CHAPTER – 1
INTRODUCTION

Companies do not confine themselves to the boundaries of a single country. In order to access new markets, new customers and generate more revenues, companies transform themselves into multinationals. As companies go global, so must the framework of rules of corporate codes to ensure that the functioning of these companies does not have negative impact on social, environmental and other stakeholders. Factors like good corporate governance and sound business ethics have now become important parameters for winning the confidence of all the stakeholders of a company.

As rational human beings we expect good governance in every facet of our life, such as economy, polity, our social and cultural life. Every stakeholder in every kind of enterprise (public or private, profit-making or non-profit service-oriented organization) expects good governance.

There are several reasons for our insistence on good governance. We naturally expect leaders to lead, to provide appropriate direction and to achieve the goal set for the organization. We look for transparency and disclosure of relevant facts and figures. We expect leaders to remain accountable for their actions and in actions understandable, we are more interested in performance than in hallow promises. Stakeholders in any enterprises rightly expect their interest to be protected.

“Corporate Governance” is the current buzzword in India and the world over. The paradigm of governance is in tune with the changing times, in keeping with the demand for greater accountability of companies to shareholders and customers, economic liberalization and deregulation of industry, business and other factors.

The buzzword of the 1990s and in the new Millennium, Corporate Governance has brought with its additional responsibilities for auditors the world over. Corporate Governance has been the most widely and if one may say so, the most misunderstood word of the modern era.
It has been understood loosely to mean discharging the social responsibility of business, practicing ethics in business, keeping the corporate wheel within the realms of law, managing the company to maximize the shareholder and other financial partners’ wealth and so on. The term was coined from the complex nature of governing problems encountered in giant corporation, particularly in the west, where ownership and management were diversified.

Joint stock companies play an important role in the economic and social well being of a country as a large number of business enterprises are organized in the form of joint stock companies. Having regard to the importance of Joint stock companies, need for good Corporate Governance in addition to efficient corporate management includes a fair, efficient and transparent functioning of companies with a view to achieve long-term strategic goal to satisfy shareholders, creditors, employees, customers and suppliers and complying with the legal and regulatory requirements, apart from meeting environmental and local needs.

Governance Boards of director should be properly structured and should consist of knowledgeable and experienced persons. Auditors should act independently and professionally. The shareholders should recognize the fact that they have to take a lead in protecting their own interest than leaving them to others. Having regard to the importance of Joint stock companies, every country endeavours that the joint stock companies that operate there do flourish and grow in a manner to provide employment, wealth and satisfaction uplift the standard of living and also enhance social cohesion. This is possible when business entities are competitive, efficient, transparent and fair in the liberalized, privatized and globalized business environment.

2. MEANING OF CORPORATE GOVERNANCE

Corporate Governance means the idea of ensuring proper management of companies through the institution and mechanism available to the shareholders. But the effective accountability to all stakeholders in the essence of corporate governance.

To have a clear understanding of the important aspect of the concept, some of the important definitions have been stated as below:
In the proceeding of the Silver Jubilee National Convention of Institute of Company Secretaries of India, “Corporate Governance is not just Corporate Management, it is something much border to include a fair, efficient and transparent administration to meet certain well defined objectives. It is a system of structuring, operating and controlling a company with a view to achieve long-term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers and complying with the legal and regulatory requirements apart from meeting environmental and local community needs. When it is practiced under a well-laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed.

According to Dr. Geeta Gauri Corporate governance is a system by which companies are run. It relates to the set of incentives, safeguards and the disputes resolution process that are used to control and coordinate the actions of the agents on behalf of the shareholders by the Board of directors. Shareholders are responsible for appointing the Directors and auditors. Creating residual value is the primary concern of shareholders, but the process of value creation and its legally are equally important. Hence corporate governance relates to code of conduct, the management of the companies observes while exercising its power. The Kumar Mangalam Committee acknowledges that the fundamental objective of Corporate Governance is the enhancement of long-term Shareholders’ value while at the same time protecting the interest of other stakeholders. The report points out that this definition harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders’ wealth whilst not in any way being detrimental to the interest of the other stakeholders in the company such as suppliers, customers, creditors, the bankers, the employs of the Company, the government and the social at large. Cadbury Committee Report 1991, defines Corporate Governance as a system by which corporates are directed and controlled.

The focus was largely on accountability. In the words of Sir Sydney, the Chairman of the financial reporting council of the UK, the good corporate governance is to ensure that the business is being soundly and effectively managed with risks being properly assessed and controlled. Rahul Bajaj, the Chairman of the National
Task Force on Corporate Governance, appointed by the Confederation of Indian Industries (CII) said that it dealt with laws, practices and implicit rules the determine a company’s ability to take managerial decisions vis-a-vis its claimant, in particular its shareholders and the creditors, the state and employee in general. Thus it is system through which a company makes decision concerning its constituents. Various experts on the subject have opined that Corporate Governance is an interplay between companies, shareholders, creditors, capital, markets and financial sectors, institutions and company law.

Although there are various attributes of corporate governance, some important rules and practice include the concentration of ownership and control and the constitution of boards and these role information to shareholders’ disclosure obligation to potential shareholders and investors, corporate take-overs, corporate restructuring etc.

3. CONSTITUENTS OF CORPORATE GOVERNANCE

There are several constituents of Corporate Governance. Some significant ones must include the following:

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<tr>
<th>Sl. No.</th>
<th>Emphasis</th>
<th>Operational Fields</th>
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<td>1.</td>
<td>Risks</td>
<td>Management should be prepared to take risks and show entrepreneurship</td>
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<td>2.</td>
<td>Protection</td>
<td>Shareholders’ interest must be protected fairly and squarely</td>
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<td>3.</td>
<td>Inside Trading</td>
<td>Corporate Governance, in its excellent operational aspects should not permit insiders’ trading</td>
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<td>4.</td>
<td>Transparency</td>
<td>There should be transparency in terms of full disclosure of information to enable shareholders to evaluate managers in their stewardship functions and to be decisive if managers are not performing according to expectations</td>
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Source: www.yahoo.com

The hallmark of sound corporate governance is that it must pave the way for a fair balance between shareholders and management interest.

PRINCIPLES OF CORPORATE GOVERNANCE

A good corporate governance will include the following principles:
1. REVIEW OF OPERATION

There should be review of operations of the company at a regular intervals. It may include comparison of month / quarterly production and sales targets with actual, cash flow analysis, etc.

2. COMPLIANCE WITH STATUTORY AND REGULATORY REQUIREMENTS

The board should ensure compliance with various statutory and regulatory requirements. It may include clearance of statutory dues, compliance with Foreign Exchange Management Act regulations, following suitable accounting policies and standards etc.

3. APPOINTMENT OF VARIOUS COMMITTEES

Various committees should be appointment to look after different matters. There can be the following committees.

a) Audit Committee

The audit committee meets periodically to review the effectiveness of the system of internal control and reports to the shareholders.

b) Grievance Committee

It looks into and looks after the grievances of the customers, suppliers, creditors in respect of price, quality, discount, etc. besides attending to the problem of executives / employees of the organizations.

c) Remuneration Committee

Its role is to fix remuneration of non-executive directors. It may be fixed in relation to company performance.
d) Investment Committee

Investment committee will look after the investment decisions. It should be in accordance with the guidelines approved by the board. Shareholders expect that investment decisions are judicious and do not suffer from any infirmities, that affect the interest of the shareholders.

4. Contribution of Employees Union

Employees or worker’s union can also contribute significantly to good corporate behaviour by promoting work culture. In this case inclusion of employees or worker’s representative on the board may be thought of.

5. Contribution of Community Development

A good corporate governance will help the community development of active participation. It adopts measures for pollution control. It adopts fair and ethical business practices. The important committee is Audit Committee which is required by its code in India.

Good corporate governance calls for accountability for all concerned. The shareholders, directors, executives, advisers and other staff who are associated with the working of the corporate should combine their efforts to improve the system and ensure good management practice. We can say that Joint Stock Company is of the shareholders and run by boards and managers for the shareholders. The process of corporate governance has to be consistent with this and nothing etc.

5. CORPORATE GOVERNANCE AND BANKS

“Banking is the crucial factor effecting economic development of an economy. It is the life-blood of a country. It is responsible for the flow of credit and for maintaining the financial balances of the economy. Since the nationalization process in 1969 banks have emerged as a tool of economic development along with social justice. The liberalization policy, which was initiated in 1991 created the environment of competition among banks. The emergency of new private sector banks made the existing banks became more quality conscious in service to the
customers. Along with quantitative achievements banks turned their focus on quality. Banking has become complex and it has been recognized that there is a need to attach more importance to qualitative standards such as internal controls and risk management, composition and role of the board and disclosure standards. Corporate Governance has become very important for banks to perform and remain in competition in the era of liberalization and globalization. The entry of new private sector banks, the freedom given to public sector banks to access capital market and series of scams particularly the one is Madhavpura Merchantile Co-operative Bank Ltd. has necessitated banks to pay more attention to the corporate governance. “In India, it was only in 1998, when inadequate / inefficient management was identified as one of the key problems associated with bank performance that the corporate governance cropped up in financial sector agenda. In 2000, the Advisory Group on Banking Supervision (M.S. Verma) suggested that all banks should accept a certain minimum level of corporate governance. It examined the issues of ownership in establishing corporate governance practices. In 2001, an Advisory group on corporate governance (R.H. Patil) was formed which quickened the reforms to make the boards of these institutions more professional and truly autonomous”.

Corporate Governance, one of the most focused and valued disciplines in management in the modern day, is integrated in the new-basel accord for the effective implementation of the Pillars (Market Discipline) of the same, which depends on the effectiveness of corporate governance. This discipline is based on an integrated strategic and holistic enterprise risk management system for evaluating the financial strength of the banks and there by achieving competitive equality and financial stability.

“Corporate Governance has become inevitable in the banking sector as the risks in financial markets that affects a bank are several and have a more sensitive and intense relationship with the economy than other corporate. From the Perspective of the financial system, Corporate governance involves, the manner in which the business and affairs of the individual institutions are governed by their board of directors and senior management which affect how banks

• set corporate objectives
• run the day to day operations
• consider the interest of recognized stakeholders.
• align corporate activity and behavior with the expectation that the bank will operate in a safe manner and
• protect the interest of the depositors\(^2\).

GENESIS OF CORPORATE GOVERNANCE

“The seeds of modern corporate governance were probably sown by the Watergate scandal in the United States of America. Subsequent investigations by the United States regulatory and legislative bodies highlighted control failures that had allowed several major corporations to make illegal political contributions and bribe government officials. This led shareholders and banks to worry about their investment in several companies in the United Kingdom saw explosive growth in the earnings in the 80s that ended the decade in a memorably disastrous manner. Such failures arose primarily out of poorly managed business practices.

The London Stock Exchange set up as committee in May 1991 under the Chairmanship of Sir. Arian Cadbury to help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it saw as the respective responsibilities of those involved. The committee investigated accountability of the Board of Directors to shareholders and to the society. It submitted its report and the associated Code of best practices in December 1992. the Cadbury report stipulated that the Board of directors should meet regularly, retain full and effective control over the company and monitor the executive management. This report generated a lot of interest in India.” \(^3\)

\(^2\) A.C. Fernando, corporate Governance, Principles policies and practices, Pearson Education India 2006, P.252
\(^3\) A.C. Fernando, corporate Governance, Principles policies and practices, Pearson Education India 2006, P.20
THE SPECIAL PLACE OF BANKING

The Banking sector is not necessarily totally corporate. Some part of it is, of course, but a segment of banks in mostly government owned as statutory corporations or run as co-operatives just like other banks. Banking as a sector has been unique and the interests of other stakeholders appear more important to it than in the case of non-banking and non-finance organizations. In the case of traditional manufacturing corporations, the issue has maximizing the shareholders value. In the case of banking, the risk involved for depositors and the possibility of contagion assumes greater importance than that of consumers of manufactured products. The involvement of government is higher in banks due to the importance of stability of financial system and the larger interests of the public. Since the market control is not sufficient to ensure proper governance in banks, the government sees a reason in regulating and controlling the nature of activities, the structure of bonds, the ownership pattern, capital adequacy norms, liquidity ratios etc.

ENSURING HIGH STANDARDS OF CORPORATE GOVERNANCE

(A) The Basel Committee

The basel committee on banking supervision is a committee of banking supervisory authorities, established by the Central Bank Governors of the G10 developed countries in 1975. The committee introduced the concept of capital Adequacy Frame work, known as Basel capital Accord, with a minimum capital adequacy of 8% in 1988. This accord has been gradually adopted not only in member countries but also in more than one hundred other countries including India.

(B) Basel II : The New Basel Capital Accord:

The Committee issued a consultative document titled “The New Basel capital Accord” in April 2003, to replace the 1988 Accord, which re-enforces the need for capital adequacy requirements under the current conditions. This Accord is Commonly known as Basel II. Basel II will be applied on a consolidated basis to internationally active banks. It is based on three pillars such as
Pillar 1 – Minimum capital requirements
Pillar 2 – Supervisory Review Process and
Pillar 3 – Market Discipline.

NEW ACCORD IMPACT ON BANKS PERFORMANCE

As of now, there has been no check on the expansion of balance sheets of the banks. Banks in some countries were constrained by their ability to mobilize deposits to acquire assets and this served as a check on the size of balance sheets. As for the quality of assets, by and large, availability of security had been the prime concern. Under Base II the Quality of assets in terms of risks will be an added factor while extending the balance sheet. Currently, the same people in some banks are attending marketing sanctioning and monitoring of credit. Another possible change is the adoption of more scientific methods to assess the risk factor of a proposal. Several specialists in economics and statistics will be needed to compute the risk. However the interpretation of the numbers needs an analytical mind without which the computed results is useless. On the Contrary,. If a non-analytical person is entrusted with the, work, it is a sure way to disaster.

“Not many Public policy issues have gained momentum and importance as corporate governance did. Every organization has been putting in efforts to refine their corporate governance practices. Major focus and studies are being made on the subject from the point of view of both law and economics. In spite of the growing knowledge, not must attention has been given as corporate governance issues in banks. Very little is being done as corporate government, especially in banks outside the United states, except for a few countries like Japan and Germany”4.

Corporate governance in banks becomes important for different reasons. First, because banks are seen as the engines that drive the economy towards growth in developing countries. Second due to under-developed financial markets in developing countries, banks are the main source of finance for many firms. Third, banks act as a repository for the economy’s savings apart from providing means of payment. Fourth, after recent privatization and disinvestments of most of the banks and the reduced role of economic regulations, the banks today are free in terms of how they are being run.

4- ICFAI Journal of Corporate Governance- Jan- 2006 – P. 69
There are two international factors of the financial intermediaries that affect corporate governance. First with the banks being more non-transparent, there arises an agency problem. The information differences between the insiders and outside investors in banking lead to more difficulty for equity and debt holders in monitoring the managers, and in turn it becomes easier for the managers to use the benefits of controls, rather than focus on maximizing the value. Second heavy regulations imposed on the banks stand as an obstacle for natural corporate governance mechanisms.

The role of a Chairman and that of a Managing Director in public sector banks has to be vested in one period as against the usual practice of separation of roles in private sector forms. This is to protect the organization interest, essential knowledge in relevant laws, ethics, duties and responsibilities, Financial analysis and effective decision – making are the key to and a major challenge in achieving in good governance.

Corporate governance in Public Sector Banks (PSBs) is important not only because they dominate the banking industry but also they are uniquely to exit the business even thought they undergo a transformation. As long as there are is public ownership in the PSBs, the Government will have multiple objectives, both as an owner and as a complex principal agent. PSBs cannot function equally like the private sector banks, though they perform under similar principles Uncertainty in ownership leads to complications. The mere chances of change also have some impact on governance. Mixed ownership results in varying interests. One set of owner looks for commercial returns while the other seeks something else. Hence the issue of corporate governance In Public Sector Banks is not only important but also complex.

Corporate governance in banks in India is not without flaws. With growing markets and integration with global economy, there arises a need for further research on whether corporate governance practices in India are growing equally or not. Of late frauds in banking show unabated spurt year after year. The magnitude is also increasing on account of financial Sector reforms and globalization.
e-Banking has added a new dimension of frauds as necessary security awareness, knowledge and expertise is not available with people in operation side. Fierce competitions amongst the banks to excel performance and to grab more and more business from others have made the banks let loose internal control system, norms and procedures. Further with the opening up of the financial sector, a greed for earning quick money has became friendly with a large section of people who interestingly design new ways and means to commit frauds. Offenders commit frauds by targeting branches where the system and procedures are not meticulously complied with or targeting loophole in the system and procedure. All this has made the preventive Vigilance an important aspect of banking business management.

There are a few crimes in which negligence is the gist of the offence. It needs to be noted that mere negligence in handing money or other valuable instrument by a banker if NOT AN OFFENCE, under the Indian Penal Code. But unfortunately, while judging the conduct of bankers, whether in allowing operations in an account or in lending more often than not negligence is being construed as a criminal act merely because such negligence results in a loss to the bank. This also happens because bankers deal with money and negligence in handing money results in banker’s constituent or any third party gaining and consequent loss to the bank, giving cause for suspicion that he banker and such third party might have colluded to enjoy the gain.

Since there is a danger that innocent bankers may suffer by attributing criminality to conduct, which may be only negligence, it is necessary to clearly understand the dividing line between bankers’ negligence and criminal conduct. The bankers ability to detect any fraudulent activity is restricted by various factors including large turnover of cheques and other instruments in clearing, presentation of relevant instrument in clearing by another bank and clever forgeries and alterations which are not visible to the naked eye.

Ethics and values play a major role in preventive vigilance. “Corporate Governance of Bank” is based on growing realization that Banks must not do any illegal or unethical things. The traditional “Mantras” of Honesty is the best policy,
Prevention is better than cure, A stitch in time saves nine and Justice delayed is justice denied” are still useful and practical guide for survival in this material world.

Code of conduct attempts to set forth the guiding principle on which the bank shall operate and conduct its daily business with its multitudinous stakeholders, government and regulatory agencies, media, and anyone else with whom it is connected. It recognizes that the Bank is a trustee and custodian of public money and in order to fulfill its fiduciary obligations and responsibilities it has to maintain and continue to enjoy the trust and confidence of public at large.

The bank acknowledges the need to uphold the integrity of every transaction it enters into and believes that honestly and integrity in its internal conduct would be judged by its external performance. The bank shall be committed in all its actions to the interest of the countries in which it operates. The bank is conscious of the reputation it carries amongst its customers and public at large and shall endeavour to do all it can to sustain and improve upon the same in its discharge of obligations. The bank shall continue to initiate policies, which are customer centric and which promote financial prudence.

The bank expects all Directors and members of the Core Management to exercise good judgement, to ensure the interests, safety and welfare of customers, employees and other stakeholders and to maintain a cooperative, efficient positive, harmonious and productive work environment and business organization. The Directors and members of the core Management while discharging duties of their office must act honestly and with due diligence. They are expected to act with that amount of utmost care and prudence which an ordinary person is expected to take in his/her own business. These standards need to applied while working in the premises, of the bank, at offsite locations where the business is being conducted whether in India or abroad, at bank – Sponsored business and social events, or at any other place where they act as representatives of the bank.

Every member of the Board of Directors and core Management has a responsibility to the Bank, its stakeholders and tone another. Although this duty does not demand that they avoid situations where a conflict of interest might occur or
appear to occur. They are expected to perform their duties in a way that they do not conflict with the bank’s interest.

The bank shall make full, fair, accurate, timely, and meaningful disclosures in the periodic reports required to be filed with Government and Regulatory agencies. The members of Core Management of the Bank shall initiate all actions deemed necessary for proper dissemination of relevant information to the Board of Directors, Auditors and other statutory Agencies, as may be required by applicable laws and regulations.

The bank’s confidential information is a valuable asset. All confidential information must be used for bank’s business only. It has many kinds of business relationship with many companies and individuals. Sometimes, they will volunteer confidential information about their products or business plans to induce the bank to enter into a business relationship. At other times, the bank may request that a third party provide confidential information to permit the bank to evaluate a potential business relationship with that party. Therefore special care must be taken by the Board of Directors and members of the Core Management to handle the confidential information of other responsibly. Such confidential information should be handled in accordance with the agreements with such third parties.

This code of Conduct is of the utmost importance to the Bank, its stakeholders and its business partners, and is essential to the bank’s ability to conduct its business in accordance with its value system.

6. ISSUED RELATED TO CORPORATE GOVERNANCE IN BANKS

“Following are some issues that have been considered significant for ensuring the presence of effective corporate governance in banks.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

It has been recognized that there should be separation of the role of Chairman and CEO. Cadbury Committee on corporate governance states that there should be clearly accepted division of responsibilities at the head of the company level, which will ensure a balance of power and authority, such that no one individual has
unfettered powers for decision – making. At present in India, in most of the banks, the position of Chief Executive Officer and the chairman is one and the same. The government appoints the chief executives of public sector banks and has preferred the composite position of the chairman and the managing director.

RESPONSIBILITY OF THE BOARD

According to the Board of International Settlement (BIS) code, bank boards should establish strategic objectives and set corporate values that will direct the ongoing activities of the bank. The board should ensure that senior management implements policies that prohibits activities and relationships that diminish the quality of corporate governance, such as conflicts of interest, self-dealing and preferential dealings with related parties. Keeping in view their oversight role, the board of directors should feel empowered to recommend sound practices, provide dispassionate advice and avoid conflicts of interests.

The Reserve Bank of India issued a circular regarding dos and don’ts for the directors of banks on March 9, 1992. Section 20 of the Banking Regulation Act, 1949 prohibits loans and advances to directors or to any firm or company in which directors are interested or loans to individuals in respect of whom any of the directors is a partner or guarantor. Some banks do have corporate values, codes of conduct and standards of appropriate behaviour, etc. Some others also have well-articulated strategy decided by the Board of Directors.

ACCOUNTABILITY TO SHAREHOLDERS / STAKEHOLDERS

The guidelines of the Securities and Exchange Board of India (SEBI) state that the Board should be accountable to shareholders for creating, protecting and enhancing wealth and resources for the company and reporting them on the performance in timely and transparent manner.

However the present scenario is that in majority of banks, Boards do not enforce clear lines of responsibility and accountability for themselves.
ELECTION

The principles of the Organization for Economic Co-operation and Development (OECD) state that the Board should ensure a transparent Board nomination process.

In terms of the provisions of section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, the government constitutes the Boards of Directors of nationalized banks. The Boards comprise two whole-time directors, a nominee each of the Government of India and the Reserve bank of India, nominee of workmen and non workmen unions, and a chartered accountant. Besides this, there are six non-official directors with specialized knowledge in agriculture and rural economy, banking, co-operation. The bank boards consist mainly of nominated members and not the elected members. Moreover, banks do not have nomination committees for nominating directors of Boards of Banks.

AUDIT COMMITTEE

According to BIS the Audit Committee of banks should provide an oversight of the banks’ internal and external auditors, approving their appointment and dismissal, reviewing and approving audit scope and frequency, receiving their reports and ensuring that management is taking appropriate corrective in a timely manner. The independence of this committee can be enhanced when it comprises external Board members who have banking and financial expertise.

The banks are required to set-up an Audit Committee of Board of Directors to oversee and provide direction to the internal audit / inspection function in banks in order to enhance its effectiveness as a management tool in India. The Chief Managing Director is not the member of the Audit Committee to ensure independence in its functioning. The members of Audit Committee are the Executive Director (ED) of the bank, two official directors (nominees of the Reserve Bank of India and the Government of India) and two non-officials and non-executive directors, at least one of them being a professional Chartered Accountant. The Chartered Accountant presides over the meetings.
REMUNERATION COMMITTEE

BIS standards state that a Remuneration Committee should be set-up for providing oversight of remuneration of senior management and other key personnel and ensuring that the compensation is consistent with the bank culture, objectives, strategy and control environment. Currently the banks in India do not constitute the Remuneration Committee.

INTERNAL CONTROL

According to Board of International Settlement (BIS) principles the banks should have a strong internal control system including internal and external control audit functions, risk management function, independent of business lines and other checks and balances. Presently banks have reasonably good internal control system. A regulatory framework for risk management function in banks independent of business lines has recently been put in place. Banks are in different stages of implementation of risk management system.

AUDITOR INDEPENDENCE

Board of International Settlement (BIS) states that the role of auditors is vital to the corporate governance process. The importance of the audit process should be communicated throughout the bank. Board should take measures to enhance the independent of auditors. The findings of auditors should be utilized in a timely and effective manner. Head auditor should report to the Boards of banks and this has to be with the prior approval of Reserve Bank of India. External Auditors present their report on the functioning of the bank to its Board directly.

STAKEHOLDERS

It is recognized by Organization for Economic Co-operation and Development (OECD) principles that the good corporate governance should take into consideration the rights of stakeholders. The stakeholders should have access to information necessary to fulfill their responsibilities. At present there is no provision regarding the protection of interest and the involvement of stakeholders in banks.
DISCLOSURE AND TRANSPARENCY

BIS states that transparency can reinforce sound corporate governance. Therefore the banks should disclose the areas such as Board structure (size, membership, qualifications and Committees), senior management structure (responsibilities, reporting lines, qualifications and experience) and basic organizational structure (lines of business structure, legal entity structure).

The Reserve Bank of India has made mandatory the disclosure of some of the indicators including performance related parameters as part of the notes to the balance sheet of banks. The banks are also required to disclose their accounting policies. Moreover they are required to disclose maturity pattern of loans and advances, investment securities, deposits and borrowing, etc.”5

PROFILE OF INDIAN OVERSEAS BANK

BRIEF HISTORY AND BACKGROUND

The Bank was founded on 10.02.1937, simultaneously setting up domestic and overseas branches on the same day. Shri.M.Ct.M. Chidambaram Chettiar, a pioneer in industry, banking and insurance was the founder of the Bank.

At the time of India’s independence, the Bank had thirty eight branches in India and seven branches abroad. Deposits amounted to Rs.6.64 crores and Advances Rs.3.23 crores. During the 1960s Indian banking witnessed strong wave of mergers of weak private sector banks with stronger institutions. Indian Overseas Bank itself took five banks into its fold, which helped the Bank widen its reach.

The Bank has been attending to the needs of small industry and agriculture for long. Personal loans were given by the Bank right in the early 1950s when the concept as new to the banking industry. Customer service was given top priority by the Bank ever since its inception. The bank also gave importance to mechanization for improving customer service as early as in the 1960s.

For thirty two years, the Bank grew globally and by the end of 1969 it had Rupees One Hundred and Forty Six crores of business transacted through two hundred and thirteen branches. The bank was nationalized under the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970. During the period of nationalization, the Bank made rapid strides in all the major business parameters. In the 1990s, consolidation has been receiving greater attention. Since 1970, the volume of business has grown by two hundred and forty five times, handled by over thousand four hundred branches. The Bank is one among the first few banks that were accorded autonomous status in 1997.

The Bank has sponsored three regional rural banks, viz. Pandyan Grama Bank in Tamil Nadu, Puri Grama Bank and Dhenkanal Gramya Bank in Orissa. It also has a wholly owned subsidiary by the name of IOB properties Pvt., Singapore. As on 31.03.2003, the Bank had One thousand four hundred and twenty seven branches and two hundred and forty three extension counters in India and one Overseas branch.

The Banking scenario has undergone a major change in the last few years. With the traditional business of banks coming under pressure, retail and other fee-based revenues are in focus. A customer – oriented workforce, proper networking and use of technology are essential for operations. In view of this, the Bank has set up a Computer Policy and Planning Department (CPPD) at the central office. Besides developing in-house software for routine banking operations, other customer support products such as Any Branch Banking (ABB), Home Utility Banking Service (HUBS) and Speedy Transfer and Realization Service (STARS) have been developed. The CPPD of the Bank has also been upgraded and certified by ISO 9001:2000 standards.

**PRESENT STATUS**

As on 31.03.2003, the Bank had one thousand four hundred and twenty seven branches in India, comprising five hundred and fifty eight rural, three hundred and forty six semi-urban, three hundred and one urban and two hundred and twenty two metropolitan/port town centres apart from six overseas branches. The branches include fifty two specialized branches (i.e. One Commercial and Institutional Credit Branch, One Treasury Branch, One Foreign Exchange Branch, One Hi Tech Agro
Branch, One Industrial Finance Branch, One large Advance Branch, Two SSI Branches, One Assets Recovery Branch, Eleven Clearing Offices, Eighteen Currency Chests and Fourteen Quick collection Branch). The bank has two hundred and forty three Extension counters.

The Bank has been entrusted with State Level Bankers’ Committee (SLBC) governorship in Tamilnadu. The bank is continuing its endeavor for economic upliftment of the state through its various developmental programmes. The Bank has lead-responsibility in twelve districts in Tamil Nadu and one district in Kerala. As convenor of SLBC in Tamilnadu, the bank had convened three meetings of the SLBC committee and one State Level meeting. The bank also organized a Special Bankers’ Review meeting in Tindivanam in March 2003 to review performance of Banks in Tamil Nadu under Priority sector credit in general and the performance under government schemes in particular.

During 2007-2008, the bank opened twenty one new branches and upgraded sixty two extension counters into full-fledged branches. At the end of the reporting period, total domestic branch network stood at One Thousand Eight Hundred and Forty Seven, comprising five hundred and seventy four rural branches, four hundred and sixty three semi-urban, four hundred and fifty three urban and three hundred and fifty seven metropolitan branches. The number of extension counters stood at fifty one. The bank has plans to takeover certain assets and liabilities of a co-operative bank; Shree Suvarna Sahakari Bank Limited, Pune, having a network of twelve branches subject to due diligence and approval of Central Government and the Reserve Bank of India (RBI).

**MAIN OBJECT OF THE BANK**

The Main object and business of the Bank, as laid down in the Bank Nationalisation Act is as under:

The main object of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 under which the undertaking of the Bank was taken over by the Central Government is as under: An Act to provide for the acquisition and transfer
of the undertakings of certain Banking Companies, having regard to their size, resources, coverage and organization, in order to control the heights of the economy and to meet progressively, and serve better, the needs of the development of the economy, in conformity with national policy and objectives and for matters connected therewith or incidental thereto.

The main object of the Bank enables it to undertake the activities for which the funds are being raised.

BUSINESS AND ACTIVITIES OF THE BANK

CORPORATE VISION

The Bank’s existing Corporate vision is to be the best among the best performing banks in the banking industry. The Bank will continue to focus its resources, strength and strategies to achieve this vision.

CORPORATE MISSION

To become the most competitive bank in the industry in the country during the next two years. For being competitive, the Bank would need to be responsive to the challenges of the market force. In this process, it would also emerge as the most profitable bank by cutting the cost and increasing the revenue.

CORPORATE FOCUS

The Corporate focus of the bank is maximization of shareholders wealth, corporate excellence through sound corporate governance and achievement of Rs.5 lakhs profit per employee.

COMPETITIVE STRENGTHS

Many new generation banks, both private and foreign, have entered the banking industry. They offer new products at competitive rates. In this scenario, the bank has defined its competitive advantage as:
• Vast branch network spread all over India and in certain overseas trading
  business centres to enable resource mobilization at low cost.
• Advancement in technological up gradation
• Well trained personnel in key fields to handle specialized products

CORPORATE STRATEGY

In the years to come the profit margins would be under increasing pressure. To
overcome such a trend the bank’s Corporate Strategy is:
• to build business volume through penetrating retail segments with innovative
  products.
• to use technology for better customer comfort and satisfaction coupled with
  reduction in operating expenses.
• to provide most efficient and speedy customer service and
to increase emphasis for fee and commission based products.

PROBLEM OF THE STUDY

An ideal system of Corporate Governance in India is supposed to function in
the following manner:

The System empowers shareholders as the owners of the company, to elect
directors and constitute the Board of Directors. The investors who had tasted the
profits flooded the market with the object of amassing wealth within a short span of
time. They expect good results they demand new issues. If the board fails to deliver
the expected results they may go even to the extent of changing the entire Board of
Directors.

With the dawn of globalization, some positive developments are taking place
within the Board. The board is chiefly responsible for monitoring managerial
performance and achieving an adequate return for shareholders. They must be able to
exercise objective and independent judgement. The board is responsible for selecting
and evaluating the Chief Executive Officer, ensuring that the corporate’s strategy is
relevant and appropriate, and ensuring the limitations on delegation to the Chief
Executive Officer in place and functioning.
Another organ in the corporate governance mechanism is auditor who is appointed by the shareholders. Though the law provides enough check and balance to ensure the independence of the auditors to enable them to maintain professional objectivity in performing their duties, the role of the auditors is still way behind the standard. His function is to attest the genuineness of the accounts submitted by the board to the shareholders. The application of high quality standards is expected especially internationally recognized standards, which improves the transparency and comparability of financial statements. Hence considering all the loopholes prevailing in corporates, which are reflected through various frauds and scams, it is difficult to believe that an effective corporate system exists in India. In the pre-globalization era qualified reports were very rare, but now, in the post globalization era, the qualified reports have stated appearing regularly. Hence the present researcher makes an attempt to evaluate the issue of corporate governance.

DESIGN OF THE STUDY

The researcher aims at describing the prevalent corporate governance practices in banks, with special reference to Indian Overseas Bank. The study describes the role of the board, shareholders, auditors and company secretary in Indian Overseas Bank. The study is of survey type. Information is collected from the shareholders of Indian Overseas Bank in Chennai, at Karaikudi and Madurai through questionnaire method. The collected data were analyzed in the ensuring chapters to measure the effectiveness of corporate governance practices in Indian Overseas Bank. Random sampling techniques were used in this survey.

OBJECTIVES OF THE STUDY

The main objectives of the study are

a) to identify the different corporate governance models globally
b) to study the composition of the Board of Directors
c) to assess the functions of the board
d) to study the role of various stakeholders in corporate governance
e) to study the corporate social responsibility of Indian Overseas Bank and
f) to assess the internal control system in Indian Overseas Bank.
RESEARCH HYPOTHESES

The following research hypothesis were framed by the researcher:

a) The average number of shareholders attending the annual general meeting is 200.

b) The job of consultancy offered to the auditor affects his independence.

c) The average duration of the annual general meeting is an hour

d) All the mandatory and non-mandatory rules are complied with.

IMPORTANCE OF THE STUDY

The term Corporate Governance is a new mantra in the corporate circle. The topic is so hot that it is at the centre stage of many seminars and workshops. Shareholders are much more interested in their rights. Financial institutions, which were once silent spectators, have now started reacting. Protecting the interest of depositors becomes a matter of paramount importance to banks. Regulators the world over have recognized have been regulating banks more tightly than other corporates. The objective of governance in banks should first be protection of depositors interests and then to optimize the shareholders’ interests. All other considerations would fall in place once these two are achieved.

After the series of scams, the entire corporate arena revolves around this topic. As a result came the Desirable code of Corporate Governance, released by the Confederation of Indian Industries (CII). Later, Securities Exchange Board of India appointed a committee under the chairmanship of Kumara Mangalam Birla to review governance practice.

The Kumar Mangalam Committee appointed by Securities Exchange Board of India confined itself to submitting recommendation for good corporate governance and left it to SEBI to decide on the penalty provisions for non-compliance.

To introduce Corporate Governance practices in the banking sector the recommendations of the working group of directors of Banks Financial Institutions, known as the Ganguly Group are of importance.
Efforts were made to rectify the deficiencies found in the original accord, known as Basel 1. The committee came out with new Basel norms that are expected to change the complexion of banking through out the world on 26 June 2004. The final version of this accord called the New Basel Capital Accord or simply Basel II came out in 1999. It aims at correcting most of the deficiencies that Basel I suffered from. The most essential ingredients of corporate governance in this context are: 1) checks and balance 2) clear division of responsibility and 3) Disclosure and Transparency. Apart from the above mentioned issues, there is another area which needs to be attended to for bringing further improvements namely the Accounting Standards. There are some gaps in Accounting Standards, which need to be closed or narrowed down for better transparency.

Bimal Jalan, governor of the Reserve Bank of India pointed out that, new banks were good at accounting but poor on accountability in terms of technology and risk consciousness.

Therefore the banking sector needs to be studied and understood how best they are managed with respect to corporate governance, considering the legal structure, the laws and their effective enforcement.

SCOPE OF THE RESEARCH
a) Reference period: The study covers a period of 5 years from 2003-04 to 2007-08.
b) Geographical area: The study attempts to cover the 3 areas namely Chennai, Karikudi and Madurai regions in Tamil Nadu.
c) Scope of the Study: The study encompasses the assessment of the performance of boards of Directors, board culture, internal control system, corporate social responsibility and the role of audit committee in respect of the Indian Overseas Bank.

RESEARCH METHODOLOGY
The study attempts to focus the present state of corporate governance in Indian Overseas Bank, by conducting a survey among long term investors. The Indian Overseas Bank has 1,28,003 long term investors holding more than 500 shares of which the researcher has chosen 200 investors using judgement sampling method.
Informal interview was also conducted by the researcher with Board of Directors on meetings, disclosure, transparency and other required information for the study. The researcher has gathered first hand information as no study was undertaken with respect to Banks’. The questionnaire was constructed exclusively to collect data from all the shareholders taken for the study. To evaluate the boardroom practices, the researcher has taken greater efforts inspite of innumerable constraints faced. Secondly sources of data were collected from books websites, annual reports and the reports of Reserve Bank of India.

CONSTRUCTION OF THE QUESTIONNAIRE

The questionnaire was framed with the five point scale and yes /no type questions in a simple manner. The questions were categorized, to solicit information pertaining to shareholders rights, transparency and disclosure, meeting, compliance and Board of Directors. The questionnaire was drafted for the first time, later submitted to the academicians for review and a final draft was constructed taking into consideration the suggestions offered by the subject experts. Later these questionnaire were taken for the final testing.

COLLECTION OF DATA

The researcher collected various literature relating to corporate governance and matters relevant to the topic. The validity of the mattes so collected was scrutinized. The questions so complied in the form of a questionnaire were given to 200 respondents covering the arrears, Chennai, Karaikudi and Madurai. The recommendations offered by the shareholders and bank employees were also taken into consideration to improve the content validity.

Based on the present Scenario, and Corporate governance structure existing in India, items were modified in order to establish the construct validity. After entering into various indepth discussions with the academicians the validity and dependability of the questionnaire was made fit and finanlized for the study undertake.

The academicians views regarding the relevance of items and objectives framed by the researcher give an insight that the questionnaire is reliable to solicit the required information.
Hence the above mentioned content validity, construct validity and reliability of the questionnaire helped the researcher to undertake the study.

LIMITATIONS OF THE STUDY

The coverage of the study is broad. As the researcher is the part-time research scholar, the time factor restricts the researcher to go for a broad perspective. Some shareholders who understood the subject and the difficulties faced by the researcher, co-operated well and respondent to the queries in person and through post. However from most of the respondents, the response was very poor inspite of repeated requests made. The reasons being they have not understood the concept of corporate governance, and their main aim to invest in shares for dividends. Hence the time and knowledge / awareness constrains prevented the researcher from studying in depth.

The views of the top management, which is considered most vital for the study is lacking in this respect for the fear of damaging the goodwill of the bank and being answerable to all investors in India and abroad. The reason being banking sector is the most sensitive sector among all other sectors as it deals with public investments.

Getting appointment with Directors, Auditors and other top management was a difficult task. If the people had been easily approachable to some extent the study would have been effective.

As no study on Corporate Governance on banks has been undertaken so far, comparison of data is not possible. The researcher also faced the difficulty in getting the addresses of shareholders and locating their residence. Some shareholders felt that the questionnaire was highly technical and were not aware of the concepts. Though some respondents were willing to help the researcher in getting the questions answered but the tile with special reference to Indian Overseas Bank made them go back without providing any answers for the simple reason that they are employees of Indian Overseas Bank.

It was very difficult to obtain the details of the board as most of the shareholders under study, do not attend all meetings as it is usually located in Chennai and other important cities which are not near to their residence. Another problem the researcher faced in this regard was that, the respondents failed to stand before us, for
the fear of Income Tax. In order to collect the data, regarding the ‘cost benefit analysis’, the researcher was replied that, banks do not function for profit as in the case of manufacturing and other sector, so it was found very difficult to go for cost-benefit analysis also.

This bank has not yet gone for Corporate Governance rating as it is not compulsory for banks. Only compliance as to clause 47 of Securities Exchange Board of India is applicable. Hence the researcher faced difficulties in applying the correct statistical tools.

The researcher also faced difficulties in locating the share brokers as they too do not want to disclose the information about their clients.

To conclude, the time, cost and resource constrains played a major role for this study. Being a woman researcher, getting things done on time was a major hindrance. In spite of the above mentioned limitations, the researcher has finished the thesis.

**CHAPTER SCHEME**

The present study is divided into seven chapters. The first chapter deals with the methodology. It contains the statement of the problem, objectives of the study need for the study, scope of the study hypothesis, Data collection and analysis, geographical coverage, period of study, construction of questionnaire, and the limitations of the study.

The second chapter is devoted to present a comparative study of corporate governance in foreign countries and an overview of corporate governance.

The third chapter attempts to present the review of related literature. This is broadly classified in two: Indian Studies and Studies in abroad.

The fourth chapter analyses the assessment of Board performance tracing the evolution given by Peter F. Drucker.
The fifth chapter critically analyses the Board culture in Indian Overseas Bank. The researcher makes a study on Board composition, Disclosure, Transparency, meetings and decisions taken etc.

The sixth chapter analyses the corporate social responsibilities, internal control system and role committee in Indian Overseas Bank.

The seventh chapter presents summary of findings, suggestion and conclusion. It incorporates suggestions to improve the corporate governance system in banks. It is also proposed to point out the areas which could be taken for further study by the future researchers.

**CONCLUSION**

Corporate Governance ensures transparency, full disclosures and accountability of companies to all its stakeholders. The latest revised Organisation for Economic Co-operation and Development (OECD) principles place their thrust on six major areas of corporate governance.

i. they call upon Governments to put in place an effective institutional and legal framework to support good corporate governance practices.

ii. they call for a corporate governance framework that protects and facilitates the exercise to shareholders rights.

iii. they strongly support equitable treatment of all shareholders including minority and foreign shareholders.

iv. they recognize the importance of the role of stakeholders in corporate governance.

v. they stress the importance of timely, accurate and transparent disclosure mechanisms and finally,

vi. they deal with Board structures, responsibilities and procedures. All issues of corporate governance, of course, emanate from and centre around on these six major areas.