tr>
<td></td>
<td>(11.0)</td>
<td>(9.8)</td>
<td>(0.5)</td>
<td>(28.4)</td>
<td>(44.1)</td>
<td>(14.6)</td>
</tr>
<tr>
<td>III. Financial Sector</td>
<td>421</td>
<td>3,787</td>
<td>14</td>
<td>1,487</td>
<td>310</td>
<td>6,019</td>
</tr>
<tr>
<td></td>
<td>(3.1)</td>
<td>(11.1)</td>
<td>(0.8)</td>
<td>(12.8)</td>
<td>(11.1)</td>
<td>(9.4)</td>
</tr>
<tr>
<td>IV. Household Sector</td>
<td>8,562</td>
<td>20,510</td>
<td>1,675</td>
<td>5,705</td>
<td>797</td>
<td>37,249</td>
</tr>
<tr>
<td></td>
<td>(63.0)</td>
<td>(59.9)</td>
<td>(91.1)</td>
<td>(49.0)</td>
<td>(28.6)</td>
<td>(58.1)</td>
</tr>
<tr>
<td>V. Foreign Sector</td>
<td>626</td>
<td>451</td>
<td>3</td>
<td>712</td>
<td>305</td>
<td>2,097</td>
</tr>
<tr>
<td></td>
<td>(4.6)</td>
<td>(1.3)</td>
<td>(0.2)</td>
<td>(6.1)</td>
<td>(10.9)</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Total Deposits</td>
<td>13,598</td>
<td>34,233</td>
<td>1,839</td>
<td>11,650</td>
<td>2,790</td>
<td>64,110</td>
</tr>
<tr>
<td></td>
<td>(100.0)</td>
<td>(100.0)</td>
<td>(100.0)</td>
<td>(100.0)</td>
<td>(100.0)</td>
<td>(100.0)</td>
</tr>
</tbody>
</table>

Note: Figures in parentheses represents share. (Source: www.rbi.org)

According to RBI bulletin dated 03 June 2013 Nationalised Banks accounted for 52.0 per cent of the aggregate deposits, while State Bank of India and its Associates accounted for 22.3 per cent. The share of New Private Sector Banks, Old Private Sector Banks, Foreign Banks, and Regional Rural Banks in aggregate deposits was 13.6 per cent, 4.8 per cent, 4.3 per cent and 2.9 per cent, respectively. Nationalised Banks accounted for the highest share of 50.9 per cent in gross bank credit followed by State Bank of India and its Associates (22.1 per cent) and New Private Sector Banks (14.7 per cent). Foreign Banks, Old Private Sector Banks and Regional Rural Banks had relatively lower shares in the gross bank credit at 4.9 per cent, 4.9 per cent and 2.6 per cent, respectively.
Table: 3.2

Offices of Commercial Banks in India – As on March 31

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Group</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SBI and its Associates</td>
<td>14313</td>
<td>14680</td>
<td>15859</td>
<td>16913</td>
<td>18240</td>
<td>19027</td>
<td>19787</td>
</tr>
<tr>
<td>Nationalised Banks $</td>
<td>35866</td>
<td>37443</td>
<td>39283</td>
<td>41011</td>
<td>43654</td>
<td>46389</td>
<td>50527</td>
</tr>
<tr>
<td>Public Sector Banks</td>
<td>50179</td>
<td>52123</td>
<td>55142</td>
<td>57924</td>
<td>61894</td>
<td>65416</td>
<td>70314</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>4817</td>
<td>4828</td>
<td>4703</td>
<td>4926</td>
<td>5245</td>
<td>5061</td>
<td>5610</td>
</tr>
<tr>
<td>New Private Sector Banks</td>
<td>2017</td>
<td>2598</td>
<td>3637</td>
<td>4335</td>
<td>5235</td>
<td>6984</td>
<td>8258</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>6834</td>
<td>7426</td>
<td>8340</td>
<td>9261</td>
<td>10480</td>
<td>12045</td>
<td>13868</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>259</td>
<td>272</td>
<td>279</td>
<td>295</td>
<td>310</td>
<td>319</td>
<td>324</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>14787</td>
<td>14827</td>
<td>15065</td>
<td>15508</td>
<td>15790</td>
<td>16185</td>
<td>16698</td>
</tr>
<tr>
<td>Local Area Banks</td>
<td>41</td>
<td>48</td>
<td>48</td>
<td>48</td>
<td>49</td>
<td>54</td>
<td>57</td>
</tr>
<tr>
<td>All Commercial Banks</td>
<td>72100</td>
<td>74696</td>
<td>78874</td>
<td>83036</td>
<td>88523</td>
<td>94019</td>
<td>101261</td>
</tr>
</tbody>
</table>

Notes:
1. Data on number of offices include administrative offices.
2. Data for 2006 to 2011 have been revised and data for 2012 are provisional.
3. $ includes IDBI Bank Ltd.

Source: Master Office File (latest updated) on commercial banks, Department of Statistics and Information Management, RBI.

The above table shows the data related to number of offices of the commercial banks and an increase in the number of offices. Public sector banks account for 70314 offices out of which 19787 are SBI and subsidiaries offices and 50527 offices set up in different locations are of nationalised banks as on March 2012.
<table>
<thead>
<tr>
<th>Bank Group/Year (as on March 31)</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of India and its Associates</td>
<td>Amount</td>
<td>5,044</td>
<td>6,071</td>
<td>7,513</td>
<td>10,020</td>
<td>10,531</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(17.5)</td>
<td>(20.3)</td>
<td>(33.4)</td>
<td>(5.1)</td>
<td>(13.6)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>(23.3)</td>
<td>(22.5)</td>
<td>(22.6)</td>
<td>(24.8)</td>
<td>(21.8)</td>
</tr>
<tr>
<td>Nationalised Banks</td>
<td>Amount</td>
<td>10,355</td>
<td>12,843</td>
<td>15,845</td>
<td>19,116</td>
<td>25,406</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(18.2)</td>
<td>(24.0)</td>
<td>(23.4)</td>
<td>(20.6)</td>
<td>(32.9)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>(47.9)</td>
<td>(47.6)</td>
<td>(47.7)</td>
<td>(47.3)</td>
<td>(52.5)</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>Amount</td>
<td>764</td>
<td>817</td>
<td>961</td>
<td>1,186</td>
<td>1,474</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(24.6)</td>
<td>(7.0)</td>
<td>(17.6)</td>
<td>(23.5)</td>
<td>(24.2)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>(3.5)</td>
<td>(3.0)</td>
<td>(2.9)</td>
<td>(2.9)</td>
<td>(3.0)</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>Amount</td>
<td>4,284</td>
<td>5,725</td>
<td>6,960</td>
<td>8,167</td>
<td>8,550</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(26.9)</td>
<td>(33.6)</td>
<td>(21.6)</td>
<td>(17.3)</td>
<td>(4.7)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>(19.8)</td>
<td>(21.2)</td>
<td>(21.0)</td>
<td>(20.2)</td>
<td>(17.7)</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>Amount</td>
<td>1,163</td>
<td>1,543</td>
<td>1,908</td>
<td>1,907</td>
<td>2,403</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(43.2)</td>
<td>(32.7)</td>
<td>(23.7)</td>
<td>(0.0)</td>
<td>(26.0)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>(5.4)</td>
<td>(5.7)</td>
<td>(5.7)</td>
<td>(4.7)</td>
<td>(5.0)</td>
</tr>
<tr>
<td>All Scheduled Commercial Banks</td>
<td>Amount</td>
<td>21,610</td>
<td>26,999</td>
<td>33,186</td>
<td>40,397</td>
<td>48,364</td>
</tr>
<tr>
<td></td>
<td>Growth Rate</td>
<td>(21.0)</td>
<td>(24.9)</td>
<td>(22.9)</td>
<td>(21.7)</td>
<td>(19.7)</td>
</tr>
<tr>
<td></td>
<td>Share</td>
<td>{100.0}</td>
<td>{100.0}</td>
<td>{100.0}</td>
<td>{100.0}</td>
<td>{100.0}</td>
</tr>
</tbody>
</table>

Bank group wise, public sector banks (comprising SBI and its associates and nationalised banks including IDBI Bank) comprised the largest share in total deposits, which had continuously increased from 70.1 per cent as on March 31, 2007 to 74.6 per cent as on March 31, 2012. Domestic private sector banks comprised 3.5 - 4.3 times of the deposits held by foreign banks during 2007-12. The RRBs' share in total deposits was the lowest at around 3 per cent during 2007-12. Institutional ownership of deposits as on March 31, 2012 indicated that the households accounted for the highest share in total deposits in all bank groups barring foreign Banks, where by non-financial private corporate sector held the largest deposits. Nationalised banks accounted to Rs. 34,233 billion with 53.4% share and 16.1% growth rate.
3.6 SHAREHOLDING PATTERN OF BANKS

Disclosure relating to the shareholding pattern which reveals the shares of institutional investors, mutual funds, foreign institutional investors must be disclosed by the nationalised banks. There have been changes in the shareholding pattern of the banks over the period. Presently, the Government is the dominant owner of the Indian banking sector. The imposition of decisions by the dominant owner influences the shareholder value. In view of the growing shareholding by the public in the capital of nationalised banks, it would be necessary to move amendments to the Bank Nationalization Act to provide for greater representation to the public shareholders at least in proportion to their shareholding.

Table: 3.4
Shareholding Pattern of Scheduled Commercial Banks
(As at end-March 2012)

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Total Government and RBI - Resident</th>
<th>Financial Institutions-Resident</th>
<th>Financial Institutions-Non Resident</th>
<th>Other Corporate -Resident</th>
<th>Total Individual -Resident</th>
<th>Total Individual -Non Resident</th>
<th>Total -Resident</th>
<th>Total -Non Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporaton Bank</td>
<td>58.52</td>
<td>30.63</td>
<td>4.44</td>
<td>1.98</td>
<td>4.09</td>
<td>0.34</td>
<td>95.22</td>
<td>4.78</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>67.72</td>
<td>11.13</td>
<td>14.48</td>
<td>1.86</td>
<td>4.73</td>
<td>0.08</td>
<td>85.44</td>
<td>14.56</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>56.1</td>
<td>21.8</td>
<td>17.37</td>
<td>0.95</td>
<td>3.76</td>
<td>-</td>
<td>82.61</td>
<td>17.39</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>55.02</td>
<td>9.74</td>
<td>4.49</td>
<td>5.32</td>
<td>24.88</td>
<td>0.55</td>
<td>94.96</td>
<td>5.04</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>66.17</td>
<td>15.51</td>
<td>4.04</td>
<td>1.91</td>
<td>12.37</td>
<td>-</td>
<td>95.96</td>
<td>4.04</td>
</tr>
</tbody>
</table>

Table 3.4 highlights the shareholding pattern of the five banks chosen for the study. Total government and RBI resident is high in case of Canara Bank with 67.72%. Financial Institutions Resident shares are high in case of Corporation bank with 30.63%. Financial Institutions Nonresident shares are high in case of Punjab national Bank with 17.37%. Other corporate resident shares are high in case of Vijaya Bank with 5.32%. Total Individual-Resident share is more in case of Vijaya Bank with 24.88%. Total individual –Non resident is 0.55% in case of Vijaya Bank. Total resident shares are high in case of Syndicate Bank with 95.96%. Total non resident shares are 17.39% in case of Punjab National Bank.
Chart 3.2: Shareholding Pattern of Five Banks as On June 2013

Shareholding Pattern - Corporation Bank

- Promoters: 60%
- Financial Institutions: 26%
- General Public: 5%
- Foreign Institutions: 4%
- NBanks Mutual Funds: 3%
- Other Companies: 0%
- Foreign NRI: 0%
- Others: 0%
- Foreign OCB: 0%

Shareholding Pattern - Canara Bank

- Promoters: 62%
- Financial Institutions: 12%
- NBanks Mutual Funds: 8%
- General Public: 5%
- Other Companies: 4%
- Foreign NRI: 1%
- Foreign OCB: 0%
- Others: 0%

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Shareholding Pattern - Punjab National Bank

- Promoters: 58%
- Foreign Institutions: 4%
- Financial Institutions: 16%
- General Public: 18%
- Other Companies: 0%
- Nbanks Mutual Funds: 0%
- Central Govt: 0%
- Foreign NRI: 0%
- Foreign OCB: 0%
- Others: 4%
- Foreign Industries: 1%

Shareholding Pattern - Vijaya Bank

- Promoters: 55%
- Foreign Institutions: 0%
- Financial Institutions: 0%
- General Public: 21%
- Other Companies: 0%
- Nbanks Mutual Funds: 0%
- Central Govt: 0%
- Foreign NRI: 0%
- Foreign OCB: 0%
- Others: 0%
- Foreign Industries: 4%
- Foreign Others: 0%
- Others: 14%
The above chart displays the shareholding pattern of five banks as on June 2013. Corporation bank promoters has 60% of the shareholdings, Canara Bank promoters with 62%, PNB promoters with 58%, Vijaya Bank promoters with 55% and Syndicate bank promoters has 66% of the shareholdings.

Shareholdings of general public vary from bank to bank. General public’s shares are also revealed by the bank. General public have held 72,34,777 shares as on June 2013 in Corporation bank with 5% of the holding, Vijaya Bank has 21% of the holding by general public 1,37,39,262 shares. Canara bank has 5% of the holding by general public with 2,10,82,423 shares, Syndicate bank has 9% of holding by general public with 5,62,03,901 shares, and PNB has 4% of the general public holding with 1,37,39,262 shares. Bank promoter is the major holder of shares.

3.7 BANK FAILURES AND CORPORATE GOVERNANCE

Worldwide failure of many firms such as Enron, Worldcom, Tyco, Qwest Merck, Mirant, AOL, FreddieMac, Sunbeam, Parmalat due to Accounting practice and Imclone, Global
crossing, Martha Stewart due to insider trading, and failure of One Tel and HIH in Australia due to lack of periodic assessment by the board of directors of respective organization has given a alarm for good governance. In 2010 there were 157 bank failures, in 2009 140 bank failures and in 2008 25 bank failures reported. US, Germany, Russia, Ireland, Latvia and many other countries have witnessed the failure of banks.

The interesting quote related to fall of 150 year old Lehman brothers was “whatever was on the left-hand side (liabilities) was not right and whatever was on the right hand side (assets) was not left”. According to Gerald Faulhaber, Wharton Professor of Management and public policy “Accounting doesn’t sink a company. Accounting sinks a company that tries to cover up the bad business. It shows that weak corporate governance can contribute to financial instability and that would increase the risk profile of companies in the corporate sector and expose the banks and financial institutions to a greater risk.

Another aspect which affects corporate governance is insider trading where insiders of the firm take undue advantage of revealing the confidential information. In order to prevent this, firms need to disseminate the material price sensitive information in a timely and proper manner to ensure that till such information is made public, insiders abstain from transacting in the securities of the company.

3.8 BANK FAILURES IN INDIA

Despite in increasing risks both in domestic and global macro economic conditions, the financial system of India remains robust. However, the concern over evolving global risks and domestic factors still looms large- RBI.

Banks are very sensitive sector which is closely monitored by the public but with respect to issues in corporate governance relatively less research is carried out in the public sector banks. Bank failures in India were out of control before Independence in the absence of comprehensive banking legislation and structured supervision mechanism for the banks. During 1913 to 1936, 481 banks had failed in the country and the situation did not improve in the post-Independence period even after the spread of the Banking Regulation Act in 1949. Almost 106 banks were liquidated during the period 1954 to 1959 among which 73 banks went into voluntary liquidation and 33 into compulsory liquidation. In the year 1960, there was amalgamation of banks where 217 banks were amalgamated. In 1969 fourteen banks and in 1980 six banks were nationalised in India.
With the loopholes in the banking system Harshad Mehta scam triggered who traded shares at a premium across many segments. Harshad and his associates triggered a securities scam diverting funds to the tune of Rs 4000 crore (Rs 40 billion) from the banks to stockbrokers between April 1991 to May 1992. Ketan Parekh too swindled crore of rupees from banks by bringing stocks in fictitious names and price rigging in the scrips of companies. Bansali scam where he raised money from public for the unexisted company which affected SBI through huge defaults. Sohin Daya also created fictitious cooperative society of cobbler and swindled money from Banks taking advantage of government schemes. Virendra Rastogi chief executive of RBG Resources was charged with for deceiving banks worldwide of an estimated $1 billion. He was also involved in the duty-drawback scam to the tune of Rs 43 crore (Rs 430 million) in India. The UTI scam led investors being panic about government securities. When there were no buyers for the scrip UTI had purchased 40,0000 shares of cyberspace.

When RBI checked the accounts of cooperative banks following unusual activities in the gilt market it found that Sanjay agarwal finance portal swindled Rs. 600 crore from more than 25 cooperative Banks. The biggest scam in Indian history Satyam scam where Ramalinga raju cooked up accounts. His efforts to fill the fictitious assets with real one through Maytas acquisition failed, after which he decided to confess the crime. In Satyam’s case the independent directors failed in their duty, the auditors have blundered, all internal and external checks and balances went haywire and the regulatory authorities, the SEBI, the stock exchanges and the company law administration have been lax. Failure of Global Trust Bank and other cooperative banks in India was accounted to poor legal structure, dominance of docile shareholders and lack of governance. These are the learning lessons to gear up to check the scams in our economy. It is observed that though India has a stringent regulatory mechanism still we can see that there are failures of Indian banks due to lack of sound corporate governance practices.

According to economic times report Post 2008 financial crisis as far as India was concerned, the 19 co-operative banks, including six from Karnataka, have failed to repay deposits to customers. The DICGC paid the maximum amount of Rs 45.4 crore to District Cooperative Bank Ltd of Gonda in Uttar Pradesh. This was followed by The Maratha Co-operative Bank of Karnataka (Rs 17.7 crore), Parivartan Co-operative Bank of Maharashtra (Rs 16.7 crore), Ravi Co-operative Bank (Rs 16.2 crore) and Indira Priyadarshini Mahila Nagrik Sahakari
Bank of Chhattishgarh (Rs 13.1 crore). The other five lenders from Karnataka are Varda Co-operative Bank (Rs 2.4 crore), Harugeri Urban Co-operative Bank (Rs 3.1 crore), Kittur Rani Channamma Mahila Pattana Sahakari Bank (Rs 2.2 crore), Challakere Urban Co-operative Bank (Rs 3.2 crore) and Basavakalyan Pattana Sahakari Bank (Rs 0.24 crore). Four banks each in Maharashtra and Gujarat went bankrupt, while two cases were reported in Uttar Pradesh. The world wide scam has led to intrigue on the lack of governance in the financial system which needs to be addressed though Nationalised banks have proved to the hilt that they stood the test of the times during the downturn economic recession of 2008 which hit the globe.

3.9 BANKING SUPERVISION AND CORPORATE GOVERNANCE

The Basel Committee on Banking Supervision (1999) states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management. This thus affect how banks:

i) Set corporate objectives (including generating economic returns to owners);

ii) Run the day-to-day operations of the business;

iii) Consider the interest of recognized stakeholders;

iv) Align corporate activities and behaviour with the expectation that banks will operate in safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors.

The Committee further enumerates basic components of good corporate governance to include:

a) The corporate values, codes of conduct and other standards of appropriate behavior and the system used to ensure compliance with them;

b) A well articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured;

c) The clear assignment of responsibilities and decision making authorities, incorporating hierarchy of required approvals from individuals to the board of directors;
d) Establishment of mechanisms for the interaction and cooperation among the board of directors, senior management and auditors;

e) Strong internal control systems, including internal and external audit functions, risk management functions independent of business lines and other checks and balances;

f) Special monitoring of risk exposures where conflict of interests are likely to be particularly great, including business relationships with borrowers affiliated with the bank, large shareholders, senior management or key decisions makers within the firm (e.g. Traders);

g) 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;

h) Appropriate information flows internally and to the public.

The Bank for International Settlement (BIS) in 1999 proposed the following seven principles to enhance corporate governance for banking organization: -

- Establishing strategic objectives.
- Setting and enforcing clear lines of responsibility and accountability.
- Ensuring that the board members are qualified for their position and are not subject to undue influence from the management or outside concerns.
- Ensuring that there is appropriate oversight by senior management.
- Effectively utilizing the work conducted by internal and external auditors.
- Ensuring that compensation approaches are consistent with the bank’s ethical values and
- Conducting corporate governance in a transparent manner.

According to the Basel committee on banking supervision (2000) accounting standards should facilitate market discipline by promoting transparent reporting of bank’s financial position and performance, risk exposures, and risk management activities. Disclosure should be adequately broad to allow review of a bank’s financial position and performance, risk exposures, and risk management activities.
3.10 CORPORATE GOVERNANCE AND RBI

The corporate governance norms followed by RBI has three approach they are

a) Disclosure and transparency
b) Off site surveillance
c) Prompt corrective action

a) Transparency and disclosure standards are also important constituents of a sound corporate governance mechanism. Transparency and accounting standards in India have been enhanced to align with international best practices. However, there are many gaps in the disclosures in India with that of the international standards, particularly in the area of risk management strategies and risk parameters, risk concentrations, performance measures, component of capital structure, etc. Hence, the disclosure standards need to be further broad-based in consonance with improvements in the capability of market players to analyze the information objectively.

b) The off-site surveillance mechanism is also active in monitoring the movement of assets, its impact on capital adequacy and overall efficiency and adequacy of managerial practices in banks. RBI also brings out the periodic data on “Peer Group Comparison” on critical ratios to maintain peer pressure for better performance and governance.

c) Prompt corrective action has been adopted by RBI as a part of core principles for effective banking supervision. As against a single trigger point based on capital adequacy normally adopted by many countries, Reserve Bank in keeping with Indian conditions have set two more trigger points namely Non-Performing Assets (NPA) and Return on Assets (ROA) as proxies for asset quality and profitability. These trigger points will enable the intervention of regulator through a set of mandatory action to stem further deterioration in the health of banks showing signs of weakness.
3.11 REFORM MEASURES AFFECTING THE BANKS PERFORMANCE

Following important measures affect the Banks performance:

1. As a step towards distancing the regulator from the functioning of the Boards, the Reserve Bank has withdrawn its nominee directors from almost all the private sector banks. Observers have been appointed as transitional measures mostly in respect of those banks which are yet to fully comply with the Reserve Bank's guidelines of ownership of governance. It is hoped that the need for observers also will diminish as the quality of governance improves.

2. Legislative amendments have been proposed in regard to the public sector banks to remove the provisions for mandatory nomination of RBI officers on their Boards and thus, to bring them on par with the private sector banks in this regard.

3. The Government has been requested to keep in view the policy framework for governance in private sector banks while deciding on the appointments of the directors on the Boards' of public sector banks and constitution of various committees of the Board.

4. The RBI, as far as possible, has been refraining from issuing circulars or instructions specifically addressed to the public sector banks. It is expected that all the existing instructions specifically applicable to the public sector banks will be reviewed by the Reserve Bank so that uniformity in regulatory framework between different categories of banks is formally established.

5. Several amendments to the Banking Regulation Act have been proposed which would enhance RBI's capacity to ensure sound governance specially relevant to the banks, consistent with global best practices.
3.12 GOVERNANCE STATUS IN INDIAN BANKING
The below table projects the report of the advisory group (2001) RBI and report of the consultative group of directors of banks and financial institutions (2004), RBI.

Table: 3.5
Governance Status in Indian Banking

<table>
<thead>
<tr>
<th>Governance Variables</th>
<th>Governance Status, 2001</th>
<th>Committee Recommendation</th>
<th>Action Taken By RBI Between 2002 And 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Responsibility of the board</td>
<td>Board members are not effective as ideally envisaged. This is more visible in nationalised banks.</td>
<td>Board to align their responsibilities in line with international best practices. Boards are to play a very active role in providing oversight to senior level management for managing different risks. Limits for individuals voting rights are one percent in nationalised banks but ten percent in private sector banks.</td>
<td>Recommendations of the Ganguly Group have been forward for implementation directors to execute the deed of covenants to discharge their responsibilities to best of their abilities, individually and collectively.</td>
</tr>
<tr>
<td>2. Accountability of the Board to shareholders/stakeholders</td>
<td>Boards of majority of the banks do not fulfill lines of responsibility and accountability for themselves.</td>
<td>The Board should be accountable to the owners of the Banks and the Banks should also keep the view the interests of main stakeholders depositors, employees, creditors, customers etc.</td>
<td>The Chairman of the Audit Committee should be present at AGMs to answer shareholder queries. Banks have also been advised to form committees under the chairmanship of a non executive director to look into the redressal of complaints.</td>
</tr>
<tr>
<td>3. Election of the Board</td>
<td>PSU boards formed by the government and through nomination. In private sector banks appointments are governed by Banking regulations Act and the companies act. One director each is the process of selection with clear and transparent criteria. Such criteria for choosing non-executive directors should be disclosed in the Annual Report. They should be independent and elected and have different tenures to ensure continuity. They should undertake a process of due diligence in regard to the suitability for the appointment of directors. The Boards of banks should form nomination committees to scrutinize declarations of candidates.</td>
<td>The process of selection with clear and transparent criteria. Such criteria for choosing non-executive directors should be disclosed in the Annual Report. They should be independent and elected and have different tenures to ensure continuity. They should undertake a process of due diligence in regard to the suitability for the appointment of directors. The Boards of banks should form nomination committees to scrutinize declarations of candidates.</td>
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<td></td>
</tr>
<tr>
<td>4. Size of the Board</td>
<td>The sizes of the Boards of PSU banks are stipulated by their respective statutes.</td>
<td>All banks should have minimum of 10 board members. Increasing number of professions on Boards by specifying proportion of non-executive members on Boards.</td>
<td>Appraised GOI on this issue and the matter is being followed up by the concerned agencies. RBI directions on fit and proper criteria for board appointments have been issued.</td>
</tr>
<tr>
<td>5. Composition of the Board</td>
<td>Not less than one half of the total number of directors of Banks shall consist of persons who have special knowledge or practical experience</td>
<td>Banks should have a specified proportion as non-executive independent directors as in case of other companies. Representation of private shareholders is required in case of mixed ownership</td>
<td>The Ganguly committee recommendations are communicated to banks</td>
</tr>
<tr>
<td>----------------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>6. Independence of directors</td>
<td>The director has to abstain from the decision making process relating to that case.</td>
<td>The recommendations of Blue Ribbon commission shall be applicable. The directors nominated by the government on the boards of nationalised banks and all nominees of the regulators should not be considered independent. A majority of non-executive directors should be identified in the Annual report.</td>
<td>Issued circular annexing the mandatory recommendations of the SEBI committee on corporate governance. It implies that in case a company has a non-executive chairman at least half of the Board should be independent.</td>
</tr>
<tr>
<td>7. Tenure for directors and Age</td>
<td>No mandatory provisions.</td>
<td>Tenure for independent directors may preferable be up to ten years at a stretch. The age limit should be a maximum of 65 years for whole time directors and 75 years for part time Directors. The liability of non-executive</td>
<td>Whole time Directors should have sufficiently long tenure. As per Banking Regulation Act, Maximum tenure of non-executive Directors is eight years. Stipulated age limit of 35-65 years for non-executive</td>
</tr>
<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td>8. Multiple board seats</td>
<td>A person cannot be on the boards of two banking companies simultaneously.</td>
<td>One Director should not serve on more than 10 Boards or be member more than 5-6 committees.</td>
<td>RBI has issued circular in June 2002 directing that a Director should not be in more than 10 committees or act as a chairman on more than 5 committees.</td>
</tr>
<tr>
<td>9. Chairman and CEO</td>
<td>The government controls the appointment.</td>
<td>Chairman and CEO should be separated positions.</td>
<td>Requested GOI for legislative changes as per the Ganguly Recommendations.</td>
</tr>
<tr>
<td>10. Board meetings</td>
<td>Nationalised Banks to have to hold at least six meetings in a year and at least once in a quarter.</td>
<td>At least six meetings in a year keeping aside the quarterly restrictions.</td>
<td>Made mandatory that Board meetings be held at least 4 times a year with a maximum gap of 4 months.</td>
</tr>
<tr>
<td>11. Disclosure of remuneration</td>
<td>A number of banks do not disclose the entire compensation package of their full time directors.</td>
<td>Remuneration package of should be disclosed in the Annual report and they should be reported to shareholder and audited.</td>
<td></td>
</tr>
<tr>
<td>12. Audit committee</td>
<td>Banks are yet to set up audit committee with right composition of various directors.</td>
<td>Audit committees should be formed as per recommendations of the Blue ribbon committee</td>
<td>Audit committee should have independent non-executive directors and Executive Director should only be a permanent invitee.</td>
</tr>
<tr>
<td>13. Remuneration Committee</td>
<td>No provision</td>
<td>Boards should be set up Remuneration Committees made up exclusively of non-executive Board members. Remuneration should be decided by the remuneration committee</td>
<td>Written GOI for making necessary legislative changes.</td>
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<td>-----------------------------</td>
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<td>---------------------------------------------------</td>
</tr>
<tr>
<td>14. Financial reporting, disclosure and transparency</td>
<td>Standard of Banks disclosure fall short of international standard. Some disclosures are made mandatory by RBI</td>
<td>Financial reporting, disclosure and transparency of banks need further improvement. Disclosures as per accounting standards should cover subsidiaries, especially where 26 percent or more shareholding exists. Disaggregated segmental information should also be provided.</td>
<td>Asked banks to include separate section on CG in their Annual reports. Made mandatory for banks to adopt all accounting standards that are required to be followed, through certain flexibility required by banks has been provided for.</td>
</tr>
</tbody>
</table>


The above table highlights the governance status of Indian banking, committee recommendation, action taken by RBI between 2002 and 2004. However at the later stages development took place in terms of the policy framework towards better governance in banks. The disclosure of remuneration is hot highlighted in the report. RBI has taken action in terms of insisting upon a separate corporate governance report in the annual reports of the firms or banks.
3.13 DEVELOPMENT IN CORPORATE GOVERNANCE POLICY FRAMEWORK

There are various developments worldwide in terms of framing corporate governance policy framework such as US Blue Ribbon Commission, UKs Cadbury Committee, World bank guidelines, OECD guidelines. It was Cadbury committee, 1991 which gave India groundwork for implementation of Best Practices. The advisory group chaired by Dr. Patil. R. H in the year 2001 and Ganguly group in 2002, UTI advisory body has given a framework for good corporate governance in India. There are various committees and the Acts which have paved the way for good governance.

The summarized report of some of the important committee recommendation and acts studied in the course of the research work is highlighted below.

- **Companies Act, 1956:**
  Companies Act, 1956 has given guidelines related to good governance of companies where the Companies (Amendment) Act, 2000 has introduced good Corporate Governance leading to more transparent, ethical and fair business practice to be adopted by Corporate at large.

- **The Tradway Report: 1987:**
  It highlights the need for a proper controlled environment, independent audit committees, an objective internal audit function and call for published reports on the effectiveness of internal control. The commission requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their control.

- **Sir Adrian Cadbury Committee on Financial Aspects of CG, 1992:**
  Cadbury committee recommended that the listed companies should comply with the Code of Best Practice and are required to include a statement of compliance/noncompliance of the Code in their Annual Report. The Code of Best Practice sets out guidelines for a governance structure monitoring the board and the governing process.

The recommendations included increasing the numbers and powers of non-executive directors (who should be independent); the separation of the posts of CEO and chairman, and the setting up of sub-committees to independently monitor and judge management.
Audit Committee should have at least 3 members, written terms of references and authority to investigate; listed companies should publish full financials, BOD must assess company’s position; report on the effectiveness of its internal control systems.

- **Sir Richard Greenbury Report 1995**: The Greenbury Report’s review included the recommendation of remuneration committees (to consist of non-executive directors to avoid potential conflicts of interest). This included preparing annual reports to shareholders with full disclosure of remuneration policies for executive directors and other senior executives; and the length of service contracts and compensation when these were terminated.

- **The Confederation of Indian Industries (CII), 1996**: It is the first institutional initiative in Indian industry on corporate governance with the objective to develop a code for corporate governance to be adopted by both public and private sector banks and financial institutions which are corporate entities.

- **OECD Principles on CG, 1998**: OECD principles emphasize transparency and accountability of all parties to CG; management, BOD, shareholders and other stakeholder.

- **The Hampel Report’ (Sir Ronald Hampel being the Chairman), 1998**: The report gives recommendations on the four major issues
  
  (a) The role of directors  
  (b) Directors compensation  
  (c) The role of shareholders  
  (d) Accountability and audit

- **Blue Ribbon Committee , 1999**: The Blue Ribbon Committee recommends that all listed companies over a certain size have audit committees composed entirely of independent directors. Independence is defined to exclude current and former employees, relatives of management, persons receiving compensation from the company (except directors’ fees) or controlling for-profit organizations receiving from or paying the Corporation significant sums, and compensation committee interlocking directorships. The BRC’s recommendations are consistent with audit committee incentives.
• The Kumar Mangalam Birla committee Report 1999:
The mandatory recommendations of the Kumar Mangalam Birla committee include the constitution of Audit Committee and Remuneration Committee in all listed companies, appointment of one or more independent directors in them, recognition of the leadership role of the Chairman of a company, enforcement of Accounting Standards, the obligation to make more disclosures in annual financial reports, effective use of the power and influence of Institutional shareholders and so on. The Committee also recommended a few provisions, which are non-mandatory.

• The Turnbull Committee 1999:
It was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control.

• The Sarbanes–Oxley Act 2002:
It was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control.

• The Ganguly Consultative Group (April 2002):
It looked into the functioning of the Boards vis-a-vis compliance, transparency, disclosures, audit committees and suggested measures for making the role of the Board of Directors more effective.

• Narayana Murthy Committee 2002:
The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to related party transactions and proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stock holder approval and improved disclosures relating to compensation paid to non-executive directors. Non-mandatory recommendations include moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board member.
- **Naresh Chandra Committee 2002:**
The auditor-company relationship, Independent directors: Role, remuneration and training were discussed in this committee report.

- **Derek Higgs Committee, UK, 2003:**
It reviewed the role of effectiveness of non-executive directors.

- **ASX Corporate Governance Council, Australia 2003:**
It deals with the Principles of Good Corporate Governance and has given Best Practice Recommendations.

- **Clause 49 of the Listing Agreement, 2005:**
A major compliance directive that came into force from the quarter ended June 2005, it has major aspects of compliance by listed companies that include; definition of independent directors; Non-Executive Director’s compensation and disclosures, other provisions as to Board and Committees, Code of Conduct, Composition of Audit Committee, Meeting of Audit Committee, Subsidiary Companies, Disclosures pertaining to (a) basis of related transactions (b) accounting treatment (c) risk management (d) proceeds from public/rights/preferential issues (e) remuneration of directors and management discussion and analysis, CEO/CFO Certification, report on corporate governance, auditors certificate on compliance etc.,

The above committees have bought major reforms in the corporate governance framework. The Cadbury committee was one of the pioneers in bringing good code of governance however Paul Ruthman committee observed that the Cadbury reporting requirement was restricted to internal financial controls only as against the effectiveness of the company’s system of internal control.

The Basel committee on banking supervision issued revised guidelines for effective supervision of banks which encourages sound practices within banks. The document is based on twenty principles under three sections:

A. Supervisory expectations relevant to the internal audit function,

B. The relationship of the supervisory authority with the internal audit function, and

C. Supervisory assessment of the internal audit function. This approach seeks to promote a strong internal audit function within banking organizations.

There are professional bodies such as The Institute of Chartered Accountants of India (ICAI), and the Institute of Cost and Works Accountants of India (ICWAI) which has set accounting standards for the companies are two professional bodies working in India towards accounting standards which is core for good governance.

3.14 RESEARCH MODEL

The study of relation between corporate governance and bank performance is an important part of the present study. Based on the literature review and the conceptual framework to determine the relation between the corporate governance disclosure level and the bank performance the following model is identified for the present study.

![Diagram](3.5 Relation between corporate governance and bank performance)

(Source: Researcher’s design)
The investigation on corporate governance in banks is done in different stages.

The first stage of the study is to identify the five nationalised banks based on their performance. Once the banks are identified, the performance of the banks is collected from the RBI annual report which comes out annually with the profile of banks indicating the performance of all the banks. Every year RBI comes out with the report with three major performance indicators being Return on Assets (ROA), Capital Adequacy Ratio (CAR) and Non Performing Assets (NPA).

In the next stage the corporate governance index is prepared using sixty five variables. The presence of the variable is marked as 1 and the absence and not properly disclosed is marked as 0.

Later the relation between the total corporate governance disclosure level and the bank performance is tested whether it is positive or negative. The corporate governance disclosure level for each bank of seven years is correlated with the ROA, CAR and NPA of seven years data.