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CORPORATE GOVERNANCE STANDARDS AND PRACTICES IN INDIAN BANKING INDUSTRY – A COMPARATIVE RESEARCH ANALYSIS

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Abstract

Banks are a critical component of any economy. The importance of banks to national economies is underscored by the fact that banking is virtually a universally regulated industry and that banks are brought under government safety nets. It is of crucial importance therefore that banks have strong corporate governance. SEBI introduced a new Clause 49 in the Listing Agreement in the year 2000, specifying the principles of corporate governance to be followed by the listed companies. Thereafter, SEBI incorporated various committees' recommendations in Clause 49 and revised it seven times within a period of 2000-2005. The latest and revised Clause 49 of Listing Agreement was introduced on 29th October 2004. The statutory and non-mandatory requirements are stipulated by the revised clause 49 of the (SEBI) Listing Agreement and also the provisions required by the Companies Act, 1956. Under the above circumstances, the present study entitled ***"CORPORATE GOVERNANCE STANDARDS AND PRACTICES IN INDIAN BANKING INDUSTRY – A COMPARATIVE RESEARCH ANALYSIS"*** *has been taken up to assess the structure and processes of corporate governance followed by select banks in India and their effectiveness in terms of substance and quality of reporting of governance practices in annual reports for the year 2005-2006. It also evaluates the state of compliance of key governance parameters in the selected banks and offers suggestions to achieve better governance standards than ever before.*

Introduction

Change is the order of the day. Advancement in science and technology, globalization and liberalization have changed the ways of doing business. The term 'governance' has been defined by the Organisation for Economic Cooperation and Development (OECD) as "the use of political authority and exercise of control in a society in relation to the management of its resources for social and economic development". With rapid change in the business environment and emergence of new regulations by world bodies like EEC, WTO, OECD, World Bank, etc., the concept of corporate governance is gaining momentum. It is a concept rather than an instrument. It focuses on appropriate management and control structure of a company, power relations between owners, the board of directors, management and the stakeholders.

There has been a great deal of attention given recently to the issue of corporate governance in various national and international fora. In particular, the OECD has issued a set of corporate governance standards and guidelines to help governments "in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance."

Corporate Governance in Relation to Commercial Banks

From a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management and how they affect banks.

- set corporate objectives (including generating economic returns to owners);
- run the day-to-day operations of the business;
- consider the interests of recognised stakeholders;
- align corporate activities and behaviour with the expectation that banks will operate in a safe and sound manner and in compliance with applicable laws and regulations and
- protect the interests of depositors.

Recent sound practice papers issued by the Basel Committee underscore the need for banks to evolve strategies for their operation and establish accountability for executing these strategies. There are four important forms of oversight that should be included in the organizational structure of any bank in order to ensure appropriate checks and balances. They are 1) oversight by the board of directors or supervisory board; 2) oversight by individuals not involved in the day-to-day running of the various business areas; 3) direct line supervision of different business areas and 4) independent risk management and audit functions. In addition, it is important that key personnel are fit and proper for their jobs. Government ownership of a bank has the potential to alter the strategies and objectives of the bank as well as the internal structure of governance. Consequently, the general principles of sound corporate governance are also beneficial to government-owned banks.

Rationale for the Study

SEBI introduced a new Clause 49 in the Listing Agreement in the year 2000, specifying the principles of corporate governance to be followed by the listed companies. Thereafter, SEBI incorporated various committees' recommendations in Clause 49 and revised it seven times within a period of 2000-2005. The latest and revised Clause 49 of Listing Agreement was introduced on 29th October 2004. The statutory and non-mandatory requirements are stipulated by the revised clause 49 of the (SEBI) Listing Agreement and also the provisions required by the Companies Act, 1956. The revised Clause 49 shall apply to all the listed companies in accordance with the schedule of implementation given. However, for other listed entities which are not companies, but body corporate (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities. Thus, the present study entitled **"CORPORATE GOVERNANCE STANDARDS AND PRACTICES IN INDIAN BANKING INDUSTRY – A COMPARATIVE RESEARCH ANALYSIS"** has been taken up to evaluate the state of compliance with key governance parameters in the selected banks in terms of substance and quality of reporting of governance practices in annual reports for the year 2005-2006.

Objectives of the Study

Following are the objectives of the present study:

1. To understand the concept of corporate governance in general and in relation to banks in particular.
2. To compare and analyse the corporate governance practices as followed in SBI and ICICI Bank
3. To develop criteria for evaluation of corporate governance standards for banking industry.
4. To evaluate the corporate governance standards and practices, based on the criteria followed in SBI and ICICI Bank

Research Methodology

Being an empirical analysis, this study requires both primary and secondary data. The primary data needed would be the information from bank officials on sound corporate governance practices. The secondary data needed would be the background material related to the concept of corporate governance in general and in relation to banks in particular and corporate governance structures and processes in select banks in particular and banking industry in general. The secondary data were collected from the annual reports, corporate governance reports and other reports of respective banks, websites, reports of RBI and journals relating to banking sector.

The sample for this study comprises of two renowned banks, viz.,

1. State Bank of India, the biggest public sector bank (first largest)
2. ICICI Bank, the biggest private sector bank (second largest)

Both are listed on the BSE Sensex and NSE Nifty. These banks have been selected on the grounds that their scrips dominate and influence the stock market movement of the country. They also represent mainly Indian Banking Industry in India with major market share in this sector. This study relied on the published annual reports for the year 2005-06 of these banks. The reason for selecting the said period is that the latest and revised Clause 49 of Listing Agreement was introduced on 29th October 2004.

This study analyses the compiled data and information in three parts, viz.,

1. Analysis of shareholding pattern and Board issues in the select banks
2. Developing criteria for governance standards for banking industry
3. Evaluating the governance standards and practices in select banks.

The study uses percentage analysis and descriptive analysis. For evaluation of governance standard, scaling technique was used.

Results and Discussions

1. Analysis of Shareholding Pattern and Board Issues in the Select Banks

1.1 Analysis of Shareholding Pattern

Share holding pattern of SBI and ICICI Bank for the year 2005-06 is shown in **Table -1.** Following are the observations made :

- The major shares of SBI are held by Reserve Bank of India (59.73%) as it is a government owned bank and it is patronised by the Non-Residents (19.83%) (including Foreign Institutional Investors, OCBs and GDRs). But ICICI Bank's (being a private sector bank) major shares are held by Non-Residents (47.06%), (Foreign Institutional Investors and OCBs), followed by Deutsche Bank Trust Company Americas (Depositary for ADS holders (26.81%).
- 6.52% of SBI's shares are held by Financial Institutions (including insurance companies/ banks) and 12.94% of ICICI Bank's shares are held by Banks & Financial Institutions (0.36%) and Insurance Companies (12.58).
- Mutual funds hold 5.07% shares of SBI and 2.13% that of ICICI Bank. Domestic Companies/Trusts hold 2.33% shares of SBI and Bodies Corporate hold 4.64% shares of ICICI Bank.
- Only negligible portion of shares (i.e., 6.52% of SBI and 6.41% of ICICI Bank) are held by resident Indians in spite of the equity cult and the Initial Public Offers made by these banks.
- Management and control of operations of SBI and ICICI Bank are delegated to the senior management team under the governance of the Board.

Further, it is found by analysis that besides Reserve Bank of India as a major shareholder, financial institutions and insurance companies figure in the top 10 shareholders of SBI. In the case of ICICI Bank Ltd., besides Deutsche Bank Trust Company Americas, LIC and other financial institutions and Foreign Institutional Investors figure in the top 10 shareholders.

1.2 Board Issues

The Board structure, strength and size of SBI and ICICI Bank Ltd., have been shown in **Table - 2** and the following points are observed.

- Total number of directors in the board is more in ICICI Bank (17) compared to SBI (14) in 2005-06.
- The percentage of Executive Directors in ICICI Bank is more (35%) compared to SBI (21%) in the year 2005-06.
- The percentage of Non-Executive Directors in SBI is more (79%) compared to ICICI Bank (65%) in the year 2005-06.
- The percentage of Independent Directors in ICICI Bank is more (59%) compared to SBI (29%) in the year 2005-06.
- The revised provision of Clause 49 of the Listing Agreement has the minimum requirement of 50% (now 33%) of independent directors while the Chairman is an Executive Director, during 2005-06. This provision has been met adequately in the case of SBI. But in the case of ICICI Bank, the Chairman is a Non Executive Director (i.,e, Independent Director) and it also has 59% independent directors.

Directors' attendance in the Board Meetings of SBI and ICICI Bank Ltd. in the year 2005-06 is shown in the **Table - 3**. The following points are observed:

- The Board of SBI met 10 times in the year and that of ICICI Bank Ltd., met only 6 times.
- It is not clear from the disclosed information as to how many times the full board in these banks met in 2005-06.
- The record reveals that one Non-Executive Director (NED) of SBI did not attend even a single board meeting in the period 2005-06. Only 3 out of 10 NEDs and 1 out of 3 Executive Directors (EDs), including Chairman, did attend all the 10 board meetings.
- The statistics of directors' attendance in the ICICI Bank's Board is somewhat better than SBI. Two directors (including the Chairman) out of 12 and all the 5 Executive Directors have attended all the six board meetings.
- The directors' attendance in the SBI Annual General Meeting is also not encouraging. Only 11 out of 14 directors attended the last AGM. On the contrary, 15 out of 17 directors ensured their presence in the last AGM of ICICI Bank and this confirms the accountability of the board members towards shareholders and other stakeholders.
- Although the provisions of revised Clause 49 of the Listing Agreement and Section 285 of the Companies Act regarding minimum number of Board meetings to be held in a year, have been met by both the banks, the longest gap between any two board meetings in ICICI was for a period of 3 months and 7 days, which is a clear violation of Clause 49 of the Companies Act, allowing a maximum gap of 3 months only.
- The SBI conducted all the 10 board meetings without violating the above clause.

2. Developing Criteria for Evaluation

After analyzing the governance structures, processes and disclosures made on corporate governance, this study has developed its own model. This model was applied for evaluation of the standard and quality of corporate governance practised in these two banks. It considered all the relevant conditions and requirements of corporate governance stipulated by the Clause 49 of the Listing Agreement of SEBI, provisions of the Companies Act, 1956, Banking Regulations Act, 1949 and SBI Act.

A set of criteria have been developed, based on the point value system to ascertain how far these banks conform to governance standards, along with their due weightage according to their importance. The key governance parameters and the criteria for evaluation of governance standards have been selected on a 100-point scale as shown in **Table – 4.**

3. Evaluation of Corporate Governance Standards and Practices in Select Banks

After determining the total score based on these parameters, both banks and industry have been evaluated on a five-point scale as stated in **Table -5**. Accordingly, each of these two banks has been awarded points on key parameters. Based on the evaluation, **Table–6** gives the result that the governance standards and practices in both the banks are "very good". SBI secured 81 points and ICICI Bank secured 83 points. It also reveals that the country's banking industry represented by these two major listed banks has an overall score of 82 points, thus showing "very good" performance in maintaining the standards and attaining the quality of governance practices.

Further Findings

- The SBI's philosophy states that the bank is committed to the best practices in the area of corporate governance and by means of which it can maintain a high level of business ethics and optimize the value for all its stakeholders. Its commitment to Corporate Governance is evidenced through its governance objectives such as transparency, integrity, accountability for performance, corporate leadership and compliance report by the Chairman.
- ICICI Bank Ltd. has established a tradition of best practices in Corporate Governance. The Corporate Governance Framework is based on an effective independent board, the separation of board's supervisory role from executive management and the constitution of committees. Its commitment to Corporate Governance is evidenced through the existence of broad based board, whistle blower policy, and prevention of insider trading, code of business conduct and ethics and CEO/CFO certification.
- Chairman and CEO are different persons in both SBI and ICICI Bank as prescribed by the good governance principle.
- In ICICI Bank, there are four Joint Managing Directors, besides one Managing Director. But in SBI, there are only two Managing Directors.
- SBI and ICICI Bank did not disclose their policy in regard to age limit of their directors. The tenure of service of directors in SBI has been disclosed as three years and if re-elected, for a further period of 3 years. Brief resumes of all the Non-Executive Directors are furnished in the SBI's Annual Report and the age of directors ranges from 42 years to 82 years.
- In ICICI Bank's Annual Report, no information is disclosed as to the tenure of service as well as the reappointment in case of re-election.
- There is no age limit for directors in both the banks.
- The disclosure of information about Non-Executive Directors (i.e., Independent Directors) and the selection criteria for its board members (by way of resumes of NEDs) are disclosed in SBI's annual report. ICICI Bank did not follow this principle and did not disclose in its annual report any information in this regard.

- Both the banks have not defined positions like 'independent director', 'financial expert' and their selection criteria.
- The annual reports of both the banks reveal that they have not disclosed any information about post-board meeting followup system and compliance in their annual reports.
- The analysis reveals that both SBI and ICICI Bank did not appoint a lead Independent Director and hence did not disclose any information in this regard in their annual reports.
- ICICI Bank has followed the norms and disclosed that none of their directors were members in more than 10 committees or the chairman of more than 5 committees individually across all companies. The report also disclosed the committee positions occupied by individual directors in other companies.
- In SBI, Chairman is holding 18 positions as chairman, one director is holding 26 positions of chairman and one director is holding 11 positions of directors. This is a clear violation of norms.
- ICICI Bank disclosed the remuneration policy in its corporate governance report in line with SEBI's requirements. A detailed breakup of remuneration as to basic performance bonus, allowances and perquisites, contribution to provident fund, contribution to superannuation fund, stock options for all the managing directors are given.
- SBI has not provided any details about the remuneration policy but it stated in its annual report that minimum requirement of clause 49 as to the composition of board, composition and quorum of the Audit Committee, Non-Executive Directors' compensation, appointment, reappointment of the statutory auditors and fixation of their fees are not binding on the banks because separate provision in the SBI Act, SBI General Regulations and RBI guidelines deal with the same.
- The annual reports of both SBI and ICICI Bank reveal that these banks furnished information about the adoption of the code of conduct.
- There is also an affirmation of compliance with the code of conduct by the directors and senior executives through Managing Director/CEO's declaration in the annual report of ICICI Bank and through the Chairman's declaration in the annual report of SBI.
- Both the banks have not disclosed their policies regarding IT, EHSM, HRD, CSR and IR in the annual report.

Suggestions

This micro study reveals that there is abundant scope for bringing the level of corporate governance standards and quality of disclosures to be practised in these banks to "Excellent Level". Hence the following suggestions.

1. Shareholdings of executive directors of ICICI should be disclosed.
2. Tenure and age limit of all directors (executive, non-executive as well as independent) should be disclosed by ICICI Bank.
3. The selection criteria of board of directors including independent directors should be disclosed by ICICI Bank.
4. Details of special resolutions passed in the last three AGMs/EGMs should be disclosed by SBI.
5. Details of resolution passed last year through postal ballot including the name of conducting official and voting procedures should be disclosed by SBI.

6. Post-board meeting follow up system and compliance of the board procedure should be disclosed by both SBI and ICICI Bank.
7. Appointment of Lead Independent Director in the board and information about the same should be disclosed by both SBI and ICICI.
8. The mechanism to evaluate non-executive directors should be disclosed by both SBI and ICICI Bank.
9. Information on the training of board members should be disclosed by both SBI and ICICI Bank.
10. Publishing the reports of meetings of the statutory board committees should be undertaken by both SBI and ICICI Bank.

Direction for Future Research

The present study has considered only two banks, viz., SBI,(from public sector) and ICICI (from private sector). Hence future studies can focus on analyzing the relationship between the board and performance relationship for a group of banks in a particular sector.

Conclusion

From the above study, it is established that the corporate governance standards, practices and quality of disclosures by the Indian Banking Industry is "very good" and it is time for it to achieve "excellent level" to compete in the global scenario. Thus, following the suggestions given above in the critical areas of corporate governance, would help the banks to achieve better governance standards than ever before.

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Table - 1

Share Holding Pattern of SBI and ICICI Bank Ltd. for the year 2005-2006

Categories	SBI(%)	ICICI Bank Ltd.(%)
Total Number of Shares	52,62,98,878	88,98,23,901
(A) Shareholding of Promoter Reserve Bank of India	59.73%	-
(B) Shareholding of Non-Promoters **1) Institutions** a)Non-residents (FIIs/OCBs/ NRIs/ GDRs)	19.83%	47.06%
b) Deutsche Bank Trust Company Americas (Depositary for ADS holders)		26.81%
c) Financial Institutions including Insurance Companies/ Banks	6.52%	12.94%
Banks & Financial Institutions	-	(0.36%)
Insurance Companies	-	(12.58%)
d) Mutual Funds/Government Companies/UTI	5.07%	2.13%
e) Domestic Companies/Trusts	2.33%	-
2) Non-Institutions (a) Bodies Corporate	-	4.64%
(b) Others including Resident individuals	6.52%	6.41%
Total	**100.00%**	**100.00%**

Source: Compiled from Annual Reports of SBI and ICICI Bank Ltd., 2005-06

Table – 2

Board Structure, Strength and Size of SBI and ICICI Bank Ltd. for the year 2005-06

Particulars	SBI	ICICI Bank Ltd.
1. Total Number of Directors	**14**	**17**
Number of Executive Directors (Whole time)		
Chairman	1	1
Managing Director(s)	2	1 (also CEO)
Others (Joint MD, Deputy MD)	-	4
Number of Non-Executive Directors(NEDs)		
Independent Directors (Elected by shareholders)	4	10
Nominees from		
Central Government	3	1
GOI Officials	1	-
RBI	1	
Representatives (Workmen and Non-workmen staff)	2	
2. Total Number and Percentage of		
Executive Directors (EDs)	3 (21%)	6 (35%)
Non-Executive Directors (NEDs)	11 (79%)	11 (65%)
Independent Directors (IDs)	4 (29%)	10 (59%)

Table – 3
Directors' Attendance in the Board Meetings of SBI and ICICI Bank Ltd., during 2005-06

Number of Board Meetings	SBI		Number of Board Meetings	ICICI Bank	
	NEDs	EDs (+C)		IDs (+C)	Whole time Directors (MDs)
0	1	-	0	-	-
1	-	-	1	1	-
2	-	-	2	2	-
3	1	-	3	4	-
4	1	-	4	1	-
5	-	-	5	2	-
6	1	-	6	2(+C)	5(+MD)
7	2	1			
8	1	-			
9	1	1(C)			
10	3	1			
Total	**11**	**3**	**Total**	**12**	**5**
Last AGM	**8**	**3**	**Last AGM**	**10**	**5**

Source : Annual Reports 2005-06. Results computed.
+C/C = Including Chairman/Chairman;
+MD – Including Managing Director ; AGM – Annual General Meeting

Table - 4

Criteria for Evaluation of Governance Standards for the year 2005-06

Governance Parameters	Point/ Score Assigned
1. Statement of Bank's philosophy on code of governance	**2**
2. Structure and strength of the board	**2**
3. Chairman and CEO Duality: a) Promoter Executive Chairman-cum-MD/CEO (1) b) Non-Promoter Executive Chairman cum MD/CEO (2) c) Promoter Non-Executive Chairman (3) d) Non-Promoter Non-Executive Chairman (4) e) Non-Executive Independent Chairman (5)	**5** **(Maximum)**
4. Disclosure of tenure and age limit of directors	**2**
5. Disclosure of a) Definition of Independent Director	 **1**
b) Definition of Financial Expert	**1**
c) Selection criteria of Board of Directors including IDs	**1**
6. Post-board meeting follow up system and compliance of board procedure	**2**
7. Appointment of Lead Independent Director	**2**
8. Disclosure of other provisions as to the Boards and Committees	**1**
9. Disclosure of : a) Remuneration of policy	 **1**
b) Remuneration of Directors	**1**
10. Code of conduct a) Information on code of conduct	 **1**
b) Affirmation of compliance	**1**
11. Board Committees and its functioning A) Executive Committee of Central Board	**(25)** **1**
B) Audit Committee	**4**
C) Board Governance & Remuneration/Compensation Committee	**3**
D) Credit Committee	**2**
E) Fraud Monitoring Committee	**3**
F) Risk Management Committee	**3**
G) Share Transfer & Shareholders'/Investors' Grievance Committee	**2**
H) Asset Liability Management Committee	**3**
I) Customer Service Committee	**2**
J) Technology Committee	**2**
12. Disclosure and Transparency: a) Significant related party transactions having potential conflicts with the interest of the bank b) Non-compliance related to capital market matters during last three years. c) Accounting treatment d) Board disclosure – Risk Management: i) Information to the board on risk management ii) Publishing of risk management report e) Management Discussion and Analysis f) Shareholders' information: i) Appointment of new director/ reappointment of retiring directors ii) Quarterly results & Presentation iii) Share transfers iv) Directors Responsibility Statement g) Shareholders rights h) Audit qualification i) Training of board members j) Evaluation of non-executive directors k) Whistle blower policy	 **2** **2** **2** **2** **1** **2** **1** **1** **1** **1** **2** **2** **2** **2** **2**

13. General Body Meetings: a) Location & time of general meetings held in last three years b) Details of special resolutions passed in the last three AGMs c) Details of resolutions passed last year through postal ballot including the name of conducting official and voting procedure	 **1** **1** **1**
14. Means of communication & general shareholder information	**2**
15. CEO/CFO Certification	**2**
16. Compliance of Corporate Governance and Auditor's Certificate a) Clean certificate from auditors (10) b) Qualified certificate from auditors (5)	**10** **(Maximum)**
17. Disclosure of Stakeholders' interests: a) Human Resources Development initiatives (HRD) b) Corporate Social Responsibility (CSR) c) Industrial Relations (IR) d) Disclosure of policies on EHS, HRD,CSR & IR	**(10)** **3** **3** **2** **2**
Total	**100**

Table – 5
Grading on Five-Point Scale

Score Range	Rank
86-100	Excellent
71-85	Very Good
56-70	Good
41-55	Average
Below 41	Poor

Table – 6
Scores secured by SBI and ICICI Bank Ltd.

SBI 's Score	ICICI Bank's Score	Indian Banking Average Score
81	83	82