CHAPTER – I

INTRODUCTION

Banks have played a crucial role in the economic development of all the nations. Banks today are important not just from the point of view of economic growth, but also financial stability. In emerging economies, banks are special for three important reasons. First, they take a leading role in developing other financial intermediaries and markets. Second, due to the absence of well-developed equity and bond markets, the corporate sector depends heavily on banks to meet its financing needs. Finally, in emerging markets such as India, banks cater to the needs of a vast number of savers from the household sector, who prefer assured income and liquidity and safety of funds, because of their inadequate capacity to manage financial risks.

Forms of banking have changed over the years and evolved with the needs of the economy. The transformation of the banking system has been brought about by deregulation, technological innovation and globalization. While banks have been expanding into areas which were traditionally out of bounds for them, non-bank intermediaries have begun to perform many of the functions of banks. Banks thus compete not only among themselves, but also with non-bank financial intermediaries, and over the years, this competition has only grown in intensity. Globally, this has forced the banks to introduce innovative products, seek newer sources of income and diversify into non-traditional activities.¹

Banking is an ancient origin in India. As early as the Vedic period between 2000 and 1400 B. C., records of taking and giving of credits are available. All throughout the period of Indian history, money lenders who were called either bankers,

or Seths, or Shroffs, are recorded to have existed, and have carried on a roaring business in money lending and banking. The great Indian Lawgiver, Manu, who flourished in the second or third century A.D., also devoted a section of his work to the question of deposits and pledges. It was recorded that by the twelfth century the Jain Bankers flourished and the famous Dilwara on Mount Abu, is said to have been built by two Jain bankers somewhere between 1197 and 1247 AD. Even during the Mogul period, the indigenous bankers of India were most prominent in connection with the financing of trade and the use of instruments of trade.

The Mogul period is said to be distinguished for its system of coinage. The coins were both of gold and silver though naturally the silver coins were in larger use. When the country was divided into multiplicity of sovereign and semi-sovereign powers the principal occupation of these bankers was that of Shroffs and money-changers. Gradually the unification of currency under the East India Company and the substitution of a single sovereign power in the place of petty principalities, took away from the hands of Shroff the most profitable business of money changing. In Bengal their business was affected later by the advent of the joint-stock banks towards the end of the eighteenth century. In Bombay, however, joint-stock banking did not come to the scene until the year 1840 with the result that the indigenous banker continued to enjoy the monopoly of banking in Bombay till that date.

The Indigenous Bankers are the private bankers doing a sort of a mixed banking and money lending business in India who are still thriving with their business. They are found among the Vaishyas, the Jains and the Marwaris all over India; the Chettiars in Madras; the Khatris and Auroras in Punjab and the Multans in Sind, Gujarat as well as in the North-West UP. These indigenous bankers perform a variety of banking functions such as accepting deposits, giving loans, discounting Hundis, etc. Their business is comparable to that of modern banks in many respects. The
indigenous bankers continue to supply the bulk of the rural finance in India.2

The remittance of money through Hundies, an indigenous credit instrument, was very popular and the history of early periods shows that Hundies issued by bankers were honored in far distant parts of the country. These bankers, known as Shroffs, Shukars, Shahus Mahajans in different parts of the country, were found in every centre of trade and commerce.

The modern type of banking, however, was developed by the Agency Houses (trading concerns in tea and indigo) of Calcutta and Bombay after the establishment of Rule by the East Indian Company in 18th and 19th centuries.

The Imperial Bank of India (predecessor of State Bank of India) was established in 1921 (27th January) pursuant to the Imperial Bank of India Act of 1920. It three Presidency Banks as ‘going concerns’ with all their assets, liabilities and management. Thus, a sound and unified quasi-central banking institution came into existence.

There was a strong urge worldwide to nationalize the bank. In India also, people had desired centralization of authority and State control over financial institutions from time to time. The need for a single State agency to meet the credit needs of the agriculture sector was emphasized by the Agricultural Finance Sub-Committee (1945) (Chairman D. R. Gadgil). Such an agency could coordinate and regulate the volume and the use of credit to the highest degree and the whole system could properly implement the social policy of the State and the working of economic controls. Soon after independence in 1947, there was a general demand for the nationalization of key and basic industries including the Reserve Bank of India and the Imperial Bank of India. Some legislators and leading nationalists wanted immediate

---

2 Davar, Sohrab R., Law and Practice of Banking (Bombay: Progressive Corporation Private Ltd), 1986, pp. 3-5.
nacionalization of the Imperial Bank of India alone leaving other commercial banks under private management. The demand was made due to the Bank’s peculiar and strong position in Indian Banking system and as “it was managed by foreigners and the management was highly bureaucratic.” The Government of India nationalized the Reserve Bank of India, as it was the central bank of the country. As regards the Imperial Bank of India, the Government had also accepted the principle of nationalization but it delayed it at the suggestion of the Governor of the Reserve Bank, who wanted waiting for a year or two before rushing into nationalization of banking institutions so as to observe carefully how the present banking system could meet the changing and developing economic needs of the country.³

Since independence, organized Western type of banking in India has evolved through four distinct phases. Firstly, foundation phase covering the decades of 1950s and 1960s. This period witnessed the development of the required legislative framework for facilitating the organization of the banking system to cater to the growing and development needs of the Indian economy; Second, Expansion phase of the mid-1960s. This trend gained momentum after the nationalization of private banks in late 1960s; Third, consolidation phase since 1985. Greater attention was paid to improving housekeeping, customer service, credit management, productivity and profitability of banks starting 1985 onwards; Fourth, reforms phase commencing since 1991.

In 1991, after the International Monetary Fund (IMF) had bailed out the bankrupt state, the government of P. V. Narasimha Rao and his finance Minister Manmohan started breakthrough reforms. This culminated with the balance of payments crisis of the Indian economy where India had to airlift gold to International Monetary Fund (IMF) to loan money to meet its financial obligations. This event called into question the previous banking policies of India

and triggered the era of economic liberalization in India in 1991. Given that rigidities and weaknesses had made serious inroads into the Indian banking system by the late 1980s, the Government of India (GOI), post-crises, took several steps to remodel the country's financial system.

It is claimed that these reforms were influenced by IMF and the World Bank as part of their loan conditionality to India in 1991. The banking sector, handling 80% of the flow of money in the economy, needed serious reforms to make it internationally reputable, accelerate the pace of reforms and develop it into a constructive usher of an efficient, vibrant and competitive economy by adequately supporting the country's financial needs. In the light of these requirements, two expert committees were set up in 1990s under the chairmanship of M. Narasimham (an ex-RBI (Reserve Bank India) governor) which are widely credited for spearheading the financial sector reform in India. The first Narasimham committee (Committee on the Financial System –CFS) was appointed by Monmohan Singh as India's finance Minister on 14 August 1991, and the second one (Committee on Banking Sector Reforms) was appointed by P. Chidambaram as Finance Minister in December 1997. Subsequently, the first one widely came to be known as the Narasimham Committee-I (1991) and the second one as Narasimham-II (1998).

The purpose of the Narasimham-I Committee was to study all aspects relating to the structure, organization, functions and procedures of the financial systems and to recommend improvements in their efficiency and productivity. The committee submitted its report to the Finance Minister in November 1991 which was tabled in Parliament on 17 December 1991.

The Narasimham-II Committee was tasked with the progress review of the implementation of the banking reforms since 1992 with the aim of further strengthening the financial institutions of India. It focused on issues like size of
banks and capital adequacy ratio among other things. M. Narasimham, Chairman, submitted the report of the Committee on Banking Sector Reforms (Committee-II) to the Finance Minister Yashwant Sinha in April 1998.

The 1998 report of the Committee to the government of India made the following major recommendations: Greater autonomy was proposed for the public sector banks in order for them to function with equivalent professionalism as their international counterparts. For this the panel recommended that recruitment procedures, training and remuneration policies of public sector banks be brought in line with the best-market-practices of professional bank management. Secondly, the committee recommended GOI equity in nationalized banks be reduced to 33% for increased autonomy. It also recommended the RBI relinquish its seats on the government nominees to the board of banks are often members of parliament, politicians, bureaucrats, etc., they often interfere in the day-to-day operations of the bank in the form of the behest-lending. As such the committee recommended a review of functions of banks boards with a view to make them responsible for enhancing shareholder value through formulation of corporate strategy and reduction of government equity.

To implement this, criteria for autonomous status was identified by March 1999 (among other implementation measures) and 17 banks were considered eligible for autonomy. But some recommendations like reduction in Government's equity to 33%, the issue of greater professionalism and independence of the board of directors of public sector banks is still awaiting Government follow-through and implementation.

Some gaps however remain (for example: lack of an inter-bank interest rate benchmark, an active corporate debt market and a developed derivatives market). On the whole, the cumulative effect of the developments since 1991 has been quite encouraging. An indication of the strength of the reformed Indian financial
system can be seen from the way India was not affected by the Southeast Asian crisis.

The new neo-liberal policies included opening for international trade and investment, deregulation, initiation of privatization, tax reforms, and inflation-controlling measures. The overall direction of liberalization has since remained the same, irrespective of the ruling party, although no party has yet tried to take on powerful lobbies such as the trade unions and farmers, or contentious issues such as reforming labour laws and reducing agricultural subsidies. The main objective of the government was to transform the economic system from socialist to capitalist so as to achieve high economic growth and industrialize the nation for the well-being of the citizens. Today India is mainly characterized as a market economy.

In the context of the new economic policy paradigm, India has chosen to enact a new competition law called the Competition Act, 2002. The MRTP Act has metamorphosed into the new law, Competition Act 2002. The new law is designed to repeal the extant MRTP Act. As of now, only a few provisions of the new law have been brought into force and the process of constituting the regulatory authority, namely, the Competition Commission of India under the new Act, is on. The remaining provisions of the new law will be brought into force in a phased manner. For the present, the outgoing law, MRTP Act, 1969 and the new law, Competition Act, 2002 are concurrently in force, though as mentioned above, only some provisions of the new law have been brought into force.

Competition Law for India was triggered by Articles 38 and 39 of the Constitution of India. These Articles are a part of the Directive Principles of State Policy. Pegging on the Directive Principles, the first Indian Competition Law was enacted in 1969 and was christened the Monopolies and Restrictive Trade Practices, 1969 (MRTP Act). Articles 38 and 39 of the Constitution of India mandate, inter alia, that the State shall strive to promote the welfare of the people by securing and
protecting as effectively, as it may, a social order in which justice social, economic and political shall inform all the institutions of the national life, and the State shall, in particular, direct its policy towards securing.

The new industrial policy announced by the government in July 1991 emphasized the following four major measures to 'reform' the public sector enterprises: (i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced still further to 3 later on) and the introduction of selective competition in the reserved area; (ii) the disinvestment of shares of a select set of public sector enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership of public sector enterprises; (iii) the policy towards sick public sector enterprises to be the same as that for the private sector; and (iv) an improvement of performance through an MOU (Memorandum of Understanding) system by which managements are to be granted greater autonomy but held accountable for specified results. In addition, there was a drastic reduction in the budgetary support to sick or potentially sick public sector enterprises.

The last ten years have seen major improvements in the working of various financial market participants. The government and the regulatory authorities have followed a step-by-step approach, not a big bang one. The entry of foreign players has assisted in the introduction of international practices and systems. Technology developments have improved customer service. Some gaps however remain (for example: lack of an inter-bank interest rate benchmark, an active corporate debt market and a developed derivatives market). On the whole, the cumulative effect of the developments since 1991 has been quite encouraging. An indication of the strength of the reformed Indian financial system can be seen from the way India was not affected by the Southeast Asian crisis.

It is practically and fundamentally impossible for any nation to exclude itself from world economy. Therefore, for sustainable development, one has to
adopt integration process in the form of liberalization and globalization as India spread the red carpet for foreign firms in 1991. The impact of globalization becomes challenges for the domestic enterprises as they are bound to compete with global players. If we look at the Indian Banking Industry, then we find that there are 36 foreign banks operating in India, which becomes a major challenge for Nationalized and Private Sector Banks. These foreign banks are large in size, technically advanced and having presence in global market, which gives more and better options and services to Indian trader.

Corporate governance has attracted considerable attention over the past decades and is defined as “the structures and processes among the board of directors, shareholders, top management and other stakeholders, and involves the roles of the steward process and exercising strategic leadership, and the objectives of assuring accountability and improving performance”. The rapid development of corporate governance and its structures reflect its importance to business entities and communities as well as governments and are particularly important in assuring accountability and improving performance.4

As defined in some corporate laws and in other laws it is stated that the corporation’s affairs should be managed under the supervision of the board. It is however ridiculous to actually allow the board to run the day to day business of a company as some or many board members could be outsiders.5 The board however has the overall duty of harmonizing the interest of the firm and its shareholders and making sure that managers are held accountable to capital providers for the use of assets.6

---

In governance there are two mechanisms that the board of directors have put in place to align the agency problem; monitoring and incentive. They could be used independently and complementarily. The effectiveness of each of these however depends on the conditions under which they are applied. With all these in place together with the variability in the board mix (size, education, presence of CEO on the board and gender), it is also worth noting that the remuneration of the board is important for its performance and the effect of board remuneration cannot be underestimated. This is because agency problems arise just because of the desire of the individual actors like acting shareholders and management to amass wealth.

The board of directors have always been considered very important and very powerful and seen to exert a lot of influence in the decisions of corporations. The collapse of the Penn Central Railroad and the Equity Funding scandal raised serious questions about the role of the board of directors, which led to suggestions about changing the structure and composition of the board. It is a delicate issue because some changes in board structure could be more destructive since it could strain the relationship between the management and the board.

Corporate governance as the liaison between ownership and management comprises mechanisms that ensure efficient decision-making and maximization of the value of the firm. There is a lot of literature on corporate governance and a lot of it focuses on the board of directors. Most studies try to establish the relationship between board attributes and firm performance. Lot of these studies focused both on developed

as well as developing countries and cover a wide range of issues.\textsuperscript{11} Most of them try to bring out the relationship between size of the board of directors, age of board members, education of board members, gender mix in the board, as well as the presence of CEO in the board amid others like independence of board members. Most of the studies use performance indicators like Tobin’s Q, return on equity, return on investment, return on asset, total expense ratio.\textsuperscript{12}

Although the subject of corporate governance has received a lot of attention in recent times in India, corporate governance issues and practices by Indian banks have received only scanty notice. The question of corporate governance in banks is important for several reasons. First, banks have an overwhelming dominant position in developing the economy’s financial system, and are extremely important engines of growth. Second, as the country’s financial markets are underdeveloped. Banks in India are the most significant source of finance for majority of firms in Indian industry. Third, banks are also the channels through which the country’s savings are collected and used for investments. Fourth, India recently liberalized its banking system through privatization, disinvestments and has reduced the role of economic regulation and consequently managers of banks have obtained greater autonomy and freedom with regard to running of banks. This would necessitate their observing best corporate practices to regain the investors’ confidence now that the government authority does not protect them anymore. Corporate governance in banks has assumed importance in India post-1991 reforms because competition compelled banks to improve their performance. Even the majority of banks and financial institutions, owned, managed and influenced by the government with neither high quality management nor any exemplary record of practicing corporate governance have realized the importance of


adopting better practices to protect their depositors and the banking public. With this perspective in mind the study has been aimed.

**Review of Literature**

Comprehensive Development is a necessity for countries. As banking system plays a pivotal role in the development of a nation, it has caught the eyes of many researchers, administrators, departments, committees. Before examining the impact of Corporate Governance as a new paradigm on performance of Indian banking, it is necessary to review the literature on the subject.

Cambridge University Press, (2000), in the study “Corporate Governance: Theoretical and Empirical Perspectives” the aim of the volume is to present new developments, theoretical and empirical, in the study of corporate governance. The volume opens with an introduction to the topic, taking stock of received knowledge, summarizing the contribution of the different chapters, and offering a point of view about the relevance of corporate governance. The following chapters deal with the role of competition and its interaction with corporate governance, the political economy of corporate governance, the effects of different corporate governance systems on growth and performance, the governance system by venture capital in Silicon Valley, and human capital and control in the new corporation.

Weston, J. Fred, Siu, Juan A. and Johnson, Brian A., (2002), in their volume "Takeovers, Restructuring, and Corporate Governance" provides a more

---

complete treatment of the leading topics related to mergers, takeovers, restructuring, and corporate control. In the future, shifts in the levels of these activities may occur with fluctuations in the economy and with changing regulatory environments. However, takeovers, restructuring, and leveraged buyouts will continue to be major forces in the economy. Additionally, some key topics such as valuation, cost of capital, and strategic financial planning—essential to the subject of financial economics—enter into the analysis of takeovers and restructuring. Therefore, important analytical concepts must be mastered. This book attempts to bring that material together in a systematic way. At the same time it tries to lay bare the theory or principles and the logical analysis that give meaning to the empirical findings.

The Institute of Company Secretaries of India, (2003), in the study “Corporate Governance (Modules of Best Practices)” stated that Indian economy has consciously shifted from a controlled one to a market driven one. In the process, several developments have been unfolded. Indian corporate need to assimilate these developments in order to survive and flourish amidst global competition. They can aspire to reach their goals with success if they pursue the right means. Good governance is the means to that end. The objectives before a business are to create wealth for the society, maintain and preserve that wealth efficiently and to share the wealth with the stakeholders. Corporate governance is the method by which the aforesaid objectives are achieved. Keeping this perspective in mind some modules have been prepared in this study.

\[\text{The Institute of Company Secretaries of India, Corporate Governance (Modules of Best Practices),}\]

\[\text{Delhi: ICSI House, 2003.}\]
Bhatia, S.K, (2004), in book "Business Ethics and Corporate Governance" covered all the major concepts and approaches on the topics of:

- Business ethics,
- Indian ethos in management,
- Corporate governance,
- Social responsibility of business,
- Some vital subjects such as: corruption, sexual harassment at workplace, work-life balance, wisdom management, spirituality and humanism, work ethics, professional ethics and managerial values.

Das, M. R, (2004), in his book "WTO: Opportunities And Challenges For Indian Banking" has examined the core issue of internationalization of banking services in India and its various aspects, since the FSA entails: (a) elimination of discrimination in the treatment between foreign and domestic financial services providers and (b) removing barriers to cross-border provisions of financial services. The work deliberates in detail on the policies that India and Indian banks have to follow in an increasingly globalized and competitive world.

The study covers the journey from GATT to WTO to GATS and to FAS before delving into an analysis of the position of the Indian banking sector in this context. The study finally comes out with a set of policy prescriptions for Indian banks to function as profitable institutions, while remaining safe and sound in the growing internationalization of banking services.

---

Shekhar, K. C. & Shekhar, Lekshmy, (2005), in their work “Banking Theory And Practice”\textsuperscript{19} opined that Indian financial system is currently undergoing a process of diversification leading to inter-penetration of markets and blurring of the traditional distinction between banks and non-banks. Non-banking financial companies are growing both in magnitude and depth. The economy is in a process of rapid churning, and the country would require judicious integration of the reach of the banking system and the zeal of the non-banking financial companies.

Behuria, Sarthak, (2006), has divided his work “Corporate Governance in Public Sector Enterprises”\textsuperscript{20} into three sections. The first section containing two chapters written by the volume’s editor rightly lays out a cognitive map of the various concepts of corporate governance and tries to assess the role of the public sector in the Indian economy. In the section that follows, address various issues facing the independence of the board, autonomy of the public sector, and ethics of business in general and the public sector in particular. The third section presents three case studies from countries abroad where the strong pressures of liberalization forced the public sector to adapt to a new economy with its old responsibilities of conjoining market competitiveness with social justice.

Mallin, Cristine A., (2007), in his book “Corporate Governance”\textsuperscript{21} pointed towards an understanding of the development of corporate governance over the last decade and illustrated the importance of corporate governance to the company itself, to directors, shareholders and other stakeholders, and to the wider business community.

\textsuperscript{20} Behuria, Sarthak, \textit{Corporate Governance in Public Sector Enterprises} (Delhi: Published by Dorling Kindersley (India) Pvt. Ltd.), 2006.
Sharma, K.C., (2007), in his study “Modern Banking in India”\(^\text{22}\) traces the history of banking from the earliest days to the current electronic era through variations dictated by time and place and responding to the changing scenario, especially so to the changing business requirements. The first chapter contains the concept of banking, its origin and development in various countries. In the second chapter, the book contains business data of nationalized banks, old private sector banks, new generation private sector banks and regional rural banks in the country on deposits, advances, priority sector advances to economically weaker sections of society, and segmental break-ups. The third chapter deals with WTO and Indian Banking. The fourth chapter contains material and information about e-Commerce and Banking. The fifth chapter discusses Electronic banking, including computer connectivity, tele-banking and internet banking as well as electronic negotiation, finalization, monitoring and termination or closure of sales or service or collaboration contracts, and electronic payment system.

Paul Justin, Suresh Padmalatha, (2008), in their volume “Management of Banking and Financial Services”\(^\text{23}\) divided the study into six parts. Part I provides an overview of the environment in the banking and financial services sector. Part II describes the banking structure, dealing extensively with analyzing banks' financial statements, sources and uses of bank funds, with a comprehensive coverage of the leading function. Part III details risk management in banks- credit risk, market risk, capital adequacy and risk measurement techniques. Part IV introduces international banking, while part V deals with some contemporary issues in bank management such as high-tech banking, cash management and consolidation of financial sector through mergers and acquisitions. Part VI and the appendices contain useful pedagogical tools-case studies and multiple choice questions.


questions. This book is also special in that each chapter has sections on basic
corcepts and the application of these concepts in banking practice.

Chandra Das, Subhash, (2008), in his work “Corporate Governance In
India: An Evaluation” pointed out that the theme is essentially, based on his
research project “Corporate Governance In India: An Evaluation”. The book
critically examined the governance system prevailing in the Indian corporate
sector in light of the notable international practices with a view to suggesting
ways and means for its improvement to serve the needs of the stakeholders within
the regulatory framework in a best possible manner.

C. Joshi, Vasant & V. Joshi, Vinay, (2009), in their book “Managing
Indian Banking: The Challenges Ahead” begins with a review of the basic
forces that have led to the almost global acceptance of deregulatory policies. A
clear appreciation of these leads to a proper approach being developed in the
overall socio-economic context.

Different opinions regarding the application of specific measures to the
financial services industry suggested to be held too firmly, both regarding the
details encompassed by the process and the measures that need to be adopted.
The book examines these areas in this light and suggests a unified approach to
what at first sight appear to be distinct aspects requiring separate treatment.

Muraleedharan, D., (2009), in his volume “Modern Banking Theory and
Practice” states that in the new era of globalization, the banking sector has
witnessed drastic changes at structural and organizational levels. In the financial

---

sector, banks act as an intermediary to transfer the resources from those who spend more than their earnings to those who spend less. Banking plays a key role in deciding the best business practices in developing new markets and clients, and creates new products for e-commerce and the Net-based technologies. Faster technological developments have transformed human life into a virtual mode, a reality that allows people to make purchase and payments online, without risking themselves to errors and frauds. The text comprises twelve chapters which deal with the latest developments in Indian and international banking. Special emphasis has been given to incorporate and illustrate the ICT-enabled banking practice.

Fernando, A.C., (2009), in his book “Corporate Governance Principles, Policies and Practices”27 starts with the meaning of corporate governance and why it rose to prominent position, tackles various issues. Any organization in a social order has to comply with legal obligations. But this is the minimum one should do. If a corporation fails to comply with the law, the law enforcers will deal a severe blow as they have done to so many corporations.

Desai, Vasant, (2010), in “Bank Management”28 focused on the comprehensive and up-to-date information about bank management.

The whole text has been discussed in twenty five chapters which are grouped in sections. Chapter one introduces the subject and provides an insight into the varied facets of bank management unfolding in the course of the rest of the study. The study discusses and analyses the new challenges and new initiatives of banks and their unique role in the economy. In short, the study acts as a motivator to pursue a career in the growing and innovative core banking,

According to Shrieves, (1992), there is a positive association between changes in risk and capital. The large sample of banks was taken and results reveal that regulation was partially effective during the period covered. Moreover, it was concluded that changes in bank capital over the period studied was risk-based.29

Wolgast, (2001), studied the merger and acquisition activity among financial firms. The author focused bank supervisors in context with success of mergers, risk management, financial system stability and market liquidity. The study concluded that large institutions are able to maintain a superior level of risk management.30

Al-Tamimi and Al-Mazrooei, (2007), examined the risk management practices and techniques in dealing with different types of risk. Moreover, they compared risk management practices between the two sets of banks. The study found the three most important types of risk i.e. commercial banks foreign exchange risk, followed by credit risk, and operating risk.31

Sensarma and Jayadev, (2009), used selected accounting ratios as risk management variables and attempted to gauge the overall risk management capability of banks. They used multivariate statistical techniques to summarize these accounting ratios. Moreover, the volume also analyzed the impact of these

risk management scores on stock returns through regression analysis. Researchers found that Indian banks' risk management capabilities have been improving over time. Returns on the banks' stocks appeared to be sensitive to risk management capability of banks. The study suggests that banks want to enhance shareholder wealth and have to focus successfully on managing various risks.\textsuperscript{32}

Zhao, Casu and Ferrari, (2008), used a balanced panel data set covering the period of 1992-2004 and employing a Data Envelopment Analysis (DEA)-based Malmquist Total Factor Productivity (TFP) index. The empirical study indicated that, after an initial adjustment phase, the Indian banking industry experienced sustained productivity growth, which was driven mainly by technological progress. Banks' ownership structure does not seem to matter as much as increased competition in TFP growth. Foreign banks appear to have acted as technological innovators when competition increased, which added to the competitive pressure in the banking market. Finally, the results of their study also indicates an increase in risk-taking behaviour, along with the whole deregulation process.\textsuperscript{33}

It was found in the study of Goyal and Joshi, (2011), that small and local banks face difficulty in bearing the impact of global economy therefore, they need support and it is one of the reasons for merger. Some private banks used mergers as a strategic tool for expanding their horizons. There is huge potential in rural markets of India, which is not yet explored by the major banks. Therefore ICICI Bank Ltd. has used mergers as their expansion strategy in rural market. They are


successful in making their presence in rural India. It strengthens their network across geographical boundary, improves customer base and market share.34

According to Fernando, (2011), transparency and disclosure norms as part of internationally accepted corporate governance practices are assuming greater importance in the emerging environment. Banks are expected to be more responsive and accountable to the investors. Banks have to disclose in their balance sheets a plethora of information on the maturity profiles of assets and liabilities, lending to sensitive sectors, movements in NPAs, capital, provisions, shareholdings of the government, value of investment in India and abroad, operating and profitability indicators, the total investments made in the equity share, units of mutual funds, bonds, debentures, aggregate advances against shares and so on.35

Financial inclusion has become a necessity in today’s business environment. Whatever is produced by business houses, that has to be under the check from various perspectives like environmental concerns, corporate governance, social and ethical issues. Apart from it to bridge the gap between rich and poor, the poor people of the country should be given proper attention to improve their economic condition.

Dev, (2006), stated that financial inclusion is significant from the point of view of living conditions of poor people, farmers, rural non-farm enterprises and other vulnerable groups. Financial inclusion, in terms of access to credit from formal institutions to various social groups. Apart from formal banking institutions, which should look at inclusion both as a business opportunity and

social responsibility, the author concluded that role of the self-help group movement and micro-finance institutions is important to improve financial inclusion. The study suggested that this requires new regulatory procedures and de-politicization of the financial system.\textsuperscript{36}

Benedikter, (2011), defines Social Banks as “Banks with a Conscience”. These social Banks focus on investing in community, providing opportunities to the disadvantaged, and supporting social, environmental, and ethical agendas. Social banks try to invest their money only in endeavours that promote the greater good of society, instead of those, which generate private profit just for a few. He has also explained the main difference between mainstream banks and social banks that mainstream banks are in most cases focused solely on the principle of profit maximization whereas, social banking implements the triple principle of profit-peole-planet.\textsuperscript{37}

Goyal and Joshi, (2011), have concluded in their study on social and ethical aspects of Banking Industry that Banks can project themselves as a socially and ethically oriented organization by disbursement of loans merely to those organizations, which has social, ethical and environmental concerns.\textsuperscript{38}

Karim et al., (1996), argued that annual reports of the companies should be considered as the most important source of information about a company and they used that for a variety of reasons.\(^{39}\)

Gopalswamy N., (1998), in his book “A Corporate Governance: A New Paradigm”, covered the basic three parts: corporate governance, business environment and globalization. For corporate governance, he has conceptual overview, role of board of directors, audit committee, corporate disclosure practices and investors’ protection. A few studies have examined corporate governance in emerging markets, although none has estimated the link between CEO turnover and corporate performance that is the focus of this paper. Researchers have studied the implications of the concentrated ownership that is common in many emerging and developed markets.

Reddy, (1998), had recommended that the positions of chairman and managing director in public enterprises. It would be needed to be vested in one person as against the popular view for the private sector. This is in order to protect the interests of the organisation. The major challenge in progressing to good corporate governance is to build essential knowledge on relevant laws, duties and responsibilities, financial analysis, strategy, business ethics and effective decision making.\(^{40}\)

La Porta et al., (1998), studied corporate governance patterns in 27 countries and concluded that “the principal agency problem in large corporations around the world is that of restricting expropriation of minority shareholders by


the controlling shareholders." More recently, the intellectual debate on corporate governance has come to focus on two different issues. The first concerns whether corporate governance should focus exclusively on protecting the interests of equity claimants, on whether corporate governance should expand its role to deal with the problem of the other group: the ‘stakeholders’ or non-shareholder constituencies. The second issue of importance to corporate governance scholars begins with the assumption that corporate governance concerns itself exclusively with the challenge of protecting equity claimants and attempts to specify ways in which the corporation can better safeguard those interests.

As regards the issue of corporate governance in banking organisation, Jalan, (2001), has examined the issue of corporate governance in public versus private banks and thereafter. Sarkar and Sarkar, (2000), provided evidence on the role of large shareholders in monitoring company value in the Indian context, whose corporate governance system is a hybrid one. Similar to other studies, this study also found that after a definite level of block holdings by directors the company value enhances. But it did not find any substantial proof that institutional investors, normally mutual funds, are active in corporate governance. The outcome advocates that lending institutions start supervising the corporation efficiently only after the equity holding cross a considerable value and this supervision is reinforced by the level of liability of these corporations. The study provides substantial proof that company value is enhanced by foreign equity ownership. In general, the analysis supports the view emerging from developed

---

country studies that the Identity of large shareholders matters in corporate governance.44

Bushman and Smith, (2001), argued that a fundamental objective of corporate governance research in accounting is to provide evidence on the extent to which information provided in financial accounting systems mitigate agency problems. But except for size and, to a lesser extent, ownership structure.45 Réal Labelle, (2002), did not find consistent and significant relations between disclosure quality of governance practices and firm performance or other corporate governance variables such as the proportion of unrelated director, the CEO’s plurality of offices and the level of financing activity in Canada.46

Mukherjee, (2002), argues that India has been moving closer to taking on an Anglo-American (Anglo-Saxon) form of corporate governance. But the author questions the usefulness of the Anglo-American model. She answers this question through an assessment of the "development impact" of the new model as pointed out by measures such as growth, employment and respect for shareholder rights. The results suggest that the Anglo-American model is not very effective in meeting the objectives of the social system in India.

Reddy, (2002), has discussed the governance challenges in public sector banking. He is of the view that corporate governance in PSBs is important, not only because PSBs happen to dominate the banking industry, but also because, they are unlikely to exit from banking business though they may get transformed

to the extent there is public ownership of PSBs, the multiple objectives of the government as owner and the complex principal-agent relationships. PSBs cannot be expected to blindly mimic private corporate banks in governance though general principles are equally valid. Complications arise when there is a widespread feeling of uncertainty of the ownership and public ownership is treated as a transitional phenomenon. The anticipation or threat of change in ownership has also some impact on governance, since expected change is not merely of owner but the very nature of owner. Mixed ownership where government has controlling interest is an institutional structure that poses issues of significant difference between one set of owners who look for commercial return and another who seeks something more and different, to justify ownership. Furthermore, the expectations, the reputational risks and the implied even if not exercised authority in respect of the part-ownership of government in the governance of such PSBs should be recognised. In brief, the issue of corporate governance in PSBs is important and also complex.47

Gompers et al, (2003), used the incidence of 24 governance rules to construct a “Governance Index” to proxy for the level of shareholder rights at about 1500 large firms in the USA during the 1990s. They found that firms with stronger shareholder rights had higher firm value, higher sales growth, higher profits, lower capital expenditures, and made fewer corporate acquisitions. Similarly, a number of attempts have been made by various researchers throughout the world regarding the determinants of corporate governance.48

Mohanty, (2003), suggests that companies with good corporate governance measures are easily able to borrow money from financial institutions as compared

to companies with poor corporate governance measures. Moreover, there is evidence that mutual funds have invested money in companies with a good corporate governance track record as compared to companies with a poor CG track record.

By making use of a simultaneous equation approach, this study wraps up by saying that this positive relationship is a result of the “mutual funds (development financial institutions) investing (lent money) in companies with good governance records” and also because “their investments have helped to enhance the financial performance of such companies”.

Boubakri et al, (2003), examines the corporate governance features of newly privatised firms in Asia and documents how their ownership structure evolves after privatisation. The results suggest that, on the one hand, privatisation leads to a significant improvement in profitability, while, on the other hand, it creates value for shareholders.49

Joh, (2003), presents evidence on corporate governance and firm profitability from Korea before the economic crisis and finds that the weak corporate governance system offered few obstacles against controlling shareholders expropriation of minority shareholders. In fact, weak corporate governance systems allowed poorly managed firms to stay in business and resulted in inefficiency of resource allocation, despite low profitability over the years.50


Anderson and Campbell, (2003), investigate corporate governance activity at Japanese banks. The results indicate that there does not exist any relation between bank performance and non-routine turnover of bank presidents, in the pre-crisis (1985-90) period, although there is an observed significant relationship between turnover and performance in the post-crisis (1991-96) period.

In the Twenty First Session of International Standards of Accounting and Reporting (UNCTAD Secretariat presented a report which was prepared after conducting a survey on 30 companies representing different geographical regions and industry) that found increasing convergence among national and international corporate governance codes and guidelines but it also reported significant deviation in terms of disclosure practices and content of disclosure. The role and the need of good corporate governance in India have been reiterated in several forums. However, Kohli, (2003) stressed that corporate governance has to be perceived and understood in a much broader spectrum, encompassing all players involved in the business, instead of restricting it only to board and executive management. It is believed that a company having better corporate governance is quoted at a premium in the bourses than those with weak corporate governance practices.

Das and Ghosh, (2004), tried to establish a linkage between CEO compensation and bank performance in India. They concluded that CEOs of properly performing banks are likely to face higher turnover than the CEOs of well performing banks. As there is a dearth of impact studies of corporate

---

governance policy implementation on financial performance of the banks, more particularly in Indian context, this study is an attempt to fill the gap.54

Morck et al, (2005), reviews the large literature that explores the connection between country level rules affecting corporate governance and firm behaviour and the strength of security markets.55

Whereas Choi and Hasan, (2005), examined the effect of ownership and governance on firm performance and discover the evidence that the extent of foreign ownership level has a significant positive association with the bank return and a significant negative association with the bank risk; the number of outside board of directors does not have any significant effect of ownership and governance on firm performance.56

Dumev and Kim, (2005), provide empirical and theoretical evidence that companies with greater growth opportunities, greater needs for external financing, and more concentrated cash flow rights practice higher quality governance and disclose more and the strength of their influence depends in part on the country's legal environment.57 On the other hand, Barucci and Falini, (2005), found that in

---

Italian financial market, governance features are affected by shareholders’ composition, balance sheet data and company features.\textsuperscript{58}

Bernard S. Black, (2001), has made a seminal contribution to the study of the impact of governance on firm valuation in Russia and other emerging markets. He finds that economically important and statistically strong correlation between governance and market value possible when the measures of corporate governance matters.\textsuperscript{59}

Rajesh Chakrabarti, (2006), said that the problem of corporate in India is different from that of the Anglo-Saxon environment. In India, the problem is the exploitation of minority shareholders by the dominant shareholders, whereas in the Anglo-Saxon environment, it is exploitation of shareholders by the managers. The author argues that in the Indian context, the capital market is more capable of disciplining the majority shareholders than the regulators. The regulator can just facilitate the market to ensure corporate governance. It cannot enforce corporate governance effectively, since it involves micro-management.\textsuperscript{60}

Anand et al, (2006), provide empirical evidence that the absence of a large empirical block holding and a high need for external financing are the firm characteristics associated with the adoption of the Canadian guidelines and when it comes to voluntarily adopting the U.S. Sarbanes-Oxley Act (SOX) provisions, firm size becomes an important determinant. Although executive pay has been a controversial issue for many years, the current financial crisis has drawn greater attention to the role of executive pay in encouraging excessive risk taking.

promotion and undue focus on the short term and rewarding senior management for poor performance and, in some cases, unmitigated failure.\textsuperscript{61}

Moody’s, (2008), has claimed that the most pressing challenges for boards in the area of executive compensation will be (a) moderating potential pay outcomes, (b) structuring pay to better promote a long term focus, (c) ensuring the appropriateness of performance targets and metrics, (d) improving exit pay practices, and (e) ensuring appropriate executive retirement and deferred composition plans.\textsuperscript{62}

Adams, (2009), compared board characteristics and incentives in financial firms and non financial firms to address the question of how much blame the board of directors should shoulder for the failure. Boards of financial firms clearly share some responsibility for the crisis because it was their duty to oversee managers who led their banks to the brink of failure.\textsuperscript{63}

Lag and Jagtiani, (2010), continued their analysis adding that one of the financial crisis was that large financial firms were willing to engage in this complex mortgage related products when they had not built the capability to analyse the portfolio risk of these activities. Further, no oversight function within the company demanded that kind of information and that kind of analysis. Irrespective of the business goal considered, effective governance guarantees that the administration (managers and the board) are responsible for achieving it. The job of successful corporate governance is of immense significance to society as a whole. In the first place it promotes efficient use of scarce resources both within the organization and the larger economy. Secondly, it makes the resources flow to


\textsuperscript{62} Moody, \textit{Corporate Governance in the Credit Crisis: Key Considerations for Investors (Special Comment)}, 2008.

those sectors or entities where there are efficient production of goods and services and the return is adequate enough to satisfy the demands of stakeholders. Thirdly, it provides a broad mechanism for choosing the best managers to administer the scarce resources. Fourthly, it helps the managers to constantly focus on enhancing the company performance, ensuring that they are sacked when they don’t succeed in doing so. Fifthly, it puts pressure on the corporation to abide by the law as well as achieve what the society expects from it. And last but not least, it assists the supervisors in regulating the entire economic sector without partiality and nepotism.64

Cheffins, (2001), cried out that market forces and management of business enterprises are acting as destabilizers of traditional business structures thereby causing convergence along Anglo American lines. Fundamental changes revolutionized governance, which led to “the end of the family” in Europe and “the end of tycoons” in Asia. Empirical studies in the UK show that ownership and control of businesses declined which gradually led to the “outsider/arms-length” that currently prevails. This process continued gradually and in a manner that one cannot point out to a particular time in history that this present corporate governance became a reality.65

Euromoney institutional investor PLC, (2006), later identified that corporate governance standards are being driven by push and pull factors. The push factors were identified as the shareholders and the state that want to make sure that companies are transparent, open, fair and working for the interest of their stakeholders. On the other hand they identified pull factors to be professionals with a desire for high integrity and

who want to conduct business at its best and maintain the ethical fabric and conduct of the organization, which they believe, is not just for morality but a necessary requirement for business success. The major role of corporate governance rests on the board of directors which is a key structure and responsible for aligning the interest of the internal and external stakeholders.66

Raja and Kumar, (2007), point out a difference between corporate governance in the developed countries and the developing countries. This study is useful because it introduces the idea of cultural differences. They say that in developed countries there is a real existence of separation of ownership and management and the reason for this they think is because the legal protection of minority shareholders is quite strong compared to the developing countries and they compare particularly India as the developing country then US and UK as the developed countries.67 This view is confirmed by a similar study in Asia when they say that because of the presence of government as shareholder majority of the control is by the government which causes individual share-holders to adopt CEO dualism to protect their interest.68 In this research Raja and Kumar, (2007), identified three board procedure components; head of audit committee, head of remuneration committee and the head of shareholders grievance committee. They also identified that board procedure components consist of board size and number of committees in the board. They used Tobin’s Q to measure firm performance. In India the company act of 1956 specified a minimum board size of three for public limited companies and two for private limited companies. In their literature review they found that smaller board size could be more effective than larger board size due to rapidity of decision taking and less degree of consulting even though

it was not enough evidence to show that smaller boards are more effective. In their findings they found that committee component has a significance relationship with firm performance as well as non-executive independent directors but the firm’s age has negative relationship with the performance of a firm.69

Yoshimori, (2005), in an attempt to bring out the relative importance of corporate governance among other institutional structures compare Toyota a Japan based car manufacturer and GM (General Motors) an American based car manufacturer as well as Canon and Xerox. In this paper he seeks to test his hypothesis “corporate governance alone does not assure sustained corporate performance” and “values, culture and strategy play an equally or perhaps more important role in corporate performance”. This study is based on the fact that the US is a total advocate and practice “corporate governance” while Japan maintains its traditional management techniques where their CEOs champion the management of companies. They lack the US style of outside board of directors with its structures but from 2000 to 2003 outperformed the US firms that are compared to it in this study. They proved that corporate governance played just a limited role in the long-term performance of the company. They highlighted other factors that were quite important in determining the performance of the company such as corporate mission, ethics, culture and strategy.70

Chalhoub, (2009), when studying the effect of corporate governance on Lebanese banks, viewed corporate governance as involving relationships between the board, shareholders, management and stakeholders. This relationship provides an environment that permits the objectives of the company to be set and the means of attaining these objectives as well as monitoring mechanisms to be put in place. There was a framework for corporate governance proposed which was a form of

---


collaboration triangle between shareholders, senior managers and the board. Here shareholders owned without managing. Managers managed without owning. This is a pure separation of ownership from control. Management then reported to the board, which brainstormed and made key decisions for the banks in Lebanon. They believed that corporate governance was more important in the banking industry than in other sectors of the economy.\footnote{Chalhoub, M. S., "Relations between Dimensions of Corporate Governance and Corporate Performance: An Empirical Study Among Banks in the Lebanon", \textit{International Journal of Management}, Vol. 26, No 3, 2009, pp. 478-481.}

They developed hypothesis based on the board variables and conducted an analysis based on the data they collected on 54 Lebanese banks. Their study showed that experience as a prerequisite to occupy management positions, application of formal code of conduct, engaging shareholders showed positive correlation with bank performance. To conclude Chalhoub defined corporate governance as “an interactive mechanism between shareholders, managers, and directors with emphasis on strategic collaboration for the overall corporate good”. Conclusively in corporate governance the protection of shareholders is crucial and in many countries the expropriation of shareholders that are in minority and creditors by controlling shareholders is extensive. The outside investors finance corporations and are exposed to risks of business failures and other hazards due to information asymmetry because the shareholders that are controlling or managers expropriate the shareholders profit. The expropriation is done in many ways like stealing of profit by the insiders, selling of output, assets and additional securities.\footnote{Porta, R. L., Lopez-de-Silanes, F. Shleifer, A. Vishny, R., “Investor Protection and Corporate Governance”, \textit{Journal of Financial Economics}, Vol. 58, 2000, p. 4.} The important question that arises in corporate governance is to ensure the ways in which the financiers get return on their financial investment. They fundamentally argued that corporate governance is concerned with principle agent problems that arise because of the separation of ownership and control between principals and agents. This shareholder or Anglo-American model of corporate
governance is accepted in US, UK and some other countries. The German model of corporate governance takes into account the interest of shareholders and non-shareholders (stakeholders). The Franco-German model of corporate governance is prevalent in Germany and Japan, wherein banks have large equity in non-banking companies.\textsuperscript{73}

Agrawal and Knoeber, (1996), examine firm performance and different mechanisms to control agency problems in the Fortune 500 US firms. The authors provide evidence for the interdependence of a range of corporate governance characteristics; management, institutions and large blockholders ownership, use of outside directors, debt policy financing, the managerial labor market and threat for takeover activity. However, when each mechanism is examined separately while ignoring the interdependence among the mechanisms, only management shareholding, outside directors, debt policy financing, and takeover activity are associated with firm performance cross-sectionally. Then insider shareholding disappears when all are examined together.\textsuperscript{74}

Mak and Li, (2001), indicate that corporate ownership and board structure in Singapore are related and that there are significant interrelationships among board structures characteristics. Their findings are similar to that of Agrawal and Knoeber (1996). Mak and Li (2001) documented that a proportion of outside directors is negatively related to management ownership, board size and government ownership. They argue that cross sectional OLS regressions of firm performance on single mechanisms may be misleading; this confirms the findings

by Agrawal and Knoeber (1996) on cross-sectionally examination of each corporate governance mechanism.75

Beiner et al., (2006), using broad corporate governance index, and corporate mechanisms for a sample of 275 Swiss firms quoted by the SWE end of 2002 document a positive association between quality of firm-specific corporate governance and firm valuation, this support the findings by Durnev and Kim (2005). The authors further confirm that corporate governance index is the major determinant of firm valuation.76

The recent study by Elyasiani and Jia, (2008), provide evidence that there a weaker positive relationship between BHC performance and institutional ownership stability than for comparable utility and industrial firms.77 Empirical research has rather mixed findings regarding the association between ownership structure and bank performance. Even though these empirical research has rather mixed findings regarding the association between ownership structure and firm performance. Morck et al. (1988)78, McConnell and Servaes (1990)79, Mudambi

and Nicosia (1998)\textsuperscript{80}, Short and Keasey (1999)\textsuperscript{81} and Davies et al. (2005)\textsuperscript{82}, have all shown that the classic Jensen and Meckling (1976)\textsuperscript{83} hypothesis of a monotonic convergence of objectives between managers and shareholders is not appropriate. Therefore, if ownership and board structure mechanisms are employed separately as governance mechanisms have mixed findings. This suggests that employing different corporate mechanisms simultaneously, each mechanism will be used to the extent at which marginal cost is equal to marginal benefit, thereafter optimal corporate governance structures of the firm can be achieved through a combination of different controls mechanisms.

Adams and Mehran, (2003), using 35 US listed Bank Holding Companies (BHCs) argue that governance structures differences may be industry-specific. The authors found large boards, with more board committees, accompanied with more frequency of meeting as compared to their peer manufacturing firms. Regulations on BHCs are cited to be one of the factors jeopardising board efficiency and willingness of board membership. Furthermore, the authors provide evidence that, larger BHCs board on average are not value decreasing, and that board composition is not related to BHCs performance. This may suggest that if different oversights mechanisms simultaneously applied to monitor banks i.e. (internal and external mechanisms, and regulations) might reduce the board


Bringing them together there is some evidence that board and ownership are related and interdependence among control mechanisms for non-financial firms. The above studies are silent on the following issues; corporate governance variables that might be relevant in the performance equation for instance some banking relying on subordinated debt, largest stakeholder, and capital risk management. Though some of these studies address the endogeneity problem, unobservable heterogeneity effect is not accounted for. Furthermore, almost all studies are measuring performance using Tobin’s Q, a measure of market valuation, and traditional measures (return on asset (ROA), a measure of operating performance and net-interest-margin (NIM)). In this study we also employ Economic Value Added (EVA) to capture the extent of shareholders wealth change.

---

The EVA takes into account the cost of all capital (i.e. debt and equity) and addresses the potential distortions caused by generally accepted accounting principles (GAAP) (Fogelberg and Griffith (2000))\textsuperscript{89}. Further Uyemura et al. document that the advantage of using net operating profits after tax (NOPAT) is that it allows EVA analysis at any level of the firm in a way that captures the volatility effects from all sources of risk (credit, interest rates, liquidity, currency or operations).

The SCP (Structure-Conduct-Performance) approach has been frequently used to study the determinants of banking firm performance (e.g. Demirguc-Kunt and Huizingha, 1998; Heggestad, 1977; Kaufman, 1966; Molyneux and Forbes, 1995). These authors have emphasized the cruciality of market structure to banks profitability. Two competing hypotheses have been put forward in explaining the relationship between structure and performance in the banking sector, the structure-performance hypothesis (SPH) and the efficient-structure hypothesis (ESH). These two models investigate, respectively, whether a highly concentrated market causes collusive behavior among the leading banks resulting in superior market performance, or whether it is the efficiency of leading banks that enhances their performance.\textsuperscript{90}

According to the SPH, profitability of a banking firm is dependent upon the market structure, specifically the level of competition; implying that the lower the level of competition in the market, the higher the profitability for the bank and vice versa. The SPH asserts that the correlation between bank profitability and market structure dimension reflects the setting of monopolistic prices in


concentrated markets as a result of competitive imperfections in these markets. It argues that, banks in a concentrated market would be able to generate higher profits by their ability to charge higher loan rates, pay lower deposit rates, and lower collusion costs. SPH considers that concentration lowers the cost of collusion and/or fosters tacit or explicit collusion. As a result, all banks in a concentrated market are expected to earn monopoly profits. In short, SPH sees banks profit rates as a consequence of market structures.

In contrast, the ESH asserts that the positive association between market concentration and firm profitability is not a consequence of market power but of the greater efficiency of firms with larger market share over years. According to the ESH, concentration is the result of firm specific factors such as superior management skills or technologies, enabling leading banks to obtain lower costs and higher profits and as a consequence leading banks increase in size and market share which will, in turn, lead to a more concentrated market. Based on these arguments bank efficiency serves as the leading force in market concentration. In summary, according to ESH, the degree of bank market concentration is dependent on the bank’s profit rates over years, which in turn is a result of a bank’s efficiency levels over the period.

Molyneux and Forbes, (1995), study the relationship between bank profits and market structure in 18 European countries over four year period 1986-1989. The data used include 756 banks in 1986, 1217 banks in 1987, 1538 banks in 1988 and 1265 banks in 1989. The regression results for this study found that banks in markets that are highly concentrated were more profitable than those in markets where market shares were less concentrated. The findings suggest that concentration in the European banking market lowers the cost of collusion between banks and result in higher than normal profits for all 24 banks in the market. In another study, using accounting decomposition as well as regressions.96 Demirguc-Kunt and Huizinga, (1998), study the determinants of commercial bank interest margins and profitability in 80 countries over the period 1988-1995. With regard to structural determinants, they find that bank size, as proxied by total assets, has significant and positive impact on interest margins only, while bank concentration ratio has significant and positive impact on bank profitability. Findings also suggested that market structures play a key role in determining the profit rates earned by a bank.97

Heggestad, (1977), studies the interaction of market structure, profitability, and risk for 238 independent banks operating in 60 medium size metropolitan areas. Employing regression models, the study finds that banks tend to place increasing weight on risk as their market power increase. The findings of this study suggest that market structure has a significant influence on long run bank profitability.98 Kaufman (1966) studies the relationship between bank market structure and performance using linear cross-sectional regressions on structure

data for all 672 Iowa banks in 1959 and all 673 banks in 1960 and performance data for 654 and 658 banks respectively in the two years. The findings of this study indicate that the market structure variable, particularly bank concentration, had a positive impact on profitability.\textsuperscript{99} Frame and Kamerschen, (1997), also study the profit-structure relationship in 208 Georgia (United States) banks that are shielded from competition by severe interstate branching restrictions for the period 1990-1994. Employing efficiency measures, they find that these restrictions create market power that leads to supernormal profits for the sample banks.\textsuperscript{100} The reviewed studies above indicate the existence of a positive association between bank performance and market structure.

**Research Problem**

A healthy banking system is essential for any economy striving to achieve growth and remain stable in competitive global business environment. Indian banks are favorable for growth, asset quality and profitability; RBI and Government have made some notable changes in policies and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulations of commercial banks. In terms of quality of assets and capital adequacy, these banks have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. But banks need to strengthen institutional skill levels especially in sales and marketing, service operations, risk management and the overall organizational performance ethic & strengthen human capital.

Structural weaknesses such as a fragmented industry structure, restrictions on


capital availability and deployment, lack of institutional support infrastructure, restrictive labour laws, and ineffective regulations, unless industry utilities and service bureaus. One of the major drawbacks of Indian's banks is its incapacity to cope up with the new realities in the globalised World.

The best indicator for the health of the banking industry in a country is its level of corporate governance. Corporate governance is one of the major concerns for banks in India. It reflects the performance of banks. Strong corporate governance generally gives the impression that banks have strengthened their credit appraisal processes over the years, control and manage risks, prevent from fraud and embezzlement, increase profitability and public confidence and ultimately consider the interests of shareholders, other stakeholders and also reduce different levels of conflict.

A perusal of the review of literature shows that most of the literature either deals with the evaluation and growth of banking system in India or about managing the banks and financial institutions in the world and India. The main focus of the present study is to examine the current status of banking system and its search for a new paradigm which has not been discussed, analyzed and examined properly by any scholar. Hence the subject is quite virgin and there is ample scope of original research in it. This research seeks to design developed model for ranking corporate governance level in Indian banks.

**Objectives**

The major objectives of the thesis are:

1. To obtain an overview of the current banking system in India.
2. To identify the problems faced by the Indian banking system in the post-economic reforms period.
3. An evaluation of the financial and operational indicators of banking system.
4. Designing the model for improving and ranking the corporate governance in Indian banking system.

5. Investigate the relationship between corporate governance and performance of banks in India.

We expect the results of this study and the subsequent recommendations to be of interest and relevance to: Board members, members of operating senior management and members of the corporate entity as well as other stakeholders in the banking sector; researchers; trainers banking issues; and to a lesser extent, relevant government agencies.

Hypotheses

Within the framework of the above objectives, the following hypotheses are verified during the course of analyses:

1. According to the designed model, private banks have higher rank than public banks in corporate governance index.

   This hypothesis on the basis of model, divided into two sub-hypotheses

   1-1. According to the designed model, private banks have higher rank than public banks in components of dimensions of corporate governance.

   1-2. According to the designed model, private banks have higher rank than public banks in dimensions of corporate governance index

2. There is relationship between corporate governance index, its dimensions, components of dimensions and banks’ performance.

   This hypothesis also tested in three groups (Overall, Public sector and Private sector) and three levels of the designed model, therefore nine hypotheses tested in this regard.
Research Methodology

The Study is based on primary and secondary data. The researcher collected data himself from the various sources like Reports on Currency and Finance (annual reports), ICICI, HDFC, SBI and CANARA Bank. Monthly RBI bulletins, published by RBI, Govt. of India, Reports published by National Institute of Bank management, Annual reports of various banks, publications and notifications of RBI, Reports published by Indian Bank Association (IBA), Reports of Credit Rating Agencies like S&P, CRISIL, ICRA, Reports of various consulting firms like Arthur Anderson, Price Warehouse, etc. With the help of questionnaire the researcher collected data himself for determining priority of dimensions and components of dimensions on corporate governance. Thus, through the Website of universities, banks, financial institutions and stock market the researcher provided list of 150 experts and connoisseurs and sent questionnaire to them. After 3 months just 38 questionnaires were received and employed in the analysis. The data collected is thoroughly processed, analyzed and interpreted. The secondary data as a main part of data collection processed and analysed.

Choice of Case Study Design

Yin, (2009), describes a case study as a method allowing intensive research including the holistic and meaningful characteristics of the research object, as for example organizational processes. A case study is an empirical inquiry that: Investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident.

The researcher examined four cases as they represent the critical case in testing a well formulated model. Furthermore, a single case can be used to determine whether a theory's propositions are correct or whether some alternative
set of explanation might be more relevant.\textsuperscript{101} In a single case study, the concern is the quality of the theoretical reasoning in which the case study researcher is involved and also how the researcher finds out theory out of the findings. This was the reason for us to choose cases and explore the scope of new theoretical findings with the help of existing theory.

**Analysis of Data**

Data analyzing techniques are: AHP (Analytical Hierarchy Process) for obtaining the priority of dimensions and components of dimensions on corporate governance (for level 1 and 2 model) and TOPSIS (Technique for Order of Preference by Similarity to Ideal Solution) for determining the priority of indices of components (level 3 model).

For AHP the researcher used software Expert Choice and for TOPSIS employed software EXCEL 2010. Furthermore for testing the hypotheses additionally the researcher used regression and t-test. For this purpose the researcher employed software AMOS and SPSS.

**Validity and Reliability**

There are certain criteria to judge the quality of a research. To ensure the quality of a research, the researchers often depends on the validity and reliability measurements of a study. Several tactics are used in this study not only just in the beginning but throughout different phases of the research.

**Validity:** Bryman and Bell, (2007), states, in business research, validity represent the integrity of the conclusions that are formulated from a research.\textsuperscript{102}


Furthermore, Yin asserts the use of four tests that are commonly used in different phases of the research by business researchers to ensure the quality of the research and are relevant to case studies. These are explained below in relation to our case.

**Construct Validity:** is the first test and occurs in data collection and composition phase. In this test the researchers need to establish operational measures for the concepts that have been studied. To cover this requirement first, we studied the theories separately that has been used in this study. Then we developed some relevant common criteria based on which we will test the links between the theories and the collected data. As a tactic multiple source of evidence is used in the data collection. For instance we have gone through articles from different sources and collected both primary and secondary data.

**Internal validity:** is the second test that rises in the data analysis phase of the research. It is concerned for causal or explanatory case studies and not for exploratory studies. As our thesis is exploratory in nature we were not so concerned about internal validity of the research. However, we have linked our empirical study on LEGO in relation to our theoretical frame that ensures the internal validity of our research.

**External validity:** is the third test and is related to research design. It deals with degree to which the findings of the case study can be generalized. It is difficult to ensure external validity in qualitative research, especially for case study. To deal with this barrier we have supported our study with a strong theoretical base.

**Reliability:** is the last test required in data collection phase. Reliability measures the extent to which data collection techniques or analysis procedures will deliver the same results no matter how many times it is.\(^\text{103}\) The objective of reliability in a

case study is to repeat the same study again and check whether findings and conclusions are same. Yet, the aim of reliability is not to replicate the same study again but to reduce the errors and biasness in a study.

To ensure that data was reliable, we made sure that all data that was used in this study was gotten from the official published audited financial statements of Indian banks. These accounts according to the various audit reports were prepared in accordance with International Accounting Standards (IAS) and all the audited reports pointed to the fact that accounts presented a true and fair view of Indian banks.