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Internal Corporate Governance and its Effective Implementation in India: A Survey

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ABSTRACT

For the better management of any organization, internal corporate governance plays a key role. The proposed research work provides a survey of Indian banking sector and also the internal corporate governance approach to be followed in the same. The purpose of the study is to examine the conceptual framework of internal governance practices prevailing in the banking sector in India and their adoption in different banks. The objective of the study is to examine the awareness level of the bank officials about the internal governance system in order to identify the factors influencing the procedures & practices of internal corporate governance in the banking sector, the impact of internal corporate governance within bank elements; to deduce the recommendations towards the current policy measures, in order to slender the differences between strategic planning and implementation of internal governance practices. The research has been conducted with the senior management and subordinate employees of public and private banks in Punjab with a total sample size of 400and 30 respectively in order to determine the level of awareness of Internal corporate governance Practices within their respective banks. Both exploratory and descriptive research has been followed by the researcher in the research process. In the present research various factors were found affecting the internal corporate governance of the banks and these are accounting/auditing standards, board structure and responsibilities, transparency, accountability, discipline, employee's organizational behavior and social awareness. The study also provides the practical knowledge about the contribution of internal and external audit committee for providing the methods of activation of internal corporate governance practices. The proposed study recommends that efficient internal corporate governance can be developed by implementing internal corporate governance practices and thus to improve the financial efficiency of banks. Study allows the board of directors to approve the calendar of corporate events within the bank. Participation of Non-Executive directors in board increases board efficiency and protects the rights of shareholders. Quarterly board meetings and semi-annual audit committee meetings should be organized to better handle corporate affairs, thereby increasing bank's efficiency. Also it must be ensured that audits must be conducted by independent auditors by following global auditing standards.

Keywords: Internal corporate governance, Internal corporate governance Practices, Indian banking sector, Basel Committee.

1. PROLOGUE

Adoption of Internal Corporate Governance within organization ensures that they are directed and controlled and failure of internal corporate governance, can lead to several problems. Stakeholders within the organization play different roles to ensure corporate governance, however in order to ensure internal corporate governance, it is important that Board of directors are able to enforce the laws properly (Leeladhar, 2006). Further, with advent of globalization, a competitive environment is created which raises important issues regarding corporate governance regulation for banking institutes. It is because of these factors that Basel Committee on Banking Supervision has laid down several areas which should be adopted within the organization. Although a lot of research has been done on the concept of corporate governance it lacks in-depth analysis about the internal corporate governance practices adopted within organizations especially within the banking sector.

Further, the research has also pointed out about the impact of lack of corporate governance and more specifically, internal corporate governance in order to mitigate the issues related to corporate governance on the very fundamental level within the banks itself, the internal variables of corporate governance need to be assessed which is related to internal stakeholders of the bank, i.e., employees. The issues of internal corporate governance are varied which includes employees' welfare and benefits to working conditions. The present study is thus focused on examining the conceptual framework of internal governance practices prevailing in the banking sector in India because there is no denial of the fact that the banks being the custodian of money of their depositors and under the government dominance discharge a crucial role of intermediary between those who have surplus funds and those who need them.

The motivation for the study is to analyze the gap between policy implementers and policy framers, who have their own agendas which may not coincide with policy implementer's interest as how to implement good governance procedures at branch levels of every bank remains elusive and it all depends upon implementer's viewpoint which is also commonly termed as agency problem. The need for conducting such study arises when the literature concerning the issue of corporate governance in banks were studied providing guidelines, rules and frameworks but a little stress was given at ground level implementers that is subject area of internal governance system at individual levels in banks and to study the reasons for gap in the regulators concepts and its execution by implementers. To suggest the ways to narrow the gap to enhance overall governance practices in banks.

Purpose of the Study

The present study is done in context to banks commitment towards internal corporate governance and its effective implementation.

2. METHODOLOGY

In the study the researcher has organized the research by focusing on the research process to draw conclusions in the real world. The research has been conducted in Private and Public sector banks of Punjab. The targeted population has covered senior management and junior management with a total sample size of 400. The researcher has followed both exploratory and descriptive research in the research process. In order to attain the objective of the research, a survey has been conducted using questionnaires among junior level employees and personal interviews with senior level employees providing with both qualitative and quantitative data. The researcher has adopted a deductive approach since the entire study has been done using pre-existing models. The entire research conducted is in accordance with all the ethical codes.

3. IMPACT OF INTERNAL CORPORATE GOVERNANCE IN BANKS

As far as impact of these policies is concerned, all the participants unanimously established that presence of internal corporate governance creates an environment where banks are sustainable for a long period of time. A senior bank employee Mr. X from HDFC explained *"An orderly and transparent business environment gives confidence to all kinds of investors. Over the period of time due to the presence of these norms, Indian banks have sustained many crisis situations. In spite of the overall global slowdown, breakdown of big banks like Lehman brothers etc.; our banks are insulated to a reasonable extent. In the presence of transparency, accountability and enforceability investors are bound to be attracted to these avenues never making them out of business."* In fact one of the new employees Mr. O from ICICI retorted *"The presence of the new reforms have led to change in demand and supply of their stocks, I myself, have invested in shares of my own banks considering a probability of positive returns."*The change in internal policies have also created a trickledown effect from the point of view of customers, Mr. G from HDFC said *"Due to changing policies we find its effect on customer satisfaction too, a lot of our in house surveys show that customers have also started showing greater confidence in us"* Therefore, the presence of internal corporate governance policies has better perception about both longevity and sustainability for the banks.

When enquired about the shuffling in the board of directors, all of the bank participants accepted that there has been a change in their board of directors in recent times considering the guidelines of RBI. There has been an increase in number of non-Executive directors up to almost half of total proportion bringing a varied outlook, fresh talent and out of the box strategies for both day today activities and future planning for the banks. Most of employees preferred them in the advisory role rather than supervisory role and were not confident if their presence individually affects the bank performance. Most the participants were anxious to see if the RBI initiative allowing private banks to pay a huge compensation to non-executive directors bear fruits. It was noted that majority of the respondents said a yes to whether CEO and chairman were same, however most of the public banks employees did not think it played a major role whereas private bank employees agreed to positive effects of CEO, duality. This result is confirmed by the study of Sarkar & Sarkar, (2016) who emphasized on the role of CEO in private banks and revealed that longer tenure of CEO proves to be even better in terms of financial performance and asset quality and performance is generally better in the latter years of tenure as compared to initial years.

Most of the banks in consideration have varied ownership structure and respondents did not seem to consider it a major aspect, this could be due to the fact that government regulations are fully in place to avoid monopolistic tendencies. More than 50% of the ownership of the public sector banks lies with the Government of India whereas the share of promoters' ownership has wide range of 20% to about 40%. One of the senior employees of HDFC bank said *"Apart from our promoters, maximum shareholding in our bank is through Foreign Institutional Investment, the ownership issue is no longer relevant after liberalization."* To sum up all initiatives of internal corporate governance bring about visible changes in terms of profitability, lower level of non-performing assets, improved return on assets, changes in share prices and better investors; and more so in private banks as compared to public banks. The effects of these ethics on public banks might be mitigated due to the sheer volume and diversified nature of their customers whereas private banks cater to limited customers from a certain economic strata bringing about the difference prior and post adoption of the internal governance policies.

4. DATA ANALYSIS AND INTERPRETATION

Purported to understand the internal corporate governance strategies within private and public banks and elements influencing their performance, primary data is collected and sampled from public and private sector banks of Punjab. This study therefore, analyses the varied responses collected from the survey as well as personal interviews in order to deduce findings about the performance of internal corporate governance practices in actual implementation mode. The results obtained from the various statistical techniques have been interpreted to answer the main research questions. The entire segment comprises of analysis of the demographic and general background of the respondents along with testing of the hypotheses to establish the interrelationship between banks' commitment towards internal corporate governance, strategies and policies formulated; their implementation and their overall impact on the banks' performance.

5. DESCRIPTIVE INTERPRETATIONS

A. Demographic Profile

Demographic profile helps to understand the characteristic of sample population Hussain, (2014). Assessment of the socio-demographic information regarding the respondents surveyed enabled the researcher to understand the general age group composition of the banks, educational qualification of the employees and the total experience in terms of years of the employees. These very factors are necessary to understand the attitude of the banks towards implementation of internal corporate governance strategies. Therefore, to achieve the purpose, frequency test has been conducted using the SPSS software.

Table 1
Descriptive Results of the Respondents Surveyed

	Frequency	*Percentage*
Age		
20-25 years	17	4.3
26-30 years	123	30.8
31-35 Years	164	41.0
36-40 years	36	9.0
Above 40 years	60	15.0
Sex		
Male	242	60.5
Female	158	39.5
Education Qualification		
Diploma	89	22.3
Graduate	167	41.8
Post Graduate	101	25.3
Doctorate	43	10.8

	Work experience	
0-5 years	79	19.8
6-10 years	127	31.8
11-15 years	118	29.5
Above 15 years	76	19.0
	Experience with the Bank	
0-5 years	191	47.8
6-10 years	61	15.3
11-15 years	93	23.3
Above 15 years	55	13.8
	Years passed since inception of Bank	
0-5 years	147	36.8
6-10 years	140	35.0
11-15 years	43	10.8
Above 15 years	70	17.5

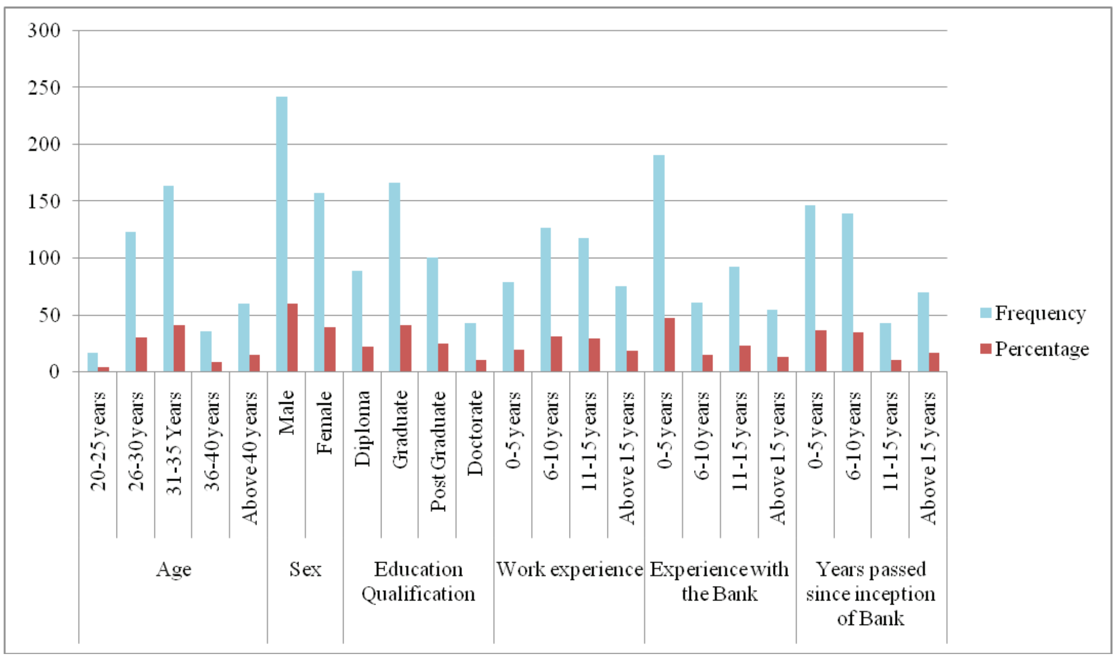

Figure 1: Descriptive Results of the Respondents Surveyed

Most of the employees belong to 26-35 years of age, and 41.8% out of the total have graduate degrees. There lies unequal gender distribution among the employees surveyed, with males (60.5%) surpassing that of females (39.5%). Survey results further projects that majority of employees (31.8%) have a working experience of 6-10 years in the same profession, implying that they belonged to middle management level, with nearly 47.8% serving the concerned banks for not more than 5 years. This implies that majority are relatively new, however, 23% of them were serving for 11-15 years, followed by fewer still 13.8%, who were having more than 15 years of experience. Therefore all these diversely experienced population helped the researcher in informing the commitment of the banks towards internal corporate governance strategies and the factors influencing the effective implementation of the same.

B. General Background of Respondents

Table 2
General Background Results of the Respondents Surveyed

Aware about the term Governance		
Yes	170	42.5
No	107	26.8
Somewhat	123	30.8
Employees in the banks adhere to the norms of RBI		
Yes	166	41.5
No	116	29.0
Can't say	118	29.5
Bank's Chairman is also the CEO		
Yes	117	29.3
No	228	57.0
Don't Know	55	13.8
Majority Owners of Bank		
Insiders	124	31.0
External owners	143	35.8
Both Insiders and External Owners	67	16.8
Don't Know	66	16.5
Nature of the company		
Public	98	24.5
Private	150	37.5
Listed	44	11.0
State owned	108	27.0
Who evaluates the Board?		
Board Members	130	32.5
Independent Party	118	29.5
External Auditor	87	21.8
Others	65	16.3
Review Undertaken		
Annually	170	42.5
Semi-annually	186	46.5
Others	44	11.0

With nearly 42.5% of the employees being aware of the term governance and (41.5%) employees stating to adhere to the norms of RBI, it is inferred that not much significant however majority of the surveyed banks has informed and knowledgeable employees, adhering to CG practices. Through the employee's survey it was analyzed that majority owners of the bank are the external owners. Most of the employees (46.5%) stated that bank review has been undertaken semi-annually.

Similar study was conducted by (Panchasara 2012), according to which most of the employees surveyed, serve in the private banks and adhere to the norms of RBI. But majority of employees are unaware about the term internal corporate governance and its practicality in the banks and other financial institutions.

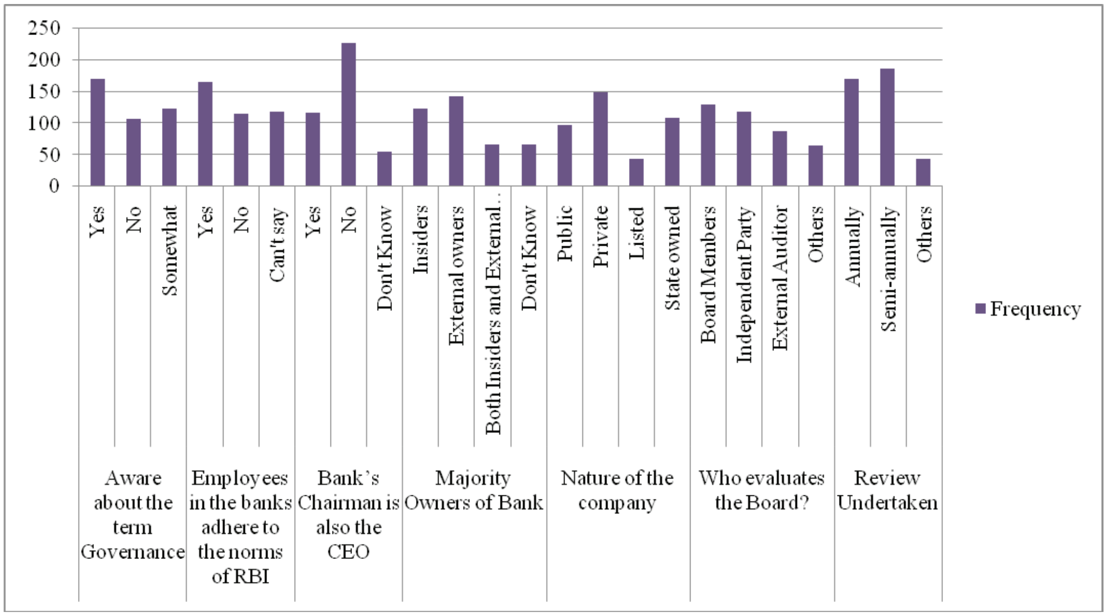

Figure 2: General Background Results of the Respondents Surveyed

6. INFERENTIAL INTERPRETATION

A. Bank's Commitment Towards Internal Corporate Governance & Effective Implementation

Hypothesis: There lies a positive inter-relationship between bank's commitment towards internal corporate governance and its effective implementation.

The dependent variables in this hypothesis is commitment of organization towards internal corporate governance and the independent variables are various CG practices like, bank disclosures with respect to internal corporate governance policies and procedures, familiarity of board of directors and the senior management with the voluntary code of internal corporate governance, possess designated officer responsible for ensuring compliance with the company's internal corporate governance policies and approval of board of directors to the annual calendar of corporate events.

Correlation analysis: Correlation analysis was performed in order to study strength of relationship between four dimensions identified with commitment of the organization towards internal corporate governance. The value of Pearson Correlation being ±1 means that variables are perfectly correlated i.e. there are perfect synchronization while moving up and down, while −1 means perfect negative correlation and zero refers to absence of any relation or the relation is not linear (Kaiser & Rice 1974). The researcher identified four dimensions, keeping the one with higher correlation value at the top.

The table above constructs correlations project that bank discloses the extent to which it is complying with its internal corporate governance policies and procedures is positively correlated (0.872) to the commitment of organization towards internal corporate governance and value is significant at 0.000. The board of directors and the senior management is familiar with the voluntary code of internal corporate governance is positively correlated (0.823) to the commitment of organization towards internal corporate governance and value is significant at 0.000. Also officer who is responsible for ensuring compliance with

Table 3
Construct Correlation Table of the Identified Four Dimensions

	Pearson Correlation	*Sig. (2-tailed)*
Commitment of the organisation Towards Internal corporate governance	1	
Bank discloses the extent to which it is complying	.872**	0.000
Board of Directors and the senior management in my Bank familiar with the voluntary code	.823**	0.000
Officer responsible for ensuring compliance with internal corporate governance	.804**	0.000
Board of Directors approve the annual calendar	.807**	0.000

internal corporate governance is positively correlated (0.804) to the commitment of organization towards internal corporate governance and value is significant at 0.000.Board of Directors who approve the annual calendar is positively correlated (0.807) to the commitment of organization towards internal corporate governance and value is significant at 0.000. This means that the internal corporate governance in the bank can be affected if the organization is committed towards the same, if the bank discloses the extent to which it is complying, if board of directors and the senior management in bank familiar with the voluntary code of conduct and if Board of Directors approve the annual calendar from time to time.

The above correlation results show that these four dimensions are highly and positively affected by commitment of organization towards internal corporate governance.

Regression analysis: In order to study the effect of individual independent variables on the dependent one, beta coefficient was calculated. The extent to which bank is complying with its internal corporate governance policies and procedures has $\beta = 0.372(p = 0.000)$ which carries the highest weightage for commitment of organization towards internal corporate governance. But board of directors and the senior management in Bank familiar with the voluntary code has $\beta = 0.121(p = 0.000)$, i.e. they are having the lowest weightage, implying the variables exerting less impact on the organizations' commitment towards internal corporate governance. Also the extent to which officer holds his responsibility for ensuring compliance with internal corporate governance has $\beta = 0.298(p = 0.000)$ which carries the high value for commitment of organization towards internal corporate governance. This means that internal corporate governance within the banks is affected if the bank officer holds responsibility by ensuring his compliance. Board of directors approving the annual calendar has $\beta = 0.264(p = 0.000)$ which also carries high value towards internal corporate governance. This means that internal corporate governance within the banks is affected if the board of directors approves the calendar from time to time.

Table 4
Regression coefficient table

	Beta	*T*	*Sig.*
Commitment of the organisation Towards Internal corporate governance			
Bank discloses the extent to which it is complying	0.372	8.680	0.000
Board of Directors and the senior management in my Bank familiar with the voluntary code	0.121	3.008	0.003
Officer responsible for ensuring compliance with internal corporate governance	0.298	11.535	0.000
Board of Directors approve the annual calendar	0.264	9.767	0.000

Analysis of the values of R, R Square and Adjusted R Square of the dependent and independent variables, projected numeric values close to 1, hence establishing the significance of the regression analysis in making predictions. Also, the values of Adjusted R Square of all the dimensions being 0.876, shows that about 87.6% of the surveyed respondents feel that commitment of organization towards internal corporate governance is dependent on the degree to which these dimensions are implemented in bank.

Table 5
Regression Model Summary and ANOVA

Model	*R*	*R square*	*Adjusted R Square*	*F*	*Sig.*	*Cronbach's Alpha*
1	.937[a]	.877	.876	705.389	.000[a]	.907

Further the value of F being 705.389 shows that the variance degree is justified. The Cronbach's Alpha value is 0.907 which signifies that the data is highly reliable. Similar study was conducted by (Bhagat & Bolton 2008), who determined the compliance of internal corporate governance within the financial sector, revealing that about 70% of the companies or organizations complied with the internal corporate governance code.

As per the above results, the null hypothesis was proved and accepted which signifies that "There lies a positive inter-relationship between bank's commitment towards internal corporate governance and its effective implementation".

7. CONCLUSION

Internal governance system is crucial in enabling banks– an important driving entity on an economy and its growth, to resolve transmission of problems by safeguarding the interest of its stakeholders in line with the public interest on 'sustainable basis' (BIS, 2015). In conformation with this and following the OECD's internal corporate governance policies, the Basel Committee, Companies Act 1956 & 2013, Securities and Exchange Board of India (SEBI), along with regulators like the Reserve Bank of India and Insurance Regulatory Development Authority (IRDA) laid down certain internal governance policies or regulatory framework for banks. This regulatory framework signifies the role of the board and its members along with risk committees in boosting the banking sectors' risk governance (Bhardwaj & Rao, 2014; Pande & Kaushik, 2013). Similar trend and practices has been observed in the primary analysis– both from the survey and interview, where, the case banks of Punjab have a strong board presence, looking after the internal governance and functioning of the entities. The case banks have shown a positive performance in its commitment towards internal corporate governance and its effective implementation through its disclosure of the practices in its annual report to its stakeholders, the board's familiarity with the voluntary code, ensuring complicity with the internal corporate governance principles and such others. Besides these, presence of independent board, audit and risk committees, appropriate compensation policies, equal employment opportunities, regular meetings among board members and effective communication with both internal and external stakeholders are some further significant areas of regulatory framework followed by the case banks, as devised by the international and national regulatory organizations and acts.

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