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CORPORATE GOVERNANCE PRACTICES: A STUDY OF PRIVATE SECTOR BANKS

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Abstract

Corporate Governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearby as possible the interest of individuals corporation and society. The study under consideration will used seven private (7) Indian Banks which already implemented ESOP for the benefits of its workforce or to enhance its financial performance. The post financial performance of private banking sector did not improve significantly after adoption of ESOP. The limitation of corporate governance can be removed if the corporate practices are implemented with true spirit to benefit not only to the society but to the corporate including banking sector.

INTRODUCTION

Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. Corporate governance is about minimizing the loss of value that results from the separation of ownership and control. It deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. While corporate governance has been a hot issue in recent years (Enron, Worldcomm, HIH and One.Tel) it is a problem that has been around for hundreds of years – Adam Smith (1776).

Historical Background of Corporate Governance

- Unlike South-East and East Asia, the corporate governance initiative in India was not triggered by any serious nationwide financial, banking and economic collapse.
- Also, unlike most OECD countries, the initiative in India was initially driven by an industry association, the Confederation of Indian Industry.

- In December 1995, CII set up a task force to design a voluntary code of corporate governance
- The final draft of this code was widely circulated in 1997 In April 1998, the code was released. It was called Desirable Corporate Governance: A Code
- Between 1998 and 2000, over 25 leading companies voluntarily followed the code: Bajaj Auto, Hindalco, Infosys, Dr. Reddy's Laboratories, Nicholas Piramal, Bharat Forge, BSES, HDFC, ICICI and many others

- Following CII's initiative, the Securities and Exchange Board of India (SEBI) set up a committee under Kumar Mangalam Birla to design a mandatory-cum-recommendatory code for listed companies
- The Birla Committee Report was approved by SEBI in December 2000
- Became mandatory for listed companies through the listing agreement, and implemented according to a rollout plan
- Following CII and SEBI, the Department of Company Affairs (DCA) modified the Companies Act, 1956 to incorporate specific corporate governance provisions regarding independent directors and audit committees
- In 2001-02, certain accounting standards were modified to further improve financial disclosures. These were:
  - Disclosure of related party transactions
  - Disclosure of segment income: revenues, profits and capital employed
  - Deferred tax liabilities or assets
  - Consolidation of accounts
  - Initiatives are being taken to (i) account for ESOPs, (ii) further increase disclosures, and (iii) put in place systems that can further strengthen auditors' independence

Constituents of Corporate Governance

- The Board of Directors
  - Pivotal role
  - Accountable to stakeholders
  - Directs management
- The Shareholders & Stakeholders
  - To participate in appointment of directors
  - To hold the BoD accountable for governance through proper disclosures

- The Management
    - To act on the direction of the BoD
    - To provide requisite information to the BoD for decision making

Disclosure Based Regulation

Components & types of disclosures

- Initial Disclosures – Disclosures for raising capital by companies, mutual funds in offer documents
    - Public Offers
    - Private Placement
- Continuous disclosures – financial / non-financial
- Frequency of disclosure
- Dissemination process – electronic, physical, centralised, dispersed
- Accessibility of information
- Initial Disclosures
- Continuous disclosures
- Corporate Governance
- Financial disclosures
- Risk based disclosures for intermediaries
- Disclosures for stock exchanges

Disclosures

Board of Directors: information that must be supplied

- Annual, quarter, half year operating plans, budgets and updates
- Quarterly results of company and its business segments
- Minutes of the audit committee and other board committees
- Recruitment and remuneration of senior officers
- Materially important legal notices and claims, as well as any accidents,
- hazards, pollution issues and labor problems
- Any actual or expected default in financial obligations
- Details of joint ventures and collaborations
- Transactions involving payment towards goodwill, brand equity and
- intellectual property
- Any materially significant sale of business and investments
- Foreign currency and other risks and risk management

- Any regulatory non-compliance

Country	Legal System	Protection	Rule of Law	
Australia	Common law	4	10	
France French	Civil law	2	8.98	
Germany German	Civil law	1	9.23	Legal
India	Common law	5	4.17	Systems
Japan German	Civil law	4	8.98	on
Korea German	Civil law	2	5.35	Corporate
Philippines French	Civil law	3	2.73	Governance
Netherlands French	Civil law	2	10	in
UK	Common law	5	8.57	Different
USA	Common law	5	10	Economy

Corporate Governance Practices

1. The corporate governance framework should protect shareholders rights.
2. The corporate governance framework should ensure the equitable treatment of all shareholders.
3. Stakeholders should be involved in corporate governance.
4. Disclosure and transparency is critical.
5. The board of directors should be monitored and held accountable for what guidance it gives.

Corporate Governance and ESOP

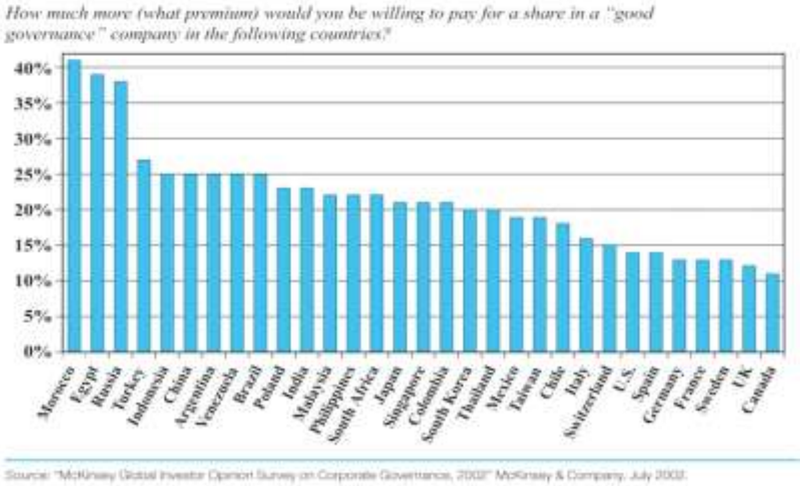
The organizations try to get standard level of profitability by employed modern profitability tools in business operation. **CORPORATE GOVERNANCE** is the system by which companies are directed and controlled by the management in the best interest of the shareholders, workforce and others ensuring greater transparency and better and timely financial reporting. The Board of Directors is responsible for governance of their companies for raising profitability. The profitability is red blood of organization which leads to development and prosperity in modern fierce competitive world. An ESOP provides a way for employer and their employees to achieve the apex tail of profitability in chaos and growth of the business. In some cases, employees can use an ESOP to acquire the whole of a business. This is technique of restructuring of the business unit with the involvement of employees. The remarkable effect of ESOP is positive in terms of productivity on thousands of enterprises as observed. It is thought that financial participation schemes provide employees with incentives to work more and better, communicate information to management and colleagues and co-operate with each other. A growing body of evidence suggests that both main forms of financial participation have greater productivity effects when employees are well informed of the affairs of the firm, there is good communication with management, and employees participate in governance and decisions. Most research on employee ownership shows positive effects. These studies show that employee owned firms are more productive and profitable, survive longer, and result in better shareholder returns. Adoption of ESOPs result in better post-adoption performance compared to pre-adoption performance and also compared to matched firms. Studies indicate nearly two-and-a-half percentage greater annual sales and employment growth among ESOPs as compared to conventional counterpart firms.

Measuring Corporate Governance

- Understanding what good corporate governance is about is quite easy. However, it is difficult to measure whether companies are really committed to good governance.
- All we can do is measure if they have certain corporate governance mechanisms in place – we don't know if they are effective or not!

Organizations such as Standard and Poor and Credit Lyonnais Securities Asia have started providing corporate governance ratings in recent years.

EXHIBT - 1 The Value of Good Governance



Empirical Research Methodology

The whole study period divided into two parts pre-adoption period and posadoption period of 3 years each. Further different ratios of Assets, Net Assets, Income, Other Income, Expenditure, Operating Expenses, Gross Profit and Net Profit on per employees basis for pre-adoption period and post-adoption period for all the seven banks are calculated. The study under consideration used seven banks which already implemented ESOP for the benefits of its workforce or to enhance its profitability before 2005.

Research Objective

The study would like to achieve the following objectives to make the output more effective in the field of finance.

- To measure the post-financial performance of Indian private banking sector with reference to corporate governance.

Hypothesis of the Research

In order to achieve the above said objectives, the study will endeavor to test the following hypotheses.

H_m: The post-financial performance of Private banking sector remains 01 unchanged due to the implementation of ESOP.

Data Sources and Sample Size

To measure the post-financial performance of Indian ESOP banking sector, the study under consideration will used seven private (7) Indian banks which already implemented ESOP for the benefits of its workforce or to enhance its financial performance. The names and year of implementation of all such Indian private bank are given below.

Sr. No.	Name of the Bank	Year
1	Kotak Mahindra Bank	2003
2	AXIS Bank	2001
3	The United Western Bank Limited	2001
4	The ABN AMRO Bank	2005
5	ICICI Bank	2003
6	HDFC Bank Limited	2000
7	ING Vysya bank	2001

The pre-adoption period has taken 3 years before the ESOP implementation in the study whereas the 3 years also decided for the post-ESOP adoption. The secondary information is used in order to get the empirical results. For measuring the post-financial performance, the statistics so collected from different sources namely research journals, Business Standard, The Economic Times, The Financial Express, periodicals and further analysis with two time window i.e. preadoption period and post-adoption period. It is assumption that any changes will be recorded in post-adoption period is due to the adoption of ESOP.

Financial Performance of Private Banks

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</table>

Table - 1 : Consolidated Average Profitability Performance of Private Indian Banks

No any value significant at a = 5%

The t –value for the HDFC bank is -1.33 whereas -1.32 for AXIS bank ltd. which is not statistically significant at á **= 0.05** level of risk. Moreover the t – value for ICICI bank is -1.22 whereas -1.30 for average profitability performance of seven banks of the study which are not significant at five percent (a **= 0.05)** level of risk. Thus null hypothesis is accepted that post-financial performance of India private banking sector did not improve significantly after adoption of ESOP.

Conclusion

Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The profitability is red blood of organization which leads to development and prosperity in modern fierce competitive world. An ESOP provides a way for employer and their employees to achieve the apex tail of profitability in chaos and growth of the business. In some cases, employees can use an ESOP to acquire the whole of a business. This is technique of restructuring of the business unit with the involvement of employees. The remarkable effect of ESOP is positive in terms of productivity on thousands of enterprises as observed. It is thought that financial participation schemes provide employees with incentives to work more and better, communicate information to management and colleagues and co-operate with each other. Evidence suggests that profit-sharing probably has a slightly stronger effect than employee share ownership on total factor of productivity. Thus null hypothesis is accepted that post-financial performance of private banking sector did not improve significantly after implementation of a good corporate governance practice known as ESOP.

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