Short Communication

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Review of Studies on Corporate Governance in Banking Sector

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INTRODUCTION

The subject of corporate governance has attracted worldwide attention with a series of collapse of high profile companies like Enron, WorldCom, HIH insurance group etc. These failures have shattered the trust of investors worldwide. Some of the scandals which made headlines all around the world were somewhere related to poor corporate governance. These include the $18 billion meltdown of Parmalat Finanziaria, SpA in 2003. Parmalat was among the largest food-based companies in the world .The Parmalat case was one of the biggest scandals to hit Europe and many analysts called this fraud as 'Europe's Enron'. The company's corporate governance structure could not keep up to some of the key existing Italian corporate governance standards of best practice (Melis, 2004). Another classic example of a corporate house collapsing due to poor decision-making and weak corporate governance was the HIH insurance group of Australia. This collapse resulted in a deficiency up to $5.3 billion, "making it the largest corporate failure" in Australia (Lipton, 2003). The collapse of the China Aviation Oil (CAO) also created certain doubts regarding the standard of corporate governance in China. This collapse came at a time when many companies were trying to get internationally-listed and foreign investors were becoming more and more eager to buy them out (Economist Intelligence Unit, 2004).

Poor corporate governance in banks is not a new subject. This inefficiency has been around for a very long time. Since the beginning of Banking in Nigeria in 1914, almost "75 banks were lost primarily because of factors related to poor

corporate governance". The banks did not fail due to lack of customers but due to how they were managed and governed. According to a study by the Nigerian Deposit Insurance Corporation, the main reason for these failures was interference of board members (www.allafrica.com). Moreover, the recent subprime crises highlighted many issues of corporate governance in banks world over. The main issue was that of independent directors. For e.g., UBS, one of the world's largest banks was among the biggest losers in the subprime crisis. It suffered a loss of about $38 billion. As a result, it replaced four of its directors. The departing members included "three outsiders with experience respectively in rail equipment, chemicals and information technology". This shows that banks should definitely use experts on their boards (Economic Times, 2008). According to Zabihollah Rezaee (2005), there may be seven reasons behind these high profile failings. These include lax regulations, overconfident and egoistic management, inappropriate business conduct by top level management, deficiency of alert oversight functions, unproductive audit functions, poor financial disclosures and negligent shareholders. The above frauds adversely affect corporate governance, auditors' creditability and the quality of financial statements.

REVIEW OF LITERATURE

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 of 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 crosses 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.

Turnbull, Shann (2000) This paper provides orientation in understanding the topic of corporate governance to further research, analysis and reform. Limitations in the theories and practices of the dominant Anglo-paradigm are identified. Various viewpoints used in analyzing corporate governance are described with their cultural specificities. To transcend and subsume other approaches and various institutional contexts, information and control theory is shown to provide a way of grounding corporate governance, theories of the firm, and the analysis

of organizations in general in the science of cybernetics.

Becht, Marco; Bolton, Patrick; and Röell, Ailsa A. (2002) believe that corporate governance is concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders. In this survey, they review the theoretical and empirical research on the main mechanisms of corporate control, discuss the main legal and regulatory institutions in different countries, and examine the comparative corporate governance literature. A fundamental dilemma of corporate governance emerges from this overview: large shareholder intervention needs to be regulated to guarantee better small investor protection; but this may increase managerial discretion and scope for abuse.

A significant amount of research has been done on corporate governance practices in the Indian context. 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.

The study by 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.

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 those sectors or entities where there is 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.

Bebchuk, Lucian A.; Cohen, Alma; and Ferrell, Allen (2004) investigate which provisions, among a set of twenty-four governance provisions followed by the Investor Responsibility Research Center (IRRC), are correlated with firm-value and stockholder returns. Based on this analysis, they put forward an entrenchment index based on six provisions - four constitutional provisions that prevent a majority of shareholders from having their way (staggered boards, limits to shareholder bylaw amendments, supermajority requirements for mergers, and supermajority requirements for charter amendments), and two takeover readiness provisions that boards put in place to be ready for a hostile takeover (poison pills and golden parachutes). They find that increases in the level of this index are monotonically associated with economically significant reductions in firm valuation, as measured by Tobin's Q which present suggestive evidence that the entrenching provisions cause lower firm valuation. They also found that firms with higher levels of the entrenchment index were associated with large negative abnormal returns during the 1990-2003 period. Moreover, examining all sub-periods of two or more years within this period, they find that a strategy of buying low entrenchment firms and selling short-high entrenchment firms out-performs the market in most such periods and does not under-perform the market even in a single sub-period. Finally, they find that the provisions in their entrenchment index fully drive the correlation, identified by prior work, that the IRRC provisions in the aggregate have with reduced firm-value and lower stock returns during the 1990s and they do not find any evidence that the other eighteen IRRC provisions were negatively correlated with either firm-value or stock returns during the 1990-2003 period.

Brown, Lawrence D.; and Caylor, Marcus L. (2004) analyzed broad measure of corporate governance, Gov-Score, based on a new dataset provided by Institutional Shareholder Services. Gov-Score is a composite measure of 51 factors encompassing eight corporate governance categories: audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. They relate Gov-Score to operating performance, valuation, and shareholder payout for 2,327 firms, and find that better-governed firms are relatively more profitable, more valuable, and pay out more cash to their shareholders. They also examine which of the eight categories underlying Gov-Score are most highly associated with firm performance and show that good

governance, as measured using executive and director compensation, is the most highly associated with good performance. In contrast, they show that good governance, as measured using charter/bylaws, is most highly associated with bad performance and also examine which of the 51 factors underlying Gov-Score are the most highly associated with firm performance. Some factors representing good governance that are associated with good performance have seldom been examined before (e.g., governance committee meets annually, independence of nominating committee). In contrast, some factors representing good governance that are associated with bad performance have often been examined before (e.g., consulting fees less than audit fees paid to auditors, absence of a staggered board, absence of a poison pill). Gompers, Ishii and Metrick (2003) created G-Index, an oft-used summary measure of corporate governance. G-Index is based on 24 governance factors provided by Investor Responsibility Research Center. These factors are concentrated mostly in one ISS category, charter/bylaws, which they show is less highly associated with good performance than are any of the other seven categories they examine. They document that Gov-Score is better linked to firm performance than is G-Index.

Rajesh Chakrabarti (2005) 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.

Kamal, Yousuf; Pervin, Tahura; and Alam, Samsul (December 1, 2007) Like other developing economies, the banking sector becomes the dominant financial intermediary in the financial system of Bangladesh due to underdeveloped capital markets, limited availability of financial instruments and lack of confidence on financial system. Given the bank's intermediary role in providing stability to the financial system, Bangladesh as well as many emerging economies has implemented policies to develop and restructure the banking sector. An important feature of these policies was to design guidelines for 'best practices' known as, 'corporate governance of banks'. The unique feature of banking industry, which deals with the money of the depositors conveys the inevitability to implement corporate governance in this sector. This paper in early part deals with the concept and evolution of corporate governance in this sector and argued the importance of a broader view of corporate governance, which encapsulates both shareholders and depositors.

The penultimate section examines the corporate governance of banks in Bangladesh in the context of ongoing banking reforms. The final section provides a set of measures for both micro and macro level to strengthen corporate governance in this sector.

Biswas, Pallab Kumar; and Bhuiyan, Md. Hamid Ullah (2008) This paper is an attempt to give a short description of the theoretical literature focusing on different conceptual models of corporate governance and empirical studies relating to whether good corporate governance leads to better firm performance. Majority of the literature has been found to focus on the relationship between shareholders, directors, and management. The findings of these empirical studies are mixed and as a result, it is often difficult for users to draw any firm conclusion on the relationship. On the other hand, studies undertaken considering the overall corporate governance mostly provide evidence of significant relationship between corporate governance and firm performance. However, whether better corporate governance causes higher firm-performance still remains a valid research question for reasons like ambiguity regarding the direction of causality.

Balasubramanian, Bala N.; Black, Bernard S.; and Khanna, Vikramaditya S. (July 2, 2008) provide an overview of Indian corporate governance practices, based primarily on responses to a 2006 survey of 370 Indian public companies. Compliance with legal norms is reasonably high in most areas, but not complete. They identify areas where Indian corporate governance is relatively strong and weak, and areas where regulation might usefully be either relaxed or strengthened. On the whole, Indian corporate governance rules appear appropriate for larger companies, but could use some strengthening in the area of related party transactions, and some relaxation for smaller companies. Executive compensation is low by U.S. standards and is not currently a problem area.

They also examine whether there is a cross-sectional relationship between measures of governance and measures of firm performance and find evidence of a positive relationship for an overall governance index and for an index covering shareholder rights. They find an overall association, which is stronger for more profitable firms and firms with stronger growth opportunities. A sub index for shareholder rights is individually significant, but sub-indices for board structure (board independence and committee structure), disclosure, board procedure, and related party transactions are not significant. The non-results for board structure contrast to other recent studies, and suggest that India's legal requirements are sufficiently strict so that over-compliance does not produce valuation gains.

Afsharipour, Afra, (July 14, 2010) This Article examines India's initial corporate governance reform efforts as well as reforms adopted in the aftermath of

the Satyam scandal. An evaluation of India's corporate governance reforms demonstrates that although extensive reforms have been instituted, there remain significant lapses in implementation and enforcement. Moreover, many of the reforms that have been adopted fail to address fundamental areas of concern such as the relationship between controlling and minority shareholders, the role of promoters, the limited activism of shareholders, including institutional investors, and issues with director independence. This article expresses concerns that these challenges may prevail because they have been shaped by unique political and social forces. These forces include the traditional closed-ownership structures of Indian firms, an ineffective institutional framework to support enforcement efforts, weaknesses in investor access to the courts, and political pressures related to government ownership of certain industries.

Vrajlal K. Sapovadia and Kandarp V. Patel (2010) Governance is system and process of organised entities, whether private or public, whether for profit or not. Governance relates with defining objectives, powers, duties, obligations & disabilities of various stakeholders. Corporates are for profit and they get funds from shareholders. Governments are generally for Sovereign functions and citizens elect the leaders. Therefore their governance differs substantially.

Fan, Steve Z.; and Yu, Linda Q. (August 2011) They develop an index to capture the deviation of a firm's governance structure from the common practice of its home country and show that the Corporate Governance Deviation (CGD) index can distinguish firms that are indifferent under the conventional Equal Weighted Sum (EWS) index. They document a strong impact of the CGD index on firm valuation and provide robust evidence that the EWS index is more appropriate for the US firms, while the CGD index works better in civil law countries. Their results indicate that a global metric is inadequate to gauge the quality of governance across the world.

Hopt, Klaus J. (August 29, 2011) Corporate governance of banks differs considerably from general corporate governance. For banks, the scope of corporate governance goes beyond the shareholders (equity governance) to include debt-holders (debt governance). From the perspective of bank supervision, debt governance is the primary governance concern. Equity governance and debt governance face partly parallel and partly divergent interests of management, shareholders, debt-holders, and supervisors. Failures in the corporate governance of banks contributed to the financial crisis. Corporate law reforms are less suited for bank governance, strengthening supervisory law requirements is more promising. Prominent proposals include clearer separation of the management and control function, possibly by a two-tier board as in Switzerland and Belgium; establishment

of a separate risk committee of the board or an independent chief risk officer; dealing with the problem of complex or opaque bank structure; and group-wise corporate governance in single entities as well as in the bank group. Appropriate supervisory law requirements are needed for bank-internal procedures, specifically for risk management, internal control and compliance, and internal and external auditing. Supervisory fit and proper tests for the board, the management and major shareholders of banks are useful. Qualification and experience of bank board members is at least as important as independence. But the severe requirements of bank regulation and bank supervision must not spill over to the corporate governance of the firm.

Sanan, Neeti; and Yadav, Sangeeta (April, 2011) Corporate governance reforms assume critical significance for developing economies like India, which is moving towards a more transparent and accountable system of economic governance. Though India has initiated serious efforts towards overhauling the corporate governance mechanisms through comprehensive corporate governance laws and regulations, their enforcement remains inadequate. Earlier studies indicate that disclosure practices of Indian companies do not go beyond the mandatory requirements, thus creating an urgent need for corporate governance reforms. The main objective of this study is to evaluate the impact of corporate governance reforms brought out by Securities and Exchange Board of India (SEBI), Clause 49 of the Listing Agreement (2006), on the level of financial disclosures of the Indian firms. The current research has been carried out with 30 Indian-listed companies which form part of Bombay Stock Exchange (BSE) index for the pre-reform period (2001-02 to 2004-05) and post-reform period (2005-06 to 2008-09). A Corporate Governance Transparency and Disclosure Score (CGS) has been constructed for the sample companies based on the attributes drawn from the Standard and Poor's (S&P) Transparency and Disclosure Survey (2008). The study indicates that despite impressive corporate governance reforms, there is only a moderate level of financial disclosures by the Indian firms. It emphasizes a need for improved enforcement of legal and regulatory structures to enhance financial reporting quality.

Heremans, Dirk and Bosquet, Katrien (April 28, 2011) In tribute to the lifetime achievements of Dr. Thomas S. Ulen, this article addresses the topic of the future of law and finance within the broader context of the future of law and economics. After highlighting some of the differences between the U.S. and European approaches to law and finance, it focuses on specific law and finance issues that were involved in the financial crisis (including the regulation of financial institutions) and draws some tentative lessons for the future development of new research paradigms in law and finance. Finally, this article advocates a more risk-based

approach of corporate governance for banks as well as the need for specific corporate governance models. Far from having a declining impact on legal reforms and scholarship, the impact of law and finance is on the rise.

Schmid, Markus M.; Sabato, Gabriele; and Aebi, Vincent (October 11, 2011) The recent financial crisis has raised several questions with respect to the corporate governance of financial institutions. This paper investigates whether risk management-related corporate governance mechanisms, such as the presence of a chief risk officer (CRO) in a bank's executive board and whether the CRO reports to the CEO or directly to the Board of Directors, are associated with a better bank performance during the financial crisis of 2007-2008. They measure bank performance by buy-and-hold returns and ROE and control for standard corporate governance variables such as CEO ownership, board size, and board independence. Most importantly, their results indicate that banks, in which the CRO directly reports to the board of directors and not to the CEO (or other corporate entities), exhibit significantly higher (i.e., less negative) stock returns and ROE during the crisis. In contrast, standard corporate governance variables are mostly insignificantly or even negatively-related to the banks' performance during the crisis.

Aguilera, Ruth V.; and Desender, Kurt A. (January 2015) This paper discusses the role that indices of corporate governance have had in comparative corporate governance research. To do so, they begin with a short discussion of what corporate governance is and its main debates. Then, they review the main indices highlighting their strengths and limitations as well as describing some of the findings that emanate from them.

Murugesan Selvam; John Raja; and Arumugan Suresh Kumar The impact of banks' organization structure on performance and corporate governance practices has been discussed for a number of years, mainly in developed countries such as UK and US. This paper chooses to address above-mentioned issue in Indian context. It investigates two categories of banks, namely government banks and private banks. This paper adopts the Tobin's Q, and Return on Capital Employed (ROCE) as bank performance indicators. The following board governance variables are used such as Board Committees, Board Directors, CEO as a chairman, Board meetings, and Women Executive and Executive-Director ratio. Multiple Regression Analysis results show that board governance variables like board committees, board directors and women director are statistically significant to performance for banks where government has considerable stake. In addition, government banks are older and also have better market valuation than private banks.

Christina James-Overheu, Julie Cotter This paper investigates whether the quality of a firm's corporate governance practices and its sustainability disclosures

are inversely-related to its assessed default-risk. It is expected that high reported standards of corporate governance will reduce the assessment of a company's default-risk by lenders, underwriters and ratings agencies, and therefore, reduce the cost of debt for such companies. A corporate governance index, based on annual report disclosures, was developed to rate each company's corporate governance quality. Derivation of this index was centred on corporate governance indicators suggested by prior research and best practice; particularly the Australian Stock Exchange "Principles of Good Corporate Governance and Best Practice Recommendations". It is similarly expected that the voluntary disclosure of sustainability information (Corporate Social Reporting or CSR) will enhance a firm's management reputation. The assessment of default risk is captured by a firm's individual credit rating supplied by Standard and Poor's. Their results indicate that neither annual report disclosures about corporate governance practices nor sustainability disclosures are significantly related to assessed default-risk when firm size is controlled.

To conclude the objective of corporate governance is to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. Hence, it harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders' wealth whilst not in any way being detrimental to the interests of the other stakeholders in the company.